CITY OF LONDON
Investment Management Company Limited

Developed Markets Quarterly Outlook

May 2025*

Overview

The Tariffs They Are A-Changin'

US equity market leadership has paused and is potentially reversing following steady outperformance since 2011. Our macro framework indicates that the US market remains exceptional, though less so than a few months ago. US tariffs are likely to settle at levels lower than those announced in April; however, the damage to business confidence and eroding perceptions of US exceptionalism will persist, weighing on the US dollar and US asset prices. We downgrade the US to underweight. We maintain overweights in non-US markets (EM, the Netherlands, and Japan) that have significant exposure to tech hardware and supply chains closely tied to AI growth.

The first half of 2025 will likely be remembered in financial market history books. Following 'Liberation Day', markets digested the potential for US tariff rates to rise above the 1930s Smoot-Hawley levels (see Chart 1), experienced a spike in volatility (VIX > 50 on April 8th), and saw a 19% drawdown in the S&P 500. At the time of writing, the US equity market is rebounding in anticipation of a potential further softening in tariff policy. Trade negotiations between the US and various countries are ongoing and may deliver positive or negative surprises.

Our base case is that the effective US tariff rate will be higher by the end of President Trump's second term than at its start. However, we expect negotiations to lower some of the rates proposed in April. Product-specific tariffs (e.g., on steel, aluminium, and autos) will likely remain elevated due to the push to onshore strategic industries for national security reasons. Moreover, negotiations with China and Europe could prove more challenging, as both are large economies capable of retaliation. On a more optimistic note, the reciprocal tariffs are likely to decline for most US allies. Political, economic, and market pressures all support some easing of tariffs.

The risk of a US recession this year has increased due to the trade shock and heightened uncertainty for businesses. A negative growth shock complicates budget negotiations and poses a risk to the Republicans' slim majorities in the Senate and House ahead of the 2026 midterm elections. These are among the factors likely to drive some easing in trade restrictions. Still, we do not expect a full reversal of the US tariff stance. Rather, we anticipate moderation from extreme levels. Regardless, multinational firms will likely continue to face uncertainty in hiring, capex, and supply chain planning. Delays in these areas remain a headwind for growth and earnings. Tax cuts, deregulation, and lower oil prices are potential positive offsets later this year.

Downgrades to US growth and lower real rates are two cyclical drivers partially explaining US dollar weakness this year. In the IMF's April 2025 World Economic Outlook, the US saw a larger downward revision to 2025 growth (-0.9 ppt vs previous quarter) than China (-0.6 ppt), Japan (-0.5 ppt), and Germany (-0.3 ppt). This downgrade coincides with still-elevated long-term valuations for the US dollar, implying further downside risk. A less 'exceptional' US may prompt increased diversification away from US assets. Recent appreciation pressures in some Asian currencies, such as the Taiwanese dollar, suggest foreign capital is shifting. Overall, the US dollar outlook appears to be softening - historically a supportive backdrop for non-US equities (see Chart 2)

Global Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
US	↓		■			
Canada	-		■			
Eurozone	-			■		
Switzerland	-				■	
UK	-		■			
Japan	-				■	
Australia	-		■			
EM	-				■	

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Source: CLIM

International Equity Allocation Breakdown

	Chg	-2	-1	0	+1	+2
Canada	-		■			
Eurozone	-			■		
Switzerland	-				■	
UK	-		■			
Japan	-				■	
Australia	-		■			
EM	-				■	

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Source: CLIM

**This publication reflects asset performance up to 30 April, 2025, and macro events and data releases up to 8 May, 2025, unless indicated otherwise.*

While US trade policy is currently in the spotlight, Artificial Intelligence (AI) is arguably the most important market theme longer-term. On top of profit motivation, we expect the US-China geopolitical rivalry to drive an AI arms race, boosting demand for research and advanced hardware. Recent weakness in technology stocks may offer a buying opportunity, as valuations have moderated. The Philadelphia Stock Exchange Semiconductor Index (SOX) forward P/E is currently around 22x, compared with a five-year average of 27x. There is still an open debate on how companies will profit from AI and some large US tech firms may still appear overvalued by bottom-up analysts. We see greater value in countries that manufacture advanced semiconductors and critical supply chain components (e.g., Taiwan, South Korea, the Netherlands, and Japan).

