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AIP

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Trade arrangements and tax cuts

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In order to address slowing growth and lessen uncertainty, the US budget, which includes USD 4.5 trillion in tax cuts, and trade agreements with important US allies will be passed. Nonetheless, growing debt and the fiscal deficit will probably continue to put pressure on the USD

We would leverage any technical USD bounce that occurs in the near future to diversify into US stocks and local currency bonds from emerging markets.

Following their successful completion of the Fed's stress tests, the anticipated easing of capital requirements, and additional deregulation of the industry, we continue to be optimistic about US banks and anticipate greater dividends.

With a 7.1% return, we round up our bullish US software sector stocks strategy

Strategy for Investing

If Trump's trade war dominated the first half of 2025, US tax cuts, trade agreements, and business deregulation are expected to dominate the second half. Fed rate cuts are most likely next. To combat slowing growth and lessen uncertainty, the US budget, which includes USD 4.5 trillion in tax cuts, and trade agreements with important US allies will be passed. Nonetheless, growing debt and the fiscal deficit will probably continue to put pressure on the USD. We would leverage any technical USD bounce that occurs in the near future to diversify into emerging market local currency bonds and non-US stocks.

Growth slowing down

After the pandemic, the US economy grew for four years thanks to fiscal stimulus, but now growth is decreasing as uncertainties about trade and policy, as well as rising interest rates, cloud the picture. After months of poor confidence indicators, or "soft" data, the so-called "hard" data has begun to deteriorate. Despite an unexpected increase in headline net new non-farm payrolls in June, government employment was the primary driver of the rise. Gains on private payroll dropped to their lowest level since October of last year. Continued unemployment claims are at their highest level since 2021, having increased since Trump's trade battle began in April. The primary engine of the economy, consumption, is declining due to a slowing labor market. In May, real personal spending in the US shrank by 0.3% month over month. Both private investment and the housing market are still struggling.

Tax cuts

To combat sluggish economy, the US budget for the fiscal year beginning October 1st should be adopted. Over a ten-year period, the budget is projected to give the USD30 trillion GDP a fiscal boost of USD3.4 trillion. Tax cuts of USD 4.5 trillion are included, including an extension of Trump's 2017 tax cuts as well as additional company tax benefits on gratuities, overtime compensation, and auto loans, among other things. Additionally, it reduces spending by USD 1.1 trillion. The latter includes reducing subsidies for clean energy, food, and healthcare. The negative effect of tariffs on growth should be more than balanced by the overall good fiscal impact. To help the US avoid the prospect of a near-term default, the budget also increased the US debt ceiling by USD 5 trillion.

Fed cuts are coming?

The fiscal stimulus is likely to be followed by monetary stimulus. Slowing growth is building the case for the Fed to resume rate cuts after a pause since last year. The surprisingly resilient jobs report in June led money markets to price out any chance of a rate cut in July. However, markets are pricing 52bps of rate cuts by the end of the year, with 70% chance of a rate cut in September, and a terminal rate of around 3.1% by the end of 2026. Although Fed Chair Powell reiterated that rates need to be on hold until the impact of tariff on inflation is clearer, other Fed governors have made the case for a rate cut in July. A deterioration in the job market would hasten cuts.

For diversification, use any USD bounce

The USD index (DXY) has plunged to a three-year low. Given worries about growing US debt and anticipation of Fed rate cuts, we predict that the USD will continue to decline over the next six to twelve months. There is a chance of a short-term technical bounce, though, as technical and positioning indications indicate the USD is oversold. Any brief recovery, maybe brought on by the completion of trade agreements, can be seized as a chance to diversify into EM local currency bonds and non-US equity markets, particularly in Asia-ex-Japan.

Trade agreements to keep an eye on next week

In the meanwhile, a significant amount of market uncertainty will be reduced by trade agreements with important allies in the upcoming weeks, if not before Trump's self-imposed deadline of July 9. The US has so far negotiated broad framework trade deals with China, Vietnam, and the United Kingdom. It is anticipated that agreements with the European Union, South Korea, and India would soon be concluded. A deal with Japan might take longer, particularly given the political sensitivities surrounding the import of rice and auto exports in the run-up to the Upper House election on July 20. Vietnam agreed to a 20% duty on all exports to the US and a 40% levy on items that are transferred across the economy, whereas the UK deal establishes a baseline tariff of 10% for most of its partners. It's unclear if comparable duties will be applied to other transhipment hubs that China has recently used, particularly in Asia. We'll also be closely monitoring China's response to the transhipment duties.

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