

MONTHLY Market Update

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American Exceptionalism Lives To See Another Day

Over the past month, we have seen a continuation of the impressive equity rebound off early April lows. Economic growth is beginning to slow but is reopening the window for Federal Reserve rate cuts starting at their September 17 meeting and continuing into 2026 should inflation resume its journey toward the Fed's 2% target as we anticipate. We expect equity markets to continue their march higher and interest rates to remain range bound.

Currency markets acted uncharacteristically in the aftermath of the April 2 Liberation Day tariff announcements. The U.S. dollar – usually a “safe haven” currency attracting inflows during periods of economic disruption and financial instability – found itself on a downward trend, ultimately falling 7% at its subsequent low. A narrative quickly emerged that “American exceptionalism” – the idea that the U.S. was unique among its peers for reasons historical, political and economic – was dead and that U.S. financial markets would suffer as a result. If this narrative held, it would shake the foundations of the global financial order in place since the Bretton Woods agreement in 1944, which effectively established the dollar as the world's reserve currency. Luckily, it appears the narrative is fading as global investors have (re)appreciated the fact that – at least for the foreseeable future – U.S. financial markets are the most liquid and deepest in the world, with effectively zero replacements at this time. This realization extended to U.S. stocks, where investors regained appreciation for America's world-class companies, notably in the economically and politically vital technology sector. U.S. equity markets (S&P 500)¹ have bounced 30% from their 2025 lows – with the technology sector up an impressive 54% – while the dollar has stabilized as well.

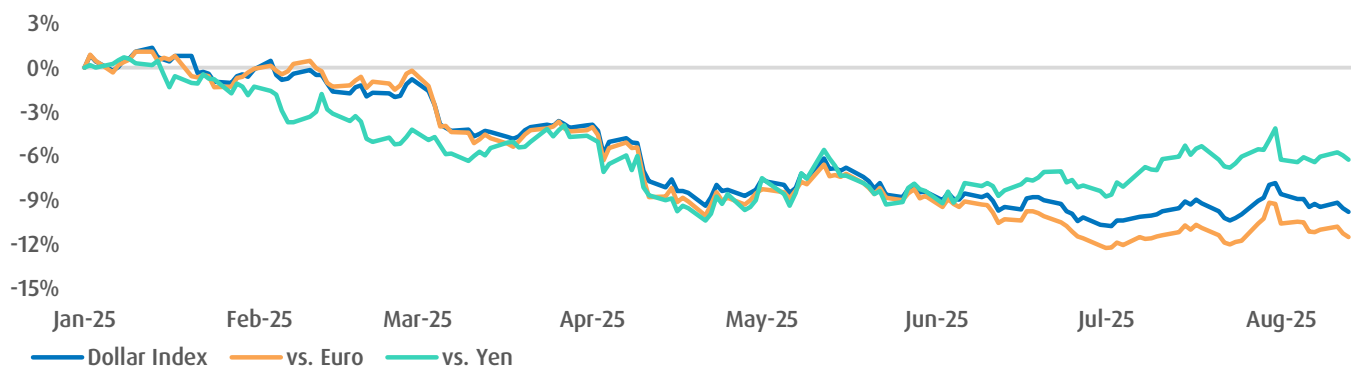
Now that the S&P 500 has moved well into positive territory year-to-date, where do we go from here? We believe the path of least resistance is higher. Momentum can be a powerful thing, especially when aided by a Federal Reserve that we believe is on the verge of rate cuts and a once-in-a-century technological transformation in the form of Artificial Intelligence (AI) – which should both boost top-line growth for AI-related companies and, over time, bottom-line growth for a broad swath of companies able to incorporate AI to increase productivity and lower costs.

At our asset allocation meetings this month we maintained our overweight to equities – biased toward U.S. equities, which we believe can eat into their 12% year-to-date underperformance vs. international developed equities (using S&P 500 and MSCI EAFE indices²) – with 9% of that lag owing to the dollar's decline. We also reiterate our conviction in our opportunistic allocations – specifically: infrastructure (benefitting from reshoring and AI themes); reinsurance (a diversifier with solid returns); and China equities (aided by constructive U.S.-China trade negotiations).

Betting your dollar bottom(ed)

After being pushed down by concerns over the death of American exceptionalism, the dollar has stabilized more recently.

