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INVESTMENT STRATEGY QUARTERLY

Letter from the Chief Investment Officer

Back to the Future: Lessons from the Past, Strategies for the Future

It's been forty years since Back to the Future hit cinemas—and its iconic time-traveling storyline reminds us that while we can't rewrite history, we can certainly learn from it. From investing to economics (and even politics), patterns emerge, lessons resurface, and the past becomes a powerful guide for navigating today's unpredictable landscape. Just like in the movie, timing, perspective, and adaptability can make all make a difference when managing the complexities of modern markets. So, let's hop in our metaphorical DeLorean time machine and revisit a few critical decades that still resonate today.

1970S: TRADE POLICY & OIL SHOCKS

Great Scott! If Marty McFly and Doc Brown set their time machine to the 1970s, they'd find themselves in a world wrestling with inflation, global trade imbalances, and energy crises. Sound familiar? Sure—but today's economy is running on a very different engine. While the headlines might echo the past, we're not headed for a rerun of 1970s-style stagflation. Inflation today, while higher than the Fed's target of 2% in the US, is far less punishing, and unemployment is roughly half of what it was back then. So no, we're not stuck in the past—we're just borrowing a few pages from its playbook.

That era, after all, left a legacy on trade policy. Congress gave the president powerful tools: the Trade Act (1974) to offer protection to domestic industries and respond to unfair trade barriers, the Trade Agreements Act (1979) to enforce fair play, the Export Administration Act (1979) to control sensitive exports, and the Customs Reform Act (1978) to tighten enforcement. Notably, the International Emergency Economic Powers Act (IEEPA) gave the White House authority to regulate trade during national emergencies.

Fast forward to today—Trump 2.0 is revving up that same toolkit. Tariffs are back, trade deals are being reworked, and IEEPA is once again front and centre as its authority is being challenged in the courts. But the rival has changed. In the '70s, it was Japan and West Germany. Now, it's China—a global heavyweight deeply embedded in supply chains and tech ecosystems. With average tariff rates projected to hit 15–17%—about five times higher than at the beginning of the year—we do expect some short-term inflation and economic drag in the US, but not a full-blown recession.

And let's not forget the oil shocks of the '70s. Long queues for petrol and soaring prices led to the creation of the Strategic Petroleum Reserve (1975) and the Department of Energy (1977)—moves aimed at reducing dependence on foreign oil. Today, US oil production nearly matches consumption, and with global supply expected to outpace demand moving forward, we see prices trending down toward $60–65 a barrel—a far cry from the inflation-adjusted highs of the past.

1990S: FED PROWESS & FISCAL DISCIPLINE

From a market and economic standpoint, our next stop, the 1990s, might be one of the most enviable decades in modern history. The US experienced its second-longest expansion, driven by a productivity boom and early waves of technology. And with Alan Greenspan at the helm, the Federal Reserve struck a near-perfect balance—cutting rates just enough to keep the momentum going.

Today's Fed faces a similar opportunity. With the fed funds rate hovering around 4.5%, there's plenty of room to ease if needed. We expect two interest rate cuts over the remainder of this year, with at least two more likely to follow in 2026. These moves should help cushion any temporary slowdown as businesses work through pre-tariff inventories, consumers adjust to initial tariff price shocks, and hiring cools a bit.

Looking ahead, growth should accelerate next year. The proposed "One Big Beautiful Bill"—which includes marginal tax cuts, expanded SALT deductions, and incentives for business investment—could provide a dose of fiscal stimulus, even as it keeps the deficit high. Our forecast calls for US GDP growth of 1.4% in 2025 and 1.5% in 2026.

One more lesson from the '90s worth remembering: fiscal discipline matters. From 1999 to 2002, the US actually ran budget surpluses—helping pay down some of the national debt. That sense of responsibility was driven, in part, by the fact that interest payments were consuming 18% of federal revenue. Guess what? We're right back

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at that level today, and there is little sign of a bipartisan appetite for restraint. Even with a growing economy, rising entitlement spending and rising interest costs are crowding out spending on other priorities. It's a warning sign that shouldn't be ignored.

2000S: TECH & US EXCEPTIONALISM

Now let's leap into the year 2000, when everyone had a Hotmail address and pockets full of flip phones, digital cameras, and GPS gadgets. Back then, tech felt futuristic, even if it was a bit clunky. Today, it's sleek, seamless, and everywhere—woven into nearly every moment of our lives. So, are we heading for another market jolt like the 'pop' of the dot-com bubble? Not likely! Unlike the speculative frenzy of the early 2000s, today's Tech sector is built on solid ground—mature companies with real earnings and diversified revenue streams. With AI accelerating innovation, we expect technology to keep transforming industries across the economy. That's why it remains one of our top sectors, alongside Industrials and Health Care.

As for the broader US market, we're a bit cautious in the short term. Our year-end S&P 500 target is 5,875, reflecting potential downward revisions to 2025 earnings—from the current consensus of $262 to our estimate of $255. But looking into next year, we see brighter skies: improving GDP growth, a more accommodative Fed, and greater clarity on tariffs and fiscal policy. That supports our 12-month S&P 500 target of 6,375.

Before we leave the early 2000s behind, it's worth remembering the debut of the euro in 1999. At the time, it raised concerns about a serious challenge to the dollar's dominance. But bringing together such a diverse group of economies proved difficult, and Europe has struggled to keep pace with US growth and competitiveness ever since. Today, there's a fresh wave of optimism in Europe—driven by increased defence spending and more flexible fiscal policies. Still, we remain cautious. We're not buying into the idea that US exceptionalism is fading. Structural challenges in Europe persist, and while some expect a weaker dollar to boost international returns, we don't see enough movement in currency markets to support that view. So, for now, we're not setting the clock forward on international markets. We continue to favour US equities, where the outlook is more stable and the path ahead is clearer.

2023: DEBT WATCH DÉJÀ VU

Our final stop is a recent one: 2023, the last time the US debt ceiling was raised. That year, the ceiling was suspended without a cap, and markets reacted quickly. The 10-year Treasury yield jumped to 5%, as investors braced for a surge in government bond issuance to replenish federal coffers and cover ongoing trillion-dollar deficits. Now, we're at a familiar crossroads. With the ceiling reinstated and the clock ticking toward another potential 'X-date' (the point at which the US government will not be able to fulfil all its financial obligations)—likely in August—markets are once again preparing for a Congressional deal that lifts the cap and triggers another wave of heavy Treasury issuance.

But we believe fears about soaring yields are overblown. While supply will increase, demand is expected to remain strong. Lessons from 2023 show that regulatory adjustments and strategic shifts—like the Treasury issuing more short-term bills over longer-term bonds—can help stabilise the market. We maintain a year-end and 12-month target of 4.25% for the 10-year Treasury yield, with the most compelling value in short to intermediate maturities. We continue to favour high-grade corporate and municipal bonds for their attractive valuations.

BOTTOM LINE: PERSPECTIVE IS POWER

For investors, market ups and downs are nothing new. Despite interim setbacks, the S&P 500 has delivered a robust average annual return of ~11% since Back to the Future's debut. Bull markets historically last six times longer than bear markets and produce returns five times more powerful. The takeaway? Stay focused on the long term, stick to a well-balanced strategy, and rely on your wealth manager. Looking back, it might seem like timing the market would've been easy—but in reality, markets move to their own rhythm. One thing is clear: time in the market is far more powerful than trying to time it. We may not be able to predict the future, but we can prepare for it—with discipline, perspective, and a little help from the lessons of the past. Or, as Doc Brown reminds us, "Your future hasn't been written yet. No one's has. Your future is whatever you make it. So, make it a good one."

Enjoy the summer!

Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer

*Financial forecasts should NOT be considered a guarantee of future performance or a guarantee of achieving overall financial objectives. Expressions of opinion are as of this date and are subject to change. Past performance is not a guarantee or a predictor of future results.

Trade Talk and Tariff Truths

Eugenio J. Alemán, PhD, *Chief Economist,* Raymond James
Giampiero Fuentes, CFP®, *Economist,* Raymond James

The fortunes of empires, kingdoms, and, until the early part of the 20th century, modern nation-states, have often hinged on trade and the revenues it generates. As capitalism overtook mercantilism, and before the industrial revolution transformed the world, revenues from trade served as a cornerstone of fiscal revenues. But revenues from tariffs were limited, volatile, and highly unreliable. As the US and its fiscal needs grew, the country moved to more sustainable, reliable, and less volatile sources of fiscal revenues.

