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# EP 193 | Quarterly Update | Q2 2025

**[00:00] Kevin Minas:** Hi, everyone. Kevin here. In this episode, we unpack the major market moves and macro developments for the second quarter with two of our portfolio managers, Crista Caughlin, lead PM of the Mawer Canadian Bond Strategy, and Steven Vischer, lead PM of the Balanced Strategies here at Mawer.

We explore the latest in central bank policy divergence, yield curve dynamics, credit markets, and shifting equity market leadership. Plus, we dig into how geopolitics and trade tensions are shifting asset allocation decisions heading into the third quarter.

**[00:34] Disclaimer:** This podcast is for informational purposes only. Information relating to investment approaches or individual investments should not be construed as advice or endorsement. Any views expressed in this podcast are based upon the information available at the time and are subject to change.

**[00:52] Kevin Minas:** Hi, Steven. Hi, Crista. Nice to have you both on the podcast for the quarterly.

**Steven Visscher:** Thank you, Kevin, great to join you today.

**[01:01] Kevin Minas:** Geopolitical tensions escalated sharply in the quarter. We started with so-called “Liberation Day” and tariff brinkmanship and ended the quarter with military engagement between Israel, Iran, and the U.S. I appreciate there's a lot to cover there, especially when you consider what happened in between. But nonetheless, Steven, if you can give us a brief rundown on these market-moving developments.

**[01:17] Steven Visscher:** Thanks, Kevin. I think it makes sense to start with tariffs. You mention Liberation Day, that refers to the Trump administration tariff policy that they announced on April 2nd.

These were sweeping tariffs across all of their trading partners. And the scope and the magnitude certainly seemed to take investors by surprise. There was immediate concern—and I think justifiable concern—that implementing tariffs at these levels would be a shock to economic growth, would lead to job losses, rising unemployment, and more than likely trigger a global economic recession. The market impact was pretty severe. We had, on the following day, the single largest one-day decline in markets since the COVID pandemic. And over the course of the next three or four days, we witnessed most major equity benchmarks decline by 10% or more.

Literally trillions and trillions of dollars of wealth evaporated in a very short amount of time. In yet another surprising twist, the Trump administration then announced a 90-day deferral on the implementation of these tariffs. The objective there was to give trading partners ample time to engage in discussions and negotiate more moderate tariff levels.

This sparked quite a bit of reassurance in the markets. We witnessed what we call a V-shaped recovery in the days and weeks that followed. As the quarter unfolded, equity markets not only fully recovered from those early April declines but added growth on top of that and ended the quarter with most equity markets either at or very close to all-time highs.

As for the geopolitical tensions, I first just want to acknowledge the human tragedy and the many lives that have been lost and many more lives that have been impacted by the violence.

But the reality is the market impact was relatively benign, certainly nothing compared to the impact that we saw tariffs and trade policy have on markets. That conflict, particularly after the direct U.S. intervention and how tensions very quickly simmered, did not really have a meaningful impact on the economic recovery.

**[03:28] Kevin Minas:** Q2 also brought no shortage of macro signals, some loud, some less pronounced, whether it be shifting inflation patterns, divergent growth rates, certainly global investors had a lot to digest, Crista. How would you characterise the macro environment in Q2? And in particular, were there any surprises, be it inflation, growth, fiscal trends that you think the market is still processing?

**[03:52] Crista Caughlin:** There were a lot of surprises with respect to events and a lot of the things that Steven talked about. I don't know if there were necessarily as many surprises on the data front. I think maybe the one thing that surprised us was the weakness in the consumer happened quicker than I would have thought.

So last quarter, we talked a lot about the impact of tariffs and a trade war and what impact a trade war would have on the economy. We noted one of the bigger impacts would be the uncertainty that a trade war creates and how that uncertainty impacts spending. And I think we're seeing that play out particularly in Canada.

Growth, both in Canada and the U.S., is showing signs of slowing. Q1 U.S. GDP ended up being negative. Now, we knew that number was going to be weak just given what was happening with trade, particularly imports, people front-running tariffs. But the details were a lot worse than expected. There was a decent slowdown in consumer spending. So, the consumer typically runs around 2% to 3% on average. In Q1, it was running at half a percent, so a pretty material slowdown. Now, some of this is likely related to the trade uncertainty. But some of it may be the continued repercussions of tighter financial conditions or higher interest rates. We are seeing signs of weakness in housing. So, housing inventory is back at close to 2008 levels, so all-time highs. And house prices fell this quarter, which isn't typical.

