

Quarterly Investment Insights 2nd Quarter 2025

Navigating Volatility: Investment Themes and Opportunities

TABLE OF CONTENTS

- 01 Market Recap
- 02 Macro & Policy Landscape
- 03 Currency Trends
- 04 Geopolitical Developments
- 05 AI Drives Global IT Spending
- 06 What's Next
- 07 Stewardship Insights -
Baillie Gifford

Key Takeaways

- **Global markets rebounded** despite early volatility from U.S. tariffs and geopolitical tensions.
- **Persistent backdrop of policy uncertainty as central banks remain cautious**; the Fed paused while the ECB cut rates.
- **In light of fading U.S. exceptionalism, the U.S. dollar is expected to remain bearish** boosting international and emerging market returns.
- **Geopolitical risks remain elevated**, but market impact was contained.
- **AI spending surged**, driving strong technology capital expenditure despite market uncertainty.
- **AIA maintains a constructive outlook**, with preference for equities over bonds.

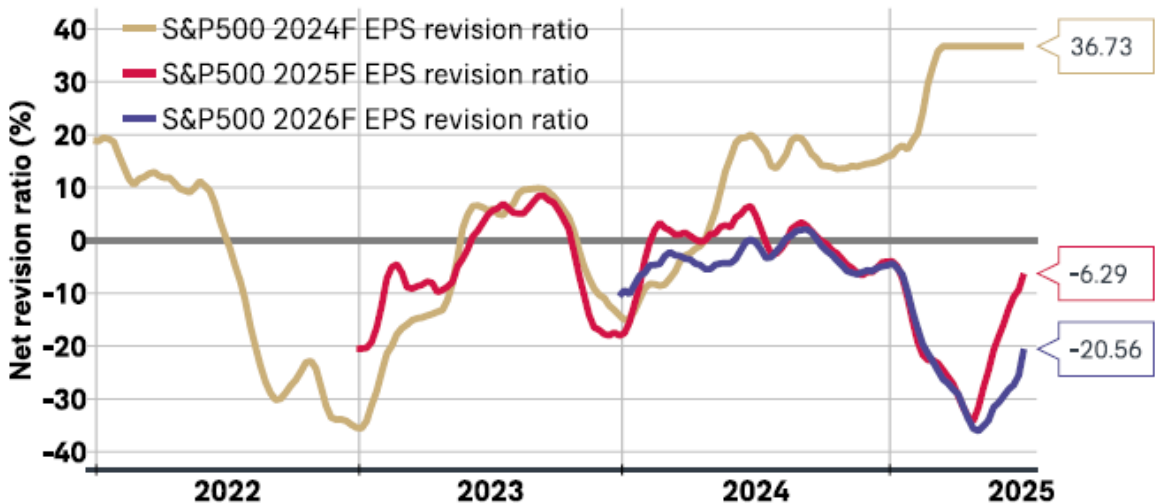
MARKET RECAP

Markets rebound despite geopolitical noise and policy uncertainty.

The second quarter of 2025 was a tale of two halves. Markets opened under pressure as U.S. reciprocal tariffs, dubbed “Liberation Day” measures, triggered fears of a prolonged trade war and briefly pushed the S&P 500 into bear market territory. However, sentiment reversed sharply in May as tariff implementation was paused, leading to a V-shaped recovery in equities. This recovery was supported by resilient corporate earnings, steady consumer spending, and easing fears around global supply chain disruption. U.S. earnings saw an uptick revision, rebounding strongly in its 2025 and 2026 forward forecast (refer to chart below).

Fixed income markets shifted focus from potential rate cuts to long-term fiscal concerns, especially as the U.S. passed the expansive “One Big Beautiful Bill Act” (OBBBA). Meanwhile, escalating Middle East tensions in June added to market jitters, but the limited impact on oil supply helped contain risk-off sentiment.

US earnings revision is rebounding strongly



Sources: Macrobond, AIA Investments, 2025 W28

MACRO & POLICY LANDSCAPE

Central banks adopted a more measured tone in Q2.

