

3Q 2025 Market Outlook

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Global growth forecasts for 2025 have been downgraded due to ongoing tariff uncertainty, with front-loaded demand and weak business sentiments pointing to softer activities ahead. The US economy remains resilient, supported by strong household finances and a steady labour market, but business investment is held back by tariffs, immigration restrictions, and policy uncertainty. The US-China tariff truce has eased recession risks, though inflationary pressures persist. The Eurozone saw early growth from demand pulled forward by tariffs and lower interest rates, but faces risks from trade uncertainty and a stronger euro. China's growth is steady due to export front-loading but further economic slowdown can be addressed with more policy support. Equities have rebounded globally, but valuations are high and earnings growth may slow. The investment outlook favors Asia Pacific ex-Japan, Singapore, Korea, and India equities, with caution on US equities due to high valuations and Asian credit due to tight spreads.

MACRO OUTLOOK

1. Global growth estimates have been revised downward since the start of the year due to tariff uncertainty. Weak soft data and tariff front-loading suggest that weaker economic activity can be expected in the second half of the year.
2. So far, US economic activity has remained robust, partly supported by tariff front-loading, but business sentiment and consumer confidence have weakened. The tariff truce between the US and China has reduced the probability of a recession and lowered inflationary risks in the US. However, business spending plans remain on hold, weighed down by the combined effects of tariffs, immigration restrictions, and policy uncertainty. The labor market has remained resilient. Cooling labor demand across both the private and public sectors, combined with a decline in net immigration, has led to slower payroll growth. However, the reduction in labor supply due to immigration crackdowns is expected to keep the unemployment rate steady. Personal incomes should also receive some support from tax cuts included in the "One Big Beautiful Bill," which is progressing through Congress and is expected to be passed in a modified form before the August recess. These factors should limit the risk that higher tariffs will drag the economy into recession.
3. Growth in the Eurozone was stronger in the first quarter, driven by tariff-induced pull-forward demand, which boosted industrial production and exports. Domestic investment also increased, aided by European Central Bank's (ECB) lower key interest rates. However, retail sales point to subdued private consumption. Elevated trade uncertainty, downward pressure on exporters' margins due to a stronger euro, risks of large influxes of Asian products into European markets, and potential EU retaliation are likely to push the economy back toward the brink of recession in the coming quarters.
4. China is on course for steady expansion in the first half of this year. Despite higher US tariffs, exports have performed well due to front-loading and shipment re-routing, while the 90-day tariff truce may spur another round of front-loading to meet US holiday season demand later this year. However, consumption growth has only been robust in sectors supported by policy stimulus through trade-in programs. Meanwhile, investment growth has decelerated, as trade policy uncertainty weighs heavily on near-term capital expenditure decisions. Combined with weak loan data, this suggests that aggregate demand remains below par, and household and corporate confidence remains fragile. The temporary US-China tariff reduction is likely to boost activity growth in the near term but lowers the likelihood of substantial policy stimulus.



5. Disinflation continues globally except in the US, where it has been temporarily interrupted by tariffs. Outside the US, weaker demand, currency appreciation, and lower oil prices are the primary drivers of disinflation. Central banks globally, outside the US, have been more forthcoming with policy easing in response to recent dollar weakness. The Federal Reserve (Fed) is likely to hold rates for now due to tariff uncertainty and its likely impact on prices and inflation expectations. Fed Chair Powell has emphasized that the Federal Open Market Committee (FOMC) will avoid preemptive action to keep longer-term inflation expectations well anchored and to ensure that a one-time increase in the price level does not become an ongoing inflation problem. We expect the FOMC to respond to acute labor market weakness, but only after it becomes apparent, and their response may be limited. The ECB is expected to continue cutting rates due to downside risks to growth and confidence in achieving its 2% inflation target. The region's shift toward expansionary fiscal policies, away from planned tightening, will keep deficits elevated and put upward pressure on longer-term interest rates.
6. Monetary policy normalization in Japan is expected to continue, driven by higher wage demands, although there is growing concern that yen appreciation could dampen momentum for rate hikes. China has ample policy room, including easing borrowing costs and lowering reserve requirements for banks, to support its economy.
7. Equity markets have broadly recovered from the significant decline observed around President Trump's Liberation Day, driven by the tariff pause—most notably between the US and China, the world's two largest economies. However, this reprieve may prove temporary, as tariff uncertainty is likely to persist until a more stable trade policy regime is established. In the US, robust economic activity has been partly supported by front-loaded demand, but business sentiment and consumer confidence have weakened. For now, the economy remains underpinned by healthy household balance sheets and a resilient labor market. The recent US-China truce has also helped reduce near-term recession risks. However, equity valuations are expensive following the rally, and corporate earnings growth may moderate as US firms struggle to pass on the full costs of higher tariffs. In Europe, there are early signs that the manufacturing sector may be emerging from a prolonged two-year downturn. Policymakers appear to be adopting a more expansionary stance, with medium-term growth expected to benefit from increased defense spending. Nonetheless, the pace and effectiveness of policy execution remain critical to supporting the recovery. Meanwhile, a weakening US dollar is expected to support Asian equities by lowering the cost of servicing dollar-denominated debt and freeing up capital for investment and spending. In China, leading technology firms have emerged as global contenders to the US "Magnificent Seven." The government has continued to ease monetary policy through lower borrowing rates and increased capital injections, with room for additional fiscal stimulus if economic growth falls short of the 5% annual target.