Market Strategy:

Market volatility remains elevated as investors navigate diverse macroeconomic crosscurrents. We see emerging opportunities and focus on three key themes. First, the US dollar appears to be in the early stages of a long-term bear market. FX rarely moves in a straight line, and temporary dollar strength may re-emerge. Nonetheless, the drive for diversification away from US assets is unlikely to be reversed by near-term policy announcements. Dollar mean-reversion implies 10-20% depreciation in the US real broad effective exchange rate. Second, AI continues to be a important long-term theme, transcending short-term policy noise. Value is beginning to emerge in countries most aligned with advanced semiconductor production. Third, while US trade policy may become less restrictive as negotiations evolve, global activity will likely suffer from delayed business decisions on hiring and investment. A slower growth backdrop remains our base case for this year. In line with these themes, we downgraded our US outlook this quarter.

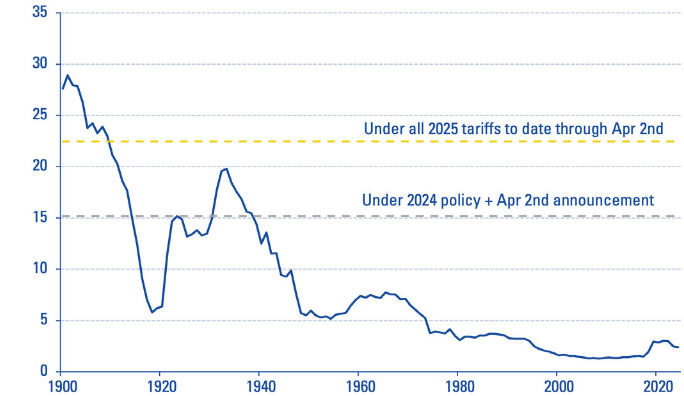
This quarter, we downgrade USA to underweight. The US continues to host many of the most innovative and profitable companies. However, a weaker dollar and a less exceptional outlook suggest the US may underperform non-US markets after its strong run since 2011. We expect some mean reversion in the data shown in Chart 2, providing a tailwind for non-US stocks. Proceeds from our US downgrade are used to reduce existing underweights in Canada, Australia, and the UK. We maintain overweight exposure in EM, Japan, and the Netherlands to reflect our positive view on semiconductor-driven demand.

Justin Kariya

*May 8, 2025***

*** The document includes contributions from Tom Traill.*

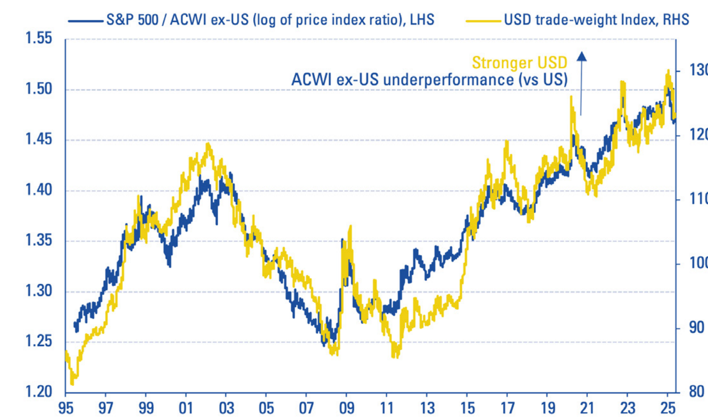
Chart 1: Historical US Effective Tariff Rates, %



Data as of May 8, 2025.

Source: Yale Budget Lab

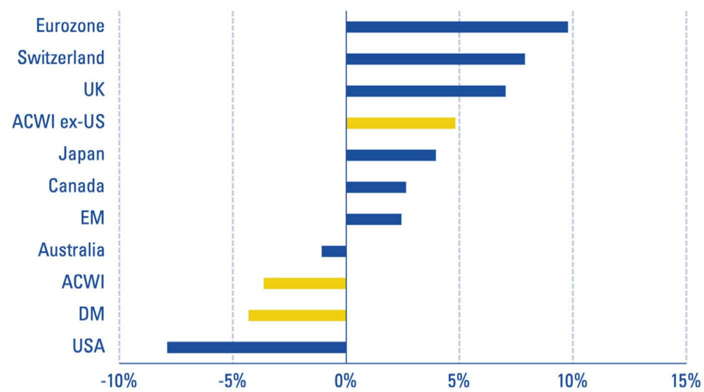
Chart 2: US Equities relative to ACWI ex-US and the US dollar



Data as of May 8, 2025.

