

INVESTMENT STRATEGY QUARTERLY

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BACK TO THE FUTURE

LESSONS FROM THE PAST, STRATEGIES FOR THE FUTURE

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Letter from the Chief Investment Officer

Back to the Future: Lessons from the Past, Strategies for the Future

It's been forty years since *Back to the Future* hit theaters—and its iconic time-traveling storyline reminds us that while we can't rewrite history, we can certainly learn from it. From investing to economics (and even politics), patterns emerge, lessons resurface, and the past becomes a powerful guide for navigating today's unpredictable landscape. Just like in the movie, timing, perspective, and adaptability can make all the difference in managing the complexities of modern markets. So, let's hop in our metaphorical DeLorean time machine and revisit a few critical decades that still resonate today.

1970S: TRADE POLICY & OIL SHOCKS

Great Scott! If Marty McFly and Doc Brown set their time machine to the 1970s, they'd find themselves in a world wrestling with inflation, global trade imbalances, and energy crises. Sound familiar? Sure—but today's economy is running on a very different engine. While the headlines might echo the past, we're not headed for a rerun of 1970s-style stagflation. Inflation today, while higher than the Fed's target of 2%, is far less punishing, and unemployment is roughly half of what it was back then. So no, we're not stuck in the past—we're just borrowing a few pages from its playbook.

That era, after all, left a legacy on trade policy. Congress gave the president powerful tools: the Trade Act (1974) to offer protection to domestic industries and respond to unfair trade barriers, the Trade Agreements Act (1979) to enforce fair play, the Export Administration Act (1979) to control sensitive exports, and the Customs Reform Act (1978) to tighten enforcement. Notably, the International Emergency Economic Powers Act (IEEPA) gave the White House authority to regulate trade during national emergencies.

Fast forward to today—Trump 2.0 is revving up that same toolkit. Tariffs are back, trade deals are being reworked, and IEEPA is once again front and center as its authority is being challenged in the courts. But the rival has changed. In the '70s, it was Japan and West Germany. Now, it's China—a global heavyweight deeply embedded in supply chains and tech ecosystems. With average tariff rates projected to hit 15–17%—about five times higher than at the beginning of the year—we do expect some short-term inflation and economic drag, but not a full-blown recession.

And let's not forget the oil shocks of the '70s. Long gas lines and soaring prices led to the creation of the Strategic Petroleum

Reserve (1975) and the Department of Energy (1977)—moves aimed at reducing dependence on foreign oil. Today, US oil production nearly matches consumption, and with global supply expected to outpace demand moving forward, we see prices trending down toward \$60–65 a barrel—a far cry from the inflation-adjusted highs of the past.

1990S: FED PROWESS & FISCAL DISCIPLINE

From a market and economic standpoint, our next stop, the 1990s, might be one of the most enviable decades in modern history. The US experienced its second-longest expansion, driven by a productivity boom and early waves of technology. And with Alan Greenspan at the helm, the Federal Reserve struck a near-perfect balance—cutting rates just enough to keep the momentum going.

Today's Fed faces a similar opportunity. With the fed funds rate hovering around 4.5%, there's plenty of room to ease if needed. We expect two interest rate cuts over the remainder of this year, with at least two more likely to follow in 2026. These moves should help cushion any temporary slowdown as businesses work through pre-tariff inventories, consumers adjust to initial tariff price shocks, and hiring cools a bit.

Looking ahead, growth should accelerate next year. The proposed "One Big Beautiful Bill"—which includes marginal tax cuts, expanded SALT deductions, and incentives for business investment—could provide a dose of fiscal stimulus, even as it keeps the deficit high. Our forecast calls for US GDP growth of 1.4% in 2025 and 1.5% in 2026.

One more lesson from the '90s worth remembering: fiscal discipline matters. From 1999 to 2002, the US actually ran budget

surpluses—helping pay down some of the national debt. That sense of responsibility was driven, in part, by the fact that interest payments were consuming 18% of federal revenue. Guess what? We're right back at that level today, and there is little sign of a bipartisan appetite for restraint. Even with a growing economy, rising entitlement spending and rising interest costs are crowding out spending on other priorities. It's a warning sign that shouldn't be ignored.

2000S: TECH & US EXCEPTIONALISM

Now let's leap into the year 2000, when everyone had a Hotmail address and pockets full of flip phones, digital cameras, and GPS gadgets. Back then, tech felt futuristic, even if it was a bit clunky. Today, it's sleek, seamless, and everywhere—woven into nearly every moment of our lives. So, are we heading for another market jolt like the 'pop' of the dot-com bubble? Not likely. Unlike the speculative frenzy of the early 2000s, today's Tech sector is built on solid ground—mature companies with real earnings and diversified revenue streams. With AI accelerating innovation, we expect Technology to keep transforming industries across the economy. That's why it remains one of our top sectors, alongside Industrials and Health Care.

As for the broader market, we're a bit cautious in the short term. Our year-end S&P 500 target is 5,875, reflecting potential downward revisions to 2025 earnings—from the current consensus of \$262 to our estimate of \$255. But looking into next year, we see brighter skies: improving GDP growth, a more accommodative Fed, and greater clarity on tariffs and fiscal policy. That supports our 12-month S&P 500 target of 6,375.

Before we leave the early 2000s behind, it's worth remembering the debut of the euro in 1999. At the time, it raised concerns about a serious challenge to the dollar's dominance. But bringing together such a diverse group of economies proved difficult, and Europe has struggled to keep pace with US growth and competitiveness ever since. Today, there's a fresh wave of optimism in Europe—driven by increased defense spending and more flexible fiscal policies. Still, we remain cautious. We're not buying into the idea that US exceptionalism is fading. Structural challenges in Europe persist, and while some expect a weaker dollar to boost international returns, we don't see enough movement in currency markets to support that view. So, for now, we're not setting the clock forward on international markets. We continue to favor US equities, where the outlook is more stable and the path ahead is clearer.

2023: DEBT WATCH DÉJÀ VU

Our final stop is a recent one: 2023, the last time the US debt ceiling was raised. That year, the ceiling was suspended without a cap, and markets reacted quickly. The 10-year Treasury yield jumped to 5%, as investors braced for a surge in government bond issuance to replenish federal coffers and cover ongoing trillion-dollar deficits. Now, we're at a familiar crossroads. With the ceiling reinstated and the clock ticking toward another potential 'X-date' (the time when the US government will not be able to fulfill all its financial obligations)—likely in August—markets are once again preparing for a Congressional deal that lifts the cap and triggers another wave of heavy Treasury issuance.

But we believe fears about soaring yields are overblown. While supply will increase, demand is expected to remain strong. Lessons from 2023 show that regulatory adjustments and strategic shifts—like the Treasury issuing more short-term bills over longer-term bonds—can help stabilize the market. We maintain a year-end and 12-month target of 4.25% for the 10-year Treasury yield, with the most compelling value in short to intermediate maturities. We continue to favor high-grade corporate and municipal bonds for their attractive valuations.

BOTTOM LINE: PERSPECTIVE IS POWER

For investors, market ups and downs are nothing new. Despite interim setbacks, the S&P 500 has delivered a robust average annual return of ~11% since *Back to the Future's* debut. Bull markets historically last six times longer than bear markets and produce returns five times more powerful. The takeaway? Stay focused on the long term, stick to a well-balanced strategy, and rely on your investment adviser. Looking back, it might seem like timing the market would've been easy—but in reality, markets move to their own rhythm. One thing is clear: time in the market is far more powerful than trying to time it. We may not be able to predict the future, but we can prepare for it—with discipline, perspective, and a little help from the lessons of the past. Or, as Doc Brown reminds us, "Your future hasn't been written yet. No one's has. Your future is whatever you make it. So, make it a good one."

Enjoy the summer!



Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer

*Financial forecasts should NOT be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. Expressions of opinion are as of this date and are subject to change. Past performance is not a guarantee or a predictor of future results.



