

2025 Mid-Year Outlook



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Tariffs and significant US policy uncertainty are anticipated to dampen global growth. Asia and Emerging Markets will experience varied outcomes following trade negotiations. Countries capable of implementing expansionary policies and reducing interest rates to support growth will be better positioned to withstand external shocks. Investment strategies should prioritise agile investing, portfolio diversification, and defensive sectors to effectively navigate market volatility. In this environment, active stock selection is key.

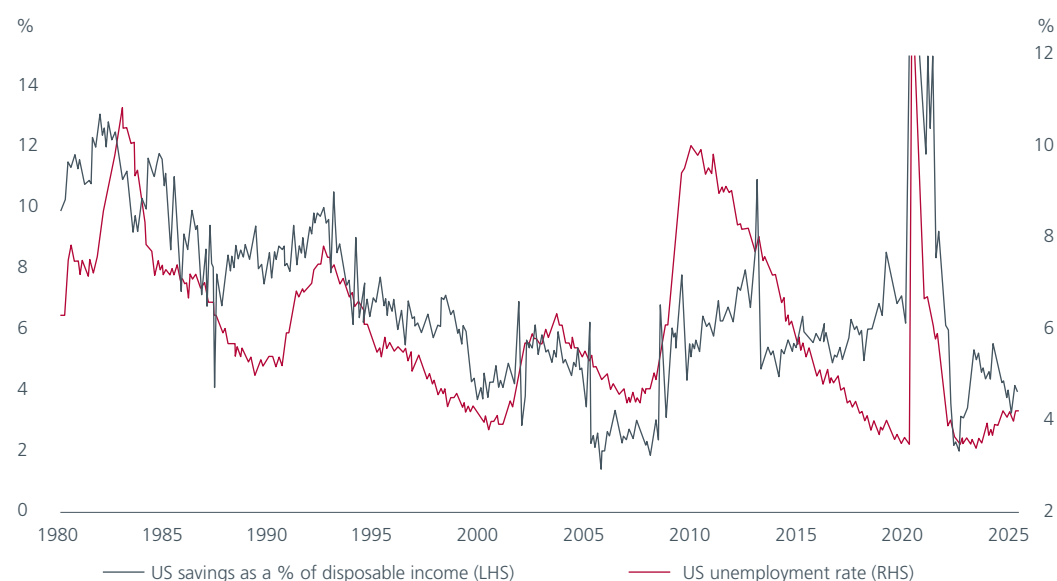
Macro perspectives

GIVEN THE CURRENT US POLICY UNCERTAINTY, WHAT IS YOUR US GROWTH OUTLOOK FOR THE SECOND HALF OF 2025?

Let's start with what could go right in the US. US consumers could keep consuming despite higher prices. US job creation remained robust at 177k new jobs, keeping the unemployment rate low at 4.2% and real payroll income growth at just over 3%¹. This labour market strength could give households the confidence to dip further into savings to maintain lifestyles. Although the US savings rate is currently low at 3.9%, it has dropped to as low as 1.8% in the past. The recent drop in oil prices helps this scenario because at current prices it provides a roughly 0.3% - 0.5% of GDP offset to the cost of tariffs. If consumers keep spending, businesses will be less likely to switch from hiring to firing.

¹As of April 2025.

Fig 1: US consumers might cut savings more...unless unemployment rises



Source: LSEG Datastream. May 2025.

This scenario would be more likely if the Trump administration quickly brings down tariff rates on China substantially and announces tariff lowering trade deals with the US' major import sources: Japan, Europe, Korea, and Vietnam. This is the best-case scenario for the US.

Unfortunately, we judge this scenario to be unlikely. We anticipate subdued US growth of 1.2% -1.5% for 2025 with risk skewed to the downside. Even if the now most commonly expected tariff "endgame" of 10% roughly across the board and 30% against China (with some exclusions) comes quickly, it would still be an over 10% increase in the US effective tariff rate from last year. This would equate to a tax hike of about 1.5% of GDP, one of the largest single year increases in decades, that would cut into household disposable income.