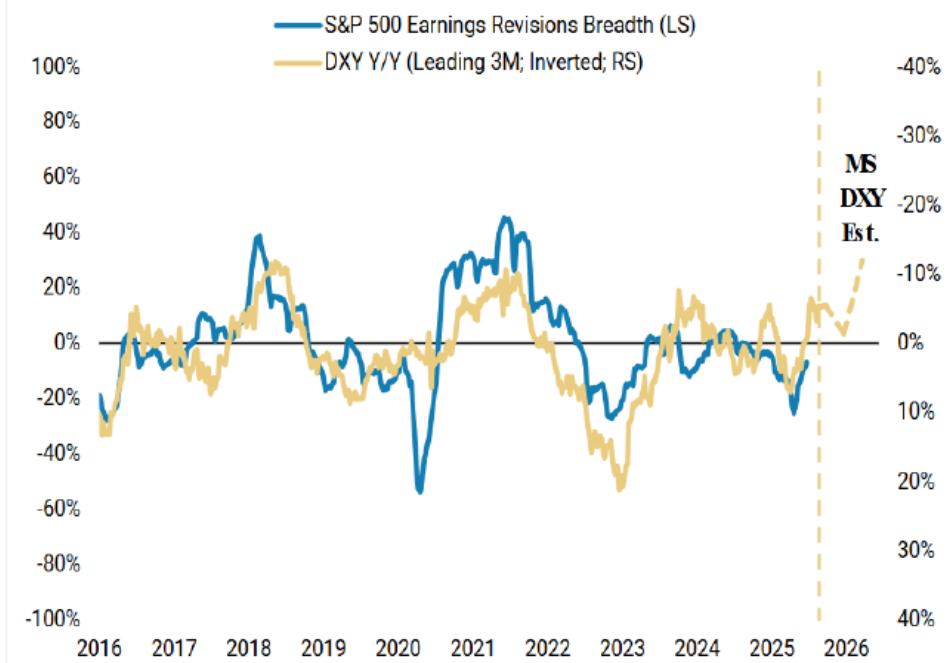
- **U.S. Federal Reserve:** After cutting rates twice in late 2024, the Fed held steady this quarter, balancing manageable inflation with early signs of labor market softening. Policymakers are expected to resume easing later in the year, though timing remains uncertain.
- **European Central Bank (ECB):** With inflation falling, the ECB delivered rate cuts in April and June, bringing its deposit rate to 2.0%. As eurozone inflation approaches the 2% target and borrowing costs easing, markets believe the ECB may be near its terminal rate, the level at which monetary policy is neither stimulating nor restricting the economy.

In the U.S., fiscal policy dominated headlines. The passage of the OBBBA which includes household tax relief, incentives for domestic manufacturing, and job creation initiatives is expected to stimulate growth in key sectors. However, it also raises long-term debt concerns, with projections pointing to a federal debt-to-GDP ratio of over 130% within a decade. For now, the OBBBA raises U.S. debt ceiling by USD 5 trillion, which removes near-term tail risks of a U.S. debt default.

CURRENCY TRENDS

A notable theme in Q2 was the **weaker U.S. dollar**, which declined ~10% year-to-date against major currencies. This was driven by expectations of fading “US exceptionalism”, growing fiscal concerns following the passage of OBBBA and lingering trade policy uncertainty. Softer economic data and a shift in investor flows toward international markets further pressured the currency. While a weaker dollar weighted on U.S. purchasing power, it provided a tailwind for international and emerging market equities, enhancing returns for globally diversified portfolios.

Weakness in *DXY likely a tailwind for U.S. multinational companies' earnings



Source: AIA Investments

* Refers to U.S. Dollar Index

Note: Strictly for illustrations only. Investors cannot invest in the indices directly. Historical performance is not necessary indicative of future performance.