HISTORY OF TARIFFS

During the early 20th century, but especially under the influence of mercantilist thinking, tariffs became a tool for protecting burgeoning American industries and culminated in the infamous Smoot-Hawley Tariff Act of 1930, which raised tariffs on thousands of goods and is widely believed to have worsened the Great Depression.

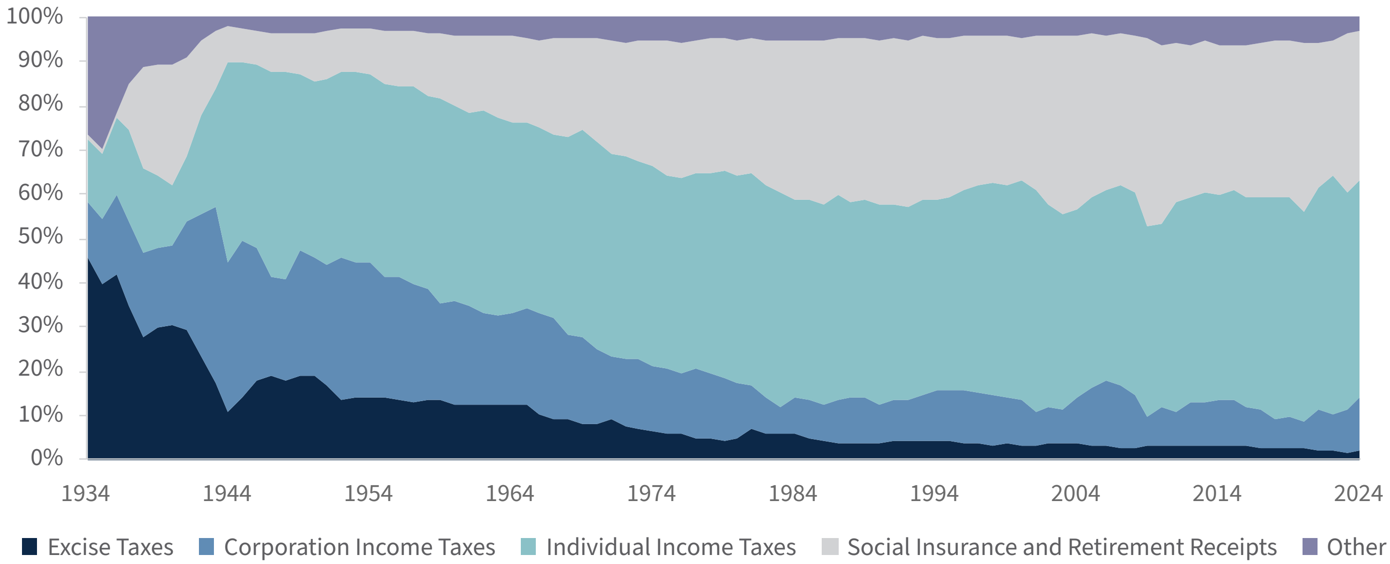
A major shift occurred with the Reciprocal Trade Agreements Act of 1934, which marked the beginning of a more liberal trade policy. This act empowered the president to negotiate tariff reductions with other countries, laying the groundwork for multilateral trade agreements and institutions like the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organisation (WTO). In the post-World War II era, the US championed global trade liberalisation, culminating in agreements such as NAFTA and the USMCA (US Mexico Canada Agreement). Since the peak of the Smoot-Hawley Tariff Act, tariff rates have declined significantly and were hovering around 2% at the beginning of 2025.

TARIFFS TODAY

Understanding this historical context helps clarify the current state of trade policy in the United States. While many view the US trade deficit as a sign of economic weakness, especially when compared to countries with trade surpluses, the reality is more nuanced.

The US tends to consume more than it produces, a pattern made possible by the existence of trade. However, the global dominance of the US dollar, its appreciation, large and persistent

Sources of Government Revenues



Source: FactSet, data as of 12/31/2024

fiscal deficits, and the strong international demand for American government debt and overall financial assets generates large trade deficits. That is, foreign savings have continued to finance US consumption and investment by purchasing American assets and investing in the US economy. Although the US must pay interest and dividends on these investments, the influx of foreign capital has lowered interest rates and helped economic growth—enabling expansion beyond that which domestic capital alone could support. Thus, the trade deficit is not as big a negative as it used to be when mercantilism was the prevailing economic theory, and tariffs are not going to help bring the trade deficit down.

Today, the biggest risk is what economists call a 'sudden stop,' which is a scenario where fearful investors put a stop to the flow of foreign savings coming into the country. This would push the US dollar much lower, i.e., a large depreciation of the US dollar, and a surge in the cost of importing goods so large that it could push the trade deficit into a surplus as Americans stop consuming foreign goods. This scenario is what typically happens when less developed countries enter into a balance of payments crisis. However, although this scenario is highly unlikely, it is not an impossibility.

TARIFFS ARE TAXES: CONSUMERS AND FIRMS PAY THEM

TThe whole discussion regarding tariffs and who pays for them boils down to the following: if you are a firm that imports goods from other countries for final sales, i.e., a retailer, the

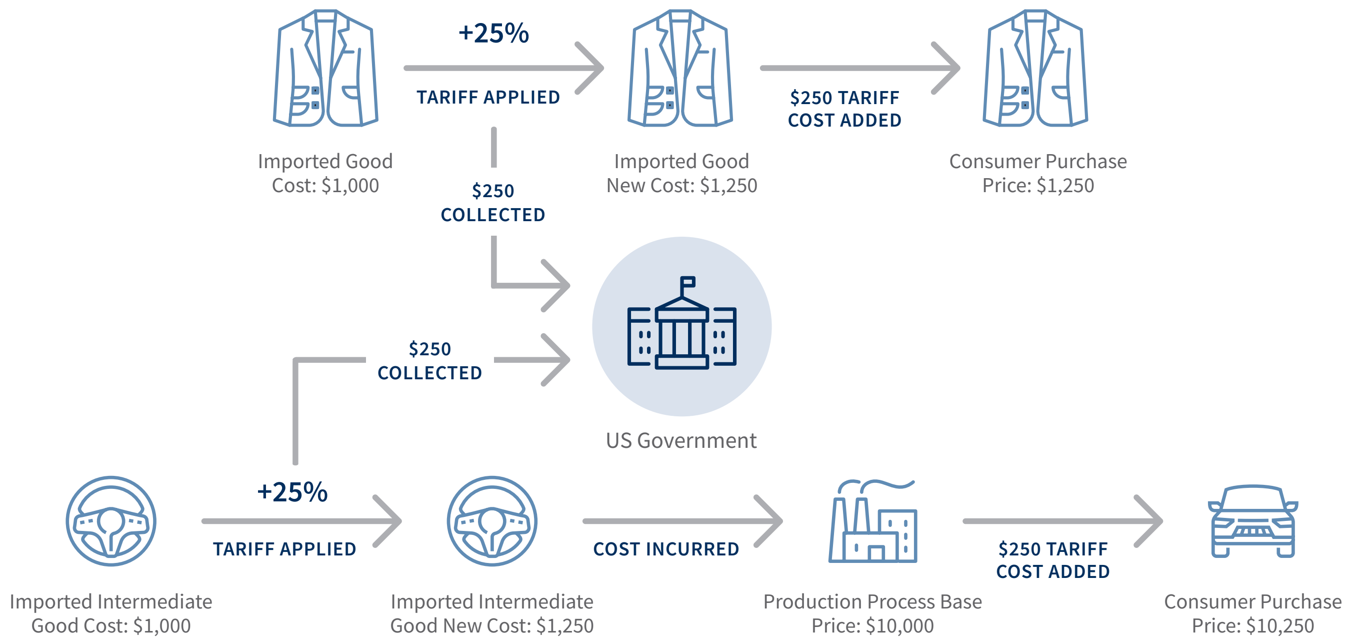
> In the post-World War II era, the US championed global trade liberalisation, culminating in agreements such as NAFTA and the USMCA.

firm pays the tariffs when it imports the item. So, if a good costs $100.00 and the import tariff for that good is 25%, then the new price paid by the firm is $125.00. If, on the other hand, a firm imports what is called an intermediate good, a good that is used in the production process of another good, then the firm pays the tariff over the price of that imported intermediate good and adds the tariff over the price of the final product. So, if a firm imports an intermediate good that has a cost of $100.00 without a tariff and the government imposes a 25% tariff on that intermediate input, then the intermediate import has a new price of $125.00. If the price of the final product without the tariff is $1,000.00, then the price after the tariff goes up to $1,025.00.

