RJL PCS: INSIGHTS & STRATEGIES

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June 2025 Insights & Strategies: Trade war skirmishes continue

Macro Highlights for May

- The Canadian economy grew more than expected, expanding at an annualized rate of 2.2% in 1Q25, partly helped by exports as U.S. companies rushed to import goods ahead of tariffs coming into effect. Expectations are for growth to stall to effectively zero in 2Q25 as the export rush normalizes, the effect of tariffs start to kick in, and overall uncertainty in the economy puts a damper on decision-making, growth plans, and hiring commitments.

- Canada's trade deficit surged to $7.1 billion in April, as exports to the U.S. dropped for a third month, by 15.7%, and the U.S. trade surplus shrank to $3.6 billion. This was offset only slightly with Canadian exports to the rest of the world increasing 2.9%. With 76% of Canada's exports shipped to the U.S., presenting over $1 trillion in two-way trade, tariff disruptions and uncertainty led to exports declining 10.8% to $60.4 billion in April. Motor vehicles and parts had the biggest impact, with exports falling 17.4%.

- U.S. GDP contracted for the first time in three years, by an annualized rate of 0.2% in 1Q25, as tariffs started to impact hard data. The biggest detractor in the quarter was the rush of imports to front-run tariffs, which we would expect to normalize going forward. There's lots of noise and (potentially) one-time events as consumers and businesses alter spending to try to deal with tariffs, but we're watching employment data to gauge the path of the economy — if people feel confident in their employment status, they spend, if not, they find ways to cut back. The unemployment rate in the U.S. has been inching up very slowly, but was steady from March to April at 4.2%.

Financial Markets in May

- The TSX Composite continued to make new highs, delivering a 5.4% price return and a 5.6% total return in May, boosting the year-to-date price returns and total returns to 5.9% and 7.1%, respectively. Meanwhile, the S&P 500 posted a 6.2% price return and a 6.3% total return for the month. Its year-to-date price return turned positive at 0.5%, with a total return of 1.1%, all in local currency.

- In the TSX Composite, cyclical sectors like Industrials, Consumer Discretionary, Information Technology, and Financials led the way, helped by ongoing progress in tariff negotiations. Defensive sectors such as Consumer Staples, Utilities, and Communication Services lagged behind. A similar trend played out in the S&P 500, though with a bit more volatility. Sentiment got a boost from the U.S. trade truce with China announced on May 12, while the disappointing U.S. Treasury bond auction on May 21 added some downward pressure.

- Consensus expectations for 2025 EPS on the S&P 500 have been lowered from US$272 at the start of the year, to US$263 currently, while our U.S. Investment Strategy team is below consensus at US$250-255. A big question now is whether the stimulative parts of the U.S. budget can offset the economic drag caused by tariffs.

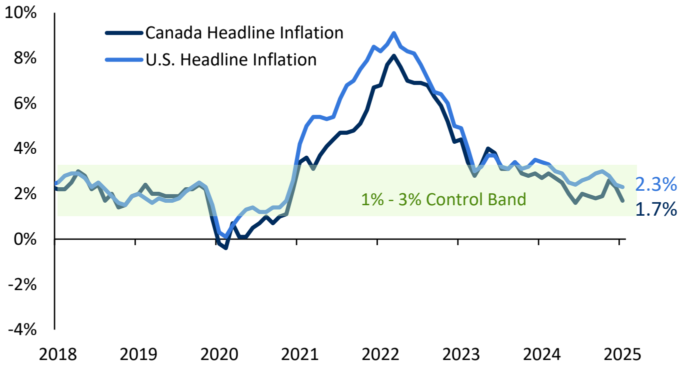
Upcoming

- After what seemed like a constructive first meeting between Prime Minister Carney and President Trump in the Oval Office, reports suggest that the two leaders are continuing their private talks on trade and security. A favourable outcome that brings greater stability in trade relations and reduces the risk of future disruptions will likely be a positive catalyst for equity markets, although certain industries are still likely to face pressures.

- Recent decisions from the U.S. Federal Reserve and the Bank of Canada have resulted in policy rates being held steady while both institutions gauge the impact of tariff policies on economic growth (or contraction), employment, and inflation. Assuming that inflation does not rise significantly, with increases seen more as transitory price level adjustments, we expect that a clearer picture on tariffs, softening economic growth, and increases in the unemployment rates will give both countries reason to lower rates twice before the end of the year.

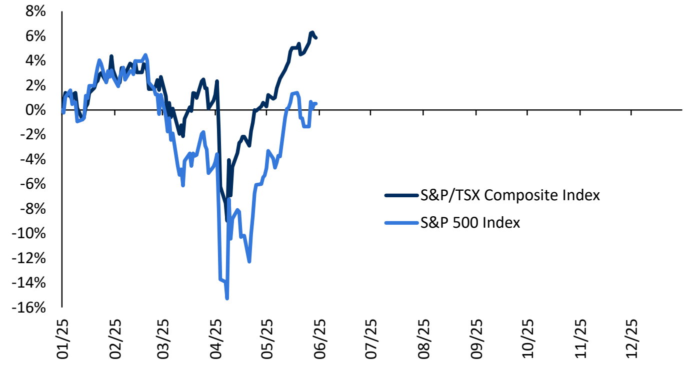
- As we wrap up 1Q25 earnings season, we saw good earnings growth despite more caution into the remainder of the year as revenues and costs start to show the impact of tariffs. 2Q25 will be a telling period as we see how companies balance slower revenue growth, the pass through of rising costs into higher prices, higher input costs, reductions to overhead and labour/workforce, and pressure on margins. With a softening U.S. economy and margin compression from higher costs to U.S. companies, our U.S. team has reduced its S&P 500 EPS forecast to US$250-255, from US$265. Our S&P 500 target has similarly been reduced to 5,800, from 6,375 at the start of the year. We will have a better idea about the longevity of these tariffs over the next weeks and months, although given the U.S. administration's goals of generating extra government revenue and enticing companies to commit to multi-year projects to move manufacturing operations, the initial intent seems to be that these will be effectively permanent, but with room for negotiation as to the rates and exclusions. We will similarly weigh adjustments to our TSX target as the longevity and breadth of tariffs become more certain, with consideration to the potential impact to the Canadian economy from a slowing U.S. economy, and quarterly earnings results and guidance. For now, however, our TSX Composite year-end target has remained unchanged at 26,300.

Chart 1 - Canada and U.S. Headline Inflation



Source: FactSet, Raymond James Ltd.; Data as of April 30, 2025. Not seasonally adjusted.

Chart 2 - S&P/TSX Composite and S&P 500 2025 Performance



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025. Price return in local currency.

Executive Summary

Despite a flurry of twists and turns in the constantly evolving tariff saga, May almost felt like a period of calm after the chaos of announcements and market sell-off, and then quick recovery, following the Liberation Day announcements in April. Last month, we questioned if we were past peak 'shock and awe', and we think that is still the case. With the May 12 deescalation of the U.S.-China conflict, markets seem to be reflecting optimism that we will see more rational tariff levels going forward. The market's tolerance for shocking announcements has also seemingly increased as a court ruling that the IEEPA tariffs were illegal, and new 50% tariffs on the E.U., barely move the needle anymore.

Although Wall Street and Bay Street reacted quickly to tariff announcements over the last few months, the impacts on Main Street are only just starting to surface, as retailers have been warning of price increases in June, and as more companies are starting to announce layoffs or restructurings in order to maintain profitability while input costs increase. As we watch to see how soft (sentiment) data maps into what has so far been relatively healthy hard data, we also watch how pressure on corporate profitability evolves. At the start of the year, we were watching to see how corporate profitability improvements would help to support the continuing advance in equities as valuation multiples had gotten extended. In the current environment, we are looking more for corporate profitability that can be maintained through these tariff-induced pressures, and for selective opportunities within certain sectors.

Equity markets staged a significant rally from mid-April to mid-May, kicked off by a 90-day delay on the Liberation Day tariffs that sparked a massive sell-off. The enthusiasm allowed the markets to gain back all those losses and even charge higher as repeated concessions by President Trump provided the markets with more and more confidence that tariffs could be negotiated down significantly. This was reinforced by a big trade deal announcement with the U.K., with a lot of specifics to be negotiated later, and rapid deescalation of the heated trade war with China. The rally seemed to top out as markets digested the "One Big Beautiful Bill" budget from the U.S. Congress, and started recognizing the risks increasing deficits.

We are starting June with still positive economic growth, despite signs of weakening ahead. As we approach various deadlines in tariff negotiations, recent reported discussions between President Trump and Prime Minister Carney suggest that progress is being made towards a new trade and security deal before the end of the year. A long awaited phone call between President Trump and President Xi, has also potentially reduced some anxiety levels and paves the way for a more productive negotiation. Additionally, Canada and China are now in talks to resolve some long-standing trade issues. Although the road ahead will likely not be straight or smooth, we are cautiously optimistic of an improving environment.

May Recap

Not surprisingly, tariffs continued to be the hot topic in May. While we believe that we passed peak 'shock and awe' with the Liberation Day tariff announcement on April 2, and the escalation with China over the following week, May has continued to provide twists and turns that look more like skirmishes in the longer-term trade war that is unfolding.

The most notable item was probably the court ruling on May 28, where the U.S. Court of International Trade (CIT) stated that the liberties taken by the Trump Administration to implement the fentanyl-based tariffs in February, and the Liberation Day tariffs in April, were beyond the scope of what was permitted under the International Emergency Economic Powers Act (IEEPA). The court gave the Administration 10 calendar days to comply with the ruling, and subsequently refund the US$15-20B that had already been collected. While we were outlining how this was at best a temporary set-back due to other mechanisms that would allow similar impacts, a federal appeals court quickly reinstated the tariffs, allowing them to stay in effect while the matter is likely moved to the Supreme Court. Ultimately we see this as a temporary inconvenience for the Trump Administration and does not derail the broader agenda, although it likely draws out the uncertainty.

Other notable tariff events of the month were skirmishes with Europe as Trump determined that negotiations were moving too slowly and announced a 50% tariff on the region, effective June 1, before subsequently delaying the effective date to July 9. Trump also doubled Steel & Aluminum tariffs to 50%, effective June 4, likely to reinforce the domestic industry after switching his stance to now endorse Japan-based Nippon Steel's acquisition of U.S. Steel. We also saw what appeared to be the first company-specific threat, with a 25% tariff on Apple iPhones that are not manufactured in the U.S., before Trump later clarified that the tax would extend to all smartphones.

Economically, we are seeing more soft data and sentiment indicators that suggest a slowdown is coming, although hard data still shows a relatively resilient economy. While Wall Street and Bay Street have been reacting to tariff headlines for months, the impact on Main Street is only just starting to show and the next thing to watch is how businesses are going to react to these new taxes. Companies may do a combination of increasing prices, reducing profitability, and/or cutting other costs and laying off workers. We have also seen a decline in shipments of cargo into the U.S., which is expected to lead to fewer items or selection on store shelves and higher prices. Announcements by multiple retailers suggest that price increases will start hitting consumers in June.

The big U.S. political item in May was the "One Big Beautiful Bill" House Reconciliation Proposal being agreed to in the House before being passed to the Senate. A lot of the focus is on the extension of tax cuts from the Tax Cuts and Jobs Act (TCJA) from Trump's first term, and cuts to Medicaid (health care for low income households), student loans, and the Supplemental Nutrition Assistance Program (SNAP, formerly Food Stamps). The Bill also takes aim at commitments to energy and clean vehicle tax credits from the Inflation Reduction Act. These government spending cuts, and anticipated revenues from tariffs, are expected to somewhat offset the tax cuts, although the Bill is still expected to keep the U.S. deficit elevated and increase the national debt.