GEOPOLITICAL DEVELOPMENTS

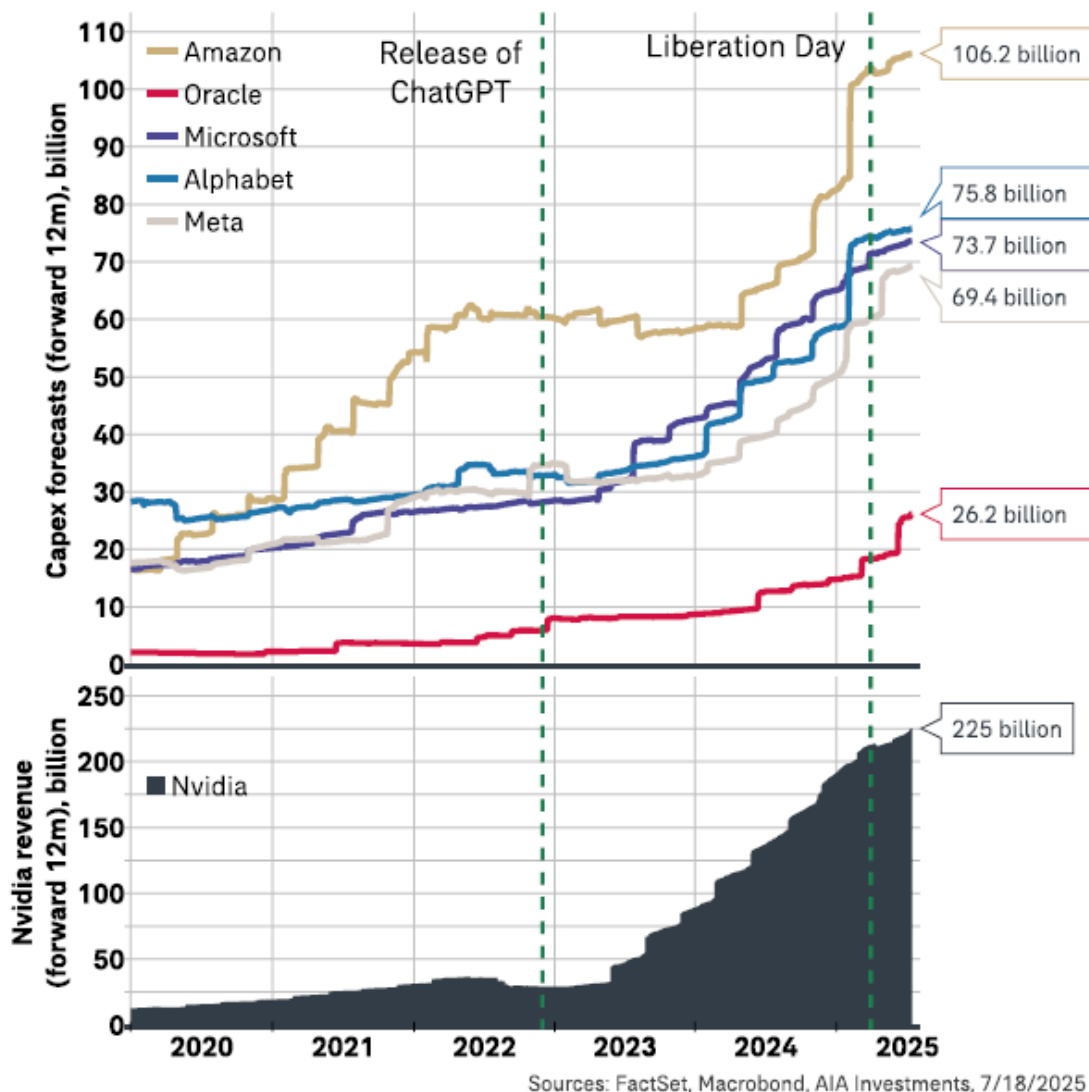
Geopolitical tensions escalated in Q2, fueled by rising conflict in the Middle East, renewed U.S.-China trade frictions, and broad U.S. policy shifts under Trump administration. Tensions deepened in June as U.S. led strikes on Iranian nuclear sites raised concerns of broader regional conflict, though oil markets remained relatively calm due to minimal supply disruption and diplomatic efforts. The Organization of the Petroleum Exporting Countries (OPEC) has also maintained its oil demand forecast, while continuing to increase production.

Beyond the short-term movement in oil prices induced by geopolitics, the longer-term outlook for oil remains anchored by the supply-demand balance.

AI DRIVES GLOBAL INFORMATION TECHNOLOGY SPENDING

Global information technology (IT) spending continues to be driven by the accelerating adoption of artificial intelligence (AI), with infrastructure demand, particularly for AI-optimized servers and data center systems leading the surge. Despite macroeconomic uncertainty and trade policy risks, corporate AI capital expenditure has remained robust across major technology firms. As shown in the chart, spending by industry leaders like Amazon, Microsoft, Alphabet, and Meta has continued to climb steadily even beyond key geopolitical milestones such as the release of ChatGPT and “Liberation Day.” Nvidia’s explosive revenue growth further underscores the scale of AI-related investment, reflecting soaring demand for high-performance chips that power AI workloads. While broader IT investment growth is showing signs of moderation due to an “uncertainty pause,” the AI segment remains a powerful long-term structural driver of spending and a key area of opportunity for long-term investors.

