TD Wealth

Q2 | Quarterly Market Review

Everything you need to know about the quarter that was

July 3, 2025

Wealth Investment Office

QMR - Q2 25 | **Highlights**

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Unless otherwise indicated, performance figures are stated on a total-return basis. This document is for distribution to Canadian clients only. Please refer to Appendix A of this report for important disclosure information.

U.S. Equities

- Stocks rebounded in the second quarter, but only after U.S. President Donald Trump backpedalled on a sweeping regime of reciprocal tariffs, which had spooked the markets.
- The S&P 500 rose by 10.9%, the Dow Jones Industrial Average rose by 5.5% and the Nasdaq Composite Index rose by 18.0%.
- Nine of the 11 sectors within the S&P 500 performed positively. Technology and communication services were the top sectors, rising 23.7% and 18.5%. The energy sector was the worst, falling 8.6%.
- Large-cap stocks outperformed small-caps; growth stocks outperformed value.

Canadian Equities

- The broad Canadian equities index performed about on par with its American counterpart, outperforming in U.S. dollars due to the greenback's decline following tariff announcements.
- The S&P/TSX Composite Index ended the quarter up 8.5%, with all 11 sectors up.
- West Texas Intermediate oil finished Q2 at US$65.11, down 8.9% from the close in Q1. In the heavily weighted financial sector, the six largest Canadian banks were up 12.8%.
- Small-cap stocks outperformed large-caps; growth stocks outperformed value.

Canadian & U.S. Fixed Income

- Global fixed income markets continued to see gains in Q2, as government bond yields across most developed markets fell.
- The FTSE Canada Universe Bond Index posted a return of -0.6%, while the Bloomberg U.S. Aggregate Bond Index posted 0.7%.
- Canadian and U.S. investment-grade corporate bond indices registered returns of 0.4% and 1.4%, respectively.
- The Canadian government bond index fell 0.9% in Q2; the U.S. government bond index rose 0.4%.

International Equities

- International developed markets underperformed their American peers in Q2, mainly due to a significant decline in the U.S. dollar after the tariff shock in April. The U.S. dollar index was down 7.0% for the quarter, leading to underperformance in local currencies.
- The Nikkei 225, after a 10% plunge in Q1, rebounded 13.9% in yen terms (15.0% in USD) — outperforming all developed markets.
- Emerging-market equities rose markedly in Q2. The MSCI Emerging Markets Index, in local-currency terms, rose 8.1%.
- Mexican and Indian indices led gains for EM, thanks to aggressive rate cuts in both regions, as well as perceived protection from U.S. tariffs. Chinese equities lagged on extreme uncertainty around U.S. trade.

Market Movers
Equities in Review

April 2

The quarter starts in crisis mode, after U.S. President Donald Trump announces bruising “reciprocal tariffs” on virtually all trading partners. The new regime overturns the global economic order, leading the S&P 500 to fall 12% over the course of a week.

April 4

Canadian labour data shows a loss of 32,600 jobs in March, kicking off a downturn that TD Economics expects will lead to a recession later this year.

April 9

Market carnage forces the White House to do issue a 90-day pause on tariffs. Risk assets rebound, but lingering uncertainty leads the U.S. dollar to trend lower over the quarter (DXY -7.0%) while safe havens like gold trend higher (+5.0%).

April 26

The Liberal Party’s Mark Carney, having run on an anti-Trump platform, achieves one of the greatest electoral turnarounds in Canadian history. The election of a pragmatic centrist raises hope for more business-friendly policies.

May 12

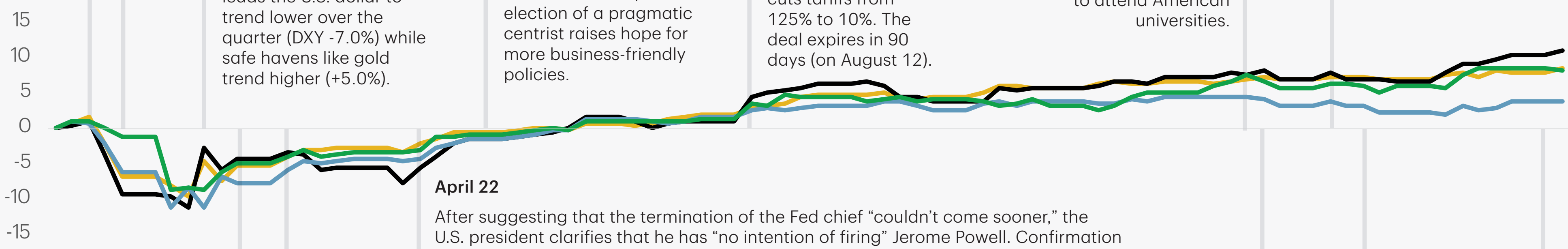
The U.S. and China reach a deal to reduce tariffs to manageable levels, with the U.S. slashing tariffs from 145% to 30%, while China cuts tariffs from 125% to 10%. The deal expires in 90 days (on August 12).

