



Midyear Value Outlook: Regime Change Takes Root



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Key Takeaways

- ▶ Long-standing macro pillars are unwinding simultaneously: 80 years of U.S.-led geopolitical order, 35 years of globalization and 15 years of ultra-low interest rates.
- ▶ The post-2025 world will be defined by scarcity, driving up demand for the capital, tools and resources needed to build infrastructure. Whether it's defense, supply chain resilience or data centers, all require similar inputs.
- ▶ Macro and technological shifts are driving a wider dispersion of outcomes — creating clear winners and losers and highlighting the need for active management over simply owning beta. To outperform in this new environment, portfolios may need to take a more deliberate shape that balances exposures across structurally advantaged areas.

Not All Companies Will Survive Structural Disruptions

Today's investment landscape feels like a garden that looks thriving and orderly on the surface but that has started to grow chaotic underneath. Above ground, the stock market is near all-time highs, brushing off bad news with ease, while geopolitical tension, deglobalization, rising debt levels and supply chain disruptions remain at the root level. Nominal growth may be faster but it is also more volatile, unpredictable and fluctuating. The blooms look good, but the sun provided by declining interest rates, low inflation and central bank support over the last few years is no longer shining. Companies must look within for resilience.

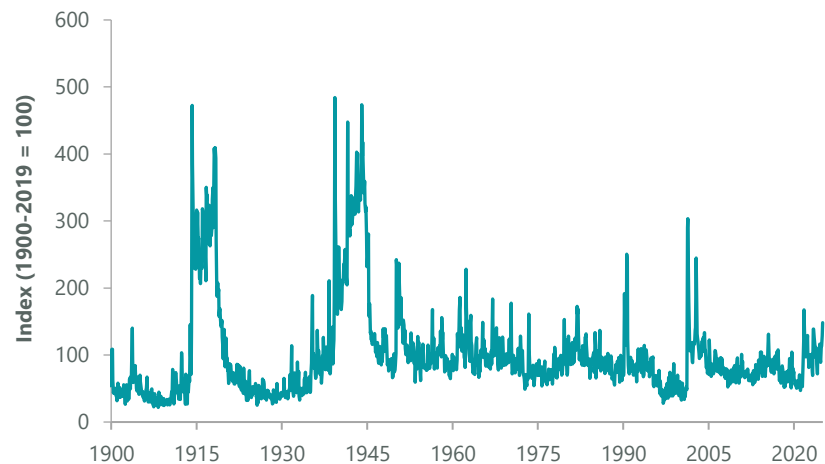
Beneath the surface, structural innovations are reshaping the very foundation of growth. AI, blockchain technology, GLP-1 therapies and decarbonization are altering the soil that businesses rely on to grow. Entire business models, such as traditional software companies, are under threat as AI can generate similar outputs instantly — and often at near-zero cost. Meanwhile, corporate traits like proprietary data, technological edge and agile leadership are becoming essential. Similar to how the internet disrupted brick-and-mortar retail, this wave will be disruptive, but will be more far reaching, more impactful and faster.

However, changes in the soil can also leave plants susceptible to changes in the weather that they otherwise could have survived. For instance, firms making marginal returns under low interest rates will need more capital just as capital gets more expensive. As these two forces come into greater conflict, we'll likely see new business species emerge — better suited to the new mix of weather and soil.

The End of the Beginning

If the years following the Global Financial Crisis (GFC) marked the beginning of these tectonic shifts, then 2025 marks the end of the beginning of this regime shift. What makes this decisive is not just the pace of change, but the convergence of multiple structural breaks. Long-standing macro pillars are unwinding simultaneously: the 80 years of U.S.-led geopolitical order, the 35 years of globalization and the 15-year era of ultra-low interest rates.

Exhibit 1: Geopolitical Risks Show Signs of Ticking Up



As of July 2025. Source: Caldara, Dario and Matteo, Iacoviello. The GPR index reflects automated text-search results of the electronic archives of 10 newspapers and calculated by counting the number of articles related to adverse geopolitical events in each newspaper for each month (as a share of the total number of news articles).

A key accelerant has been Donald Trump's tumultuous return to the presidency — a monsoon in the market garden — most visible in his early April tariff announcement, which, even with temporary exemptions, carry global and far-reaching implications. Geopolitical weeds are also taking root: the war in Ukraine grinds on, Israel and Iran have traded salvos and U.S.–China tensions remain high.