AI spending continues despite trade uncertainty



Note: Historical performance is not necessary indicative of future performance. References to specific securities (if any) are presented to illustrate the application of our investment philosophy only and are not to be considered as recommendation.

WHAT'S NEXT

Despite a volatile start to the quarter, markets displayed impressive resilience. Repeated postponements of tariff deadlines eased immediate market concerns, triggering a relief rally fuelled by resilient corporate earnings and steady consumer spending. Looking ahead, we expect volatility to persist amid:

- Ongoing U.S. tariff negotiations
- Lingering inflationary effects of trade policy
- Uncertainty around the path of interest rate cuts
- Elevated geopolitical tensions

Nevertheless, the backdrop for risk assets remains constructive. Fiscal stimulus and potentially easier monetary policy are likely to support growth and corporate earnings. Meanwhile, structural trends particularly in AI and digital infrastructure continue to attract investor interest.

In light of this backdrop, our AIA House views reflect a cautiously constructive stance balancing near-term risks with longer term opportunities across regions and asset classes.

AIA GROUP INVESTMENTS HOUSE VIEW

Asset Class				Comment	Underweight (-)	Neutral (=)	Overweight (+)
	-	=	+				
Global Equities			+	<ul style="list-style-type: none"> Upgraded from Neutral (N) to Overweight (OW) in view of improving market internals and risk sentiment. Investors appear to be looking beyond trade-related uncertainties, indicating a more supportive backdrop for equities. At country level, U.S. equities are favored over European equities due to stronger earnings revision breadth in the U.S. Upcoming earnings announcements in the U.S., coupled with a weaker U.S dollar, may serve as potential catalysts for outperformance. 			
- Asia Ex-Japan Equities			+	<ul style="list-style-type: none"> An OW position is maintained for Asia ex Japan equities relative to developed markets, supported by stronger regional market internals and more attractive valuations. 			
Fixed Income	-			<ul style="list-style-type: none"> Downgraded from N to Underweight (UW) due to rising fiscal pressures and easing recession fears, which are putting upward pressure on yields. A more risk-on environment, supported by strong equity performance and tightening credit spreads, makes bonds relatively less attractive (as compared to equities). 			
Cash		=		<ul style="list-style-type: none"> Shifted from OW to N, reflecting an intention to redeploy cash into risk assets where more attractive opportunities are emerging. 			

Stewardship Insights:

Exploring Investment Excellence with

Baillie Gifford™

STEWARDSHIP INSIGHTS: Baillie Gifford

We have seen European equities doing well in 2025, catalyzed by record fiscal budget, accommodative monetary policies and attractive valuations. What is your view on U.S. exceptionalism? How would that affect your views about investments in the other regions?

Baillie Gifford : At the heart of our investment approach lies bottom-up stock picking, rooted in a disciplined search for resilient businesses. While our process is fundamentally company-focused, we do not operate in a vacuum. Macro developments matter—not in isolation, but in how they shape the environments our companies must navigate. We aim to understand these dynamics and their implications at the level of individual holdings. Ultimately, we look for companies with strong products or practices that can absorb, adapt to, and even thrive through short-term macroeconomic dislocations.

We continue to own a number of high-quality U.S. businesses, many of which are global leaders in innovation. Yet for some time, we have been mindful of valuations. In our view, the market has increasingly concentrated around a handful of U.S. growth names, many of which now trade at historically elevated multiples. While their quality is not in question, the margin for error in many of these cases is slim. As long-term investors, valuation discipline remains central to our ability to compound returns sustainably.

We believe many investors today are over-reliant on U.S. equities to deliver growth. In contrast, our philosophy champions a broader, more balanced perspective. Our focus is on companies—wherever they are in the world—that can deliver enduring growth by creating long-term value for society. We look for businesses that make a genuine difference. Over time, we believe this creates a virtuous circle: by addressing real societal needs, these companies attract talent, retain customers, deepen their competitive moats, and ultimately deliver durable financial returns.