June 11

China and the U.S. reach an agreement on rare earth minerals. China agrees to lift certain restrictions, while the U.S. agrees to allow Chinese students to continue to attend American universities.

June 16

Bank of Japan holds rates at an ultra-accommodative 0.5%, despite inflation at 3.5%. The dovish decision supports the Nikkei 225, which outperforms all markets in Q2, up 13.9%.



April 22

After suggesting that the termination of the Fed chief “couldn’t come sooner,” the U.S. president clarifies that he has “no intention of firing” Jerome Powell. Confirmation of Fed independence supports a relief rally and reduces volatility for the remainder of the quarter.

April 14

China plays hardball, restricting the export of rare earth minerals used in U.S. automobiles and defence equipment. U.S. rhetoric begins to soften.

June 12

Israel strikes Iran, quickly taking out the country’s air defences. Oil prices spike about 15% within a week, but then come down to earth after an American strike, on June 22, results in a weak Iranian response, suggesting that a wider war can be averted.

April 11

China receives no reprieve on reciprocal tariffs. This results in a tit-for-tat escalation in tariffs, ending on April 11 — with U.S. tariffs at 145% and Chinese tariffs at 125%. The effect is a mutual trade embargo.

June 18

With extreme tariff uncertainty looming, the Federal Reserve opts to hold rates at 4.50% for the fourth meeting in a row, despite the U.S. president’s personal attacks on social media.

June 29

The U.S. president calls off trade talks with Canada, arguing against a new Digital Services Tax that would hit American tech companies. The new pragmatic PM agrees to shelve the new tax in exchange for a return to the negotiating table. (TD Economics expects a contraction in Q2.)

S&P 500
MSCI EAFE
S&P/TSX Composite
MSCI Emerging Markets

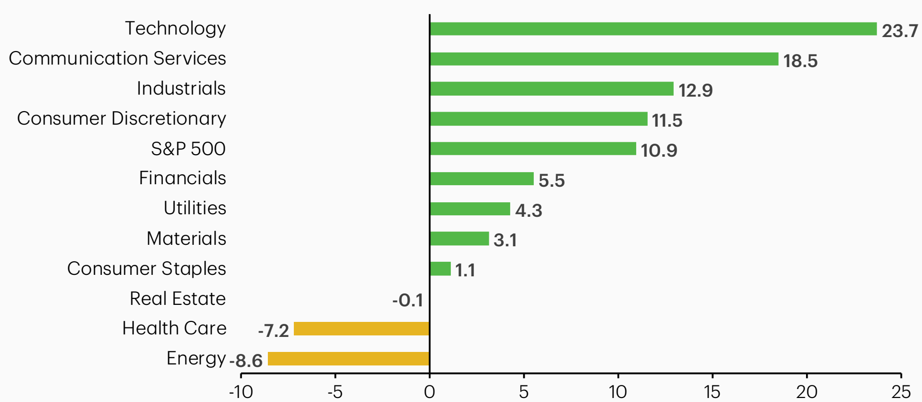
Source: TD Wealth, Reuters, FactSet as of June 30, 2025.
Note: Indices are tracked in local currency.

U.S. Equities

Indices	Q2 Return (%)	Q2 Return (%, C$)	YTD Return (%)	YTD Return (%, C$)
Dow Jones Industrial Average	5.46	-0.04	4.55	-1.00
S&P 500	10.94	5.15	6.20	0.56
S&P 400	6.71	1.14	0.20	-5.12
Nasdaq Composite	17.96	11.80	5.85	0.23
Russell 2000	8.50	2.84	-1.78	-7.00

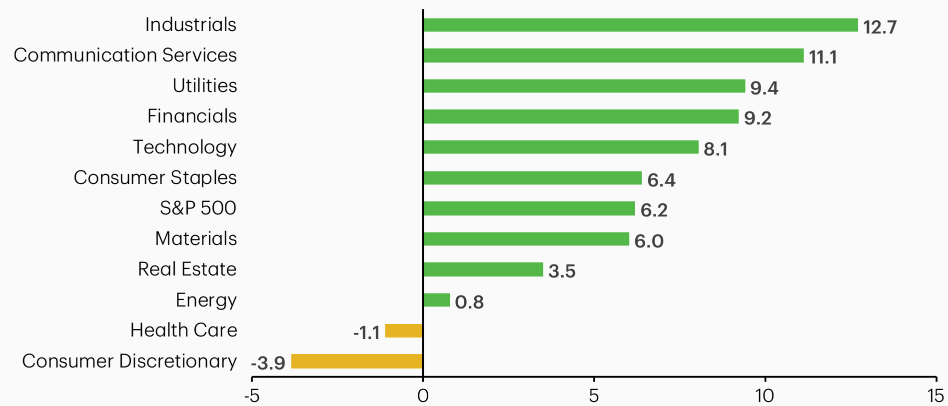
Source: FactSet as of June 30, 2025. Total returns including dividends and distributions. Index returns calculated in U.S. and Canadian dollars.