However, trade deals tend to be long, drawn-out affairs. The new US deal with the UK had several years of negotiations behind it before the Trump Administration came into power. It also probably benefited from the fact that the US ran a goods trade surplus with the UK in 2024. Shortly after the announcement of the deal, Commerce Secretary Lutnick said that negotiations with Japan, Korea, and even India were much more complicated and would take more time. The press reports that negotiations with the European Union ("EU") are struggling. To be sure, the EU has announced a list of potential retaliatory tariffs on the US worth USD 107bn at the point of writing².

In the event US consumers move from purchasing expensive electronics and apparel to consuming more services, the economy may struggle to reallocate labour. Layoffs in goods, trade services, and small and medium manufacturing enterprises could occur before hiring in services picks up. Rising unemployment may lead households to cut spending, pressuring businesses to cut workers.

The worst case would be that the 90-day pause in reciprocal tariffs passes without meaningful trade deals, US tariffs rise sharply, depressing US consumption and employment, all working to push the US economy into a recession by year end.

²As of 13 May 2025.

As for interest rates, the US Federal Reserve (“Fed”) is expected to cut the Fed Funds rate if the unemployment rate rises above 4.4% to 4.5% and weekly initial job claims exceed 350k on a four-week moving average basis. This could lead to two 25bps rate cuts by September or October. If job claims rise faster to over 400k, a 50bps reduction might occur. Conversely, if unemployment and job claims remain stable below 4.4% and 300k respectively, while inflation increases due to tariffs, the Fed may keep the rate unchanged longer. In this scenario the Fed would probably need measures of household inflation expectations to fall back to 2024 levels to resume cautious rate cuts of 25bps every other meeting.

GIVEN YOUR BASE CASE SCENARIO FOR THE US, WHAT IS THE IMPACT ON GROWTH IN ASIA?

Our base case of high tariffs, high uncertainty, and slower US growth implies that Asia will see slower growth but also lower interest rates and stronger currencies.

For China, the recent cut in the US tariff rate to 10% from over 100% has reduced the weighted average rate to about 35% (the 20% “fentanyl” tariff and 25% tariffs on some sectors still apply)³. This implies a roughly 1% of GDP headwind to China’s growth this year. Despite this we expect China’s GDP to grow close to 4.4% this year. The government has announced fiscal stimulus of close to 2% of GDP with an estimated 1% - 1.5% of GDP more likely to come later this year. It has also begun to cut interest rates and increase special lending for multiple sectors of the economy.

India is probably Asia’s largest winner. Its exports to the US are the second lowest in Asia at only 2.2% of GDP. A trade deal with the US could benefit India by making it a more attractive production site for companies relocating from China. The recent drop in headline inflation to 3.2% year-on-year in April, below the Reserve Bank of India’s 4% target, creates room for 50bps – 75bps of rate cuts by year end. India is expected to grow 6.3% this year and 6.5% next year.

Japan’s growth, projected at 0.6% - 0.8%, hinges on securing a trade deal with the US. Exports which drive Japan’s overall growth will likely weaken this year, but the rise in wage growth is expected to offset this somewhat by boosting domestic consumption.

ASEAN countries face varied outcomes, with growth in trade-dependent nations like Vietnam, Malaysia, Singapore, and Thailand likely to slow 0.5% - 2.0% due to weaker exports. Indonesia and the Philippines stand out as likely to be least affected and we expect Philippines GDP growth to sustain at 5.6% this year.

COULD THE PLANNED US TAX CUTS IN THE SECOND HALF OF 2025 HELP OFFSET THE EFFECTS OF TARIFFS AND BOLSTER EQUITY MARKETS?

The Trump administration announcements that trade negotiations are progressing with 18 countries have resulted in intermittent rallies. Still healthy US economic data through March – largely pre-tariff – has also helped. However, export and industrial production are likely to begin weakening from May, the data for which will come out in June. Weaker data may weigh on the equity market for countries that have not announced progress in trade deals by then.

