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Tariffs, Trump, and the tug of war: mid-year check-in

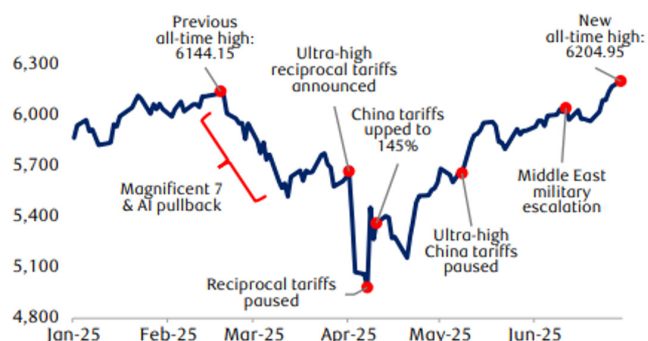
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The story so far

As we reflect on the first half of the year and opine on the second, our only strong view is that the only constant is change; and one should get comfortable with contained chaos if such conditioning has not yet been achieved. The U.S. trade tariffs rollout, and the potential magnitude of its negative impact on the global economy, remains a dominant theme in the minds of investors, as this remains a key source of uncertainty. By the same token, we would be remiss if we did not point out the resilience of global equity markets as they shrugged off the April post-“Liberation Day” swoon in the spring, the introduction and then removal of Section 899 in President Trump’s “One Big Beautiful” bill, and the rising and (seemingly) quickly subsiding geopolitical tensions in the Middle East.

In the discussion that follows, we seek to provide context and perspective on several moving targets that are likely to shape the economic narrative going forward, particularly for Canada and the U.S. The backdrop remains fluid, but we maintain that skirmishes in the short-to-medium term should not deter investors from remaining focused on their long-term investment goals.

S&P 500 performance through economic and geopolitical events



Note: Daily data through 6/30/25. Source: RBC Wealth Management, Bloomberg.

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Tariffs – an on-again, off-again story...

On the trade tariff front, there seems to have been some favourable developments recently, although it also seems it all comes with some caveat or another. The term “TACO” emerged this April, an acronym that captures the increasingly widely held view that Trump and his team are pursuing a discernable pattern in their tariff negotiations. This pattern is captured by their use of extreme threats, followed by walking back the worst of those threats, and then negotiating from what they perceive as a position of strength – a kind of “shock and awe” approach. Ultimately, Trump and team default to what most allies interpret as a “better than feared” outcome.

...for Canada...

Earlier in the quarter, we saw the favourable development of a 90-day reprieve between the U.S., Canada, and Mexico. Canada, for now, has landed in the “better than feared” category with one of the lowest effective tariff rates relative to other trade partners – though this is meaningfully above the near-zero level prior to Trump re-entering office.

Prime Minister Mark Carney and President Trump agreed at the recent G7 summit in Alberta to seek some sort of trade deal within 30 days. Since then, Carney has floated new measures that include a quota on foreign steel (in response to Trump’s executive order doubling steel and aluminum tariffs from 25% to 50%), and a proposed tax hike on U.S. imports if Canada and the U.S. are unable to secure a deal by the self-imposed deadline of July 21.

In yet another capricious turn of events that seems to have become a hallmark of these ongoing negotiations, the ante was dialed up again in late June when Trump abruptly announced on his Truth Social platform that his team was ending all talks with Canada, citing its Digital Service Tax (DST) as

the key reason. The DST, announced in 2020 by the then-Trudeau government, would result in companies like Amazon, Google, Meta, Uber, and Airbnb paying a three per cent levy on revenue from Canadian users. In fact, the first payment, retroactive to 2022, was to be submitted on June 30, and would have cost the impacted companies an estimated \$2 billion. And yet, just 48 hours after Trump’s Truth Social post, and in a nod to the considerable leverage the U.S. maintains in the trade talks, Canada announced it would rescind the DST to help ensure that trade talks would resume with its southern neighbour, and so they would have a chance to adhere to the July 21 deadline.

Importantly, in just the last few days before the completion of this commentary, and in keeping with the U.S. administration’s mercurial meandering on tariffs thus far, the target date for reciprocal tariffs on, or reaching a trade deal with, Canada was revised from July 21 to August 1, aligning it with every other nation on Trump’s reciprocal tariff “hit list”. In what one might presume is further evidence of brinkmanship, the U.S. has ratcheted up the heat by threatening to increase tariff rates on Canada to 35% if a deal is not reached by the new deadline.

