Midyear equity outlook: Staying selective amid volatility

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In an environment of elevated macro risks and uncertainty, there are bright spots fueling our optimism for equities.

A year that began with a rosy outlook for equities was soon jolted by tariff announcements, sending markets reeling. Looking out for the remainder of 2025, we remain constructive in our outlook on equities. Tariff tumult and a challenging macroeconomic environment remain acute in many regions. While the overall global situation is fragile, there are bright spots fueling our optimism for equities. Amid the volatility, we see opportunities to capitalize on stock dispersion across sectors, geographies and individual companies. The rapid advancements in AI technology and the resilience of financial sectors present attractive areas of opportunity.

Tariff paths will drive earnings outcomes

The direction of tariff policy and the resulting impact on the economy and corporate earnings are key questions our investment team is closely monitoring. Thinking through this tariff framework, our team is modeling three different scenarios shaping both the U.S. and global economy over the next six months (refer to table **on the next page**).

In a scenario of prolonged uncertainty, we would likely see a continuation of current policies, with a persistent cloud over the economy and an extended state of uncertainty. This would also likely lead to an economic slowdown. However, we are not yet seeing data points signaling material weakness in the U.S. economy.

Alternatively, in a resolution scenario we would see trade deals negotiated over the next couple of months, easing tariffs and positively impacting economies and earnings over the remainder of the year. On this path, investors could expect average tariff rates to come down, albeit not quite returning to nearer pre-"Liberation Day" levels but nevertheless a more favorable backdrop for earnings progression. Within this environment, we would expect U.S. growth to be solid at low single-digit ranges (2%-3%), with continued strong employment and falling short-term interest rates driving earnings growth in the high single-digit range. Our last and most problematic scenario — a path of recession — would be marked by an escalation of tariffs, which could increase the risk of recession due to higher costs, inflation and interest rates, negatively impacting employment, consumer sentiment and corporate earnings.

Macroeconomic scenarios	Description
Scenario 1: Resolution	A return to pre-January global trade conditions could benefit equities. This path would be driven by trade deals negotiated over the short term that ease tariffs, positively impacting economies and earnings over the next six months.
Scenario 2: Prolonged uncertainty	A protracted process of negotiating trade deals with multiple countries could create a continued cloud over the economy and an extended state of uncertainty. Data points are not yet signaling material weakness in the U.S. economy.
Scenario 3: Recession	Economic contraction would be marked by an escalation of tariffs, which could increase the risk of recession due to higher costs, inflation and interest rates. This would challenge equity markets.

Source: Columbia Threadneedle Investments.

Global lens

There are global implications of the U.S. market scenarios. While the U.S. may face challenges, trading partners could be in an even more vulnerable position.

- **Europe is calling.** Germany’s decision to loosen the fiscal purse, coupled with increased spending in defense and energy, boost the growth picture in Europe. Led by Germany, a significant amount of capital expenditure may infuse the European economy, which could pave the way for moves across the continent, creating a more supportive investment climate for the future. Importantly, this spending will target sectors poised to benefit from Europe's evolving economic landscape. Defense stocks, infrastructure companies and industrial companies exposed to German projects stand to gain notably.

Another tailwind for Europe is the economic support from a monetary policy perspective. Central banks in Europe, namely the Bank of England and the European Central Bank, have shown a willingness and are freer to lower interest rates to provide economic support.

- **China: Mixed outlook.** We remain cautious on China, which carries a mixed outlook given less reliable data points. Government support might mitigate negative impacts, especially given the great latitude around what it can do to support the domestic economy and growth trajectory.

Cautious earnings picture

Earnings growth should be the largest driver of equity returns in 2025. We began the year modeling a high single-digit earnings growth. Despite market gyrations, our team has not changed earnings growth projections materially coming out of the first quarter, but that may change if weakness in employment and corporate expenditures were to play out. Companies are certainly more cautious in tone and expectations for their businesses; however, our analysts are not ratcheting down their estimates.

Our view is that we are likely on a path to hit high single-digit earnings growth figures for 2025, which is higher than consensus for the year. We also project forecasts for 2026 to come in at the low double-digit earnings levels. While current estimates remain stable, there is a bias toward downside risks if fragile macroeconomic conditions persist.

