

ECONOMIC RESEARCH – JULY 2025

INVESTMENT INSIGHT USA



- ✓ Between recession and inflation rates also waver
- ✓ Chaos has not been kind to the dollar
- ✓ Rebalancing in favor of more defensive sectors

THE HOUR OF TRUTH DRAWS NEAR

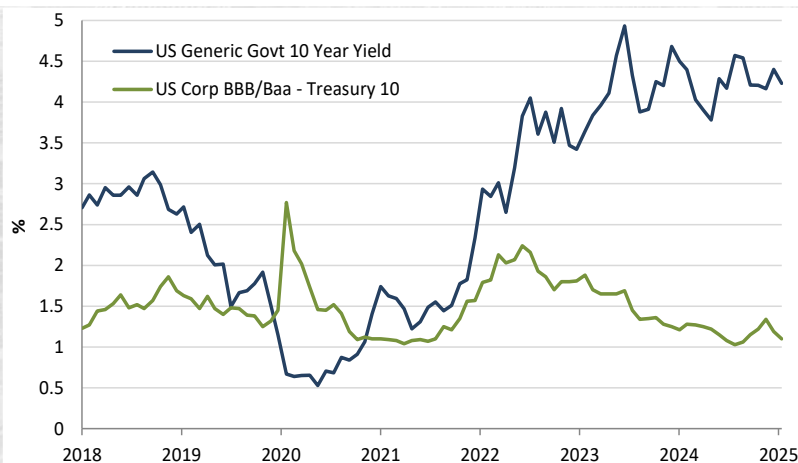
Bond market's central dilemma

Fixed-income markets face a challenging dilemma, caught between the opposing forces of inflationary risks and fears of a sharp economic slowdown. This difficult situation is largely due to the dual nature of Trump's tariff policy, which is poised to be both inflationary by raising import prices and recessionary by dampening consumer spending and business investment.

Financial pressures and the treasury's challenge

The complex environment is further compounded by the substantial financing and refinancing needs of the U.S. Treasury, projected to reach an enormous \$7 to \$9 trillion in 2025. This vast supply of new debt is weighing on interest rates, a dynamic made more acute by the Federal Reserve's absence as a market participant on the buy side. The combined pressures from tariffs and massive government borrowing make a stagflation scenario, characterized by slow growth and rising prices, a distinct possibility. These factors are expected to keep long-term rates volatile, fluctuating within a wide range of 3.9% to 4.8%.

US Treasury yields and BBB bonds (Spread)



Sources : Bloomberg, BBGI Group

The Dollar's loss of ground

The U.S. dollar has lost significant value, depreciating by 10% since Trump's inauguration. This underperformance is directly tied to investor concerns over the administration's policies, particularly those related to trade and fiscal management. These concerns have been clearly reflected in the market, with the U.S. Treasury's Credit Default Swap (CDS) doubling between February and May.

Factors driving the currency's decline

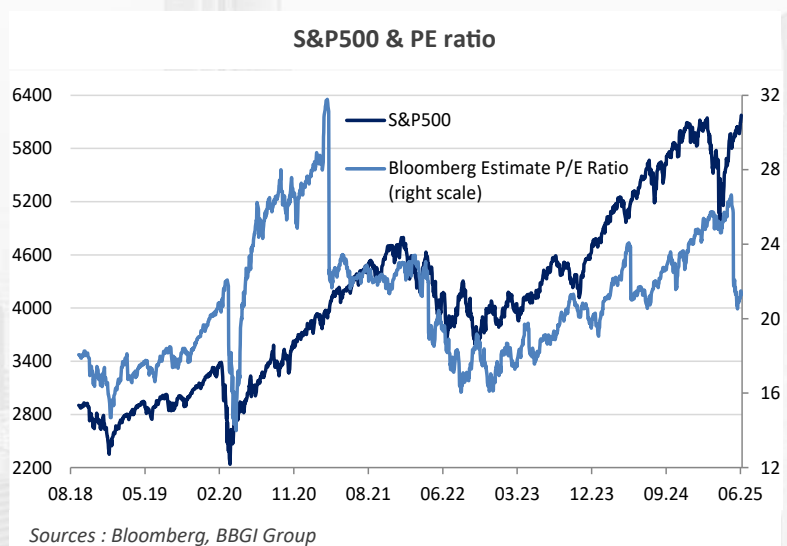
The passage of the OBBBA, along with the President's aggressive tariff strategy, has contributed to a notable lack of confidence from international investors, leading to a wave of dollar selling. The dollar's weakness is particularly noteworthy given that higher real rates in the U.S. and a positive yield differential would normally be supportive of the currency. The market is clearly anticipating new developments to reverse this downward trend, although from a technical perspective, the trade-weighted dollar is beginning to show some early signs of a possible trend reversal.

Equity markets face a new reckoning

The recent optimism that drove a significant rally in the S&P 500 and Nasdaq indices, largely fueled by hopes for favorable trade agreements, could be challenged in the coming days. The potential for the imposition of punitive tariffs, which could reach 25% to 30% for major trading partners, could trigger a sharp reversal of the "risk-on" trading environment. The current low level of the VIX index, at 17, suggests a degree of investor complacency that may not be sustainable in such a highly uncertain environment.

Strategic rebalancing toward defensive positions

A significant disparity has emerged between the performance of growth stocks, which surged by 40% during the recent rally, and defensive stocks, which only rebounded by 20%. Given the increasing risks of market consolidation, a strategic rebalancing of portfolios is now more prudent. Moving away from highly volatile growth stocks and toward more defensive, value-oriented sectors is an optimal strategy to mitigate potential losses and better navigate the growing economic uncertainty.



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