However, what is more consequential for Canada at this juncture is the very sudden Trump administration announcement that it will impose a 50% tariff on imported copper. This is on top of the tariffs already announced on steel and aluminum, all of which have been invoked under “Section 232” of U.S. trade law that allows the president to impose levies on certain goods that are said to threaten “national security.”

Canada’s copper trade with its southern trading partner is meaningful. According to Natural Resources Canada, ~\$5 billion of copper and copper-based products were exported to the U.S. by Canada in 2023, which represents just over 50% of all the country’s copper exports in that year.

By some estimates, Canada is the second largest foreign supplier of copper to the U.S. after Chile.

It is difficult to know how this recent development will influence negotiations leading into August 1. The exact timing of when such tariffs may come into effect is yet unknown. The U.S.’s reliance on Canadian copper (despite the U.S. being one of the largest producers of copper itself) and the potential increase in costs to importers of the metal, may yet temper Trump’s stance on this issue in the short to medium term. As ever, yet another aspect of the zig-zagging trade developments worth monitoring going forward.

Considering developments to date, it seems rather clear that trade negotiations will not transpire in a linear fashion. However, putting the bigger, long-term picture in perspective, it is perhaps comforting that under the Canada-US-Mexico agreement (CUSMA), broad exemptions for U.S. imports from Canada to remain customs-free seem to have immunized most Canadian exports against tariffs. According to RBC Economics, more than 85% of Canadian exports to the U.S. last year would still be duty free under current rules.

Also, as global trading partners of the U.S. potentially pivot away from the country and look to further diversify their trading relationships, Canada stands out as a meaningful option. For example, the recent trade pact signed between Canada and the European Union (EU) signals a significant strategic shift, deepening not only economic ties but also expanding into the realm of security collaboration. The deal aims to foster greater partnership between Canada and the region on military purchases, effectively reducing Canada’s dependence on the U.S. for defense procurement. This move has been described by the nations’ leaders as a step towards participation in the E.U.’s €150 billion (US\$173 billion) joint-purchase loan pool called Security Action for Europe (SAFE) – a part of its

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proposed €800 billion “ReArm Europe” initiative. In announcing the agreement, Prime Minister Carney suggested that the U.S.’ desire to rewrite the global trade order left Canada at a crossroads: “We can nostalgically look back and long for the old order to somehow return, or we can build a new one with purpose and partnership.”

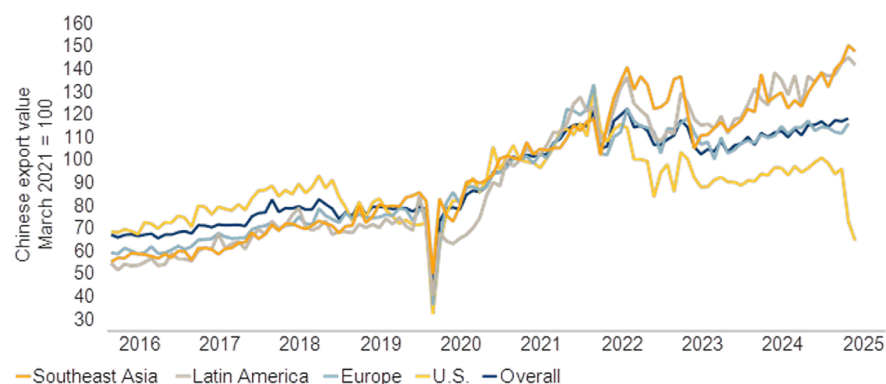
...and the world...

To date, 14 nations, including Japan, South Korea and South Africa, have received letters from President Trump detailing new tariff schedules. Most levies are in the range of 25% to 40%, and are to be implemented by August 1 unless the targeted nation works out as a trade deal with the U.S. administration. More countries are being added to that list almost daily. Where these negotiations may go is hard to say at this point, but it is becoming clearer by the day that the answer is increasingly nowhere, or at least not by August 1 – and setting up another possible “moving target date” situation. TACO anyone?