Canada has fared relatively well so far (compared to some other countries), after being excluded from the Liberation Day tariffs, and having USMCA-compliant products being excluded from the 25% 'fentanyl' tariffs, although industry-specific tariffs on automotive products, steel, and aluminum are still significantly disruptive. Plus, we could still be caught up in subsequent waves of tariffs, which are expected to include pharmaceuticals and minerals. While 50% of Canadian exports (up from 40%) to the U.S. are considered formally USMCA-compliant, it is believed that many exporters just never went through the process to get their products approved, instead just accepting the previously minimal rates or operating in a segment that was exempt from tariffs anyway. Now that those non-compliant products could be hit with 10-25% tariffs, we expect a rush to get these products certified, so that compliance rates will certainly rise, potentially to the 75-80% range.

Prime Minister Carney's Oval Office meeting with President Trump seemed to go as well as could have been expected. While this likely doesn't translate into any immediate reprieve in U.S. measures against Canada, it takes some pressure off country-specific escalation, while the countries move towards a renegotiation of the USMCA trade agreement, before mid-2026, and as Trump courts Canada as a partner in a 'Golden Dome' joint missile defense initiative.

In equity markets, Canada's TSX Composite ended May up 6% for the year, with the main U.S. index, the S&P 500, essentially flat. Canada's outperformance can be partly attributed to the Materials sector's weighting towards gold stocks, as the metal's price shot up on geopolitical uncertainty.

Tariffs

Last month, we titled our report "Are we past peak 'shock and awe'?". While we think that it would be difficult to outdo the Liberation Day announcement, this month we were still subjected to several new twists and turns in the tariff game. The first was a 90-day deescalation in the US-China conflict, followed by a company specific tariff, as President Trump took aim at Apple's iPhone, later revising the threat to any smartphones manufactured outside the U.S. President Trump also singled out Walmart after the retailer disclosed that it may need to raise prices on a wide variety of items. Trump told Walmart to just "eat the tariffs", after which other companies warned of their own price increases coming in June, although many were careful to avoid specifically attributing the measures to tariffs. Then we had a court ruling deeming the initial 'fentanyl' and the subsequent 'reciprocal' tariffs to be illegal, and we kicked off June with a doubling of Steel & Aluminum tariffs.

On the deal front, the U.S. and U.K. announced that a new trade deal had been struck, although many of the details were still to be worked out. Trump later announced an immediate 50% tariff on the E.U. due to trade discussions not progressing to his satisfaction, before walking back the implementation date. Most recently, Trump has expressed frustration with progress on a China deal, with mutual accusations of not delivering on agreements made in the May 12 deescalation negotiation.

The average effective tariff rate of all goods entering the U.S. currently stands at ~15%, up from ~2.5% at the beginning of the year. A rule-of-thumb is that for each 1% increase in this average effective tariff rate, we would expect a negative impact of 0.1% to U.S. GDP and 0.1% increase in the inflation rate.

Are IEEPA-based tariffs legal?

On the evening of May 28, the U.S. Court of International Trade (CIT) ruled unanimously (3-0) against President Trump's use of the International Emergency Economic Powers Act (IEEPA) to impose unlimited global tariffs. This has been the Trump Administration's favoured tool to quickly implement massive tariff rates against various countries — including the 'fentanyl' tariffs against Canada, Mexico, and China, that were first announced in early February, and are still being used against non-USMCA-compliant products, as well as all the 'reciprocal' tariffs that were announced on April 2.

IEEPA was by no means the only tariff tool in President Trump's toolbox, and the other sector-specific tariffs, such as against the automotive industry, steel, and aluminum, that were implemented using Section 232, are unaffected by this ruling. We do not think this CIT ruling was a surprise to the Administration, and within hours, an appeals court ruled that the tariffs could continue to be collected while the ruling was being appealed, and ahead of it potentially being escalated to the Supreme Court. Even if the CIT ruling is upheld, we will likely just see a shift in how the tariff agenda is imposed, which will do little more than extend the period of uncertainty for countries, companies, and markets. This ruling could also complicate the negotiation of trade deals.

While a ruling against the President could require the reimbursement of tens of billions of dollars already collected, we expect that the Trump Administration was already prepared for the possibility, and aside from challenging it, will also potentially use Section 122 authority, which allows the President to impose tariffs of up to 15% for up to 150 days to address “large and serious” trade deficits (Table 1). An existing Section 301 authorization against China could also be used to continue the pressure on China, and new investigations using Section 301 and 232 are likely to be used against various countries as the Section 122 tariffs expire. Section 232 investigations on pharmaceuticals, semiconductors, copper, and lumber are already underway. Overall, although the mechanisms might change, we see this Administration continuing along the same tariff path regardless of this ruling.

April 2 — Liberation Day tariffs — clock is ticking down to July 9 re-implementation

On April 2, President Trump announced sweeping tariffs on most countries. While termed “reciprocal” tariffs based on each country’s tariff and non-tariff trade barriers to U.S. products, the rates displayed were instead based on U.S. trade deficits with each country in 2024, divided by the value of U.S. imports from that country. This rate was then halved to derive the tariff rate that the U.S. would apply against each country, subject to a minimum rate of 10%, but escalating to as high as 50%. These rates stacked on existing rates however, such that the 34% “reciprocal” rate on China was stacked onto the 20% rate that was previously announced under the ‘fentanyl’ tariffs, for a combined rate of 54%. On April 9, the reciprocal tariffs over the universal base-rate of 10% were put on hold for 90-days, except for China, until July 9. The 90-day delay is intended to allow countries to reduce or eliminate their own trade barriers, which may also include commitments to purchase large amounts of U.S. goods, in order to gain relief from “reciprocal” tariffs being reimposed July 9. Based on the few details released from the U.K. deal, it seems like the most favourable outcome will still include a universal 10% tariff, except for certain sector or product exemptions.

While 90 trade deals in 90 days seemed ambitious, the Administration is suggesting that it may just unilaterally re-evaluate “reciprocal’ tariffs on a regional basis and provide updated rates for countries, beyond the 18 most ‘important trading partners’, that have not negotiated better deals by July 9.

China tariffs

After China retaliated to the April 2 tariff plan, which imposed a 34% tax on all goods entering the U.S., a back-and-forth escalation ensued before ending up with a 145% tariff on U.S.-bound products and 125% tariff on China-bound products. This equated to a near trade embargo. After one analyst crunched the numbers and published that the price of an iPhone forced to be produced in the U.S. would be approximately US$3,500, President Trump carved out exemptions for electronics such as smartphones and computers, although there are questions as far as how permanent these exemptions are. President Trump assured the public that China’s President Xi had called him and that they are in daily negotiations, such that the tariff rate will come down significantly, China is claiming that no such call was made and that no discussions are or will occur before all tariffs are dropped. The first call between the two leaders was finally held on June 5.

With concerns growing of product shortages on store shelves, and supplies of critical minerals from China, on May 12 the two countries announced a deescalation and delay in the prohibitive tariff rates for 90 days. Since then, both countries have accused the other of violating the agreement, although no re-escalation has been indicated.

European tariffs

President Trump took sharper aim against the European Union in May, as he grew frustrated at the speed and direction of negotiations. It seems that the E.U. proposed a mutual tariff reduction and market access plan, while Trump was more interested in unilateral concessions on the E.U. side. The threat of a 50% tariff on E.U. goods starting June 1 was delayed to July 9 only two days later, after a phone conversation with E.U. Commission Chief Ursula von der Leyen. The E.U. has prepared a list of €21 billion (US$24 billion) worth of U.S. goods on which it intends to impose counter-tariffs if a deal is not struck.

De minimis exemption

Wrapped up in the tariff discussion was the ‘de minimis’ exemption. A major tax-loophole for American consumers had a dramatic overhaul last month. Previously, shipments by mail that were valued under US$800 were exempt from duties. Now, Americans using e-commerce sites, many of which were primarily sourcing from China, such as Temu and Shein, are going to have to cover taxes, which as in the case of shipments from

China, is currently 30%. In 2022, 80% of all U.S. bound e-commerce shipments were covered by the ‘de minimis’ exemption, with the vast majoring coming from China, and last year, U.S. Customs and Border Protection (CBP) processed 1.36 billion ‘de minimis’ exempt packages.

Fentanyl-driven tariffs

After numerous threats, both before and after the election, the first real salvo was fired by President Trump on February 1 with an executive order for 25% tariffs on all goods entering the U.S. from Canada and Mexico (with a reduced 10% tariff on Canadian energy — oil, natural gas, electricity, coal, and uranium), and a 10% tariff on Chinese goods. This round of tariffs was primarily justified as addressing the issue of the influx of fentanyl into the United States.

After various delays and temporary exemptions, these IEEPA justified tariffs settled down to 25% imposed on USMCA non-compliant goods, except for energy and potash, which have a 10% tariff. Overall, we estimate that 50% of Canadian goods imported into the U.S. are exempt from these tariffs due to USMCA compliance, up from 40% at the beginning of the year. This could rise to 80% as exporters complete the necessary paperwork.

Steel & aluminum tariffs

On March 12, a 25% tariff was placed on steel & aluminum products imported into the U.S., including from Canada. This tariff applies to raw metals and finished goods made of steel and aluminum, which is quite an exhaustive list of products. There’s an exemption for the finished product if the steel or aluminum is “melted and poured” in the U.S. This tariff threat seems similar to a June 2018 action where President Trump enacted a 25% tariff on steel and 10% tariff on aluminum in his first term. That round resulted in Canadian exports to the U.S. falling approximately 20% over the following year before rebounding after the USMCA ratification in May 2019. Canada is the most exposed economy to this specific tariff as it represents approximately 20% of such U.S. imports and 90% of Canada’s exports of these goods, equivalent to approximately US$24.4 billion, or roughly 1% of Canada’s GDP. China, by comparison, was already subject to a 47.5% tariff on steel and 32.5% tariff on aluminum and so any incremental tariff there would be of negligible impact, although that country still sold US$15.4 billion of steel and aluminum into the U.S. last year.

On June 4, President Trump doubled the tariff on all steel and aluminum tariffs to 50%. The only country that may be exempted at this point is the U.K., which announced a trade deal with the U.S. that removed the previous 25% tariff on steel & aluminum, and could potentially be finalized in the coming weeks to allow a full exemption. Although the Canadian steel industry faces a significant amount of pressure from these tariffs, Prime Minister Carney, despite denouncing this move, is holding off on further escalating the situation as bi-lateral trade negotiations continue.

In retaliation for the initial fentanyl and steel and aluminum tariffs, Canada has imposed up to 25% tariffs on $30 billion of U.S. goods such as tools, computer, servers, display monitors, and sports equipment. No escalation has been announced in response to the recent doubling of steel & aluminum tariffs, which was a world-wide measure, and not targeted against Canada.

Smartphone tariffs

President Trump seemed to threaten his first company-specific tariff in May, against Apple. It seems that Apple’s plan to move some iPhone manufacturing from China to India was seen by the U.S. Administration as a way for Apple to avoid excessive tariffs on products coming out of China, although we don’t know where tariffs on China and India will ultimately end up. It was interesting in that it came just weeks after an exemption for certain electronics and computers that were thought to have alleviated some of the pressure on Apple specifically. President Trump now wants Apple (and others) to produce all U.S. sold smartphones in the U.S., a measure that is estimated to drive the price of an iPhone to US$3,500 (over 3x the current price), and would still require tens of billions of dollars and years to achieve. Alternatively President Trump is threatening 25% tariffs, which sound like the vastly better option, although it is unclear if this is another threat that could ultimately be defused by Apple making some commitments to invest in more U.S. operations. This tariff implementation is expected by the end of June.

Lumber

Canada and the U.S. have had a long-standing dispute over softwood lumber. The U.S. objects to the fees that the Canadian government charges the forestry industry, deeming them too low and effectively sees them as the government providing unfair subsidies. The U.S. raised the duty on softwood lumber from 8% to around 14.5% last year. An investigation into global lumber imports and derivative products was launched on March 1, and is to be completed within 270 days. After that, a final determination will be made on tariffs (likely 25%). The expectation is for an increase in anti-dumping duties on Canadian softwood lumber to 20.07%, in combination with countervailing duties of 6.74%.