Trade Talk and Tariff Truths

Eugenio J. Alemán, PhD, *Chief Economist*, Raymond James
Giampiero Fuentes, CFP®, *Economist*, Raymond James

The fortunes of empires, kingdoms, and, until the early part of the 20th century, modern nation-states, have often hinged on trade and the revenues it generates. As capitalism overtook mercantilism, before the industrial revolution transformed the world, revenues from trade served as a cornerstone of fiscal revenues. But revenues from tariffs were limited, volatile, and highly unreliable. As the US economy and its fiscal needs grew, the country moved to more sustainable, reliable, and less volatile sources of fiscal revenues.

HISTORY OF TARIFFS

During the early 20th century, but especially under the influence of mercantilist thinking, tariffs became a tool for protecting burgeoning American industries and culminated in the infamous Smoot-Hawley Tariff Act of 1930, which raised tariffs on thousands of goods and is widely believed to have worsened the Great Depression.

A major shift occurred with the Reciprocal Trade Agreements Act of 1934, which marked the beginning of a more liberal trade

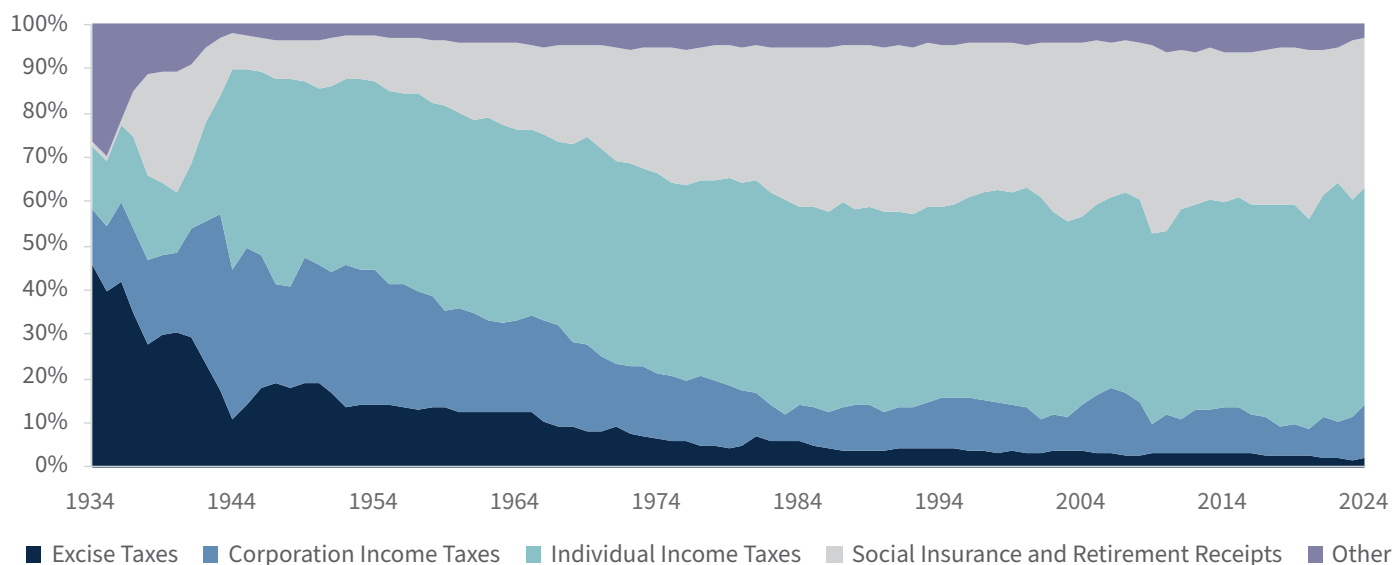
policy. This act empowered the president to negotiate tariff reductions with other countries, laying the groundwork for multilateral trade agreements and institutions like the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO). In the post-World War II era, the US championed global trade liberalization, culminating in agreements such as NAFTA and the USMCA. Since the peak of the Smoot-Hawley Tariff Act, tariff rates have declined significantly and were hovering around 2% at the beginning of 2025.

TARIFFS TODAY

Understanding this historical context helps clarify the current state of trade policy in the United States. While many view the US trade deficit as a sign of economic weakness, especially when compared to countries with trade surpluses, the reality is more nuanced.

The US tends to consume more than it produces, a pattern made possible by the existence of trade. However, the global dominance of the US dollar, its appreciation, large and persistent fiscal deficits, and the strong international demand for Amer-

Sources of Government Revenues



Source: FactSet, data as of 12/31/2024

ican government debt and overall financial assets generates large trade deficits. That is, foreign savings have continued to finance US consumption and investment by purchasing American assets and investing in the US economy. Although the US must pay interest and dividends on these investments, the influx of foreign capital has lowered interest rates and helped economic growth—enabling expansion beyond what domestic capital alone could support. Thus, the trade deficit is not as negative as it used to be when mercantilism was the prevailing economic theory, and tariffs are not going to help bring the trade deficit down.

Today, the biggest risk is what economists call a ‘sudden stop,’ which is a scenario where fearful investors put a stop to the flow of foreign savings coming into the country. This will push the US dollar much lower, i.e., a large depreciation, and cause a surge in the cost of importing goods so large that it could push the trade deficit into a surplus as Americans stop consuming foreign goods. This scenario is what typically happens when less developed countries enter into a balance of payments crisis. However, although this scenario is highly unlikely, it is not an impossibility.

TARIFFS ARE TAXES: CONSUMERS AND FIRMS PAY THEM

The whole discussion regarding tariffs and who pays for them boils down to the following: if you are a firm that imports goods from other countries for final sales, i.e., a retailer, the firm pays the tariffs when it imports the item. So, if a good

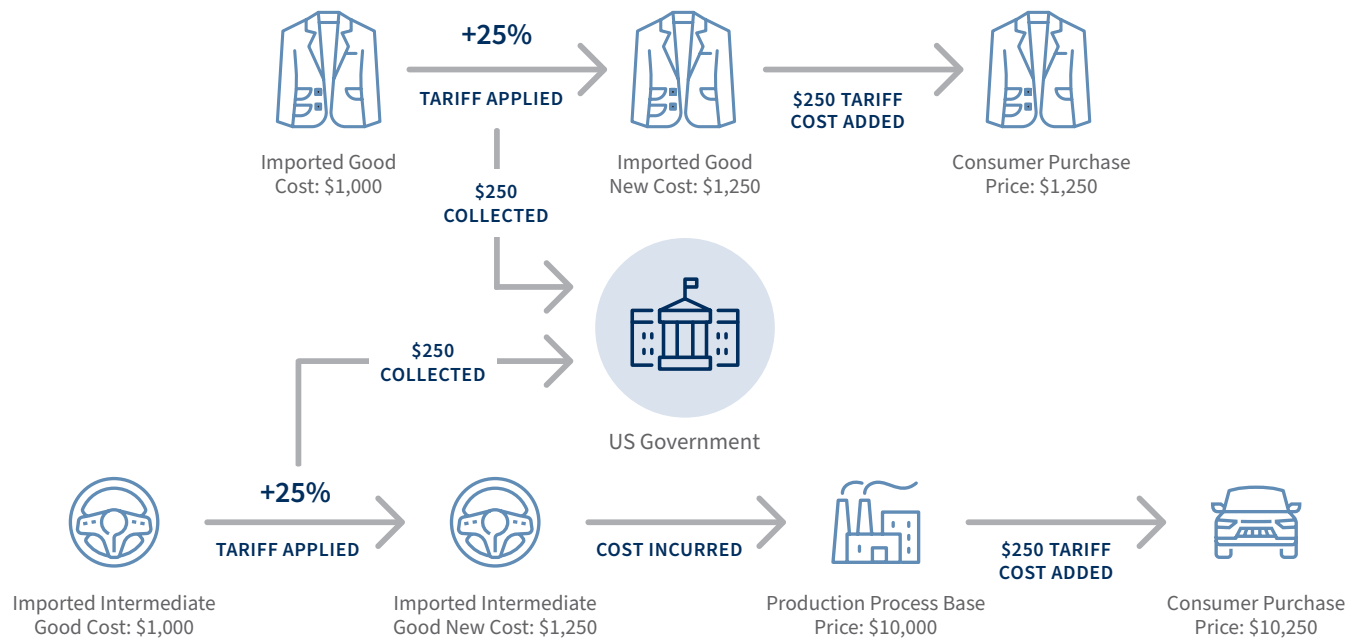
In the post-World War II era, the US championed global trade liberalization, culminating in agreements such as NAFTA and the USMCA.

