



Capital Markets 3Q25 Update

Of lower taxes and higher debt: a modern tale of Beauty and the Beast

The passage of the "One Big Beautiful Bill" in early July delivered major fiscal stimulus, boosting near-term growth but raising long-term debt concerns. Investors are favoring short-duration Treasuries and investment-grade credit.

Global balance is the next smart move

Mega-cap tech continues to lead US equities, but valuations and concentration risks are prompting investors to diversify globally and by sector.

The return of the old economy in a new geopolitical era

Old economy sectors are resurging amid rising capital investment, rearmament, and policy-driven onshoring and energy production.

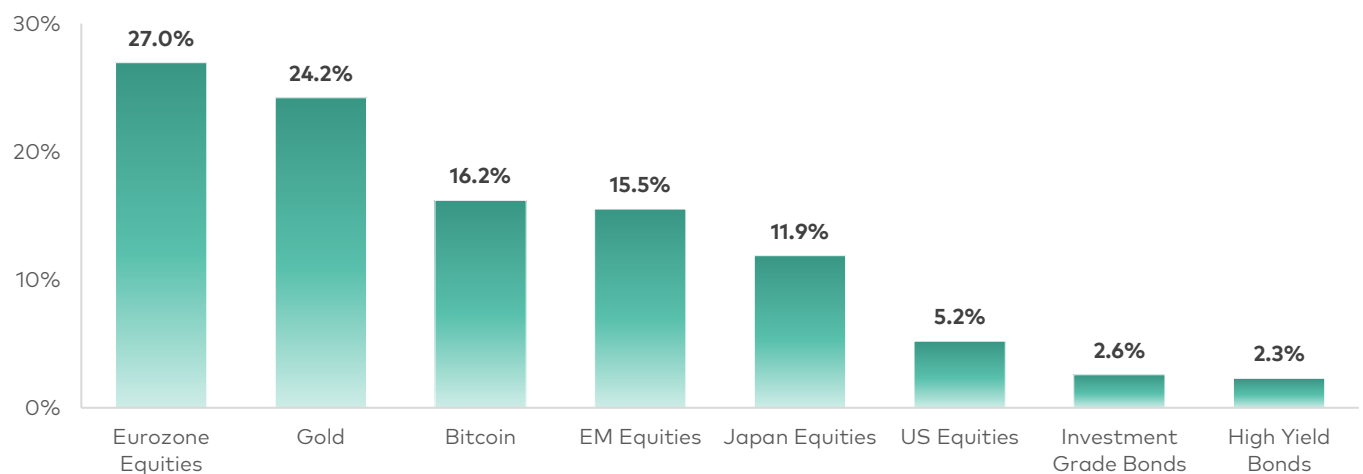
Late-cycle positioning: quality, income, and liquidity

Investors are favoring high-quality, dividend-paying, and low-volatility stocks, alongside gold, short-term bonds, and selective alternatives.

Summary

- Eurozone equities dethroned gold in 2Q25, delivering 27% return in all of 1H25.
- Bond markets offer attractive yields, but selectivity and short-duration focus are critical.
- US equities remain strong, but high valuations and fiscal concerns make global diversification increasingly important.
- Industrials and defense benefit from reindustrialization, global rearmament, and onshoring trends, making them strong cyclical opportunities.
- Defensive equity strategies - focused on quality, yield, and minimum volatility, are gaining traction as the cycle matures and risks rise.

Select asset class returns, 1H25



Source: Bloomberg

Eurozone Equities: iShares MSCI Eurozone ETF (EZU); Gold: SPDR Gold Trust (GLD); Bitcoin: BTC/USD; EM Equities: iShares MSCI Emerging Markets ETF (EEM); Japan Equities: iShares MSCI Japan ETF (EWJ); US Equities: Dow Jones US Total Market Index (DWCF); Investment Grade Bonds: iShares Investment Grade Corporate Bond ETF (LQD); High Yield Bonds: iShares High Yield Corporate Bond ETF (HYG)

Fixed Income

Fiscal indiscipline triggers return of bond vigilantes

In 3Q25, bond markets are reacting to a major fiscal shift. In July, US lawmakers passed the "One Big Beautiful Bill," a large tax-cut and spending package that avoided a debt ceiling crisis but is projected to add \$3.4 trillion to the national debt over 10 years. The bill includes permanent tax relief, larger tax breaks for business investments, and new spending, which could boost GDP by 0.5% in 2025. Despite the higher growth prospects, yields on US Treasuries remain elevated.

