

THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

MID-YEAR REVIEW



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Welcome to our 2025 mid-year review issue.

Michael Chu and I have collaborated on a mid-year review of how Canadian, U.S. and international markets performed in the first half of 2025 – and what the major influences were over the last six months. We hope you find this review both informative and useful in understanding the current economic context – and how we’re keeping your portfolio firmly on course.

Enjoy your summer!

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Mid-Year Review:

SO FAR, MARKETS ARE WITHSTANDING OUR UNCERTAIN TIMES

By Stan Clark, Senior Wealth Advisor and Michael Chu, Senior Wealth Advisor

We trust you are enjoying summer! Being the midpoint of the year, summer is also a good time to review 2025 so far – and to look ahead.

The second quarter of 2025 opened with lingering anxiety from March losses, plus fears of a new round of protectionist measures from Washington, among other geopolitical risks.

However, despite persistent trade and geopolitical uncertainties, stock markets did well, with most recovering and reaching new record highs by June. The stock market rally was primarily fuelled by investor optimism about corporate earnings, lower inflation and potential interest rate cuts. Softer-than-expected inflation data reinforced the view that monetary policy would turn more accommodative.

Geopolitical tensions escalated sharply in the quarter, starting with President Donald Trump’s so called “Liberation Day” on April 2, when he announced a broad package of tariffs. The quarter concluded with military engagement in the Middle East.

The scope and magnitude of Trump’s sweeping tariffs – across all of America’s trading partners – seemed to take investors by surprise. The immediate concern was that tariffs at these levels would be a shock to economic growth, leading to job losses and a high chance of a global economic recession. Over the next few days, most major equity markets declined into *correction territory* (i.e., a more than 10% decline).

But soon after, in another surprising twist, Trump delayed the tariffs. This sparked reassurance in the markets, resulting in a V-shaped recovery over the

ensuing weeks. In fact, as the quarter unfolded, equity markets more than recovered. By the end of June, most markets were at or near all-time highs.

The World Equity Index, a gauge of stocks around the world, was up 3.6% (in C\$) in the first six months of 2025. At home, the TSX was up 10.2%. The chart below shows the returns of major markets around the world. Note that these returns are in Canadian dollars, so the effects of currency changes are included.

	Q1 2025	Q2 2025	H1 2025
Canada (S&P/TSX)	1.5%	8.5%	10.2%
U.S. (S&P 500)	-4.3%	4.9%	0.5%
Europe	10.8%	4.3%	15.6%
Japan	-5.5%	12.1%	5.9%
EAFE (Europe, Australia, Far East)	6.9%	5.7%	13.0%
Emerging Markets	2.9%	5.9%	9.0%
World	-1.8%	5.4%	3.6%

Source: Bloomberg

Valuations

As you can see in the next table, dividends from Canadian stocks are slightly less than 10-year bond yields, while forward earnings yields are more than double. Although not as cheap as before, this still shows decent value when comparing stocks to bonds in Canada. In the U.S., dividend yields are much lower than 10-year bond yields, but earnings yields are higher – giving us mixed signals of value in U.S. stocks.

Other regions like Europe, Asia and Emerging Markets show good-to-decent value when

compared to their average yield on 10-year bonds - but again, not as good value as a year ago. Since then, stocks have become more expensive relative to earnings and dividends.

Lower valuations bode well for future long-term performance. So far in 2025 we've seen some proof of that, with cheaper Canadian and international stock markets out-performing the more expensive U.S. stock market.

	Forward P/E	Forward Earnings Yield	Dividend Yield	10-Year Bonds*
Canada (S&P/TSX)	16.3	6.1%	2.7%	3.3%
U.S. (S&P 500)	22.1	4.5%	1.2%	4.2%
Europe	14.3	7.0%	3.1%	3.0%
EAFE (Europe, Australasia, Far East)	14.7	6.8%	3.0%	2.5%
Emerging Markets	12.7	7.9%	2.6%	3.3%
World	19.7	5.1%	1.7%	4.1%

Source: Bloomberg

*Weighted average for regions

Five years of resilience - so far

According to top economist Ed Yardeni, the U.S. economy has remained recession-resistant since the COVID lockdown in 2020. That's over five recession-free years, despite not only the pandemic, but the Ukraine war, rising interest rates, Middle East war and Trump's tariffs. Despite all these crises, it really has been the Roaring 2020s so far. In the U.S., real Gross Domestic Product (GDP) is at a record high and so is the stock market.

The weird thing is that, even so, there's not much excitement in measures of business and consumer confidence. Yet the stock market numbers show the opposite. For example, the *Buffett ratio*, the total value of U.S. stocks divided by nominal GDP, was at a record high in July 2024, before the correction earlier this year.