costs \$100.00 and the import tariff for that good is 25%, then the new price paid by the firm is \$125.00. If, on the other hand, a firm imports what is called an intermediate good, a good that is used in the production process of another good, then the firm pays the tariff over the price of that imported intermediate good and adds the tariff over the price of the final product. So if a firm imports an intermediate good that has a cost of \$100.00 without a tariff and the government imposes a 25% tariff on that intermediate input, then the intermediate import has a new price of \$125.00. If the price of the final product without the tariff is \$1,000.00, then the price after the tariff goes up to \$1,025.00.

In both scenarios, however, the final buyer of both goods will probably pay slightly less than the price that includes the tariff while the firm importing the product will have to pay the portion of the tariff that is not paid by the final consumer. Who pays the tariff cost will depend on the price elasticity of demand¹ for each one of these goods. That is, the more inelastic the demand for a product is, the larger will be the proportion of the tariff paid by the final consumer, leaving the importer to pay the rest.

¹Price elasticity of demand is the consumer’s responsiveness to price changes.

Tariff Math: How It Adds Up



Source: RJ Economics

The more elastic the demand for a product is (the more alternatives in the market), the smaller will be the proportion of the tariff that is paid by the consumer, and the larger the proportion paid by the importer of the good.

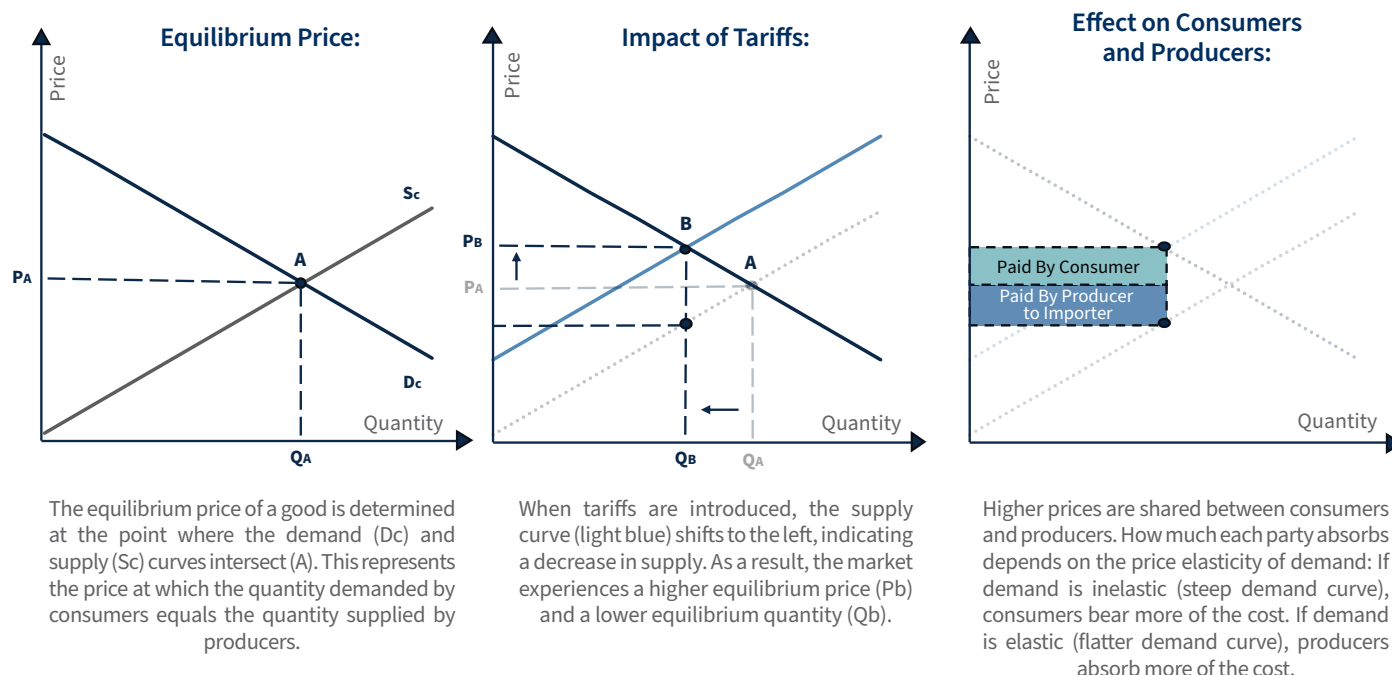
When faced with tariffs, companies have several options to mitigate their impact and maintain competitiveness. One of the most immediate responses is to reevaluate and restructure supply chains. This might involve shifting sourcing to countries that are not subject to the same tariffs or that have favorable trade agreements. For example, a US company importing goods from China might consider shifting its sources and/or factories to Vietnam or Mexico instead. Companies will adjust their pricing strategies to manage the increased costs by passing the cost on to consumers through higher prices.

REDISTRIBUTIVE IMPLICATIONS OF TARIFFS

Tariffs work as a regressive tax on lower income individuals and households. Tariffs increase the price of necessities that are typically not produced domestically. At the same time, if these products are domestically produced, tariffs on import-competing goods allow domestic producers to raise prices on those goods. Since lower-income households typically spend a larger portion of their income on necessities, then tariffs affect them

Thus, the trade deficit is not as negative as it used to be when mercantilism was the prevailing economic theory, and tariffs are not going to help bring the trade deficit down.

disproportionately. At the same time, higher-income consumers have more alternatives to try to avoid tariffs as they may purchase more expensive versions of the product that are typically produced domestically and would not be affected by the tariffs. Tariffs are primarily designed to protect domestic industries and jobs, but there are unintended effects that can reinforce economic inequality. Many times, as was the case during the first Trump administration, governments try to offset these effects through subsidies or tax credits for the sectors negatively affected by reciprocal tariffs. Not only do tariffs impact lower-income groups the hardest but, as we saw during the pandemic recession, the US government is not well equipped to identify and correctly target the sectors most affected by tariffs. That is, as is the case with any tax collected by the government, tariffs have unsuspected redistributive implications.



Source: RJ Economics

THE BOTTOM LINE:

Tariffs, while often framed as tools of trade policy, are ultimately taxes that influence both corporate strategy and consumer behavior. When imposed on imported goods, whether final products or intermediate inputs, tariffs raise costs that firms often try to pass along through higher prices. The extent to which these costs are transferred to consumers depends on the elasticity of demand, which refers to how sensitive consumers are to price changes. If demand is inelastic (few substitutes, essential goods), more cost is passed on to the buyer; if it's elastic (many alternatives, non-essentials), firms may bear more of the burden. For consumers, this can mean higher prices on a wide range of products, even those manufactured domestically but reliant on global supply chains. For investors, the implications are equally material: tariffs can compress margins, alter sourcing strategies, and introduce inflationary pressures that ripple through earnings and valuations. Understanding how these dynamics unfold is essential for interpreting shifts in pricing, consumption, and corporate performance in an increasingly interconnected global economy. ■

Tariffs are regressive because they disproportionately affect lower-income individuals and households.

KEY TAKEAWAYS

- Post World War II, the US has championed global trade liberalization, resulting in the US enjoying an average effective tariff rate of ~2.5% at the beginning of 2025.
- Tariffs were primarily used as a source of revenue for the federal government. They have evolved and are now also used for trade protection.
- Tariffs are fundamentally taxes paid by importers and consumers, not foreign countries. When a company imports goods, it pays the tariff directly to the government.
- Tariffs are regressive and disproportionately affect lower-income households that have fewer options than higher-income households.