Year-to-date Dollar Performance



Source: BMO Wealth Management, Bloomberg L.P. Data through 8/15/2025.

¹S&P 500 and Information technology sector returns from 4/8/2025 through 8/14/2025; ² YTD performance through 8/15/2025

Macro Outlook

Growth

Investor perceptions of U.S. economic growth took a big hit with the release of the most recent jobs report. Jobs added in July came in at just 77 thousand – 31 thousand less than expected – and, more detrimentally, the past two months were revised significantly downward by a total of 258 thousand. All said, these lost jobs (shown in the chart in light blue) changed the economic narrative from full steam ahead to looking a little gassed. And while second quarter GDP grew at a solid 3%, consumption grew at a less impressive 1.4%.

Economic growth will likely slow as job growth moderates (with companies slowing hiring as tariffs come into effect) and consumer spending eases (with credit card delinquencies recently rising to 3% from a cyclical low of 1.5%)³. Though we expect the economy can avoid recession as construction continues – notably in AI-related data centers – driven by lingering fiscal stimulus from Biden-era spending bills, the recent 100% expensing of capital investments included in the recently passed tax bill and a Fed on the cusp of rate cuts.

Inflation

Inflation's long journey from the peaks of the post-Covid period back to the Federal Reserve's 2% target has hit a roadblock. After reaching a cyclical low of 2.6% in April and showing a 3-month annualized figure of just under 2% in May, the June report topped expectations and reversed the 3-month annualized data series' encouraging trendline. The inflationary path from here will be dictated by the tug of war between the economic growth slowdown and the impact recently increased tariffs have on consumer goods.

We expect the growth slowdown to overcome any tariff impact. To provide some math, goods make up ~30% of the consumption basket and, of that, only ~30% of goods are imported – meaning only ~10% of consumer purchases are directly impacted by goods inflation. Some of that tariff impact will be eaten by exporters and retailers. Relief will also come via lower oil prices, deregulation and potential reversal in some of the dollar's recent decline. Finally, the quicker-than-expected application of AI should serve as a deflationary force.

Monetary policy

Just as investor hopes for Fed rate cuts this year were on the ropes – tired out by stubbornly elevated inflation data and receiving a blow from Fed Chair Jerome Powell's hawkish press conference after the 7/30 Fed meeting – the disappointing jobs report (see growth section above) gave them new life. Markets are now pricing in a September rate cut as a near-certainty. Generally, the Fed likes to telegraph its intentions to the markets – and Chair Powell will get that chance at the upcoming annual Fed retreat to Jackson Hole on August 21-23.

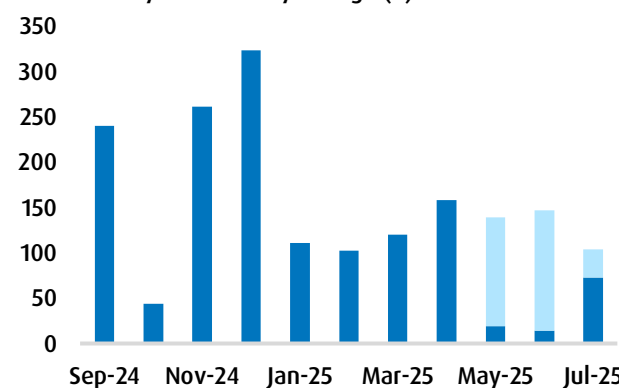
Inflation data that resumes its path toward the Fed's 2% target – as we expect – will bolster the case for rate cuts. Last Fed meeting, there were two dissents to the decision to leave rates as is – suggesting there is appetite amongst Fed voting members to begin the rate-cutting process. The primary risk to an otherwise constructive monetary policy backdrop is if the markets view rate cuts to be politically influenced. President Donald Trump has made no secret that he wants rates lower – and markets won't like it if rate cuts seem forced.

³Credit card delinquency data as of 3/31/2025 (Bloomberg).

Not so fast!

Downward revisions to the jobs data suggests a slower economy.