Does that mean the market is irrationally exuberant and set for another fall, i.e., another correction or even a bear market? That all depends on whether the next (inevitable) crisis will just raise fears of a recession or actually cause one. Corrections in the stock market happen when recession fears depress the valuations, followed by a rebound when no recession actually happens. Yardeni calls these "panic attacks."

As for bear markets, these occur when recession fears accurately anticipate an economic downturn. In this scenario, both valuations and corporate earnings fall.

Many measures, including the Buffett Ratio, have rebounded to where they were before the last correction, thanks to increased investor confidence in the economy's resilience. The longer the economy is expected to grow, the more likely we are to see higher valuations.

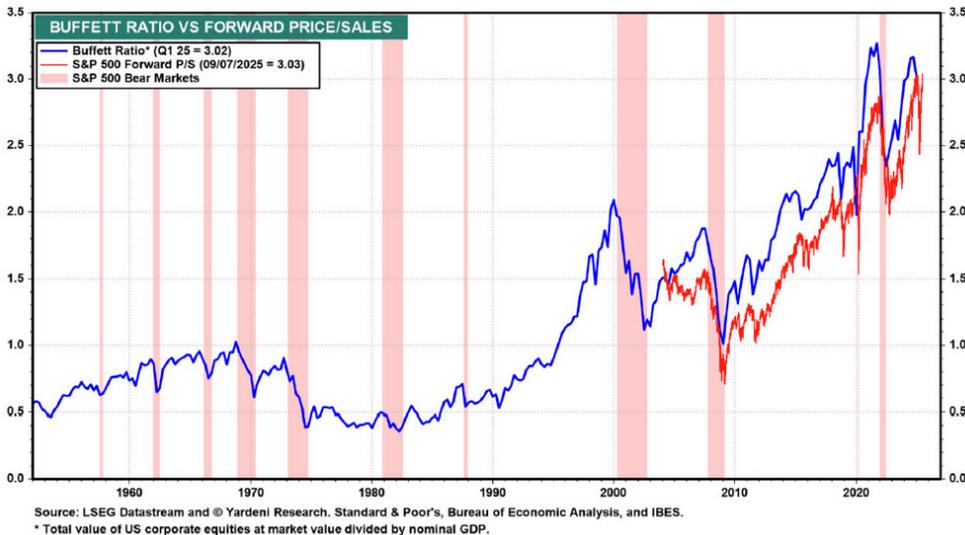
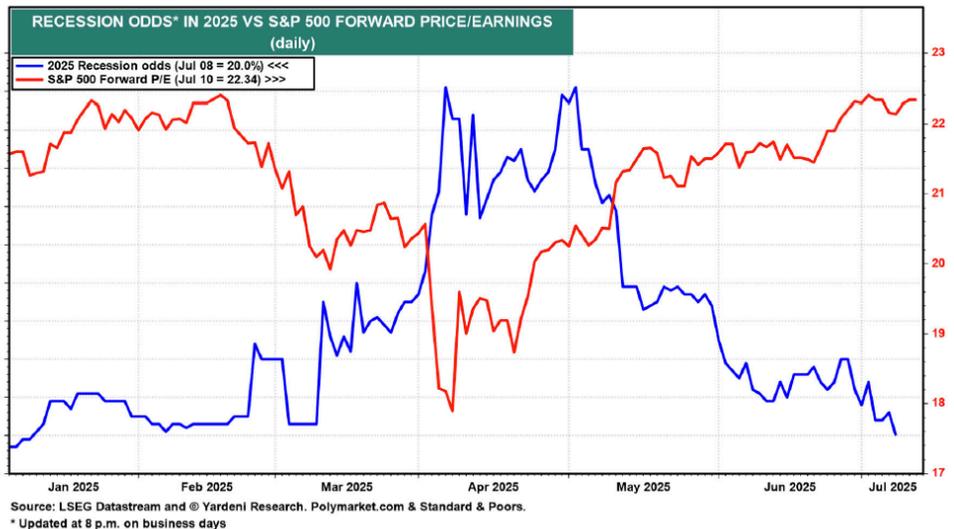
More tariff turmoil

We earlier referred to Liberation Day, April 2, when President Trump imposed "reciprocal tariffs" on America's trading partners. Stock markets then dropped until Trump postponed the tariffs to July.

Our original expectation was that the tariff turmoil would be less tumultuous by the end of the summer. We thought Trump would start to declare victory in his trade war, and move on to other issues to reduce the risk of recession. Now it seems the trade war is not quite over, but hopefully most of the feared damage to the economy has been reduced.