Q2/25 S&P 500 Sector Returns



Source: FactSet as of June 30, 2025

YTD S&P 500 Sector Returns



Source: FactSet as of June 30, 2025

Equities rebounded in Q2, but only after the U.S. president backpedalled on policies that had spooked the markets. On April 2, the White House announced reciprocal tariffs on its trading partners, leading the S&P to plunge more than 12% — its worst decline since the pandemic. The announcement also prompted China and the U.S. to take turns raising tariffs to unfathomable levels, effectively instituting mutual trade embargoes.

On April 9, the market carnage forced the U.S. to back down, with President Trump issuing a 90-day pause on new tariffs to allow for deal-making. China, however, received no such reprieve, and countered with export restrictions on rare earth minerals essential to many U.S. industries. These trade restrictions ultimately forced both sides to soften their rhetoric, laying the groundwork for an inevitable détente (in May).

Markets were also reassured by Trump's 180-degree turn with respect to central-bank independence. Days after suggesting that the Fed chair's "termination cannot come fast enough," the U.S. president clarified, on April 22, that he had "no intention of firing" the head of the central bank. This

Q2/25 Vitals

Policy Rate ↔
0 bps to 4.5%

Core Inflation ↓
February 3.1% | May 2.8%

Economic Growth ↓
Q4 2.4% | Q1 -0.5%

Unemployment rate ↑
February 4.1% | May 4.2%

Confidence (Services PMI) ↓
February 53.5 | May 49.9

prompted a relief rally that was further supported by positive economic data, a strong earnings season and a deal with China on May 12 to reduce tariffs to levels that, while high, still allowed for essential trade.

After a raucous April and May, the final month of the quarter proved relatively stable, with stocks trading within a narrow range. The Fed held rates steady throughout the quarter, but geopolitical turmoil more than made up for a sleepy Fed. In late June, the U.S. decided to join Israeli attacks on nuclear facilities in Iran. Oil spiked briefly, but then came back down to earth as markets cheered a muted response from the weakened adversary, suggesting that a prolonged war might yet be avoided.

Overall, for the three months ended June 30, 2025, the S&P 500 rose by 10.9%, the Dow Jones Industrial Average rose by 5.5% and the Nasdaq Composite Index rose by 18.0%. Nine of the 11 sectors within the S&P 500 rose. Technology and communication services were the top sectors, rising 23.7% and 18.5%. The energy sector was the worst, falling 8.6%. Large-cap growth stocks outperformed. Large-cap stocks (S&P 500) rose 10.9%, outperforming small-caps (Russell 2000), which rose 8.5%. Growth stocks (S&P 500 Growth Index) rose 18.9%, outperforming value stocks (S&P 500 Value Index), which rose 3.0%.

In late June, the Bureau of Economic Analysis released its third and final estimate for the first quarter. The U.S. economy went into reverse in Q1, contracting 0.5% (q/q annualized, 2.4% in Q4) after a long streak of expansion. This was much worse than the 1.4% expansion forecasted by TD Economics (TDE) three months ago. The contraction can be largely attributed to a surge in imports, as consumers and businesses tried to get ahead of the pending tariff regime. Imports skyrocketed 42.6%, while exports rose by 2.4%, resulting in a subtraction of 4.9 percentage points (pp) from headline growth.

While the import surge may be seen as a one-off, there are other signs that the economy is deteriorating as we enter Q3. Survey data from purchasing managers show a notable decline, for example. The Institute of Supply Management's purchasing managers index (PMI) for manufacturers slipped back into contraction, from 50.3 in February to 48.5 in May. More importantly, the larger services side of the economy, which had remained above the 50 threshold for the past 12 months, also fell into contraction, diving from 53.5 in February to 49.9 in May. The PMIs show that, as widely anticipated, the U.S. economy is beginning to slow.

This gradual decline is also starting to show up in the labour figures. The economy generated 120,000 jobs in March, 147,000 in April and 139,000 in May. That represents a modest three-month average of 135,000 jobs — about 33% fewer than the previous three months. These numbers, it should be noted, came in above expectations, reflecting a challenged but resilient jobs market overall, with the unemployment rate ticking up a mere 10 bps over this time, to 4.2%, still near the historical low. The labour market is showing clear signs of cooling, but not yet enough to force the Fed to move on interest-rate cuts. TD Economics anticipates a rebound in the second quarter, as imports drop off, with real GDP expected to grow 2.7%. The weak Q1 performance, however, has led TDE to reduce its full-year forecast from 1.9% to 1.7%.

