QUARTERLY INSIGHTS – Q2 2025

INTRODUCTION

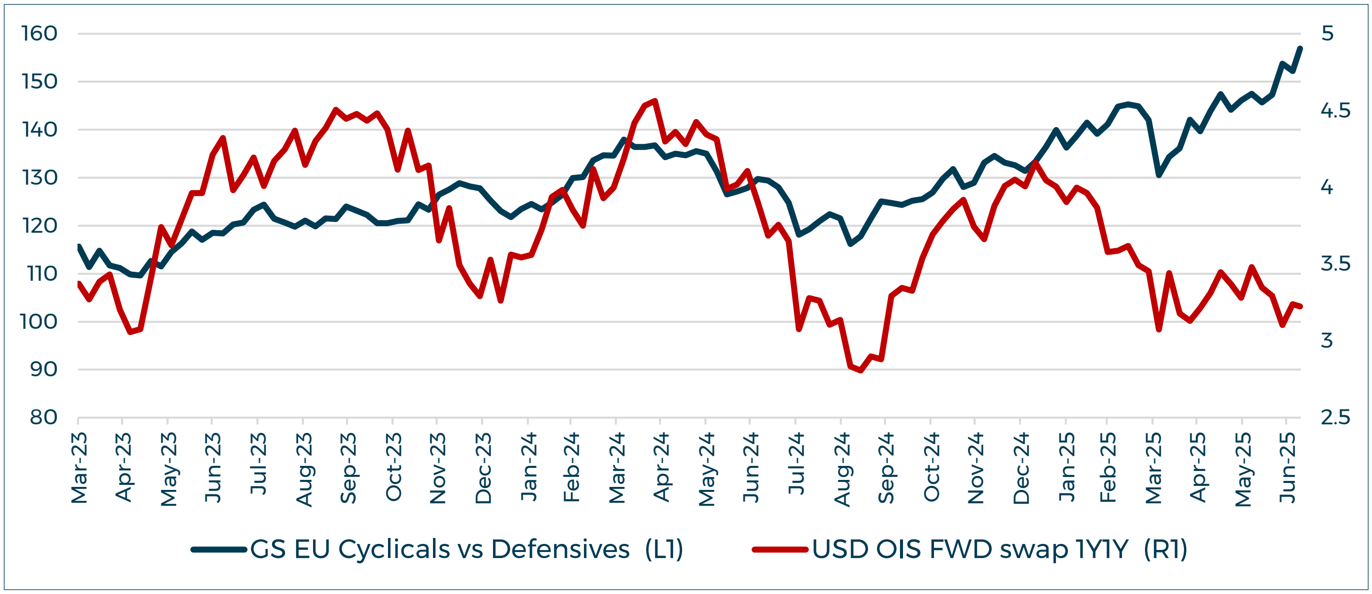
THE OVERHANG VS THE OPPORTUNITY

"SHOW ME THE INCENTIVES, AND I WILL SHOW YOU THE OUTCOME" ~ Charlie Munger

The bond market is signalling expectations of an upcoming Fed rate cut, reflecting concerns that economic growth is slowing. In contrast, the stock market is favouring cyclical stocks over defensive ones, suggesting investors believe growth is set to pick up.

These two perspectives are at odds with each other. If the bond market is mistaken and growth is indeed accelerating, interest rates may need to rise. Conversely, if the equity market is wrong and growth is actually slowing, stock prices, especially among cyclicals, could face downward pressure.

Exhibit 1: The disconnect between cyclical equities making new highs vs bond markets pricing in meaningfully lower interest rates at the short end of the U.S. treasury curve:

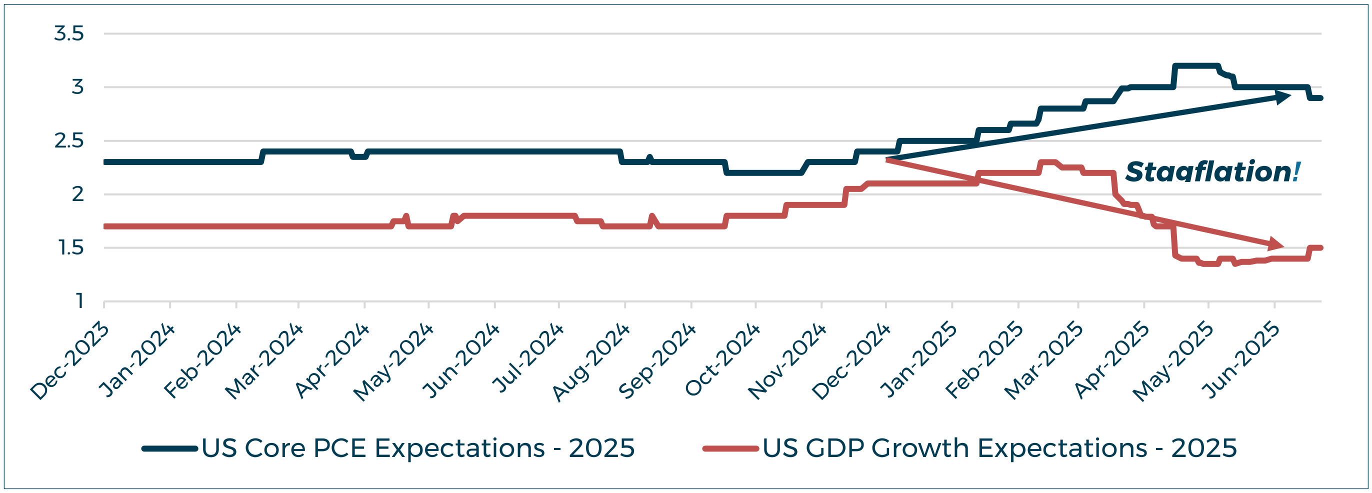


Source: Bloomberg, Shard Capital, 30/06/2025

US economic growth is currently facing headwinds from rising uncertainty and slowing investment. In particular, uncertainty regarding the consequences of tariffs and a slowdown in global trade. Furthermore, volatility in oil prices, the resumption of student loan payments, and higher long-term interest rates associated with the fiscal situation, is also causing major headwinds.

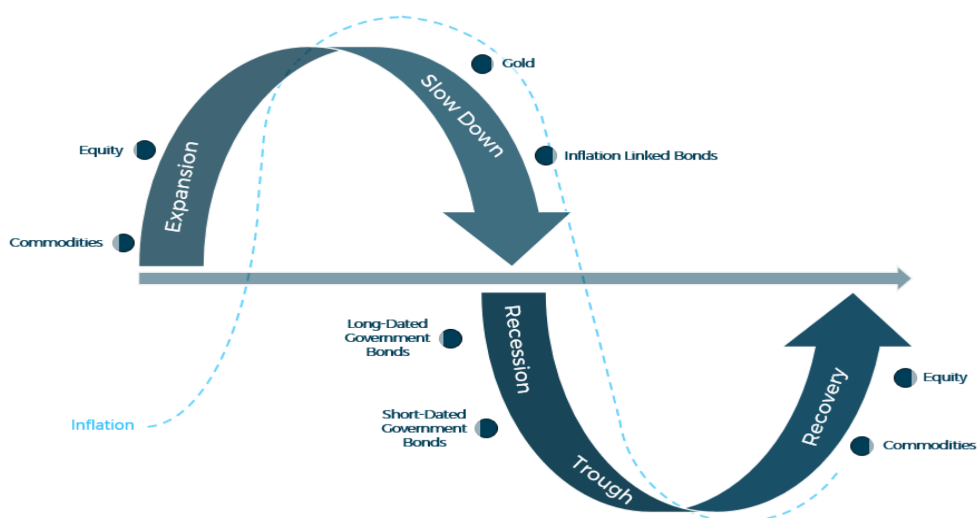
The question is whether these headwinds to growth are sufficient to push the economy into a recession.

Exhibit 2: Macroeconomists and market pundits have been too pessimistic about the growth and inflation outlook, which have not materialised yet and resulted in a 'positive surprise'. This in turn boosted risk appetite and the recent rally. But just like monetary policy, it is fair to assume trade policy works with variable lags. Stagflation is not off the cards, and the global economy is not out of the woods.



Source: Bloomberg L.P., Shard Capital, 30/06/2025

Exhibit 3: Where are we in the cycle?