Has the US Lost its Safe-Haven Appeal?

Tracey Manzi, CFA, *Senior Investment Strategist*, Investment Strategy

American exceptionalism has been a dominant theme in financial markets—and there are good reasons for that. For decades, the US has offered investors a rare trifecta: enviable economic growth fueled by a resilient consumer, equity outperformance relative to the rest of the world and a strong dollar. However, the fallout from President Trump's tariff announcements has shaken investors' confidence. The financial market's unusual reaction post-Liberation Day (April 2) which featured a simultaneous decline in the US dollar, Treasury prices and equities has led many investors to ask an uncomfortable question: Is the US at risk of losing its relative safe-haven status if Treasuries (and the dollar) are no longer providing protection during risk-off environments? Below we discuss the reasons why we think the safe-haven status of the US remains intact.

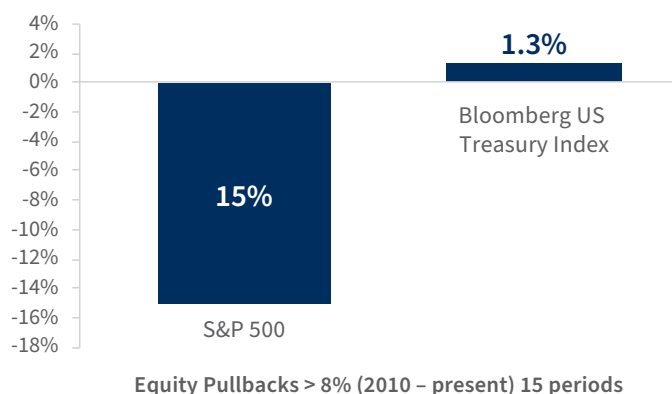
SAFE-HAVEN STATUS CONFIRMED, BUT WITH A CAVEAT

US Treasuries have long been considered the world's preeminent safe-haven asset. That's predominately because Treasuries act as a crisis hedge for investors, meaning they retain their value or

appreciate during periods of heightened economic or geopolitical stress—what we commonly refer to as a 'flight to quality'. While the post-April 2 Treasury selloff has attracted a lot of media attention, with headlines suggesting US Treasuries were trading like an emerging market or risk asset, we think these concerns are overexaggerated. In fact, we would argue that despite heightened volatility, Treasuries have provided ballast to equity risk during market downturns. Case in point: the last 15 times the S&P 500 had an 8% or greater pullback since 2010, the Bloomberg US Treasury Index was up on average 1.3%. If you excluded the inflationary period in 2022, US Treasuries would have delivered an average return of 2.3% versus the S&P 500's average decline of 15%. This confirms that Treasuries are doing what they are meant to do—holding their value or appreciating when most needed.

Despite heightened volatility, Treasuries have provided ballast to equity risk during market downturns.

Treasury Returns During Equity Pullbacks



Source: FactSet, as of 6/13/2025

The safe-haven status of the US is also supported by the central role it plays in global finance. Not only is the US dollar the most widely used currency in global transactions, accounting for over 50%¹ of all SWIFT payments, US Treasuries serve as the benchmark rate in pricing everything from mortgages to consumer loans, and corporate debt. Treasuries are also a key component in calculating equity risk premiums and the most common form of collateral used in the lending markets due to their credit worthiness, liquidity and widespread acceptance. Any perceived loss of confidence in US Treasuries or the dollar would quickly ripple across the globe. While the April 2025 tariff tantrum led to a significant breakdown in historic correlations, we think it is premature to suggest that this brief episode signals a regime shift. There simply is no other market that can rival what the US has to offer.

Despite these structural advantages, the world's most systematically important bond market has had a few tremors in recent years. The sudden increase in Treasury yields in April 2025 served as another reminder of the building fragilities in the system. Fortunately, the dislocation proved short-lived. However, the most notable tremor occurred in March 2020. Treasuries did not behave as a traditional shock absorber when the COVID panic set in, as the dash for cash quickly overwhelmed market liquidity, which amplified rate volatility and led to wider bid-ask spreads. The result: soaring long-term bond yields, with the 30-year Treasury yield climbing 80 bps in one week. With market functionality impaired (rightfully so as the world economy had never shut down before), the Federal Reserve was forced to step in to purchase large quantities of Treasuries to stabilize the market. While these flare-ups have been rare, they do serve as a warning sign that the market's resilience can sometimes be tested.

CAN ANOTHER BOND MARKET RIVAL THE US TREASURY MARKET?

While investors have become jittery as President Trump tries to reshape the global trade landscape and fiscal concerns are in the spotlight, the US is still the 'cleanest dirty shirt' among its peers. Of course, this could change in the future—particularly if the nation's fiscal situation continues to deteriorate. However, right now there is no other market that matches the size, liquidity, depth, or global influence of the US Treasury market. The US Treasury market, at \$28.5 trillion,² dwarfs all others. In fact, the size of the Treasury market is roughly equivalent to the combined government bond markets of China, Japan, UK, France, Italy and Germany. While the size of Japan's bond market is massive, after years of quantitative easing (i.e., central bank bond purchases), the Bank of Japan owns over 50%³ of all Japanese government bonds—meaning the liquidity and depth of the market is compromised. In addition, the average daily trading volume of Treasuries now exceeds \$1 trillion⁴ a day. For comparison, the average daily trading volume for the German Bund market, which is considered the benchmark within Europe, is only 27 billion⁵ euros or \$30 billion USD-equivalent. All else being equal, a higher daily trading volume signals that the market has better ability to absorb daily trading activity without any significant price disruptions. These quick facts cement our view that there is no viable alternative to Treasuries, now or in the foreseeable future.

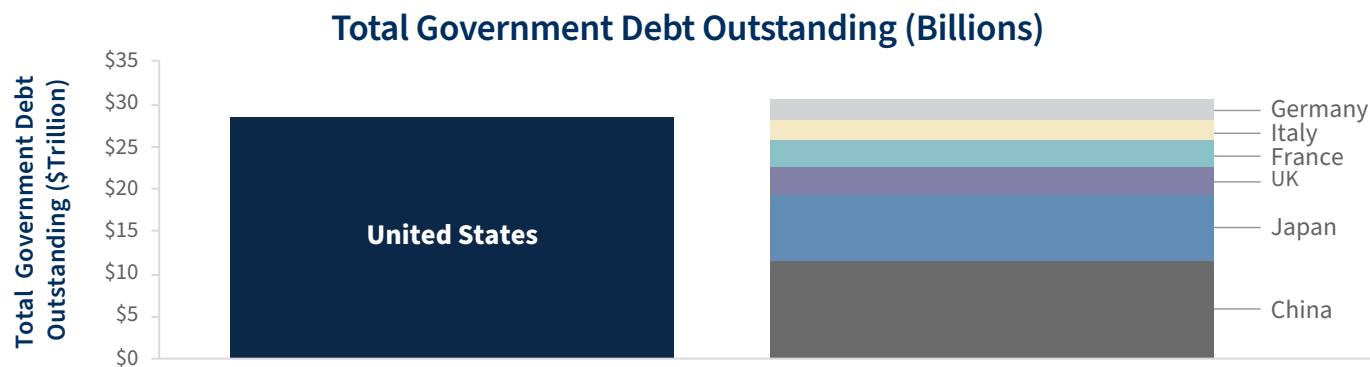
“There simply is no other market that can rival what the US has to offer.”

ARE FOREIGN INVESTORS BACKING AWAY FROM US TREASURIES?