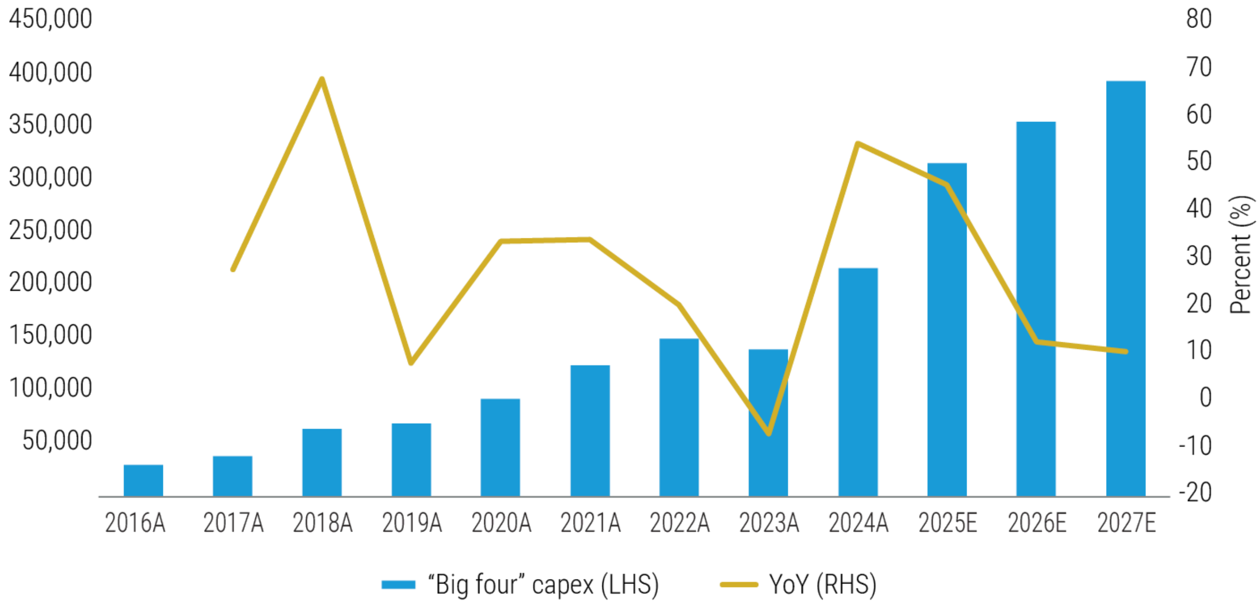
Opportunities in focus: AI, financials

Given this backdrop, where are we finding opportunities in the U.S. and in global markets? Amid market turbulence, we are seeing opportunities in two themes:

- **Artificial intelligence (AI):** Companies are spending on AI, particularly a small number of global technology leaders, or "hyperscalers," who are driving global innovation in this area. Capital expenditure spending is steady from these companies and shows no signs of slowing down. The semiconductor industry is a key beneficiary of this AI spending. While the market may be cautious, we have high conviction that AI is an area where the projected 2025 growth forecasts from the start of the year should materialize.

Hyperscalers boost AI spending

Forecasted capital expenditure ($ millions)



Source: Columbia Threadneedle Investments analysis, as of May 15, 2025. Represents capital expenditure estimates for Google, Meta, Microsoft and Amazon.

- **Financials:** We came into 2025 with expectations for deregulation to be a focal point of policy. With the onset of tariffs, deregulation has taken a backseat. However, we believe the theme will reemerge and eventually favor banks, supporting earnings growth and valuations.

Our focus on research intensity and understanding company fundamentals aligns with identifying opportunities in high-potential sectors such as AI and financials. The rapid advancements in AI technology and the resilience of financial sectors present attractive areas for selective investment — companies excelling in these fields are likely to be at the forefront of innovation and stability.

Volatility positioning for investors

Active management and diversified portfolio construction are key in helping investors navigate the volatile market environment. The ability to focus on research and identify important company metrics position active strategies to assist investors in managing volatility.

- **Stay invested.** Historically, missing key market days can significantly impact returns. From April 2-9, the S&P 500 was down more than 10%, but since that time has almost recovered. Investors are still better served staying invested than sitting in cash or seeking to time the market. It is critically important to stay invested and understand the significance of long-term investment strategies over market timing.

- **Stay diversified.** Diversification is a critical tool to navigate turbulent equity markets. We believe diversification across sectors and styles will be critical to effectively navigate uncertain conditions. For example, a mix of value and growth investments is beneficial. Combining undervalued names with those offering scope for future expansion allows for a more resilient portfolio capable of thriving in diverse market conditions.

- **Stay active.** In this environment, research really matters. Our teams can focus on research and identifying important company metrics, better positioning our strategies to assist investors in managing volatility.

The bottom line
The path forward will likely be paved with more uncertainty. To capitalize on dispersions among companies, sectors and regions, we believe it is an opportune time to adopt an active approach to equity investing. Broadly, rigorous stock selection will be essential to uncovering compelling equity opportunities. Through our deep research-driven investment approach, our investment teams stay on the pulse of industry and company dynamics. Leaning into research intensity enables us to identify opportunities and to build resilient portfolios, enabling us to better serve our clients.

HEAD OF EQUITIES, NORTH AMERICA

Nicolas Janvier, CFA

Nicolas Janvier is the head of equities, North America at Columbia Threadneedle Investments. He took up this role in April 2025. Nicolas was previously head of U.S. equity research and U.S. equities EMEA.

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