Tariff pressures and higher oil prices seem to be keeping price growth near the top of the Fed's 1% to 3% range of tolerance. The consumer price index ticked down to 2.7% year-over-year in May from 2.8% in February. Core inflation (which excludes volatile food and energy prices) offers a more optimistic view, continuing to decline from 3.1% in February to 2.8% in May. A slight fall in wage growth, from 4.0% in February to 3.9% in May, also shows inflation moving in the right direction, but not nearly quickly enough to move the needle on rate cuts.

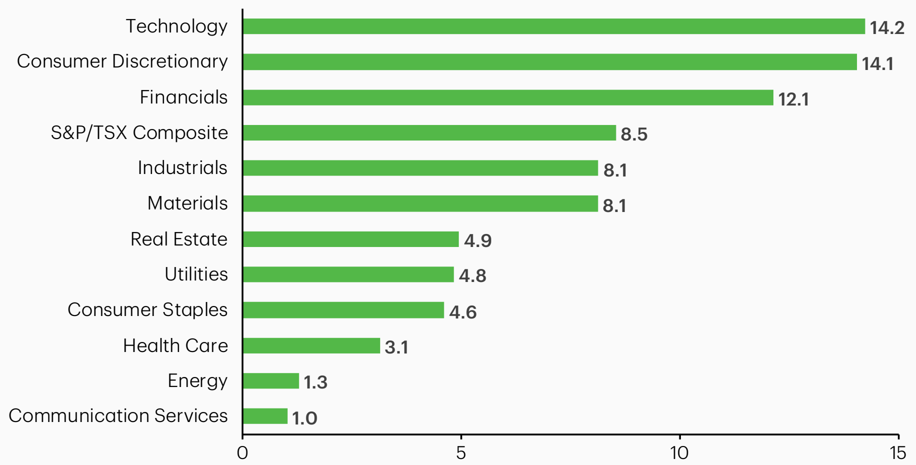
The Fed has now been on the sidelines for the first half of the year, leaving the policy rate (the upper bound for the federal funds rate) at 4.5%. What's more, the median projection of Fed committee members for the end-of-year policy rate has also remained steady, at 4.0%. A weaker-than-expected performance in Q1, however, has led TDE to raise its projection for cuts this year. It now concurs with the futures-market forecast of three 25-bp rate cuts, which would leave the policy rate at 3.75% at year-end.

Canadian Equities

Indices	Q2 Return (%)	YTD Return (%)
S&P/TSX Composite	8.53	10.17
S&P/TSX 60	7.59	9.46
S&P/TSX Completion	12.53	13.14
S&P/TSX SmallCap	11.75	12.74
S&P/TSX Preferred Share	4.59	7.30

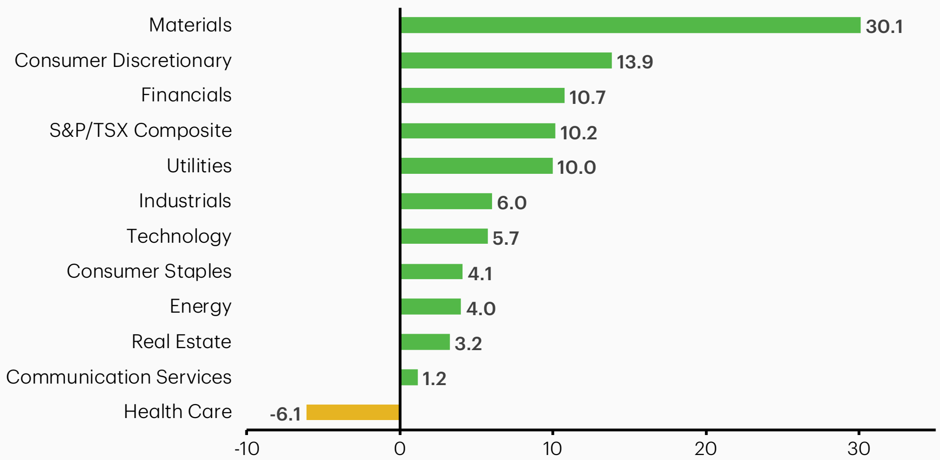
Source: FactSet as of June 30, 2025. Total returns including dividends and distributions.

Q2/25 S&P/TSX Sector Returns



Source: FactSet as of June 30, 2025. Index total returns.

YTD S&P/TSX Sector Returns



Source: FactSet as of June 30, 2025. Index total returns.

The broad Canadian equities index performed about on par with its American counterpart, outperforming in U.S. dollars. The second quarter got off to a rough start, though. On April 2, the White House announced sweeping reciprocal tariffs on virtually all its trading partners, sparking fears of a global recession. This triggered the TSX's steepest drop since the outset of the pandemic, dragging the composite index briefly into correction territory. Defensive assets like gold initially fell in the liquidity scramble but then spiked as investors rushed to safety.

