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Market drivers to watch in the second half of 2025

Weekly Global

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Key Messages

Global equities have returned to all-time highs as markets enter the second half of 2025. Over the past six months, investors have contended with shifting policy, swings in sentiment, and geopolitical events. Yet, beneath the surface, the outlines of a more constructive environment are forming.

We see five key factors that we expect to drive investment outcomes in the months ahead:

First, US trade and fiscal policies are gradually taking shape. While the expiration of the US "reciprocal" tariff pause and legal debates around the basis for tariffs risk near-term volatility, we expect the final contours of US trade policy to become clearer in the weeks ahead. Meanwhile, Treasury and legislative actions, including the likely passage of the One Big Beautiful Bill Act, should provide greater clarity on fiscal policy. Elevated tariffs and persistent deficits may periodically unsettle markets, but we do not expect them to end the broader economic expansion or trigger a sustained market drawdown.

Second, geopolitical risk remains a feature of the current environment. Ongoing conflicts in the Middle East and Eastern Europe pose tail risks. The challenge for investors is how to effectively diversify and hedge the risk of further escalation.

Third, we expect interest rates and bond yields to fall. The Federal Reserve has been on hold all year, but we expect it to resume cutting in the second half. We believe lower rates, lower growth, slower inflation, and "safe-haven" flows will lead to lower high grade bond yields by year-end.

Fourth, we expect further US dollar weakness. After a significant decline in the first half, the pace of further depreciation may moderate, but we expect the longer-term trend of "de-dollarization" to persist.

Finally, we believe structural growth trends—particularly artificial intelligence, power and resources, and longevity—will continue to drive equity market returns, supported by further innovation, adoption, and monetization in the second half and beyond.

Against this backdrop, we recommend that investors align portfolios with these key drivers while managing the risk of renewed volatility.

From the studio

Video: **Five things to watch in the second half, with CIO's Kiran Ganesh** (3:16)
Video: **CIO mid-year checklist– your next portfolio steps, with CIO's Jon Gordon** (5:50)
Podcast: **Jump Start – Key deadlines for US trade and fiscal policy, US-Iran talks, and jobs data** (5:02)

Questions for the week ahead

Will we see more clarity on US trade and fiscal policy? Two key deadlines are approaching. First, President Trump is pushing to get the One Big Beautiful Bill Act over the finish line before the Independence Day holiday on 4 July. The second deadline is the expiration of the 90-day tariff pause, just over a week away at the time of writing. Investors will be hoping for renewed progress on trade relations in the coming days. Regarding US fiscal policy, markets seem to be resigned to a bill that expands US debt over the coming decade.

Will relations between the US and Iran improve? The US had been scheduled to hold talks with Iran over a more lasting solution to its conflict with Iran. After an exchange of hostile rhetoric late last week between the leaders of the two nations, the outlook remains unclear. Investors will be hoping for signs that diplomatic efforts can resume, lowering geopolitical risks.

Could upcoming economic data add to hopes for an earlier Fed rate cut? Fed officials sent mixed signals last week on the timing of potential rate cuts.

For those underallocated to equities, progressively increasing exposure to diversified global stocks or balanced portfolios can help position for stronger potential returns in the years ahead.

We also recommend deploying cash into quality bonds and diversified income strategies, which can help enhance yield and improve income durability, and considering hedges or diversification to reduce excess dollar holdings.

Finally, we view gold as an effective hedge against geopolitical risks, while hedge funds and private markets can provide alternative sources of portfolio returns.

For more details read the CIO Monthly Letter "Five things to watch in the second half."

Also see our: 2H outlook: Action amid uncertainty

Governor Bowman suggested that easing could come sooner than expected, while Chair Powell emphasized the need for patience, indicating the Fed may wait for more evidence before acting. This week, investors' focus will turn to key economic data releases—including nonfarm payrolls, ISM data, and JOLTS job vacancy figures—to see if these numbers could tilt the Fed toward an earlier cut or reinforce Powell's call for patience.

