

# Macro Monthly

Economic insights and asset class views

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For global professional / qualified / institutional clients and investors

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## Can markets look past a worsening economy?

### Highlights

- After a volatile first half, global equities are back to all-time highs, just as tariffs start to weaken the economy.
- We think the market can look through this soft patch, as rate cuts, fiscal stimulus and AI-led productivity gains set the stage for a better 2026.
- In light of our outlook, we are overweight equities, short the USD and long EM carry.
- Front end government bonds remain the best hedge in case the labor market weakens by more than we expect.

It was an extraordinary first half of the year for markets. After a near 20% drawdown, the S&P 500 staged the fastest-ever rebound from a >15% decline and closed at fresh highs just before June's end. Investors can be forgiven for feeling some whiplash.

Notably, the primary (though certainly not exclusive) source of volatility, tariffs, is only now beginning to have an impact on real economic data. Does it make sense for equities and credit to 'look through' a worsening in inflation and growth outcomes over the coming quarters? Our answer is yes.

### We already got the (slowdown) memo

The effective US tariff rate has climbed from 2.5 % in early 2025 to roughly 15 % today. Companies are now deciding how much to pass through to consumers vs. absorb in margins. Either choice implies softer consumption as real incomes slip or hiring slows. Slower immigration and still restrictive interest rates add to the drag.

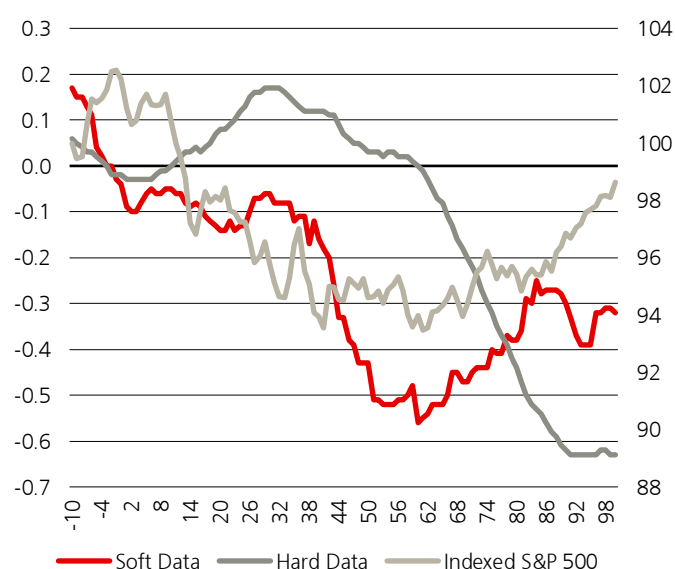
Yet consensus already reflects this step down. Economist consensus pegs 2025 US GDP growth at 1.4%, down from 2.3% in January. The Fed's June Summary of Economic Projections matches that figure and sees unemployment rising to 4.5%. Near term earnings estimates have been marked lower as well.

## Markets move on

But markets don't just discount cash flows for the next six months. As worst case scenarios are avoided, risk appetite rebounds even before the data does. There is plenty of precedent for markets to 'move on' despite worsening economic outcomes. Equities typically bottom when the news is at its worst.

Typically, after a negative catalyst, such as Trump's dramatic ratcheting up of tariffs, soft data like consumer and business confidence deteriorate along with equity market performance. However, once policy shifts and soft data bottom out, equities start to bottom as well even as the hard data deteriorate (Exhibit 1). This has been precisely the pattern this year, with President Trump backing off worst case scenarios and settling with policies that while painful, are not likely to be cycle-ending.

**Exhibit 1: S&P 500 performance after event-driven recessions**



Source: Goldman Sachs. Data as of June 2025.

Moreover, this 'pain' is setting the groundwork for next year's potential lift. With the labor market softening and services inflation cooling faster than expected, the Fed is likely to cut rates in the second half. Expectations of lower rates, along with a softer USD, are easing financial conditions now, which will support the economy with a lag into 2026.

Meanwhile, the likely summer passage of the 'Big Beautiful Bill' will add stimulus to the economy via incremental tax cuts and business expensing provisions. As it turns out, tariff revenue is going to offset much of the incremental deficit increase from the bill – in other words, the pain (tax hikes) is coming now, but the economic support (tax cuts) come in early 2026. Markets can anticipate this, along with building deregulatory actions by the administration.

Finally, AI is progressively being incorporated into the operations of numerous companies. This integration is expected to enhance efficiencies, potentially boosting corporate profits. Therefore, it is prudent to overlook short-term challenges, as we may be standing on the brink of significant structural profit gains.

## Two Main Risks

We recognize that this is an optimistic outlook, especially after the swift rebound in markets and valuations once again elevated. As such it's important to identify risks to our view: of known unknowns, we see one risk that we are comfortable with and another that warrants greater concern. The first risk is that President Trump, now emboldened with stronger stock and bond markets, decides to dramatically raise tariffs again at the deadline on July 9th. While we certainly think the President may raise tariffs on some countries (though below Liberation Day levels) and expect volatility, we are not overly concerned about fresh tariff shocks driving a durable turn lower in the market.