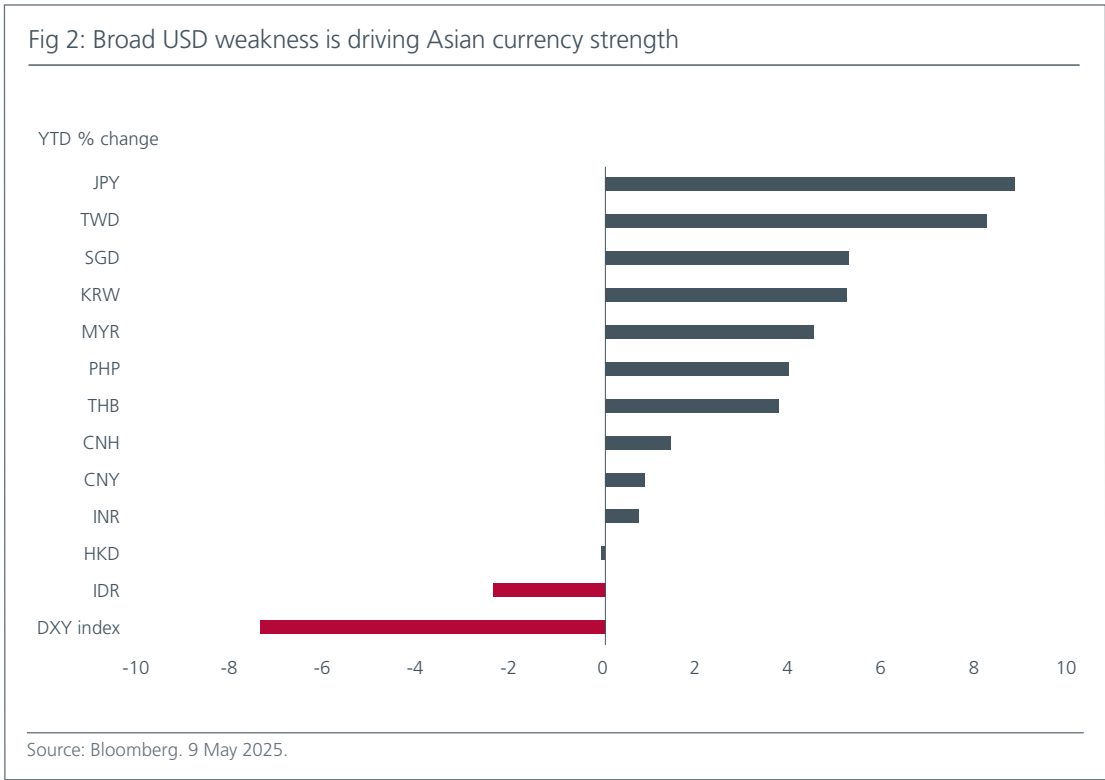
³US and China announced a 90-day tariff pause on 12 May 2025.

Most of the tax “cuts” in the US 2026 budget represent avoiding the tax rate increase that was scheduled to take place next year as the Tax Cut & Jobs Act of 2017 (“TCJA”) expired. Congress is now discussing some cuts in the form of exemptions of income from overtime work and perhaps tips from tax, but these are likely to come with tight limits on eligibility by income level and caps on total value. Additionally, Congress will be cutting current spending to partially pay for its extension of TCJA tax rates beyond this year. Crucially, tariffs are a tax hike that are not included in the budget plans.

As such we doubt that the new budget will have much impact on equities. In contrast, it probably will have negative long-term implications for US Treasuries. Current budget negotiations imply a roughly USD 4tn increase in US Federal debt over the next decade. Market concerns about this appear to already be putting longer-term US Treasury yields under upward pressure by increasing term premia. This will not stop US Treasury yields from falling later this year if US economic growth slows to 1% or less. However, it may reduce the extent of the decline and imply a snap back higher in late 2026 as the economy begins to recover.

WHAT IS THE LONG-TERM OUTLOOK OF THE USD AS THE WORLD’S RESERVE CURRENCY AND THE IMPLICATIONS OF A WEAKER US DOLLAR ON CAPITAL FLOWS?