In both scenarios, however, the final buyer of both goods will probably pay slightly less than the price that includes the tariff while the firm importing the product will have to pay the portion of the tariff that is not paid by the final consumer. Who pays the tariff cost will depend on the price elasticity of demand (see diagram 2) for each one of these goods. That is, the more inelastic the demand for a product is, the larger will be the pro-

[5] Price elasticity of demand is the consumer's responsiveness to price changes.

Tariff Math: How It Adds Up



Source: RJ Economics

portion of the tariff paid by the final customer, leaving the importer to pay the rest.

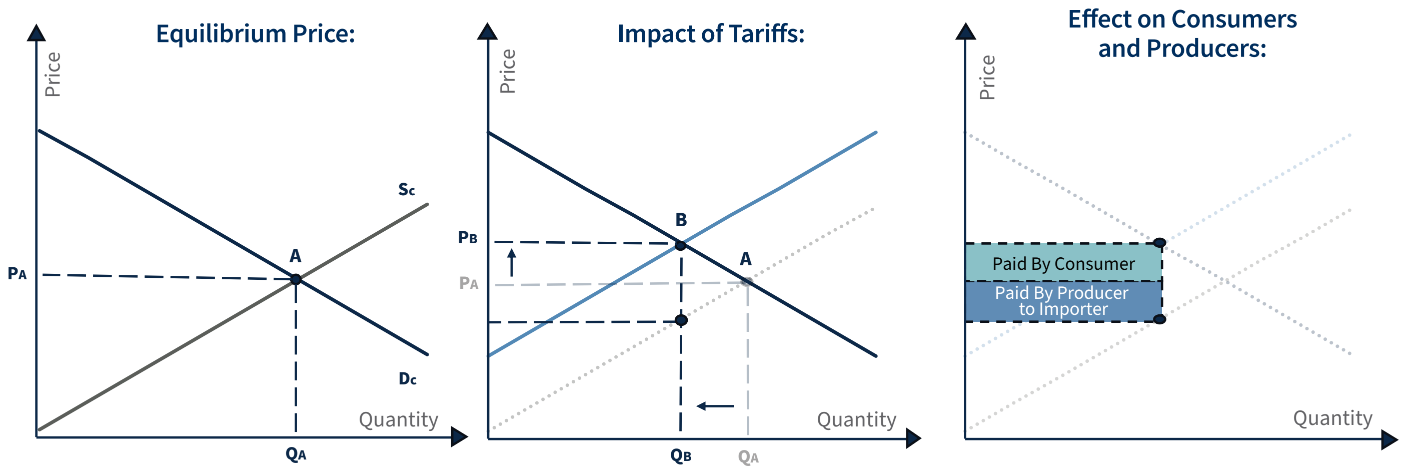
The more elastic the demand for a product is (the more alternatives in the market), the smaller will be the proportion of the tariff that is paid by the customer, and the larger the proportion paid by the importer of the good.

When faced with tariffs, companies have several options to mitigate their impact and maintain competitiveness. One of the most immediate responses is to reevaluate and restructure supply chains. This might involve shifting sourcing to countries that are not subject to the same tariffs or that have favourable trade agreements. For example, a US company importing goods from China might consider shifting its sources and/or factories to Vietnam or Mexico instead. Companies will adjust their pricing strategies to manage the increased costs by passing the cost on to consumers through higher prices.

REDISTRIBUTIVE IMPLICATIONS OF TARIFFS

Tariffs work as a regressive tax on lower income individuals and households. Tariffs increase the price of necessities that are typically not produced domestically. At the same time, if these products are domestically produced, tariffs on import-competing goods allow domestic producers to raise prices on those goods. Since lower-income households typically spend a larger portion of their income on necessities, then tariffs affect them disproportionately. At the same time, higher-income consumers have more alternatives to try to avoid tariffs as they may purchase more expensive versions of the product that are typically produced domestically and would not be affected by the tariffs. Tariffs are primarily designed to protect domestic industries and jobs, but there are unintended effects that can reinforce economic inequality. Many times, as was the case during the first Trump administration, governments try to offset these effects through subsidies or tax credits for the sectors negatively affected by reciprocal tariffs. Not only do tariffs impact lower income groups the hardest but, as we saw during the pandemic recession, the US government is not well equipped to identify

> Thus, the trade deficit is not as negative as it used to be when mercantilism was the prevailing economic theory, and tariffs are not going to help bring the trade deficit down.



The equilibrium price of a good is determined at the point where the demand (Dc) and supply (Sc) curves intersect (A). This represents the price at which the quantity demanded by consumers equals the quantity supplied by producers.

When tariffs are introduced, the supply curve (light blue) shifts to the left, indicating a decrease in supply. As a result, the market experiences a higher equilibrium price (Pb) and a lower equilibrium quantity (Qb).

Higher prices are shared between consumers and producers. How much each party absorbs depends on the price elasticity of demand: If demand is inelastic (steep demand curve), consumers bear more of the cost. If demand is elastic (flatter demand curve), producers absorb more of the cost.

Source: RJ Economics

and correctly target the sectors most affected by tariffs. That is, as is the case with any tax collected by the government, tariffs have unsuspected redistributive implications.

THE BOTTOM LINE:

Tariffs, while often framed as tools of trade policy, are ultimately taxes that influence both corporate strategy and consumer behaviour. When imposed on imported goods, whether final products or intermediate inputs, tariffs raise costs that firms often try to pass along through higher prices. The extent to which these costs are transferred to consumers depends on the elasticity of demand, which refers to how sensitive consumers are to price changes. If demand is inelastic (few substitutes, essential goods), more cost is passed on to the buyer; if it's elastic (many alternatives, non-essentials), firms may bear more of the burden. For consumers, this can mean higher prices on a wide range of products, even those manufactured domestically but reliant on global supply chains. For investors, the implications are equally material: tariffs can compress margins, alter sourcing strategies, and introduce inflationary pressures that ripple through earnings and valuations. Understanding how these dynamics unfold is essential for interpreting shifts in pricing, consumption, and corporate performance in an increasingly interconnected global economy.

Tariffs are regressive because they disproportionately affect lower-income individuals and households.

KEY TAKEAWAYS

- Post World War II, the US has championed global trade liberalisation, resulting in the US enjoying an average effective tariff rate of ~2.5% at the beginning of 2025.
- Tariffs were primarily used as a source of revenue for the federal government. They have evolved and are now also used for trade protection.
- Tariffs are fundamentally taxes paid by importers, not foreign countries. When a company imports goods, it pays the tariff directly to the government.
- Tariffs are regressive and disproportionately affect lower-income households that have fewer options than higher-income households.

Has the US Lost its Safe-Haven Appeal?

Tracey Manzi, CFA, *Senior Investment Strategist,* Investment Strategy

American exceptionalism has been a dominant theme in financial markets—and there are good reasons for that. For decades, the US has offered investors (both domestic and international) a rare trifecta: enviable economic growth fuelled by a resilient consumer, equity outperformance relative to the rest of the world and a strong dollar. However, the fallout from President Trump's tariff announcements has shaken investors' confidence. The financial market's unusual reaction immediately post-Liberation Day (April 2nd) which featured a simultaneous decline in the US dollar, Treasury prices and the stock market has led many investors to ask an uncomfortable question: is the US at risk of losing its safe-haven status if Treasuries (and the dollar) are no longer providing protection during risk-averse environments? Below we discuss the reasons why we think the safe-haven status of the US remains intact.