The driver is the surge in US Treasury supply. With deficits widening, the Treasury must issue huge volumes of debt. Non-partisan estimates show the US will be flooding the market with roughly US\$ 500bn in new Treasuries each week. At the same time, some traditional buyers are pulling back. BlackRock warned in July that foreign investors' appetite for Treasuries is waning, just as issuance is climbing. This imbalance is forcing prices down and yields up. The bond market's so-called "vigilantes" have reawakened: in early July, a selloff in Treasuries was attributed to investors demanding greater risk premiums for US debt. Bond vigilantes usually "punish" loose fiscal policy by making it costlier for governments to borrow.

Investment implications

With yields up, short-term bonds now offer c. 4%, with less interest-rate risk than long bonds. BlackRock is overweight short-term Treasuries and investment-grade credit, while avoiding longer-duration positions. For risk-tolerant investors, corporate credit looks attractive. Companies are in strong shape with low debt, and high-grade bonds can now deliver stock-like returns when held to maturity. But with tight credit spreads, focus on quality is key. The high-yield bond market is also stronger than in past cycles, with better-rated issuers and lower default risk. Still, with economic uncertainty, keeping some cash flexibility is wise.

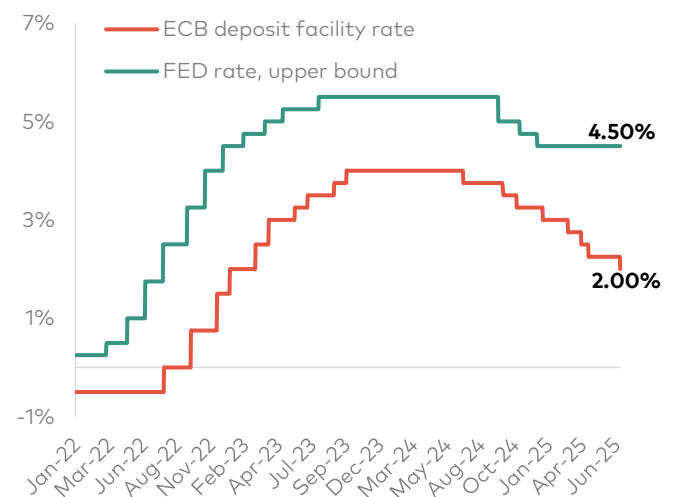
This environment favors locking in yields and adding inflation protection. Bonds are finally generating income again, but active management and selectivity matter more than ever.

US 10-year Treasury yield, %



Source: Bloomberg

Fed and ECB interest rates



Source: Fed, ECB

US Equities

Opportunities in disguise – global valuation gaps

US stock markets entered 3Q25 on a strong note. The S&P 500 hit a record high in early July. Since early 2024, US equities have returned about 30%, outpacing most major asset classes except gold. The rally has been driven by solid earnings, investor optimism, and growing expectations of Federal Reserve rate cut. Confidence has also been lifted by the new administration's tax cuts and deregulation. Big Tech stocks, especially in AI and cloud computing, have led the gains.

However, gains have been narrowly focused. A small group of mega-cap tech firms - the "Magnificent 7" accounts for most of the S&P 500's rise. The US now makes up over 70% of the MSCI World Index, a record high, raising concerns that investors may be overexposed to just a few companies. At the same time, international stocks look more attractive. Valuations (forward P/E) are lower: about 17x in Europe, 15x in Japan, and 14x in EM, compared to 25x in the US. Stimulus efforts in Europe, China, and Japan are picking up, and a weaker US dollar has made foreign investments more appealing.