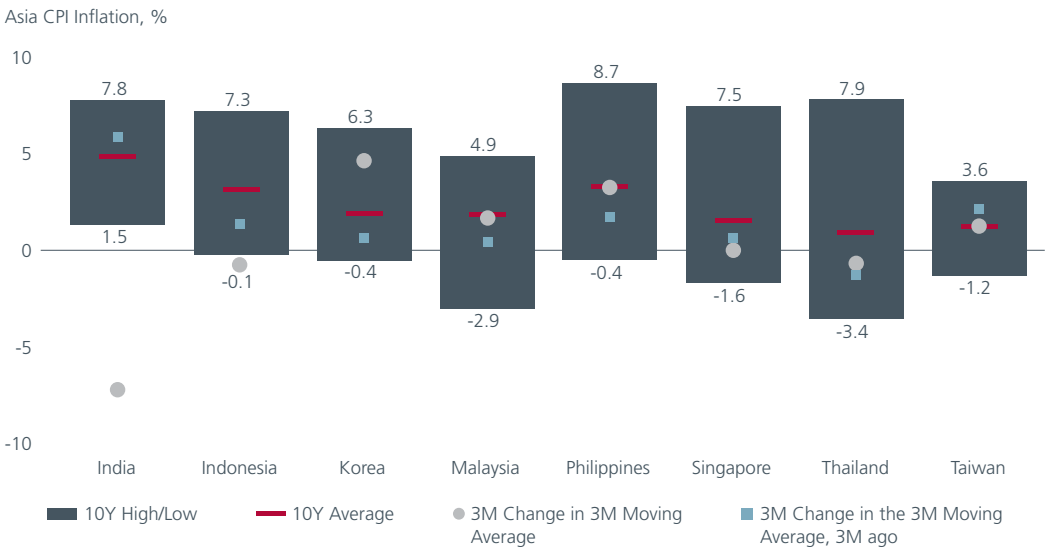
The practical realities of US remaining the world’s largest economy and non-US government debt markets remaining relatively small and less liquid will maintain USD reserve currency status for the foreseeable future. However, weaker US growth, Federal Reserve rate cuts, rising US debt, and ongoing geopolitical stress are likely to drive some further repatriation of funds out of the USD over the next year. We expect this to push the currently still expensive USD at least 4% weaker in broad terms and possibly as much as 10% lower over the next year.



We expect most Asian currencies to strengthen somewhat as part of this USD depreciation. Importantly, Asian central banks are likely to allow more appreciation than historically because they will want to avoid being accused of currency manipulation during current trade negotiations with the US.

One benefit of stronger Asian currencies is Asian central banks should have greater freedom to cut interest rates in economies where inflation is below target. This combination of stronger currencies and interest rate cuts should increase the attractiveness of Asian asset markets for international capital flows.

Fig 3: Low Asian inflation leaves room for rate cuts and lower yields



Source: LSEG Datastream. 11 April 2025.

Investment implications

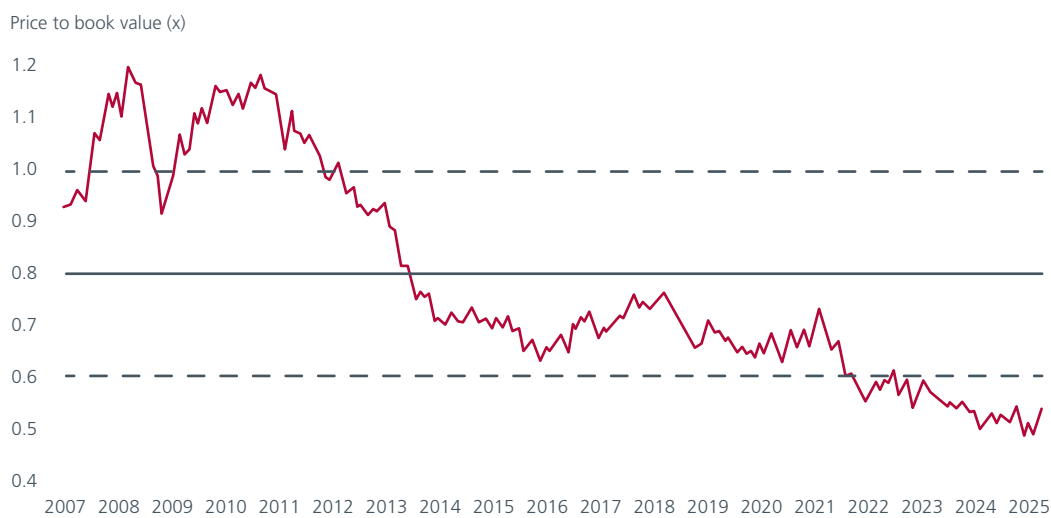
OUR 2025 ANNUAL OUTLOOK REPORT “EMERGING MARKETS AND ASIA: OPPORTUNITIES AMID SHIFTING TIDES” HIGHLIGHTED THE INVESTMENT OPPORTUNITIES AMID POLICY AND ECONOMIC SHIFTS. HOW IS THIS PLAYING OUT?

