Market Review - May 2025

The month of May was no exception to the trend observed in 2025, marked by high market volatility and numerous political twists and turns. Fortunately, equity markets posted positive performances, driven in part by a renewed appetite for risk among investors. Various announcements of trade talks between the USA and several international partners, aimed at concluding agreements, helped restore confidence. Another supporting factor was the release of corporate earnings for the first quarter of 2025. These better-than-expected figures benefited from analysts' downwardly revised expectations, prompted by concerns that tariffs would weigh on margins and profits.

On the political front, Republicans managed to push through President Trump's "Big Beautiful Bill" after intense last-minute negotiations. This did little to help the markets, as the proposed plan appears far more deficit-laden than had been announced in March. On May 23, Mr. Trump also threatened the European Union, stating that talks were not progressing and announcing the introduction of 50% tariffs starting June 1. Two days later, he backtracked following a call from Ursula von der Leyen requesting a postponement. He agreed to delay the measure until July 9.

On May 28, the Court of International Trade ruled that the tariffs imposed by the President were illegal, triggering a brief jump in the markets. However, the very next day, the Court of Appeals overturned this decision, upholding the Presidential measures. As of now, the tariffs remain in force.

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Between the "Big Beautiful Bill" and the tariff hikes, economists fear a resurgence of inflationary pressures something the Federal Reserve has been trying to contain for the past three years. Moreover, according to the new federal budget, the deficit is expected to widen further, raising concerns that the cost of debt could become unsustainable. This, in turn, could lead to a higher risk premium on U.S. Treasury bonds. In this context, long-term interest rates are rising, adding to the uncertainty surrounding both a potential Fed rate cut and the future path of inflation.

Market trends to end-May 2025

			Equities in Local Currencies					
End of May	MSCI World	S&P 500	EuroStoxx	CAC	Spain	Switzerland	MSCI EM	CSI 300
Perf 1 Month	5.69%	6.15%	4.00%	2.08%	6.51%	0.91%	4.00%	1.85%
Perf 3 Month	1.53%	-0.72%	-1.77%	-4.43%	6.03%	-5.98%	5.48%	-1.28%
Perf YTD	4.20%	0.51%	9.61%	5.03%	22.05%	5.40%	7.61%	-2.41%

		Commodities				Currencies vs EUR		
End of May	WTI Oil	Brent Oil	Gold	Copper	USD	JPY	GBP	CHF
Perf 1 Month	4.43%	1.24%	0.02%	4.09%	-0.16%	-0.89%	0.81%	0.30%
Perf 3 Month	-12.86%	-12.68%	15.10%	1.50%	-8.56%	-4.40%	-2.18%	0.41%
Perf YTD	-15.24%	-14.39%	25.33%	8.33%	-8.76%	-0.42%	-1.86%	0.73%

			Bloomberg Indices Bonds Total returns					
End of May	Global Aggregate	US Aggregate	Euro Aggregate	US 10 Year Treasury	German 10 Year Bund	Global Credit	Global High Yield	Emerging Sovereign $
Perf 1 Month	-0.36%	-0.72%	0.17%	-1.17%	-1.06%	0.10%	1.65%	0.67%
Perf 3 Month	3.21%	-0.29%	0.27%	0.21%	-3.27%	2.99%	2.19%	0.26%
Perf YTD	5.28%	2.45%	0.93%	3.71%	-4.04%	5.24%	4.41%	2.97%

Source: Bloomberg 05/31/25

- **Big Beautiful Bill**

After several last-minute twists and turns, the House of Representatives finally voted in favor of the "Big Beautiful Bill." The narrow vote, 215 in favor and 214 against, was made possible by last-minute compromises. This new budget framework will impact many aspects of the economy. On the tax front, it extends the tax cuts introduced in 2017 by President Trump, sparing taxpayers from a potential tax hike of up to 22%. While this measure is expected to stimulate domestic consumption, it also represents a significant revenue shortfall for the federal government, further complicating debt financing.

Another major change concerns access to public healthcare assistance. Eligibility requirements for the Medicaid program are set to be tightened, potentially affecting the most vulnerable populations. If approved by the Senate, beneficiaries would be required to prove a minimum of 80 hours of work per month. This requirement aims to reduce public spending but could come at the expense of the most disadvantaged.