Tariffs on automobiles

President Trump has reiterated his call for carmakers to close their Canadian facilities and move production to the U.S. As we have suggested before, moving manufacturing of that scale, with integrated global supply chains, is not a quick project.

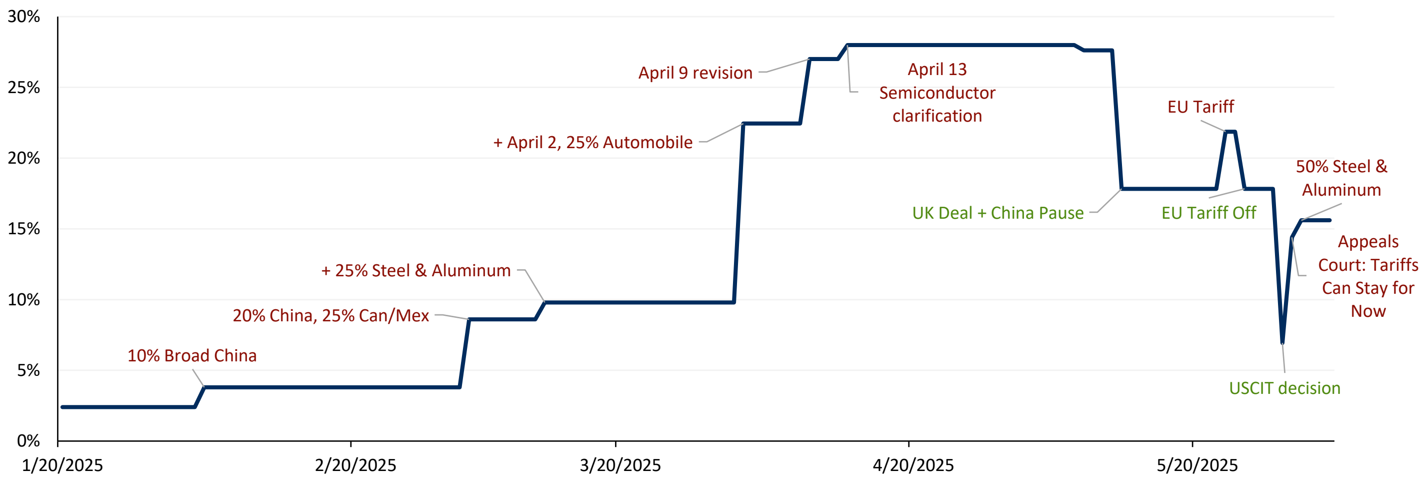
As of April 3, the U.S. placed 25% tariffs on finished vehicles, while key parts, such as engines, engine parts, transmissions and powertrain parts, and electrical components, began being tariffed May 3. For now, tariffs on vehicles from Canada and Mexico, covered by the USMCA, will only apply to the non-US made content, and the tariff will not apply to parts imported from Canada and Mexico that are USMCA-compliant. These are likely to be short-term exemptions until the U.S. establishes a process to apply the tariff to all the value of the non-US content.

At the end of April, President Trump announced some modest relief in the auto sector by reducing duties on imported parts used in U.S.-manufactured cars, as well as removing the stacking effect when auto levies are compounded by metal tariffs. Additional relief included a 3.75% reimbursement on tariffs paid on auto parts by U.S. automakers, which will be scaled back to 2.5% after one year, and eliminated in year three.

Upcoming sector threats

President Trump has threatened that more sector-specific tariffs would be coming for semiconductors, pharmaceuticals, and Canadian dairy. An investigation into copper imports is also in process, with the expectation that tariffs similar to the ones of steel and aluminum could be in the works.

Chart 3 - U.S. Effective Tariff Rate



Source: The Budget Lab at Yale; Data as of June 4, 2025.

Table 1 - Summary of U.S. Tariff Announcements Affecting Canada as of June 4, 2025

Date	Targeted Products	Tariff Rate	Trade Remedy	Notes
March 7, 2025	Non-USMCA Compliant goods (excl. potash, Canadian energy)	25%	IEEPA (may be affected by court order)	Close to 80% of imports from Canada entered the U.S. free of duty in 2024, of which about half are USMCA compliant. By March, the share of USMCA-compliant goods had grown to around 50%
March 7, 2025	Non-USMCA Compliant goods (potash, Canadian energy)	10%		
March 12, 2025	Steel & Aluminum	50% (25% from March 12 to June 3)	Section 232 (remain in place)	
April 3, 2025 / May 3, 2025	Autos and Autos Parts	25%	Section 232 (remain in place)	Auto tariffs apply only to non-U.S. made components in USMCA-compliant vehicles USMCA-compliant auto parts are exempt from tariffs Auto parts tariffs are not stacked with Canada and Mexico fentanyl tariffs, nor with the steel and aluminum tariffs

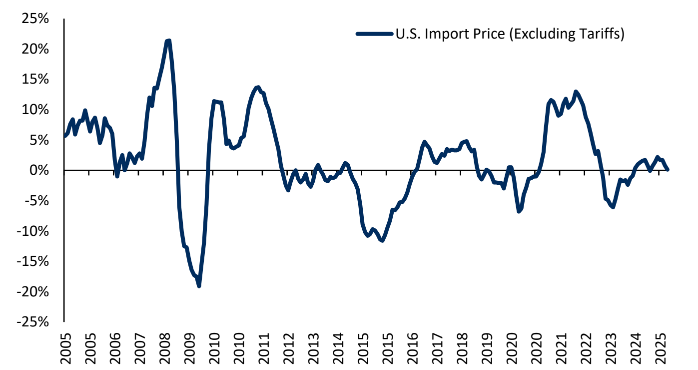
Source: Raymond James Ltd.

How Tariffs Have Affected Major U.S. Trading Partners

Contrary to how tariffs are being portrayed by certain commentators, tariffs are not paid by the exporting nation (for example Canada). Tariffs are collected by the importing nation's government (in this case the U.S.) as a tax, although it is possible that the (U.S.) retailer, (U.S.) distributor, or (Canadian) manufacturer might decide to reduce their profits and absorb some impact, so as not to increase prices dramatically for the (U.S.) consumer.

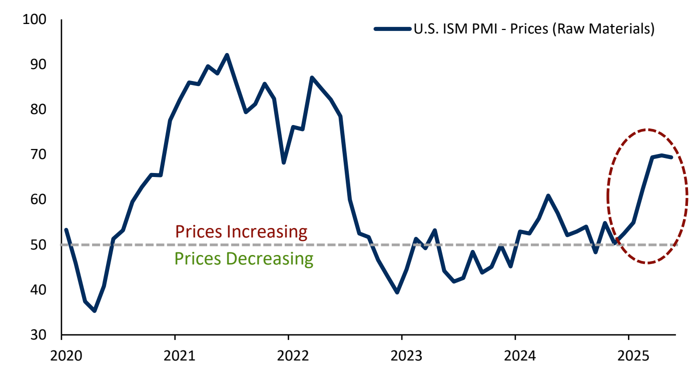
So what has happened so far? U.S. import price indexes, which exclude the tariffs collected by the U.S. customs agency, have shown little change since the beginning of the year (Chart 4). This suggests that U.S. importers are still paying roughly the same base prices for goods as they would have without tariffs, but now they also have to pay the tariffs on top. (As noted earlier, importers typically pay the tariffs.) If exporters were absorbing a portion of the tariff burden, we would expect to see a decline in the import price index. Furthermore, the sharp rise in the ISM Purchasing Managers' Index (PMI) for raw material prices also supports the view that U.S. importers are shouldering the tariff burden (Chart 5).

Chart 4 - U.S. Import Prices (Excluding Tariffs) Has Seen Little Movement Year-to-Date



Source: Bureau of Labor Statistics; Data as of April 30, 2025.

Chart 5 - Manufacturing Input Prices Surge, PMI Data Reveals



Source: ISM PMI; Data as of May 31, 2025.

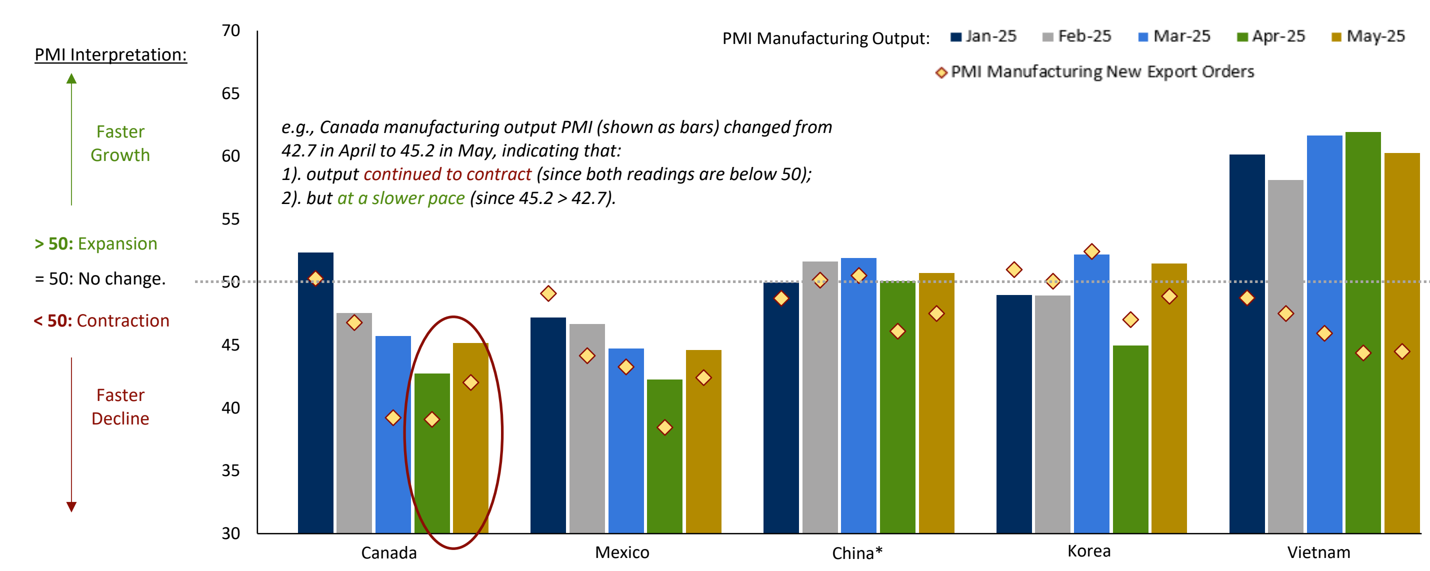
At the country level, Bloomberg Economics suggests that in the current round of tariffs, Canada and Mexico have absorbed more of the cost than other major U.S. trading partners. However, even in these cases, the portion absorbed has been modest. This is consistent with recent research showing that the burden of tariffs almost always falls on importers and their consumers.

However, even if exporters don't lower their prices to absorb tariffs, it doesn't mean they escape the negative effects from tariffs. One of the most noticeable impacts is often a decline in new orders. This tends to happen for two main reasons. First, higher prices resulting from tariffs can lead to weaker total demand. Second, shrinking margins could force some importers out of the market, allowing domestic producers to step in and capture more market share. The extent of the first effect depends on how sensitive customers are to price changes, while the second depends on how quickly domestic producers can scale up their production capacity.

The PMI for new orders points to weakening export demand across all major U.S. trading partners (as shown by the diamond-shaped markers in Chart 6), although in Korea's case, the dip in April may partly reflect the "front running" orders in March. Canada and Mexico are among the countries most negatively affected by the new U.S. tariff policies. While neither of them faces reciprocal tariffs, and most goods, aside from a few industry exceptions, can still enter the U.S. duty-free under USMCA, the impact is still widespread. That's because roughly 76% of Canada's exports and 80% of Mexico's exports go to the U.S., making the countries highly sensitive to the trade disruptions from the U.S. In contrast, only 14% of China's, 20% of Korea's, and 28% of Vietnam's exports go to the U.S.

