



Window on the World

JULY 2025



Just like that, the first six months of 2025 has passed. And what a six months it's been for investors, with a sharp drawdown in equity markets in March and April followed by an equally sharp rebound.

As of the end of June 2025, despite the uncertainty created by many of President Trump's policies and the war in the Middle East, many major global equity indices are at, or close to, all-time highs. This month's Window on the World looks back at the first half of 2025 before examining more closely US fiscal policy and debt sustainability.

Capital Market Returns June 2025

	Total Returns (%)			
	1 Month	3 Months	12 Months	YTD
UK Equities	0.0	3.2	11.2	9.5
US Equities	5.1	10.9	15.1	6.2
European Equities	-1.1	3.2	11.8	11.1
Japanese Equities	2.0	7.4	4.1	3.8
Emerging Market Equities	6.1	12.2	15.9	15.5
UK Gilts	1.6	2.0	1.2	2.5
UK Corporate Bonds	1.8	3.0	5.6	3.4
UK High Yield Bonds	1.0	2.4	10.6	4.4
US Corporate Bonds	1.8	1.8	6.9	4.2
US High Yield Bonds	1.9	3.6	10.2	4.5

Source: Bloomberg, Verso Investment Management, as of end June 2025

It's hard to think of a period in recent market history that has been so dominated by the policies and key events of one US President. President Trump and his policies have been the key drivers of market volatility, and since his inauguration in January, investors have focused on the US administration's efforts to reduce government expenditure (led by Elon Musk before his controversial departure in May), tariff and trade policy, and immigration. Tariffs have been unquestionably the over-riding driver for capital markets, initially generating significant volatility in April, before a backtrack enabled equity markets to recoup their losses and in most cases more. And right at the end of the first half of 2025, we saw President Trump moving to pass his 'One Big Beautiful Bill' – more on this later.

Outside of the US, and what we expect to be a key development in the years to come, is the decision by Germany's newly elected government to significantly increase fiscal spending on infrastructure and defence – this hike in defence spending has been driven by President Trump's intention to reduce US military support for Europe, and has led many other NATO countries to also increase their defence expenditure. Meanwhile, conflict in the Middle East between Israel and Iran erupted in June, which briefly added to geopolitical volatility, causing the oil price to spike upwards, although it quickly fell back. Intervention from the United States, which included the bombing of three key Iranian nuclear facilities, led to a fragile ceasefire by the end of June. However, the prospects for further military action from both sides remain a very live possibility.

A sharp sell-off in equities in March-April was followed by an equally sharp and powerful rebound in May-June



JUST A NORMAL DAY AT THE NATION'S MOST IMPORTANT FINANCIAL INSTITUTION...



Emerging markets have provided the best returns in the first six months of the year, led by Chinese and Korean equities. In the case of Korea, the rally has been driven by technology and semiconductor names, which has been a similar story in China (and Hong Kong-listed technology names). European equities have also recorded double-digit gains this year, propelled by growing optimism that the economic outlook for the region will continue to improve as Germany leads the way with higher fiscal spending on defence and infrastructure. Meanwhile, the low valuations and attractive dividend yields on UK equities have attracted investors, who have also performed well.

It has been harder going for US equities, which have lagged, and returns from US equities are negative once you account for the weakness in the US dollar. Currencies can have quite an impact on performance, and in the case of the dollar, the US administration's shift towards what is seen as a more protectionist approach may account for its weakness, as well as investors diversifying into regional markets – a process we undertook across our strategies during 2024. More recently, there has been renewed strength in the US large technology stocks – the Magnificent Seven – as investors return their focus towards the AI theme and its impact on businesses and economies.

In fixed income markets, yield curves have steepened – this means yields on shorter-dated Government bonds have declined, while yields on longer-dated Government bonds (those which mature in 10 or more years) have risen. This has meant that returns from shorter-dated bonds are positive for the year, which is where we are predominantly positioned, while longer-dated bonds have lagged. The shape of the yield curve is influenced by two key things, inflation and interest rates – so the recent steepening has been driven by a combination of interest rate cuts from Central Banks and likely fears of the inflationary impact from tariffs, and longer term, the size of government deficits, especially in the US. Meanwhile, credit spreads have remained tight, reflecting reduced concerns of economic growth slowing down, resulting in positive returns from this asset class.



Source: Bloomberg, Verso Investment Management, as of 4 June 2025. Graph shows the performance of US equities relative to long-dated US Government Bonds since the end of December 2024

One Big Beautiful Bill or One Big Scary Deficit?

The US administration looks set to pass into legislation the One Big Beautiful Bill Act in early July. This is a comprehensive legislative package put together by President Trump and touches many areas of US federal policy. It is expected to define many elements of his second term. It is vast in size (940 pages long!) and covers areas such as tax (including the extension of tax cuts he implemented in his first term), the welfare system (cuts to healthcare and food assistance), energy policy (dismantling policies put in place by his predecessor) and immigration (tighter border security, and greater deportation authority).

