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MARKET OVERVIEW JULY-AUGUST 2025

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LESSONS FROM THE FIRST SEMESTER OF 2025

Investors held their breath as tensions escalated between Israel and Iran and the United States' brief but intense involvement in the bombing campaign targeting Iranian nuclear facilities. Despite some upheavals in the oil markets (increased risks of traffic being blocked in the Strait of Hormuz), the markets remained rather phlegmatic, with Iran's supporters (primarily Russia and China) avoiding adding fuel to the fire. Ultimately, Donald Trump's desire to end this war as quickly as possible opened a fragile path for diplomacy and appeasement. Oil prices eased significantly.

THE WAR

The war between Israel and Iran obviously adds to the global geopolitical uncertainty that has continued to grow since Russia's intervention in Ukraine in 2022. We can cite, in no particular order, the regular tensions between China and Taiwan, the skirmishes last May between India and Pakistan - two nuclear powers - over Kashmir, not to mention the reshuffled cards in the violence in the Middle East since Israel's muscular and decisive interventions against Iran's allies in the region (overthrow of the Syrian Alawite regime, weakening of Hezbollah in Lebanon and war against Hamas responsible for the attacks of October 7, 2023). The Shiite arc between Tehran and the Mediterranean, via Iraq, has finally been broken, under the benevolent gaze of the Sunni monarchies of the Gulf. While this region of the world remains an impossible tangle of age-old struggles that are often incomprehensible to Westerners, investors are keeping their eyes fixed on the only issue whose vital importance for the global economy they understand: the Strait of Hormuz in the Persian Gulf, a narrow passage between Iran and the Arabian Peninsula through which 20% of the world's oil passes (barely a quarter of which could potentially be rerouted in the event of a blockage). Wouldn't the weakened Iranian theocratic regime be tempted, in the scenario of its overthrow–which is currently not guaranteed–to plunge the world into chaos by adopting a headlong rush strategy (blocking the Strait of Hormuz and damaging the oil infrastructure of US allies in the region)? For the **moment, there is no indication that Tehran has chosen this suicidal option, synonymous with a global economic crisis.** Iran's budgetary resources, essential for paying the salaries of its security forces, come approximately 30 to 35% from hydrocarbon exports. The Beijing government, which supports Iran, has itself clearly understood the threat, as China buys 90% of Iranian oil exports and 12% of its hydrocarbon consumption passes through the Strait. **China has no interest in destabilizing the Persian Gulf trade routes. We conclude that Tehran does not seem to have a free hand in its military choices. This is the message sent by oil prices, which have fallen by more than 15% since their recent peaks, with a clear easing in the hours following the ceasefire demanded by Donald Trump.** We note that Iranian oil infrastructure was not targeted by the strikes, so as not to force Tehran to escalate. In this explosive context, we note that Russia has remained measured in its diplomatic reactions to the US-Israeli intervention, given that the warming of relations between Washington and Moscow since Donald Trump's arrival in the White House is working rather in Russia's favor in the context of the conflict in Ukraine. Nevertheless, anti-Western authoritarian regimes can also recognize that democracies do not hesitate, when the situation demands it, to go to war by putting the means to it **. Donald Trump does not like war, he has often repeated this, but in cases of absolute necessity his hand does not tremble when the red lines he sets for himself are crossed. The completion of the Iranian military nuclear program is one of them.**

The major lesson of events in the Middle East is the confirmation that international relations have entered a long-term era of great disorder, synonymous with volatility for financial markets. The question today is no longer whether or not liberal democracies will have to manage high-intensity conflicts, but when. NATO is preparing for a confrontation with Russia, which is considered inevitable by 2030 without credible conventional deterrence. **For states, this era of confusion requires a considerable investment effort in military capabilities and in so-called security infrastructures on which defense largely depends** (cybersecurity, satellites, energy, transport, etc.), while other issues are still struggling to find funding (ecology, climate, health, etc.) in a generally very tight budgetary context. In the European Union (EU), the reindustrialization effort is no longer a political option driven primarily by sustainable development goals, but an absolute emergency within the framework of its strategic autonomy, while capacities remain constrained (the military industry is based primarily on a vast network of small, undercapitalized companies with production runs accustomed to small series), which inevitably disrupts the EU's ideological choices of the last twenty years. **The competitiveness compass presented by the Commission last January, inspired by Mario Draghi's report, and the**

" Readiness 2030" plan aimed at mobilizing 800 billion euros in defense (with priority given to equipment) are only the starting point of a salutary awakening of the Old Continent.

ECONOMIC AND FINANCIAL LESSONS FROM THE FIRST SEMESTER

From a macroeconomic and financial market perspective, several trends emerged during the first half of the year that will continue to influence investors' asset allocation choices. We summarize them below.