The breakdown of export categories is a key factor in assessing trade vulnerability as well. In Canada's case, due to its proximity to the U.S. within the manufacturing value chain, industries with overlapping production strengths (offering similar products or value) are particularly vulnerable. For instance, while around 88% of vehicles produced in Canada are exported to the U.S., they make up less than 15% of total U.S. imports in that category. On top of that, the U.S. produces around 70% of its vehicle sales domestically. This supply setup gives the U.S. considerable flexibility to source from elsewhere and potentially displace Canadian suppliers in the value chain.

Chart 6 - PMI Manufacturing New Orders and Output



Source: Capital Economics, Raymond James Ltd.; Data as of May 31, 2025. *China's PMI represents the average of NBS and Caixin PMI surveys.

The PMI for output also signals a decline in manufacturing activity in Canada and Mexico, while conditions in China and Korea have remained relatively stable (as shown by the bars in Chart 6). In contrast, Vietnam has seen an increase in output, benefiting from lower tariffs compared to China and its role as the region's closest alternative. Output readings appear slightly more resilient than new orders for now, partly because U.S. importers need time to realign their supply chains. Nonetheless, unless major trading partners can secure alternative buyers to offset the drop in U.S. demand, which is a significant challenge, or there's a meaningful shift in tariff policy, output is likely to decline further as the slowdown in new orders begins to filter through. Notably, in Canada, we've already seen the trade surplus with the U.S. shrink to $3.6 billion in April, as exports to the U.S. dropped for a third month, by 15.7%.

However, we expect to see a slightly more optimistic picture in Canada. Again, for many industries, once goods meet USMCA compliance standards, they can still enter the U.S. tariff-free, keeping supply chain operations largely intact. Encouragingly, there's been progress on this front: the share of USMCA-compliant exports to the U.S. rose by over 10% in March alone, reaching 50%. Consensus estimates suggest this could eventually climb to 80%. Ultimately, the impact on Canadian exporters will hinge on their ability to maintain or regain market share once the paperwork is in order and disruptions settle.

We also believe the timeline for USMCA renegotiation may be brought forward. A revised agreement could reset the trade landscape between the U.S., Mexico, and Canada, ideally resulting in a more comprehensive and stable framework. While the transition may not be painless for all parties, it could ultimately provide greater clarity and direction for North American trade.

Economics

Canada — Economy Is Softening but Not Deteriorating Significantly

Another month of tariff turmoil, yet the economy continues to show signs of resilience, at least for now. Stronger-than-expected GDP growth in the first quarter of 2025, at an annualized rate of 2.2%, suggests that Canada's economy held up well during the initial wave of tariff threats. However, the composition of this growth, driven largely by a buildup in business inventories and a temporary boost in net exports, indicates that much of the gains may be borrowed from the future. The surprise strength in Q1 GDP also allowed the Bank of Canada (BoC) to keep its policy rate unchanged at 2.75% at its June 4 meeting, amid ongoing concerns about persistent core inflation. Nonetheless, cracks are beginning to show in the labour market, particularly in sectors more exposed to U.S. tariffs, and soft data continues to point toward a potential slowdown. Thus, we maintain our view that economic growth will stall in 2Q25. We also expect the BoC to continue lowering the policy rate throughout the remainder of the year, albeit at a slower pace, ending 2025 at 2.25%.

1Q25 GDP Growth Shines, But Underlying Details Disappoint

Canada's Q1 2025 GDP came in much stronger than expected, rising at an annualized rate of 2.2% compared to the flash estimate of 1.5% (Chart

7). The advance information also indicates that real GDP increased 0.1% month-over-month in April (Chart 8), suggesting the economy continues to hold up well despite ongoing tariff-related disruptions. However, a closer look at the underlying details reveals a less optimistic picture than the headline figures suggest.

A major driver of GDP growth in 1Q25 was the buildup in business inventories, a highly volatile component. This increase may have been partly due to Canadian importers placing advance orders for U.S. goods, as imports also rose significantly during the quarter. Another key contributor was net exports. Although imports grew at an annualized rate of 4.4%, exports outpaced them with a 6.7% increase, largely driven by uncertainty surrounding U.S. tariffs. Interestingly, exports to the U.S. actually peaked in January and then declined in February and March, though the March exports were still slightly above where they were at the end of 2024. What also boosted exports in March was a sharp increase in exports to the U.K. (of gold) and the Netherlands (crude oil). However, it's unlikely Canadian exporters can continue to rely on other markets over the longer term to make up for softer U.S. demand. Notably, we've already seen the trade deficit widen to a record $7.1 billion in April, as a sharp 10.8% month-over-month drop in exports outweighed a 3.5% decline in imports. Therefore, the sustainability of these two growth drivers appears questionable. On the other hand, consumer spending lost momentum, with quarter-over-quarter annualized growth slowing considerably to 1.2% in 1Q25, down from 4.9% in the previous quarter. Investment in fixed capital also took a hit, contracting at an annualized rate of 3.1%. Residential investment saw the steepest drop, falling 11% on an annualized basis after surging by 16% in 4Q24.

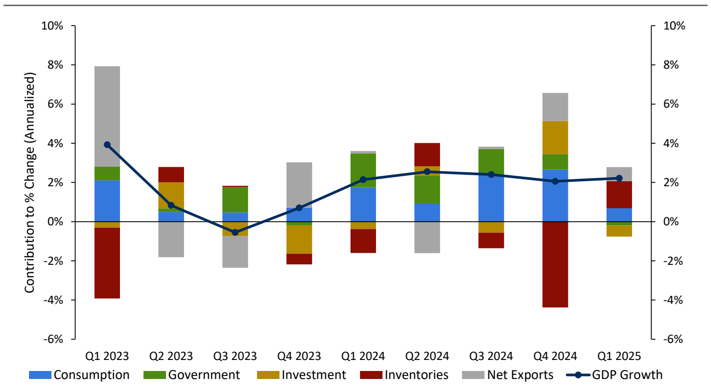
With tariff uncertainty still looming and leading indicators showing signs of weakness, we remain aligned with Bank of Canada projections that essentially call for a stalling of the economy in 2Q25. On a more positive note, export orders to the U.S. could see a rebound in the coming months as more goods are certified as USMCA-compliant. However, it may be difficult to fully return to pre-tariff levels.

March Retail Sales Boosted by Strong Auto Purchases

As we watch to see if weakness in soft data (sentiment) translates into hard data, March retail sales in Canada have held up well, as consumers may have been front-running potential tariffs. A jump in motor vehicle sales in March (+5.2%) helped to boost the 0.8% m/m increase, after a 0.5% decline in February. This was despite a 6.5% drop in gasoline sales, two-thirds of the decline being attributed to lower prices. Preliminary estimates suggest further retail sales gains of 0.5% in April.

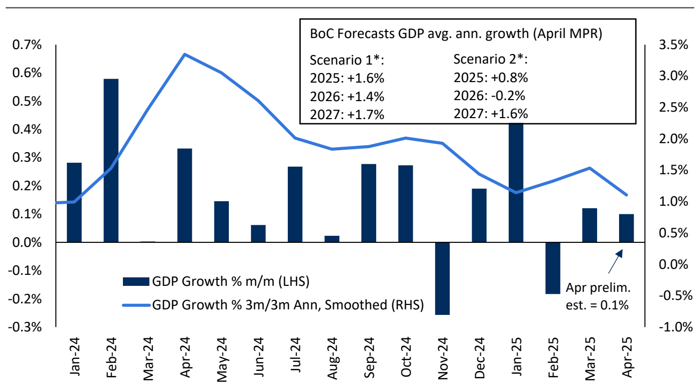
However, we expect retail sales to soften once the surge in auto purchases fades. According to Equifax, average non-mortgage debt per consumer rose in 1Q25, largely driven by a strong auto loan market, as buyers rushed to secure vehicles ahead of anticipated price increases. Average credit card spending per cardholder declined by $107 during the quarter, reaching its lowest level since March 2022, suggesting that consumers are pulling back on discretionary spending amid ongoing uncertainty. At the same time, the average credit card payment rate fell, pointing to rising financial stress. Overall, during 1Q25 the non-mortgage delinquency rate increased 17% year-over-year to 1.6% in Canada. While this level isn't alarming yet, it reinforces our view that consumer spending is likely to slow in 2Q25.

Chart 7 - Contributions to Real GDP Growth by Major Component



Source: Statistics Canada, Raymond James Ltd.; Data as of March 31, 2025.

Chart 8 - GDP Contracted in February, But Expected to Rebound Slightly in March



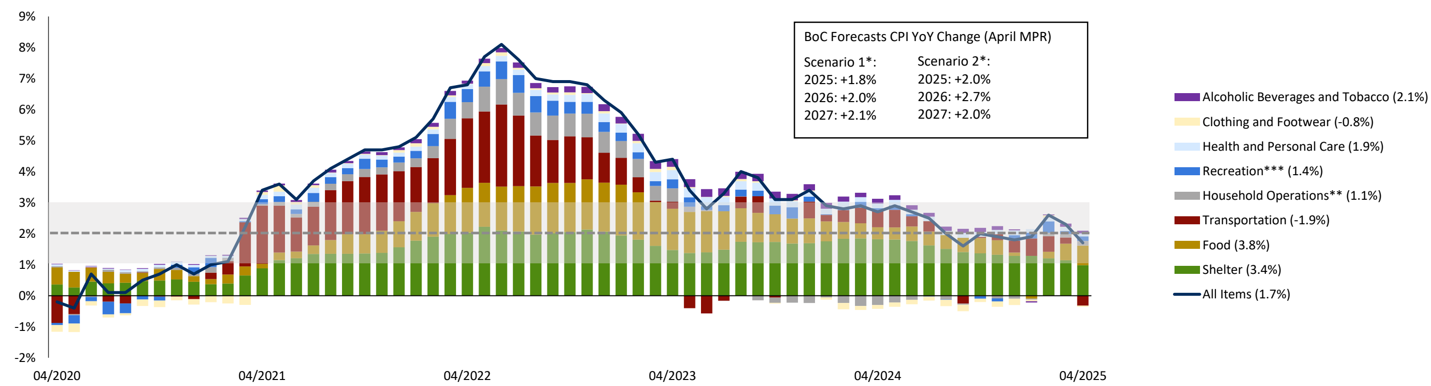
Source: Statistics Canada, Raymond James Ltd.; Data as of March 31, 2025.

Upward Pressure on Core Inflation Is Unlikely to Persist

Headline Consumer Price Index (CPI) inflation cooled dramatically in April, to 1.7%, from 2.3% in March (Chart 9), helped significantly by the removal of the federal carbon tax, although Quebec operates a different cap-and-trade system, which remained intact and resulted in the province having the highest provincial rate at 2.2%. Excluding the benefit from energy, CPI rose 2.9% in April, up from 2.5% in March.

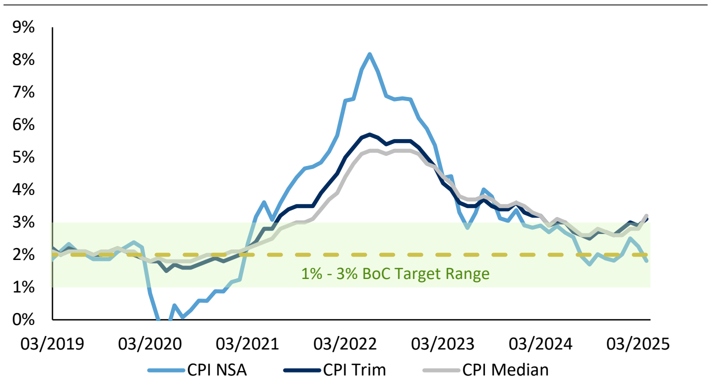
The Bank of Canada prefers to look at core measures such as CPI-trim and CPI-median (Chart 10), which were up in April on food and services prices. The uptick in food prices may partly reflect retaliatory tariffs on certain U.S. food imports. As for services inflation, we believe that in a slowing economy, exasperated by trade uncertainty, and anticipating labour market weakness, sustained upward pressure on services prices is unlikely. According to S&P Global, Canadian services firms, on average, lowered their selling prices for the first time in nearly four years, due to intense competition and weak demand. The CFIB Business Barometer also shows that while the average expected price increase over the next 12 months reached 3.6% in March, it dropped quickly to 2.9% by May (Chart 11). This supports our view that sustained upward pressure on prices is unlikely in a slowing economy.