Then, a week later, the U.S. president did an about-face, announcing a 90-day pause on many of the new tariffs. This fuelled a fierce rebound in risk assets, particularly in tech and energy shares. In Canada, the composite index leapt 5.4% in a single day — its biggest one-day jump in five years. The recovery continued through April, with the election of Prime Minister Mark Carney in late-April helping to remove some policy uncertainty and raise the prospect of a more business-friendly government. By early May, the index had recouped its losses on the tariff announcement.

Q2/25 Vitals

Policy Rate ↔
0 bps to 2.75%

CAD/USD ↑
5.4% to 73.3 cents

WTI Oil ↓
-8.9% to US$65.11

Spot Gold ↑
+5.0% to US$3,307.70

Big Six Bank Earnings ↑
+5.6% (y/y) to $13.96

The final stretch of Q2 saw a sustained advance. One pivotal catalyst came in mid-May, when Washington and Beijing struck a tariff truce: the United States slashed its April tariffs (from 145% to 30%) while China cut its own duties (from 125% to 10%) for 90 days. By late June, the TSX was hitting record highs. The party almost ended on a sour note, though, when the U.S. president cut off trade negotiations due to a controversial digital services tax. Canada, however, agreed to drop the new tax in order to return to the negotiating table.

The S&P/TSX Composite Index ended the quarter up 8.5%, with all 11 sectors up. Small-cap growth stocks outperformed. Small-cap stocks (S&P/TSX Canadian Small Cap Index) rose by 11.8% in Q2, outperforming large-caps (S&P/TSX 60 Index), which rose by 7.6%. Growth stocks (MSCI Canada Growth Index) rose by 8.6%, outperforming value stocks (MSCI Canada Value Index), which ended the quarter up 8.3%.

West Texas Intermediate oil prices dropped by 8.9% from the close of US$71.48 on March 31 to a finish at US$65.11 on June 30. Within the quarter, the price swung from an intraday low of US$55.12 set on April 9, to an intraday high of US$78.40. Both highs and lows were driven by fears: of a tariff-induced economic slowdown (driving the lows) and of oil shortages because of conflicts in the Middle East (driving the highs).

Gold closed the quarter with a solid gain, closing at a price of US$3307.70, up 5.0%. Three factors appear to account for the continued strength of gold: a softer U.S. dollar; expectations for tariff-induced inflation; and geopolitical uncertainty. In the heavily weighted financial sector, meanwhile, the six largest Canadian banks increased 12.8%, outperforming the broad index by 500 bps. The group beat consensus estimates by 5%, with pre-tax pre-provision earnings increasing 16.2% y/y.

Turning to the broader economy, real GDP growth accelerated slightly to 2.2% in Q1 (q/q annualized, 2.1% in Q4), easily topping expectations of 1.8% three months ago by TD Economics (TDE). While the U.S. economy contracted due to an excess of imports ahead of the new tariff regime, the Canadian economy benefited from this dynamic, with a healthy gain in exports. Digging beneath the surface, however, it's clear that trade tensions have started to affect economic activity. Growth in consumer spending slowed rapidly in the quarter (1.2%, 4.9% in Q4) and there wasn't much to celebrate on the business-investment front either.

Dark clouds were easier to spot in the labour market, which has begun to contract. In March, the Canadian economy lost 32,600 jobs — its worst performance since the depths of the pandemic in June 2022. Then, in April and May, the jobs market essential treaded water, generating a negligible 7,400 and 8,800 new jobs. That amounts to a total three-month loss of 16,400 jobs — compared to a gain of 168,000 jobs in the previous three months. By May, the unemployment rate was at 7.0%, up three months in a row from 6.6% in February.

Although weakness in the labour market hasn't shown up meaningfully in household finances, we are starting to see some deterioration. Average net worth increased just 0.8% in Q1 (q/q, 1.4% in Q4, 1.7% in Q3) due to stagnant real estate prices and weak U.S. equity markets early in the year. Although wages are still rising faster than inflation (3.4% wage growth versus 1.7% inflation in May), labour weakness will eventually be reflected in household income, with serious implications for domestic demand.

Despite some clear signs of weakening in the economy — namely, job losses and a drop in consumer spending — the Bank of Canada held its policy rate steady at 2.75% at both its meetings in April and June. In justifying its stand-pat decision, the Bank pointed to tariff uncertainty and an unusual rise in inflation. From February to May, CPI inflation in Canada fell from 2.6% to 1.7%. However, core inflation (CPI-median) remained stubbornly high, rising from 2.8% to 3.0% over this time.

Looking ahead, though, BoC Governor Tiff Macklem has expressed a willingness to reduce rates if the economy weakens and inflation is contained. TDE expects that, barring a trade-negotiation miracle, Canada's economy will tip into recession this year, and more interest-rate cuts will be required. It expects economic growth to contract 2.0% in the second quarter, and for the BoC to issue two more 25-bp rate cuts, leaving the policy rate at 2.25% by year's end (compared to 3.75% in the U.S.)

