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Growth gains might mask growing pain

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Benign US and China economic data and earnings releases will likely boost the risk appetite in financial markets, even as the Trump administration restarted its tariff escalation. Investors though should be mindful that the risks remain elevated as tariff negotiations will continue for a few more weeks. Investors should ensure their equity exposure is skewed toward sectors with strong structural drivers. Erratic policymaking, rising fiscal debt, and risks to central bank independence, are all likely to contribute to de-dollarization.

Investors should be wary though and note that many of these positives are double-edged in nature. China's exports growth being boosted by frontloading implies that a slowdown is likely on the horizon. The feed-through from tariffs into US inflation is only just beginning and could well accelerate, lifting core PCE inflation (the US Federal Reserve's favored measure) further beyond the Fed's 2% by year's end. Also, for the S&P 500, being around 0.5% below the all-time high after a three-month 21% climb amid slowing growth provides some cause for concern.

On earnings, we would also be somewhat circumspect as we expect EPS growth to moderate from previous quarters to 5% for 2Q25. While there is a silver lining in the form of companies appearing to be more comfortable navigating the tariff environment, the threatened additional tariffs increase both the risk of economic disruptions, and uncertainty that suppresses business investment. These should in turn slow global—especially US and China—growth in 2H25. To support portfolio returns, investors should try to maintain exposure to the current resilient growth, while also girding against the simmering tariff and geopolitical risks.

Tech sector offers structural resilience. We view the technology sectors in both the US and China as attractive on account of strong structural drivers. In the US, the tech sector's earnings growth rates are normalizing. They should remain solid going forward driven by AI deployment and adoption, which continues to gain traction. We expect profits for mega-

cap tech firms for example, to slow from around 30% in each of the last four quarters to around 20%—still far ahead of the broader market.

In China, the risk-reward profile for the technology sector is improving, supported by the de-escalation in Sino-US tensions, robust AI innovation, and attractive valuations. However, we remain Neutral on the broader market given the backdrop of slowing growth in 2H25 as tariffs start to bite and policymakers remain cautious on intensifying policy stimulus.

Onshore China dividend stocks attractive. Within onshore A-share markets, dividend-yielding stocks are particularly attractive given the declining yield environment. We favor sectors with stable cash flows and attractive yields, such as banks, insurance, utilities, and telecoms, while selectively pursuing growth names with alpha potential. We do also expect the policy environment to remain accommodative, with monetary easing to continue amid low inflation. We anticipate 50-100bps of RRR cuts and 20-30bps of policy rate cuts by year-end, which should help support a full-year growth rate of around 4.5%, with some upside risk.

Quality European equities a key de-dollarization option. Regardless of how the negotiations over tariffs turn out, one key lasting impact is likely to be continued erosion of confidence in USD assets. Erratic policymaking, rising fiscal deficits and debt, and persistent risks to central bank independence, are all likely to contribute to doubts about US exceptionalism. We thus expect the ongoing reversal in the EURUSD's 13% year-to-date rise to be short-lived. As the most liquid alternative to the USD, the EUR is likely to remain a key beneficiary of the erosion of confidence in the USD. Also, fiscal measures in Germany and increased European defense spending will likely be supportive for the EUR. We have just raised our EURUSD June 2026 target from 1.20 to 1.23; we would look to go long the pair on dips to 1.15.

The Quality investment style meanwhile tends to work well in volatile, slow growth periods, making this an attractive option for investors looking to diversify excess USD-equities exposure. The European Quality style has underperformed MSCI Europe in total return terms since its relative peak in October 2020 compared to an outperformance of 2 percentage points per year on average over the last 35 years, with lower volatility.

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