But in other “better-than-feared” news across the world, China and the U.S. agreed to a framework on trade in early June following a rapid and tempestuous escalation of tariffs that nearly paralyzed trade between the world’s two largest economies. Critically for the U.S., China has agreed to provide access to its rare earth minerals of which the Chinese mine 70% of the world’s supply, of which it processes an even larger proportion. It’s worth noting that even with the recent de-escalation in trade tensions, the U.S. continues to impose large 30%-plus tariffs on China. As such, it stands to reason that the flow of goods from China to the U.S. has fallen precipitously in recent times, as the former understands the power of its leverage and reduces its reliance on the U.S. import market.

Prime Minister Keir Starmer of the UK also secured a diplomatic victory in the last quarter, confirming a U.K.-U.S. trade deal of sorts, making him the first world leader to reach a tariff

Chinese exports to U.S. plummet



Note: As of 04/25. Monthly series, sa. X-11 ARIMA, rebase 03/21=100. Source: China General Administration of Customs (GAC), Macrobond, RBC GAM

deal with Trump. The U.S. president has stated that the U.K. would have protection against tariffs “because I like them”. The deal, which was presented at the Alberta G7 summit, covers the aerospace (no tariffs) and auto sector (10% tariffs, down from 25%), and is expected to be in place by the end of June. However, the 25% tariffs on steel imports persist for now, though this is less than the U.S.’s global rate of 50% on steel and aluminum. Discussions are underway between the two nations to move these tariffs closer to 0%. Other British exports to the U.S. will continue to be subject to a baseline tariff of 10%.

Negotiations with the E.U. are ongoing. The region has indicated that it is willing to accept a 10% universal tariff by the U.S. on many of the bloc’s exports, but in exchange the U.S. must commit to lower tariff rates on key sectors such as pharmaceuticals, alcohol, semiconductors, and commercial aircraft. In addition, the EU is pushing back against the 25% tariff on automobiles and car parts, as well as the 50% tariff on steel and aluminum.

...today, and alas, very likely for months to come

The “shock and awe” approach of the Trump administration of announcing a series of trade edicts is likely to remain the norm even as a multitude of negotiations remain ongoing. To wit,

Trump has now threatened leaders of developing nations in the BRICS (Brazil, Russia, India, China, and South Africa) consortium that met recently in Brazil with an additional 10% tariff if they adopt “anti-American” policies. Very shortly thereafter, and not to be outdone by himself, Trump threatened to announce tariffs on imported semiconductors and pharmaceuticals, and suggested levies as high as 200% for medicines if drugmakers did not “get their act together” over the next year.

The White House clearly intends to continue leveraging the U.S.’s economic heft in negotiations and dabbling in brinkmanship with its allies and trading partners. But recent deal precedents might signal that a “better than feared” outcome is plausible. Based on the nature of the negotiations so far, we believe that U.S. tariffs on its global trading partners will move higher than what they were during Trump’s first term in office, but will ultimately be lower than what was promised on “Liberation Day” (April 2). Put differently, expect tariff-related uncertainty to remain high – though perhaps not as high as it may have been in early April. A path to de-escalation seems to exist, but the economic purgatory that transpires in the interim could preclude important investment and purchasing decisions, resulting in real and material negative consequences.

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Canada Day check-up: At the halfway mark of 2025, good news and not-so-good news

The economic outlook for Canada seems layered with a number of crosscurrents. The economy has proven resilient, and we believe we have passed the point of peak pessimism. But economic vulnerabilities remain, and forward visibility is opaque. While our base case is not calling for a recession, the prospects of sluggish growth in the short- to medium-term remain.

As highlighted earlier, while Canada continues to find itself in the “better-than-feared” tariff camp, much can change between now and August 1. The renegotiation of CUSMA – due next year – could have a more meaningful impact in the medium-to-long-term, to the extent that the U.S. abides by the same polemical and unpredictable playbook it has used so far, while seeking to re-write the trade order...again.

To the extent that Canada remains out of direct harm (relatively speaking) in the context of tariff negotiations, it could still be indirectly hurt by a slowdown in global economic growth and a shrinking import market in the U.S. as a result of a further escalation of the trade war. Indeed, the Canadian economy contracted moderately in April, as the U.S. trade disruptions weighed heavily on the export of goods. Most of the pain was localized within the manufacturing and wholesale sectors, while most other sectors reported gains. StatsCan’s early estimate is for another 0.1% decline in Gross Domestic Product (GDP) in May. Compounding this dynamic, a deliberate pullback in immigration is unlikely to be supportive of GDP and per capita GDP growth for the balance of the year.