Canadian & U.S. Fixed Income

Government Bond Yield	Canada			United States		
	Current (%)	Q/Q Change (pp)	YTD Change (pp)	Current (%)	Q/Q Change (pp)	YTD Change (pp)
91-Day Treasury Bill	2.66	0.03	-0.47	4.29	0.00	-0.02
2-Year Government Bonds	2.59	0.14	-0.34	3.72	-0.16	-0.52
5-Year Government Bonds	2.82	0.21	-0.14	3.80	-0.15	-0.58
10-Year Government Bonds	3.27	0.30	0.05	4.23	0.02	-0.34
30-Year Government Bonds	3.56	0.34	0.23	4.77	0.20	-0.01

Source: FactSet as of June 30, 2025. Index returns are reported on a total-return basis; pp (percentage point).

Global fixed income markets continued to see gains in the second quarter. The highlight this time around was the lower government bond yields across most developed markets, especially at the short end of the yield curve. Despite market volatility stemming from the global tariff negotiations with the U.S., activity and labour data show that the economy remained resilient, with inflationary pressures moderating. Most central banks, including the Federal Reserve, adopted a cautious stance, monitoring the potential impact of tariffs on inflation. U.S. fixed income markets saw gains during the quarter, while the Canadian bond markets, which saw higher yields, were modestly negative. The FTSE Canada Universe Bond Index posted a return of -0.6%, while the Bloomberg U.S. Aggregate Bond Index (CAD-hedged) posted 0.7%.

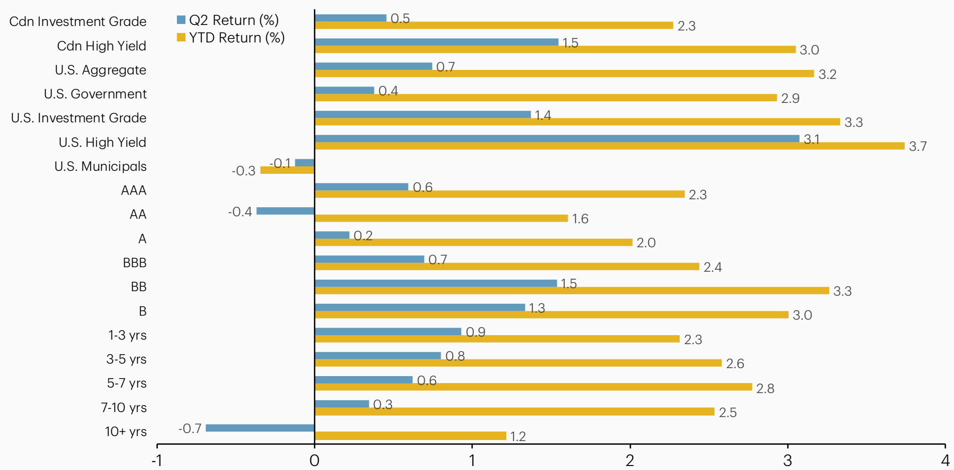
In the United States, the Federal Reserve left its policy rate unchanged in the second quarter. In the press conference following its June meeting, Fed Chair Jerome Powell said that uncertainty about the economic outlook has decreased but still remains high. The Fed's Summary of Economic Projections (SEP) now takes into account recent tariff announcements, forecasting higher inflation and slower growth for this year, with upward revisions to inflation forecasts for 2026 and 2027. The median projection of Fed committee members continues to imply two rate cuts this year, but a few officials have shifted their projections higher, suggesting that they expect inflation to persist due to higher tariffs.

The Bank of Canada (BoC) kept its overnight rate unchanged at 2.75% in the second quarter. At its June meeting, the Bank signalled that a rate

Fixed Income Indices	Q2 Return (%)	YTD Return (%)
FTSE Canada Universe Bond Index	-0.6	1.4
FTSE Canada Universe All Government Bond Index	-0.9	1.2
FTSE Canada All Corporate Bond Index	0.5	2.3
FTSE Canada Real Return Bond Index	-2.2	1.2
FTSE Canada Provincial Bond Index	-1.0	0.9

Source: FactSet as of June 30, 2025. Total index returns.