Other provisions include a $150 billion increase in the defense budget. Additionally, overtime pay and tips would no longer be subject to taxation.

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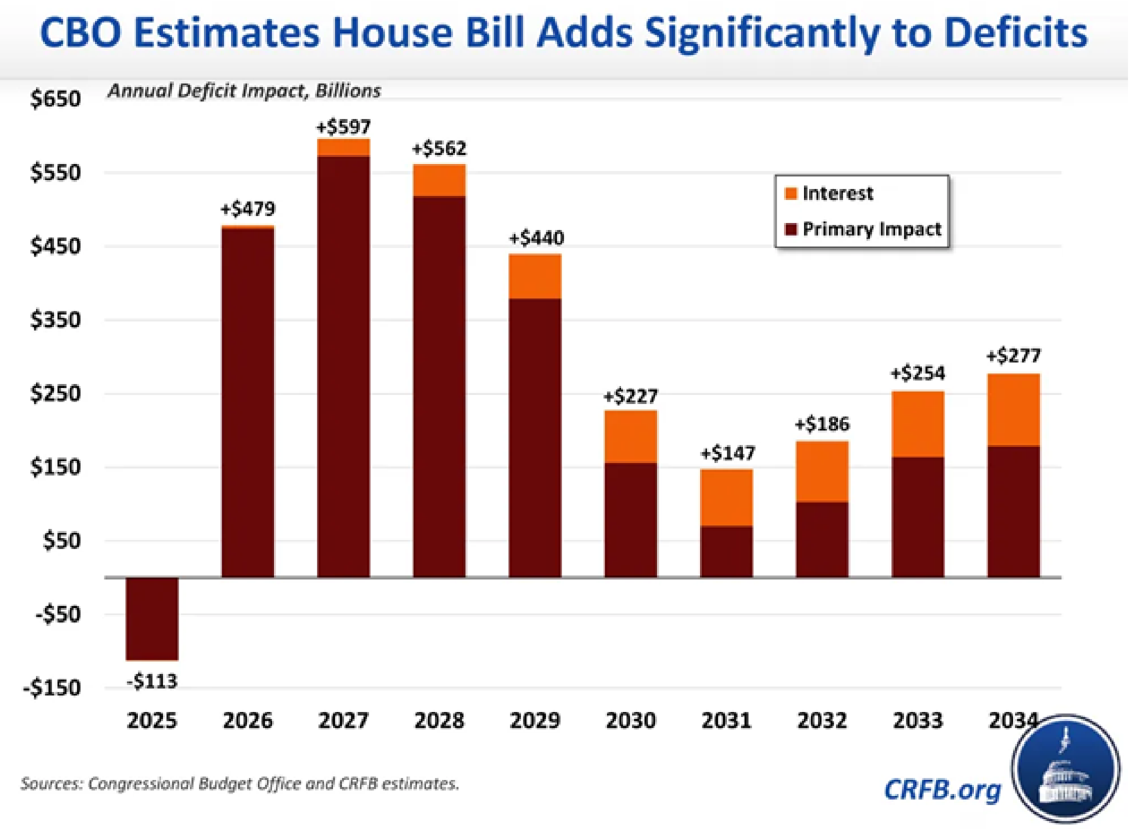
In short, apart from cuts in Medicaid spending, most of the proposed measures are expected to increase the public deficit. According to some projections, the plan could add $3.8 trillion to the federal debt over the next decade. As a result, the House of Representatives also voted to raise the debt ceiling by $4,000 billion to finance these new measures as well as existing commitments.



As previously mentioned, the text must now be reviewed by the Senate, which is expected to deliver its verdict by July 4. Amendments remain possible before the final adoption of a compromise acceptable to all parties. Some Republican lawmakers may raise objections, citing the need for stricter fiscal discipline.

For now, the bond market remains relatively calm in response to these announcements, suggesting that investors still trust the government's ability to meet its obligations and issue new debt successfully. However, this confidence could be challenged if foreign holders of U.S. debt such as China, begin to withdraw. It would take only a small trigger for long-term interest rates to surge again. Moreover, although surveys like the University of Michigan's 1-Year Inflation Expectation indicate rising inflation concerns among households for the near term, long-term expectations, reflected in 10-year breakeven rates, remain well anchored, suggesting no imminent inflation threat.