Equity and bond markets started 2025 on a relatively firm footing but performances soon diverged across markets and asset classes. Market volatility rose in late January, triggered by the breakthrough of DeepSeek, China’s startup AI lab, foreshadowing a turbulent year.

US equities initially rallied on optimism over potential tax cuts and stronger economic growth following Trump’s presidential win. While this momentum was interrupted by the administration’s immigration and tariff policies, which raised concerns over higher inflation and slower economic growth, at the point of writing⁴, US equities have recovered following the 90-day tariff reprieve between US and China.

The strong rallies in US assets in recent years have led to stretched valuations and significant positions in many investor portfolios. On the other hand, Asia and EMs offer more attractive valuations and lighter positioning. This remains the case and suggests greater upside potential for Asia and EMs. Some markets in these regions benefit from clearer policy making and strong domestic growth drivers. India and China have greater policy room to respond to tariff challenges. Meanwhile Japan has introduced reforms that improve shareholder returns. In Latin America, the absence of incremental tariffs (at the point of writing) on Mexico was a positive surprise. Brazil is also a relatively closed economy with 80 to 85% of its GDP domestically driven. Meanwhile, the CE3 economies (Poland, Czech Republic, and Hungary) have less than 2% of their revenues tied to the US.

Fig 4: Emerging markets offer more attractive valuations



Source: MSCI, Refinitiv Datastream, Eastspring Investments. As of March 2025. MSCI DM-EM= MSCI EM relative to MSCI World trailing PB(x). PB = price to book. Past performance is not an indication of the future or likely performance. For illustration purposes only. The indices described are unmanaged and not available for direct investment. The use of indices as proxies for the past performance of any asset class/sector is limited and should not be construed as being indicative of their future or likely performance.

⁴As of May 2025.

US corporates are being more cautious but are not panicking either, adopting a “wait and see” approach. They seem reluctant to shed labour too early in case trade deals get done. Although capex remains relatively healthy, some damage has been done. Project delays however are still well below COVID-19 levels.

Uncertainty over the longer-term outcome of the tariff negotiations can continue to trigger intermittent market volatility. Nonetheless we believe that Asia and EMs are well-positioned to benefit as investors seek greater diversification. The USD has strengthened considerably over the last few years. Historically, a weaker dollar has been positive for Asia and EMs. In this fluid environment, **active management** and bottom-up security selection would be key to capturing alpha.

WE HAVE SEEN A LOT OF VOLATILITY IN THE MARKETS THIS YEAR. HOW ARE YOUR TEAMS NAVIGATING THIS BACKDROP AND WHAT CAN INVESTORS DO?

Agile investors can take advantage of dislocations arising from market volatility. Being bottom-up investors in Asia and EMs, we remain focused at finding companies with strong long-term fundamentals that are trading at attractive valuations. Our multi asset team is also using different **tools** such as derivatives (where allowed) to capture emerging opportunities while limiting their downside risks. This improves the portfolios’ risk/return profiles. The team is also being more agile, banking their wins when they arise – this helps mitigate the risks associated with sudden market downturns and maintain portfolios’ long-term financial stability.

