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Beyond the Portfolio - Mid-Year Market Reset with Brent Joyce and Carol Schleif

Michael Miranda:

Welcome to Beyond the Portfolio. I'm Mike Miranda, head of investments for BMO Private Wealth North America. In each episode, we'll bring you expert analysis from BMO's top strategists and economists to help you navigate market conditions and stay informed.

Today, I'm thrilled to kick off our very first episode with two of the senior leaders from BMO's North American Strategy team. We're recording this on Tuesday, June 17th, and I'm joined by Carol Schleif, chief market strategist for BMO Private Wealth, and Brent Joyce, chief investment strategist for BMO Private Wealth. Carol, Brent, great to have you both here.

Brent Joyce:

Thanks, Mike. Excited to be on the inaugural edition.

Carol Schleif:

Thanks for having us, Mike. Glad to be here.

Michael Miranda:

Well, as we see here in mid-June, markets have already given investors a lot to digest. As we all remember, stocks were down meaningfully at one point earlier this year, but we've seen a strong rebound, with most major indices now in positive territory. In fact, many markets outside the US are significantly higher to date. Look at something like the MSCI World ex USA and it's up over 15% year to date. We've also seen sharp swings in bond yields and meaningful movement in currencies, particularly around the US dollar, all of which has kept investors on their toes.

Today's conversation is a chance to reflect on what's driven these moves, but more importantly to look ahead. What can we expect for the second half of 2025? And how are we thinking about the path into 2026? So let's dive in.

Brent, let me start with you. As we look back on the first half of 2025, what developments in equities, fixed income, or currencies most surprised you? And how did those surprises challenge or reinforce our investment framework?

Brent Joyce:

Thanks, Mike. Three questions in there, I think. We can cover each of them, equities, bonds, and currencies. Let's start with equities.

You asked me what surprised me, I'll say what didn't surprise me first is the sharp reaction to the April 2nd policy announcements on tariffs. The market quickly looked at those and felt that they would cause a slowdown significant enough that we would term it a recession. And we had the equity market move very swiftly to price in what you would expect from a recession, sharp contraction in earnings, and that was reflected by the downdraft.

The recovery though, was just as quick as the policy choices were scaled back, and that is also to be expected. But what did surprise me from that, I would say, is the extent of the rally, how quickly that it recovered, and then continued on as we moved through the back half of April, all of May, and as you mentioned, now into June.

And really, the surprising part I think is the willingness of market participants to look past the uncertainty and the short-term hiccups because we're not out of the woods yet with the uncertainty. We're in pauses and delays and deals. And certainly, there's been other factors, uncertainty brought into the equation with Israel, Iran and other issues. And yet this market so, we used to call the Teflon market, things bouncing off of it. And that resilience, I think is surprising.

What it did for me, you asked how did it challenge or reinforce my investment framework, what it did for me was it reinforces this resiliency that we can get back on track if we can bottle up and compartmentalize some of these uncertainties, and tariffs being the large one? And on track is back to what was expected in January and February when markets were making all-time highs, on track is a good place to be. The global economy, the US economy was heading in a decent shape into 2025 by all accounts, and we've just had a bit of a shock here in the middle of the year.

When we think about fixed income, the pleasant surprise from the bond market was there's a lot of feedback loops that are built into, codified into the US system, checks and balances that we're all familiar with, judiciary and Congress, etc, public opinion. One that has really shown its mettle as a feedback loop that's not written in any constitution is the bond market. And I think it was a pleasant surprise that the reaction to tariff policy, the One Big Beautiful Bill that's working its way through Congress at the moment, is that you didn't have to have a really loud screaming signal from the bond market in order to force some change. The feedback loop, you look at 30-year US government bonds, they went up by less than 1%, swiftly, mind you. So the feedback was quick, but it certainly caused policymakers' heads to turn. Some folks heads to roll, names we know aren't around the White House any longer.