Now, on the positive side, at least in the U.S., employment has been holding up. The unemployment rate continues to sit around 4% and claims seem to be contained. Now, some would argue that the employment number is not really consistent with the consumer spending numbers, so that's something to watch. If we think the weakness in the consumer is going to persist, it's likely we will start seeing that in the employment data. But if the employment numbers are right and employment continues to hold up, I would expect to see a rebound in consumer spending in the coming months and quarters. So that's the U.S.

In Canada, we're seeing something similar, at least with respect to the consumer. Q1 GDP in Canada was actually decent. It came in at around 2%, but that wasn't driven entirely by inventories and trade. Again, people front-running tariffs. Final domestic demand in Canada was negative, and that was on the back of a really weak consumer and even weaker business spending. Business spending was negative in Canada. I think that uncertainty that happens around a trade war is really starting to impact spending in Canada, both at the consumer level and at the business level. Now, unlike in the U.S. where employment's a bit of a bright spot, in Canada, employment was negative this quarter. So, we lost just over 16,000 jobs over the last three months, and the unemployment rate continues to move higher and is now sitting at 7%.

We expect growth to continue to be weak in Canada. The employment picture suggests that weakness in the consumer may persist. Given the uncertainty continues to exist, it's unlikely we're going to get a material bounce in business spending. And exports, which were really the driver of growth in Q1, have completely reversed in Q2. And we just got one of the largest declines in exports that we've seen in over 30 years. We know it's going to be a drag in coming months.

One potential offset to this weakness is on the fiscal side, and this is really a theme that we're seeing globally.

Last quarter, we talked about how Germany came out with large fiscal spending plans. In the U.S., Trump has pushed through this "big, beautiful bill", which will increase fiscal spending. And in Canada, we're going to get our budget released, I think, sometime in the fall. But early indications show an increase in the deficit in Canada as well, which will support a weaker economy. So that's growth.

On the inflation front, inflation has moderated over the quarter, which maybe is a bit surprising. Inflation in Canada was negative over the last three months. So, it's now running at 1.8% year over year. In the U.S., PCE [Personal Consumption Expenditures] is running at just over 2.3%. However, core inflation in both of those countries remains sticky. In Canada, it's running around 3% and, in the U.S., 2.75%, so above target. And in Canada, at the high end of the range.

Now, the one thing to note on the inflation side is that inflation hasn't necessarily increased yet. We talked about Canada, core inflation is running at 3%. It's actually been running at 3% since the beginning of the year. So, from that perspective, it's not clear that tariffs have had an impact on inflation yet. You haven't really seen that shift higher. And so, the question at this stage is obviously, why haven't we seen that?

It could come down to two things. It could be that businesses can't really pass on prices the way they thought they could or the way they had hoped. If you're seeing weak consumer spending, if you're seeing weaker demand, it's really challenging to increase prices in the face of that. So it could be that weak consumer spending is causing inflation to not shift higher. Or it could just be that businesses haven't increased prices yet, and it's coming. I think the market is more concerned about the latter. I think there is an expectation that if these tariffs persist, we will start seeing inflation drift higher here.

**[09:23] Kevin Minas:** Certainly, interesting because, as you said, conventional wisdom was we would see an uptick in inflation given all the tariff brinkmanship. And going back a few quarters ago, the conventional wisdom was also you'd see an appreciation in the U.S. dollar, and that didn't play out, at least not yet. Picking up on your last point there about a concern that perhaps the inflation is yet to come, I think that's a nice lead into central bank activity.

The Fed didn't move in the quarter, neither did the Bank of Canada, but the ECB and Bank of Canada have been leaning a bit more dovish than the U.S. Maybe what you kind of described there in terms of the macro data, that's perhaps why the U.S. hasn't moved yet. But anyway, nonetheless, if you can kind of give us a rundown on the developments of the central banks in the quarter. And then also, do you think that divergence that we've seen—you painted a more rosy picture for the U.S. versus other economies—would you expect that there continue to be a divergence in terms of monetary policy? Or is this sort of a temporary divergence and things will get more back in line over the next quarters and years?

**[010:20] Crista Caughlin:** I think there has been some divergence, but I think that's more of a timing thing. I think central banks are going to set policy for their domestic economies. Their domestic economies aren't always going to be the same. And so, you will get some divergence from that perspective.