Chart 9 - Major Components' Contributions to Canada CPI (Stacked Bars) and Latest Monthly CPI (Bracket Beside the Legend)



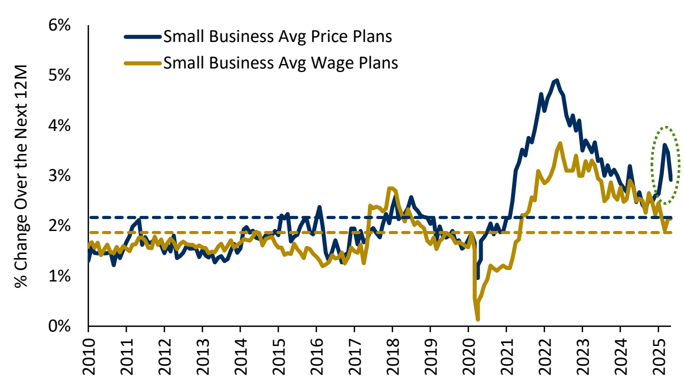
Source: Statistics Canada, Raymond James Ltd.; Data as of April 30, 2025. *Assumptions for both scenarios are in "Possible GDP impacts of tariffs in Canada" section; **Household operations, furnishing and equipment; ***Recreation, education and reading.

Chart 10 - Core Inflation Heats Up as Headline Inflation Cools



Source: Statistics Canada, Raymond James Ltd.; Data as of April 30, 2025.

Chart 11 - Price Growth Indicator Normalizes as Wage Growth Holds Steady



Source: CFIB Monthly Business Barometer; Responses received from May 6 to May 12.

Surprise 1Q25 GDP Strength Leads BoC to Pause Again in 2025, Holding at 2.75%

On June 4, the Bank of Canada (BoC) held its policy rate steady at 2.75% for the second time in 2025, following stronger-than-expected GDP growth in the first quarter (Chart 12). The decision was widely anticipated by markets, as uncertainty surrounding U.S.-imposed tariffs on Canadian goods has temporarily subsided somewhat.

The BoC Governing Council continues to monitor three key factors closely:

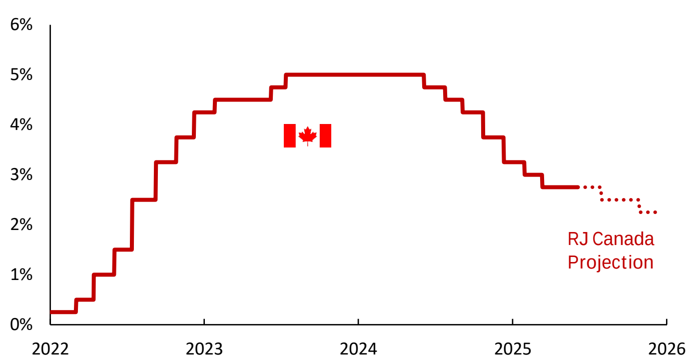
1. The extent to which higher U.S. tariffs dampen demand for Canadian exports;
2. The spillover effects on business investment, employment, and household spending;
3. The pace and magnitude at which cost increases are passed on to consumers, and how inflation expectations evolve.

Economic hard data, such as consumption, exports, and the unemployment rate among the core working-age group, has remained relatively stable so far, easing fears of a rapid economic deterioration. With the peak of tariff uncertainty in Canada seemingly passed, at least for the next few months, and the economy remaining stable, the BoC has enough leeway to wait out more information as the situation develops. The good news is that, in this environment of heightened uncertainty, the BoC is placing greater emphasis on soft data and business outreach, while adopting a less forward-looking stance than usual. This approach reduces the risk of falling behind the curve.

Looking ahead, we maintain our projection that the BoC will continue to lower the policy rate throughout the remainder of the year as economic weakness becomes more evident, while inflation remains relatively contained, ending 2025 at 2.25%. While the pace of cuts may slow, the direction remains clear given growing signs of economic softness. We're already seeing more tangible effects of the tariffs in the soft data. For instance, manufacturing new orders and output indices have contracted for four straight months, discretionary spending, tracked through VISA card transactions, has slowed from February to May, and employment plans have declined across multiple business surveys, including the Ivey PMI, S&P Global PMI, and CFIB. Also, as discussed earlier, we also don't expect core inflation to remain elevated for long, given the broader economic slowdown.

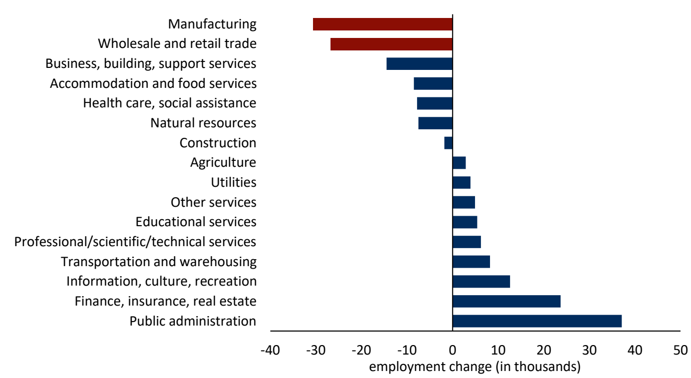
Besides the external macro and geopolitical impacts, let's not overlook the domestic challenges, such as slower population growth, ongoing issues with residential/business investment, and weak productivity growth, which would bring additional downward pressure on the policy rate. These topics are likely to return to the main stage in the second half of the year once the tariff situation in Canada stabilizes.

Chart 12 - BoC Maintains 2.75% Rate for Second Time This Year



Source: FactSet, Raymond James Ltd.; Data as of June 4, 2025.

Chart 13 - Tariff-exposed Sectors Shed Most Jobs in April



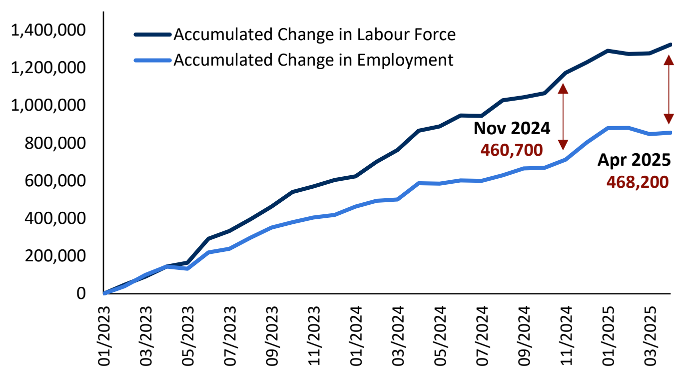
Source: Statistics Canada; Raymond James Ltd.; Data as of April 30, 2025.

Unemployment rises as tariffs begin to weigh on the labour market

The Canadian labour market continued to show signs of weakening in April, as the unemployment rate rose by 0.2 percentage points to 6.9%. This follows a 0.1 percentage point increase in March, marking two consecutive months of rising unemployment. These back-to-back increases have effectively reversed the modest improvements made in previous months, bringing the unemployment rate back to its November 2024 peak. In April, employment losses were most pronounced in the manufacturing sector (-31k) and in wholesale and retail trade (-27k) — the two segments that are more exposed to the U.S. tariffs (Chart 13). In contrast, public administration recorded a notable gain of 37k jobs; however, much of this increase was attributed to temporary positions linked to activities surrounding the federal election. Overall, the average hourly wages among employees were up 3.4% y/y in April, following growth of 3.6% in March (not seasonally adjusted).

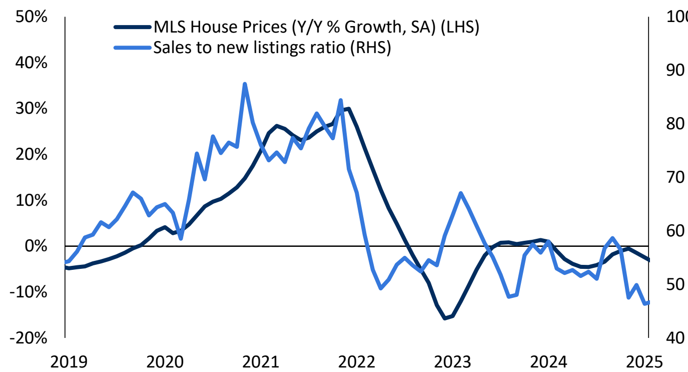
While the growth in the labour force has remained relatively modest, the continued weakness in employment gains has further widened the gap between the cumulative change in the labour force and employment. This divergence has now surpassed the previous peak observed in November 2024 (Chart 14). As we have been mentioning, even under our base case assumption that each round of threats can be managed with negotiations or that enacted tariffs will be relatively short-lived, it will, unfortunately, cause layoffs and deferrals in adding workers, and we are not expecting any significant improvements in this metric over the short term.

Chart 14 - Labour Force Growth Outpacing Job Additions Again



Source: Statistics Canada, Raymond James Ltd.; Data as of April 30, 2025.

Chart 15 - National Sales-to-New Listings Ratio Remain Muted in April



Source: CREA, Raymond James Ltd.; Data as of April 30, 2025

Growing Worries Surround the Housing Market

The Canadian housing market remained quiet in April, with demand levels similar to those observed in the second half of 2022. Home sales declined slightly by 0.1 percent compared to March, while new listings also fell by 1 percent on a monthly basis. The national sales-to-new listings ratio inched up from 46.4 in March to 46.8 in April, though it remains relatively low (Chart 15). Tariffs and ongoing market uncertainty continue to be the main factors contributing to the renewed weakness in the housing sector. Slower population growth, resulting from reduced immigration targets, is adding further pressure to the market.

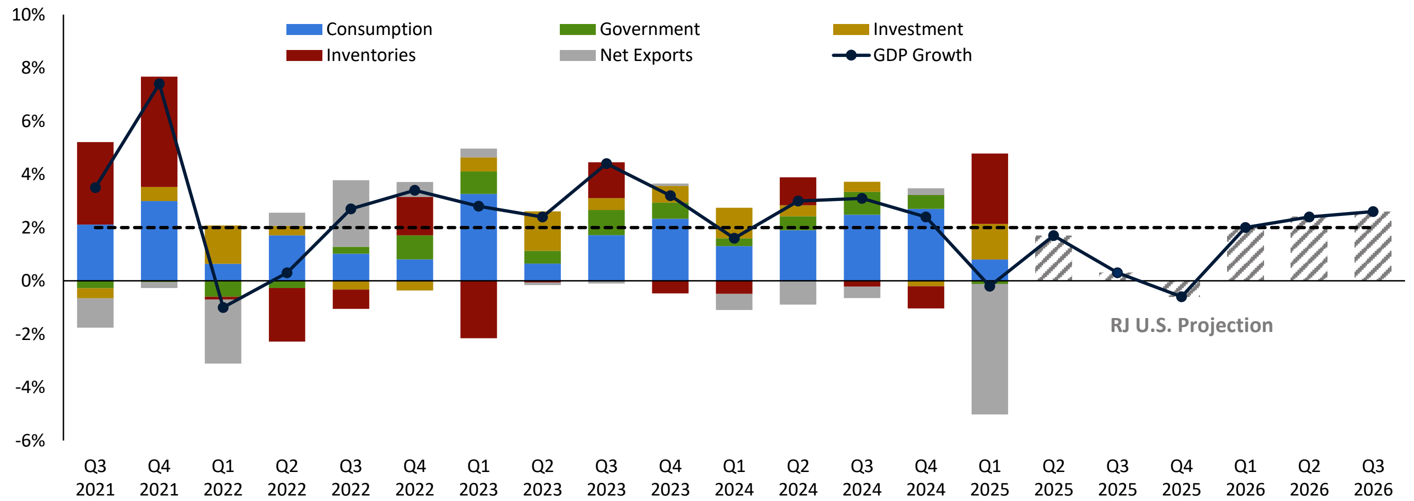
To support first-time home buyers, the Canadian government introduced a new GST rebate known as the First-Time Home Buyer GST Rebate on May 27. This initiative allows eligible buyers to save up to $50,000 on a newly built or owner-built home. The program is expected to provide $3.9 billion in tax savings to Canadians over five years, beginning in the 2025–26 fiscal year. While this measure aims to improve affordability, housing data from June may offer more insight into its effectiveness.