Key Messages

Equity markets shrug off trade and geopolitical uncertainty

The S&P 500 closed at a fresh record high on Friday, for the first time since February, fully erasing losses caused by worries over the prospect of a trade war between the US and its major partners. After the latest advance, the index is now 24% higher than its 2025 low on 9 April, when fears over trade were at their most intense. The rebound has been driven by optimism that cooler heads will prevail in trade negotiations, geopolitical conflicts will not disrupt the global economy, and AI adoption will boost corporate profits.

We believe the rally can go further over the coming 12 months. However, events late last week also underlined that risks remain. On Friday, President Trump said he was cutting off trade talks with Canada and would announce additional tariffs on the nation over Canada's taxation of US tech companies. Though talks got back on track after Canada rescinded the planned digital services tax, the episode served as a reminder that the success of trade negotiations cannot be taken for granted. Notably, the 90-day pause on higher tariffs on imports from a range of nations is due to expire on 9 July.

Hopes that planned talks between the US and Iran could result in a more lasting peace also suffered a setback. President Trump said he would "absolutely" consider bombing Iran again to stop them developing nuclear weapons, after Iran's supreme leader said last week's attacks "did not achieve anything."

Takeaway: While economic uncertainty and geopolitical risks may generate periodic market volatility in the second half, we believe that the emergence of greater policy stability, falling interest rates, and enduring structural growth trends will provide a foundation for improved market performance in the years ahead. For investors under-allocated to equities, we recommend gradually increasing exposure to diversified global stocks or balanced portfolios to position for stronger potential returns in 2026 and beyond. In our base case, we see the S&P 500 reaching 6,500 by June 2026.

Tech rally has legs amid rising AI adoption

The broad rally in stocks continued to be led by the tech sector. The tech-heavy Nasdaq 100 also topped record highs from the start of the year and is now up 32% from its April low point.

Despite the scale of the rally, we continue to see a supportive backdrop for the sector, given recent positive trends in AI adoption and monetization. The US Census Bureau's latest report that tracks AI adoption across 1.2 million firms in the US showed another step-up in companies' use of the technology, with 9.2% of companies using the technology in the second quarter from 5.7% in the final three months of 2024. This means AI adoption is likely to soon cross the 10% threshold that took US e-commerce 24 years to reach.

This adoption is also broadening across industries, including in the medical field, where it is being more widely used in identifying abnormal tissues from tests. Without taking any single-name views, we believe a peak in overall AI adoption is still a long way off, and accelerating AI use is set to drive further monetization across industries.

Takeaway: We continue to recommend a more balanced exposure across the AI value chain, including leading internet and software companies as well as names along the AI semiconductor supply chain globally. We think investors can also gain access to breakthrough innovation and long-term opportunities in AI through private markets. Investors should, of course, consider the risks associated with private markets before investing.

Treasury yields should fall further amid lower rates

Investors pulled nearly USD 11bn from long-dated US government and corporate debt in the second quarter, the fastest pace since the height of the COVID-19 pandemic in early 2020, according to a Financial Times report. This comes as Senate Republicans advanced President Trump's sweeping tax cut and spending bill over the weekend, with a vote on a long list of amendments to the One Big Beautiful Bill Act (OBBBA) scheduled for Monday. President Trump is pushing to get the legislation over the finish line before the Independence Day holiday on 4 July. The non-partisan Congressional Budget Office has forecast that the OBBBA would add about USD 3 trillion to government debt over the coming decade.

But while the trajectory of US debt warrants careful monitoring, our view is that Treasuries remain attractive, and the 10-year yield is likely to end the year around 4%, versus 4.26% at the time of writing.

Deep US capital markets, the US dollar's reserve currency status, and the significant wealth held by US households should keep the debt manageable, in our view. The Trump administration has also demonstrated sensitivity to higher bond yields, pointing to a willingness to adjust in the event of much higher yields. A relaxation in banks' capital ratios on low-risk assets, announced by the Federal Reserve last week, should support liquidity in the Treasury market. We also expect support for Treasuries from a resumption of Fed easing later this year, most likely starting September.

Takeaway: With yields and cash rates expected to fall for the remainder of this year, we believe high grade and investment grade bonds offer an attractive risk-return compared to cash, as investors can still lock in elevated yields. Long-term investors can also consider diversified fixed income strategies.

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Appendix

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