The more favourable framing for Canada’s economic story may lie in greater fiscal spending by the government. This could potentially

provide a partial offset to the trade headwinds and breathe life into existing feeble levels of business investment. Prime Minister Carney’s Liberal government recently announced a plan to fast-track NATO defense spending by five years, which is expected to increase Canada’s defense allocation to at least 2% of GDP. This marks a considerable fiscal shift for Canada, as it has consistently ranked lowest among G7 NATO members in defence spending as a share of GDP. Positively, this could confer meaningful long-term economic benefits via greater infrastructure investment and industrial innovation. The economic multiplier (which measures the effect across the economy from a change in spending in a sector) is higher for the defense sector than that of the broad economy average, and is in line with many service sectors, according to RBC Economics.

Other initiatives include: a modest personal income tax cut for (22 million) middle-class Canadians; the elimination of GST for qualifying first-time homebuyers; the cancellation of the planned capital gains inclusion rate increase; and the removal of interprovincial trade barriers. While it is too early to measure the impact of such initiatives, none of which is a silver bullet for the country’s challenges, we believe these could help drive positive,

albeit incremental, economic benefits for Canada.

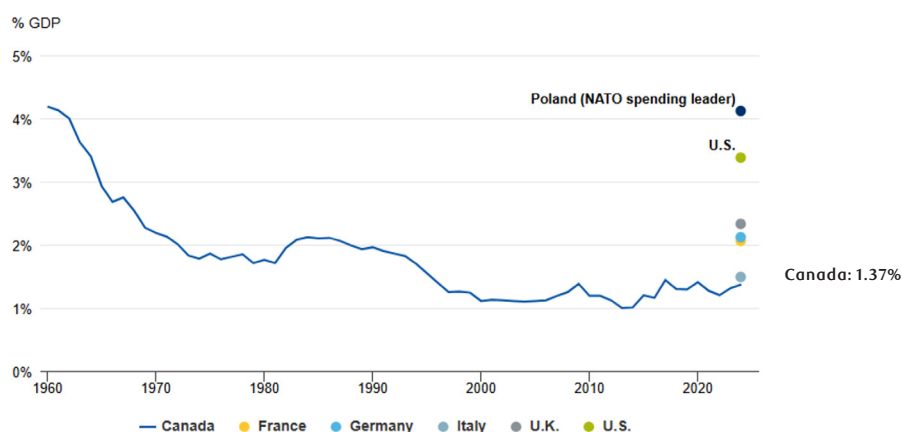
When the government presents its budget in the fall, estimates suggest that their planned spending could be meaningfully higher, and even possibly in line with pandemic-era stimulus. The subsequent increase in Canada’s fiscal deficit will need to be monitored, particularly with regards to its duration and focus. That said, the federal balance sheet capacity exists, as the country’s debt levels remain moderate versus other developed peers, particularly the U.S.

Monetary policy: rates likely to be in a holding pattern in the short-to-medium term

Bank of Canada

The Bank of Canada (BoC) held rates steady at 2.75% in June, acknowledging both GDP resilience and rising unemployment. RBC Economics believes that the central bank has reached the end of its cutting cycle for now, as the policy rate is estimated to be within the neutral range (i.e., neither stimulative nor restrictive to economic growth). Overall inflation rose 1.9% in

Canada’s spending amongst G7 NATO members



Note: These figures estimated by NATO are for 2024; GDP based on 2015 prices and exchange rates. Source: World Bank Group, NATO, RBC Economics

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June from May's 1.7%, and core inflation remained stubbornly high at 2.7%. The unemployment rate in June moved down modestly to 6.9% from 7.0% in May, as the economy added over 80,000 jobs (although many were part-time positions, perhaps suggesting that employers remain cautious in light of the tariff and economic uncertainty), and recent data from job sites seem to suggest that hiring conditions have stabilized. RBC Economics believes any further deterioration in the labour market going forward will be limited.