First, markets now have visibility on the process behind tariff increases and what the worst-case outcomes would be. As such we think it is fair for measures of trade policy uncertainty to remain well below their peak. In short, the private sector is more adaptable now that it is familiar with the risks. Second, Trump has shown that he responds to his own constraints, whether market or economy driven (see [Macro Monthly: Trump has Constraints](#)). His pattern is fairly straight forward – announce a big tariff, try to extract concessions, and then make a deal, if possible. But Trump has shown he will back down himself if the costs to the economy or market appear too high.

The second risk, which concerns us more, is simply that the labor market doesn't just bend but breaks. While labor market cooling to date has been gradual, there are plenty of historical examples where weakness reaches a point where it accelerates (i.e., the Sahm rule) and unwinds before the Fed can adjust quickly enough. This speaks to maintaining government bonds as a hedge in a portfolio, despite concerns about sticky inflation and high debt levels. We have confidence that in a recession, bonds will rally despite these concerns, particularly at the front end of the curve.

## Asset allocation







We upgraded our equity exposure early in June as it became apparent that worst case scenarios would be avoided and equity revisions turned significantly more positive. Despite sharp recent gains, we maintain this overweight as we think over time, markets will continue to look forward to a better 2026 despite weaker near-term data.

In the meantime, a 'muddle through' economy is usually positive for pro-carry strategies, including emerging markets and credit. Within emerging market currencies, we like the Brazilian real and Indian rupee – which we think can both benefit from attractive volatility-adjusted carry.







All of these views would be helped by a weaker USD, which we think will remain as a structural theme, driven in part by a narrowing of the growth gap between the US and the rest of the world. Ex-US investors remain incentivized to FX hedge their US asset exposures due to changing correlation dynamics, and expected rate cuts from the Fed will make this a less costly endeavour.

## Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 30 June 2025. The colored circles provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, bonds, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

					Underweight	Overweight				
										
<b>Global Equities</b>										We are overweight equities as we think the market continues to look through near-term economic headwinds towards anticipated AI-driven earnings revisions and policy support. We like US vs. Europe and maintain a preference for high quality.
US										We expect US equities to outperform as high-quality stocks continue to drive strong earnings, and the weaker USD is a tailwind. Earnings revisions favor the US vs. other regions, and we believe sentiment/positioning is not stretched despite recent gains.
Europe										After the strong YTD rally, European equities have priced in a lot of good news, and valuations are now less supportive. Earnings continue to be weak relative to other regions, and the recent EUR strength is going to be a headwind. Moreover, European equity seasonality is historically the worse across regions in the next 3-4 months. Within Europe, we continue to like European banks which remain inexpensive and are delivering good earnings growth.
Japan										Japan has seen better nominal GDP growth, resilient earnings and improved corporate governance, which are tailwinds. JPY strength and sharp rises in long JGB yields keep us neutral.
Emerging Markets										China's recent tech advancements in AI continue to make progress, and EM earnings are strong across regions. Tariff de-escalation creates a window for outperformance, amid inexpensive valuations.
<b>Global Government Bonds</b>										We are neutral duration as a slower growth profile this year is counteracted by increased bond supply globally. Short-tenor bonds offer some protection against risk assets should downside risks to growth materialize.
US Treasuries										We are neutral on US duration as Treasuries face volatility from policy-induced changes. The front end of the curve offers better protection against a weaker labor market, as global debt supply puts upward pressure at the long end.
Bunds										We think the front of the German curve could rally on external growth risks, but ultimately think the curve will remain steep, given fiscal stimulus that is now expected to arrive later this year.
Gilts										Overweight Gilts on attractive valuations and slowing growth; expect the UK government to avoid disorderly widening of deficit.
JGBs										Wages & underlying inflation are accelerating, but we expect the BoJ to wait for more clarity on external growth before hiking rates.
Swiss										Valuations are historically expensive, and the SNB is already poised to cut rates into negative territory.
<b>Global Credit</b>										We think IG & HY credit spreads have marginal room for compression at these levels but still face the risk of material widening in case the economic outlook deteriorates more than expected. Regionally, we see Asia HY as offering the best risk-reward.
Investment Grade Credit										With spreads less than 15bps higher than the recent local tight at the end of last year, the risks to spreads are asymmetric to the upside. Still, corporate fundamentals and all-in yields remain attractive outright.
High Yield Credit										HY spreads have already tightened considerably since Liberation Day and are little priced for downside risks. Still, all-in yields and investors inflows remain supportive.
EMD Hard Currency										We think Asia HY provides the most attractive risk-adjusted carry across global credit segments.

## FX

USD					We are bearish the USD as US growth and rates are 'catching down' to peers. There is also growing evidence that foreign investors are hedging more of their USD exposure.	
EUR					We think the EUR provides the best reflection of USD weakness, as the most natural USD alternative. We also like long EUR against both GBP and CHF, with rates likely to decline in the UK, and Swiss rates at risk of becoming negative.	
JPY					We are neutral on JPY as the BoJ has paused its tightening cycle and long positions are expensive.	
CHF					We are negative on CHF against other non-USD reserve currencies as we see increased risk of more SNB cuts or FX-intervention.	
EM FX					EM carry is becoming more attractive as volatility declines and the global economy hangs in. We like BRL and INR the most.	
<b>Commodities</b>						We are constructive on silver, and think it has room to catch-up to the strong performance of gold. Oil is set for oversupply as Middle East risks are unlikely to escalate from here.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 30 June 2025. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

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