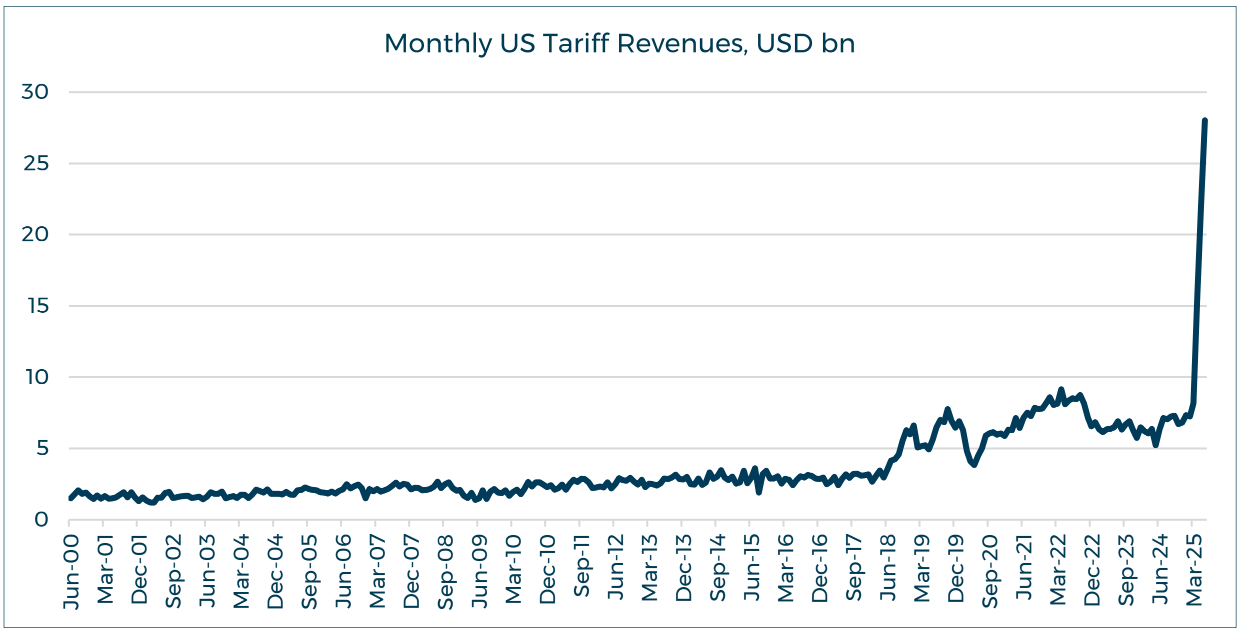
Source: Shard Capital, 2025

ON POLITICS AND POLICY

The political and policy landscape in Q2 2025 continues to be dominated by the interplay of trade, fiscal challenges, and the evolving role of technology in shaping economic priorities. The US administration's aggressive tariff agenda has introduced a new era of economic nationalism. While the partial pause on some tariffs offers temporary relief, the broader direction remains one of mercantilist protectionism aimed at reducing the US trade deficit, revitalising US domestic manufacturing and using the power of the US consumer to increase US tax revenues via trade.

However, history and economic theory caution that such policies often lead to unintended consequences, including supply chain disruptions, higher consumer prices, and retaliatory measures from trading partners. Jay Powell and the members of the FOMC agree as much.

Exhibit 4: Monthly Federal Custom revenues have surged in Q2. In the grand scheme of things, the absolute number is perhaps more trivial. That is not what DJT will tell you!



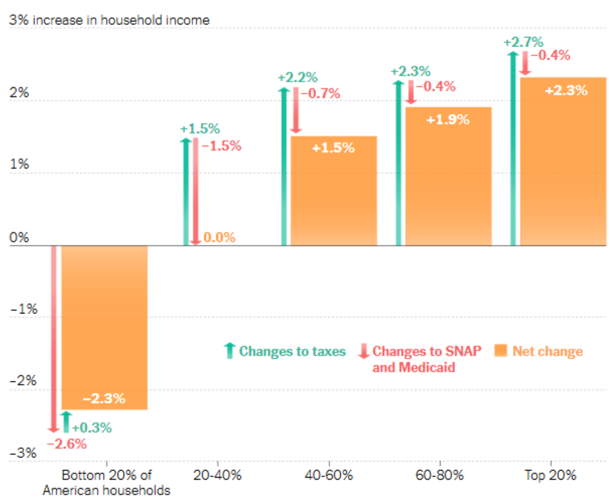
Source: Bloomberg L.P., Shard Capital, 30/06/2025

We've noted in past quarterlies, that the appointment of Scott Bessent as U.S. Treasury Secretary has been crucial and potentially marks a significant policy pivot. His three-pronged agenda focused on lowering energy costs, boosting real trend growth, and reducing budget deficits is undoubtedly the right approach for the US to maintain its 'exceptionalism' narrative. Achieving these objectives simultaneously, however, presents a formidable challenge.

Increasing oil and gas supply through deregulation and expanded drilling on federal lands aims to reduce energy costs, a critical input for the burgeoning AI and technology sectors. This energy strategy underpins the broader goal of raising US trend growth to 3%, supported by tax cuts, deregulation, and reshoring of key manufacturing industries.

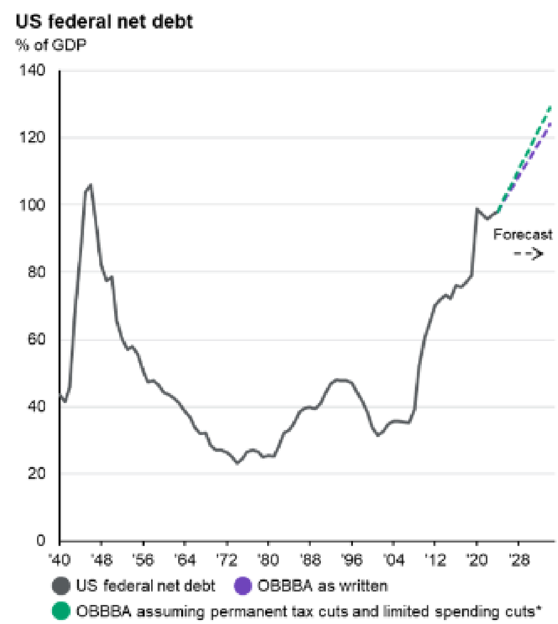
Indeed, these are all pro-growth measures, and, in their absence, the US administration might already have found itself facing economic contraction. It is specifically for this reason that fiscal discipline remains elusive. Despite the rhetoric of deficit reduction, political realities and the MAGA agenda suggest that deficits will widen before any meaningful consolidation occurs. OBBBA confirms as much. Indeed, Donald Trump's 'One Big Beautiful Bill' will only exacerbate inequality, and the unfunded tax cuts and increased government spending risk aggravating bond vigilantes and inflationary pressures. The tension between growth-oriented policies and fiscal sustainability will be a defining theme for markets during the second half of 2025.

Exhibit 5: The One Big Beautiful Bill's impact on household finances, by income quintile. The bottom line is that the more you make, the more you benefit!



Source: https://budgetlab.yale.edu/research/long-term-impacts-one-big-beautiful-bill-act, The Budget Lab and C.B.O. calculations; data from estimates released June 30, 2025

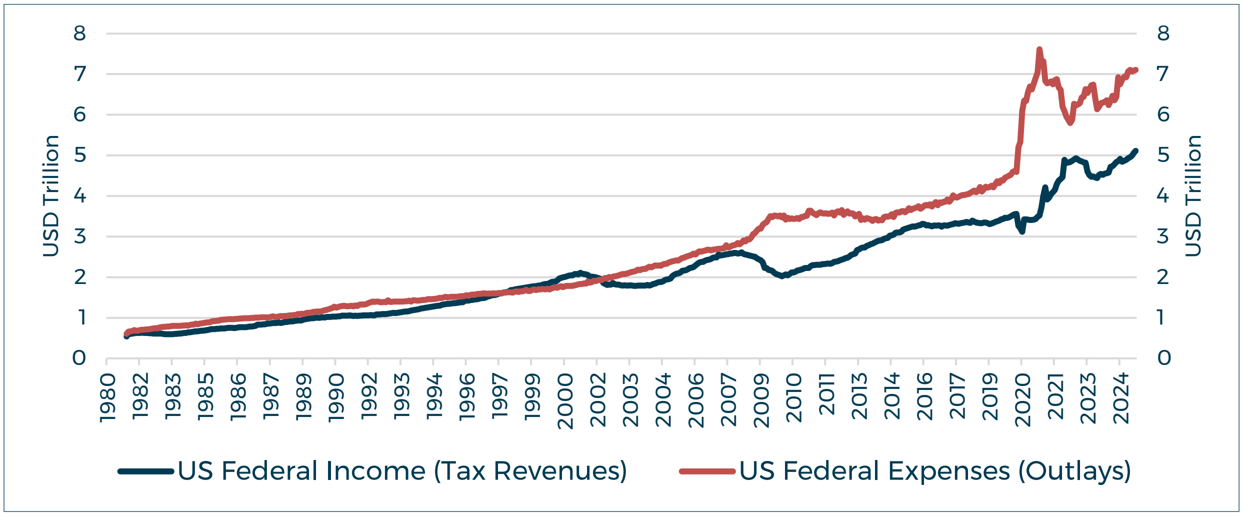
Exhibit 6: The new tax bill will push federal government debt well past the WWII highs.