Non-Farm Payrolls Monthly Change (K)

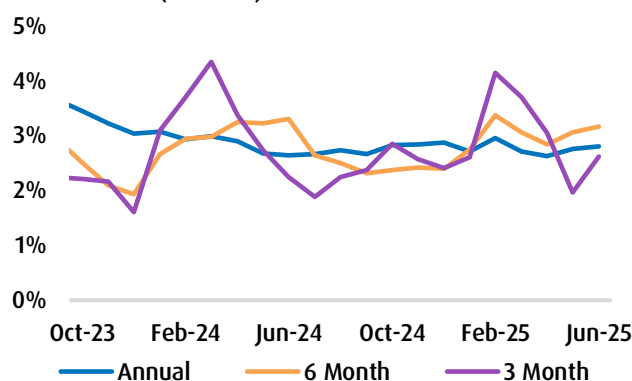


Source: BMO Wealth Management, Bloomberg L.P. Data through July 2025.

Lost progress

Inflation's progress towards its 2% target has been halted.

Core Inflation (Core PCE)

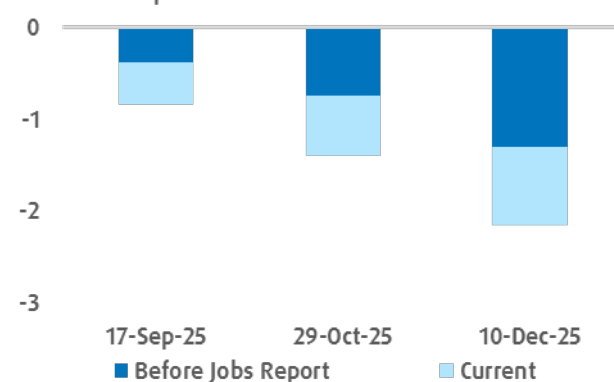


Source: BMO Wealth Management, Bloomberg L.P. Data through June 2025. 6-Month and 3-Month data series are annualized.

Doubling down

Post-jobs report, rate cut expectations effectively doubled.

Number of Expected 0.25% Fed Rate Cuts



Source: BMO Wealth Management, Bloomberg L.P. Dates indicate upcoming Federal Open Market Committee meetings. Current as of 8/15/2025.

Market Outlook

Fixed income

Interest rate volatility has been slowly returning to normal after spiking in reaction to the Liberation Day tariff announcement – calming concerns that U.S. protectionism and debt levels would cost the dollar its reserve currency status and unanchor U.S. interest rates. Instead, the 10-year U.S. Treasury yield is in the middle of its recent 4.2%-to-4.5% channel, responding to the weak jobs report. Meanwhile, concerns that post-debt-ceiling Treasury issuance (refilling reserves) would suck up market liquidity have been reduced – ironically – by tariff revenues.

With the Fed arguably late to the rate-cutting game, the back end of the yield curve should stay contained (as opposed to moving higher if the markets believed the Fed was inappropriately cutting) – with the caveat being if the markets believe rate cuts are politically motivated (see monetary policy section above). We expect the 10-year U.S. Treasury yield (currently at 4.32%) to remain in its recent range. However, we maintain a modest underweight tactical position to fixed income as we ride the ongoing momentum in equity markets.

Equities

With earnings season wrapping up, the S&P 500 has posted earnings growth of 11.3% – an 8.3% surprise over the 3.0% growth expected from those companies that have reported thus far. Driving the earnings surprises were the financials and technology sectors. The key theme has been the power of AI – currently as a revenue producer for the big tech companies, but likely to be a productivity booster more broadly. This rapid penetration is impressive for a technology commercialized less than three years ago (i.e., ChatGPT in November 2022).

We continue to favor U.S. equities. U.S. equity valuations are well above those of equity markets abroad – with U.S. equities (S&P 500) sporting a 24.1 price-to-earnings ratio as compared to 16.3 for international developed equities (MSCI EAFE) and 14.1 for emerging market equities (MSCI EM). But the valuation premium is well deserved given greater profitability and the large exposure to the fast-growing tech sector (34% of the index). Catalysts for U.S. equity outperformance over international markets include a rate-cutting Fed and a stabilized dollar.

Opportunistic

Infrastructure stocks – with a 14% year-to-date return (as measured by the Indxx U.S. Infrastructure Development Index) vs. 10.0% for broad U.S. equities (as measured by the Russell 3000) – continue to benefit the portfolio. Manufacturing construction spend had recently faded (see chart) as the tailwind from Biden-era stimulus programs ran into the headwind of tariff uncertainty and a Fed on hold. But both of these headwinds should abate as trade deals reduce tariff uncertainty and a slowing labor market puts Fed rate cuts back in play. As we wait for the manufacturing restart, support remains from mega projects – including LNG terminals, pharmaceutical plants and data centers – which never slowed. All said, we retain our infrastructure allocation, which continues to benefit from AI and reshoring themes.