The U.S. economy seems in good shape, with full employment and lower inflation. So why mess with success? (Un)predictably, Trump recently announced new reciprocal tariffs on countries that don't have "deals."

To date, the stock and bond market response has been relatively muted. So, instead of relenting by now as expected, Trump remains



unrelenting in his trade war. But this might just be his response to TACO, short for Trump Always Chickens Out. Financial Times commentator Robert Armstrong coined the term to describe the president's pattern of announcing heavy tariffs on countries, causing economic shock, panic and stock market hits - and then later reversing course, with pauses or reductions that create market rebounds.

Hopefully the tariff issue will be resolved soon, or the current recovery could get choppy.

Furthermore, Trump continues to bully Fed Chair Jerome Powell, criticizing him for not lowering rates because of Powell's fear that tariffs might boost inflation. Ed Yardeni's humble advice to POTUS: Don't push your luck on tariffs and don't mess with the Fed's independence. Otherwise the bond vigilantes will sell, pushing up bond yields.

The worst of tariff turmoil might be over, but “it ain’t over ‘til it’s over.” Trump knows he needs to put an end to his trade war soon, before the U.S. economy suffers any serious economic damage. A recession, or maybe even rising inflation, in the coming months would most likely cause the Republicans to lose their narrow majorities in both houses of Congress in the upcoming mid-term elections. U.S. and stock markets around the world evidently support this view, as they are also at or nearing record highs.

There is one major casualty of the trade war: the U.S. dollar. Trump may view this as a positive, as it makes American exports cheaper and depresses U.S. imports. And if we were travelling to the U.S. we might like it, too!

But it does weaken the value of our U.S. holdings. For example, the S&P 500 is up 6.2% for the first half of this year. In Canadian dollars, though, it’s only up 0.5%, because the U.S. dollar is down about 5% relative to the Canadian dollar.

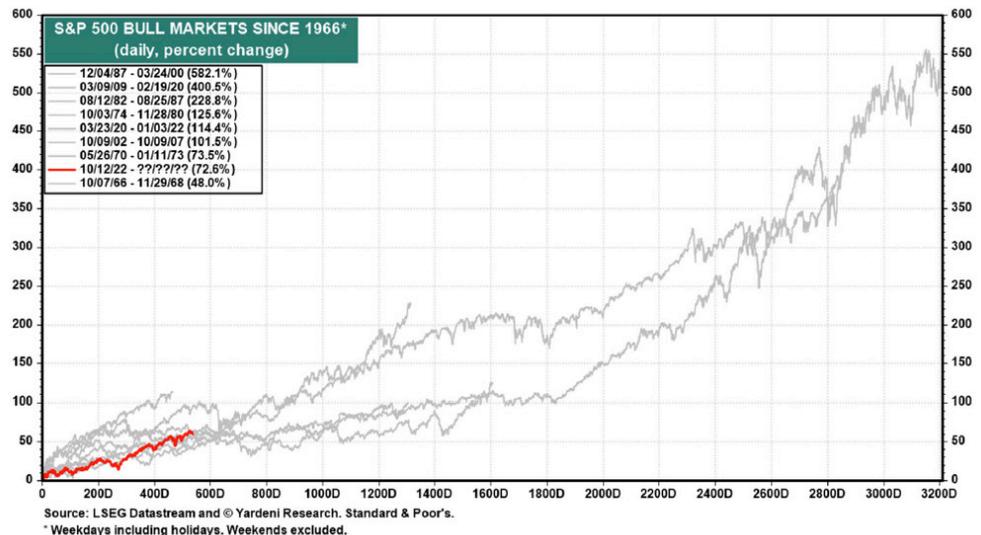
Why are financial markets so calm?

With the new round of tariffs, shouldn’t the bond and stock vigilantes respond adversely to the escalation of tariffs? They certainly did in early April, when stocks went down and bond yields went up – which forced Trump to de-escalate. That doesn’t seem to be happening now, at least not so far, and this may embolden Trump.

Maybe investors have learned that Trump’s huffing and puffing is simply the way he negotiates trade deals. The risk for the economy and investors is that, if Trump has concluded that financial markets will not be vigilant about his trade war, he may move forward unchecked. If so, then tariff issues could continue beyond this summer. Then again, maybe investors think that “this too shall pass” by summer’s end, and that the economy will remain resilient and inflation will moderate.

Nobody likes tariffs. They are like a sales tax on imported goods. Maybe the market has decided that it could live with a 10% general tax and a 30% tax on China. If inflation becomes higher, then at least the tariffs could be adjusted. The market does seem to think the economy can overcome the hurdle of tariffs. Wharton Finance Professor Jeremy Siegel believes it’s the usage of artificial intelligence (AI) and other technologies to lower costs that enables the market to look beyond tariffs. Siegel further cites the benefits of tax cuts and lighter regulations.