Source: J.P. Morgan Asset Management. [Guide to the Markets – UK](), 30/06/2025

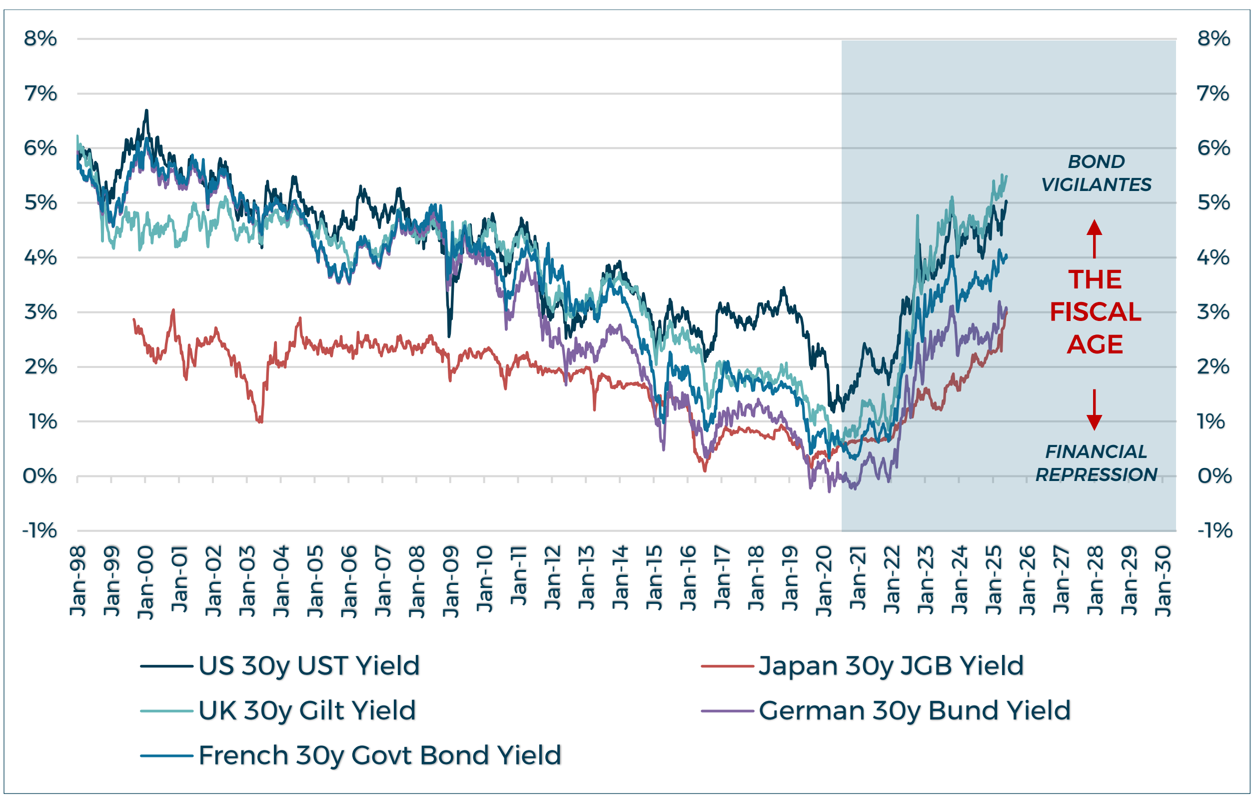
As we know, debts and deficits can only grow to a certain level. Beyond that the pro-growth benefits of debt becomes the destructive force of consequences.

Exhibit 7: Spending Has Drifted Out of Balance – and the dynamics of demographics and the Welfare State means the trajectory is only going up!



Source: Treasury.gov, Shard Capital, 30/06/2025

Exhibit 8: Long-term government bond yields across the developed world. Bond markets are telling us debt is a concern!

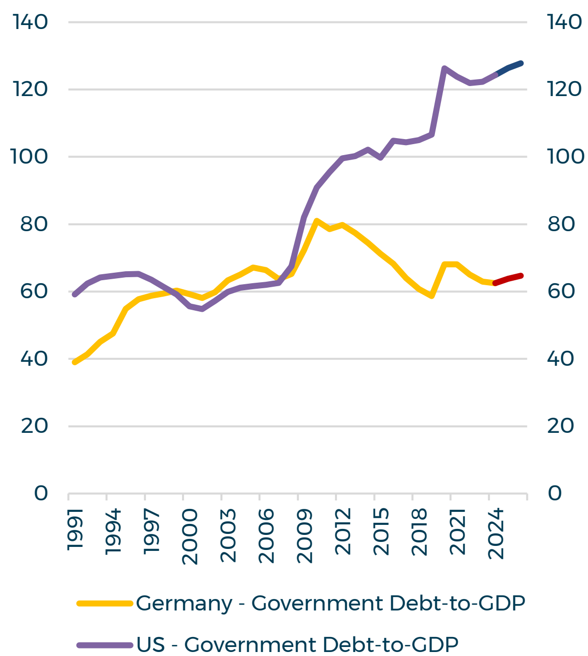


Source: Bloomberg L.P., Shard Capital, 30/05/2025

Globally, Europe faces its own policy conundrum. While Germany's shift away from fiscal conservatism and increased defence spending signal a new fiscal regime, the overall multiplier effect remains questionable without broader stimulus measures. The continent's economic challenges are compounded by US tariffs on European exports, which threaten to dampen growth prospects further.

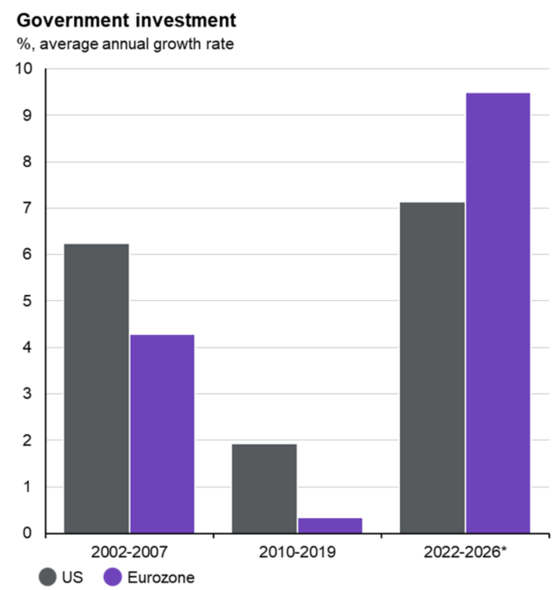
However, regime change is undoubtedly underway and with it comes immense opportunity. US defence programs effectively developed the internet, GPS, touch screen technology and canned food. Who knows, we might be on the cusp of the emergence of European Big Tech.

Exhibit 9: US Debt-to-GDP vs German Debt-to-GDP highlights the flexibility Germany has to increase spending.



Source: Bloomberg LP, Shard Capital, 30/06/2025

Exhibit 10: Spending in Europe is expected to outgrow that of the US for the first time in decades.



