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MARKET  
OUTLOOK

# 2025 Mid-Year Outlook: Navigating Tariffs, Tailwinds, and Tech



Equity markets reached new all-time highs during the first half of the year. Global equities were up 9.47% during the first six months of the year, with a return of 6.2% and 14.1%, across US and European equities, respectively. Despite the strong performance year-to-date, the first six months were characterised by swings in volatility. Global equities overcame concerns in the AI growth trend triggered by DeepSeek, Liberation Day Tariffs, and a short-lived flare up in the Middle East. Monetary policy easing and expansionary fiscal policy drove European equity markets to outperform. Recent renewed interest in US equity markets was driven by strong performance in the technology sector as well as easing concerns on tariff impact. Fixed income markets also generated positive returns, as credit spreads tightened, locking in a return of 7.3% in global investment grade and 6.8% in global high yield. **We expect policy volatility, event risks and some softness in economic data to remain key characteristics for the second half of the year. However, we are likely past peak uncertainty on trade and geopolitical tensions, and risks of a cyclical downturn are well-contained. We remain neutral between equities and fixed income, while implementing tactical tilts within each asset class. Within equities we are favouring specific industries while actively managing interest rate sensitivity on the fixed income side.**

The key main drivers for the next six months are:

- **Short term slowdown, medium term growth.**

Worst case trade outcomes seem to be behind us, with US tariffs expected to settle at a substantially lower level than that anticipated in April. The effects of higher level of tariffs on the economy, particularly the increase in US prices is still yet to be seen. The same applies for the second order effects on consumer expenditure, inflation and the labour market and likely to feature in the second half of the year. Looking beyond, economies are expected to see a rebound in 2026. In Europe, expectations that Germany's fiscal stimulus and ECB rate cuts will support economic growth while the US tax bill is also expected to offer fiscal support to the US economy.

- **Monetary policy in easing mode**

The ECB has cut interest rates by 2% over the past year, approaching "the end of a monetary policy cycle". Further easing is still likely but current rates are accommodative and should continue to enable economic growth in the euro area. In the US, Fed officials are taking a more gradual easing approach. Slower core inflation and a potential rise in the unemployment rate may lead to 25bp rate cuts starting in September. While the job market seems strong with payrolls rising and the unemployment rate falling, underlying data shows weaknesses. Market expectations for US interest rates show two rate cuts by the end of year and additional cuts in 2026.

- **Fiscal policy to support economic growth**

In Europe, Germany's fiscal stimulus, composed of a €500 billion infrastructure fund and an exemption of defence spending from the country's borrowing limits, came as a boost to Europe's growth outlook. In total, the European Commission announced a European rearmament plan with over €800 billion in defence spending, aimed at reaching 3.5% of GDP within ten years. In the US, the Big Beautiful Bill aims to make temporary tax cuts permanent, increase spending on security defence and energy production, and cut spending on food and health insurance. It is estimated that the fiscal policy will add \$3.3 trillion to federal deficits.

# FIXED INCOME OUTLOOK

Although monetary policy has become more accommodative, yield curves have steepened significantly in recent months. While short-term yields remain closely linked to monetary policy expectations, the overall shape of the curve is largely influenced by fluctuations in the term premium. Consequently, policy and inflation expectations play a more critical role in shaping the yield curve.

The key expectation is that yield curves will steepen over the long term, reflecting bondholders' increasing demand for higher returns on long-term bonds. The term premium, which represents the additional compensation investors require for bearing the risks of longer-dated bonds, has risen significantly over the past months. In addition, given ongoing debates regarding U.S. fiscal policy and budget deficits, this steepening trend may persist. Persistent budget deficits, projected to remain in the 5-7% of GDP range by 2030, are becoming a structural feature of the economy, raising questions about long-term debt sustainability.

In Europe, the anticipated German fiscal stimulus is expected to result in substantial bond issuance. This increased supply of bonds could exert upward pressure on yields, particularly at the longer end of the curve. Additionally, Dutch pension reforms are likely to decrease demand for longer-dated bonds, further contributing to the steepening of the yield curve. These reforms may lead to a shift in investment strategies, with pension funds potentially reallocating assets away from long-term bonds.

Credit spreads are currently tight, suggesting that investors are being compensated minimally for assuming credit risk, especially the risk of default. This constrained risk premium makes credit instruments less appealing from a risk-return standpoint, reinforcing our preference for higher-quality issuers with stronger fundamentals and more resilient balance sheets.