The U.S. — 1Q25 Contraction Driven by Record Import Surge; Sentiment Deterioration Not Evident in Hard Data Yet

The first significantly negative hard data was released on April 30, showing that the U.S. economy contracted by 0.2% (annualized) in 1Q25 (Chart 16). This was the first contraction in three years and was significantly impacted by an increase of imports as U.S. firms rushed to build inventories and consumers advanced purchases before tariffs kicked in. Imports increased 43%, which pushed the 'net export' component of GDP to -4.9% in the quarter. Having more imports than exports drags down GDP, and this massive surge was the highest since record-keeping began in 1947. Our U.S. economics team has reduced its GDP growth forecast for 2025 from 2.4% to only 1.3% growth.

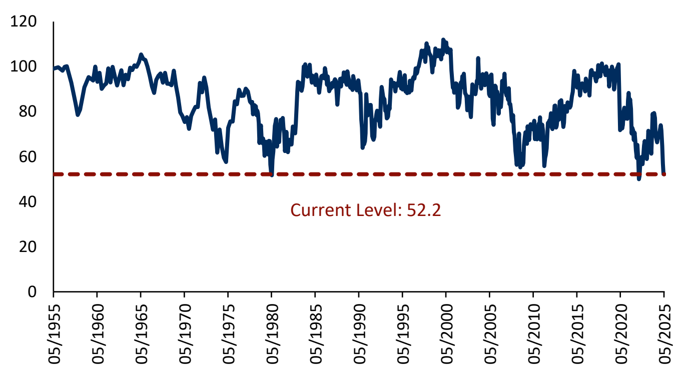
Nonetheless, the U.S. consumer has continued to spend despite all of these concerning headlines (Chart 17). With imports likely to reverse course in the short term, as already seen in the April data, Q2 GDP could rebound. Most of the price increases from tariffs are expected to reach store shelves only by the end of the quarter and therefore may not significantly impact consumer spending during this period, especially in the absence of widespread job losses so far. However, there will also likely be a reversal in inventories as businesses work through stockpiles built up ahead of the tariffs. Still, this drop in inventory contribution is unlikely to offset gains from stronger net exports.

Chart 16 - Contributions to Real GDP Growth by Major Component



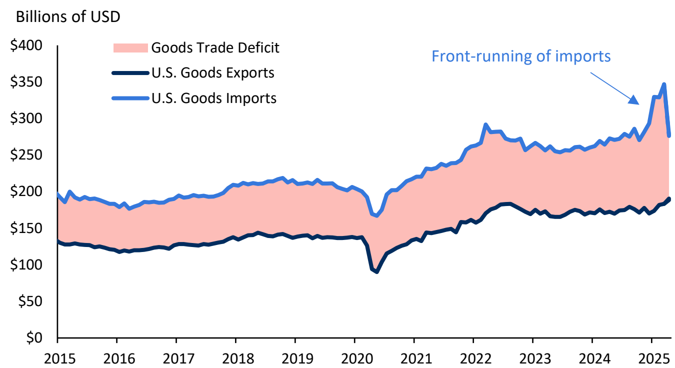
Source: U.S. Bureau of Economic Analysis; Data as of March 31, 2025.

Chart 17 - U.S. Consumer Sentiment Stays Near Record Lows



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025.

Chart 18 - U.S. Trade Deficit to Narrow as Pre-Tariff Import Surge Fades



Source: Bureau of Economic Analysis, United States Census Bureau, Raymond James Ltd.; Data as of April 30, 2025.

Trade Deficit Narrows Dramatically as Tariff-Driven Import Surge Fades

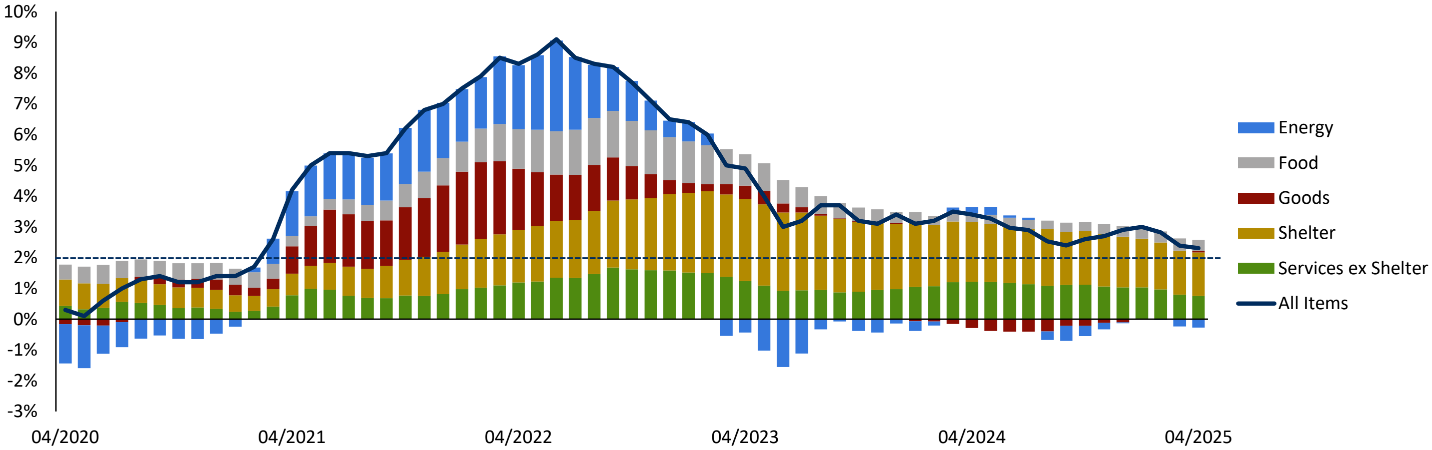
In April, the U.S. trade deficit narrowed sharply as imports of goods and services fell by $68.4 billion from March to $351 billion, a 16% drop. Goods imports, in particular, experienced a sharper drop, down 20% from the month before (Chart 18). This single-month shift nearly erased the widening in the goods trade deficit that had accumulated from October 2024 to March 2025. At the category level, the largest declines were seen in pharmaceutical products, finished metal shapes, and passenger cars.

The narrowing of the goods trade deficit in April came as expected, following the earlier surge in imports ahead of tariff implementation. With those front-loaded shipments now behind us, we anticipate the trade deficit will continue to shrink in the coming months. However, this improvement is likely to stem more from a reduction in imports than from any meaningful increase in exports, an outcome that may not align with the Trump administration's intended goals.

Modest Tariff Pass-Through to Consumer Prices

The Consumer Price Index (CPI) rose 2.3% year-over-year in April, slightly down from 2.4% in March (Chart 19). Core CPI growth held steady at 2.8% year-over-year. While the April CPI report was generally soft, it did show some modest tariff pass-through to goods prices, particularly in categories with high exposure to Chinese imports, such as furniture and audio equipment. We expect further upward pressure on goods prices as firms attempt to pass higher input costs on to consumers. However, easing inflation in some service categories may help partially offset this pressure. The Fed's preferred inflation gauge, core PCE (which excludes food and energy), rose 2.5% year-over-year in April, its smallest increase in over four years.

Chart 19 - Major Components' Contributions to U.S. CPI



Source: U.S. Bureau of Economic Analysis, Raymond James Ltd.; Data as of April 30, 2025.

Fed holding rates for now

As widely expected, the Fed held interest rates steady at its May 7 meeting. The threshold for a rate cut remains high, with the Fed now acknowledging rising risks of stagflation. In its policy statement, it noted that "the risks of higher unemployment and higher inflation have risen."

Given the evolving tariff landscape, along with resilient economic conditions and a low unemployment rate, Chair Powell emphasized during the press conference that "we don't think we need to be in a hurry" to cut rates. Following the meeting, market expectations shifted, pricing in roughly two rate cuts in 2025, down from three prior to the announcement.

Labour market healthy for now, but data shows signs of a slowdown in hiring

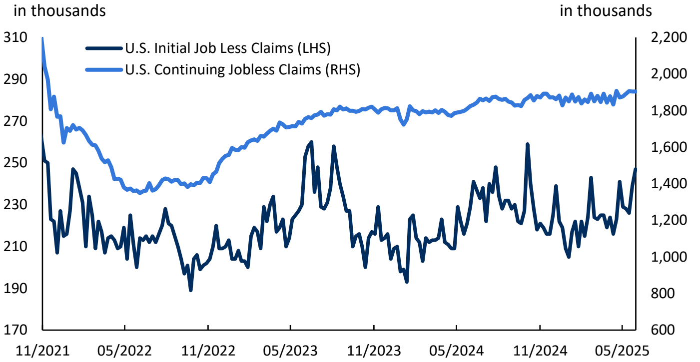
Cracks are forming in the U.S. labour market. The percentage of people who saw jobs as "hard to get" in the May consumer confidence report rose to the highest level since February 2021. Continuing jobless claims, for people remaining on unemployment insurance, rose to a 3.5 year high (Chart 20), as workers are taking longer to find jobs, while employers are cautious on adding jobs in this uncertain environment. The ratio of job openings to job seekers has slipped to about 1:1, falling below pre-pandemic levels (Chart 21).

According to the Challenger report, which tracks layoff announcements across both the private and public sectors using mass layoff data from state labour departments, U.S.-based employers announced roughly 94k job cuts in May. That's down 12% from April's 105k but still 47% higher than the same month last year.

From January to May 2025, total announced job cuts have reached nearly 700k, an 80% increase compared to the same period in 2024. To put that in perspective, 700k is equivalent to about 37% of the continuing jobless claims recorded in December 2024. Since mass layoffs typically come with a notice period of at least 60 days, we expect these announced cuts to gradually show up in continuing jobless claims over the coming months, putting upward pressure on the unemployment rate.

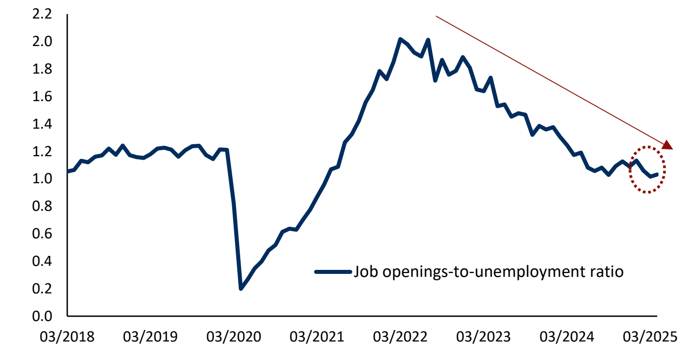
The May employment report published June 6, by the U.S. Bureau of Labor Statistics showed 139k jobs added to the U.S. economy in May, which was slightly above the consensus expectation of 130k, but still softer than the (revised) April addition of 147k. The unemployment rate stayed steady, as expected, at 4.2%.