(Continued...)

While the U.S. continues to attract much of the market's attention, we believe investors risk overlooking strong opportunities elsewhere. Europe offers a compelling opportunity set that is often overlooked. We are finding a wealth of companies capable of growing earnings at 10% or more annually, and we believe this growth can be sustained over five to ten years. Unlike their U.S. counterparts, many of these businesses trade at more modest valuations, simply because they lie outside the prevailing market narrative. As the strength of the U.S. dollar unwinds, the case for European equities has become even more attractive on a relative basis.

This valuation gap is one of the reasons we have maintained an overweight position in Europe. For us, the combination of strong, sustained growth and reasonable valuations is exactly the kind of asymmetry we seek to capture for clients.

It is not just Europe that offers promise. A wider opportunity exists among select companies across other markets, including Japan. In many cases, we see the same desirable blend: robust fundamentals, long growth runways, sensible valuations, and increasingly supportive policy environments. The combination of currency dynamics, valuation advantages, and geopolitical diversification is creating a tailwind for these high-quality ex- U.S. companies—many of which are exceptionally well placed to contribute meaningfully to both client outcomes and societal progress.

Can you identify industries or sectors that are both negatively and positively impacted by Trump tariffs and how these influence your investment decisions?

Baillie Gifford : The recent shifts in U.S. trade policy, particularly the introduction of tariffs and the broader erosion of predictable global trade norms, have introduced a complex set of challenges for investors. While certain industries are more exposed than others, we believe the real issue lies not in identifying winners and losers by sector, but in recognizing how individual companies are positioned to respond to uncertainty. As long-term, bottom-up investors, we focus on adaptability and control, not categories.

Historically, global trade frameworks underpinned the efficiency of modern supply chains. This was especially true for sectors like Automotive Manufacturing and Industrial Machinery, where production is deeply fragmented across regions. These businesses thrived in a world of low trade friction, but that world is now shifting. With rising tariffs and geopolitical unpredictability, the structural complexity that once enabled margin optimization has become a liability. Consequently, we have significantly reduced our exposure to such globally entangled industries. The difficulty these businesses face in reconfiguring their operations quickly reinforces our conviction that agility matters more than ever.

(Continued...)

In contrast, a different group of companies has emerged as enablers of stability in this environment. Firms like DSV, a leader in logistics, and Kinaxis, which provides supply chain planning software, are helping their clients manage disruption and build resilience into their operations. These businesses are not just surviving amid policy volatility; they are benefiting from it. Their ability to support the adaptation of others makes them valuable in a world where strategic responsiveness has become a differentiator.

We also see structural advantages in companies that are naturally insulated from global trade dynamics. Many service-oriented firms and those with a strong domestic focus, remain largely unaffected by tariff regimes. These include businesses with “local-for-local” operating models: firms that serve national markets with minimal reliance on international inputs or exports. For instance, MSA Safety and Savers Value Village in the U.S., or CTI and Meituan in China, derive their strength from deep integration within their local ecosystems. Their growth does not depend on global supply chains, and they remain largely shielded from the regulatory noise of international trade disputes.

What binds these diverse examples together is not sector or geography, but resilience, the ability to respond to external shocks without losing strategic momentum. While we recognize that macro uncertainty is here to stay, we don’t aim to predict its course. Instead, we focus on identifying businesses with the internal capacity to manage through it: companies with control over their own success, and the flexibility to adapt as the environment evolves.

Looking ahead with greater policy uncertainties, how are the portfolio managers overcoming these challenges and identifying companies that can deliver high growth potential over the next 5-10 years? Could you share example of stocks you have added, and the rationale behind the investments?

Baillie Gifford : In a world of growing policy unpredictability, our response is not to second-guess the next move by policymakers, but to focus instead on how companies manage uncertainty. What we look for are businesses that have the tools to adapt, the culture to make sound decisions, and the relevance to continue solving meaningful problems for society. These qualities—resilience, adaptability, and purpose—are what give us confidence in a company’s long-term growth potential.

Of course we continue to be mindful of risk. There are a few areas where we are proceeding with particular caution. First, we are avoiding highly leveraged businesses. With interest rates higher and the path forward for monetary policy unclear, we are deliberately steering clear of companies that might be vulnerable to a tightening credit environment.