Being mindful of the potential for continued upward pressure on long-term yields, we continue to favor the intermediate segment of the curve. This segment comprises of bonds with maturities ranging from 5 to 10 years, which offer a more attractive risk-return profile in the current environment.

Furthermore, we are actively seeking opportunities to lock in higher yields given the expectation of ongoing monetary easing and potential shifts in demand dynamics.

# EQUITY MARKET OUTLOOK

We continue to see upside within the global equity markets, driven by a balance of tariff risks, and expansionary fiscal and monetary policies.

Tariff news continues to feature daily. Although uncertainty on outcome of negotiations remains high, trade tariffs are likely to settle far below the “Liberation Day” announcements and the more recent high levels threatened by President Trump. Ongoing headlines point to more targeted, country by country tariffs, and we expect new tariffs to be sectoral focused. Despite the progress on trade levels, the effective tariff rate is still meaningfully higher compared to past years. This is likely to impact US margins through higher input costs. In Europe, heightened macro policy uncertainty and the negative impact from the strong surge in Euro against the US dollar have also led to earnings expectations to be downgraded.

Despite the near-term growth concerns, expansionary policies in Europe are shaping an improving business cycle. On this basis, we remain positive across the European region. This is underpinned by structural and fiscal spending across the region, willingness to negotiate trade deals as well as monetary policy easing by the ECB are driving expectations to reflect an improving economic and earnings story. With European equity markets cyclical by nature, and dominated by the financial services sector, European equities are still expected to continue to perform.

In the US, the AI trade has regained momentum, as the capex boom continues to support growth. We continue to expect the AI story to deliver long term growth for technology companies, and it remains a defensive growth story during evolving macro-economic concerns. Focus shifts on companies that benefit from the adoption of AI through improving earnings expectations, by translating revenue growth to cashflows and profits, irrespective of the macro-economic developments.

Against this macroeconomic backdrop we hold an industry bias. We continue to prefer US technology companies for growth momentum, with the media and internet, software and semiconductor industries expected to continue to benefit from the growing implementation of AI. The banking sector is expected to continue to benefit from steeper yield curves and increase loan demand, boosted by expansionary policies. This is offset by an underweight across cyclical sectors that are still in the middle of ongoing tariff negotiations, predominantly the consumer discretionary sector as we remain cautious on US consumer spending expectations.

# LOCAL MARKET OUTLOOK

The economic outlook for Malta remains positive, with forecasters expressing cautious optimism despite ongoing geopolitical uncertainties. Real GDP growth is projected to moderate to a strong 4% annually over the medium term, a rate significantly higher than in the euro area. Fiscal health is expected to improve, with the deficit projected to narrow to below 3% by 2026 and public debt stabilizing below 50% of GDP. The primary risk on the horizon is the highly uncertain outcome of trade tariff negotiations between the US and the EU. The current consensus suggests that Malta's service-driven economy will likely be shielded from the most direct and adverse effects of these potential tariffs. However, indirect risks may still arise through Malta's exports to more hard-hit countries, a situation that warrants continued vigilance.

The equity market in Malta is expected to benefit from the overall positive economic outlook. Strong performance in key sectors such as tourism and real estate will likely drive investor confidence. The tourism sector is expected to continue its robust performance, with inbound arrivals and expenditure surpassing 2024 levels. This will support related industries such as accommodation and food services, potentially leading to positive movements in stock prices for companies within these sectors. Additionally, the stable growth in the property market, with steady house prices and transaction volumes, will further bolster the equity market.

The corporate bond market in Malta is likely to remain attractive to investors, given the strong economic fundamentals and sectoral resilience. The financial and insurance sectors have shown strong expansion, which could lead to increased corporate bond issuance. The corporate bond market in Malta is expanding, with the total size expected to exceed €3 billion by the end of this year. Retail investors are increasingly participating in longer-dated offerings due to low interest rates on short-term securities and fixed deposits. The demand for income-generating assets is growing as investors seek better alternatives for their idle cash.

Government bonds are expected to remain a stable investment option, supported by Malta's strong fiscal health. The European Central Bank's monetary easing, with further rate cuts anticipated, will likely keep government bond yields attractive. The yield on Malta's ten-year government bond is expected to hover within its current range, broadly mirroring dynamics in the euro area. This stability makes government bonds a reliable choice for risk-averse investors seeking steady returns.

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