Recall that the BoC has already cut rates over the last year by more than 225 basis points (a basis point is 1/100th of a percentage point). These cuts operate with a lag, and therefore the Canadian economy may be yet to feel the stimulative benefits in the months ahead. To the extent that fiscal stimulus is in the offing and tends to have a more immediate impact on the economy (and perhaps inflation), we believe the central bank has reasonable grounds for a pause in cuts at this juncture.

To the extent that the Canadian economy weakens further, this may compel the BoC to shift to a more dovish stance. In this regard, the central bank maintains some flexibility to cut rates further, provided inflation related to higher tariffs or fiscal policy impacts are not too imposing.

U.S. Federal Reserve

Down south, the narrative of U.S. exceptionalism seems to be fading with recent signs of a slowdown in economic growth. Consumer spending (a critical driver of the economy) grew at its weakest pace in the first quarter since the onset of the pandemic, largely due to a sharp deceleration on spending on services. This trend, combined with a front-loading of imports and a decrease in government spending, conspired to drive a modest contraction in the U.S. economy in the first quarter of 2025 – the first time a contraction has been registered in three years.

To be clear, we believe that the impact from imports in the first quarter could likely be reversed in the second, which would suggest a reversal higher in U.S. GDP growth next quarter. Indeed, the Conference Board of the U.S. forecasts GDP accelerating at a pace of around three percent on a quarter-over-quarter basis. Setting aside the swings in imports, signs remain of slowing economic momentum: U.S. job growth in May slowed against a backdrop of greater uncertainty around the Trump administration's tariff policies. While the unemployment rate held steady at 4.2% for the third consecutive month, this was largely due to a sharp decline in the labour force participation rate, suggesting a lack of confidence in the jobs market. The data also saw job creation for the month of March and April revised lower by 95,000 jobs.

As it pertains to the outlook for interest rates, in the immediate term, we do not believe that the Federal Reserve (the Fed) will feel a sense of urgency to cut rates over the summer, despite being on pause since December of last year, and considering a tame inflation reading in May, which was lower than economists' expectations. On the latter point, there is still a possibility that the full impact of tariff-related inflation has not yet shown up in the numbers. It has been suggested that this may be due to businesses absorbing the higher prices via shrinking margins in the hopes that import duties may come back down. It's too early to know if such a move will prove to be the right one, and if not, businesses will ultimately seek to protect profitability.

U.S. fiscal policy is consequential to the Fed – now, about that Big Beautiful Bill...

Tariff uncertainty aside, political risk remains high, especially with respect to the potential for profligate fiscal spending under the Trump administration. The sweeping "One Big, Beautiful Bill Act" was passed by Congress on July 3, ahead of the president's self-imposed deadline of July 4. The bill includes more than

\$4-trillion worth of tax cuts, and funds mass migrant deportations in part via spending cuts to a wide range of programs, such as food subsidies and healthcare for lower-income Americans.

The bill is enormously consequential for a U.S. economy that is not in a recession nor at war. The bipartisan Congressional Budget Office estimates that the bill's measures would add \$3.3 trillion to U.S. deficits over a decade, with the federal debt already sitting at \$37 trillion today. While part of the new deficit load may be offset by anticipated tariff revenues, the starting point remains precarious: the U.S. already ranks among the most fiscally constrained developed economies in the world. Despite the headline size, in our view the bill is unlikely to be a major accelerant of economic growth for the U.S.. Instead, it may provide a modest tailwind heading into 2026 via deregulation, as most of its measures (e.g., tax cut extensions and capital allowances) are designed to prevent economic deceleration.

Bringing it back to the Fed, we believe that this bill could have important implications for the rate path going forward. For now, RBC Economics is aligned with consensus expectations of another two to three rate cuts by the end of this year, likely beginning in September concurrent with further softening of the economy. However, the bill runs the risk of reigniting inflation simply from greater economic activity. Under such an outcome, we believe a "wait-and-see" mode for the Fed may remain in place for the balance of the year. Importantly, in either scenario, interest rates for 2025 are likely to remain above average.

Navigating the way forward: positioning your portfolio with purpose

Global equity markets have remained generally resilient and recovered from the correction recorded in April. Notably, equity performance in

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developed markets outside the U.S. have broadly outperformed the S&P 500 Index, which itself has ascended in the mid-single-digits range. Valuations of the S&P 500 Index remain expensive. The Index is trading at more than one standard deviation above its long-term average, and at a considerable premium to the S&P/TSX Composite that is trading closer to its long-term average.