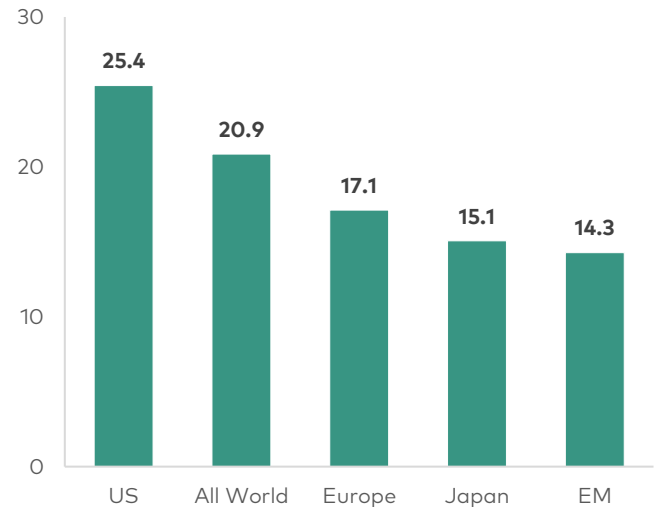
Investment implications

With the US market heavily tilted toward a few tech giants, investors may benefit from rebalancing their portfolios. Adding international exposure, through diversified global or regional funds, can reduce risk and tap into undervalued opportunities.

Foreign markets not only offer lower valuations but also exposure to sectors like industrials and banks, which are underrepresented in the US. A weaker dollar boosts returns on these investments. Diversifying globally doesn't mean abandoning US stocks, it means building a more balanced, resilient portfolio for the next phase of the cycle.

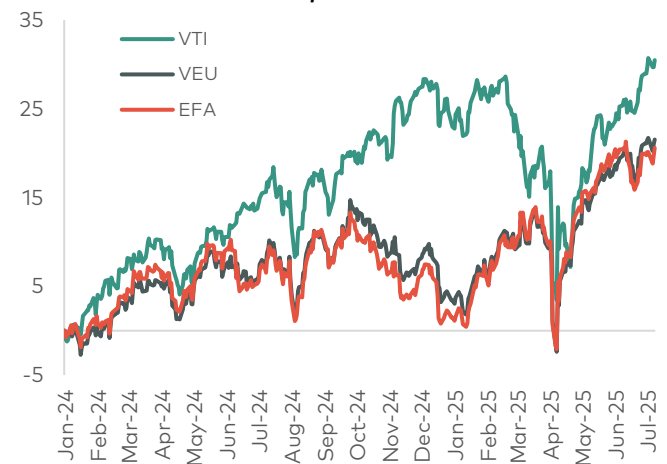
Investing globally comes with its own risks. Europe's economy has been sluggish, and it faces headwinds from higher energy costs and anemic manufacturing data. Emerging markets depend on China's trajectory, which remains uncertain as Chinese policymakers grapple with a property downturn and only a gradual recovery. Geopolitical tensions also hang over international markets. Thus, selectivity is crucial.

US Equity valuations vs. global peers (Forward P/E)



Source: Bloomberg

Total return of select ETFs, %



Source: Bloomberg

ETF	Description
Vanguard Total Stock Market ETF (VTI)	Broad exposure to the entire US stock market including large, mid, and small caps. Helps diversify away from mega-cap concentration.
Vanguard FTSE All-World ex-US ETF (VEU)	Provides access to developed and emerging markets outside the US, supporting the global diversification theme.
iShares MSCI EAFE ETF (EFA)	Gives exposure to developed international markets like Europe, Japan, and Australia—regions with lower valuations and policy support.

Industrials

Industrial Renaissance: the revival of old economy

A quiet shift is underway in markets: "old economy" sectors like industrials, energy, and materials are making a comeback. After years of tech dominance, investors are rediscovering the value of companies that build, supply, and power real-world systems. Defense spending is a key driver. The US military budget is projected at US\$ 950bn in 2025, its highest since the Cold War. Europe is moving aggressively too, with NATO allies raising defense spending targets to 3.5% of GDP, plus 1.5% for broader security. These trends are fueling strong gains for defense stocks. European defense shares are up nearly 49% YTD, and US giants like Lockheed Martin are also hitting new highs.