And that really reinforced my belief that the bond market is the most powerful feedback loop. Policymakers clearly noticed, they recalibrated. But it's also good that bond yields responded to the recalibration positively, retreating when policies did shift and they did pivot.

And then lastly, you asked about anything on this currency front. This one maybe is the most surprising and certainly did sort of challenge a bit of my conventional thinking. US dollar weakness, the safe haven not being there in April with the debt downgrade. The last rating agency to downgrade wasn't really a huge surprise. But for the US dollar not to be a safe haven, that's a very rare occurrence.

It did challenge my sort of investment framework because that's been a very reliable relationship, even when the source of the uncertainty, like it was in April, is internal to the US itself. If you think back to the first debt downgrade, the US dollar was actually resilient and strong in the face of that and fairly confusing to some folks. But it really, in the end, was a positive in that it helped to reinforce that message that was coming from the bond market.

What hasn't changed my view is that the US dollar remains a safe haven. And we certainly saw that with the Israel-Iran flare-up, war I guess we can call it now. And the US dollar did strengthen on the initial outbreak of that. And it's been wobbling to and fro on the headlines negative, positive and the reaction as being expected from the US dollar.

Michael Miranda:

Thanks, Brent. Really appreciated those points on what's driven the market over the first six months. I particularly enjoyed your thoughts there on the bond market and how important it is here as a feedback loop. Many probably know that we've been looking for the US 10-year to be in this four and 1/4 to four and 3/4 range all year. And even amidst those moves you noted, we sit here today at 4.4% as the market continues to digest those offsetting forces that you talked about, slower growth, Fed cuts on one side, offset by inflation concerns from tariffs, and the impact of some of those continued higher deficits and that large US debt balance.

We remain believers that this range makes sense and as we'll talk about later in the podcast, have been positioned largely close to targets across the portfolios. But stay focused on this bond market because I do think, importantly, it is something that the market needs to pay attention to.

Carol, let's pivot it to you. From your perspective, what were the most unexpected macro or market dynamics in the first half, especially in terms of maybe asset class performance or investor behavior? And how did this adapt your outlook in response?

Carol Schleif:

Well, first off, I think it's really important to step back and look at the macro and remember how we entered the year. Because we came into this year, as Brent alluded to as well, after two very solid 20% kinds of returns from equity markets. We had an economy that was firing on almost all cylinders. We had inflation coming down the way it needed to. So we entered on with a lot of strength and there was quite a bit of optimism actually, particularly among the stock market investors as it related to an incoming President Trump 2.0, if you will, and a Republican House and Senate, that you would see a lot of pro-growth, pro-business friendly things happen right away, much like you had in Trump 1.0.

So probably the two biggest macro surprises that hit at the beginning of the year were the fact that the order of priorities for that incoming administration was reversed from the first Trump administration, and the fact that there were a whole bunch of campaign promises and they were all basically addressed simultaneously rather than sequentially. So markets were faced early on with a whole bunch of different objectives, executive orders, lots of news that hit all at once. So that took investors a bit by surprise and led to quite a bit of the volatility that we saw.

So in short, investors come into the year expecting a carbon copy and they get a mirror image instead, such that all of a sudden we were dealing with tariffs first. We were dealing with major cuts initiated by the Department of Government Efficiency and a lot of different things, a lot of different headlines. And investors were really having to deal with a lot of market volatility, a lot of emotion that went into it.

How it adjusted our expectations in the way our portfolios were positioned was really not much at all because we had come into the year expecting that we would see increased volatility, particularly because you hadn't seen much volatility in the prior couple of years. So we came in expecting to see that and not only did we have the political uncertainty and the geopolitical uncertainty, but we also had some technological uncertainty that took investors by surprise. If you recall back in January, there was the DeepSeek announcement which caused some excess volatility in markets at the time.