Source: J.P. Morgan Asset Management. [Guide to the Markets – UK](), 30/06/2025

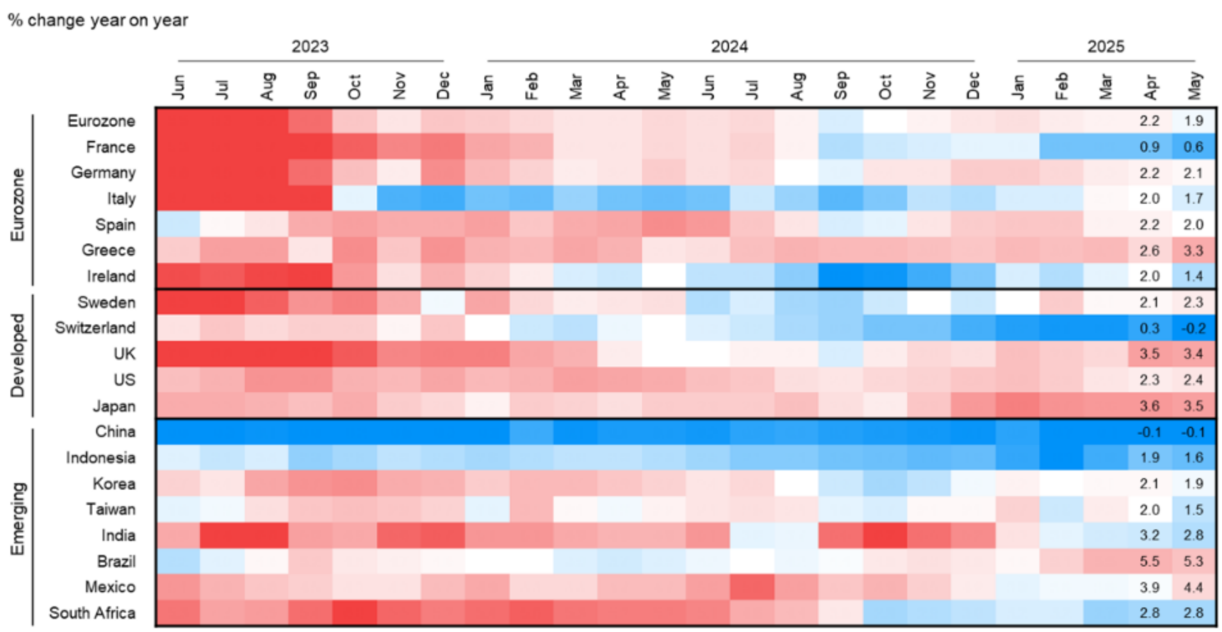
In summary, Q2 2025 was characterised by heightened policy uncertainty. Not least the arrival of Liberation Day, but also general protectionism, fiscal challenges, and technological transformation shaping the investment landscape. Navigating this environment requires a keen understanding of the evolving policy dynamics and their implications for growth, inflation, and market liquidity.

However, rather than trying to guess the next move of any politician, it is worth asking, what are their incentives. More often than not, the most likely outcome will be become clear. It is no one's interest to throw their own economy into recession. Austerity is unlikely and achieving deficit objectives even less so. Ultimately, financial repression seems inevitable as we embark on an uncertain future.

ON INFLATION

Inflation dynamics remain complex and finely balanced. Despite expectations, the world broadly continues to experience disinflation. In the US headline CPI is hovering just under 2.5%, whilst China struggles with outright deflation. The exceptions are the UK, Japan, and Brazil, where realised inflation is starting to pick up again.

Exhibit 11: Headline inflation broadly continues to show signs of a declining price pressures

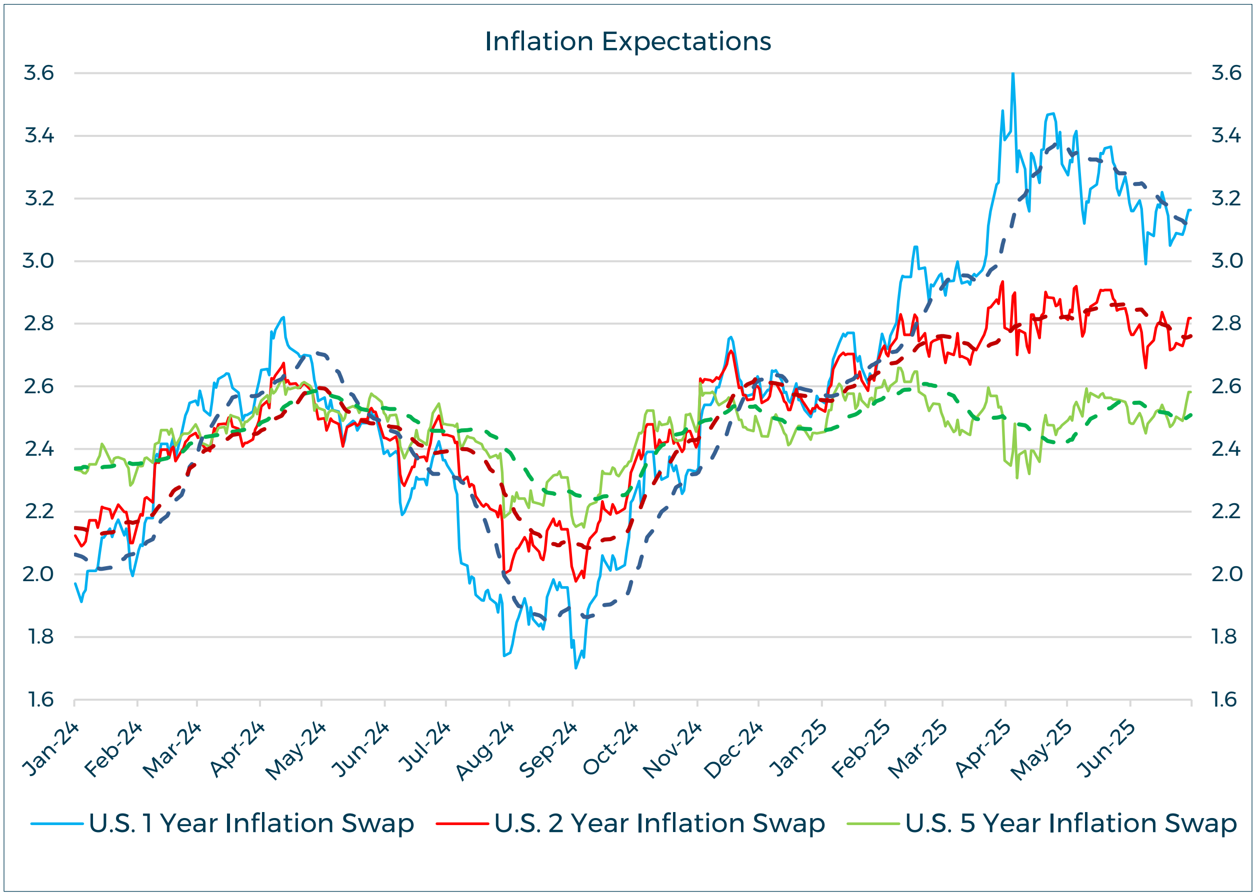


Source: J.P. Morgan Asset Management. Guide to the Markets – UK, 30/06/2025

Tariffs are expected to contribute to cost-push inflation, particularly in sectors reliant on global supply chains and labour cost arbitrage, such as apparel, automotive and electronics. However, the relationship between tariffs and inflation is nuanced. Tariffs act as a one-off price increase on imports, but their broader inflationary impact depends heavily on demand conditions. In a slowing growth environment, tariffs may constrain demand and thus limit sustained inflationary pressures.

Near term inflation expectations rose materially into Liberation Day. Whilst it has been pulling back, short term expectations remain elevated.

Exhibit 12: Short term inflations expectations (as measured by the 1-year Inflation Swap), peaked in April. Whilst down marginally since, it remains well above 3%. Highlighting fears of tariff driven inflation.