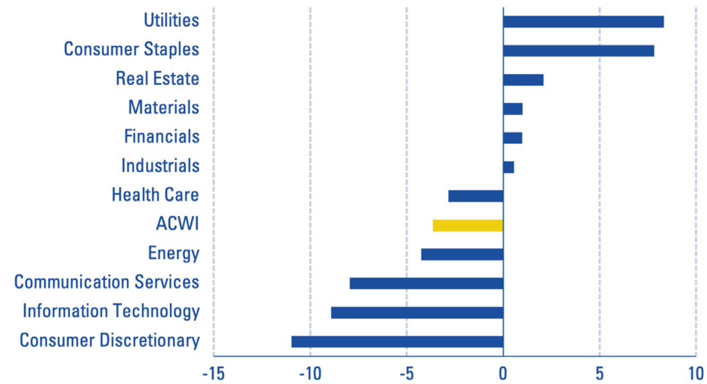
Source: Bloomberg

MSCI ACWI, Net Total USD Return, Feb-April, %



Source: Bloomberg

MSCI ACWI Sectors, Net Total USD Return, Feb-April, %



Source: Bloomberg

United States

↓UW (Global Index)

	3Y history	Latest	
GDP, % qoq saar		-0.3	Q1
PMI, index		48.7	Apr
CPI, % yoy		2.4	Mar
Policy rate, %		4.38	Apr
MSCI USA*		-4.3%	Apr
EPS, % yoy		10.3	Apr
Trailing P/E		24.2	Apr

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

- US economic policy has dominated headlines since President Trump's inauguration. The tariffs announced on "Liberation Day" were more severe than most expectations. Additionally, the perceived threat to the independence of the Federal Reserve has been poorly received. Despite the tariffs being largely postponed and some reassurances being given about the Fed, confidence in US exceptionalism has eroded and may not fully recover.
- The US economic growth outlook has been downgraded, and there is a growing risk that the US economy will enter a recession. Historically the US has outperformed in a slower growth environment, but that may not be the case if it slows due to US trade policies. In addition, the expensive US dollar is depreciating, which historically favours non-US equity markets.
- US earnings expectations remain strong but may be downgraded. A less exceptional US growth outlook, weaker US dollar, and elevated valuations leave the US market exposed to further weakness. We downgrade our allocation to a small *underweight*.

Eurozone

NW (Global and Global ex-US index)

	3Y history	Latest	
GDP, % yoy		1.2	Q1
PMI, index		49.0	Apr
CPI, % yoy		2.2	Apr
Policy rate, %		2.40	Apr
MSCI Eurozone*		13.1%	Apr
EPS, % yoy		-3.3	Apr
Trailing P/E		14.5	Apr

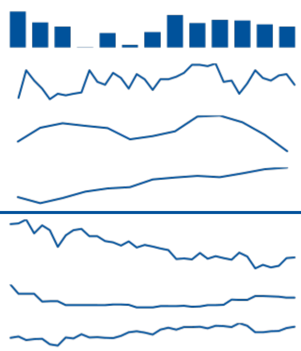
**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

- The Eurozone has faced multiple headwinds, including the threat of US tariffs (with the bloc frequently singled out for criticism), and sluggish export growth. The manufacturing sector has remained weak; however, recent PMI data indicates tentative signs of stabilisation – the manufacturing data has risen year-to-date but remains below 50. Historically, ECB rate cuts have provided support with a lag.
- Equity valuations remain cheap despite recent strength, and there are several potential upside catalysts. For example, the relaxation of the German fiscal spending limits may support the industrial sector and earnings growth. European policymakers ability to deploy capital effectively will be a key driver of long-term growth.
- We continue to see value in the Tech hardware space, which is most apparent in the Netherlands. We maintain a *neutral* position for the Eurozone overall, with an overweight in the Netherlands funded from a small *underweight* in the bloc's other countries.