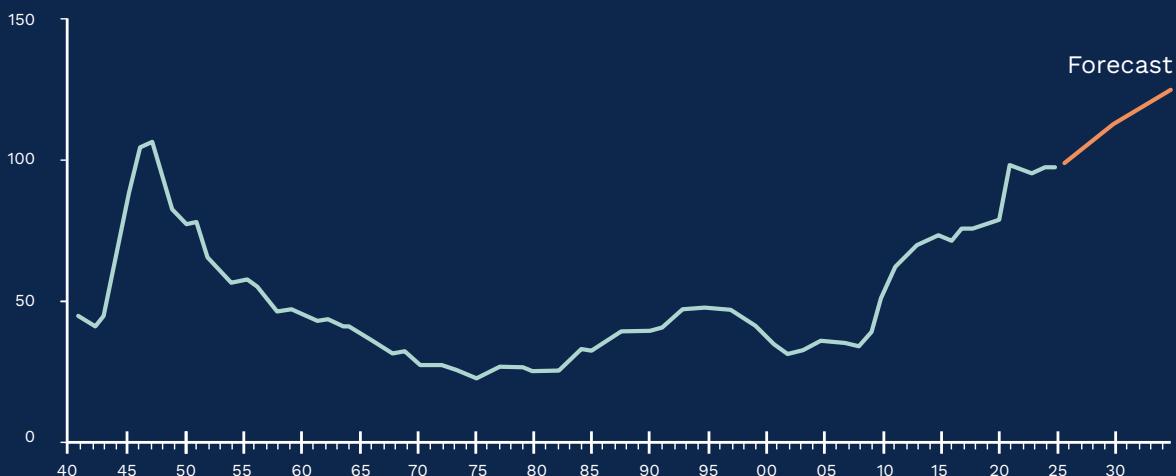
For investors, there are two areas to focus on – firstly, the implications for the US economy, particularly in the near-term, and secondly, what it means for the US deficit and outstanding US debt. The Bill itself is estimated to add up to \$4.0 trillion to the US's deficit over the next decade. For context, the size of the US economy was approximately \$27.7 trillion at the end of 2023.



For the economy, things such as tax cuts are likely to be supportive (starting in 2026) and will help to offset some of the slowdown in the economy resulting from higher tariffs. While the risk of a recession has faded, as a result of the new tariff policy, the US economy is likely to expand by just 1.5% in 2025, which is quite a drop from 2.8% in 2024. Fiscal support arising from this bill should provide some support for the economy from 2026 onwards.

However, the president's One Big Beautiful Bill will mean that the US economy continues to operate a high fiscal deficit, north of 6% and possibly reaching 7% annually in the years ahead. As a result, the US government will have to issue more bonds, further increasing its outstanding debt, taking it above levels seen during the second world war (chart below).

FIGURE 4: PUBLIC DEBT TO GDP
% OF GDP FORECASTS ARE FROM YALE BUDGET LAB AS OF JULY 1



Source: Yale Budget Lab, CBO, J.P. Morgan

As with any conventional lending/borrowing facility, as you take on more debt, your annual payments to service the debt grow. In addition, the cost of the debt fluctuates as interest rates change – higher interest rates mean higher interest costs – something which has become increasingly apparent to all borrowers as Central Banks moved to aggressively raise interest rates in 2022. Interest rates remain high today compared with much of the past decade, raising interest payment costs for borrowers as they remortgage or issue new debt. Governments are not immune to this, and the US government is now having to pay 4.3% annually to investors when issuing new 10-year bonds – up from 0.6% five years ago!

The relevance of this for the US economy is that interest payments the Treasury will make in 2026 will exceed \$1 trillion (more than 3% of the GDP). And this will continue to rise as the total amount of debt outstanding grows unless interest rates come down. So, it's not a surprise that President Trump continues to put pressure on the Chairman of the Federal Reserve to cut interest rates quickly and aggressively (or resign), but cutting interest rates is likely to fuel inflation, which central banks then have to combat by raising interest rates! So, until the final shape of tariff policy is clear, it's hard for the Federal Reserve to have a clear picture of where inflation is headed.

As debt “spirals” can become self-fulfilling, the state of a country's finances requires monitoring. As we experienced in the UK three years ago, there comes a point at which investors balk at continuing to provide capital to governments if they are concerned about their fiscal prudence and sustainability. Our base case does not reflect the US facing a fixed income crisis of its own in the near-term, but given the scale of its deficit and the increase in outstanding debt, it's a tail risk that we continue to monitor.

What some find beautiful, others may see as ugly.



Positioning and Outlook

With a backdrop of slowing but not contracting economic growth, declining interest rates, a US tariff policy that is likely to be somewhat more constrained than initially signalled, and fiscal support, there is broadly a constructive macro backdrop as we move into the second half of the year. Lower energy prices, assuming no disruptions to supply from the Middle East, will act to offset some of the upward pressure on inflation from higher tariffs. Near-term risks to this central scenario include weaker-than-expected economic activity arising from tariffs having a greater impact on the US economy than expected, long-dated bond yields rising further, increased geopolitical risks, and a shift back towards a more aggressive trade policy by the US.

We retain a preference for equities in the UK, Japan, Europe and emerging markets over the US, where valuations are more attractive, and in many cases where a positive catalyst exists to support regional outperformance. Valuations in the US remain at very high levels relative to history and may, of course, remain so if the economy remains resilient, but there is a clear risk here. Outside of equities, our fixed income exposure across portfolios remains centred on shorter-dated government bonds (conventional and index-linked) and high-quality investment-grade credit.



Rory Smith
Chief Investment Officer





versoim.com / info@versoim.com / 020 7380 3300

Verso Investment Management is a trading name of Verso Investment Management LLP (VIM)
Registered in England No. OC351100 at Cannon Place, 78 Cannon Street, London, EC4N 6HL
Authorised and regulated by the Financial Conduct Authority - 517235