



QUARTERLY THINKING

OPTIMISM AMIDST MARKET UNCERTAINTY

JULY 2025

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KEY TAKEAWAYS

- Current equity market optimism may be tested by further tariff challenges
- Irrespective of any near-term volatility, we remain highly positive on the outlook for the world's leading companies
- Over time, enterprise and innovation always prevail



After an initial bout of turbulence, the equity market pendulum swung in favour of optimism in the second quarter. The April 2 'Liberation Day' announcement of US reciprocal tariffs sent stock markets into a tailspin, but their subsequent postponement triggered a significant rebound, with many bourses posting solid gains. The on-off nature of their deployment has continued to fuel the belief that they are being used as a negotiating ploy, and that deal-making between the US and its trading partners will prevail.

However, recent proclamations from the Oval Office suggest that such a view is not a 'given'. The Trump administration continues to view trade policy as a multi-warheaded weapon of choice in addressing the US trade deficit, filling fiscal holes, promoting investment in the US, and registering disapproval of the political stance of a few of its trading partners. Several of the revised proposals are viewed by some as draconian, such as the 30% tariff rate on Europe and a 50% levy on Brazil. The latter reflects President Trump's dim view of the country's investigations into its former president, Jair Bolsonaro.

CORPORATES BIDDING THEIR TIME

The tariff situation clearly remains fluid, and while investors have been relatively optimistic about the likelihood of trade deals, it continues to deprive many businesses of the prized commodity of policy stability. This was highlighted by Executive Director Charlie Macquaker and Investment Analyst Jay McLeod on a recent trip to Sweden. The management teams of the companies they met echoed the uncertainty fostered by President Trump's ever-changing tariff agenda which has, in many cases, inhibited corporate investment rather than encouraging it. Aside from corporate wariness over making long-term commitments to supply chain changes in such an environment, it remains the case there are deep strands of economic connection across the globe that are hard and expensive to unravel.

TRUMP'S NEW DEAL

Nonetheless, President Trump can point to high-profile investments into the US, such as the US\$165 billion Taiwan Semiconductor (TSMC) has earmarked for fabrication plants and chip packaging facilities. He can also highlight deals with countries that have acquiesced in the face of tariff threats. The readiness to employ trade policy or other forms of intervention as a battering ram to achieve economic and political goals may continue to define the current US administration.

The President's efforts to get a fair deal for America extend to a range of sectors including healthcare, where he is aiming to reduce drug prices. At the moment, it is still uncertain how the proposals will actually pan out,

but our recent article, ['Healthcare – still a compelling long-term growth opportunity'](#), discusses this issue and the broader healthcare environment.

The net result of all this is that there remains uncertainty as to the impact of tariffs on growth, supply chains, consumer prices and indeed, corporate earnings. It has, however, been insufficient to dislodge the bullish tone in equity markets. Aside from trade deal optimism, so far, the broad earnings environment has been supportive. Nonetheless, tariff tremors have percolated their way through to an array of tell-tale data, although not to the extent it would suggest an imminent economic trainwreck. In the US, the reported shrinkage in GDP in the first quarter was more to do with a precautionary import surge ahead of tariffs, rather than out and out economic contraction. Imports are subtracted from the calculation of GDP. However, nervousness has been evident in US consumer confidence indicators and manufacturing purchasing managers indices. This is not unique to the US, and has been evident in the narrative of a number of industrial and consumer-facing businesses across the globe.

FISCAL INDULGENCE?

While the extension and expansion of the 2017 Tax Cuts and Jobs Act, now wrapped up in the One Big Beautiful Bill Act, is viewed as broadly positive for growth, concerns remain about its impact on the government budget deficit. To some extent, these worries have been reflected in the weak US dollar. They have been less evident in the US bond market. Yields have picked up slightly in recent months, but nothing to suggest imminent bond market vigilantism.

Notwithstanding current debates about the role of the US dollar in a world which is becoming multi-polar economically, it remains the world's reserve currency, so the US can withstand the stress of fiscal indulgence for now. This may be less true for countries such as the UK, which is struggling with its government budget, with efforts to cut spending proving unpalatable to certain dissenting members of the ruling Labour administration. At some stage, equity and bond markets may pay greater attention to fiscal profligacy, with potentially higher bond yields impacting the cost of credit.

EURO-ENTHUSIASM

Across the pond, the European Commission downgraded its expectations for euro area growth in 2025. The region's GDP is expected to expand by 0.9% instead of the 1.3% forecast last November. However, investor sentiment has been buoyed by a number of factors, aside from hopes that a sizeable tariff bullet can be dodged.