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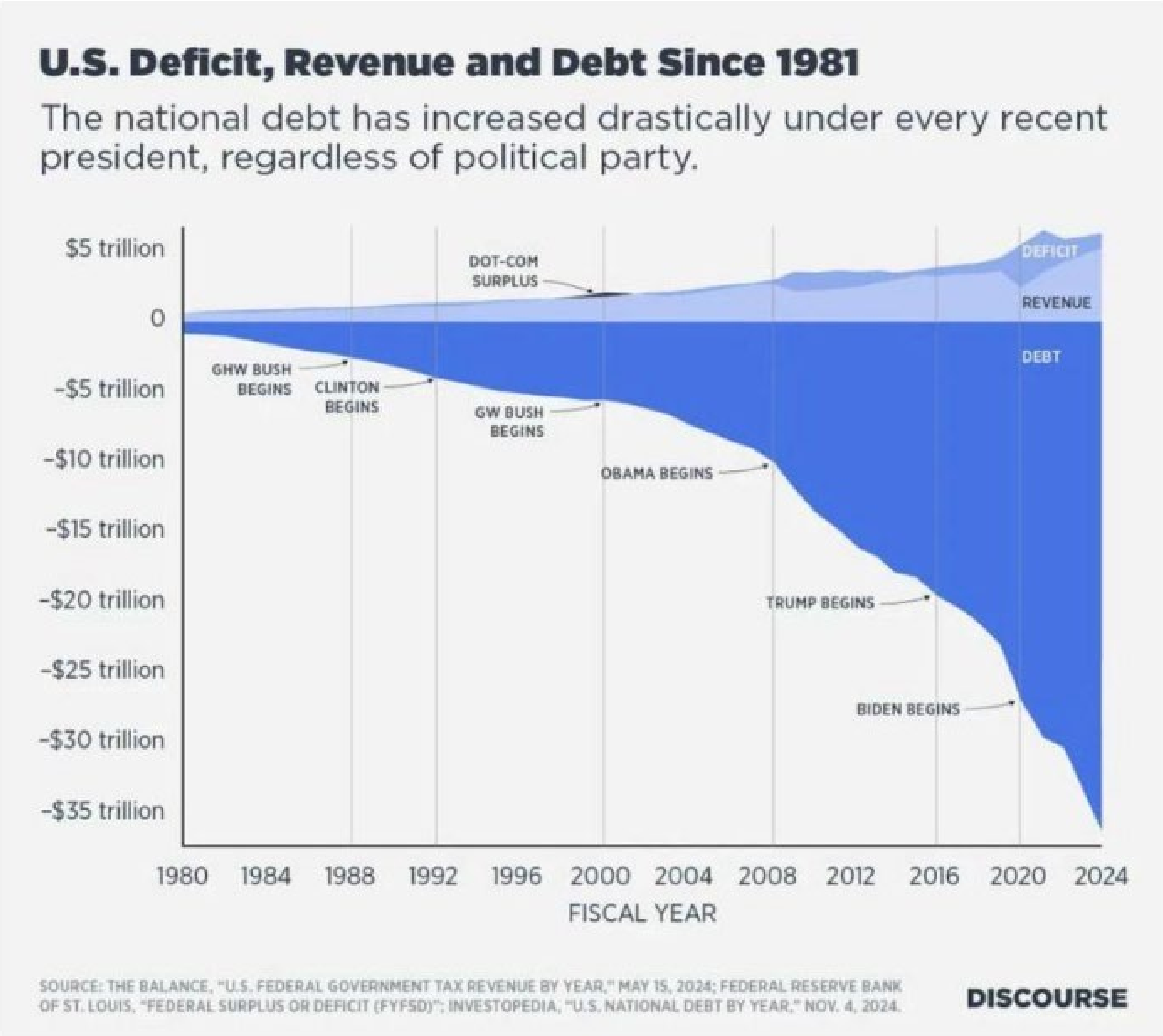

- **<u>Customs duties</u>**

On the tariff front, several announcements were made during the month, though none significantly altered the overall situation. The most notable development was the negotiation round between the United States and China, held in Geneva at the beginning of May. After a weekend of discussions, the two economic superpowers reached a temporary agreement: the U.S. agreed to reduce its tariffs from 145% to 30%, while China lowered its tariffs from 125% to 10%. These reductions, set to last for 90 days, are intended to provide a window for further negotiations. This long-awaited announcement triggered a strong market response, even though much of it had already been priced in, given that such elevated tariff levels were unsustainable for either economy over the medium term.