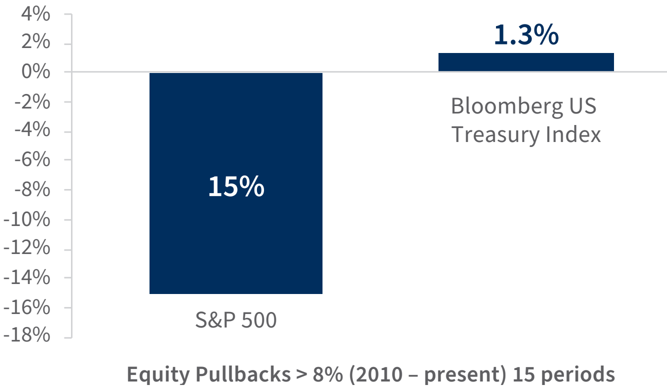
SAFE-HAVEN STATUS CONFIRMED, BUT WITH A CAVEAT

US Treasuries have long been considered the world's preeminent safe-haven asset. That's predominately because Treasuries act as a crisis hedge for all investors, meaning they retain their value or appreciate during periods of heightened economic or geopolitical stress—what we commonly refer to as a 'flight to quality'. While the post-April 2nd Treasury selloff has attracted a lot of media attention, with headlines suggesting US Treasuries were trading like an emerging market or other risky asset, we think these concerns are exaggerated. In fact, we would argue that despite heightened volatility, Treasuries have provided a hugely important portfolio diversification to equity risk during market downturns. Case in point: the last 15 times the S&P 500 had an 8% or greater pullback since 2010, the Bloomberg US Treasury Index was up on average 1.3%. If you excluded the inflationary period in 2022, US Treasuries would have delivered an average return of 2.3% versus the S&P 500's average decline of 15%. This confirms that the US government bond market is doing what it is meant to do—holding its value, or appreciating, when most needed.

> Despite heightened volatility, Treasuries have provided ballast to equity risk during market downturns.

[1]https://www.bloomberg.com/news/articles/2025-02-20/us-dollar-s-use-in-global-transactions-tops-50-swift-says
[2]SIFMA | [3]Japan's Ministry of Finance

Treasury Returns During Equity Pullbacks



Source: FactSet, as of 6/13/2025

The safe-haven status of the US is also supported by the central role it plays in global finance. Not only is the US dollar the most widely used currency in global transactions, accounting for over 50% of all SWIFT payments, US Treasuries serve as the benchmark rate in pricing everything from mortgages to consumer loans, and corporate debt in the most powerful economy in the world. Treasuries are also a key component in calculating equity risk premiums and the most common form of collateral used in the lending markets due to their credit worthiness, liquidity and widespread acceptance. Any perceived loss of confidence in US Treasuries or the dollar would quickly ripple across the globe. While the April 2025 tariff tantrum led to a significant breakdown in historic correlations, we think it is premature to suggest that this brief episode signals a regime shift. There simply is no other market that can rival what the US has to offer.

Despite these structural advantages, the world's most systematically important bond market has had a few tremors in recent years. The sudden increase in Treasury yields in April 2025 served as another reminder of the fragilities in the system. Fortunately, this dislocation proved short-lived. However, the other most notable tremor occurred in March 2020. While Treasuries did behave like a traditional shock absorber when the COVID panic set in, the dash for cash in 2020 quickly overwhelmed market liquidity. This dislocation impaired liquidity and amplified rate volatility, leading to wider bid-offer spreads. The result: soaring long-term bond yields, with the 30-year Treasury yield climbing 80 bps in one week. With market functionality impaired (rightfully so as the world economy had never shut down before), the Federal Reserve was forced to step in to purchase large quantities of Treasuries to stabilise the market. While these flare-ups have been rare, they do serve as a warning sign that the market's resilience can sometimes be tested.

CAN ANOTHER BOND MARKET RIVAL THE US TREASURY MARKET?

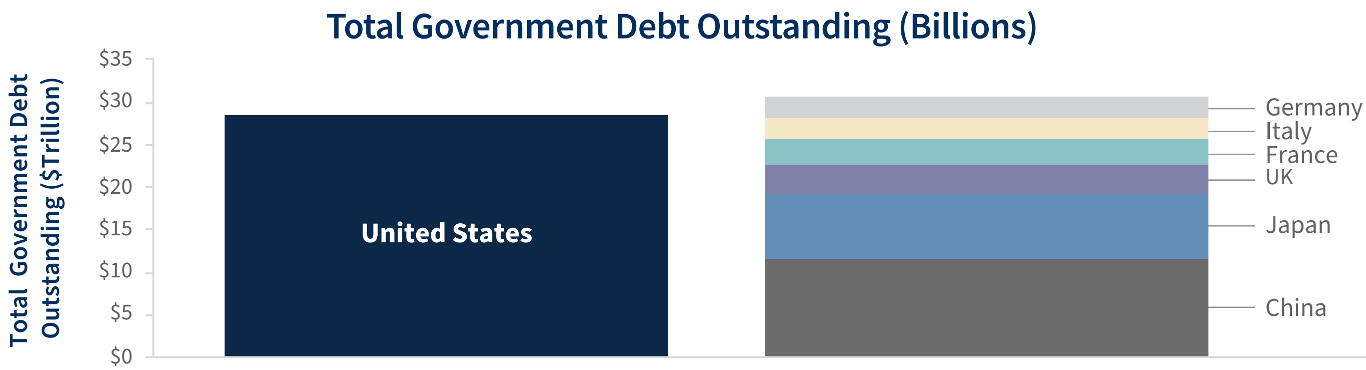
Investors have become jittery as President Trump tries to reshape the global trade landscape and fiscal concerns are in the spotlight, but the US is still the 'cleanest dirty shirt' among its peers. Of course, this could change in the future—particularly if the fiscal situation continues to deteriorate. However, right now there is no other market that matches the size, liquidity, depth, or global influence of the US Treasury market. The US Treasury market, at $28.5 trillion , dwarfs all others. In fact, the size of the Treasury market is roughly equivalent to the combined government bond markets of China, Japan, UK, France, Italy and Germany. While the size of Japan's bond market is massive, after years of quantitative easing (i.e., central bank bond purchases), the Bank of Japan owns over 50%3 of all Japanese government bonds—meaning the liquidity and depth of the market is compromised. In addition, the average daily trading volume of Treasuries now exceeds $1 trillion. For comparison, the average daily trading volume for the German Bund market, which is considered the benchmark within Europe, is only 27 billion euros (or $30 billion USD-equivalent). All else being equal, a higher daily trading volume signals that the market has better ability to absorb daily trading activity without any significant price disruptions. These quick facts cement our view that there is no viable alternative to Treasuries, now or in the foreseeable future.

> "There is simply no other market that can rival what the US has to offer."

ARE FOREIGN INVESTORS BACKING AWAY FROM US TREASURIES?

With the market searching for answers to explain the adverse price movements over early April, the media narrative attributed it to foreign selling. Fears of foreign selling have been a consistent theme down the years, but aside from foreign exchange intervention purposes, total foreign holdings of US debt has swelled to $9.1 trillion , even though its share as a percentage of total debt has eased—with Japan, the UK and China among the top holders. Speculation concerning foreign selling reached a feverish pitch in

[9]https://www.sifma.org/resources/research/statistics/us-treasury-securities-statistics/
[5]https://www.deutsche-finanzagentur.de/fileadmin/user_upload/Institutionelle-investoren/auktionen/bund_fact_sheet.pdf



Source: SIFMA and Bank for International Settlements (BIS), as of 12/31/24

April, with some headlines reporting that foreigners could try to weaponise their Treasury holdings as leverage during forthcoming tariff negotiations. To date, there has been no evidence of this in the Treasury International Capital (TIC) reports. There have also been concerns about a possible 'buyer's strike' particularly for longer-maturity Treasuries. That is a key reason why we monitor who is buying Treasury debt in addition to overall demand at regular market auctions. And for now, indirect bidders (i.e., a proxy for foreign demand) have been within recent norms while demand ratios have remained healthy.

DOES THE US DOLLAR RISK LOSING ITS RESERVE STATUS?

The sharp depreciation in the US dollar (down 9% YTD at the time of this writing) has reignited fears that the administration's aggressive tariff policy has structurally damaged investors' confidence in the currency. To be fair, calls for the dollar's demise as a reserve currency have been floating around for years—however, the "greenback" still reigns supreme. While news headlines continue to suggest that this time is different, we think these concerns are overstated, particularly as the US dollar still accounts for almost 60% of all global reserves. The weaker US dollar is not a crisis of confidence, but rather a recalibration of expectations amid significant trade and fiscal policy uncertainty. Souring sentiment, a correction from a highly overvalued state and shifting portfolio allocations have also been factors contributing to the move. However, we would not extrapolate the recent weakness as a signal that the US dollar's reserve currency status is at risk. While there could be more reserve diversification—a slow-moving trend that has been in place for years—and a slow grind lower as its overvaluation unwinds, the US dollar is not likely to be replaced by another currency anytime soon. The dollar remains far too deeply enmeshed in the global financial markets for such a radical shift to occur in such a short time frame.