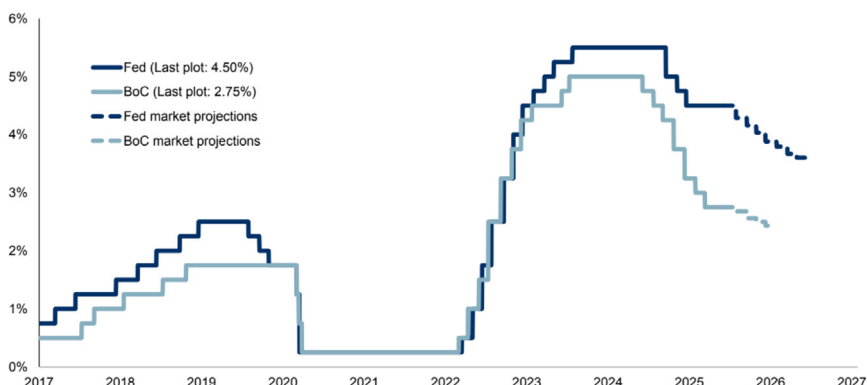
However, removing the impact of the Magnificent 7 stocks of Microsoft, Amazon, Meta, Alphabet (Google), Tesla, Nvidia, and Apple, and many of which trade at premium valuations and collectively constitute close to 30% of the S&P 500 Index' market capitalization – valuation drops closer to its long-term average – i.e., neither is it cheap nor expensive.

To be fair, there is room for equity performance to remain robust for the balance of the year, provided a recession is avoided and consensus estimates continue to reflect healthy earnings growth, which is currently the case for developed markets.

For now, we are content to maintain our modest overweight in equities, though our preference is for ownership within the International equity space. Valuations there are more palatable, and prospects exist for a favourable move higher in GDP growth from a low base as a result of greater fiscal spending. In our view, further defensive positioning and upscaling towards a quality bias (i.e., strong balance sheets, economic “moats”, and a track record of compounding earnings and free cash flow) are warranted.

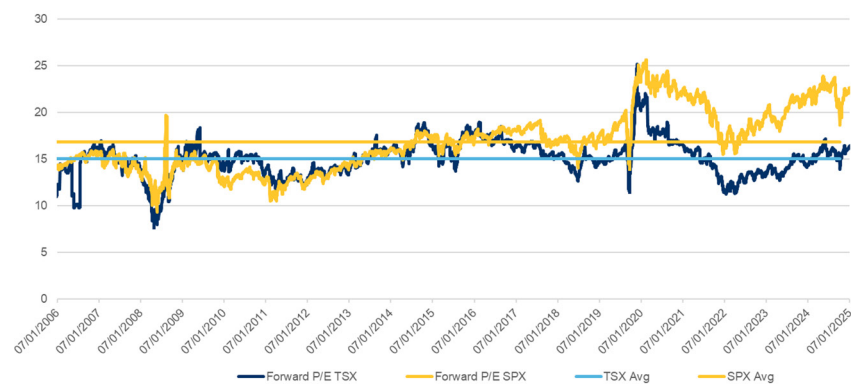
In fixed income, the economic themes of growing fiscal profligacy worldwide, and elevated macroeconomic uncertainty have led investors to justifiably demand greater compensation to lend to governments, especially over longer periods. According to RBC Global Asset Management, this extra compensation, also referred to as the term premium, is the highest it has been since the

North American central bank policy rates & market expectations



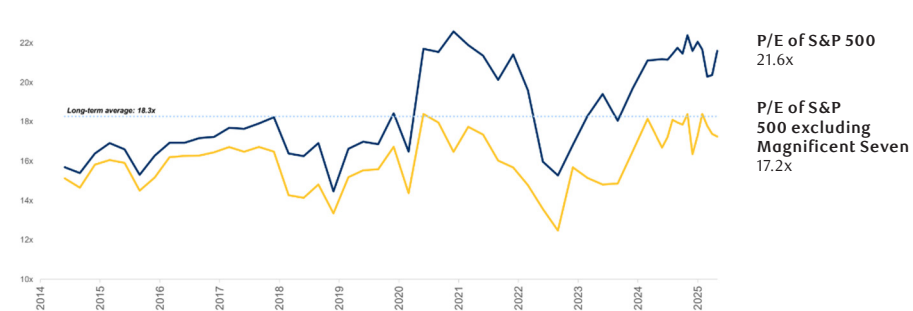
Note: As of 6/06/25. Source: Bloomberg, RBC GAM