Chart 20 - Ongoing Rise in Continuing Jobless Claims Despite Steady Initial Claims



Source: FRED, Raymond James Ltd.; Data as of May 30, 2025.

Chart 21 - Slow Hiring Has Led to a Decline in Job Openings Per Job Seeker Ratio



Source: FRED, Raymond James Ltd.; Data as of April 30, 2025.

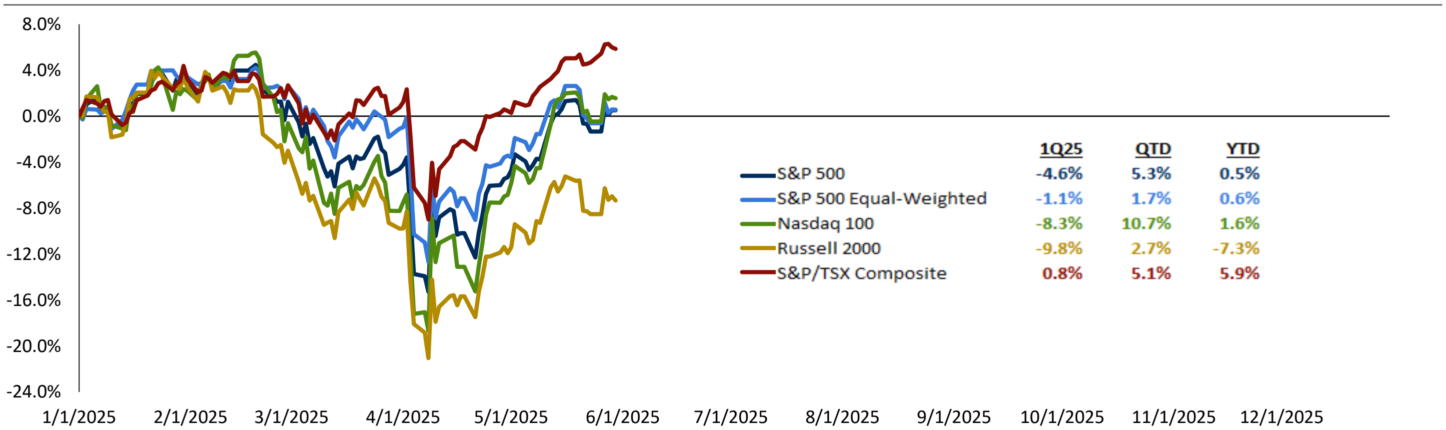
Financial Markets

In May, both the TSX Composite, Canada's main stock market index, and the S&P 500, the leading U.S. large-cap benchmark, delivered their strongest monthly returns of 2025 so far. The VIX has eased from its elevated levels in April, largely due to progress on the tariff front, including the U.S.-U.K. trade agreement and the 90-day trade truce with China. However, we anticipate that volatility may rise again as these tariff pauses expire and other macroeconomic factors, such as the 'X-date' (when the U.S. Treasury can no longer meet all government financial obligations in full and on-time) and economic data releases, come into play. In May, the TSX Composite continued to make new highs, delivered a 5.4% price return and a 5.6% total return, boosting the year-to-date price return and total return to 5.9% and 7.1%, respectively. Meanwhile, the S&P 500 posted a 6.2% price return and a 6.3% total return for the month. Its year-to-date price return turned positive at 0.5%, with a total return of 1.1%, all in local currency.

In the TSX Composite, cyclical sectors like Industrials, Consumer Discretionary, Information Technology, and Financials led the way, helped by ongoing progress in tariff negotiations. Defensive sectors such as Consumer Staples, Utilities, and Communication Services lagged behind. A similar trend played out in the S&P 500, though with a bit more volatility. Sentiment got a boost from the trade truce with China announced on May 12, while the disappointing U.S. Treasury bond auction on May 21 added some downward pressure.

All of the "Magnificent Seven" stocks, except Apple, continued their rallies from late April. This momentum helped the Nasdaq 100 and the market-cap-weighted S&P 500 outperform the equal-weighted version of the index in May. The Nasdaq 100 has now pulled ahead of the equal-weighted S&P 500, and the performance gap between the two S&P 500 versions has become quite narrow. Meanwhile, the Russell 2000, which tracks U.S. small cap stocks, continued to struggle due to ongoing concerns about the U.S. economy.

Chart 22 - Selected Indices Price Returns



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025. Price return in local currency.

U.S. Equity Markets

The key U.S. equity market index, the S&P 500, is essentially flat for the year, after a wild ride around the Liberation Day tariff correction and subsequent relief rally as a 90-day pause was announced and markets started pricing in the expectation that tariffs could be negotiated away, for the most part. This may still be a little optimistic, although we are now waiting to see how Main Street reacts to price hikes expected to start in June, with inflation and some product shortages possible. Consensus expectations for 2025 EPS on the S&P 500 have been lowered from US$272 at the start of the year, to US$263 currently, while our U.S. Investment Strategy team is below consensus at US$250-255. So far, 1Q25 reporting season was good, with earnings up 12% from last year, which was double the consensus expectation, however the test will really be in 2Q25 and 3Q25 results as increased costs chip away at profit margins, exporters contend with anti-U.S. sentiment and counter-tariffs, and consumers face higher prices on the shelves.

A big question now is whether the stimulative parts of the U.S. budget can offset the economic drag caused by tariffs. Moreover, the outlook is further complicated by a recent court ruling on IEEPA, which could affect the timing of the 'X-date', along with possible changes the Senate might make to the "One Big Beautiful Bill". In this uncertain environment, we think it's important to stay diversified across sectors. Within each sector, being selective in stock picking by focusing on quality metrics is key.

As for the broader market, it's still unclear whether the S&P 500 will push to a new high or if we're nearing the end of the current cycle. We lean toward the latter. Nonetheless, we could see quick rotations between cyclical and defensive sectors in the months ahead. After two strong years, and with valuations running high, even if the S&P 500 does reach a new high, we expect some consolidation before the next sustained bull market takes hold. If it doesn't break out, history suggests we may be in the final stretch of the cycle. In past cycles, the period after the major trough, April 8 in this case, has typically made up only about 10% of the full cycle. During that time, leadership among sectors tends to shift quickly as the market tests its bottom. In short, staying diversified is essential as we navigate a late-cycle environment with growing macro uncertainty.

As the economy slows and tariffs begin to take effect, being selective becomes even more important, especially since the impact can vary widely even among companies within the same sector. Tariff exposure can be assessed across three main dimensions:

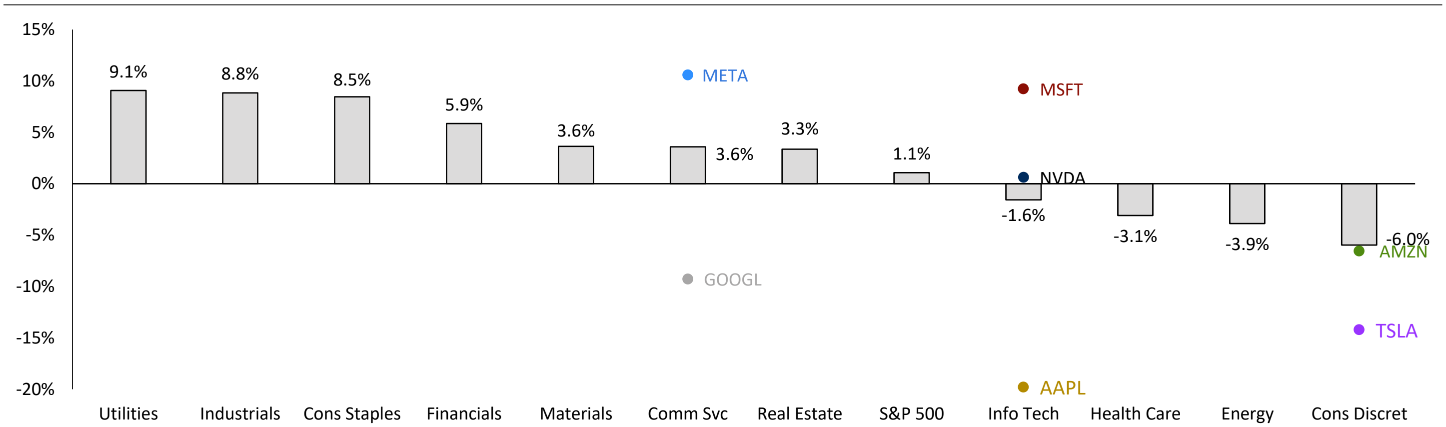
Impact on input costs — This can be estimated by analyzing the blended tariff rate and the portion of cost of goods sold (COGS) affected, along with qualitative factors like supplier bargaining power, internal cost-saving measures, and supply chain diversification. Together, these help estimate the tariffs' effects as a percentage of earnings before interest and tax (EBIT).

Required price increases — The ability to offset tariffs through pricing depends on a company's profitability and revenue exposure. Some global firms may be able to spread the impact by raising prices in other markets, not just in the U.S.

Price elasticity of demand — This measures how much of the tariff cost can be passed on to consumers without significantly hurting demand, which directly affects profitability.

These are just a few of the key metrics and areas we can analyze to better understand how tariffs may affect individual companies.

Chart 23 - S&P 500 Sector and "Magnificant Seven" Year-to-Date Total Returns



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025.

Canadian Equity Markets

The TSX Composite has been on an upward path since April 8, hitting new highs throughout May. But beneath that overall strength, we've seen some sharp sector rotations. Early in the year, cyclical sectors were leading the way, supported by an improving Canadian economy fueled by the earlier BoC rate cuts. That changed in February, when tariff threats started to dominate market sentiment. Since then, sector performance has largely been driven by shifts in trade tensions. Defensive sectors have tended to outperform when tensions rise, while cyclicals have rallied when the pressure eases. We've already seen a few of these rotations play out.

Despite the recent strength in cyclical sectors, we remain cautious. Much of the performance has been driven by forward-looking price-to-earnings (P/E) multiple expansion, which reflects market expectations for the coming months—expectations that can shift quickly in today's environment. It's also important to note that not all industries within a sector fit neatly into either the cyclical or defensive category. This highlights the need for a more selective approach. For instance, dollar stores, though part of the Consumer Discretionary sector, tend to behave more defensively. Similarly, general waste management companies within the Industrials sector are relatively insulated from tariffs and broader economic cycles. As such, we believe that in the current environment, it's worthwhile to look beyond broad sector classifications and assess the nature of certain industries. Looking ahead, given our outlook for a slowing Canadian economy, we continue to favour defensive sectors/industries, and high-quality names.

Top 3 Sectors (May 2025):

- **Industrials:** The sector saw broad-based gains, with the Construction & Engineering industry standing out in particular. However, much of the performance was driven by forward P/E multiple expansion. The recent trade truce between the U.S. and China provided a notable boost, as Industrials have the second-highest revenue exposure to the U.S. within the TSX Composite—second only to Information Technology. Looking ahead, we expect continued volatility in this sector due to ongoing trade developments. Additionally, a potential economic slowdown in both Canada and the U.S. could place further downward pressure on this cyclical sector while general waste collection industry may remain relatively stable.
- **Consumer Discretionary:** May marked the second consecutive month of outperformance for this sector relative to the TSX Composite. Unlike in April, when gains were almost entirely driven by discount retailers, May's strength was more broadly based. While the earnings outlook showed modest improvement during the month, Consumer Discretionary remains among the sectors with the largest year-to-date decline in forward EPS. Despite the recent upward trend, the outlook for the broader sector remains somewhat cautious. Although the initial shock of tariff uncertainty may have passed, the actual economic impact is likely to emerge in the 2Q25 or 3Q25. The automobile components industry continues to appear most directly affected by U.S. tariffs, while industries such as apparel, leisure products, and specialty retail may face increasing pressure as the broader economic effects of tariffs begin to weigh on consumer demand.
- **Info Tech:** The sector saw strong performance in May, largely driven by the May 12 trade truce between the U.S. and China, given its significant revenue exposure to the U.S. and its cyclical nature. Renewed excitement around A.I. has also added some momentum, offering a potential tailwind going forward. However, we expect the sector may go through a period of consolidation before seeing more sustained gains.