Emerging Markets

OW (Global and Global ex-US index)



	3Y history	Latest	
GDP, % yoy		4.2	Q3
PMI, index		50.5	Apr
CPI, % yoy		3.4	Mar
Policy rate, %		6.93	Apr
MSCI EM*		6.1%	Apr
EPS, % yoy		7.9	Apr
Trailing P/E		15.2	Apr

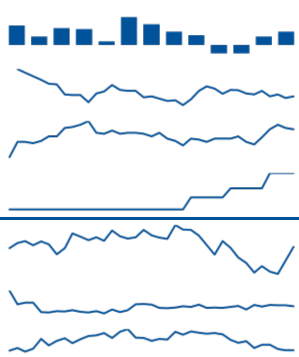
**US$ total return relative to MSCI ACWI. Latest is three-month return. Economic indicators are GDP-weighted with the exception of PMI, which is value-added-weighted.*

Source: Bloomberg

- EMs were among the hardest hit following the initial announcement of Liberation Day tariffs, due to many of the countries having large trade surpluses with the US. It seems likely that most governments will seek to negotiate trade deals with the US. Tensions with China remain elevated, with high tariffs in place between the countries in both directions at the time of writing.
- Despite the tensions, EMs (primarily Taiwan and Korea) remain leaders in the production of advanced semiconductors and high-bandwidth memory chips. Efforts to onshore production to the US will take time, and we still believe in the structural growth story underpinning this sector. Mexico may benefit from nearshoring as US imports shift away from China.
- The dollar has weakened in recent months, a backdrop that is historically beneficial for EMs. There are reasonable signals that the USD is in the early stages of a structural bear market. EMs are trading at a wider discount to ACWI than their five-year average and are expected to see robust earnings growth. We remain *overweight*.

Japan

OW (Global and Global ex-US index)



	3Y history	Latest	
GDP, % yoy		1.1	Q4
PMI, index		48.7	Apr
CPI, % yoy		3.6	Mar
Policy rate, %		0.50	Apr
MSCI Japan*		7.6%	Apr
EPS, % yoy		10.0	Apr
Trailing P/E		14.5	Apr

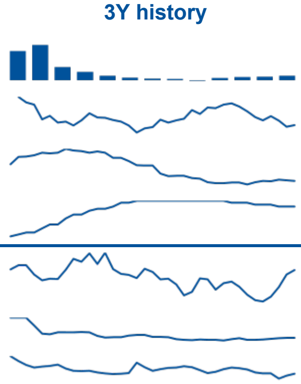
**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

- Japan is among the countries most likely to secure a favourable trade deal with the US. In addition, a decline in US exceptionalism and capital repatriation leave Japanese equities well positioned as large alternative market to the US.
- Japan's ongoing corporate governance reforms seek to unlock shareholder value. If firms continue to make progress, a higher multiple would be justified. There are encouraging signs, including an increase in the number of firms disclosing governance initiatives such as share buybacks, dividend increases, and unwinding of cross shareholdings. The Trump administration's stated aim of lowering oil prices and interest rates has historically benefited Japan.
- Japanese equities are currently trading at a wider discount to ACWI than the five-year average. We maintain our *overweight* position.

United Kingdom

UW (Global and Global ex-US index)



	3Y history	Latest	
GDP, % yoy		1.5	Q4
PMI, index		45.4	Apr
CPI, % yoy		2.6	Mar
Policy rate, %		4.50	Apr
MSCI UK*		10.3%	Apr
EPS, % yoy		1.0	Apr
Trailing P/E		12.9	Apr

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

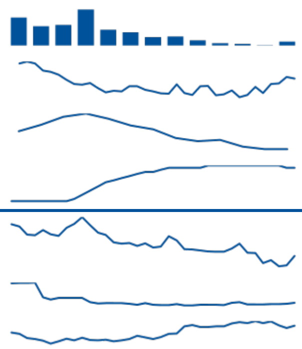
Source: Bloomberg

- Higher global rates have historically favoured the more value-oriented UK large-cap stocks. If global central banks continue cutting rates, this would typically be less supportive. UK small- and mid-cap stocks could benefit from tentative improvements in the industrial cycle.
- The UK has a comparatively high weight in the energy sector, and any weakness in global economic growth or continued excess capacity could negatively impact this. Indeed, President Trump is seeking to lower energy prices as part of his efforts to curb inflation. However, there remains an outside chance that geopolitical events could trigger a sharp rise in energy prices.
- UK valuations remain cheap, but they are likely to stay that way. Earnings expectations for 2025 are negative, well below the global estimate, and the UK's P/E multiple is consistent with this weak earnings growth. We remain *underweight*.