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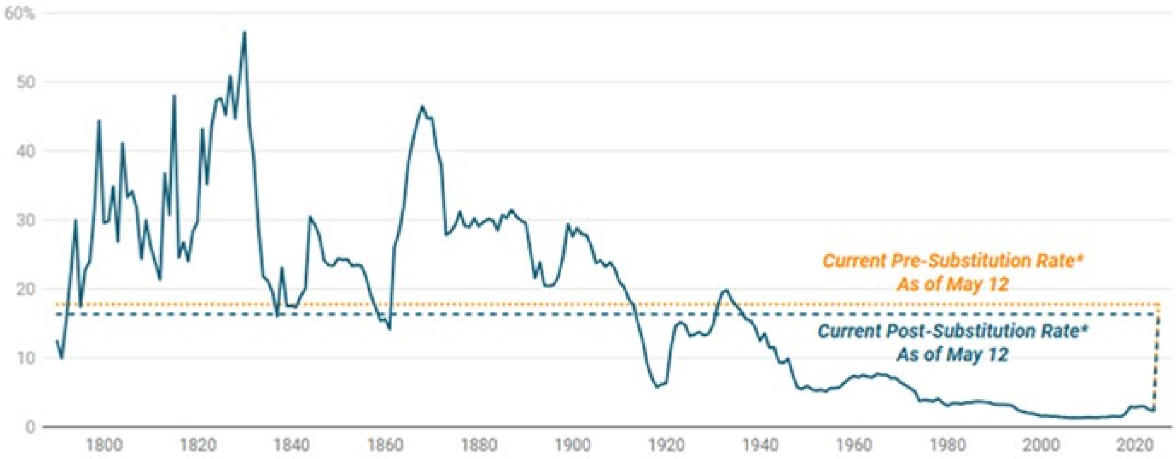
As previously mentioned, at the end of the month, the U.S. President threatened the European Union with 50% tariffs starting June 1, before quickly backtracking. In addition, during the final week of May, a court initially ruled the tariffs illegal, only for a higher court to later validate them. This sequence of contradictory announcements highlights the climate of uncertainty that has prevailed in the markets since the new president took office. Each week brings headlines with the potential to impact the global economy, only for them to be swiftly walked back or overturned. At the very end of May, tensions between the United States and China resurfaced, with each side accusing the other of failing to honor the commitments made in Geneva.

All eyes are now on the July 9 deadline, when the 90-day truce on reciprocal tariffs is set to expire. Although negotiations are ongoing, a lasting compromise appears unlikely. In the absence of a final agreement particularly with the European Union markets are likely to grow increasingly jittery as the deadline approaches. Meanwhile, equities have rebounded sharply since Liberation Day and are now trading at relatively high valuations. This renewed optimism is partly driven by what has come to be known as the "TACO Trade" ("TACO" standing for *Trump Always Chickens Out") a popular expression reflecting the belief that the President consistently retreats under pressure. This perception contributes to the prevailing complacency in equity markets, which seem to be betting on another presidential reversal as major decisions loom. However, if this time the President does not back down, markets could be caught off guard, potentially triggering a sharp correction.

Figure 2. U.S. Average Effective Tariff Rate Since 1790

Customs duty revenue as a percent of goods imports



* Assumes revised April 9 tariffs stay in place.

Chart: The Budget Lab • Source: Historical Statistics of the United States Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis. • Created with Datawrapper