Bottom 3 Sectors (May 2025):

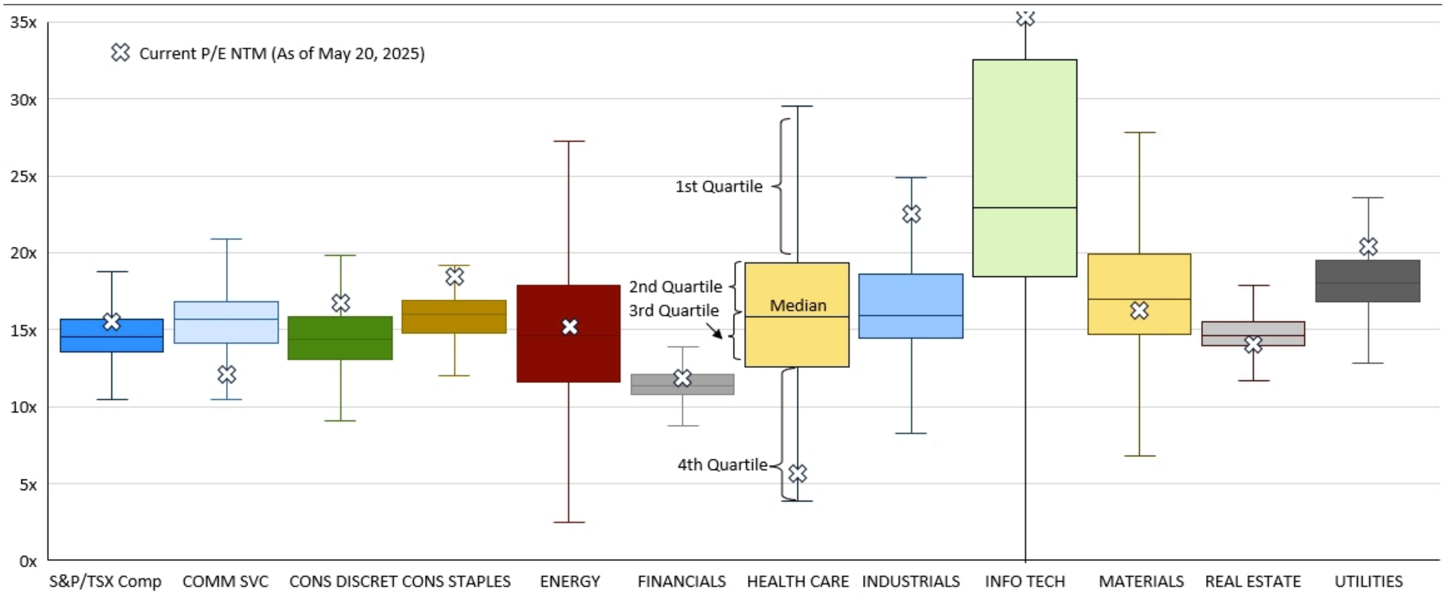
- **Consumer Staples:** After leading the market in April, this traditionally defensive sector lost momentum in May as easing tariff concerns prompted a rotation into more cyclical sectors. While earlier concerns about grocers' profit margins, stemming from potential retaliatory tariffs, have started to ease alongside improving U.S.-Canada trade relations, other challenges persist. Shifts in consumer behaviour toward discounts and promotions continue to weaken grocers' pricing power and profitability. These pressures could intensify if the economy slows further. As a result, careful consideration of individual company's profitability within the sector is increasingly important.
- **Utilities**: Like Consumer Staples, the Utilities sector, typically seen as defensive, underperformed the TSX Composite in May, as easing tariff concerns led investors to rotate into more cyclical areas. However, we expect earnings growth in this sector to remain relatively stable compared to most other TSX sectors. The Independent Power and Renewable Electricity Producers segment showed some improvement in May, possibly supported by renewed interest in A.I. and recent headlines highlighting future investments in data centers.
- **Communication Services:** Although this sector is relatively well-insulated from the impact of tariffs, intensified rivalry remains a strong headwind, resulting in reduced pricing power and consequently weaker revenue. With slower population growth this year, a strong recovery in this sector seems unlikely in the near future.

Table 2 - S&P/TSX Composite Sector Performance and Valuations (Ranked by Quarter-to-Date Total Return)

Sector Name	Sector Weight	YTD Total Return	QTD Total Return	1M Total Return	Current P/E NTM	Historical P/E NTM
Consumer Discretionary	3.5%	9.8%	10.0%	8.1%	17.3	14.4
Information Technology	10.2%	0.8%	8.9%	8.0%	35.7	23.0
Financials	34.6%	6.9%	8.2%	6.5%	12.0	11.4
Industrials	13.2%	5.7%	7.8%	8.9%	22.8	15.9
Consumer Staples	4.2%	6.3%	6.8%	1.2%	18.5	16.0
S&P/TSX Composite	--	7.1%	5.5%	5.6%	15.7	14.5
Utilities	4.1%	9.7%	4.6%	1.9%	20.6	18.0
Materials	14.2%	25.4%	4.3%	2.5%	16.2	16.9
Real Estate	1.9%	1.8%	3.5%	4.4%	14.0	14.6
Communication Services	2.4%	1.9%	-0.3%	2.2%	12.4	15.7
Energy	16.8%	0.6%	-2.0%	4.5%	15.4	14.6
Health Care	0.3%	-14.2%	-5.7%	1.1%	5.9	15.9

Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025. The S&P/TSX Healthcare sector has been excluded from the performance commentary due to its minimal representation in the S&P/TSX Composite Index.

Chart 24 - S&P/TSX Composite Sector Current vs. Historical P/E NTM



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025. Historical P/E: 1/1/2000 – 05/31/2025. Excluding outliers.

Fixed Income & Treasury Yields

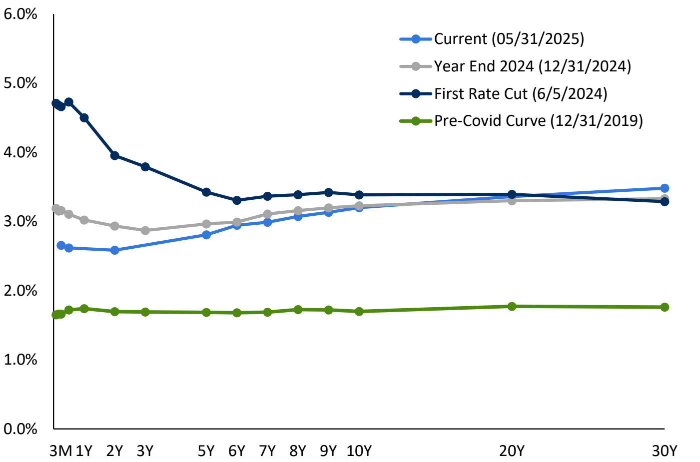
In the U.S., the bond market shrugged off a downgrade from Moody's, which was not overly surprising, especially after S&P had done the same thing in 2011, followed by Fitch in 2023. What was more impactful were a poorly received 20-year auction and the House tax bill reigniting concerns about fiscal sustainability. This pushed the 30-year U.S. Treasury yield above 5%. The rise in yields for longer-dated Treasuries has been a concern for the White House, as it pushes up the cost of issuing the increasing amount of debt that will be required for the administration's spending and tax cutting goals.

For equity markets, the 10-year Treasury, which has been inching up recently to 4.5%, also acts as the base for discounting future cash flows and therefore a higher yield makes equities less appealing. The recent rise in long-term yields and decline in the value of the U.S. dollar signals that international investors may be looking at more opportunities outside the U.S., compared to the last few years when the U.S. looked like the safest place to park funds.

For Canada, as tariff concerns eased, the front end of the government yield curve shifted slightly higher compared to the end of April. This reflects both a slower pace of rate cuts by the Bank of Canada and the market's relatively calm response to potential short-term disruptions from tariffs, suggesting that a severe recession is not anticipated. Meanwhile, yields at the mid and long ends of the curve continued to rise modestly.

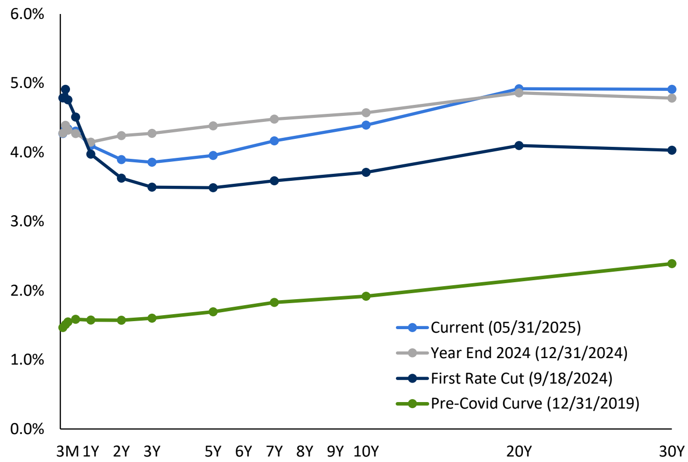
Yields on longer-dated government bonds are on the rise in other countries as the markets reflect concerns about higher inflation rates and more fiscal commitments, with investors becoming worried about any long-term commitments in a still uncertain environment.

Chart 25 - Canada Government Yield Curves



Source: Factset, Raymond James Ltd.; Data as of May 31, 2025.

Chart 26 - U.S. Treasury Yield Curves



Source: Factset, Raymond James Ltd.; Data as of May 31, 2025.

Table 3 - Global Equities Performance

Select Global Equity Indices	May (in LCL)	May (in USD)	May (in CAD)	3 Mo (in LCL)	3 Mo (in USD)	3 Mo (in CAD)	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Major Aggregates												
World (Global)*	5.9	5.9	5.4	2.1	2.1	-2.6	5.1	5.1	0.5	19.1	15.9	3.1
EAFE (DM ex U.S. & Canada)*	4.6	4.6	4.1	8.6	8.6	3.7	17.4	17.4	12.3	14.7	13.6	1.2
EM (Emerging Markets)*	3.9	3.9	3.4	5.7	5.7	0.9	8.4	8.4	3.7	12.3	11.8	0.6
Selected Developed Markets												
Nikkei 225 (Japan)	5.3	4.1	3.6	3.0	7.6	2.7	-4.0	4.6	0.0	17.3	16.8	0.5
Euro STOXX 50 (Europe)	5.4	3.9	3.4	0.3	7.2	2.3	12.3	20.2	14.9	15.5	13.2	2.3
FTSE 100 (U.K.)	3.8	4.3	3.8	1.0	6.6	1.8	9.4	15.6	10.5	12.8	12.3	0.4
CAC 40 (France)	3.9	3.8	3.3	-2.1	6.9	2.0	7.7	18.1	12.9	15.6	13.5	2.1
DAX (Germany)	6.7	6.5	6.0	6.4	16.2	10.9	20.5	31.8	26.0	15.6	12.7	2.9
Hang Seng (Hong Kong)	5.9	4.7	4.3	2.8	2.0	-2.7	18.0	16.9	11.8	10.4	12.4	-2.0
Selected Emerging Markets												
CSI 300 (China)	2.0	3.0	2.6	-1.0	0.1	-4.6	-1.9	-0.5	-4.9	13.3	13.7	-0.5
Nifty 50 (India)	1.9	0.8	0.4	12.1	14.6	9.2	5.2	5.2	0.6	21.4	18.9	2.5

Source: FactSet, Raymond James Ltd; Total returns, data as of May 31, 2025. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 5/31/2025. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

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