And I think that's a little bit what's happening right now. The ECB, you mentioned, cut rates twice this quarter. They have had weaker growth, they've continued to have weaker growth, it's persistently weaker than the U.S., and they believe they have inflation somewhat more contained. Headline is at target. And although core is modestly above target, it's moving lower. Whereas in Canada and the U.S., it's sort of been flat at a higher level. And so, I think this containment in inflation has given them some cover to respond to that weaker growth profile. And so, it allowed the ECB to cut twice this quarter. Along with the cut, or at least at the last meeting, they've effectively left the door open for a pause. Even though they have been dovish, they have cut, they're now in that wait-and-see mode, similar to the Fed, similar to the Bank of Canada.

The Bank of Canada, as you mentioned, didn't change rates this quarter. Their last cut was in March, no real change, they're in a wait-and-see mode. But if you look at the guidance from the Bank of Canada, or the scenarios that they've given us, they're on the dovish side. And so, although they're in wait-and-see mode, if they get inflation contained, it's likely they will cut again by the end of the year.

The Fed has paused; they haven't cut at all this year. But even here, if you look at the Fed's dots, they still expect two rate cuts by the end of the year. Now, in reality, as I mentioned, they've effectively paused, they're waiting, they're seeing how the trade war is going to play out. But if inflation is contained, and you get some clarity on the trade front, they're also biased to continue to cut rates from here.

We've seen a bit of divergence, particularly in terms of quarterly rate cuts. But I don't think it's sort of a new phase of monetary policy moving in separate directions. The way I would categorise it is they sort of all started the year in easing mode, they all had the goal of getting rates back to neutral, some got further along in that goal relative to others, and then the trade war hit. And it's all made them shift into this wait-and-see mode, shifting to be a little bit more reactive than proactive. At least for now, they all do still have that dovish bias or that bias towards easing.

**[12:45] Kevin Minas:** So that's a good picture in terms of what's happened in the quarter as far as tariffs, geopolitics, central bank activity, and so on. Moving to risk assets, so equities in particular. Back to you, Steven. Pretty positive results. You mentioned off the top that although there was volatility, ultimately quarter over quarter, pretty strong results globally for equity markets. What stood out in particular for you in Q2, whether it be sector or regional leadership, or any other sort of themes that you saw within the equity markets globally?

**[13:11] Steven Visscher:** To me, one of the more noteworthy or interesting developments over the quarter has been the underperformance of U.S. equities and the weakness of the U.S. dollar relative to the rest of the world. Let's not forget the U.S. economy is the largest, most diverse, considered the most innovative economy in the world, has high levels of efficiency and labour productivity, high levels of corporate profitability. The U.S. dollar and the treasury market have been long viewed by foreigners as safe haven assets and trusted holdings in times of duress. And not just this quarter, but frankly, so far this year, we've seen a bit of a reversal in that trend. The last 10 or 15 years, we've seen U.S. assets outperform the rest of the world by very wide margins, not just a percent or two, but significant margins, leading some to even question the merit of diversification. Why not have all of your assets in the U.S., which has been certainly dominating capital markets again for the last 10 or 15 years.

But in Q1, we saw a real stark reversal. International equities outperformed the U.S. by a wide margin, and specifically European equities. Here in Q2, that's broadened. We've now seen Canadian equities, a number of economies in Asia, emerging markets, they've all outpaced the U.S. again, so far this year by wide margins. That to me is noteworthy. I think some have questioned whether this is a pivotal moment, whether this is perhaps the end of this era of U.S. exceptionalism.

There's been theories that foreigners no longer view the U.S. as a trusted ally and are less comfortable holding U.S. dollars and U.S. assets. Personally, I think it's premature to reach that conclusion. Kevin, I think we could easily be sitting a year from now and talking about how U.S. assets had this resurgence and once again led the world higher. But given that we're six months into the year and the divergence has been noteworthy, we're at least intellectually open to the possibility that we are witnessing a pivotal moment in the end of U.S. exceptionalism and certainly have taken notice and will monitor that closely as the quarters unfold.

**[15:25] Kevin Minas:** So if there was ever a time to be well-diversified, this is probably the time is what I'm hearing there. So it seems like perhaps the opinion, at least on the team, is that the end of U.S. exceptionalism is

perhaps a little bit exaggerated. At least that's where we seem to be right now.

As a follow-up to equity market performance generally, Steven, if you could speak a little bit about how the balanced strategy held up and positioning within some of the equity sleeves.

**[15:51] Steven Visscher:** The success of the balanced strategy, as you know, is not predicated on the performance of one particular region or one particular asset class. We're broadly diversified. So, despite the U.S. weakness that I just described, the portfolio was pretty resilient given that we're broadly diversified out of the U.S.