CONCLUSION

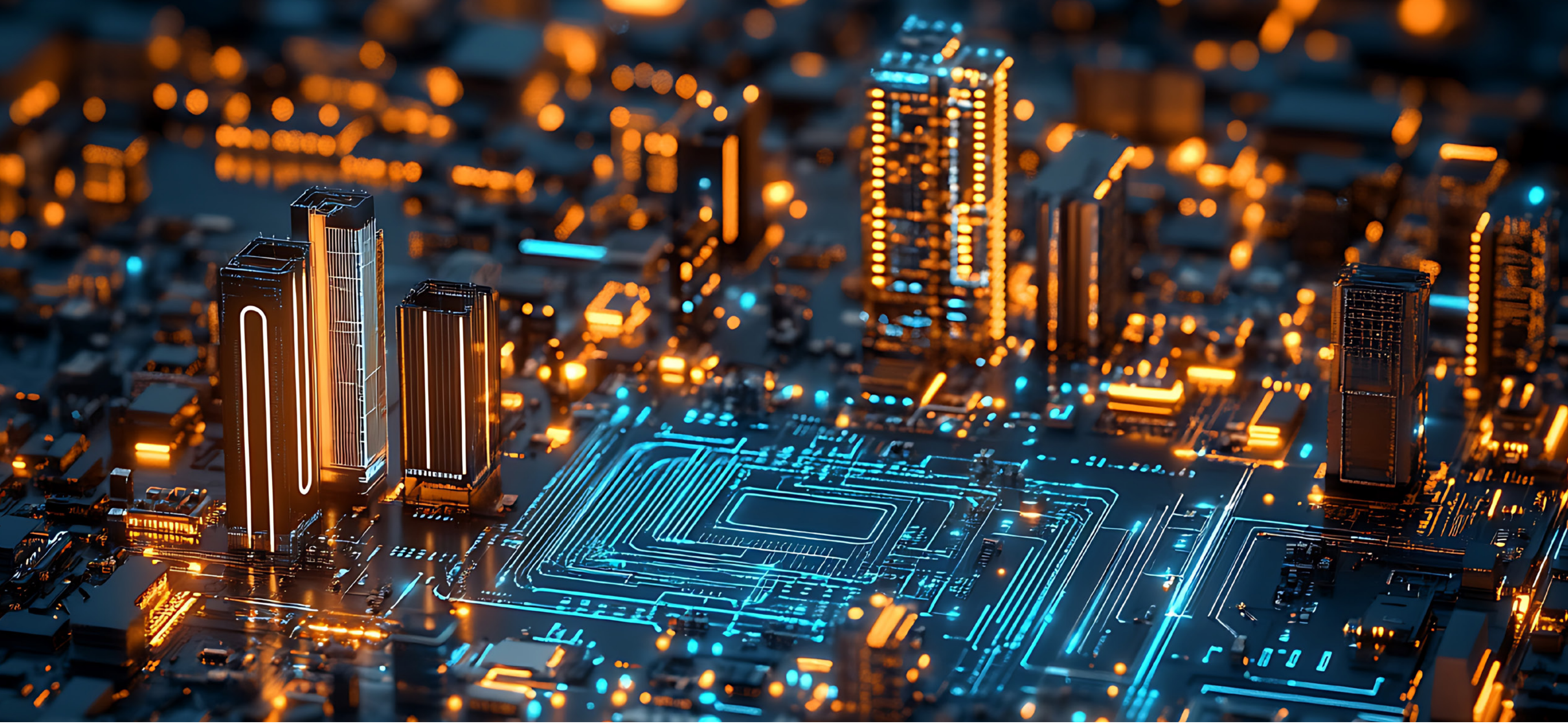
While the rapidly evolving trade landscape and concerns about the US' fiscal trajectory have caused some historic correlations to breakdown, we don't think this is the start of a regime shift. Yes, heightened market stress caused some unusual price action during the tariff tantrum, but we continue to believe that Treasuries will fulfill their role as a shock absorber if, and when, growth falters. Furthermore, we would not confuse cyclical fluctuations in the dollar with the loss of reserve currency status. While sentiment shifts can sway markets during shorter periods of time, the appeal and safe-haven status of the US is not something that will vanish overnight. Until there are viable alternatives, the Treasury market will remain the most dominant safe-haven bond market in the world and the dollar's supremacy will remain intact.

The weaker US dollar is not a crisis of confidence, but rather a recalibration of expectations amid significant trade and fiscal policy uncertainty.

KEY TAKEAWAYS

- The US has long been considered a safe-haven for investors delivering a rare trifecta: enviable economic growth fuelled by a resilient consumer, superior equity performance relative to the rest of the world and a strong dollar.
- Recent market activity, much of it fuelled by Liberation Day and ever-changing trade policy has caused some to question the US and the US dollar's role.
- There is simply no viable alternative to the US Treasury market or to the dollar as the world's reserve currency.

[6]https://www.sifma.org/resources/research/statistics/us-treasury-securities-statistics/
[7]https://www.cnbc.com/2025/05/30/could-the-euro-topple-the-us-dollar-as-the-worlds-reserve-currency.html



Power Prices Propel US Data Centre Buildout

Pavel Molchanov *Investment Strategy Analyst,* Investment Strategy

What comes to mind when you think of artificial intelligence (AI)? Probably something to do with chatbots or microchips. Well, the AI megatrend is also about energy. The scale-up of AI requires the buildout of data centre infrastructure. All data centres use hefty amounts of electricity, and those that serve AI applications are especially energy intensive. Compared to other major economies in Europe and Asia, the US has a structural cost advantage vis-à-vis data centre operations. This goes a long way towards explaining why the US share of the world's data centres is nearly double the US share of global GDP. Supporting the data centre buildout will require sustained investment in power generation and the electric grid, which means that the Utility and Industrials sectors are playing vital roles alongside the Tech sector.

THE US HAS NEARLY HALF OF THE WORLD'S DATA CENTRES

By way of background, there are 11,800 data centres around the world—a number that is continually increasing—and the US has more than 5,300, or 46%. China is a distant second, with around 600, followed by 500 each in Germany and the UK. It is unsurprising that data centres tend to cluster around big cities, but you may be surprised to learn that California's Silicon Valley is nowhere near the top of the rankings. Northern Virginia is far and away the largest data centre hub in the world, outpacing Beijing, China by around 50%.

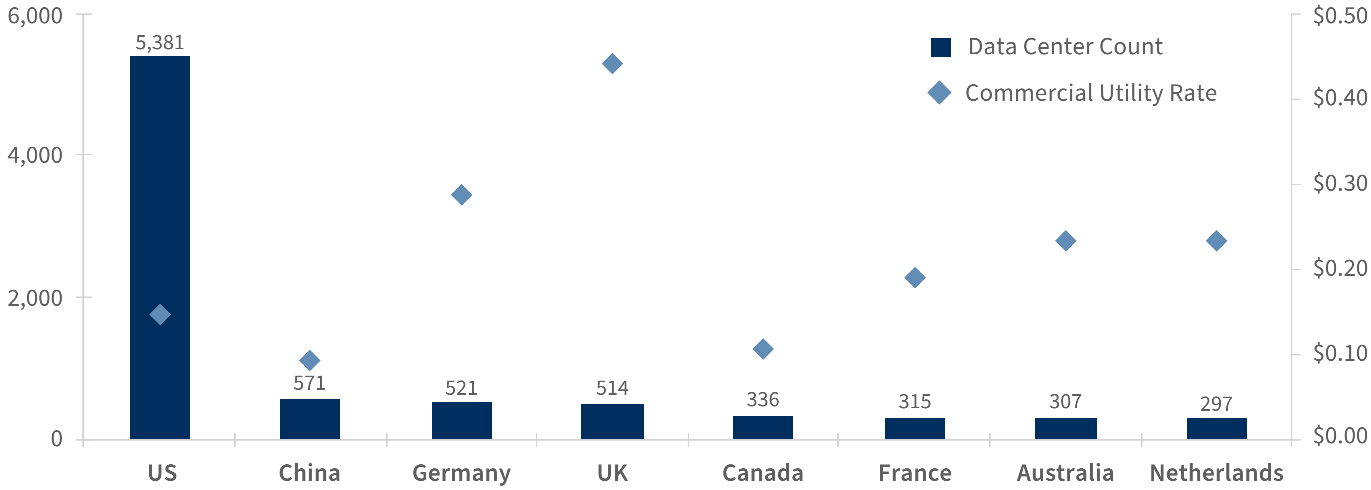
> The AI megatrend is also about energy

HYPERSCALE DATA CENTRES USE AS MUCH ELECTRICITY AS A MID-SIZE CITY

The largest type of data centre—what's known as hyperscale—can have peak demand of as much as 1,000 megawatts, which equates to the amount of electricity used by 700,000 homes in a city of 1.8 million people. Although the vast majority of data centres are smaller than that, hyperscale facilities will need to become more common for AI to become truly mainstream.