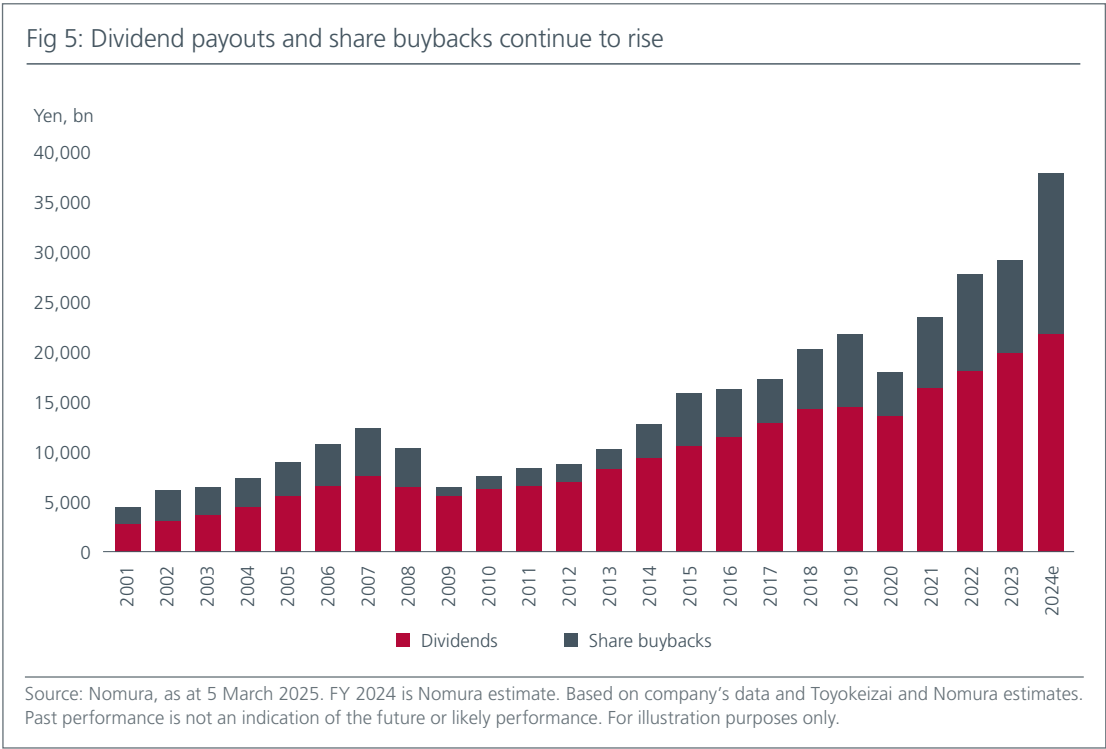
We are also leveraging data and **risk management tools** to protect portfolio alpha and validate our convictions. Even then, we remain mindful of the assumptions behind our risk models. Given shifting market correlations, risk metrics can be influenced by the data periods used, so we stress-test portfolios across varying scenarios and timeframes.

For investors, portfolio diversification is important – rebalancing from overvalued markets to more attractively valued ones with improving fundamentals seem prudent. Steady income from high quality bonds and **dividend paying equities** can also help dampen portfolio volatility when there is increased earnings uncertainty. By now investors have seen how recovering from drawdowns can be challenging. **Low volatility** strategies can help to minimise downside while still allowing investors to participate in the market’s upside.

CAN THE JAPAN EQUITY MARKET REGAIN ITS STRONG MOMENTUM OF 2024? WHAT ARE SOME OF THE CATALYSTS?

In early 2025, an appreciating yen and Trump’s tariffs weighed on large-cap exporters which had led the market in the earlier two years. Meanwhile, the small caps outperformed.

On the tariff front, any progress could lift investor sentiment. Beyond tariffs, other longer-term market drivers are at play. While corporate reform is not a new narrative, the momentum – such as increased dividends, share buybacks and cross shareholding unwinds – remains strong. In April, a large Japanese automaker’s USD 42bn bid to privatise its subsidiary sparked optimism for broader corporate restructuring. The Tokyo Stock Exchange’s push for better corporate governance clearly continues to provide investors with an idiosyncratic and uncorrelated alpha source.