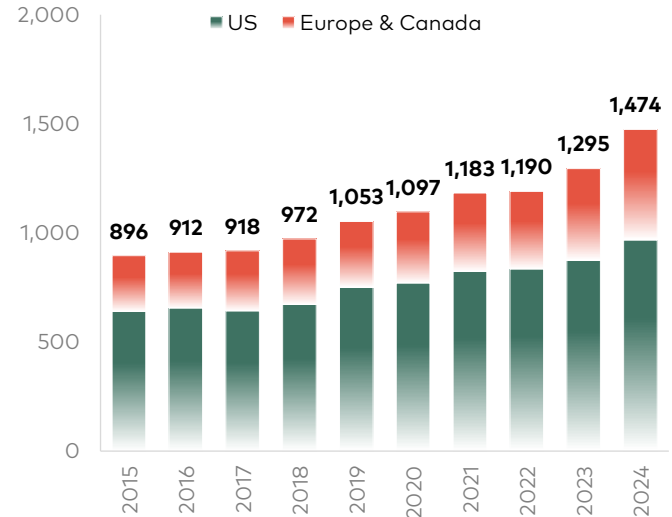
At the same time, infrastructure and onshoring are gaining momentum. Delayed funding from the 2021 infrastructure law and 2022's CHIPS Act is now flowing into projects. The current Congress is advancing new infrastructure proposals as well. Construction firms, heavy equipment makers, and engineering companies report rising demand.

A broader theme is the effort to reduce supply-chain reliance on geopolitical rivals. The US is incentivizing domestic manufacturing to ensure supply chain resilience. Likewise, Europe is pursuing supply-chain "friendshoring." Over time, this trend could benefit local industrial players. Goldman Sachs strategists specifically cite manufacturing and domestic-focused companies among top opportunities for 2025.

Investment implications

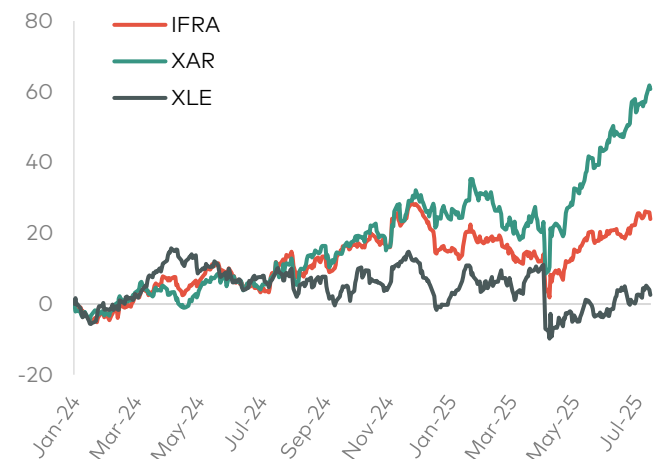
Rebalancing into "old economy" may boost portfolio diversification. ETFs focused on infrastructure or manufacturing can offer broad exposure. Focus on quality companies within these sectors - those with strong balance sheets and stable earnings. In defense, firms with long-term contracts are attractive. In energy, integrated oil majors provide both dividends and inflation protection. While cyclical sectors can be volatile, gradual allocation, dividend reinvestment, and diversification across themes - defense, infrastructure, and energy can help reduce risk. For investors looking beyond tech, the industrial revival is a trend worth watching.

NATO military spending, US\$ bn



Source: NATO

Total return of select ETFs, %



Source: Bloomberg

ETF	Description
iShares US Infrastructure ETF (IFRA)	Targets US infrastructure-related companies across construction, engineering, and materials.
SPDR S&P Aerospace & Defense ETF (XAR)	Provides exposure to US aerospace and defense firms benefiting from rising global security spending.
Energy Select Sector SPDR Fund (XLE)	Covers major US energy companies involved in oil, gas, and energy infrastructure.

Defensive Positioning

Late-cycle playbook: quality, dividends, and defense

As the economic cycle matures and uncertainty remains high, investors are shifting toward defensive strategies. Historically, late-cycle periods, marked by slower growth and tighter credit, reward quality and low-volatility stocks. That trend is repeating in 2025. After a shaky first half, income-generating stocks are back in focus.