SPX vs. TSX Forward 12-month Valuation



Note: as of 07/2025. Source: Bloomberg

The valuation of the S&P 500 is much reasonable without the MAG7



Note: From June 30, 2014, to May 31, 2025. Long-term average reflects 15 years. “S&P 500 excluding Magnificent Seven” refers to P/E of the S&P 500 if the “Magnificent Seven” were removed and the weights of the other stocks were grossed up proportionally. Note: you cannot invest directly into an index. Source: Bloomberg, RBC GAM.

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early 2000s, and underscores attractive valuations for this asset class. We recommend a neutral allocation to fixed income, considering attractive starting yields and the desire to create sufficient ballast in portfolios against volatility.

We continue to advocate for a risk-profile appropriate degree of inclusion of alternative investments within the broader portfolio framework. In recent history, there have been greater incidences of equities and fixed income moving in the same direction (i.e., high levels of correlation), particularly during periods of acute stress and uncertainty in the financial markets. The inclusion of alternatives – provided astute manager selection – offers the potential for enhanced risk-adjusted returns over the long-term, largely driven by this asset class's lower correlation to public markets.

Golden glitter

Remaining on the topic of weakening correlative relationships, gold is an asset class that has most recently carried considerable favour as evident by its 12.86% growth rate on

a compounded basis over the last five years. This ascent represents a departure from the historic relationship gold has demonstrated with real interest rates, i.e., an inverse correlation. Since 2022, gold has remained resilient despite a rapid rise in rates, as central banks globally sought to rein in post-pandemic runaway inflation.

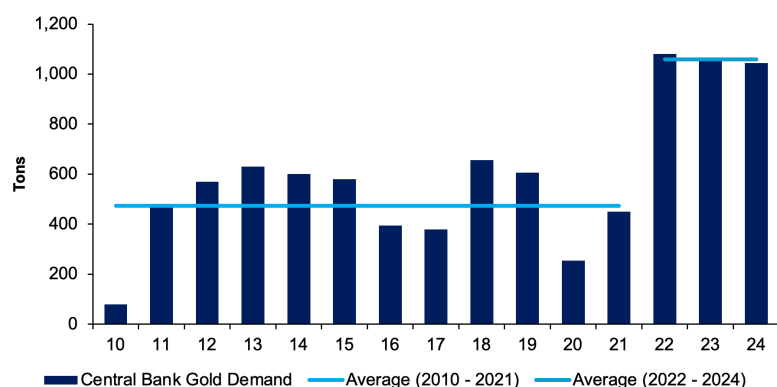
The breakdown of this historic correlation may be attributed to a potentially structural inflection in demand, particularly from global central banks that seek to diversify their reserves away from the U.S. dollar. The freezing of Russia's foreign currency assets after its invasion of Ukraine in 2022, likely had a chilling effect on the demand for the U.S. dollar particularly amongst emerging market central banks. To wit, central bank net purchases of gold have surpassed 1,000 tons over the last three years. This is double the annual average in the previous 11 years. Gold now accounts for 20% of global official reserves, second only to the U.S. dollar (at more than 40%). Recent indications

from central banks suggest that their appetite to diversify further into gold has yet to be sated.

Other factors that likely contributed to this pivot include elevated geopolitical tensions, and rising political risk in the U.S. which have hurt confidence in the US\$ and US\$-denominated Treasuries - not to mention (again) the potential for greater fiscal spending that could invite higher inflation. It is worth noting that retail and speculative demand is also on the rise for the asset, though this is not a key driver of the recent strength.

In light of gold's growing attractiveness as a source of diversification and a hedge against low economic visibility in the medium term, we believe that investors can consider its inclusion in portfolios that are well diversified across all asset classes, and as part of the long-term strategic asset framework. However, we would caution against the inclusion of this asset class as a tactical play, particularly in light of gold's already expensive valuation relative to history suggesting a great deal of optimism is already priced in.

Central banks have increased their gold allocations (in tonnes)



Note: 12/24; Source: RBC Wealth Management, World Gold Council



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