

Investment Outlook

Q3 2025



IS THE TRADE WAR CAUSING STAGFLATION?

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We have revised the layout of our *Investment Outlook* publication as part of a broader redesign of our corporate identity. Our new website will go live in the coming weeks. In this updated format, we have reduced the number of standalone charts and instead integrated them more directly into the text to better support our key arguments.

President Trump's aggressive and unpredictable trade policies have introduced considerable uncertainty, leading to a clear deterioration in consumer and business sentiment in the United States. Despite a sharp market correction in April, financial markets have remained relatively calm—likely based on the assumption that the so-called "TACO" paradigm (*Trump Always Chickens Out*) continues to apply: after initial confrontational rhetoric, the President typically retreats or waters down announced policy measures.

Nonetheless, even with many tariff increases postponed until August 1, the average US tariff rate has already risen to nearly 16%—the highest level in over 90 years. While recent economic data has remained surprisingly resilient, the full impact of trade measures tends to unfold with a time lag. International shipments from China or Europe take weeks to reach US retailers, and delayed consumer or business purchasing decisions may take months to be reflected in official statistics. Moreover, the front-loading of imports and inventory accumulation earlier this year has temporarily cushioned the economic effects.

We expect the uncertainty caused by erratic and arbitrary US policies to weigh increasingly on consumer and



business spending. Sentiment indicators have already declined sharply. Tariffs are inherently stagflationary: they increase prices while dampening demand and purchasing power. As a result, we expect the US economy to slow in the coming quarters, while inflation is likely to remain elevated or even accelerate. This, in turn, will limit the Federal Reserve's ability to implement meaningful rate cuts this year. We also see an increased risk of further US dollar depreciation, as global investors reassess the risk premium on US assets.

Given these global uncertainties and elevated valuation levels, we continue to maintain a defensive portfolio stance. We remain underweight in equities, high-yield bonds, and commodities, while maintaining an overweight in nominal government bonds.

During the second quarter, we closed our underweight in European equities and moved to a neutral position. At the same time, we further increased our underweight in US equities.



Financial markets

The second quarter began with a bang: On April 2, US President Trump unexpectedly announced comprehensive and significantly increased import tariffs. As a result, the S&P 500 Index lost around 12% within just a few days, while yields on 10-year US Treasuries rose from 4.1% to nearly 4.5%. Following a temporary suspension of the announced tariffs about a week later, equity markets quickly and significantly recovered.

In the second quarter, despite trade tensions and the Iran war, most equity markets posted strong gains. The S&P 500 rose by 10.6% even reaching a new all-time high, the German DAX by 7.9%, and Japan's Nikkei 225 recorded a double-digit increase of 13.7%. After lagging behind European equities in the first quarter, US equities managed to outperform in the second quarter.

Gold continued its strong performance: following a 19% rise in Q1, the gold price gained another 5.7% in Q2 and reached a new all-time high of nearly USD 3,500 in June.

At the same time, the US dollar came under considerable depreciation pressure. Although US equities and



Price of Gold, USD per oz

bonds remained in demand among international investors, there are increasing signs that these investors are actively hedging their USD exposure. These hedging transactions, which involve the sale of US dollars, contributed to the pronounced weakening of the currency. The US dollar lost 4.3% against the euro in Q1 and an additional 8.2% in Q2.

Macroeconomics

Just recently, President Trump announced a new wave of tariffs to take effect on August 1. These include a 30% tariff on goods from the European Union and a 35% tariff on Canadian goods. He also threatened to impose 50% tariffs on Brazilian goods, despite the fact that the US runs a trade surplus with Brazil. The move was reportedly linked to political pressure: Trump demanded that Brazil halt legal proceedings against former right-wing president Jair Bolsonaro, who faces charges for his alleged attempt to overturn the 2022 election results.

While equity markets reacted negatively in early July, losses remained moderate. It appears that market participants are still adhering to the so-called TACO (*Trump Always Chickens Out*) strategy—assuming that initial threats will ultimately be softened or reversed.

While the US economy has shown resilience so far, we expect the new tariffs to increasingly weigh on growth and push inflation higher in the months ahead.