Interest in Europe has stemmed from caution over the US economy and the perceived valuation differentials between European equities and the US. A weakening US dollar trend has perhaps prompted US investors to look elsewhere. While the UK and France are still doing battle with high, seemingly intractable budget deficits, Germany has retreated from fiscal parsimony and has embarked on economic stimulus. With European inflation now at its target rate of 2%, the European Central Bank has obliged investors with lower interest rates.

Across Europe, money is being earmarked for higher defence spending, as noted by equity markets, but there is a difference between promises and actual delivery. Aside from budget constraints, an electorate bemoaning a rebalancing of spending towards defence might eventually induce a reining in of some of the loftier expectations regarding European rearmament. We are also of the view that software has become a weapon of war not just shells, given the role of technology in modern warfare. The defence story may therefore expand beyond the current perceived beneficiaries to some degree. This is explored in our recent article, [‘Drones, AI, and cybersecurity: the new arsenal of European Defence’](#).

A FEW HEADWINDS IN JAPAN

As with elsewhere, Japanese equities were helped last quarter by hopes of a not-too-disruptive outcome of tariff talks with the US. A potential fresh wave of levies was set for 1 August delivery, with Japan being hit with tariffs of 25%, replacing the baseline 10% levy. The recent trade deal sees a still-significant 15% US tariff rate being imposed on Japan. Prior to these latest events, the Bank of Japan Tankan, or quarterly survey, had nonetheless indicated some resilience among large manufacturers, although the auto industry outlook remained subdued.

Post Covid-19, a number of Japanese industrial stocks have battled against a weak manufacturing environment in many developed economies, and a capital expenditure strike by their Chinese customers. But it is also the case that increasingly, China is snapping at Japan's heels in a variety of industrial and technology sectors, and this is a phenomenon not confined to Japan, as evidenced by the travails of German automobile companies.

IF YOU CAN'T JOIN THEM, BEAT THEM

China continues to march up the value-added ladder. This is highlighted by its growing success and competitive intrusion in several mid-to-high-tech industrial sectors, including renewable energy, electric vehicles, electronics, robotics, and shipbuilding. Members of the Research team were in China this quarter, investigating recent developments in the country's semiconductor industry.

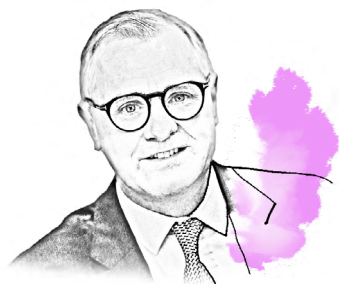
Despite efforts by the US and others to hamstring the development of high technology in China, their moves have fostered innovation, rather than quashing it.

However, China still lags in certain areas. The development of semiconductor lithography at the advanced level that enables the manufacture of the most powerful and most energy and cost-efficient chips will take China a long time. Dutch semiconductor lithography company ASML remains in a strong competitive position in China, even though the export of the company's extreme ultraviolet (EUV) lithography machines to the country remains prohibited. EUV lithography machines are used in the manufacture of very advanced chips.

INNOVATION AND ENTERPRISE ALWAYS WIN OUT

While the world continues to ponder the current uncertainty, it's important for us to keep a longer-term perspective. Consider the events of the last 20 years – the GFC, the debt crisis in Europe, the Covid pandemic, war in Ukraine and now a possible reset in global trade. Yet, over that time, we've continued to see huge advances in areas such as the internet, e-commerce, mobile technology, factory automation, software, cloud computing, healthcare, and most recently, artificial intelligence. Throughout history, crises and the vagaries of cycles and politics have rarely inhibited the propensity for economies to develop, grow, get richer and for innovation and enterprise to flourish. It is this focus on the long term that is at the heart of our investment process, as we seek out the world's best companies as they capitalise on or indeed drive such trends.

With the trade deal clock ticking, investors will likely focus on the next steps of the tariff saga. So far, markets have reflected a relatively sanguine view of economic prospects, and a belief that not-too-disruptive agreements founded on economic pragmatism will prevail. The Research team is continuing to assess how the world's leading businesses are navigating and adapting to the current challenges. Earnings growth is not always linear, and some of these companies may continue to experience near-term share price or earnings volatility. But we believe that for the patient investor, their attributes of market leadership, financial strength and the ability to weather macroeconomic challenges, augur well for long-term returns.



ROY LECKIE

Roy is Executive Director, Investment & Client Service at Walter Scott. Since joining the firm in 1995, he has held a range of investment, management, client service and governance responsibilities. Roy was integral to the development of the firm's emerging market capabilities, and he has played a central role in the stewardship of Walter Scott's global and international strategies since 2007. Roy joined the firm's Board in 2008 and is Co-Chair of the Investment Management Committee. He holds a BSc (Hons) in Statistics from the University of Glasgow.

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STOCK EXAMPLES

The information provided in this article relating to stock examples should not be considered a recommendation to buy or sell any particular security. Any examples discussed are given in the context of the theme being explored.

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