However, the difference is real interest rates. For the first time in decades, the U.S. Treasury is paying a meaningful yield on new debt and annual interest expense on U.S. government debt is approaching \$1 trillion. This is no longer just a balance sheet issue to defer — it's an income statement problem demanding immediate attention.

If the post-2008 era was defined by surpluses — of capital, labor, goods and trust — the post-2025 world will feature scarcity. In this new era, governments are racing to localize supply chains and build strategic stockpiles, meaning large-scale duplication of infrastructure and manufacturing across a world increasingly split between the West and the East in order to ensure military systems, energy supply, metals and food reserves and pharmaceuticals.

Much of this new capacity is being built in high-cost regions, by players with little comparative advantage. The result is not just

Where supply is constrained and demand is inelastic, inflation turns from a headwind into a tailwind.

inefficiency, but a massive deadweight loss that drives up the cost of everything needed to construct these new systems: capital, labor and materials. Meanwhile, countries like China will continue to hold excess capacity, but that will no longer be used efficiently. Underinvestment in commodities and power infrastructure will further amplify the cost of shifting supply chains.

The outcome is a new regime of sticky cost pressures, with a potential consequence of persistent inflation. Affordability becomes an issue for all kinds of buyers, consumers, corporations and especially governments. Fiscally, the government will increasingly struggle to fund its spending, while the mandates driving spending — defense, essential supply chains, technological competition in AI and automation, and climate adaptation — are non-negotiable. Whether funded directly through fiscal programs or indirectly via corporate mandates and incentives, these priorities might crowd out spending on health care, education and social programs. Over time, higher taxes may even be on the table. Meanwhile, sovereign debt issuance is set to continue to rise. Most developed nations already carry high debt-to-GDP ratios, but the spending demands outlined above leave them little choice. To fund defense, industrial policy and climate adaptation, governments will either issue more debt or monetize it — or both.

While fiscal spending can support headline GDP growth — especially through higher inflation — the underlying returns on that spending are likely to disappoint. For corporations, margin pressure is intensifying on multiple fronts since structural inflation means higher input, energy and labor costs as well as increased interest expense. Free cash flow conversion could drop due to rising capital expenditure.

More importantly, this new regime will be reshaped by the tech innovations unfolding beneath the surface — some shifts may be offset, others reinforced. For instance, AI could help ease labor shortages by automating routine jobs and counterbalance the inflationary pressure. The resulting productivity gains might be strong enough to counter inflationary pressures in other parts of the economy and, if so, the value created could help fund other investment needs and allow the cost of capital to remain at today's levels. AI might also help companies offset margin pressure through efficiency improvements. But in reality, this won't be seamless. The current boom in infrastructure investment and supply chain reshoring is driving up demand for physical labor. For many companies, margins may dip before any AI-driven efficiencies show up, due to the scale and timing of the upfront investment required.

Of course, everything above is only a first-order inference. Macro shifts never unfold in isolation. They are always shaped, counterbalanced and sometimes even reversed by how different actors — governments, corporations and investors — respond.

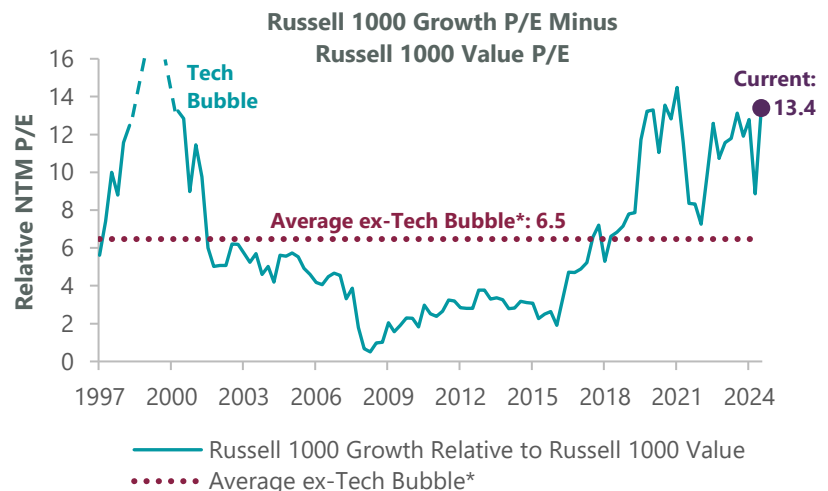
What's striking is that the forces above and below the surface are converging in one critical way: they are all driving up the demand for

the capital, tools and resources needed to build infrastructure. Whether it's defense, supply chain resilience or data centers, all require similar inputs. Power infrastructure and technical talent are becoming universally indispensable.