We've got a healthy allocation both to Canadian and international equities, and that helped us steer through this six-month period so far of U.S. weakness. Leading into "Liberation Day", we were diligent in keeping our equity weight at a neutral level. So when we entered that chaotic environment, the portfolio was not significantly offside or significantly exposed to equities. We were close to neutral at 60%, and that other 40% in money market and fixed income helped provide some resiliency during that chaotic week. Our balanced strategies during that "Liberation Day" period, they were down approximately 6%, so certainly less than the 10% or more weakness that we saw in equity markets. But again, the strategy recovered as equity markets did.

We not only recovered those early April losses, we ended Q2 with gains of over 3% on the balanced strategy. On a year-to-date basis, that strategy is up over 6%, so very solid absolute returns over that six-month period. And that result is also ahead of our benchmarks during the year-to-date time period thus far.

**[17:20] Kevin Minas:** Shifting to bond markets, we saw another wave of repricing in Q2, particularly in the front end, which was especially reactive. What drove yields in the quarter, Crista? Was it data? Was it policy tone, something structural, long-term growth rates? How would you characterise what happened in the rates markets in the quarter?

**[17:40] Crista Caughlin:** There's definitely been a lot of intraday volatility, big day-over-day swings in rates. I think your comment on the front end is right. We've seen some volatility there. We've gone from pricing in, call it, four to five more rate cuts in the U.S. to pricing that out. Currently, the market is pricing one more cut in Canada and two more cuts in the U.S. by year end.

Although we have seen a lot of volatility, I think for the most part rates have really just reversed what we saw happen in Q1. Last quarter, we saw rates fall. Steven talked about Liberation Day, recession fears were picking up, and rates fell in the face of that. Since then, we've had the delay of tariffs, increased fiscal spending, recession fears have really subsided. Rates have moved higher to reflect that. In Canada, rates hit 3.50% earlier this year, moved down to 2.90% around Liberation Day, and are now sitting back at 3.40%. In the U.S., it's effectively the same story. They started the year at around 4.60%, went down to 4%, and they're now back at 4.40%.

What's interesting is if you go back over the last two to three years, interest rates have been range bound. It feels like there's lots happened this month, this quarter. They've been range bound for the last two to three years. I think in Canada, that range is roughly 2.75% to 3.75%. Today, we're 3.40%, probably close to the upper end of that range. In the U.S., it's similar. Their range is higher, 4% to 5%. We're sitting at 4.40%.

If I think about the question about a structural rethink of long-term growth rates or long-term interest rates, I don't necessarily see that shift happening right now. I think that shift happened two, three years ago over the last few years. Neutral has shifted higher in both Canada and the U.S. I think that structural rethink has already happened. Now, it may be happening again, but for now, our view is that we've already seen that, and we're going to continue to be range bound.

**[19:42] Kevin Minas:** Despite that volatility in the rates market, which again was similar to equity as a function of tariffs amongst other things, shifting, I guess, to the credit markets, there was a similar theme where April was a bit more volatile, but by the end of the quarter, you look at where spreads are now versus where we started the quarter, still quite benign, surprisingly tight, meaning rates haven't moved all that much. If anything, they've come in a little bit.

How would you characterise that in terms of, is that a reflection of investor confidence or is this just late cycle yield-seeking behaviour? How would you characterise where we are in the credit markets?

**[20:14] Crista Caughlin:** Credit spreads continue to grind tighter here. In Canada, spreads are 15 to 20 basis points tighter on the quarter, really reversing that widening we saw during “Liberation Day”. In Canada, outside of a handful of days, we're actually at 30-year tights in Canadian investment grade spreads.

In the U.S., it's similar. Both investment grade and high yield spreads have completely reversed the widening we saw around “Liberation Day” and are now back at cycle tights. Your question, does it reflect confidence? Is it yield seeking or yield-starved investors? I think it reflects confidence or maybe complacency in the cycle. It's not just credit spreads that are at all-time tights. Steven talked about risk assets; equity markets have generally performed well and some reaching new highs here. I think it's maybe more, you could either call it confidence or complacency in the cycle.

**[21:09] Kevin Minas:** Just wrapping things up in terms of asset allocation. For allocators, Q2 was definitely a bit of a test of conviction. You had sticky inflation, rates were certainly volatile, earnings were perhaps a bit uneven, and certainly equity markets and credit markets saw pretty meaningful drawdowns.

Given all that, Steven, what actions did the asset mix committee take, if any, in the quarter? And then more generally, how are you thinking about risk at the portfolio level, given the current market environment?