With the market searching for answers to explain the adverse price movements in early April, the media narrative attributed it to foreign selling. Fears of foreign selling have been a consistent theme throughout the years, but outside of foreign exchange intervention purposes, total foreign holdings of US debt has swelled to \$9.1 trillion,⁶ even though its share as a percentage of total debt has eased—with Japan, the UK and China among the top holders. Speculation concerning foreign selling reached a feverish pitch in April, with some headlines reporting that foreigners could try to weaponize their Treasury holdings as leverage during the upcoming tariff negotiations. To date, there

⁴<https://www.sifma.org/resources/research/statistics/us-treasury-securities-statistics/>

⁵https://www.deutsche-finanzagentur.de/fileadmin/user_upload/Institutionelle-investoren/auktionen/bund_fact_sheet.pdf



Source: SIFMA and Bank for International Settlements (BIS), as of 12/31/24

has been no evidence of massive foreign selling in the Treasury International Capital (TIC) reports. There have also been concerns about a possible ‘buyer’s strike’ particularly for longer-maturity Treasuries. That is a key reason why we monitor who is buying Treasury debt and the demand at auctions. And for now, indirect bidders (i.e., a proxy for foreign demand) have been within recent norms and bid-to-cover ratios in the most recent auctions remain healthy.

DOES THE US DOLLAR RISK LOSING ITS RESERVE STATUS?

The sharp depreciation in the US dollar (down 9% YTD at the time of this writing) has reignited fears that the administration’s aggressive tariff policy has structurally damaged investors’ confidence in the currency. To be fair, calls for the dollar’s demise as a reserve currency have been floating around for years—however, the US dollar still reigns supreme. Yet, news headlines continue to suggest that this time is different. We think these concerns are overstated, particularly as the US dollar still accounts for almost 60%⁷ of all global reserves. The weaker US dollar is not a crisis of confidence, but rather a recalibration of expectations amid significant trade and fiscal policy uncertainty. Souring sentiment, a correction from a highly overvalued state and shifting portfolio allocations have also been factors contributing to the move. However, we would not extrapolate the recent weakness as a signal that the US dollar’s reserve currency status is at risk. While there could be more reserve diversification—a slow-moving trend that has been in place for years—and a slow grind lower as its overvaluation unwinds, the US dollar is not likely to be replaced by another currency anytime soon. The dollar remains far too intertwined in the global financial markets for such a radical shift to occur in such a short time frame.

The weaker US dollar is not a crisis of confidence, but rather a recalibration of expectations amid significant trade and fiscal policy uncertainty.

CONCLUSION

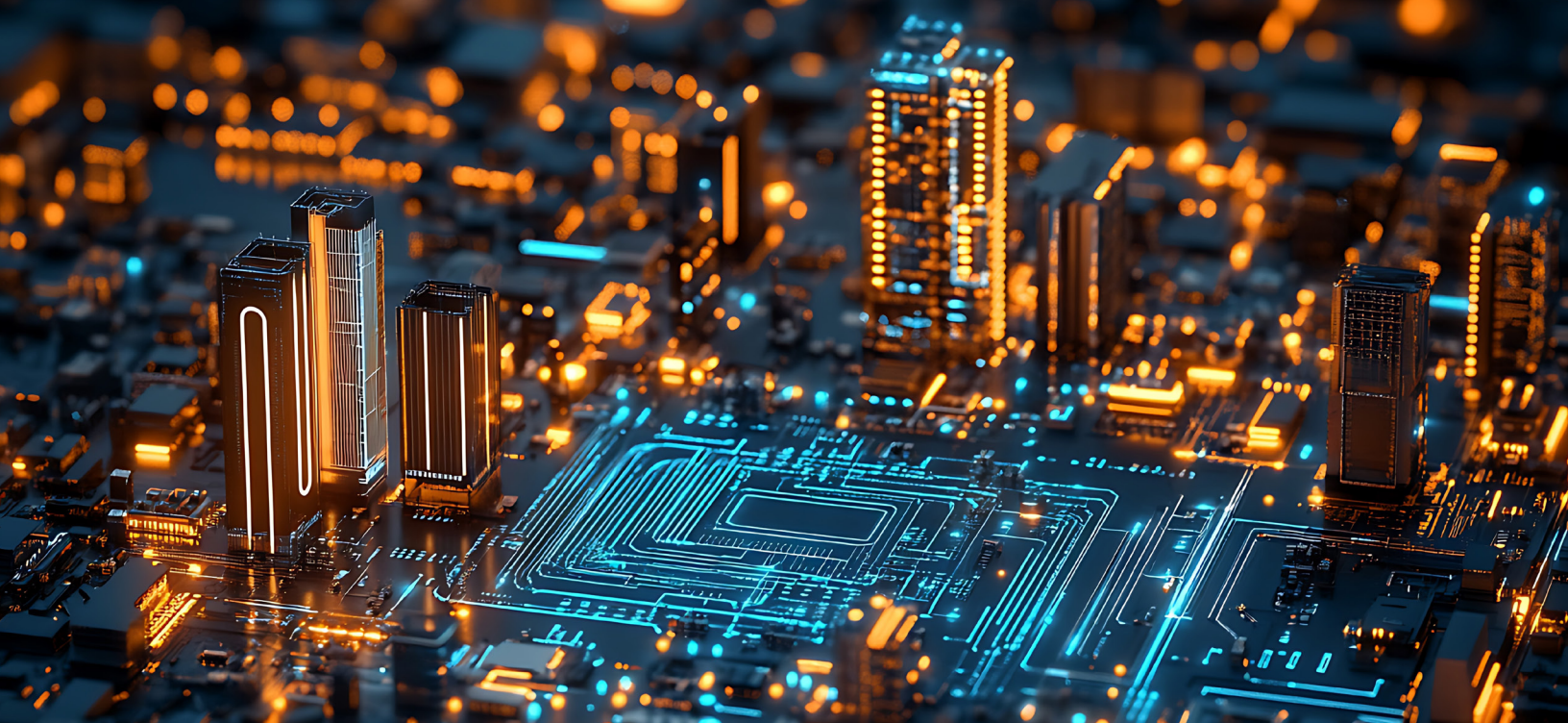
While the rapidly evolving trade landscape and concerns about the nation’s fiscal trajectory have caused some historic correlations to breakdown, we don’t think this is the start of a regime shift. Yes, heightened market stress caused some unusual price action during the April tariff tantrum, but we continue to believe that Treasuries will fulfill their role as a shock absorber if, and when, growth falters. Furthermore, we would not confuse cyclical fluctuations in the dollar with the loss of reserve currency status. While sentiment shifts can sway markets during shorter periods of time, the appeal and safe-haven status of the US is not something that will vanish overnight. Until there are viable alternatives, the Treasury market will remain the most dominant safe-haven bond market in the world and the dollar’s supremacy will remain intact. ▀

KEY TAKEAWAYS

- Despite recent volatility, the safe-haven status of the US remains intact.
- There has been no evidence of massive foreign selling of US Treasuries during the April tariff tantrum.
- There is no viable alternative to the US Treasury market or to the dollar as the world’s reserve currency.

¹⁰ <https://www.sifma.org/resources/research/statistics/us-treasury-securities-statistics/>

⁷ <https://www.cnbc.com/2025/05/30/could-the-euro-topple-the-us-dollar-as-the-worlds-reserve-currency.html>



Power Prices Propel US Data Center Buildout

Pavel Molchanov, *Investment Strategy Analyst*, Investment Strategy

What comes to mind when you think of artificial intelligence (AI)? Probably something to do with chatbots or microchips. Well, the AI megatrend is also about energy. The scale-up of AI requires the buildout of data center infrastructure. All data centers use hefty amounts of electricity, and those that serve AI applications are especially energy intensive. Compared to other major economies in Europe and Asia, the US has a structural cost advantage vis-à-vis data center operations. This goes a long way toward explaining why the US share of the world's data centers is nearly double the US share of global GDP. Supporting the data center buildout will require sustained investment in power generation and the electric grid, which means that the Utility and Industrials sectors are playing vital roles alongside the Tech sector.