But our expectation coming into the year of increased volatility meant that we really leaned into globally diversified portfolios and focusing on that. And as you alluded to in the setup comments, a lot of non-US forces have done exceedingly well this year. So those diversified portfolios that we leaned into have really served us well, especially with the volatility that's happened because as Brent touched on, markets retraced very quickly and they absorbed the news very quickly, but they also absorbed the shift in headlines and the backing off of some of the worst case scenarios, if you will, and recovered quickly. So by and large, those investors that were patient, leaned into the fact that they were well diversified across asset classes and around the globe, their portfolios basically rode through that volatility in a lot finer stead.

Michael Miranda:

Thanks, Carol. Appreciate those comments. Let's pivot maybe to the second half outlook then. You both, I think, articulated very well what's driven the market volatility through the first six months of the year, but for our clients and others, we certainly want to think about how are we managing the forward-looking backdrop.

So maybe I'll stick with you, Carol, here. As we look ahead, how are we navigating there? There's obviously this tension between uncertainty. I think you both talked about uncertainty being elevated, and yet this resilience in the markets. Particularly, there's a lot of discussion around the divergence between soft data and hard data.

Carol Schleif:

Yeah, great question. And it has been interesting because the word uncertainty has crept into lots of earnings announcements, tons of headlines, and it's been pounded into all of us, if you will, in the first half of the year how uncertain things are. And it's not surprising because actually when you step back and look at it, in the first couple of months we had more than 160 executive orders, we had more than 50 key headlines on tariff announcements alone. And when you're basically deluged day by day, that does increase the uncertainty.

But the thing that's been talked about a lot less has been the resilience. And that has come through in the fact that by and large, up until arguably this week with some of the data that we've seen most recently, the so-called hard data, the economic data that tracks what's going on in the economy has stayed very sturdy. And as I touched on earlier, we came into this year on very solid footing and the fact that we had that to lean back on was very important.

And it's also important for investors to remember that even while things are uncertain, businesses cannot stand still. They have shareholders, they have clients, they have customers, they have employees, they have bankers to satisfy. There's a lot of different things and a business can't stand still. They might need to pull back or delay or do some things, but they still have to basically execute on their growth plans. So businesses have worked really hard to figure out how they were going to adapt and adopt new technology and emerging things as they wait for more positive things, hopefully coming in the back half of the year, particularly as the administration starts leaning into some of the more pro-growth friendly aspects in terms of deregulation and more favorable tax treatment and a lot of things.

But the divergence you touched on in terms of hard data and soft data means that all of us as investors, consumers, business leaders, will tell pollsters that we're not feeling very comfortable about the situation. And consumers in particular, there's been wide divergence and wide swings, if you will, in terms of their lack of optimism for the near term or the longer term future. And yet they're employed, they're still spending. They might be making some different choices, but by and large, consumers have been very consistent in their spending. And their earnings and income growth on average has been growing above the rate of inflation for the last couple of years, so they're pretty sturdy as well as steady in what they're doing.

And economists will tell you, including the economists at the Federal Reserve, will tell you that quite frequently there's a very loose connection between that sentiment data and what actually happens. So as investors it behooves us to really look at that through line and follow the economic fundamentals and what's coming through that way. And they have, by and large, been quite sturdy.

Michael Miranda:

Thanks, Carol. Great points there. Brent, over to you then. Maybe a similar question but framed a little differently. As you think about the second half of the year, we oftentimes talk about the difference between noise versus signal. And I was at a client event last week and I got a similar question from a client in the audience who was interested in how we think about the world. And in this landscape that we have with increasingly filled with noise, what signals are we looking at? What are we looking and prioritizing to shape our second half outlook? And how are we distinguishing durable trends from some of the short-term volatility that we've seen in the first half of the year? And likely we'll continue to see in some aspect during the back half too.

Brent Joyce:

Yeah, thanks, Mike. Four key words jump out from your question. Noise, signals, durable, short-term. A lot of what we are dealing with at the moment is noise, and so I would start from a standpoint of saying be very liberal in chucking things into the noise bucket and say, "Well, that's just noise," right? Because most of it is, and so don't be too shy about putting things in the noise category.