**[21:35] Steven Visscher:** I spoke earlier about aiming to keep our equity weight fairly neutral. We did continue to do that through the quarter, but we did reallocate within the equity component of the portfolio from a regional standpoint. Both in Q1 and in Q2, we have deliberately reduced our direct exposure to U.S. equities and have reallocated those proceeds to other regions of the world.

In Q1, we allocated some of that U.S. equity to international and global small cap equity. Here in Q2, we've done the same and included an allocation to emerging markets as well. So just at the margin, wanting to de-emphasise our exposure to the U.S. and broaden exposure to other regions. For much of this last 10 or 15 year period in which the U.S. has dominated markets, that has represented the largest single country or regional exposure in the balanced strategy.

Because of these incremental changes that we've executed so far this year, that has now reversed. For the first time in a long time, we actually have slightly more direct exposure to Canadian equities vis-à-vis the U.S. and have a much larger overweight to international and emerging markets equities than we have in the past. At the margin, responding to that potential pivotal change and just looking for a little less direct exposure to the U.S. and broadening that elsewhere.

Kevin, as for your question on risk, I think about risk in a couple of different ways. And whether that be the risk of a global economic slowdown or a recession, maybe there's a risk that as Crista said, markets are too complacent. And we may see some of that unwind. There's two layers to it, to me. The first is at the security selection level. So each of our underlying asset classes are building portfolios of high-quality companies with sustainable competitive advantages, led by excellent management teams and trading at discounts to their intrinsic value.

We feel these are the type of businesses that can be resilient in the face of a recession or in the face of trade disruptions. Often, these types of companies can emerge from that environment in an even stronger competitive position. So that's the first layer of risk. It has nothing to do with asset allocation. That's at the security selection level.

The next way that we mitigate risk is at the asset allocation level. And that's by building broadly diversified portfolios. As I said, we've had a healthy exposure across Canada, U.S. and international equities. There have been moments in time when the U.S. has led the world.

We're now at a juncture where that has reversed and other asset classes and other regions have taken the lead. But we've got a portfolio that although we make changes at the margin and we make incremental shifts from one region to the other, it's not drastic. It's typically gradual and incremental because we're living in an uncertain world. We don't know how the future is going to unfold and we want to make sure that we've got appropriate allocation and diversification across all areas. Maybe the last comment I'll make is on fixed income. We've talked a lot about equities thus far, but I can share that on the fixed income portion of the portfolio.

We're excited that we've now formally introduced our global credit strategy to our balanced portfolios. That actually didn't happen in Q2, it happened just this week. But we're excited about the additional diversification that we can now bring to the fixed income component of the portfolio. We're of the belief that over time, this will lead to better outcomes for our balanced clients.

**[25:15] Kevin Minas:** I'm glad you mentioned the global credit allocation. Maybe just to connect it to one of the earlier points for astute listeners who are thinking, hold on, didn't you just tell me that global credit was relatively expensive? The logic behind our global credit strategy is that it's dynamically managed. We really do insulate the portfolio. In other words, take relatively little risk when we think that credit spreads are expensive.

Then we shift into what we call activating, which basically means we take on a lot more risk when we think that credit valuations are attractive. Right now, given Crista's comments, and just more generally with global credit being relatively expensive, we are very defensively positioned, but nonetheless, much more global than our traditional core Canadian fixed income. It's a way of getting global diversification without necessarily increasing risk all that much today. But of course, as market circumstances change, that strategy will shift its level of risk. Just another way, also tying it back to Steven's comments about risk, you can do it at the security level or at the top-of-house level. This strategy does both.

**[26:09] Steven Visscher:** Kevin, I couldn't describe that any better. You did fantastic on that. The other thing I would mention is we're also hedging currency on that global credit portfolio. The influence of changing currencies is not going to exert influence on the performance of global credit. Fully hedged back to Canadian dollars.

**[26:25] Kevin Minas:** Yeah, that's good to know. I think that's a good spot to stop. Thank you very much, both of you, for joining today. Always learn lots talking to both of you. Hopefully, we'll see you guys' next quarter.

**[26:35] Steven Visscher & Crista Caughlin:** Thanks.

**[26:37] Kevin Minas:** Hey, everyone. Kevin here again. To subscribe to the Art of Boring podcast, go to mawer.com. That's M-A-W-E-R dot com forward slash podcast, or wherever you download your podcasts. If you enjoyed this episode, be sure to leave a review on iTunes, which helps more people discover the be boring, make money philosophy. Thanks for listening.