THE US HAS NEARLY HALF OF THE WORLD'S DATA CENTERS

By way of background, there are 11,800 data centers around the world—a number that is continually increasing—and the US has more than 5,300, or 46%. China is a distant second, with around 600,

The AI megatrend is also about energy.

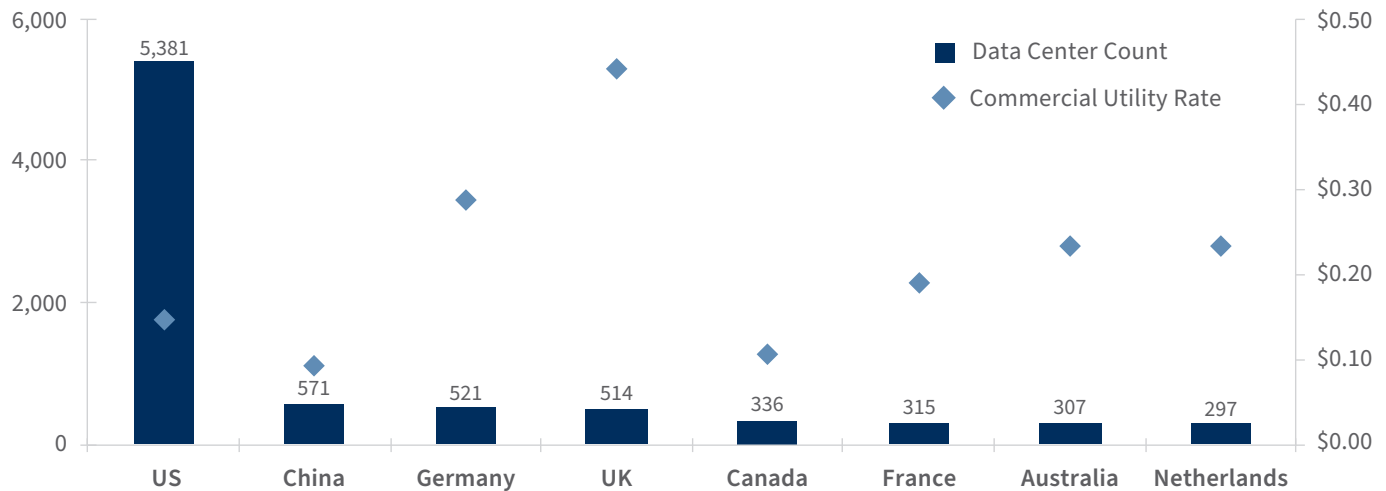
followed by 500 each in Germany and the UK. It is unsurprising that data centers tend to cluster around big cities, but you may be surprised to learn that California's Silicon Valley is nowhere near the top of the rankings. Northern Virginia is far and away the largest data center hub in the world, outpacing Beijing, China by around 50%.

HYPERSCALE DATA CENTERS USE AS MUCH ELECTRICITY AS A MID-SIZE CITY

The largest type of data center—what's known as hyperscale—can have peak demand of as much as 1,000 megawatts, which equates to the amount of electricity used by 700,000 homes in a city of 1.8 million people. Although the vast majority of data centers are smaller than that, hyperscale facilities will need to become more common for AI to become truly mainstream.

In many emerging markets, including China, electricity demand has been growing for decades, so the incremental demand from AI does not involve anything too needle moving. In the US, on the

Top Countries by Number of Data Centers, 2024



Source: Visual Capitalist, Global Petrol Prices, as of 6/13/2025

other hand, the electric power industry is coming out of a 20-year period with essentially flat demand, and therefore AI is a game changer. We anticipate that US electricity demand will grow more between 2024 and 2030 than during the previous quarter-century. While utilities naturally welcome this growth, there is no getting around the fact that massive, costly investments will need to be made in new power generation capacity. This will be an all-of-the-above story: natural gas in Virginia and the Southeast; wind in Texas and the Great Plains; solar in California and the Southwest; and nuclear, including small modular reactors, on a case-by-case basis (and with very long timetables for construction).

One point that is not always appreciated is how vital it is for data centers to have an extremely reliable power supply. None of us like it when the local grid has an outage, but the data center's business model is especially mission-critical and requires power to flow on a 24/7 basis. This points to the importance of modernizing the electric grid. For example, grid-scale power storage systems—batteries as well as non-battery technologies—need to become much more common than they are currently. In addition, utilities are taking advantage of sophisticated software to more effectively manage the flow of power along the grid.

COST OF ELECTRICITY IS KEY

As with many areas of tech innovation, Silicon Valley is leading in AI. California is well known as a fantastic place for R&D, but that does not translate into being an optimal site for operating data centers. The reason is that electricity is just too costly there... along with everything else, from cappuccinos to homes.

Virginia's power pricing, although by no means the cheapest in the US, is roughly half of California's.

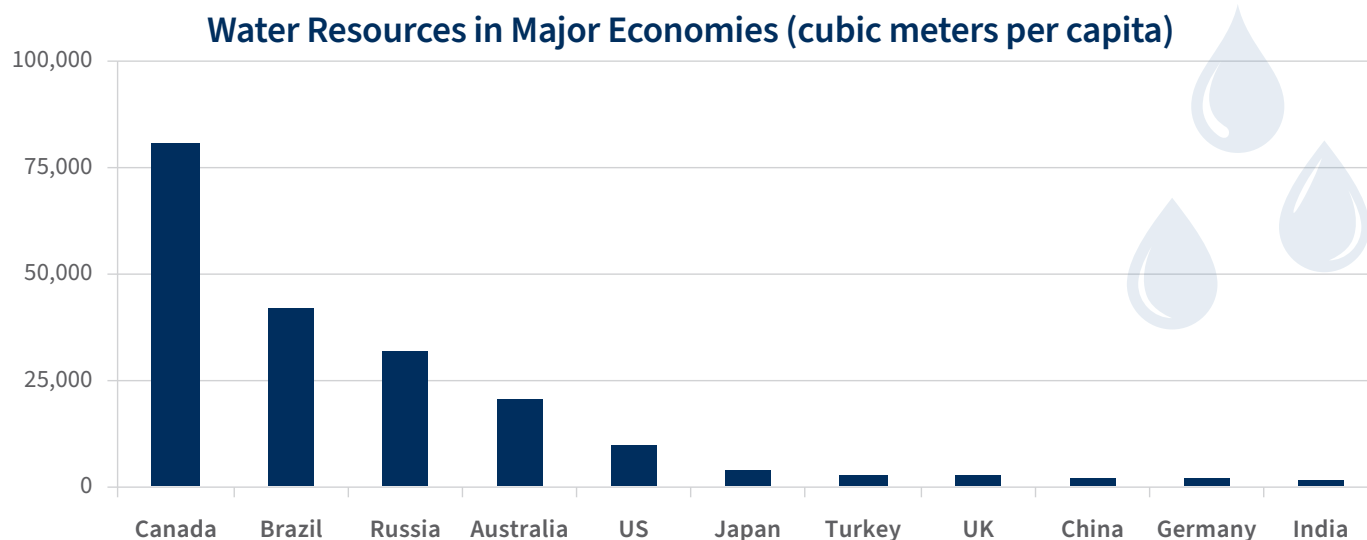
Well, imagine an entire continent with power prices averaging close to California levels—that is the situation in Europe. Italy is near the high end (commercial utility rate: \$0.46/kWh), Germany is better (\$0.29), and France is better still (\$0.19), but all of them are higher than the US national average of \$0.13. Interestingly enough, there are two European countries with cheaper power than the US—Norway (\$0.11) and Iceland (\$0.08), both of which are rich in clean, low-cost hydropower—and it will be interesting to see if they turn into data center hubs.