Canadian & U.S. Fixed Income



Source: FactSet as of June 30, 2025

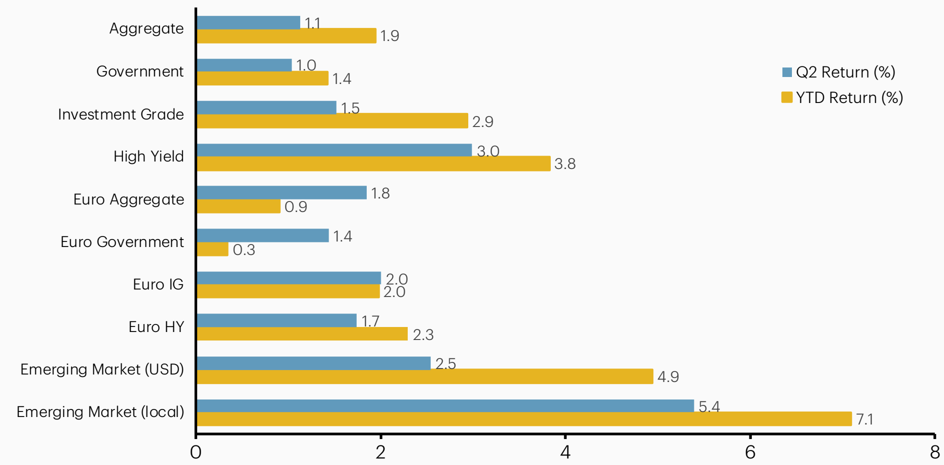
cut may be necessary if the economy weakens and inflation remains contained. BoC Governor Tiff Macklem warned that such a statement should not be interpreted as "forward guidance," and that the Bank will focus on incoming data rather than trying to predict the future direction of the economy. With high uncertainty about U.S. tariffs, the Bank is willing to wait for clearer signs regarding the trade dispute.

The broad global fixed income universe, represented by the Bloomberg Global Aggregate Index (CAD-hedged), posted a 1.1% return over the second quarter. Canadian government bonds underperformed both U.S. Treasuries and the global universe, with the Canadian government bond index posting a return of -0.9%, while the U.S. Treasury index (CAD-hedged) posted a return of 0.4% and the global government bond index posted a return of 1.0%. The U.S. 10-year Treasury yield started the quarter at 4.21% and ended at 4.23% (a 2-bp increase), while the equivalent Canadian government bond yield started at 2.97% and ended at 3.27% (a 30-bp increase).

Following a credit selloff in early April, corporate bonds saw gains in the second quarter, supported by easing trade tensions and a decline in recession fears. On the Canadian side, the investment-grade (IG) spread performed positively, tightening by 16 bps and ending at an option-adjusted spread of 97 bps, while U.S. IG spreads tightened by 9 bps to end at 83 bps. Strong coupon income and tighter spreads helped offset the underperformance of Canadian government bonds. The corporate sector posted a return of 0.5%, outperforming the -0.6% return of the aggregate Canadian fixed income index. Looking closer, lower-quality credit outperformed the other cohorts, with BBB-rated credit posting a return of 0.7%, with A-rated credit posting 0.2% and with AA-rated credit posting -0.4%.

The yield curve for Canadian government bonds steepened over the quarter, leading short-maturity corporate bonds to outperform both medium- and long-maturity corporate bonds. Over the quarter, the longest-maturity cohort of 10-year-plus posted returns of -0.7%. The shorter-maturity cohorts of one- to three-year bonds and three-to five-year returned 0.9% and 0.8%. The medium-maturity cohort of seven- to 10-year and five- to seven-year returned 0.3% and 0.6%. Higher real yields led to negative performance for Canadian real-return bonds, which posted a return of -2.2% over the quarter. They underperformed the government bond universe, at -0.9%. Canadian provincial bonds, with longer maturity profiles, underperformed corporate bonds over the second quarter, posting a return of -1.0%.

Global Fixed Income



Source: FactSet as of June 30, 2025

For global corporate bonds, lower government yields and tighter credit spreads across geographies led to solid performance. In the United States, IG corporate spreads tightened by 9 bps over the quarter, while U.S. high-yield (HY) corporate spreads tightened by 50 bps. The U.S. IG corporate bond universe (CAD-hedged) returned 1.4%, underperforming the global IG corporate universe (CAD-hedged), which returned 1.5%. U.S. HY corporate bonds (CAD-hedged) also performed positively, posting a 3.1% return, marginally outperforming the global HY corporate universe (CAD-hedged) at 3.0%. USD-denominated emerging-market debt also performed well, posting a return of 2.5% over the quarter, while local-currency debt returned 5.4%.

International Equities

Indices	Q2 Return (%)	Q2 Return (%, C$)	YTD Return (%)	YTD Return (%, C$)
FTSE 100	3.19	3.92	9.50	13.58
DAX	7.88	11.24	20.09	28.97
CAC 40	0.96	4.11	6.81	14.96
MSCI European Monetary Union	3.28	8.64	10.80	21.85
Nikkei 225 Stock Average	13.87	12.17	2.58	6.07
MSCI Emerging Markets	8.13	6.34	11.09	9.43

Source: FactSet as of June 30, 2025. Total returns including dividends and distributions. Index returns calculated in local currencies and Canadian dollars.