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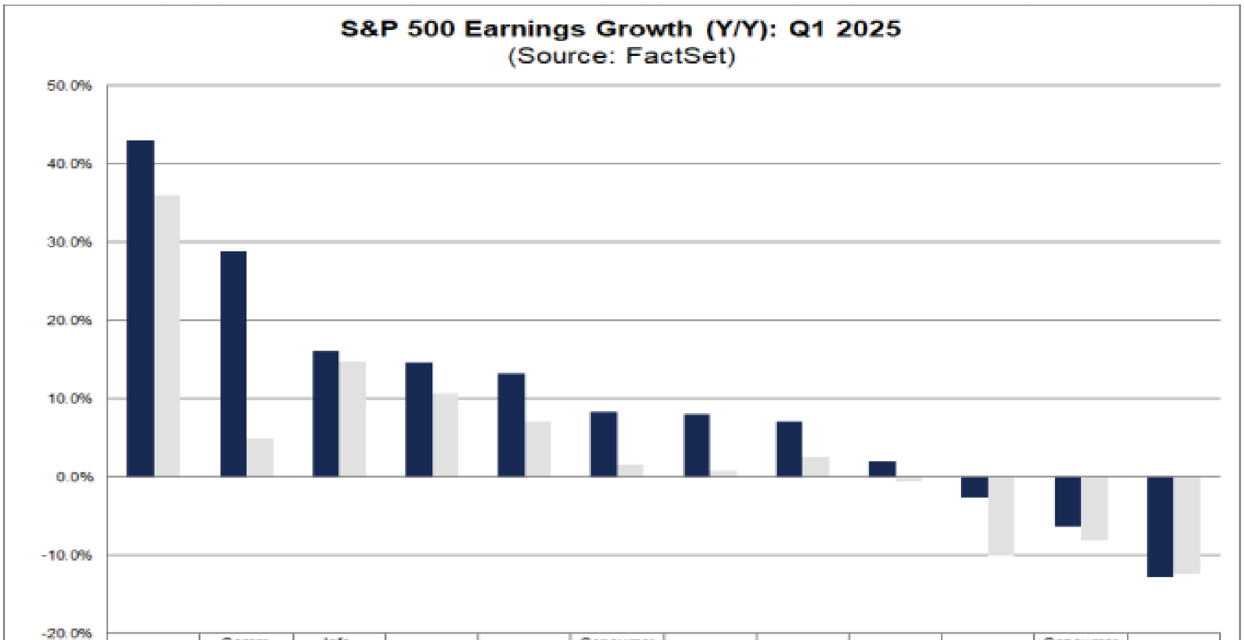
- **Company results**

Despite a highly uncertain environment, equity markets posted broadly positive performances, continuing the rebound that began after the Liberation Day correction. The Nasdaq led the way with a monthly gain of over 9%, followed by the S&P 500, which rose 6.3%. In Europe, the Stoxx 600 advanced more than 5%, while China's CSI 300 ended the month up 2%. Although U.S. markets extended their upward momentum more strongly than other regions, Europe still holds the lead in year-to-date performance, with a gain of 10.75%.

The U.S.–China agreement naturally contributed to this upward trend, but first-quarter earnings releases also played a crucial role both in easing the concerns of cautious investors and reinforcing the optimism of more bullish ones. Following recent government policy announcements, many analysts had revised their growth expectations for the first quarter downward. However, because most tariffs were only implemented in April, their impact on Q1 results was limited. In fact, some companies benefited from the timing, having stockpiled inventory in advance at lower costs.

As a result, earnings growth for S&P 500 companies has significantly outpaced expectations. While the consensus as of March 31, 2025, forecast 7.2% growth, actual earnings were up 13.3% by May 30. Profit margins improved, and revenues also exceeded forecasts. Overall, earnings reports beat expectations across the board.



	Health Care	Comm. Services	Info. Technology	Utilities	S&P 500	Consumer Disc.	Industrials	Financials	Real Estate	Materials	Consumer Staples	Energy
Today	43.0%	28.9%	16.1%	14.7%	13.3%	8.4%	8.1%	7.1%	2.1%	-2.6%	-6.3%	-12.7%
31-Mar	36.0%	4.9%	14.8%	10.7%	7.2%	1.6%	0.9%	2.6%	-0.6%	-10.0%	-8.1%	-12.3%