US core inflation (excluding food and energy) came in below expectations in June but remained elevated at 2.9%, still clearly above the Federal Reserve's 2% target. Price declines for used vehicles helped offset gains in other categories. Notably, prices for goods affected by tariffs have begun to rise, suggesting that the inflationary impact of trade measures is starting to filter through to consumers.

A further warning sign comes from the Conference Board Leading Economic Index (LEI), which dropped again in May—following a sharp, downwardly revised 1.4% decline in April, the largest monthly drop since the COVID-19 pandemic in 2020. The 6-month annualized change in the LEI fell to -5%, a level historically associated with rising recession risks (see chart below). That said, Conference Board economists currently do not forecast a US recession, but rather expect growth to slow materially in the coming months.

Central Banks

The US Federal Reserve kept interest rates unchanged at 4.25–4.50% during the second quarter and reiterated that elevated uncertainty—particularly around the inflationary impact of tariffs—warrants a wait-and-see approach. The latest dot plot, which reflects FOMC members’ expectations for future interest rates, indicates that a modest rate cut may be possible later this year. Meanwhile, President Trump has repeatedly criticized Fed Chair Jerome Powell for not cutting rates more aggressively.

The European Central Bank lowered interest rates by 25 basis points in both April and June, bringing the deposit rate down to 2.00%. ECB President Christine Lagarde emphasized that inflation is nearing the ECB’s 2% target, but she also noted that the easing cycle is now nearly complete, with at most one further cut expected later this year.

On June 19, the Swiss National Bank (SNB) also cut its policy rate by 25 basis points, bringing it to 0%. This move had been widely anticipated and reflects the SNB’s concern over the strong Swiss franc, which is amplifying disinflationary pressures. Swiss inflation is now projected to fall to just 0.2% in 2025. If this trend continues, the SNB may consider further rate cuts, potentially even returning to negative interest rates.

Outlook

Uncertainty surrounding the future direction of US economic and trade policy under President Trump remains high. This unpredictability is dampening confidence among both businesses and consumers. In the first half of the year, real consumer spending in the US declined. Meanwhile, a supply overhang has emerged in the US housing market, leading to a noticeable drop in property prices.

Despite these risks, global equity markets are trading near historic highs. The forward price-to-earnings ratio (P/E) of the S&P 500 currently stands at around 23 – a historically elevated level. In our view, the underlying



Conference Board Leading Economic Indicator, 6M chg. ann. in %

earnings expectations (+10% for 2025) are overly optimistic. In particular, we see the major US technology stocks as significantly overvalued.

We expect US inflation to remain above the Federal Reserve’s 2% target or even rise further. The weakening of the US dollar, increased tariffs, and migration-driven supply bottlenecks all contribute to inflationary pressure. A renewed spike in inflation could unsettle markets and limit the Fed’s ability to cut interest rates.

In this context, we believe the risk of an equity market correction has increased significantly. At the same time, several factors argue for a continued weakening of the US dollar – not least the declining confidence of international investors in the fiscal and political stability of the United States.

In contrast, we expect European equity markets to perform relatively better – as already observed in the first quarter. In addition to more moderate valuations, we anticipate a fiscal boost in Europe driven by increased public spending on infrastructure and defence.

The following three risk scenarios have the potential to unnerve market participants and to lead to a meaningful market correction:

- An escalating trade war between the US and the European Union. So far, trade talks have been relatively calm. However, the EU has prepared retaliatory tariff measures of significant size. If trade negotiations failed it would be easy to imagine an upward spiral of tariff policies.
- A surge of US inflation. So far it seems that US inflation has hardly moved. This may be explained by the large build-up of inventories ahead of the introduction of tariffs. However, inventories will be depleted soon and inflationary pressure could start building.

- The US deficit is already at 6% of GDP and is expected to rise further to about 7%. At the same time, some countries like Taiwan and Japan have indicated that they may reduce purchases of US treasuries. If, at one of the future US bond auctions, demand for treasuries should be disappointing, this could drive US bond yields higher, which could, in turn, negatively affect equity markets.

