Quarterly base-case scenario

CIO Office | Q3 2025

The fog is gradually lifting

Equity markets began the second quarter in turmoil, as the reciprocal tariffs announced by the White House on April 2 were so substantial that they threatened to derail the global economy. Fortunately, it didn't take long for the Trump administration to change course and adopt a more conciliatory tone, leading to a strong market rebound that overshadowed the initial decline. As a result, equities ended the quarter higher, with Canadian stocks leading the way, while returns elsewhere were tempered by a significant appreciation of the Loonie. Meanwhile, despite heightened uncertainty, the Canadian fixed income universe ended the period with slight losses as investors questioned the path ahead for interest rates.

In addition to the president's reversal on tariffs, renewed market optimism stems from the continued resilience of the U.S. economy; the labour market is still on track, corporate earnings remain relatively strong, and inflation shows no signs of re-accelerating so far. Furthermore, although there is still some underlying anxiety among consumers and businesses, confidence surveys have quietly begun to improve as the parameters of the White House's policy agenda become clearer.

In this regard, although the Trump administration's proposed tax cuts should begin to provide some stimulus to the economy starting at the end of the year, the "One Big Beautiful Bill" has been a source of disappointment for those hoping for a reversal of the unsustainable trajectory of U.S. federal debt, partly explaining the recent underperformance of government bonds.

In short, while uncertainty remains high, the gradual dissipation of the political fog is nevertheless revealing an improvement in the balance of risks compared to the last quarter. As such, we believe that the risks of a global recession have diminished, giving us greater confidence in our base case scenario of a modest economic slowdown. Moreover, beyond the trade agreements that the U.S. is hoping to announce in the coming months, we will also need to closely monitor the Fed's policy outlook, as a more dovish stance cannot be ruled out, provided that inflation continues to cooperate.

In this context, although the risk level of our asset allocation strategy remains moderate ahead of what is likely to be a volatile summer, we increased our equity allocation relative to bonds at the end of May. Within equities, we raised our allocation to Emerging Markets from underweight to neutral.

	Q3 2025	Key elements and investment implicationss
Bull case	**Above-trend growth (10%)**	• The U.S. labour market strengthens, inflation stagnates near 3% because of tariffs. The Fed keeps rates on hold. • Trade tensions ease, leading to a series of agreements and substantial reductions in U.S. tariffs. Europe, China, and Canada continue to support their economies through pro-growth fiscal measures. • In the U.S., business sentiment improves on the back of more accommodative regulatory and fiscal policies, while consumer spending remains supported by strong real wage growth. **Economic implications:** Real GDP growth > 2%, stable unemployment rate around 4% **Market implications:** ↑Equities, ↑Bond yields, ↓Volatility, ↓USD
Base case	**Sub-trend growth (70%)**	• The U.S. labour market weakens slightly, inflation stagnates near 3% because of tariffs. • The Trump administration announces a series of trade agreements that reduce the effective tariff rate to around 10%. Uncertainty declines, and businesses and consumers adapt. • After a pause, the Fed resumes gradual rate cuts. The Bank of Canada moves into slightly accommodative territory. • Worldwide fiscal expansion cushions the tariff shock on global economic growth. **Economic implications:** Real GDP growth between 1-2%, U.S. unemployment rate near 4.5% **Market implications:** ↑Equities, ↕Bond yields, ↓Volatility, ↓USD
Bear case	**Recession (20%)**	• The U.S. labour market weakens rapidly, inflation slows but is partly held up by higher tariffs. • The Trump administration's policies backfire. Negotiations are failing, leading to a rise in global tariffs. At the same time, the One Big Beautiful Bill is deadlocked in Congress. • Initially hesitant, the Fed eventually brings its policy rate to accommodative territory. • Faced with uncertainty, households increase savings and reduce spending. **Economic implications:** Real GDP contraction, U.S. unemployment rate above 4.5% **Market implications:** ↓Equities ↓Bond yields, ↑↑Volatility, ↑USD

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