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More broadly, we are not taking on financial system risk at this stage. It's been some time since we experienced a true credit cycle, and we see no reason to introduce that exposure now. As such, we are not currently adding to financial services holdings. While we may revisit this stance in the future, our current positioning reflects a desire to stay focused on high-quality, self-determined businesses, those most capable of delivering enduring growth in an unpredictable world.

We're not chasing themes or sheltering in defensive sectors. Instead, we're backing companies that regardless of the external backdrop are pushing forward and, in some cases, helping to address emerging challenges. One recent purchase is Kinaxis, a Canadian software firm that helps large manufacturers build supply chains that are more responsive and efficient. We've spent the better part of a year researching the company and were struck by how mission-critical its technology has become. For firms that used to model supply chain changes over weeks using manual systems, Kinaxis's Maestro platform can cut that process to minutes. This kind of agility is increasingly valuable in a world shaped by trade tensions, transport bottlenecks, and logistical fragility. Kinaxis enables customers to take back control in an unpredictable environment, and we see a long growth runway ahead.

Another recent addition is Tetra Tech, an engineering consultancy focused on sustainable infrastructure, water management, and environmental services. This company has been under our radar for a while, and initially we decided not to take a holding as it appeared to be vulnerable to shifting policy direction. However, we have been impressed by the company's ability to adapt. Tetra Tech demonstrated resilience following the cancellation of its USAID contracts, which had accounted for a significant portion of its revenue. It quickly redeployed talent and maintained earnings growth, despite the loss of what was previously its largest client. That kind of operational resilience gave us confidence not just in the business model, but in the leadership behind it. With long-term drivers like climate resilience and population growth supporting its markets, we saw a compelling opportunity at a more attractive valuation.

Ultimately, our focus is on companies that are in charge of their own destinies. We believe the most compelling investment opportunities in uncertain times are businesses solving real-world problems, companies that continue to grow not because of policy support, but because they are equipped to succeed across a variety of policy and market conditions.

The financial landscape is evolving, compelling investors to reconsider their investment strategies. How do you see the investment regime ahead? How should an investor position his portfolio?

Baillie Gifford : We continue to be mindful of risk. The investment regime ahead is likely to be defined not by one macro theme, but by persistent unpredictability: tariffs, shifting regulation, geopolitical instability, and tighter financial conditions. Costs are going up for businesses, and the policy environment has become harder to interpret, let alone anticipate. Yet valuations in some areas, particularly in parts of the U.S. market, remain elevated. That disconnect is a source of concern.

In our view, this makes resilience more important than ever. Investors need to rethink what it means to build a balanced portfolio. Diversification and balance are critical. We've long believed that index exposure can mask concentration risk, both in terms of style and sector. Simply owning "the market" is not a risk-free strategy. Thus, we believe a thoughtful diversification is essential. That means asking harder questions of the businesses we invest in.

We believe the right approach is company by company, grounded in fundamentals. For us, that begins with a clear threshold: can this business deliver 10% profit growth per annum over a decade? Historically, only the top quintile of companies have achieved this, and they've significantly outperformed over the long term. But delivering that kind of growth in today's world requires more than a large addressable market. It requires adaptability, financial strength, and a leadership team that knows how to navigate uncertainty.

We also look for companies whose success is aligned with broader progress, those creating value not just for shareholders, but for society. This might be through what they offer, like more efficient supply chains or sustainable infrastructure, or through how they operate, with high standards and long-term thinking. We believe these businesses build stronger competitive moats over time, making them more durable in a shifting world.

Alongside this, we are taking a disciplined stance on risk. We are avoiding highly leveraged companies; particularly as financial conditions tighten. We are also refraining from adding exposure to financial services, where we believe systemic risks are underappreciated and the full effects of higher rates are yet to play out.

We've also been pruning exposure where valuations no longer offer a margin of safety, even in names we continue to admire. And, more structurally, we are reducing the pro-cyclicality of the portfolio, favoring long-term compounders whose growth is less tied to short-term economic momentum.

In essence, we are not chasing the next regime, we are preparing for a range of them. That means building a balanced, resilient portfolio, one capable of capturing enduring growth without taking undue financial or macro risk. It means investing in companies that aren't dependent on favorable winds to succeed but are equipped to sail through them regardless.

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