Markets might also be strong because investors expect upcoming second-quarter



earnings to be full of positive surprises. First-quarter earnings for the S&P 500 were up 11.5% year over year. The consensus growth rate for second-quarter earnings was cut from 8.5% earlier this year to 3.7% currently. Yardeni expects actual earnings to be much higher than expected, up 7.6%.

Reasons for optimism

The current bull market started in October 2022 and is alive and well following a 19% correction in the S&P 500 earlier this year. The fast rebound since April’s Liberation Day is attributable to lower fears about tariffs and the economy. The S&P 500 volatility index (VIX) peaked at 52 in April and now is back down to 17.5, which is below its average of 19.5. It wouldn’t be that surprising to see the VIX drop further this summer, as many uncertainties are abating:

1. Stock prices soared when tariffs were postponed. The markets rightly concluded that tariffs would be negotiable.
2. While the tariff issue hasn’t gone away, it hasn’t had a big negative effect on the economy. According to Yardeni, the odds of a recession have dropped from 65% in May to 20% currently. The labour market also remains resilient, with the unemployment rate edging down to 4.1% in the U.S.
3. Companies confirmed their commitment to spend 10s of billions of dollars on AI capital investments, despite “DeepSeek” fears about China’s significant technological innovation.
4. Industry analysts stopped dropping their earnings expectations for 2025 and 2026.
5. The chaos in the Middle East has lately

become less chaotic. And fears that Iran would close the Strait of Hormuz have also eased.

6. Trump’s “Big Beautiful Bill” has passed, extending tax cuts. For now, the bond market doesn’t seem overly concerned about the higher deficit and debt implications.

So far the current bull market looks like a normal one, with the potential to match the returns of some of the best bull markets since the mid-1960s. Yardeni is targeting 6,500 for the S&P 500 by the end of 2025 (for another 5% increase for the rest of the year) and 10,000 by the end of this “Roaring 20s” decade. Hard as it is to believe, the main risk might be a stock market *melt-up*, i.e., a speculative bubble.

Reasons to worry

True to his reputation as a “perma-bear,” legendary value investor Jeremy Grantham¹ compares the market to pea soup. Grantham notes that a lot of traditional measures of the markets aren’t currently working, making it difficult to see what’s going on. He cites three reasons: 1) COVID stimulus has created a new class of stock speculators. 2) The introduction of AI in 2022 ended the bear market overnight and dragged the markets upwards. 3) Tariff tantrums have introduced a lot of complexity for companies and the economy. Grantham believes these three factors create much uncertainty.

When predicting long-term stock market returns, Grantham relies on something similar to the Buffett Ratio, that is, total market capitalization vs GDP. Based on this, he suggests the market could easily go down by 50% and still be within its historical

boundary. According to Grantham, this collapse wouldn't even be to a colossal low like in 1982 or 1974. A colossal low would be valuations around 7 times and on depressed earnings too. Today's trailing P/E ratio is about 23 times for the S&P 500. So, down 50% would be to about 12 times earnings.

Further, says Grantham, AI is a major development. Like past transformative inventions such as railroads and the Internet, AI is expected to change the world. But, for the people who invested in railroads and Internet companies early on, the results were mostly terrible. True, out of the wreckage the world became a better place, as had been promised. But again, most companies originally involved in the boom were not good investments.

The same could happen now, Grantham warns. AI has lured all of the Magnificent 7 tech companies - currently as big as countries - into a fast-paced race, one that requires tons of investment and may not bode well for all. "The more serious a new technology is, the more obvious it is that it's serious, the more guaranteed you are to have a bubble."

Grantham feels U.S. stocks are overpriced, but foreign stocks are still reasonable. He says in major bubbles you get a stretching of traditional relationships. As examples: the high gap between value and growth valuations; and the valuations between U.S. and foreign stocks.

In making his warnings, Grantham isn't calling for an immediate crash. He concedes that, while every bubble breaks, you can't time the break perfectly.

Bull-bear ratio

With the stock market's rebound over the last few months, the American Association

of Individual Investors' (AAII) sentiment indicator has recovered from being super-pessimistic. However, this is a contrarian indicator, meaning that the more bullish people are on stocks, the more bearish you should be.

And vice-versa: The more negative people are, the more positive you should be. Surprisingly, even though markets are at record territory, the sentiment indicator is only neutral - being near its long term average of 1.1. There seems to be more room for upside in the stock market since the sentiment isn't too bullish.