In many emerging markets, including China, electricity demand has been growing for decades, so the incremental demand from AI does not involve anything too needle-moving. In the US, on the other hand, the electric power industry is coming out of a 20-year

Top Countries by Number of Data Centers, 2024



Source: Visual Capitalist, Global Petrol Prices, as of 6/13/2025

period with essentially flat demand, and therefore AI is a game changer. We anticipate that US electricity demand will grow more between 2024 and 2030 than during the previous quarter-century. While utilities naturally welcome this growth, there is no getting around the fact that massive, costly investments will need to be made in new power generation capacity. This will be an all-of-the above story: natural gas in Virginia and the Southeast; wind in Texas and the Great Plains; solar in California and the Southwest; and nuclear, including small modular reactors, on a case-by-case basis (and with very long timetables for construction).

One point that is not always appreciated is how vital it is for data centres to have an extremely reliable power supply. None of us like it when the local grid has an outage (just ask the people of Spain and Portugal following the outages there), but the data centre's business model is especially mission-critical and requires power to flow on a 24/7 basis. This points to the importance of modernising the electric grid. For example, grid-scale power storage systems—batteries as well as non-battery technologies—need to become much more common than they are currently. In addition, utilities are taking advantage of sophisticated software to more effectively manage the flow of power along the grid.

COST OF ELECTRICITY IS KEY

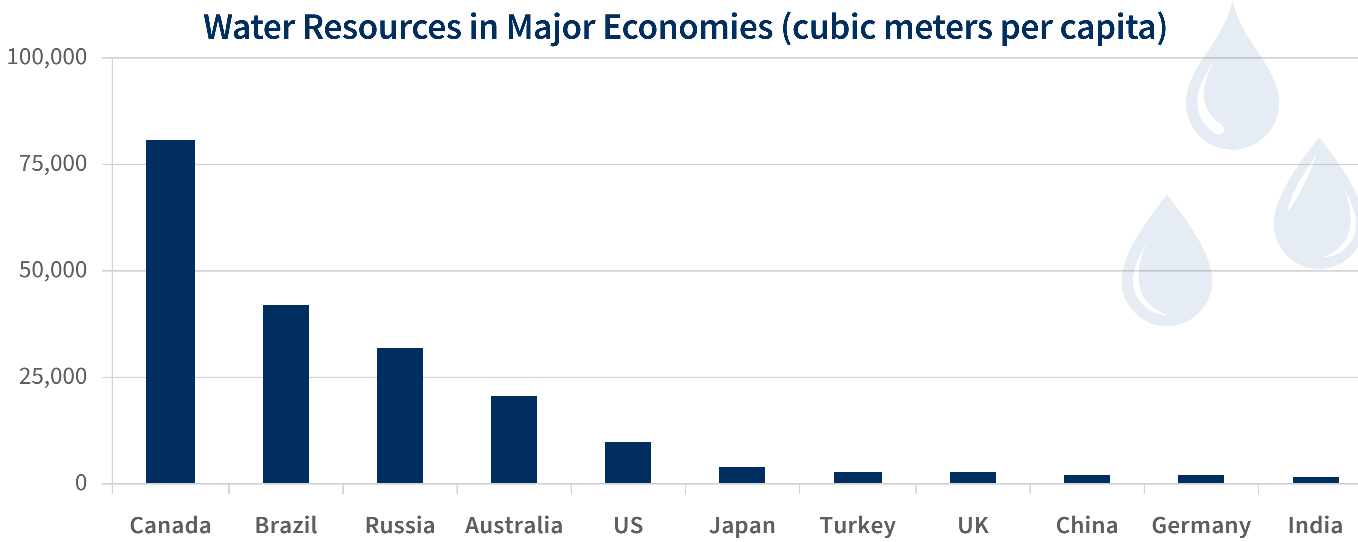
As with many areas of tech innovation, Silicon Valley is leading in AI. California is well-known as a fantastic place for R&D, but that does not translate into being an optimal site for operating data centres. The reason is that electricity is just too costly there… along with everything else, from cappuccinos to homes. Virginia's power pricing, although by no means the cheapest in the US, is roughly half of California's.

Well, imagine an entire continent with power prices averaging close to California levels—that is the situation in Europe. Italy is near the high end (commercial utility rate: $0.46/kWh), Germany is better ($0.29), and France is better still ($0.19), but all of them are higher than the US national average of $0.13. Interestingly enough, there are two European countries with cheaper power than the US—Norway ($0.11) and Iceland ($0.08), both of which are rich in clean, low-cost hydropower—and it will be interesting to see if they turn into data centre hubs.

US Utility Rates, National Averages
"cents/kWh"

	Residential	Commercial	Industrial
Change, 2010-2021	+18%	+10%	+6%
2022 Change from prev. year	15.12 cents/kWh +11%	12.55 +12%	8.45 +18%
2023 Change from prev. year	15.98 cents/kWh +6%	12.74 +2%	8.06 -5%
2024 Change from prev. year	16.48 cents/kWh +3%	12.85 +1%	8.15 +1%

Source: https://www.eia.gov/electricity/monthly/epm_table_grapher.php?t=epmt_5_03



Source: China Water Risk, as of 6/13/2025

Unsurprisingly, Japan at $0.21 is well above the US, reflecting its status as a densely populated island economy that needs to import nearly all of its energy resources. China is much better at $0.09, though this reflects government subsidies to power companies, which makes numbers difficult to compare.

To be sure, US electricity prices are moving up —all of us as consumers are experiencing that in our utility bills—and the same is generally true around the world. After COVID-era inflation led to utility rate increases briefly reaching double digits, prices have regained a semblance of stability, but the trend is still heading higher.

WHAT ABOUT WATER?

The other natural resource that data centres require is large quantities is water. Precisely because data centres use so much energy, they emit heat, and water is needed for cooling. When it comes to water availability, there are significant differences around the world. Among the major economies, Canada and Brazil are by far the best, benefiting from low population density and prolific river systems. India is at the opposite end of the spectrum, not to mention the entire Middle East. The situation in Europe varies, with the Scandinavian region in good shape, whereas the Mediterranean countries are suffering from drought conditions that can be almost as difficult as in the Middle East.

The US is also a mixed bag: there is no near-term risk of water shortages in Virginia, but our readers in California and Texas need no reminders that their communities are facing water challenges. In contrast to power generation, which can always be expanded (it just depends at what cost), the unfortunate reality is that water supply is limited by climate conditions and geology. In other words, economics is not everything.

BOTTOM LINE

The AI megatrend is a key reason for our overweight to the Tech sector. Alongside the big technology companies that are most commonly associated with this theme, the mainstreaming of AI also requires the buildout of data centres, which use vast amounts of electricity and water. While data centres are being built around the world, the US has some of the lowest power prices among the major economies, which provides a competitive advantage. The US has less of an advantage vis-à-vis water supply. Ultimately, AI presents a massive opportunity for the entire global economy, albeit with adoption curves that differ from country to country.

KEY TAKEAWAYS

- Hyperscale data centres, which are key enablers of AI, are examples of highly energy-intensive infrastructure.
- The US has nearly half of the world's data centres, with a particularly large concentration in Virginia.
- Lower-cost electricity gives the US an advantage in the data centre buildout, but power prices are trending up, and we also need to keep an eye on water risks.