Source: Bloomberg L.P., Shard Capital, 30/06/2025

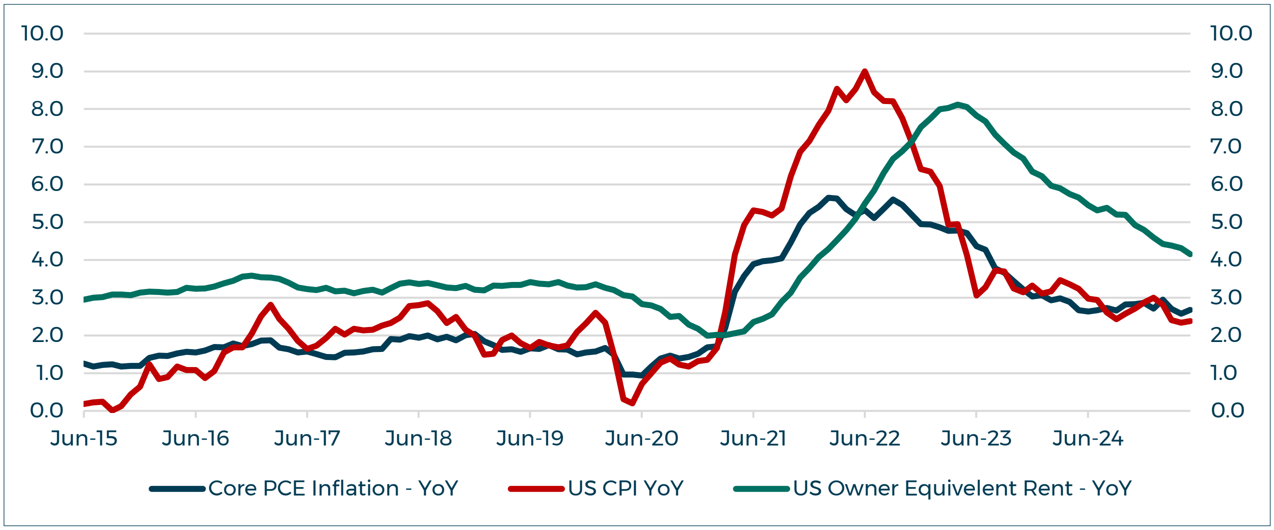
Realised CPI data has not been impacted in any meaningful way as has been expected, however. This might be because of two factors:

1. The primary factor in Core PCE inflation is Owner Equivalent Rent (OER). This is an imputed price – i.e. based on perception, and
2. A variable lag in trade policy and realised inflation.

At the same time, energy costs have actually declined as oil prices fell on the back of Scott Bessent's policy objectives. Indeed, realised CPI excluding Shelter is down to 1.5% in the US.

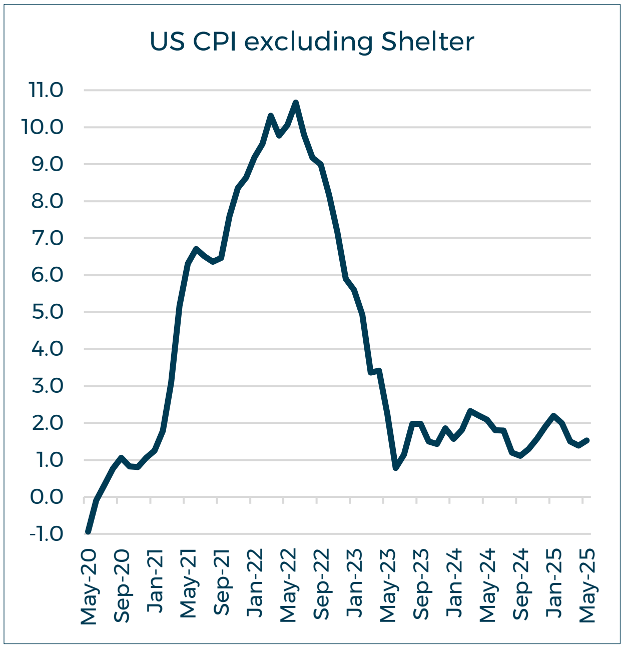
New tenet rest actually fell YoY in Q1, the first time since the housing market collapsed during the Global Financial Crises.

Exhibit 13: Whilst the overall disinflationary trend in US Core PCE inflation have stalled just below 3%, the trend in OER remains one of less pressure.



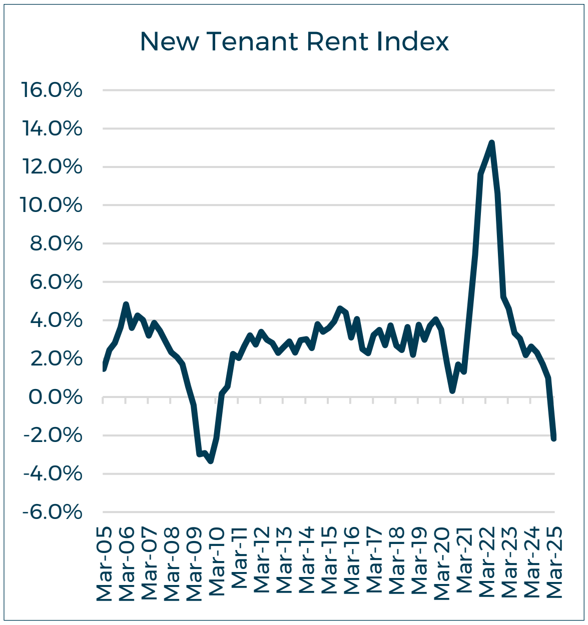
Source: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics via FRED®, Shard Capital, 30/06/2025

Exhibit 14: Excluding shelter, inflation remains below 2%, where it has been for some time.



Source: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics via FRED®, Shard Capital, 30/06/2025

Exhibit 15: New tenant rent actually fell year-over-year in Q1, the first time since the housing market collapsed during the Global Financial Crisis.



Source: Bureau of Labor Statistics, Shard Capital, 30/06/2025

Energy prices, influenced by geopolitical tensions and supply policies, remain a key driver of inflation volatility. The recent spike in oil prices due to Middle East conflicts underscores the sensitivity of inflation expectations to geopolitical risks. Central banks remain vigilant, with the Federal Reserve maintaining a cautious stance amid persistent inflation fears and fiscal concerns. Bond markets reflect this uncertainty, with yields elevated and volatility heightened.

Underlying inflation measures suggest some moderation, particularly in ‘super-core’ inflation (core services excluding housing). However, imputed components of inflation, such as owner-equivalent rent, continue to exert upward pressure, reflecting the impact of higher interest rates and the realities of Rentier Capitalism, which I discussed last year.

It is perhaps worth taking a step back and reconsidering the following three definitions:

Rentier Capitalism, according to ChatGPT:

Rentier capitalism refers to an economic system where a significant portion of wealth and income is derived from owning or controlling access to assets, such as land, property, or financial instruments, rather than from productive economic activities like labour or entrepreneurship. In this system, individuals or entities extract economic rents - excess profits or income obtained beyond what would be necessary to keep an asset in its current use - by exploiting their ownership or control of scarce resources or assets.

Owner occupiers’ housing costs rental equivalence, according to the Office for National Statistics (ONS):

The owner occupiers’ housing costs rental equivalence approach uses the rent paid for an equivalent house as an estimate of the cost of housing services that are consumed. That is, we value housing services by looking at the cost of the next best alternative to home ownership, namely renting a property.

Greedflation, according to the Collins Dictionary:

Greedflation is an increase in the price of goods and services caused by businesses increasing their prices by more than their costs have risen.

You put these three together, alongside the fact that greed is a human characteristic that has been around for as long as man has lived and you realise this neatly describes the society we live in today. The very nature of Capitalism drives inequality.

It is worth noting that the deflationary forces of demographic decline as the labour force starts to shrink and the AI Revolution that is upon us, implies that the medium-term inflation risks are skewed to the downside.

Monetary and fiscal policy interplay will be critical in shaping inflation trajectories. While central banks are poised to pivot toward easing as growth slows, fiscal policy remains expansionary, with large deficits and government spending supporting demand. This dynamic creates a delicate balance.

But make no mistake, short-term inflation risks are skewed to the upside if trade deals do not materialise or retaliatory tariffs become a reality. This alongside fears of slowing growth, describes the Stagflation narrative.

Over the medium term, we believe deflation is the major risk factor. Deflationary spirals lead to depressions, and accordingly this is a risk central bankers and policy makers will avoid at all costs.