International developed markets underperformed their American peers in Q2, mainly due to a decline in the U.S. dollar after the tariff shock in April. The U.S. dollar index was down 7.0% for the quarter, leading to underperformance (as calculated in local currencies). Japan was the exception, leading all markets after a plunge earlier in the year. In the UK, the FTSE 100 recorded a middling performance, posting a total return of 3.2% (9.5% in USD). Although the UK was the first major economy to strike a trade deal with the U.S. (on May 8), fears of a global recession have weighed on the multinationals that dominate the index. Meanwhile, persistent inflation raised the fear of higher-for-longer rates, bolstering the pound and hurting exports. The energy-heavy index was also hurt by a drop in the price of Brent crude, after OPEC and its allies increased supply.

As for the British economy, an acceleration in Q1 masked serious underlying weakness. Real GDP rose 0.7% in the first quarter (q/q annualized, 0.1% in Q4), but the rise was attributable to unseasonably warm weather, which boosted activity in the service sector, while exports rose on the back of U.S. customers front-loading purchases in advance of the tariff regime. The British economy has been defying calls for a recession for a couple of quarters now. As it happens, it may do so again in Q2 — after a brief contraction in April, PMIs rose back over the 50 threshold, recording a slight expansion of 50.7 in June. Despite rising inflation (3.4% in May, 2.8% in February), the Bank of England issued one 25-bp rate cut in Q1. For justification, the Bank pointed to rising unemployment levels, which could necessitate further stimulus later in the year.

The story was much the same across Europe, with the MSCI European Monetary Union (EMU) Index underperforming in euro terms (3.3%) but outperforming in U.S. dollars (11.3%). Relative strength in the euro — as investors flock to perceived safety — has eroded export competitiveness and squeezed corporate earnings. In addition, geopolitical conflicts, such as the protracted war in Ukraine, have weakened sentiment. Major European economies saw weak growth in the quarter, while falling commodity prices (notably oil) hit the energy-heavy index hard.

Backward-looking economic data show a slight acceleration in Q1, with real GDP rising 0.6% (q/q annualized, 0.3% in Q4). Europe benefited from tariff front-loading in the first quarter, but exports should cool significantly as the effect of front-loading fades and tariffs start to bite. Consumer sentiment, as measured by the Euro Area Economic Sentiment Indicator, has been negative since June 2022 and stuck at around 95 for the past 12 months. Business confidence, however, has been resilient, hovering in expansionary territory around 50.3. Economists expect short-term growth to be highly volatile due to erratic U.S. policy and knock-on effects from the U.S.-China trade war.

Volatile Japanese markets once again reversed course in the second quarter. The Nikkei 225, after a 10% plunge in Q1, rose 13.9% in yen terms (and 15.0% in USD) — outperforming all developed markets. This was due in part to the Bank of Japan's reluctance to raise interest rates (despite high inflation, at 3.5%). The BoJ, after issuing a 25-bp hike in January, has stayed on the sidelines, maintaining an ultra-accommodative rate of 0.5%.

This kept the yen weak in Q2, allowing exporters on the Nikkei to earn more in local-currency terms. And while energy-heavy indices suffered from the decline in oil prices, Japan's energy-light index benefited from reduced costs.

The rebound may be short-lived, however. Real GDP in Japan contracted 0.7% in Q1 (q/q annualized, +2.4% in Q4), due mainly to a weakening of Japan's trade surplus; exports fell 2.3% in Q1, while goods imports rose 12.1%. Business confidence has remained resilient, with the composite PMI rising to 51.5 in June, but economists expect the economy to slow for the remainder of the year, after an unexpectedly large rise in U.S. tariffs. If inflation falls alongside economic activity, the BoJ's reluctance to hike may yet prove prescient.

Finally, emerging-market equities rose markedly in Q2. The MSCI Emerging Markets Index, in local-currency terms, rose 8.1%, led by Mexican stocks, which rallied 9.5% as the central bank cut its policy rate aggressively (100 bps) over the quarter. Even with lower rates, the peso jumped 8.3% against the USD, as foreign investors flocked to the USMCA-protected market. In India, meanwhile, the Nifty 50 climbed 8.5% after the Reserve Bank of India shifted to an accommodative stance, surprising markets with 75 bps worth of rate cuts. Deft diplomatic overtures also won India a reprieve on tariffs, with the prospect of a forthcoming U.S. deal.

The Brazilian Bovespa index rose 6.6%, thanks in part to a relief rally spurred on by the socialist administration's decision to adhere to a new fiscal framework aimed at curbing deficits, without any major spending surprises. The Brazilian central bank, meanwhile, hinted at possible cuts later in the year after a series of bruising hikes in 2025. The weakest among the top four emerging markets was China, where the SSE Composite Index rose 3.2%. Tough negotiations with the U.S. have generated extreme uncertainty, leading the People's Bank of China to cut rates and lower reserve requirements for banks.

The economies of Mexico, India, Brazil and China (the four largest emerging markets) grew 1.2%, 6.4% (fiscal year), 2.9% and 5.0%, respectively, in 2024. TD Economics forecasts 2025 growth of 0.2%, 6.7%, 2.6% and 4.6% for these nations.

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