Q&A: Rumours of the Dollar's Demise are Exaggerated

Prof. Jeremy Batstone-Carr, *European Strategist,* Raymond James Investment Services Ltd.*

The first half of 2025 has proved a tough period for the dollar. A brief period of relative calm in early June was preceded by a sharp 10% depreciation in the trade weighted DXY since January, one of the sharpest falls on record over so short a period. The drop is, however, by no means unprecedented including, fairly recently, in the summer of 2020 as the pandemic and associated lockdowns held sway. Most unusually, since the 2nd April "Liberation Day" the currency has disconnected from interest rate differentials, which typically serve to determine exchange rate levels in the near term and reflect shifting perceptions of the economic outlook, both for the US and elsewhere.

Q: The dollar has depreciated on the foreign exchanges, but that's nothing new?

A: Firstly, the dollar's performance should be viewed not just over the past six months, but over a longer time period. In fact, over the last fifty years the dollar has suffered numerous and sometimes rapid falls, including three major bear markets (in which the currency fell by over 25%). Secondly, what the weakness is not about is the loss of the much-cherished global reserve currency status. Despite numerous doom-laden headlines, conflating weakness with imminent loss of special status is inappropriate, in our view. The currency maintains a dominant position in short-term funding markets, trade invoicing and foreign exchange transactions, the key plumbing in global finance. Efforts to develop alternatives to supplant the dollar's status are still a very long way from achieving the critical mass necessary to mount a serious challenge.

Despite numerous doom-laden headlines, conflating weakness with imminent loss of special status is inappropriate.

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Q: But the dollar's disconnection from both short-term interest rates and longer-term yield differentials is almost unprecedented?

A: Quite true. In fact, the currency's weakness is more likely to be explained by a sharp reassessment of the near-term outlook for the economy and financial markets. If this is an emergent risk premium, whilst troubling, the US experience is far from unique; both sterling and the euro have recovered from recent – much more severe – crises over the past decade as government rhetoric and policy settings adjusted more constructively. Dollar analysis since 2nd April concludes that whilst the currency has been on a weakening trend all year, accompanied by international concerns regarding the sustainability US exceptionalism, in large part the consequence of DeepSeek revelations in late January calling the previously believed technology sector's imperviousness into question, the disconnect really only started in early April as the Trump administration's tariff policy began to take shape.

Q: Can the dollar's weakness be ascribed to fiscal policy uncertainty?

A: The fact that the dollar remains under pressure even as the risks surrounding trade uncertainty lessen hints at concerns regarding the fiscal policy outlook and prospects for the Treasury market. The main issue in terms of fiscal policy is all too familiar: continued large deficits and an unsustainable path for federal debt resulting in an ever-increasing load of Treasury issuance. This risks a diminishing appetite from the private sector, including from overseas investors, to absorb the additional bonds flooding the market. This, in turn adds upward pressure on Treasury yields through a higher term / risk premium, typically leading to pressure on the dollar.

More recently, attention has switched to a previously little-known provision in the legislative package working its way through Congress. Section 899, now struck out of "One Big, Beautiful Bill", would have allowed the administration scope to impose a new levy on the income foreign investors earn on their US assets. Particularly vulnerable would have been those countries or regions where the US considers the tax regime of those investors' home countries to be "unfair". The legislation, as originally proposed, echoed the rationale for reciprocal trade tariffs and would, if finding its way onto the statute book, have significantly reduced the attractiveness of US financial assets, and the dollar, for overseas investors. Taking prevailing uncertainty into the capital markets, as was threatened, would be unambiguously negative for the dollar.

The critical question surrounding the provision really related to whether it was aimed at raising additional revenue, or to serve simply as a threat to generate more leverage in trade negotiations? Our assessment was that the provision would, ultimately, be either modified / diluted, or withdrawn completely to avoid what would surely be a sharply negative market pricing reaction. This assumption proved correct. Even if the Trump administration might like a weaker dollar to boost US manufacturing, higher Treasury yields, as a consequence of reduced overseas investor participation, would be a serious deterrent.

Mixed Fortunes After The Labour Party's First Year In Office

Prof. Jeremy Batstone-Carr, *European Strategist,* Raymond James Investment Services Ltd.*

It's been a year of mixed fortunes for the UK Labour Party administration since it swept to power with a substantial 174-seat majority at the 4th July 2024 General Election. The landslide victory, the Party's third best result ever and the best since 2001, should have provided a strong mandate for the administration's agenda after 14 years out of power. However, as is often the case with the UK's first past the post electoral system, an apparently dominant majority in terms of seats won (411, +209) does not tell the whole story. The Party achieved a mere 33.7% share of the popular vote, the lowest of any majority party on record. So, whilst Labour performed strongly, the result had as much to do with disaffected Conservative voters abstaining and the opposition split by the emergent, populist, Reform Party. Therein lies the administration's weakness, a vulnerability confirmed by the Party's poor showing in May's local council elections and more particularly, the loss of the Runcorn and Helsby by-elections to a jubilant Mr Nigel Farage. Prime Minister Sir Keir Starmer has scored some notable successes, particularly in terms of international relations and not lost on the UK's largely outward-looking index of leading 100 companies which hit an all-time high in June. But the going has been much tougher on the domestic front, high profile policy "U"-turns serving to complicate the job of Chancellor Ms Rachel Reeves as she battles to deliver a lasting improvement in the economy's fortunes.

FOREIGN POLICY: "WHAT THE RIGHT HAND GIVETH, THE LEFT HAND TAKETH AWAY"

The UK has been shielded from much of the uncertainty surrounding US trade policy following an agreement, the first, reached between negotiators on 8th May. Admittedly, the deal struck (likely having been in the works since Brexit) falls well short of a full free trade agreement, which would be both broad-based and permanent, but every little helps and the optics for both sides were favourable even if the overall economic impact proves limited (other than for directly affected sectors). Arrangements with the US were swiftly followed by a UK-EU reset accompanied by much fanfare, at the heart of which lies a common defence and security pact but also includes a "common understanding" including cutting customs checks on food products and improving student mobility programmes.

The positive impact on economic activity associated with both developments, and indeed the trade deal secured with India, is not a game-changer, the collective benefit estimated to amount to less than 0.5% of GDP. However, what benefits that are ultimately secured are likely to be offset by the impact of a new migration policy, a clear policy lurch to the centre in response to the surging Reform Party. The policy, designed to contribute to a reduction in

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net migration, would both detract from the labour force (working on the assumption that the labour participation rate, at 63%, is the same as for the rest of the population) and potential GDP.

ECONOMIC POLICY: MISSION IMPOSSIBLE?

Despite much fire and brimstone regarding a possible £20bn "black hole" in the public accounts, the incoming Labour administration actually inherited an economy in fairly good shape, certainly in relation to that of the United States or even France (the latter experiencing electoral turmoil at the same time). The UK had had its "Liz Truss moment" in September 2022 and politicians had learned to avoid preaching fiscal policy indiscipline. The incoming Chancellor promised to get the deficit under control and the country (and financial markets) were agog. The King's Speech on 17th July unveiled numerous manifesto pledges (rail nationalisation, clean energy investment, planning reform etc), but no defining surprise. Things started to go off the rails on 29th July when Ms Reeves announced that she would means-test future winter fuel payments (a policy lasting just one winter). The speech was supposed to be about what the government could and could not afford, but instead it raised eyebrows and left households and businesses nervously awaiting the 30th October Budget.

Ahead of the Budget the economy stagnated. Households and businesses knew that plans would be big, both in size and in scope and on that front they weren't disappointed. Tax increases of £42.1bn were confirmed by 2029/30 (one of the biggest tax-raising Budgets on record), mainly reflecting increases in employer National Insurance Contributions, capital gains and inheritance tax. The pledge not to increase taxes on "working people" felt more than a little hollow.

But while tax raising initiatives were "back-loaded" a substantial £74.2bn increase in spending was very much orientated to the present in an effort to kick start an economic revival whilst placating uneasy financial markets by remaining committed to rigid fiscal rules.