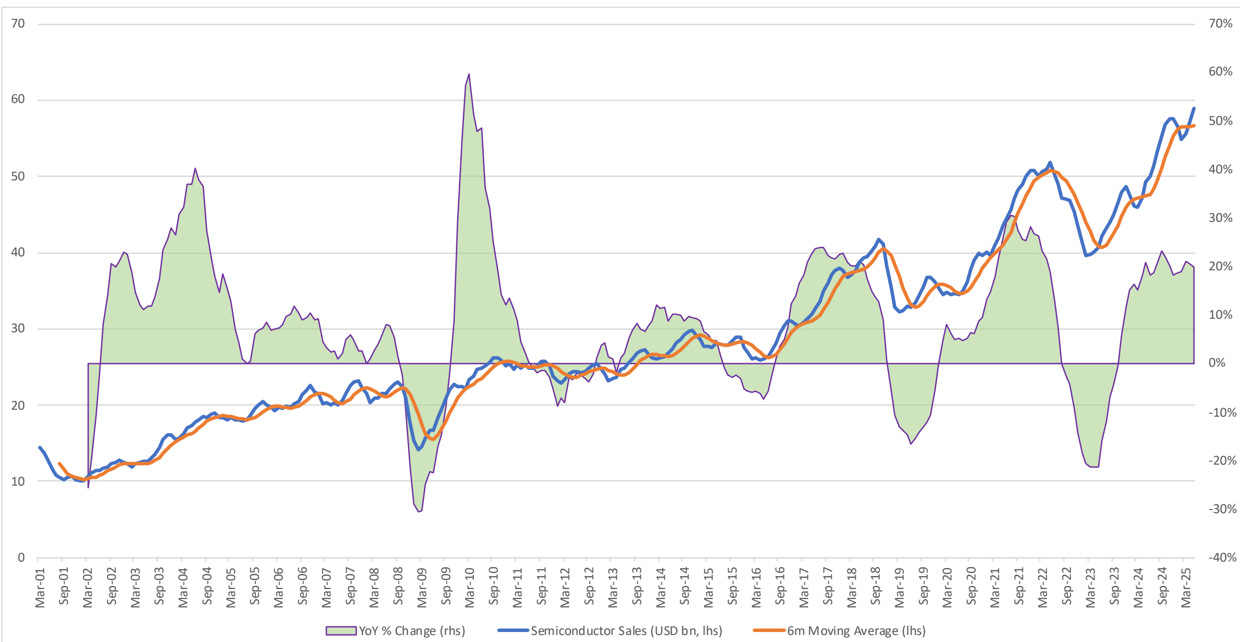
Understanding these risks are crucial, but it also implies that financial repression is inevitable. Strategic allocations to inflation-protected securities, precious metals, and other real assets remain prudent in this environment.

ON ECOOMIC GROWTH

Global economic growth is slowing, with consensus forecasts for 2025 revised downward to approximately 2.6% globally and under 1.5% for the US. The slowdown reflects a confluence of factors: tariff-induced trade disruptions, geopolitical tensions, tightening financial conditions, and waning consumer and business confidence.

The US economy, while supported by a resilient consumer and robust employment, shows signs of strain. Consumer liquidity is diminishing as excess savings from the post-pandemic period are depleted. Rising interest rates and policy uncertainty weigh on housing and capital expenditures. The "demand-side deflation hangover" described by analysts is evident in weakening consumption growth and cautious corporate investment. However, the AI-driven capital expenditure boom, particularly in data centres and technology infrastructure, provides a counterbalance, supporting pockets of growth and productivity gains.

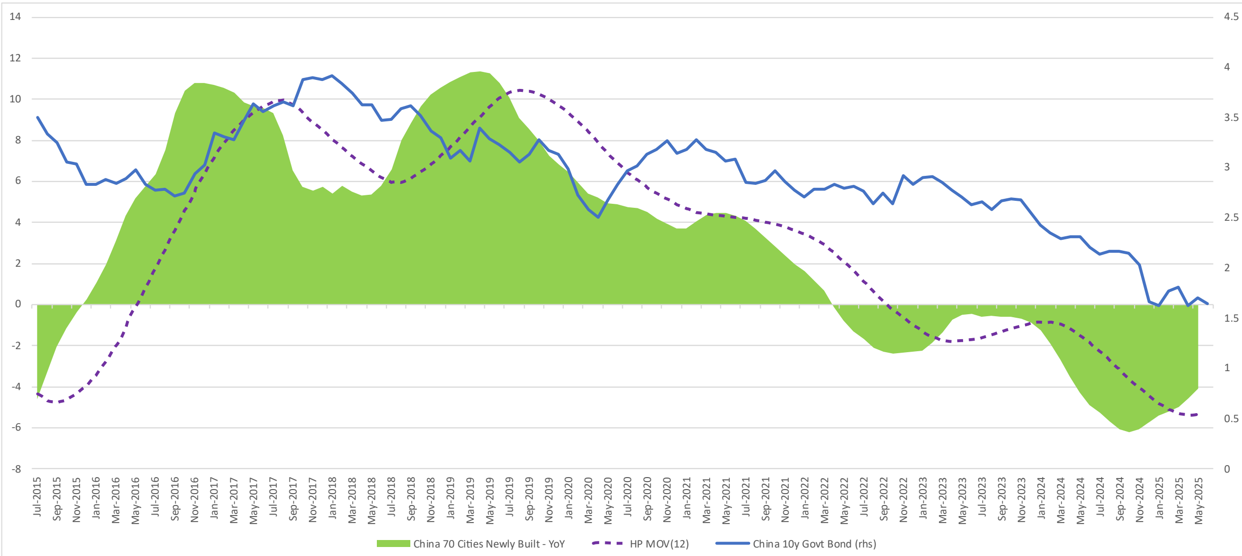
Exhibit 16: Semiconductor sales remain robust. We see this as a key indicator of global economic health.



Source: Bloomberg L.P., Shard Capital, 30/06/2025

China faces immense challenges. Stimulus efforts are beginning to stabilise a housing market that is on its knees, but structural headwinds such as demographic shifts and debt overhang persist.

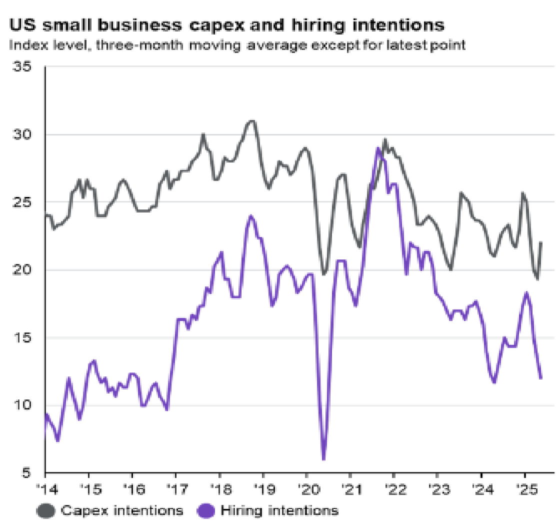
Exhibit 17: Chinese House Prices are now entering its 4th year of decline.



Source: Bloomberg L.P., Shard Capital, 30/06/2025

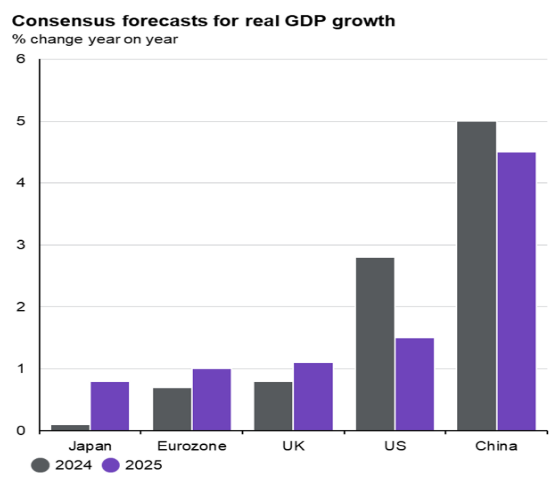
The opportunity presenting itself to Europe is unlike anything it has seen since the Marshall-plan allowed for the rebuilding of post-WWII Europe. As mentioned above, defence spending, when done correctly, can have massive positive payoffs for innovation and job creation alike. Indeed, there is a chance that the Euro rise from the ashes and plays an increasingly important role as a diversifier away from the hegemony of the US Dollar. Perhaps unlikely, but not impossible.

Exhibit 18: Sentiment and investment in the US remain weak.



Source: J.P. Morgan Asset Management. [Guide to the Markets – UK](), 30/06/2025

Exhibit 19: Whilst US and Chinese growth has been downgraded; Europe and Japan has been revised up!