Australia

UW (Global and Global ex-US index)

3Y history



	Latest	
GDP, % yoy	1.3	Q4
PMI, index	51.7	Apr
CPI, % yoy	2.4	Mar
Policy rate, %	4.10	Apr
MSCI Australia*	2.6%	Apr
EPS, % yoy	-1.1	Apr
Trailing P/E	18.7	Apr

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

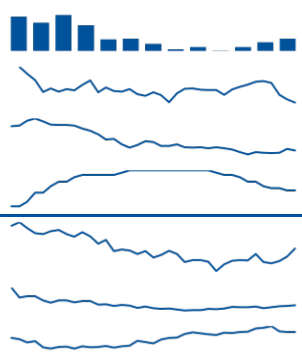
Source: Bloomberg

- The Australian economy has been relatively imbalanced in recent years, with low productivity growth and reduced demand for natural resources from China. Although China may seek to stimulate its economy in response to the US trade war, it is likely to focus on domestic consumption rather than infrastructure spending. There are limited near-term prospects for another property boom to drive a new ‘commodity supercycle’.
- The Australian equity market has a high weighting in the financial sector. Lower rates and compressed net interest margins are a risk for the sector. In addition, high household leverage poses an additional risk as global growth slows.
- The MSCI Australia Index trades at a multiple that appears excessively high relative to the level of earnings expectations (flat in 2025). Australia will likely de-rate if earnings do not surprise to the upside. We stay *underweight*.

Canada

UW (Global and Global ex-US index)

3Y history



	Latest	
GDP, % yoy	2.4	Q4
PMI, index	45.3	Apr
CPI, % yoy	2.3	Mar
Policy rate, %	2.75	Apr
MSCI Canada*	6.3%	Apr
EPS, % yoy	6.0	Apr
Trailing P/E	18.3	Apr

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

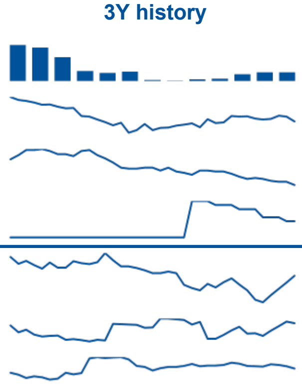
Source: Bloomberg

- The appointment of Mark Carney as Prime Minister removes some political uncertainty. Bilateral tariffs of c.25% remain between the US and Canada. A deterioration in relations would be damaging to the Canadian economy given that nearly 80% of exports go to the US.
- The Canadian index is overweight energy, which leaves it exposed to a slowing global economy, excess global supply, and President Trump’s aim to lower energy costs. It also has a high weight to the financial sector, which has performed comparatively well in recent months, but may suffer if the economy slows.
- Given the ongoing negotiations with the US, we are maintaining our *underweight* position. A positive change in the trading relationship could lift the index, but the market remains unattractively valued.

Switzerland

OW (Global and Global ex-US index)

3Y history



	Latest	
GDP, % yoy	1.6	Q4
PMI, index	45.8	Apr
CPI, % yoy	0.0	Apr
Policy rate, %	0.25	Apr
MSCI Switzerland*	11.5%	Apr
EPS, % yoy	13.8	Apr
Trailing P/E	18.5	Apr

**US$ total return relative to MSCI ACWI. Latest is three-month return.*

Source: Bloomberg

- The Swiss index is defensively tilted due to its sectoral composition – with high weights in healthcare and consumer staples. The market is likely to be more insulated from global policy uncertainty. Historically, it has also benefited from the strength and reputation of the Swiss National Bank and the Swiss franc, both of which have offered protection during risk-off periods.
- The Swiss index has outperformed year-to-date against a backdrop of growing uncertainty, reinforcing its reputation as a safe haven. In historical episodes with similar economic characteristics, the Swiss index has often been among the best-performing markets.
- Swiss earnings expectations have held up in recent months and are forecasted to grow 4.7% and 11% in 2025 and 2026 respectively – stronger than in many other European countries. We keep our *overweight* position.