Source: Factset 05/30/25

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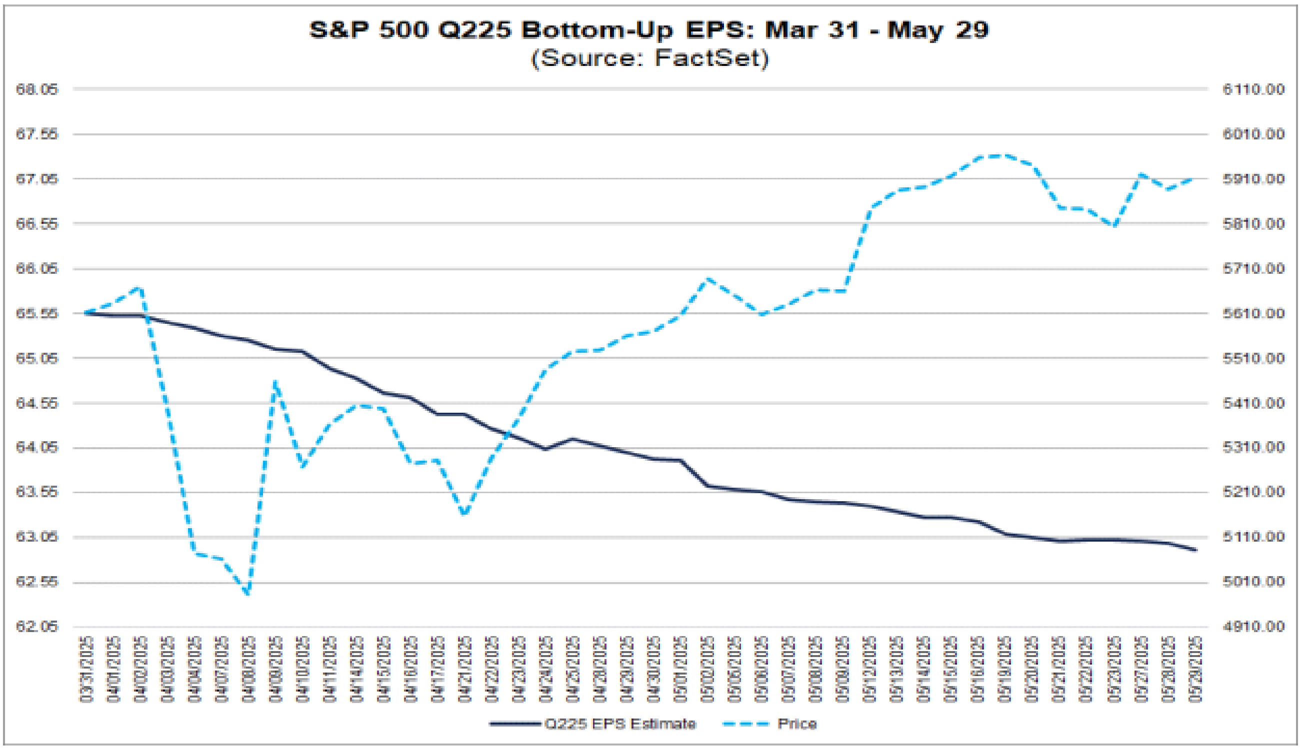
Nevertheless, several indicators point to risks ahead. The slowdown in earnings growth among the "Magnificent 7" is beginning to materialize, with a sharp deceleration expected in the second quarter unless, once again, analysts have been overly cautious. Given that these seven stocks now account for nearly one-third of the S&P 500, any earnings disappointment could exert significant downward pressure on the index. The true test for growth will come in the second quarter, when U.S. companies will have fully absorbed the impact of rising import costs. Two main scenarios could unfold: if companies pass these costs on to consumers through higher prices, consumption may weaken, leading to slower sales growth. Conversely, if businesses choose to absorb the cost increases themselves, profit margins particularly for firms reliant on imported goods will likely suffer.

These dynamics are expected to have international repercussions as well. A decline in U.S. imports could hurt European and Chinese exporters, who may see falling sales or be forced to reduce prices to remain competitive, thereby compressing their margins. The range of potential outcomes remains broad, and it is still too early to accurately assess the full impact of the new trade measures.

From an analyst's perspective, the second quarter is shaping up to be less favorable than the first, with downward revisions to earnings forecasts continuing. However, companies appear relatively resilient. Despite the ongoing uncertainty, most have reaffirmed their annual targets, very few have withdrawn guidance, and only a slightly higher-than-average share have revised forecasts downward or widened their forecast ranges.



