

Data and opinions as of July 31, 2025

Markets at highs, policy in flux

Markets reached new highs in July, but beneath the surface, concentration risk and valuation concerns are growing—especially in the U.S., where the top 10 stocks now dominate index performance. Diversification across regions and sectors remains essential. Meanwhile, the Fed held rates steady, but political pressure and stronger-than-expected economic data have clouded the outlook. A dovish pivot seemed likely until late-month surprises—including robust GDP and jobs numbers—prompted markets to reassess. Equity indices pulled back, and yields rose, reflecting renewed uncertainty. On the trade front, Canada faces a 35% tariff on non-CUSMA goods starting August 1, yet markets have responded with surprising calm. While energy and potash are exempt, other sectors may feel the pinch in Q3. Overall, the environment remains supportive but fragile. Advisors should emphasize flexibility, diversification, and a long-term view as policy, politics, and pricing continue to evolve.

NEI perspectives

Markets at all-time highs—stay diversified: Equity markets continued to climb in July, but leadership remains narrow and valuations are stretched—especially in the U.S. **Bottom line:** Don't let record highs deter disciplined investing. Diversify across regions and sectors to manage risk.

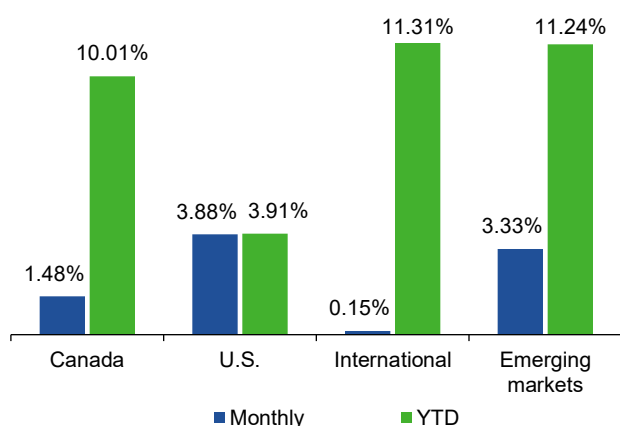
The Federal Reserve (Fed) holds steady, but uncertainty rises: The Fed kept rates unchanged, but late-month economic surprises and political pressure have clouded the outlook. **Bottom line:** A less hawkish Fed supports markets, but recent data has rattled rate-cut expectations. Stay flexible.

Tariff risks persist, but markets stay calm: Canada faces a 35% tariff on non-CUSMA goods starting August 1, yet markets have remained resilient. **Bottom line:** Tariffs are back in focus. Watch for sector-specific impacts, especially in manufacturing and retail.

– NEI Asset Allocation team

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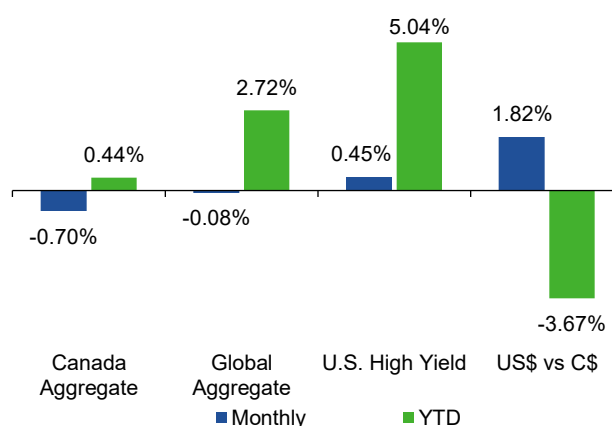
Equity returns (in C\$)



Canada: MSCI Canada Index TR; **U.S.:** MSCI USA Index TR
International: MSCI EAFE Index TR; **Emerging markets:** MSCI Emerging Markets Index TR.

Source: Morningstar Direct.