US Utility Rates, National Averages

"cents/kWh"

	Residential	Commercial	Industrial
Change, 2010-2021	+18%	+10%	+6%
2022 Change from prev. year	15.12 cents/kWh +11%	12.55 +12%	8.45 +18%
2023 Change from prev. year	15.98 cents/kWh +6%	12.74 +2%	8.06 -5%
2024 Change from prev. year	16.48 cents/kWh +3%	12.85 +1%	8.15 +1%

Source: https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=epmt_5_03



Source: China Water Risk, as of 6/13/2025

Unsurprisingly, Japan at \$0.21 is well above the US, reflecting its status as a densely populated island economy that needs to import nearly all of its energy resources. China is much better at \$0.09, though this reflects government subsidies to power companies, which makes numbers difficult to compare.

To be sure, US electricity prices are moving up—all of us as consumers are experiencing that in our utility bills—and the same is generally true around the world. After COVID-era inflation led to utility rate increases briefly reaching double digits, prices have regained a semblance of stability, but the trend is still heading higher.

WHAT ABOUT WATER?

The other natural resource that data centers require is large quantities is water. Precisely because data centers use so much energy, they emit heat, and water is needed for cooling. When it comes to water availability, there are significant differences around the world. Among the major economies, Canada and Brazil are by far the best, benefiting from low population density and prolific river systems. India is at the opposite end of the spectrum, not to mention the entire Middle East. The situation in Europe varies, with the Scandinavian region in good shape, whereas the Mediterranean countries are suffering from drought conditions that can be almost as difficult as in the Middle East.

The US is also a mixed bag: there is no near-term risk of water shortages in Virginia, but our readers in California and Texas need no reminders that their communities are facing water challenges. In contrast to power generation, which can always be expanded

(it just depends at what cost), the unfortunate reality is that water supply is limited by climate conditions and geology. In other words, economics is not everything.

BOTTOM LINE

The AI megatrend is a key reason for our overweight to the Tech sector. Alongside the big technology companies that are most commonly associated with this theme, the mainstreaming of AI also requires the buildout of data centers, which use vast amounts of electricity and water. While data centers are being built around the world, the US has some of the lowest power prices among the major economies, which provides a competitive advantage. The US has less of an advantage vis-à-vis water supply. Ultimately, AI presents a massive opportunity for the entire global economy, albeit with adoption curves that differ from country to country. ■

KEY TAKEAWAYS

- Hyperscale data centers, which are key enablers of AI, are examples of highly energy-intensive infrastructure.
- The US has nearly half of the world's data centers, with a particularly large concentration in Virginia.
- Lower-cost electricity gives the US an advantage in the data center buildout, but power prices are trending up, and we also need to keep an eye on water risks.



Q&A: Rumours of the Dollar's Demise are Exaggerated

Prof. Jeremy Batstone-Carr, *European Strategist*, Raymond James Investment Services Ltd.*

The first half of 2025 has proved a tough period for the dollar. A brief period of relative calm in early June was preceded by a sharp 10% depreciation in the trade-weighted DXY since January, one of the sharpest falls on record over so short a period. The drop is, however, by no means unprecedented; consider the summer of 2020 as the pandemic and associated lockdowns held sway. Most unusually, since the 2 April 'Liberation Day', the currency has disconnected from interest rate differentials, which typically serve to determine exchange rate levels in the near term and reflect shifting perceptions of the economic outlook, both for the US and elsewhere.

Q: The dollar has depreciated on the foreign exchanges. Should investors be concerned?

A: Firstly, the dollar's performance should be viewed not just over the past six months, but over a longer period. In fact, over the last 50 years, the dollar has suffered numerous

Despite numerous doom-laden headlines, conflating weakness with imminent loss of special status is inappropriate.

and sometimes rapid falls, including three major bear markets (in which the currency fell by over 25%). Secondly, what the weakness is not about is the loss of the much-cherished global reserve currency status. Despite numerous doom-laden headlines, conflating weakness with imminent loss of special status is inappropriate, in our view. The currency maintains a dominant position in short-term funding markets, trade invoicing, and foreign exchange transactions—the key plumbing in global finance. Efforts to develop alternatives to supplant the dollar's status are still a very long way from achieving the critical mass necessary to mount a serious challenge.

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Q: What about the dollar’s disconnect from both short-term interest rates and longer-term yield differentials? Isn’t it almost unprecedented?

A: Quite true. In fact, the currency’s weakness is more likely to be explained by a sharp reassessment of the near-term outlook for the economy and financial markets. If this is an emergent risk premium, whilst troubling, the US experience is far from unique; both sterling and the euro have recovered from recent—much more severe—crises over the past decade as government rhetoric and policy settings adjusted more constructively. The dollar has been on a weakening trend throughout the first half of 2025. The initial weakness was spurred by the DeepSeek headlines in January, which raised questions about US technology leadership in AI. Pressure on the dollar has intensified since early April, as the Trump administration’s tariff policy began to take shape.

Q: Can the dollar’s weakness be ascribed to fiscal policy uncertainty?

A: The fact that the dollar remains under pressure even as the risks surrounding trade uncertainty lessen hints at concerns regarding the fiscal policy outlook and prospects for the Treasury market. The main issue in terms of fiscal policy is all too familiar: continued large deficits and an unsustainable path for federal debt, resulting in an ever-increasing load of Treasury issuance. This risks a diminishing appetite from the private sector, including from overseas investors, to absorb the additional bonds flooding the market. This, in turn, adds upward pressure on Treasury yields through a higher term/risk premium, typically leading to pressure on the dollar.

More recently, attention has switched to a previously little-known provision in the legislative package working its way through Congress. Section 899, if enacted, would allow the administration scope to impose a new levy on the income foreign investors earn on their US assets. Particularly vulnerable would be those countries or regions where the US considers the tax regime of those investors’ home countries to be “unfair.” The legislation, as proposed, echoes the rationale for reciprocal trade tariffs and would, if it found its way onto the statute book, significantly reduce the attractiveness of US financial assets and the dollar for overseas investors. Taking prevailing uncertainty into the capital markets, as is threatened, would be unambiguously negative for the dollar.

The critical question surrounding the provision relates to whether it is aimed at raising additional revenue or to serve simply as a threat to generate more leverage in trade negotiations? Our assessment is that the provision will, ultimately, be either modified/diluted, or withdrawn completely to avoid what would surely be a sharply negative market pricing reaction. Even if the Trump administration might like a weaker dollar to boost US manufacturing, higher Treasury yields, as a consequence of reduced overseas investor participation, would be a serious deterrent. ■

Economic Snapshot

The ongoing economic slowdown, which will not be reflected when the 2Q GDP growth is released later this year, will complicate the market's interpretation of the state of the US economy and the Federal Reserve's (Fed) decision-making process for the rest of the year. Because GDP is measured on a seasonally adjusted basis compared to the previous quarter, the comparison will show a strong quarter-over-quarter performance, but year-over-year comparisons will show the true state of the economy, which will be on trend. Furthermore, although the tariff shock after the April 2 'Liberation Day' tariff announcement has yet to fully show in the inflation numbers, we continue to expect a spike in inflation during the second half of the year. However, the spike will probably be smaller than originally estimated due to the underlying weakness in economic activity as well as the still tight monetary policy stance from the Fed. The labor market has continued to weaken even if the headline employment number has remained relatively strong and the rate of unemployment has stayed in the low 4% range. However, most of the employment sectors have weakened considerably compared to last year's pace, while government employment has added to the weakening trend. On the investment side, we continue to expect strong investment flows from the lingering effects of the IRA and the CHIPS acts, while, at the same time, firms try to move investments to the US to reduce the impact of higher tariffs. However, we do not expect these decisions to generate lots of employment because we expect these investments to be in highly technologically advanced industries, which require more investment in machinery and equipment than in workers. On the fiscal side, we don't see much progress in reducing the fiscal deficits over the next several years, and this, together with recent geopolitical tensions, will keep the US dollar in a weaker but narrow band.