Signals, we have to think about, and Carol talked a bit about this, the data and how has the data been jumbled up or impacted over the past weeks and months and quarters. And then try to sift through that to see if we can find something that is telling us closer to the truth. And then we would want to have that and corroborate that with other signals that we can look at. We'll talk concretely about what some of those might be.

Trend and short-term volatility were the other two words. So the durable trend, Carol really did a great job articulating that. We have pretty strong underlying fundamentals. What's important to think about today in this whole resilience conversation is all the things that we think about that are actions that are happening, the headlines, quite frankly, tariffs, deals, big beautiful bill, geopolitics, fiscal and monetary policy both inside the US and outside the US. None of these things are imbalances that are internal to the economy, like the dotcom or like the financial crisis where we had years and years of debt built up feeding into one particular part of the economy, the internet build out or housing bubble.

That's not the case that we have today. These are external things that are being applied to or impacting the economy. So largely, that's the noise piece. And I think we're going to fall into a pattern where the resilience gets us, as I mentioned back on track, back on track is a good place for capital markets. And in the medium term, which is likely the remainder of this year, is going to be this cycle, action, reaction, recalibration, and re-repeat.

So the actions I spelled out, these are anything that does, that is external, largely what politicians and policymakers are doing, tariffs, deals, big beautiful bill, geopolitics, fiscal and monetary policy, right? Those are the actions. Then the reaction is going to be that these are the signals that we want to look at. So the first bucket, actions or noise, the second piece is that, okay, what are the signals?

Well, what do equity markets do? What do bond yields do? Credit spreads. How do currencies react? We can look at sector signals, cyclicals versus defensive, tech and mega cap versus small and midcap, EM and international markets versus North American markets. Those are all the relative movements between those are going to give us a sense of how the market is digesting any of those various actions, tariffs, fiscal, et cetera.

And then there'll be a recalibration. The policy makers will take the signals and they will have to recalibrate. That will eventually get us, and I have a very, very strong belief that this will work because it's some of these immutable laws, they're not quite gravity, but they're pretty darn close, that we have to get to a place where all the actions that are not internal to the economy, these are what's happening external to the economy, are going to be browbeaten and hammered into a place where they have to be agreeable to the equity and the bond market.

And we'll do that action, reaction, recalibration in varying degrees over the next coming weeks and months until we land at a place that everybody can live with, everybody meaning the capital markets. And at that point then we'll certainly be talking about getting back on track, and on track is a positive place to be. So it is a, wrapping it all together between both Carol's conversation on where the economy sits and how we're going to get to that and get back to that place through this reaction, recalibration framework.

Michael Miranda:

All right. Thank you both. Thanks, Carol, thanks, Brent for your insights. I took away a few things from your comments. I think it's clear that while uncertainty remains this constant, that the underlying economic and market fundamentals continue to provide a solid foundation, and so we stay anchored to that.

Maybe a couple of thoughts on positioning for our clients across North America, whether in Canada or the US, we remain positioned close to our strategic asset allocation targets, but with a modest bias towards equities. And that reflects where we see the opportunity in the current environment. Those very modest overweights to equities are being funded largely by a modest underweight to fixed income.

But you've probably heard us say this a couple of times here, we are not fearful of interest rates in this current environment. We see fair value of 4.5% for the US 10-year and 3.3% for the Canadian 10-year, which is very close to current levels.

At the same time, we're staying focused on this evolving landscape. We're watching key risks, making sure the portfolios remain resilient. And while we're leaning slightly into risk, diversification remains central to how we manage through the ups and downs. This year is a perfect example of the benefits of this diversification strategy.

And with that, thanks for listening to Beyond the Portfolio. We'll see you next time.

Thank you for listening to Beyond the Portfolio. You could follow us on Apple Podcasts, Spotify, or your favorite podcast app. Until next time, I'm Mike Miranda.

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