ASSET ALLOCATION

In Q2 bond and stock markets performed well. The major headwind for Euro-based investors comes from the strong currency appreciation, most notably against the USD. If an investor holds only 10% USD in their portfolio, the performance impact amounts to -1.5% from USD de-

preciation alone. YTD European stock markets outperformed, but in Q2 US stocks strongly rebounded. Gold is the best performing asset class this year, driven by strong central-bank buying.



RISK MONITOR

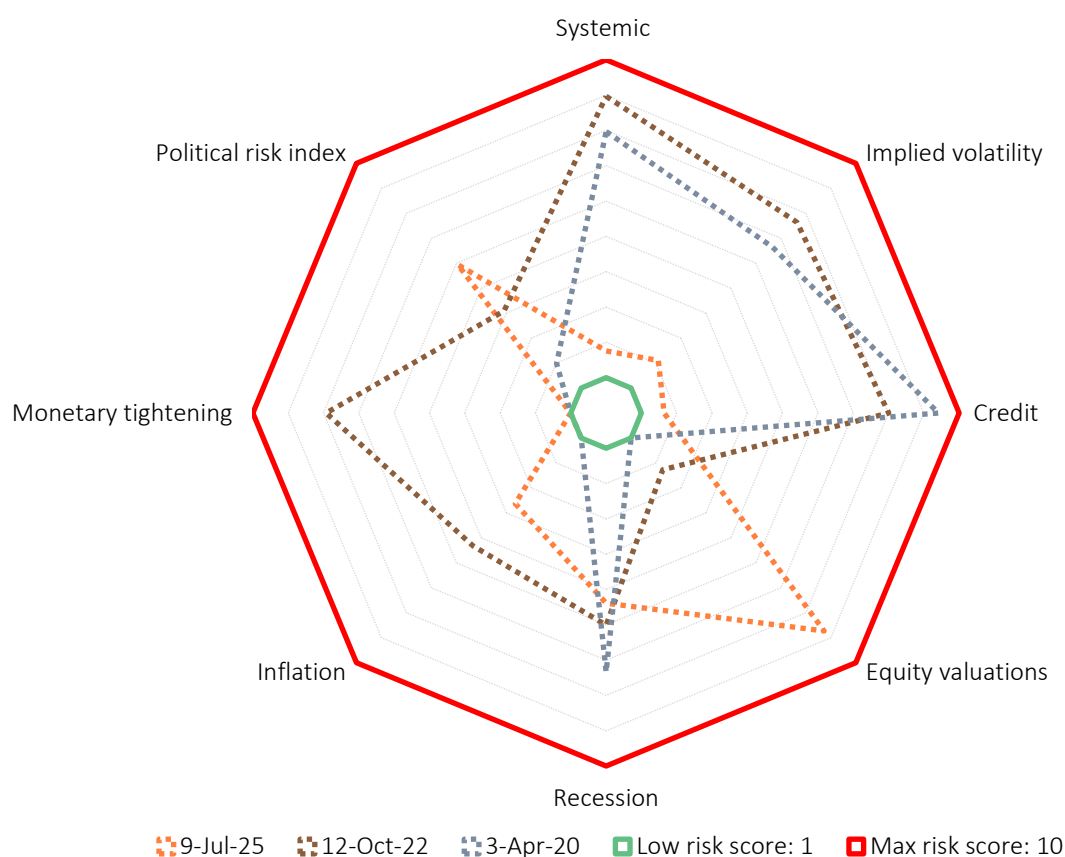
We have revised our Risk Monitor and made several changes to the indicators we are using and to the calculation for normalizing the risk indicators. For example, we now use the Conference Board Leading Economic Indicators for the US and the Euro area as recession risk indicators, instead of the manufacturing PMIs. The calculations for normalizing the indicators have been

amended to obtain more meaningful risk signals.

Currently, the most prominent risk factors include elevated equity valuations, recession and political risks. Inflation risks have clearly subsided since 2022, but remain somewhat elevated.

3-Apr-2020: Global pandemic

12-Oct-2022: Inflation shock



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