EUGENIO J. ALEMÁN, PhD
Chief Economist

	ECONOMIC INDICATOR	COMMENTARY
NEUTRAL	GROWTH	GDP growth will see a pronounced slowdown in Q3 but will remain in positive territory QoQ. This further supports a no-recession scenario for the US economy.
	EMPLOYMENT	The labor market has been cooling down, and we expect it to weaken further and stabilize around its long-term average.
	CONSUMER SPENDING	While consumer spending remains at healthy levels, it continues showing signs of deceleration compared to earlier quarters marked by tariff-driven, front-loaded spending. The slowdown is particularly pronounced among low-income earners, who are increasingly struggling with credit card debt.
	BUSINESS INVESTMENT	Higher policy uncertainty around tariffs and immigration has caused some businesses to delay or postpone major investment decisions. However, we believe this impact will be short-lived and contributions will remain positive to the economy in aggregate.
	MANUFACTURING	The manufacturing sector is on a favorable trajectory but remains in contractionary territory. We expect this trend to persist through the year, with a gradual shift into expansion in 2026 as interest rates begin to decline.
	MONETARY POLICY	The Fed started its easing cycle in September, and we expect it to cut rates 50 bps in 2025 and another 50 bps in 2026, taking the federal funds rate to 3.25-3.50% at the end of 2026.
	LONG-TERM INTEREST RATES	The deceleration in inflation, a cooling economy, and expected rate cuts will all likely contribute to lower long-term interest rates. However, rates will not go back to pre-pandemic levels.
	THE DOLLAR	Economic weakness and fiscal deficit fears have pushed the US dollar to an almost three-year low. However, its perceived role as a safe-haven currency during times of global instability should support the US dollar in the short term.
	REST OF THE WORLD	We continue to expect a relatively weak global economy in 2025 despite central banks worldwide turning more dovish.
UNFAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	High mortgage rates, rising construction costs, and new tariffs will keep this sector of the economy in the red. Meanwhile, the low supply of homes will continue to put pressure on prices and limit the number of potential home buyers.
	INFLATION	In the short term, we will see a reversal in the disinflation path as a result of base effects from the year prior. However, risks around tariffs imposed by the Trump administration have the potential to amplify this reversal. Regardless, we expect inflation to resume its disinflationary path through next year.
	FISCAL POLICY	With an expected increase in the fiscal deficit due to higher spending and lower taxes, and lower tax collections, the fiscal deficit debate will continue to keep the markets on edge.

Sector Snapshot

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate

a strategy customized to their preferences, needs, and goals.

These recommendations will be displayed as such:

Overweight: favored areas to look for ideas, as we expect relative outperformance

Equal Weight: expect in-line relative performance

Underweight: unattractive expectations relative to the other sectors; exposure might be needed for diversification

For a complete discussion of the sectors, please ask your financial advisor for a copy of *Portfolio Strategy: Sector Analysis*.

MIKE PAYNE
Investment Strategy Analyst

	SECTOR	S&P WEIGHT	COMMENTARY
OVERWEIGHT	HEALTH CARE	9.7%	The sector's NTM P/E of 17x is below the S&P 500 NTM P/E of 22x despite having superior earnings growth (15% Y/Y in 2025 vs. 9% for the S&P 500). There is no decision yet about the pharma tariff, but whenever it is unveiled, we expect a high degree of pass-through—thus, only mild effect on earnings. Additionally, the sector should benefit from long-term demographic trends (e.g., aging population). The sector's YTD underperformance reflects what we view as excessive market fears about pharma-related policy changes in Washington.
	INFORMATION TECHNOLOGY	32.3%	We maintain our Overweight stance on Technology as AI investment should continue to propel earnings going forward. AI-related capex is expected to remain strong through 2025, which supports first derivative beneficiaries (semiconductors), and monetization has begun to broaden into second derivative beneficiaries (cloud, software applications, and hardware devices). The sector is expected to have the strongest EPS growth (+20% Y/Y) in 2025, which justifies premium valuations in our view.
	INDUSTRIALS	8.7%	Reshoring of global supply chains as a result of recently announced tariffs, robust defense spending, and strong fixed investment in data centers driven by AI should outweigh cyclical headwinds enough to drive an earnings acceleration in 2H25. Despite strong performance YTD, valuations relative to the market remain within 1 standard deviation of the historical mean.
EQUAL WEIGHT	COMMUNICATION SERVICES	9.8%	The outperformance of Communication Services has been supported by relative earnings strength driven by robust digital ad spend and significant efficiency initiatives (e.g., cost cutting). The sector's 17% Y/Y EPS growth is second only to the Technology sector, which we view as better positioned to capture the initial earnings benefit from AI.
	FINANCIALS	14.0%	While fundamentals in the Financials sector are expected to improve Y/Y in 2025, driven by expectations for a resilient economy and a gradual recovery in investment banking activity within capital markets and banks, valuations have moved higher in anticipation (trading above 2x book value vs. the historical mean of 1.5x). An uncertain policy outlook has led to volatility in business and consumer sentiment which could challenge the anticipated recovery in capital markets activity and loan growth in the year ahead.
	CONSUMER DISCRETIONARY	10.4%	Softening consumer sentiment data as a result of tariff uncertainty has led to material YTD underperformance for the sector relative to the S&P 500. However, consumer sentiment data has begun to improve recently as easing trade tensions have removed the worst-case scenario from most economic outlooks. As the policy outlook clarifies, we expect consumer spending to regain strength and remain robust through 2025.

Sector Snapshot (cont.)

	SECTOR	S&P WEIGHT	COMMENTARY
EQUAL WEIGHT	CONSUMER STAPLES	5.7%	Dominated by defensive, lower-beta stocks, the Consumer Staples sector has minimal exposure to economic cyclicality, whether up or down. However, there are two headwinds—one temporary, the other long term—which lead to our neutral stance. The temporary headwind is input cost risk—and thus margin pressure—resulting from volatile commodity prices, as well as tariffs, on products such as cocoa, coffee, and aluminum. The more structural issue is an ongoing shift in consumer preferences away from packaged foods, a mainstay of this sector.
	UTILITIES	2.3%	AI-driven tailwinds and the electrification megatrend point to US power demand growing more between 2025 and 2030 than the previous 25 years. We are upgrading the sector to neutral with the growth curve on the cusp an inflection point. While balance sheets in the sector are highly leveraged with low interest coverage (driving high interest rate sensitivity), we anticipate that Treasury yields will be little changed toward our year-end target of 4.25%.
UNDERWEIGHT	ENERGY	3.1%	Weak growth in global oil demand, alongside the unwinding of OPEC+ production cuts and a near-record amount of new oilfields starting to produce, means that 2025 is tracking to be the fifth consecutive year of oil market oversupply. Escalation of the Israel-Iran conflict may lead to brief spikes in oil prices, but in fact, we envision downside toward \$65/bbl WTI by the end of 2025.
	REAL ESTATE	2.1%	Earnings trends are expected to remain weak relative to the broader index through 2025 with the sector expected to grow EPS by only 1% Y/Y in 2025 vs. 9% for the S&P 500. Consistent with our forecast for treasury yields to remain little changed toward our 4.25% target through year end, we don't see much room for outperformance without an economic growth scare that would bring rates materially lower.
	MATERIALS	1.9%	By definition, the Materials sector is highly commoditized, and it can be difficult for companies to pass higher costs (including tariffs) onto customers. While a few companies in the sector (notably steelmakers) benefit from tariffs, for most it is a headwind to profitability. We'd like to see greater clarity on the longer-term tariff landscape before closing our sector Underweight.

Disclosure

All expressions of opinion reflect the judgment of the authors and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

US government bonds and Treasury bills are guaranteed by the US government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. US government bonds are issued and guaranteed as to the

timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the US government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

Disclosure (cont.)

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

The indexes mentioned are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index

of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The MSCI China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region. The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Europe index is a European equity index which tracks the return of stocks within 15 European developed markets.

The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg US Treasury Index measures the performance of fixed-rate, nominal debt issued by the US Treasury and denominated in US dollars. It is a benchmark for the US Treasury market, excluding Treasury bills (which are covered by a separate index) and certain special issues according to Bloomberg.

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