8. Within fixed income markets, the resilience of the US economy is expected to slow the pace of disinflation, while higher tariffs may keep inflation elevated, limiting the Federal Reserve's capacity for further easing. At the same time, the US federal deficit has been widening, with the Congressional Budget Office (CBO) projecting that national debt could climb to 118% of GDP within the next ten years—a historic peak. This projection does not account for the administration's newly proposed tax bill, dubbed the "One Big Beautiful Bill," which includes significant front-loaded tax cuts and delayed spending reductions. According to the CBO, this bill could add nearly \$2.8 trillion to the budget deficit over the next decade. The US Treasury yield curve is expected to steepen in response to these developments, with long-term bond yields increasing to reflect higher risk premiums and heightened concerns over debt sustainability. Moody's recently joined Standard & Poor's (2011) and Fitch (2023) in downgrading US debt, citing the government's lack of progress in reining in the fiscal deficit and the worrisome trend of growing interest costs, resulting in the loss of the nation's last triple-A credit rating.

INVESTMENT OUTLOOK



1. While ongoing tariff negotiations have not yielded any trade deals beyond the US-UK agreement, global stock markets have mostly recovered and, in some cases, moved beyond the initial shock of the reciprocal tariffs announced in early April and temporarily suspended shortly afterward. We believe the recent rally in equities has shifted risk skew to the downside, as valuations are no longer attractive. Tariff uncertainty remains, given that the reprieve is temporary, and markets appear to be underpricing tariff risks. The pull-forward demand ahead of tariffs has contributed to resilient economic activity, but "soft" survey measures have deteriorated. With the divergence between "hard" economic data and "soft" survey data, the expectation is that hard data will weaken as front-loaded demand tapers off. On the fixed income side, rates have risen above 4.5%, and the market is now pricing in fewer than two rate cuts this year, down from as many as five to six cuts previously. Inflation remains contained, and any short-term increase could prove transitory if the tariff truce is sustained. The term premium has also increased, and any further rise in yields could present an opportunity to extend duration.

2. Regionally, we are more positive on Asia Pacific ex-Japan equities, neutral on Europe and Japan equities, and have turned more negative on US equities. US equities have recovered from the Liberation Day sell-off, but valuations remain expensive. First-quarter earnings in the US have been strong, but there is a risk of margin erosion as companies may be unable to pass on the full cost of tariffs. Upside risks include potential positive developments on tax cuts and deregulation. European equities have also rallied. Valuations are cheaper than US equities but still not particularly attractive.
3. The weaker US dollar has supported Asian equities by easing financial conditions, allowing Asian central banks to lower interest rates without fear of excessive currency volatility. This shift also reduces the cost for Asian companies to service US dollar-denominated debt and manage working capital needs. Moreover, the weaker dollar drives investors to seek higher returns in Asian markets.
4. The South Korean Presidential election outcome has boosted its equity market, with President Lee promoting a plan to reduce the "Korean Discount" by encouraging listed companies to raise dividend payouts and stock buybacks while cracking down on unfair corporate actions that disadvantage minority shareholders.
5. Although tariff concerns linger, Asian markets gain comfort from US President Trump's pivot from spending cuts to deregulation and tax cuts aimed at spurring economic growth, a strategy that helps offset tariff challenges alongside expectations of a continued weak US dollar. However, rising bond yields in developed markets remain a concern.
6. The Indian equities market has enjoyed a modest rally, supported by the de-escalation of global trade tensions and the conflict between India and Pakistan. Additional tailwinds include lower global interest rates, a weak dollar, and India benefiting from the global diversification of supply chains. Despite rich valuations, we remain positive on Indian equities due to these supportive factors.
7. The Japanese stock market has mostly recovered and moved beyond the initial shock of the reciprocal tariffs announced in early April. Corporate earnings outlooks remain uncertain, and an unfavorable tariff negotiation outcome could lead to greater volatility. Japanese companies have significantly increased shareholder returns in recent years, and these efforts appear to be continuing despite the uncertain outlook. This provides valuable assurance to investors during times of uncertainty and supports the Japanese equities market.



8. Given tariff uncertainties and a slowing Chinese economy, we are slightly cautious on the Asian credit market for 2025. While strong technical factors and attractive yields provide some support, tight credit spreads in investment-grade credit offer limited compensation for risks. As a result, a defensive positioning is preferred, focusing on the front end of investment-grade credit and defensive sectors.
9. Credit spreads on credit bonds are trading near historically tight levels, considered unattractive. A decompression of credit spreads in response to falling interest rates is possible. Nonetheless, bond markets are currently driven more by the focus on all-in bond yields, which are attractive by historical standards. In an expected soft-landing scenario, we anticipate company fundamentals and credit trends to remain supported. In the near term, credit spreads are expected to move sideways to modestly wider, supported by supply technical. The trajectory for central bank policy rate easing has been lowered globally. What remains uncertain for the Fed is the frequency and magnitude of rate cuts beyond the initial insurance cuts in 2024. The main risk for longer-dated bonds is a resurgence of inflationary pressures in the US, partially resulting from tariffs.

*All data are sourced from Lion Global Investors and Bloomberg as at 15 June 2025 unless otherwise stated.

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