1) **In the context of the trade war and the challenge to the United States' development model** (exorbitant privilege of the dollar, aspiration of global savings, labor immigration, technological leadership, military reassurance of its allies), **we note the growing concerns of investors around American exceptionalism. Economists are unanimous: the United States will be the country most impacted by the increase in customs duties** (hypothesis of average tariffs around 15%, six times the level before the start of Donald Trump's second term, a record level since the 1930s). Households will obviously be the first victims. The consensus for economic growth in volume has thus been halved (+1.4% in 2025 and +1.6% in 2026 compared to +2.8% in 2024). The impact on growth in other regions of the world is more measured (global growth forecast at +2.7% in 2025 and +2.8% in 2026 compared to +3% last year). China's economic growth, less impacted by the increase in customs duties than expected (rare earths remain an effective negotiating lever), is favored by its competitiveness and the rerouting of its exports, particularly to Europe. The recovery in domestic consumption is more sluggish and benefits little from the fiscal stimulus.

2) In a context of a still very high US budget deficit (around 7% of GDP according to projections based on the *One Big Beautiful Bill Act* which will have little effect on growth, since for the most part it only extends the tax cuts decided during Donald Trump's first term), which fuels the debate on the sustainability of the trajectory of the federal debt, **we observe the beginning of a reallocation of global savings to the detriment of the United States** . The weakness of the dollar (desired by the White House), the uncertainties weighing on corporate investment decisions (new threat of taxation for non-resident investors with section 899 of the budget program which concerns foreign countries accused of unfair trade and tax practices), **the valuation gap between the New York Stock Exchange (very expensive) and the rest of the world (attractive risk premiums), as well as the earnings growth differential now more favorable for foreign indices (especially from 2026) argue for a more balanced geographic allocation of portfolios.** However, the American private sector remains solid, profit margins remain high and AI, in which the United States remains essential, represents a tremendous promise of productivity gains. The resilience of American equities (slightly positive performance in dollars since the beginning of the year) demonstrates that investors do not believe in the scenario of a US recession and remain measured in their change of geographic allocation.

3) **Global disinflation continues, accentuated by falling energy prices (excess global oil production) and Chinese overcapacity (deflationary pressures, production redirected to Europe).** While the Federal Reserve has adopted a pause in its process of lowering its key rates (inflation surge expected due to the trade war; however, two rate cuts expected before the end of the year in a context of stagflation), other central banks are continuing their monetary easing. The European Central Bank's (ECB) key rates are approaching the monetary neutrality zone, which means that the rate cutting process is probably close to its end (consensus for the deposit facility rate at 1.75% by the end of 2025, down 25 basis points). Inflation expectations remain well anchored; customs tariffs are seen as a short-term shock. It should be noted that long-term real interest rates (excluding inflation expectations) remain stable despite uncertainties: around 2% in dollars and 1% in euros on average, which is favorable to investors seeking income.

4) **Europe's political and strategic awakening, both on the part of the Commission and Germany (awareness of its fragilities and dependencies on the rest of the world), is reflected in new support programs (especially German) and a strong outperformance of European stock markets since the beginning of the year, undeniable winners of the rebalancing of investors' portfolios.** The considerable increase in military spending and investments in security infrastructure could bring 0.3% to 0.6% additional growth to European GDP by 2028, according to economists at Natixis (the estimate range depends on assumptions regarding the distribution between European production and imports of American equipment). In 2026, the rate of economic growth in the eurozone could be close to that of the United States. Europeans have somehow found their technology sector in terms of growth potential and stock market performance, namely the defense industry, which has outperformed US technology stocks since the beginning of the year and is now on par with AI stars in terms of valuation multiples. We are also seeing the revival of the European small-cap segment.

CONCLUSION

At present, nothing has been settled regarding customs tariffs. Negotiations between the EU and the United States are continuing ahead of the July 9 deadline, the end of the trade truce declared by Donald Trump shortly after his famous "Liberation Day" on reciprocal rights. **Faced with the numerous macroeconomic and geopolitical uncertainties that make forecasting difficult, we can only reiterate our advice on portfolio diversification, both in terms of asset classes and in terms of geography, sectors, and management styles.** A

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trend is emerging after a good fifteen years of outperformance by US stock markets, driven by technology stocks: investors are showing clear signs of a desire to revise their asset allocations in favor of the rest of the world, which today offers a more attractive expected risk/return ratio. This is not a default move, simply a consequence of the uncertainties induced by the White House's questioning of the United States' development model. The economic growth outlook for the rest of the world is now more favorable compared to that of the United States, especially when we look ahead to 2026, when Europe is taking a new strategic turn and the China/United States decoupling is becoming a credible scenario. The extreme concentration of major global indices in American assets and therefore in dollars argues for a rethinking of passive management. It is interesting to note that American investors are themselves debating these issues.

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