GLOBAL EQUITY - KEY ECONOMIC AND FINANCIAL INDICATORS

	Developed Market	Annual GDP Growth	Quarterly GDP Growth QoQ*	Industrial Production Growth	Consumer Price Index	Budget Balance % of GDP 2025F**	Trade Balance	Current Account Balance	Foreign Reserves 2025 Latest	Foreign Reserves 2024 Year Ago	Currency vs $ 2025 Latest	Currency vs $ 2024 Year ago	Short-Term Interest Rates	Sovereign Rating S&P	% MSCI ACWI Net***	Stock Market Index (MSCI ACWI Net) US$	Change since 12/31/24 US$	Change since 12/31/24 Local	2025 P/E Forecast	3 month Currency vs $ +/-
		Macroeconomic Data: % change on year ago				Macroeconomic Data: Latest 12 months									Market Performance				Forecast†	
		%	%	%	%		$ Bns	$ Bns	$ Bns	$ Bns			%		April 30, 2025	April 30, 2025	%	%		
Overweight	EM	4.2	n.a.	4.0	3.4	-4.7	1140.2	557.0	7894.95	7799.63	1811.90	1723.99	6.93	n.a.	10.37	598.45	4.28	2.43	12.5	n.a.
Overweight	JAPAN	1.1	2.2	-0.3	3.6	-3.6	-34.0	199.0	1118.98	1163.52	145.04	155.63	0.44	A+	5.07	9099.97	5.58	-4.17	15.3	+
Overweight	SWITZERLAND	1.6	0.8	2.3	0.0	0.3	74.0	46.7	822.34	793.17	0.83	0.91	-0.75	AAA	2.30	20703.68	16.69	5.81	18.2	-
Neutral	DENMARK	3.9	7.4	-5.3	1.5	1.5	41.4	56.2	101.81	96.87	6.62	6.92	1.85	AAA	0.53	47261.68	-11.06	-18.92	17.1	-
Neutral	EUROZONE	1.2	1.6	1.2	2.2	-3.3	2.1	5.0	342.55	294.62	1.13	1.08	0.70	n.a.	8.18	522.18	18.22	7.76	14.6	+
Neutral	HONG KONG	3.1	8.2	1.0	1.4	-2.0	-48.1	121.4	416.17	425.02	7.78	7.81	2.58	AA+	0.43	58994.69	4.45	4.28	12.2	-
Neutral	ISRAEL	6.0	2.1	-21.9	3.3	-5.0	-34.8	16.9	214.41	209.26	3.54	3.73	4.49	A	0.22	212.02	2.92	2.89	12.6	-
Neutral	NEW ZEALAND	-1.1	2.8	5.0	2.5	-3.3	-3.8	-16.0	22.60	12.89	0.59	0.60	3.10	AA+	0.04	558.29	-6.27	-11.51	124.8	+
Neutral	NORWAY	-0.2	-1.6	0.1	2.5	11.0	73.0	82.2	81.25	74.51	10.35	10.87	4.60	AAA	0.14	11649.53	19.31	8.94	10.9	+
Neutral	SINGAPORE	3.8	2.0	5.8	0.9	0.9	192.4	96.0	365.85	343.13	1.30	1.35	2.40	AAA	0.38	1681.95	10.76	7.00	13.9	-
Neutral	SWEDEN	2.4	3.2	-2.9	0.3	-1.4	7.3	45.1	43.17	41.63	9.68	10.86	2.31	AAA	0.85	36202.78	16.66	3.82	21.2	+
Underweight	UK	1.5	0.4	0.1	2.6	-4.1	-42.6	-96.4	106.35	105.49	1.33	1.25	4.29	AA	3.44	9576.99	12.61	5.59	12.7	+
Underweight	UNITED STATES	2.0	-0.3	1.3	2.4	-6.5	-1107.4	-1133.6	35.60	36.08	1.00	1.00	4.10	AA+	63.68	15944.48	-5.12	-5.12	21.4	uc
Underweight	AUSTRALIA	1.3	2.4	0.2	2.4	-1.0	40.1	-34.6	41.10	34.21	0.64	0.66	2.90	AAA	1.57	5737.11	3.97	0.61	17.9	-
Underweight	CANADA	1.6	2.6	1.1	2.3	-1.7	-4.6	-11.3	97.78	89.91	1.39	1.37	2.67	AAA	2.87	9208.37	5.52	1.35	16.1	+

*Note: All data shown are as at May 8, 2025 unless otherwise stated. S&P credit rating shown is long-term foreign currency rating. * % change in GDP on previous quarter, annual rate. **Bloomberg consensus forecast. ***MSCI All Country World Index Daily Total Return Net. ****IP data from CPB; Currency level from MSCI EM Currency Index; GDP, CPI, budget and interest rate data from Bloomberg.*

†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results. This is Stage Two of City of London's three-stage asset allocation process.

Source: Bloomberg, CLIM

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