Fixed income and currency returns (in C\$)



Canada Aggregate: Bloomberg Barclays Canada Aggregate Bond Index; **Global Aggregate:** Bloomberg Barclays Global Aggregate Bond Index; **U.S. High Yield:** Bloomberg Barclays U.S. High Yield Index.

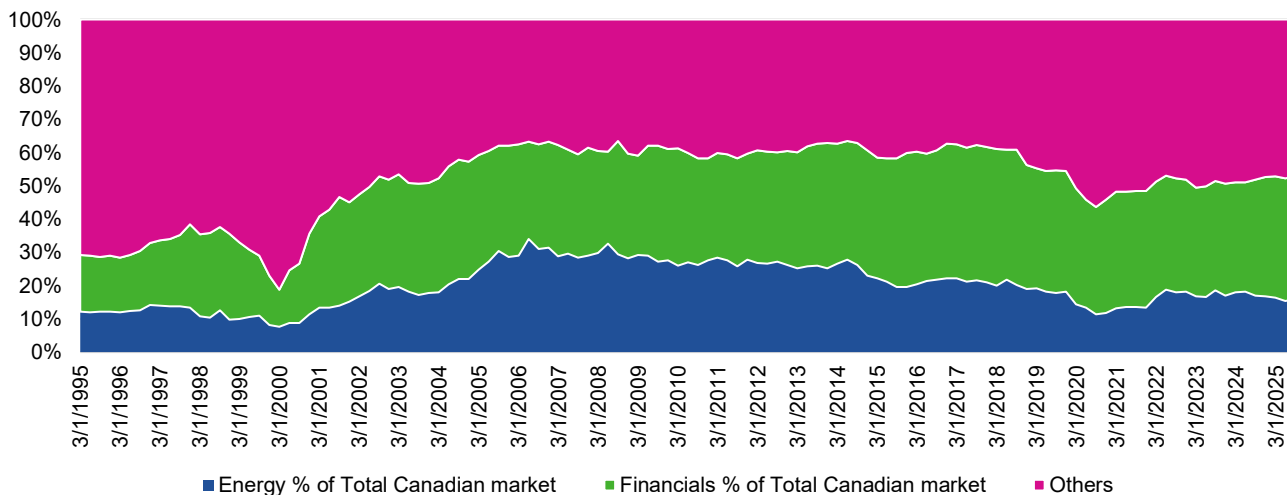
Source: Morningstar Direct.

Investing at all-time highs: why diversification matters

Markets reached new highs in July, with the S&P 500 and MSCI World Index continuing their upward momentum. While this can trigger investor hesitation, historical data shows that investing at all-time highs has often led to positive returns—over 80% of the time over the past three decades. The real concern isn't the level of the market, but its composition. In the U.S., the top 10 stocks now account for over 35% of the S&P 500's market cap, a level not seen since the early 2000s. These names—mostly tech giants—carry elevated valuations and dominate performance, raising concentration risk.

International markets offer a compelling contrast. Europe and Japan present more balanced sector exposure and trade at significantly lower valuations. For example, MSCI Europe's forward P/E is around 13.2, compared to 20.1 for the U.S. Meanwhile, sector leadership continues to evolve. Canada's index, once dominated by energy, now sees financials and tech playing a larger role. This shift underscores the importance of diversification—not just across asset classes, but across geographies and sectors.