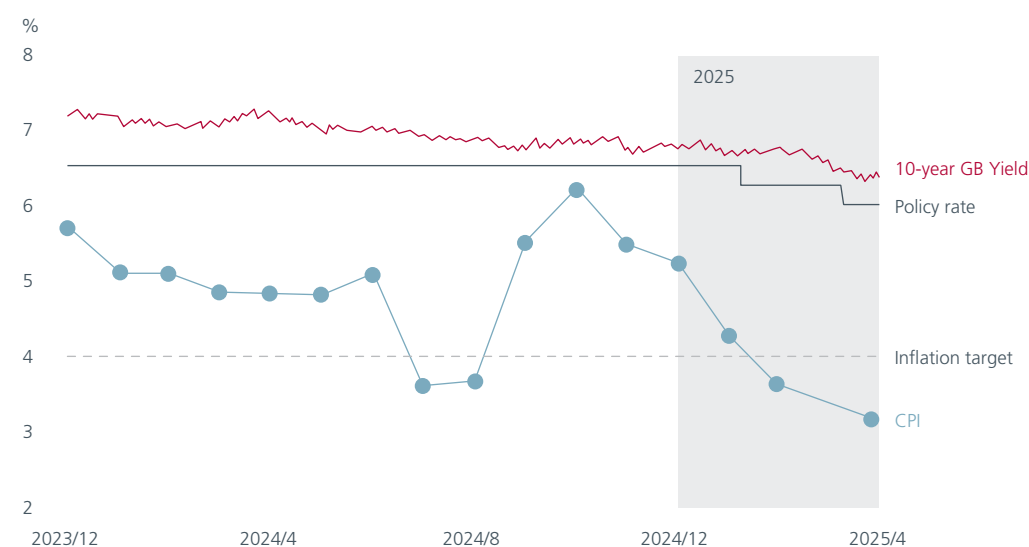
Meanwhile, Japan is experiencing its highest nominal wage growth in over three decades, driven by labour shortages, easing deflation and government policy. Reflation is helping real wages to recover, supporting domestic consumption and buffering against external shocks. It is also encouraging companies to shift from cash hoarding to improving returns on equity.

Japan remains one of the cheapest markets globally, on a price-to-book basis. Earnings growth and free cash flow are also relatively strong. With robust corporate reforms and rising wage growth, Japan equities offer a compelling long-term proposition for global investors.

WHY HAVE INDIA EQUITIES BEEN RESILIENT YEAR TO DATE DESPITE BEING DEEMED “EXPENSIVE” AT THE START OF 2025?

The market’s resilience is partly due to the Reserve Bank of India’s (“RBI”) dovish and pro-growth stance. The RBI cut the benchmark rate twice this year, and another 50-75 bps of cuts are expected as inflation remains under control. More importantly, the RBI’s liquidity injection into the banking system addresses a key growth constraint from 2024.

Fig 6: Contained inflation paves way for further rate cuts



Source: Bloomberg. May 2025.

Domestic investor flows have been resilient while foreign institutional investors turned net buyers in the second half of April. India appears relatively better positioned amid the US tariff campaign given its large domestic economy. India equities also have limited exposure to US exports – aside from IT services, which is not subjected to tariffs. Moreover, the Q4FY25 results season has been resilient, with minimal downward revisions.

Continued RBI support, sluggish oil prices and resilient domestic inflows create a favourable backdrop for **India equities**. While valuations could become a headwind at some point, active managers should still be able to find opportunities.

WE HAD CAUTIONED AGAINST BEING TOO BEARISH ON CHINA EQUITIES. ARE WE STILL “CAUTIOUSLY OPTIMISTIC”?

We remain cautiously optimistic towards China equities over the medium to long term. Valuations of H and A-shares remain attractive, providing opportunities for bottom-up investors. With expectations for a major **stimulus** tempered post the April Politburo meeting, the risk of disappointment is lower, leaving room for upside surprises.