"THE WORLD IS CHANGING"

By the time the so-called "fiscal event" took place on 26th March the world looked a very different place to that just five months earlier. Confirmation of Mr Donald Trump's US election victory and subsequent inauguration generated a political and economic earthquake the consequences of which reverberate to this day. Most notably, the incoming President insisted that NATO allies do more in support of regional defence, rather than simply relying on a US military umbrella. The Fiscal Event focused on rotating spending away from overseas aid and towards defence, to the substantial (and ongoing) benefit of domestic and Euro Area contactors but simultaneously setting Ms Reeves on a collision course with her fellow Cabinet members.

While the shifting global political and economic landscape formed the backdrop to the March set-piece, a combination of rising gilt-edged yields (higher borrowing costs) and still stagnating economic activity left the Chancellor with no option other than to embrace austerity ahead of the independent Office for Budgetary Responsibility's anticipated downward growth and productivity forecasts in the coming autumn. Spending plans had to be pared to restore a £10bn "buffer" against still inviolable fiscal rules lost since the Budget.

"IT DOESN'T GET ANY EASIER"

Throughout a year of unrelenting toil there have been a number of bright spots. Boosted by fears regarding US trade policy, economic activity grew by a stronger-than-expected 0.7% in the first quarter, as manufacturers and exporters pulled forward activity ahead of the 2nd April tariff "Liberation Day". Elsewhere, sterling has proved resilient against both the euro and flagging US dollar, while energy prices, beyond a brief spike during the recent Israel – Iran conflict, have remained becalmed. This has helped keep the lid on inflation and allowed the Bank of England, very cautiously to lower interest rates.

But after its brief flicker, growth is subsiding again while the recent tight Spending Review has signalled no let-up in the tough decisions piling up in the Chancellor's in-tray. Policy "U"-turns on benefit and welfare spending, increased pressure to spend more on defence and higher borrowing costs leave Ms Reeves in a difficult position. If she wishes to avoid a political backlash from already disaffected back-benchers from her own Party and or an adverse reaction from the financial markets, tough budgeting decisions for departments outside the ring-fenced health, education and defence may have to be followed up by yet more tax increases in the autumn.

The Labour government closes its first year with a chequered report card. Having been out of office for fourteen years, assuming the reins of power was never going to be an easy task. A challenging domestic and international backdrop has hardly helped the novice administration, with no let-up in sight. Investors can at least be thankful that the financial markets have proved enduringly resilient. A Labour government good for the stock market? Who'd have thought it!

Section 899 Has Been Struck Out Of The US One Big Beautiful Bill Legislation

Prof. Jeremy Batstone-Carr, *European Strategist,* Raymond James Investment Services Ltd.*

Meandering its way through the labyrinthine US legislative process is President Trump's "One Big, Beautiful Bill", a cornerstone of the executive's fiscal policy agenda. In truth, while certainly big, the legislation is far from beautiful. The sheer scale and scope of the proposed plan makes it unwieldy and vulnerable to relentless tinkering by lawmakers in a deeply divided Congress. The Bill, approved by the House of Representatives by a single vote, passed to the upper house Senate where, following much debate, the Finance Committee handed back its amended draft legislation. Sweeping proposals covering taxation policy, Medicaid and energy-related provisions are now the subject of intense negotiations prior to a final vote. Arguably, the element of the legislation of greatest concern to investors, notably those outside the US, would have been the treatment of a highly controversial provision known as Section 899. To much relief, Treasury Secretary Mr Scott Bessent has ordered its removal from the final draft.

WHAT WAS SECTION 899 AND WHY DID IT MATTER?

The provision outlined how the US government might seek to impose taxes on individuals, businesses and other entities located in countries deemed by the administration to have a tax regime that discriminates against US interests. The proposal, regarded as an augmentation to ongoing trade (tariff) – related negotiations was dubbed a potential "revenge tax" designed to provide US negotiators with additional leverage in ongoing discussions. Included under the provision would have been those countries that levy a so-called digital services tax on the US, thus potentially affecting the UK, France, Germany, Canada, Australia and India.

The originally planned legislation did not lack precedent. In fact, Section 891 of the US tax code has sat on the statute book since the Great Depression era of the 1930s, when US protectionism was last at its peak. Although never utilised, the law authorises the doubling of tax on citizens and businesses from countries that operate tax policies thought discriminatory to US interests. Just because this and the proposed legislation surfaced, in an already febrile environment for the dollar (discussed elsewhere in this publication) and other US assets, the proposal was described in some quarters as a "ticking time bomb", an extension of trade conflict into the world of capital controls.

Capital controls are, by definition, designed to limit the flow of capital into and out of a country. In fact, Section 899 didn't seek to do that, limiting its scope to act only against those countries operating, in the eyes of the administration, against US interests. Although not now part of the legislative package, it is far from inconceivable that some form of capital control might be envisaged in the future in an effort to rein back large and growing trade and current account deficits. Indeed, earlier this year

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American Compass, a think tank with links to Vice President Mr JD Vance argued for capital control in the form of a market access charge which, if implemented, could raise as much as $2 trillion in revenue over the next decade.

WHY WERE FINANCIAL MARKETS ON EDGE?

The key point relates to what might have fallen out from initiatives aimed at reducing the US current account and trade deficits. In theory, a country's balance of payments must balance. Were capital inflows to the US to be reduced by the threat of an additional tax imposition (i.e. overseas investors to become less willing to finance these deficits) the deficits themselves must be reduced. If this is what President Trump wants (wanted) then restricting inflows of foreign capital, hand-in-hand with making American manufacturing great again. might be a way to do it.

The problem is, and remains, that this is not a cost-free adjustment. The mere threat of imposition could wreak havoc across US financial markets. One of the key planks behind the evolution of US exceptionalism is the relatively frictionless access to US financial assets for overseas investors. The mere whiff of a threat could cause international investors, key holders not just of US stocks but more importantly, its bonds, to take flight. This would, all things being equal, drive-up US borrowing costs, in turn squeezing domestic demand in the US, causing imports to fall. Whilst certainly one way to reduce the current account deficit, the reduction in domestic demand would likely result in higher unemployment. The Federal Reserve could act to mitigate the impact by lowering interest rates (a live issue), in which case the main channel through which capital controls would work would be through a weaker dollar, a tried and tested means of achieving a balance of payment adjustment even if, for it to work, US firms would be required to produce more goods domestically rather than abroad.

THE SENATE (PARTIALLY) DEFUSED THE TIME BOMB, TREASURY SECRETARY BESSENT DID THE REST

Contained amongst numerous adjustments to the proposed House legislation, the Senate handed back a number of important changes to the lower house version of Section 899 including, in particular, that the original plans had been softened in scope and delayed in implementation. The key points contained in the Senate document include a capping of new taxes at 15% after three years, a notable dilution from a possible maximum 50% (and confirmation that interest payments to central banks would fall outside the legislation's scope), while the entire plan would not be implemented until at least the start of 2027, one year later than originally envisaged. Critically, for investors, the watered-down version reflected very obvious upper house unease regarding the potential ramifications were the provision to have been implemented.

Sensing this discomfort and very much desirous of getting the fiscal package past the legislature to avoid yet another debt ceiling, possible default crisis, Treasury Secretary Bessent has, at least for now, killed off this most controversial element: "I have asked the Senate and House to remove the Section 899 protective measure from consideration in the One Big, Beautiful Bill".

We now move into the final stages of the Bill's enactment process and will be sure to keep readers informed of important developments should they arise.

KEY TAKEAWAYS

- Section 899 outlined how the US government might seek to impose taxes on individuals, businesses and other entities deemed to have a tax regime that discriminates against US interests, including the UK and Europe.
- Possible capital controls, although never enforced so far, might be one way of reducing the US trade and current account deficits but are far from cost-free. Overseas investor flight would potentially drive-up US borrowing costs.
- The Senate partially defused the original legislative time bomb, both softening and delaying implementation and Treasury Secretary Bessent has delivered the coup de grace.
- A vote on the sprawling legislative package, shorn of Section 899, is expected soon.

Disclosure

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Disclosure (cont.)

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The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

The MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world. The MSCI China A Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges. The MSCI Pacific Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in the Pacific region. The MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the US market. The MSCI Europe index is a European equity index which tracks the return of stocks within 15 European developed markets.

The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

The Bloomberg US Treasury Index measures the performance of fixed-rate, nominal debt issued by the US Treasury and denominated in US dollars. It is a benchmark for the US Treasury market, excluding Treasury bills (which are covered by a separate index) and certain special issues according to Bloomberg.

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