Canada

Canadian stocks are doing well this year. Still, Canada's economy has been disappointing, showing more signs of slowing for several months now. Our GDP declined by 0.1% in both April and May, the first back-to-back negative readings since 2022. At this stage, it looks like Canada's economy contracted slightly in Q2.

This follows a healthy 2.2% annualized GDP gain in Q1, although that was largely due to an increase in exports and inventory investment ahead of threatened tariffs. Canada's unemployment rate rose to 7.0% in May, up from 6.3% a year earlier. Job losses have been concentrated in the manufacturing sector, and to a lesser extent in transportation and warehousing, suggesting trade-exposed industries are bearing the brunt of economic damage.

A potential offset to this weakness is on the fiscal side. Around the world, we've seen countries come up with large fiscal spending plans. We might see this in Canada, too, when the budget comes out in the fall.

Canada faces a pivotal moment. The

government's new focus on streamlining regulations and supporting the resource sector signals a shift toward re-industrialization, creating opportunities in infrastructure, energy and defence. However, this also raises questions about fiscal sustainability and the potential for higher taxes as deficits grow. The Bank of Canada is expected to hold rates steady for now, with possible cuts later in the year if inflation cools or the job market weakens further. The Canadian dollar is likely to remain volatile, influenced by interest rate moves and fiscal policy.

Looking ahead

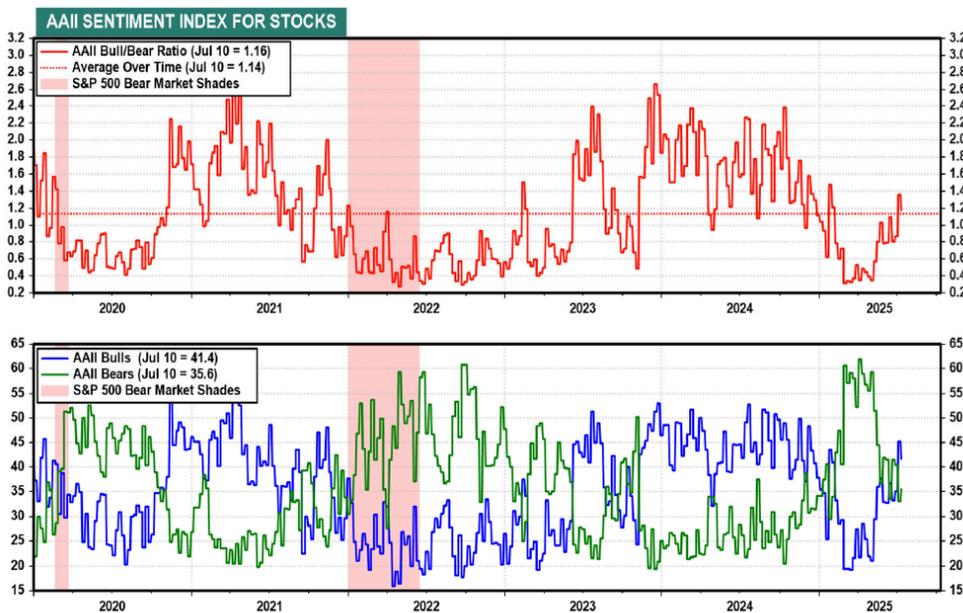
As we move into the second half of 2025 (and of the decade, already!), the global outlook remains uncertain, shaped by ongoing trade tensions, fiscal challenges and geopolitical risks.

The upcoming expiration of the tariff reprieve is a key concern. However, the deadlines might be extended again, as the U.S. has signaled flexibility - effectively kicking the can down the road - which would probably be welcomed by investors. Alternatively, if the reprieve ends and higher tariffs are imposed, markets could react negatively. But recent history suggests the administration may quickly soften its stance or roll back tariffs in response to financial market turmoil. Still, although some tensions have eased, tariffs remain high and the risk of escalation persists.

Events so far this year have reaffirmed the importance of diversification, quality and adaptability in navigating today's markets. In this environment of ongoing uncertainty, our approach remains rooted in resilience and disciplined decision-making. Ultimately, when uncertainty is the only certainty, our strength comes not from trying to predict what lies ahead, but from preparing thoughtfully for a range of outcomes.

Stocks might fall in the short term, but we remain comfortable holding good companies for the long term. Even with recession uncertainty clouding the outlook, our philosophy remains constant. For us, it's all about making sure that we're sticking with our financial plan and investment philosophy, and rigorously following our processes.

We welcome your comments and questions - and wish you the best for the rest of the summer!



¹ www.gmo.com/americas/research-library/

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