Source: Factset 05/30/25

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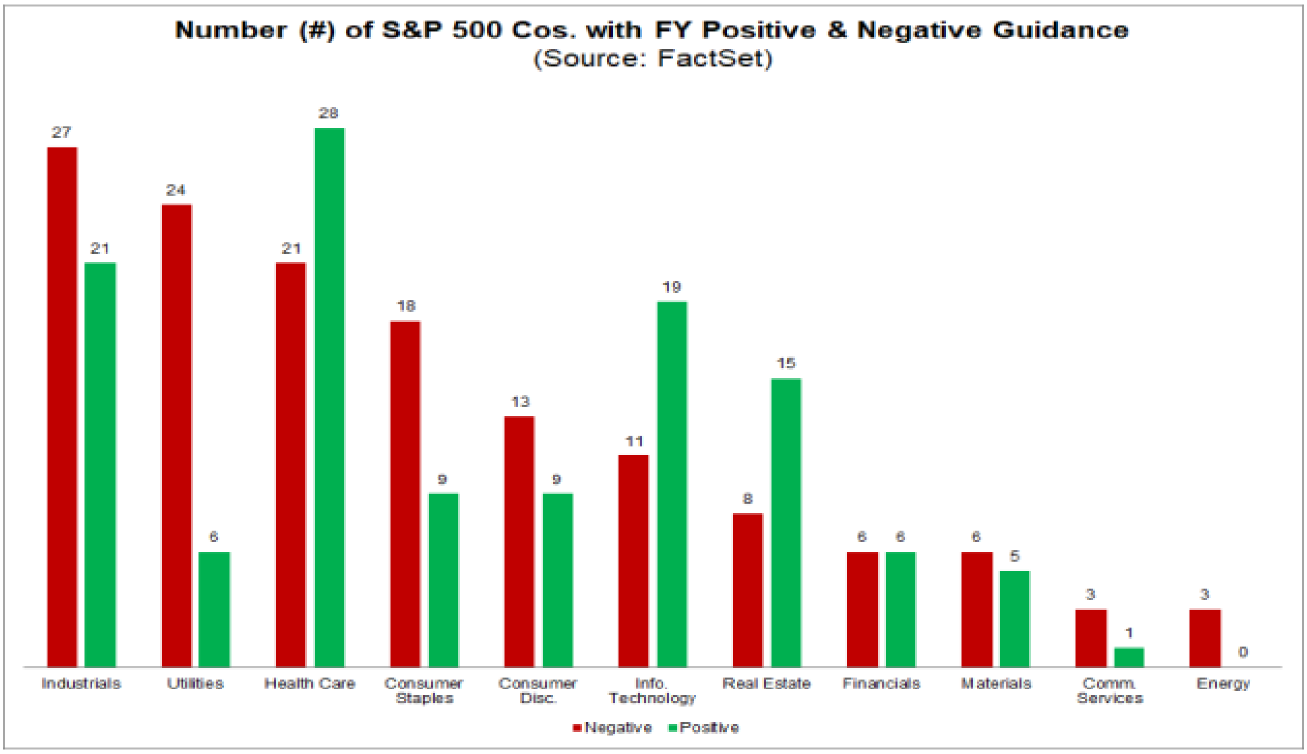
FY 2025 / 2026: EPS Guidance



Source: Factset 05/30/25

- **<u>Flows</u>**

If we were to judge solely by the performance of global stock indices, one might assume that market sentiment has turned decisively positive and that investors are positioning themselves to capitalize on further upside. However, this impression is somewhat misleading. The renewed optimism is not shared uniformly across investor categories. In recent weeks, the equity rally has been driven primarily by retail investors. In contrast, institutional investors and hedge funds citing continued uncertainty over macroeconomic trends have taken a more cautious stance, reducing their equity exposure. Meanwhile, individual investors have persisted with a “buy the dip” strategy, which has continued to yield strong returns.

That said, the equity bull run may be losing momentum. Following an 18% rebound in the S&P 500 from its April lows, JP Morgan has reported early signs of profit-taking by retail investors who had been fueling the rally. Should they begin to pull back more broadly, the current buying momentum could falter, leaving limited support for valuations.