We also reiterate our conviction in our reinsurance and Chinese equities allocations. Reinsurance continues to provide solid returns uncorrelated to the rest of the portfolio, while China equities have benefitted from an economic cyclical upturn and constructive U.S. trade negotiations.

Back to boring?

After spiking in April, interest rate volatility has returned to normal.

Interest Rate Implied Volatility

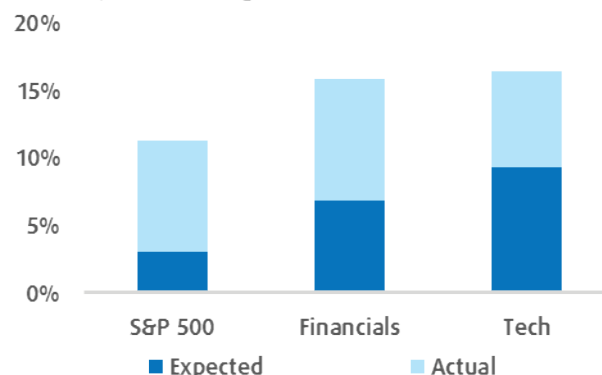


Source: BMO Wealth Management, Bloomberg L.P. Data through 8/14/2025.

Earnings strength

S&P 500 earnings have been powered by banks and technology.

Second Quarter Earnings Results

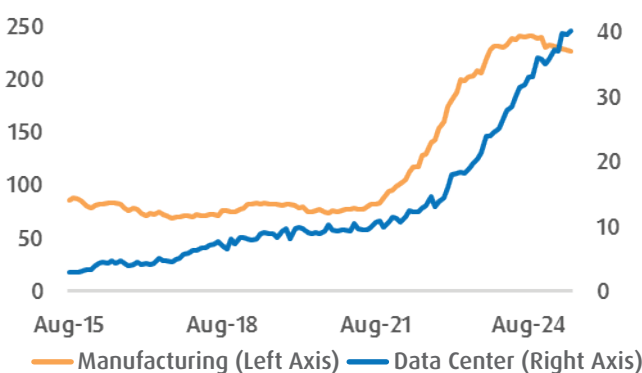


Source: BMO Wealth Management, Bloomberg L.P. Data as of 8/15/2025. 459 companies reported.

Construction renaissance

Manufacturing and data center construction have both ramped.

US Construction Spending (\$B)



Source: BMO Wealth Management, Bloomberg L.P. Data through 6/30/2025.

Scenarios

DOWNSIDE RISK CASE: Tariff-Fueled Inflation	BASE CASE: Moderating expansion	UPSIDE RISK CASE: AI-Fueled Gains
<i>20% Probability</i>	<i>60% Probability</i>	<i>20% Probability</i>
The new round of tariff pricing pressures and immigration curtailment pushes inflation higher and pressures the consumer, leading to a modestly stagflationary environment with a Fed unable (or unwilling) to cut rates.	The economic expansion continues but growth starts to moderate as the impact of tariffs are felt with the labor market softening and the consumer modestly pulling back. The Fed resumes cutting rates toward the end of the year.	AI deployment continues to expand, fueling continued gains across AI-associated companies with broader economic benefits from increased productivity, helping to alleviate inflation and allowing for additional Fed rate cuts.

Index Definitions

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

S&P 500® Index is an unmanaged index of large-cap common stocks.

MSCI EAFE Index (NDDUEAFE) (Developed Markets) - MSCI EAFE Index Europe, Australasia, and Far East Index (EAFE) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International.

MSCI Emerging Markets Index (NDUEEGF) is a market capitalization weighted index representative of the market structure of the emerging markets in Europe, Latin America, Africa, Middle East and Asia.

Indxx U.S. Infrastructure Development Index is designed to measure the performance of U.S. listed companies that provide exposure to domestic infrastructure development, including companies involved in construction and materials, composites and products, industrial transportation and producers/distributors of heavy construction equipment.

The Russell 3000® Index measures the performance of the largest 3,000 US companies designed to represent approximately 98% of the investable US equity market.

Data is as of 8/15 unless otherwise specified.



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