Encouragingly, China’s May Day holiday data points to some domestic resilience. Tourism traffic and revenue rose 6.4% and 8% respectively year-on-year while restaurant/retail sales gained 6.3%. Macau Gross Gaming Revenue, a proxy for small and medium-sized enterprises’ sentiment, rose 12%.

Southbound flows are becoming a major driver of H-shares, with net buying reaching USD 78bn to date, 75% of 2024’s total. Southbound ownership has more than doubled since 2021 to 11-12% of market capitalisation, increasing the market’s resilience.

That said, market volatility remains high. US-China tensions can still escalate. We favour companies with a track record of stable shareholder returns, strong competitive positions and greater earnings growth certainty.

For investors looking to gain exposure to China equities, beyond a standalone allocation, we believe a combined China and India portfolio offers diversification across two Asian giants that have low correlated markets and distinct growth drivers.

WITH THE FEDERAL RESERVE WALKING A TIGHT ROPE BETWEEN INFLATION RISKS AND GROWTH FEARS, HOW SHOULD INVESTORS BE THINKING ABOUT BONDS?

Despite the 90-day pause on tariffs, uncertainty over the longer-term outcome is still likely to weigh on global growth. Investors should maintain a globally diversified bond portfolio and rotate to countries that benefit from tariff de-escalation, supply chain re-routing, and domestic support.

Our fixed income team is closely monitoring for any deterioration in **credit quality**. Security selection is key, and they are prioritising defensive sectors such as the government, quasi government and utilities. There are opportunities to acquire high-quality assets at favourable valuations.

Slower growth suggests that central banks are likely to adopt a more accommodative stance, particularly in countries where inflation has waned. Asian local currency bonds present a compelling investment opportunity due to their attractive real yields and resilient economic fundamentals. Their low correlation with developed market assets and gradual inclusion in major bond indices also enhance their diversification appeal. Accordingly, the team will add duration to bond portfolios across local Asia and Emerging Markets on any meaningful rates sell-offs. On currencies, they remain more tactical and look for extreme moves to accumulate USD as a portfolio hedge.

Growing concerns over the USD's reserve currency status are raising doubts about the long-term foreign demand for US Treasuries. Still, in the near term, US Treasuries should retain their "safe haven" status, supported by the US Treasury and the Federal Reserve's liquidity backstop, as seen during the COVID-19 crisis.

Investment themes

Theme	Rationale	Strategy
1. Enhancing portfolio diversification	<ul style="list-style-type: none"> The strong rallies in US assets (including the USD) in recent years have led to stretched valuations and significant positions in many investor portfolios. It is prudent to diversify as US growth slows. 	<ul style="list-style-type: none"> Asia/EM equities, bonds and currencies
2. Identifying tariff winners	<ul style="list-style-type: none"> India is probably Asia's largest winner in the tariff war given its low export exposure to the US. A potential trade deal could increase its attractiveness as an alternative manufacturing site. Below target inflation allows RBI to cut rates further to boost growth. Selected EMs may be less exposed to tariff shocks. 	<ul style="list-style-type: none"> India equities and bonds EM equities and bonds
3. Harnessing policy opportunities	<ul style="list-style-type: none"> Low expectations for a major stimulus leave room for attractively priced equities to benefit from any upside surprises. Accommodative policy is also supporting growth. Still strong corporate reform momentum provides idiosyncratic alpha source; reflation boosts wage growth and consumption. 	<ul style="list-style-type: none"> China equities Japan equities
4. Navigating rate cuts	<ul style="list-style-type: none"> Contained inflation in most of Asia and EMs, as well as stronger Asian currencies give central banks room to cut rates to support growth. 	<ul style="list-style-type: none"> High quality local Asia and EM bonds
5. Building portfolio resilience	<ul style="list-style-type: none"> Market volatility to remain high given uncertain tariff outcomes and lower earnings visibility. Recovering from drawdowns is challenging. 	<ul style="list-style-type: none"> Quality income (from dividends and bonds) Low volatility strategies

Source: Eastspring Investments.

Source: Eastspring Investments for all economic forecasts.

Other contributors: Eastspring Equity, Fixed Income and Quant investment teams.

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