What Are the Implications?

- Low volatility is out. Value is in.** Higher nominal GDP growth — driven by fiscal expansion and sticky inflation — tends to favor value and cyclicals over growth and defensives. Sectors tied to industrial activity, energy production and raw materials are poised to re-rate as supply chains are rebuilt and infrastructure modernized. Companies that enable automation, electrification and energy efficiency — solutions to cost pressure — stand to benefit, as do firms with real assets, pricing power and capital intensity, especially in infrastructure and heavy industry. Conversely, the “safe havens” of the last cycle — low-vol, low-growth names trading at high multiples — face valuation headwinds. Rising rates compress both valuations and margins. And in a world of higher capital costs, companies with weak returns on capital and growth may struggle to justify their existence.

Exhibit 2: Value at Attractive Starting Point



Note: Price Return. NTM = Next 12 Months. *The Tech Bubble period removed from the chart is from June 30, 1999 through Dec. 31, 2000. Data as of June 30, 2025. Sources: FactSet, Russell. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

- Passive is out. Active is in.** For over a decade, falling rates and disinflation helped passive strategies flourish. Beta outperformed alpha while diversification often diluted returns. In volatile, policy-driven markets however, owning the index often means owning the noise. Positive real rates are also exposing the vulnerabilities of so-called “zombie” firms — companies that could previously survive on cheap capital but now struggle to cover their cost of funding. Passive indexes hold both winners and zombies, but in this new environment, the drag from zombies is becoming more pronounced. At the same time, macro and technological shifts are driving a wider

dispersion of outcomes — creating clear winners and losers. To outperform in this new environment, portfolios may need to take a more deliberate shape — one that balances exposures across structurally advantaged areas. On one end, value-oriented companies participating in the wave of infrastructure rebuilding. On the other, reasonably valued AI beneficiaries that can deliver durable growth without excessive multiple risk.

- **60/40 is out. Equity diversification is in.** If inflation stays structurally higher, the historical negative correlation between stocks and bonds may break down, undermining the diversification core of the 60/40 portfolio. Global dispersion is rising — a change from the era of a globally synchronized economy that marked the peak of globalization. Growth, inflation and policy responses now differ sharply by region, and diversifying across uncorrelated macro regimes helps reduce exposure to the fading exceptionalism of the U.S.
- **Financial assets are out. Real assets are in.** After a decade of underinvestment, commodity supply curves are tight while ESG constraints, permitting delays and geopolitical friction make new production difficult. The world may be entering a long stretch of real asset inflation — just as financial assets face valuation compression.
- **Having no illiquidity premium is out. Self-funding is in.** Capital is no longer cheap — and investors are rewarding companies that can self-fund growth. High-burn, long-duration business models are under pressure, and many venture-backed companies may not survive with private markets especially vulnerable. The era of free capital flattering illiquid assets is over; rising funding costs and falling exit multiples are set to reveal the risks hidden behind inflated valuation marks and illusion of costless exits.
- **Chasing growth is out. Pricing power is in.** During the secular stagnation following the GFC, volume growth was scarce — and therefore prized — because strong margins were largely taken for granted. In today's world of rising input costs, this no longer suffices. To preserve value, companies need pricing power, shifting the advantage to business models that can preserve margin: luxury goods, monopolistic structures, mission-critical infrastructure and industries with high barriers to entry. Where supply is constrained and demand is inelastic, inflation turns from a headwind into a tailwind.

Near-Term Opportunities

Currently, we think the U.S. economy is being supported by continued fiscal expansion, with deficits running at levels more typical of recessions. While the unsustainability of continued fiscal expansion is causing major macro concerns, for now deficit spending continues to support the U.S. economy and shield it from the shocks of tariffs and ongoing geopolitical shifts.

However, we think tariffs and immigration policies will result in higher inflation and less growth in the second half of the year. We are finding opportunities in areas like real assets, including gold and copper, which are cheap insurance against higher inflation, a lower U.S. dollar and the ongoing geopolitical risks. On the other side, AI spending and growth will occur regardless of the macro environment, and we continue to benefit from the enablers of AI such as power and computational memory.

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