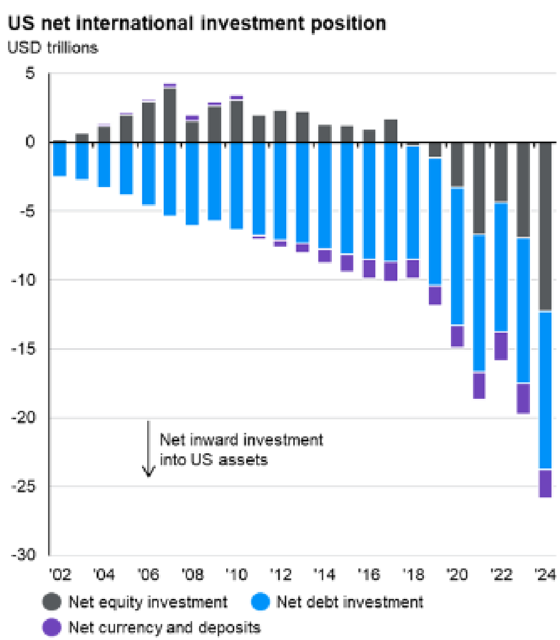


Source: J.P. Morgan Asset Management. [Guide to the Markets – UK](), 30/06/2025

One thing Europe has, is a union that allows this much. Not many other parts of the world have the institutional structures in place to ensure cross-border trust and cooperation in the same way as Europe. Despite cultural differences and headaches of fiscal sovereignty, the Union that is Europe might just be the opportunity investor will jump on.

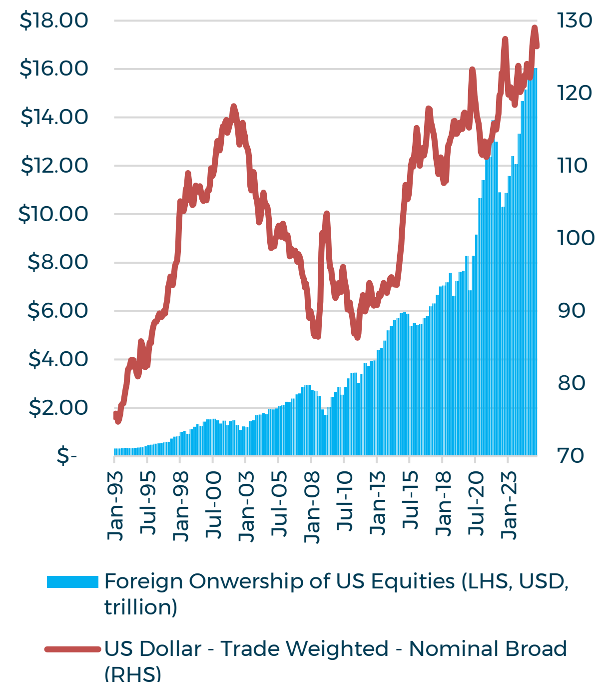
Imagine if investment and capital flows reverse in full.

Exhibit 20: Investment flows into US assets have been unlike anything seen in history.



Source: J.P. Morgan Asset Management. [Guide to the Markets – UK](), 30/06/2025

Exhibit 21: Chasing US Exceptionalism:



Source: Board of Governors of the Federal Reserve System, Shard Capital, Bloomberg L.P., 23/06/2025

Emerging markets present a mixed picture. India remains a bright spot with growth above 6%, benefiting from favourable demographics and reform momentum. Latin America and parts of Asia are adjusting to the new global trade realities, with nearshoring and supply chain diversification creating opportunities amid uncertainty.

The global economy appears to be transitioning from a late-cycle expansion to an early-cycle slowdown, characterised by increased volatility, lower earnings growth, and a repricing of risk assets. Investors should prepare for a period of adjustment, with growth risks skewed to the downside but tempered by technological innovation and selective fiscal support.

ON VALUATIONS

Exhibit 22: Below is our basic 5-year return assumption:

US Equity	
FCF Yield	2.77%
EPS Est CAGR	7.00%
Multiple Expansion - 10Y MOV	-3.78%
5y Ann Expected Total Return	5.81%

UK Equity	
FCF Yield	6.67%
EPS Est CAGR	5.00%
Multiple Expansion - LTAVE	5.17%
5y Ann Expected Total Return	17.79%

Japan - Topix	
FCF Yield	4.21%
EPS Est CAGR	7.00%
Multiple Expansion - LTAVE	5.01%
5y Ann Expected Total Return	17.09%

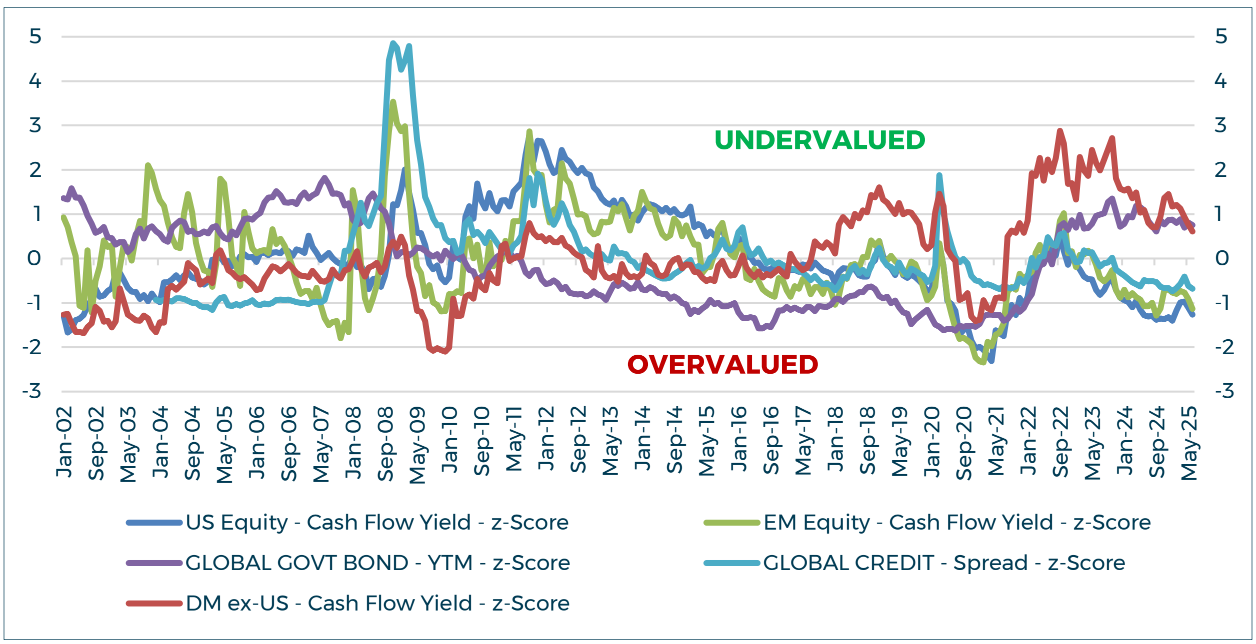
EU ex-UK Equity	
FCF Yield	5.51%
EPS Est CAGR	5.00%
Multiple Expansion - LTAVE	1.35%
5y Ann Expected Total Return	12.28%

China	
FCF Yield	6.52%
EPS Est CAGR	7.00%
Multiple Expansion - LTAVE	-0.95%
5y Ann Expected Total Return	12.89%

EM ex-China Equity	
FCF Yield	3.85%
EPS Est CAGR	10.00%
Multiple Expansion - LTAVE	0.12%
5y Ann Expected Total Return	14.38%