Chart 1: TSX Sector Composition Across Decade



Source: Bloomberg

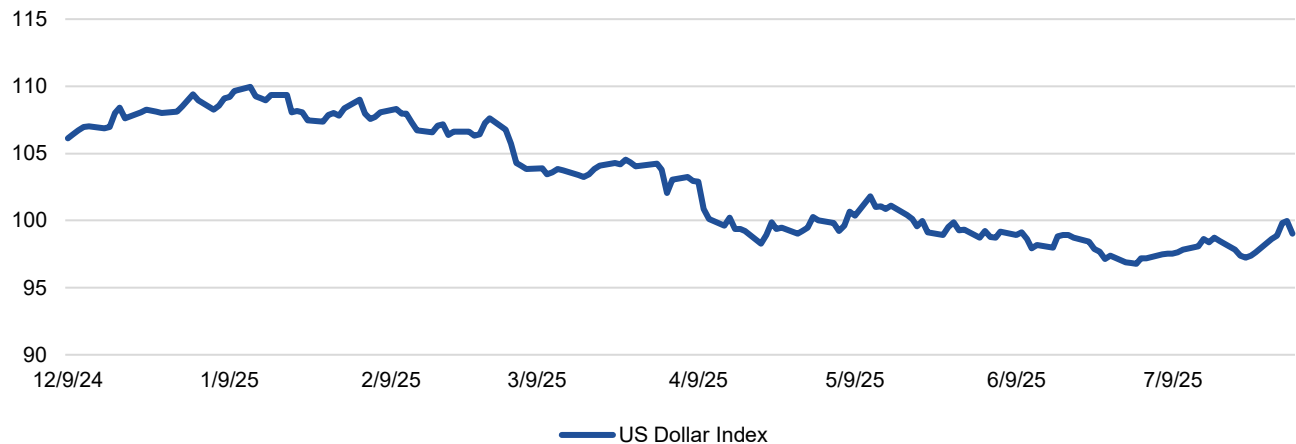
Bottom line: Market highs aren't a signal to retreat—they're a reminder to stay diversified. A globally balanced portfolio helps manage risk and capture opportunity, especially when leadership is narrow and valuations are elevated.

Cooling inflation, political pressure, and a cautious Fed

The Fed held rates steady at 4.25%–4.50% in July, but the decision came with growing tension. Chair Powell maintained a cautious tone, citing sticky services inflation and uncertainty around the impact of recent tariffs. Meanwhile, two Fed governors dissented in favor of a rate cut—the first dual dissent in decades—reflecting political pressure from former President Trump, who has called for lower rates to ease the \$1 trillion interest burden on the government's debt.

Initially, markets interpreted the Fed's stance as supportive. But sentiment shifted dramatically in the final days of July. Stronger-than-expected Q2 GDP growth (3% annualized) and firmer inflation readings conflicted with negative revisions and a much weaker than expected jobs report on August 1, which raised the likelihood of rate cuts in September. Equity markets pulled back, Treasury yields fell, and the U.S. dollar weakened, reflecting renewed uncertainty about the Fed's path forward.

Chart 2: U.S. dollar as ticked up in July, but weakened YTD



Source: Bloomberg

Bottom line: While inflation is cooling and political pressure is mounting, the Fed remains cautious. Recent economic surprises have rattled markets, reminding investors that rate expectations can shift quickly. Advisors should emphasize flexibility and risk management in portfolio strategy.

Tariff tensions: muted reaction, lingering risks

On August 1, the U.S. imposed a 35% tariff on Canadian goods not covered by CUSMA. While key exports like energy and potash are exempt, sectors such as autos, machinery, and consumer goods are directly affected. Europe, by contrast, secured extensions and lower rates, avoiding the brunt of the tariff wave. Despite the headline risk, markets have responded with surprising calm. The Canadian dollar held steady, and equity indices showed little reaction.

This muted response may reflect the fact that many companies had already adjusted supply chains earlier in the year. However, the long-term impact could still be felt in corporate margins and pricing, particularly in manufacturing and retail. Canada’s government is reviewing potential countermeasures, but for now, the focus remains on monitoring sector-level fallout.

Table: Canadian tariff update

Sector	Tariff Rate	Status
Energy	10%	Exempt
Potash	10%	Exempt
Autos	35%	Affected
Machinery	35%	Affected
Consumer Goods	35%	Affected

Source: Bloomberg

Bottom line: Tariffs haven’t triggered broad market volatility, but risks remain under the surface. Advisors should stay alert to earnings impacts and supply chain disruptions, especially in trade-sensitive industries.

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