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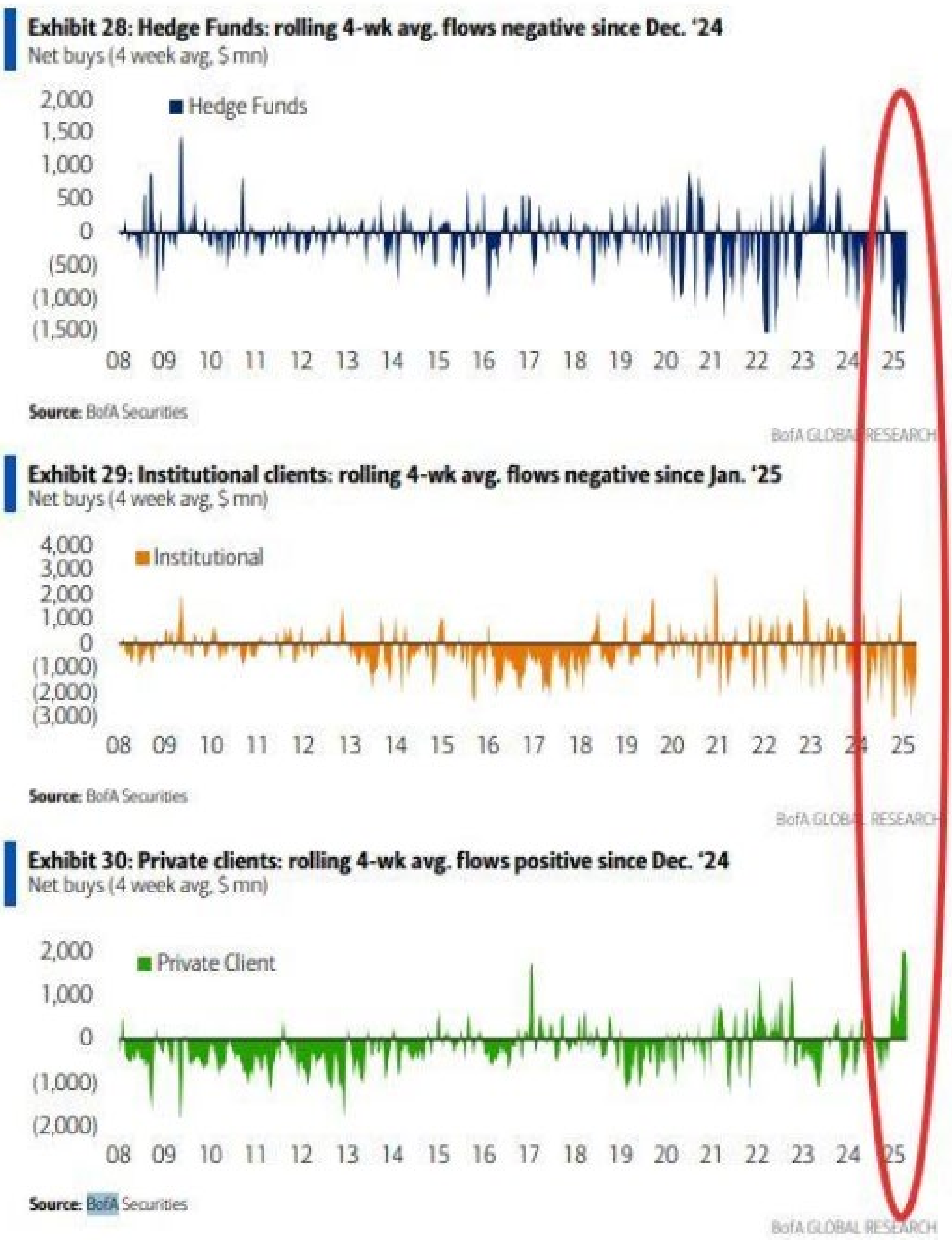

Several major events are scheduled for July: on the 4th, the U.S. Senate will vote on the "Big Beautiful Bill"; on the 9th, the tariff truce between the United States and China is set to expire. July also marks the beginning of the second-quarter earnings season. In the meantime, central banks will hold their respective policy meetings, with particular attention focused on the Federal Reserve. Investors will be closely watching Chairman Powell's comments for any signals of renewed inflationary pressures. At this stage, markets are not pricing in a rate cut at the upcoming Fed meeting. If Mr. Powell manages to strike a reassuring tone, June could unfold in a relatively calm, wait-and-see manner. However, absent a meaningful agreement on tariffs by July 9, market tensions are likely to rise as the deadline approaches.

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In this uncertain environment where economic data is as crucial for investors as it is for central banks establishing a clear outlook remains challenging. However, it's important to remember that volatility is a natural feature of financial markets. Short-term turbulence should not overshadow the favorable long-term outlook. And if you've followed the old adage "Sell in May and go away," then June should hold few surprises.

We wish you an excellent start to the summer and a very happy vacation to those already fortunate enough to be enjoying a break.

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