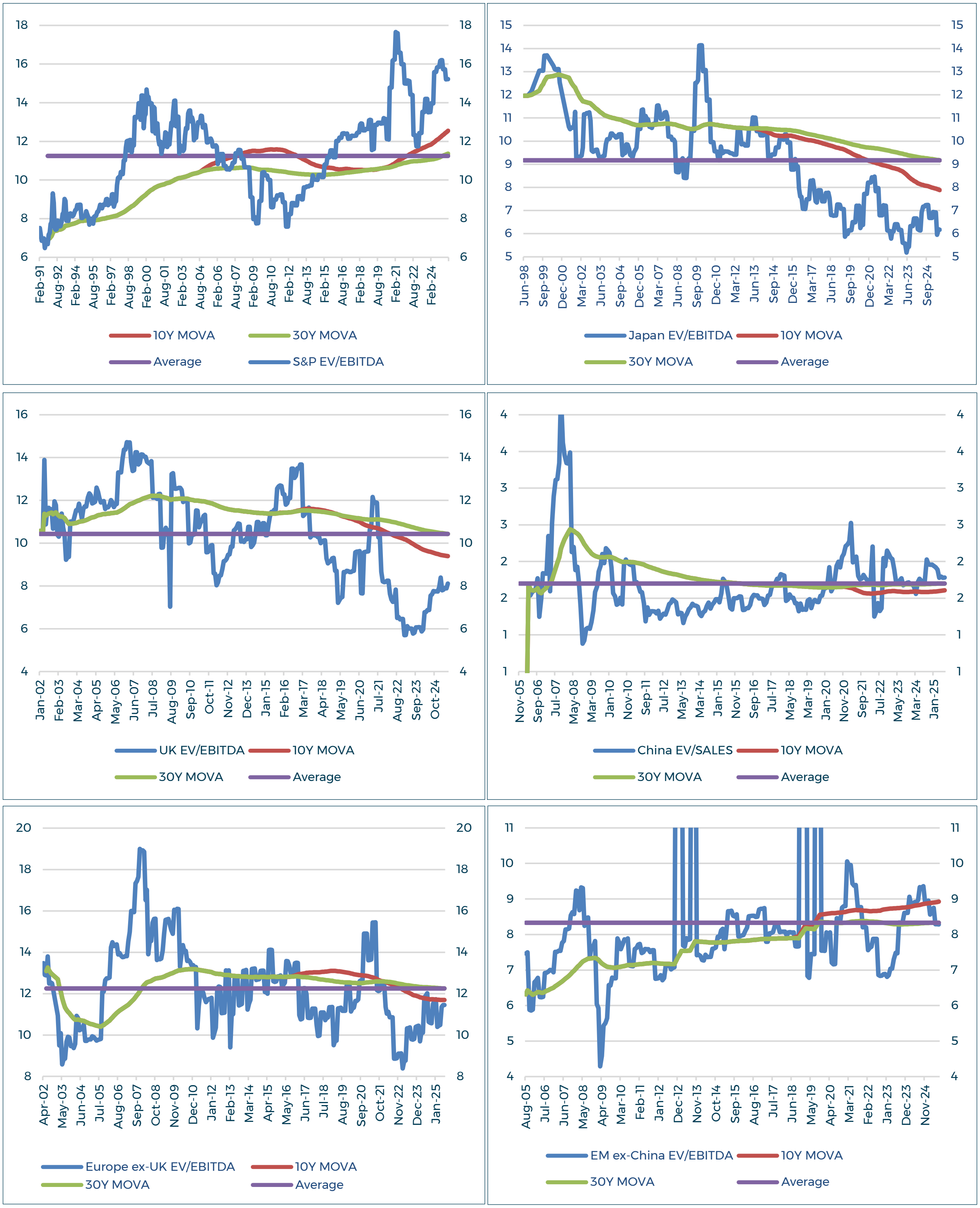
Source: Bloomberg LP, Shard Capital, 30/06/2025

Exhibit 23: The following chart provides a high-level overview of market valuations.



Source: Bloomberg LP, Shard Capital, 30/06/2025

Exhibit 24: Individual Market Valuations.



Source: Bloomberg LP, Shard Capital, 30/06/202

ON ASSET ALLOCATION

	Positioning	Investment Thesis
FIXED INCOME		
DM – Government Bonds	NEUTRAL	Whilst yields in the U.S. Treasury markets are attractive, we note the risks from supply-demand mismatch, inflation and term-premia for longer duration U.S. Treasuries. We find short-dated TIPS especially attractive with high real rates relative to history. Duration in Europe and U.K. Gilt markets look more attractive as we believe long-term growth and inflation expectations remain too high.
DM – Corporate Bonds	UNDERWEIGHT	The risk-reward profile remains unattractive given tight credit spreads and macroeconomic risks.
EMD – Government Bonds	OVERWEIGHT	A strong US Dollar has negatively impacted EM Govt bonds. However, the tide has turned, and we believe the current administration will ensure a weaker US Dollar prevail, whilst current yields reflect most of the negative sentiment.
EMD – Corporate Bonds	NEUTRAL	Risks include negative economic shock, FX-mismatch. Attractive security specific / RV opportunities, where we prefer high quality, short-duration and hard-currency credit, which offers attractive yields with lower relative risk.
ALTERNATIVES		
Property & Infrastructure	NEUTRAL	We retain conviction behind infrastructure, especially in digital infrastructure and electrification where attractive and sustainable tailwinds persist. We believe infrastructure that provides long-term CF's and inflation protection offer attractive opportunities at current levels. Property markets remain uncertain and less attractive. Whilst there are perhaps niche / specific property assets with attractive characteristics, cap rates and valuations broadly do not reflect a higher interest rate regime we entered post-pandemic.
Commodities	OVERWEIGHT	We remain positive on precious metals, in particular gold, as geopolitical and economic uncertainty remains high, with optionality driven by policy missteps. Whilst sustainability of near-term demand remains uncertain, energy security, climate change, Asian growth, and the long-term demand characteristics, could provide attractive opportunities to increase exposure to the energy complex, Natural Gas in particular.
Private Equity	UNDERWEIGHT	Listed PE is always vulnerable to liquidity risks during periods of increased market dislocations. Furthermore, the risks from rising cost-of-capital and difficulties in refinancing is a risk we believe not fully reflected in private markets. We remain Underweight. On a selective basis, attractive discounts have opened up, which warrants attention.
Alternative Strategies	OVERWEIGHT	Uncertainty behind inflation and economic growth drive the opportunity for uncorrelated investment propositions, e.g. Hedge Funds. However, investors should consider the absolute opportunity relative to T-Bills. Attractive strategy specific opportunities exist with i) lower volatility, ii) uncorrelated profiles, iii) attractive risk-adjusted return expectations, and iv) long-volatility pay-off profile. We are especially bullish on CTA's and trend-following Managed Futures.

	Positioning	Investment Thesis
DEVELOPED MARKET EQUITY		
North America	**UNDERWEIGHT**	US equity market outperformance over the last 15 years have been significantly supported by multiple expansion, and valuations remain elevated on both absolute and relative levels. Despite the longer-term benefits from the AI revolution, we believe risks to profit margins remains significant. Whilst valuations in small and midcaps looks marginally more attractive, policy uncertainty and weakening sentiment we believe are major headwinds to U.S. small and midcaps.
UK	**NEUTRAL**	Whilst equity valuations, especially in the small and midcap market are attractive, political uncertainty, deteriorating economic outlook and inflation risks remain material. We retain a preference for high quality and stability and note the opportunity in small and midcap companies.
Europe ex-UK	**NEUTRAL**	Whilst FX and Stagflation risks remain material, we belief the changing European fiscal regime represents a major macroeconomic and policy shift in European policy. Valuations remain relatively attractive; however, we note a preference for quality and pricing power.
Japan	**OVERWEIGHT**	Attractive valuation, macroeconomic tailwinds and ongoing market reform all underpin the opportunity in Japan. Corporate Japan's strong balance sheet and low valuations make for attractive risk-reward profile. We believe the Japanese Yen is significantly undervalued, and exposure to Japan should not be hedged.
EMERGING MARKET EQUITY		
Asia ex-Japan & China	**OVERWEIGHT**	We retain a preference for Asian emerging economies over non-Asian EM, driven by better fundamentals and lower reliance on externalities. However, we note the risks of contagion as China embark on a local deleveraging cycle and economic growth slows. India remains one of our highest conviction opportunities in the region, but valuations are stretched.
China	**OVERWEIGHT**	Overly pessimistic outlook and sentiment towards China are reflected in valuations. Whilst question marks with regards to demographics, real estate, debt, policy and alignment remain, sentiment are showing signs of turning less negative. The risk-reward remain skewed to the upside, and selectively attractive long-term opportunities have emerged.
Latin America	**OVERWEIGHT**	The changing political and macroeconomic environment, specifically the benefits from the 'near-shoring' of supply chains and the consequences of deteriorating China-US relations, creates attractive opportunities in Central and South America. Some uncertainty remains in the near term from US-policy and the outlook for global growth.
EMEA	**UNDERWEIGHT**	Preference for Asia & Latin America.

CONTACT US

For further information on any of our services, or if you would like to arrange a meeting with an investment manager to see how we can work with you, please get in touch.

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