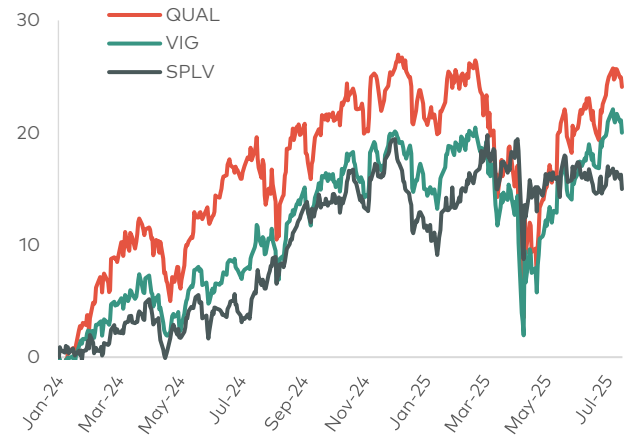
Dividends have become especially attractive. With interest rates high but unstable, dividends provide steady income. Outside the US, dividend yields in Europe and Asia average 3–5%, while the S&P 500 sits near 1.4%. Defensive sectors like utilities, healthcare, staples, and telecoms have outperformed, offering resilience during volatile months. REITs and energy pipeline firms, once hurt by rising rates, have also bounced back in 2Q25. Dividend growth remains strong, fueled by corporate cash from tax savings and solid earnings. These rising payouts offer inflation protection, preserving investor purchasing power. Importantly, many high-dividend stocks also qualify as quality stocks, with strong balance sheets and consistent profits. These firms have weathered input costs and wage pressures better than most.

Beyond dividends, quality and minimum volatility factors have outperformed. Investors favor stable companies as economic growth slows.

Investment implications

In this environment, investors may tilt toward quality and income. Focus on strong companies in stable sectors like healthcare, staples, and utilities. Investors should add minimum-volatility or dividend ETFs to smooth returns during swings. On the bond side, now is the time to lock in yields. Short-term Treasuries and investment-grade bonds are yielding around 4-5%. These safer fixed-income options complement dividend stocks and reduce overall risk. Alternative strategies like market-neutral or multi-strategy hedge funds can add uncorrelated returns. Gold, up sharply since early 2024, offers a hedge against inflation and geopolitical tension. The late-cycle playbook is about balance: investors should combine growth with defense, income with liquidity, and keep some cash ready.

Total return of select ETFs, %



Source: Bloomberg

ETF	Description
iShares MSCI USA Quality Factor ETF (QUAL)	Focuses on high-quality US companies with strong fundamentals like return on equity and earnings consistency.
Vanguard Dividend Appreciation ETF (VIG)	Tracks US companies with a record of growing dividends, offering steady income and financial strength.
Invesco S&P 500 Low Volatility ETF (SPLV)	Targets the least volatile stocks in the S&P 500, offering downside protection during market swings.

Forecasts for 2025 and beyond

Based on market expectations, by the end-2025, a 2-year US Treasury yield is expected to touch 3.70% (down from current 3.90%), while a 2-year German bund yield is expected to stay flat at around 1.80%-1.85%.

According to BlackRock Investment Institute, the outlook is neutral for Europe, Emerging Markets, the UK, and China, and slightly positive for US and Japan over the next 6 to 12 months.

Meanwhile, in terms of fixed income securities, BlackRock overweighs short-term US treasuries and short-term IG (investment grade) credit, while underweighting long-term US treasuries, Japan government bonds, and long-term IG credit.


































FIXED INCOME

Yield forecasts (%)



















	Last	3Q25F	4Q25F	1Q26F	2Q26F
US treasuries					
30-year	4.99	4.81	4.70	4.64	4.63
10-year	4.44	4.36	4.29	4.22	4.20
5-year	3.98	3.97	3.91	3.84	3.82
2-year	3.90	3.83	3.70	3.59	3.56
SOFR	4.33	4.14	3.92	3.69	3.50
German bunds					
10-year	2.66	2.56	2.62	2.68	2.73
2-year	1.85	1.83	1.82	1.87	1.92
EURIBOR	2.02	1.84	1.83	1.84	1.87



Source: Bloomberg

6-12 month outlook

Fixed income	Outlook		
Short US treasuries			
Long US treasuries			
Global inflation-linked bonds			
Euro area govt. bonds			
UK Gilts			
Japan govt. bonds			
China govt. bonds			
Short-term IG credit			
Long-term IG credit			
Global HY			
Asia credit			

Source: BlackRock Investment Institute

Equities	ETF	Outlook		
US	SPY			
Japan	EWJ			
China	MCHI			
UK	EWU			
Emerging Markets	EEM			
Europe	IEUR			

 Positive  Neutral  Negative

Source: BlackRock Investment Institute

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