APOLLO

Mid-Year Outlook: At the Crossroads of Stagflation—What's Next?

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KEY TAKEAWAYS

- President Trump's new tariff regime—introduced on April 2 and still evolving through a series of ongoing developments—has marked a notable turning point in US trade policy. As of this writing, the average US tariff rate is 15.8%.[1] While below initial expectations, this is still the highest level of tariffs the US has had in nearly nine decades and, if kept, will have substantial impact on the US and global economies. All of this has injected a historic level of volatility into financial markets.
- Tariff hikes are typically stagflationary shocks—they simultaneously increase the probability of an economic slowdown while putting upward pressure on prices. In our view, the current tariff regime increases the chance of a US recession to 25% over the next 12 months. (In our last pre-tariff outlook, we expected no recession in 2025.[2]) Our year-end inflation expectation has moved up to 3.0%, a significant increase from our pre-Trump-tariff estimate of 2.4%.

  As a result, we continue to expect interest rates higher for longer. As of this writing, we see the Federal Reserve cutting rates only once in 2025, with a year-end fed funds-rate target range of 4.00% to 4.25%. We believe that Fed Chairman Jerome Powell will likely take a conservative approach to easing policy to safeguard against fears of runaway inflation.
- Economic data have mirrored the volatility in the markets and trade policy. Soft indicators (e.g., confidence surveys) have fluctuated in tandem with news of on-again, off-again tariffs, while hard data (i.e., employment and inflation) have shown more resilience. This discrepancy has added to uncertainty and continues to fog the economic outlook.
- On the demand side, as of this writing, we see the uncertainty around tariffs translating into lower corporate and consumer spending. Fluctuating trade policies have created an unpredictable business environment, causing companies to delay investment and reevaluate supply chains. A number of surveys have already shown a contraction in new orders and a heightened volatility in US corporate capex plans. While consumer confidence did rebound in May[3] after five consecutive months of decline, it still sits at levels last seen during COVID. Meanwhile, tourism—which accounts for 10% of US GDP[4]—has fallen, and the housing market is showing signs of softness.

continued on next page

[1] Source: Yale Budget Lab. Based on all US tariffs and foreign retaliation implemented in 2025 through June 15, including the effects of the higher 50% steel & aluminum tariffs announced May 30. YBL analyzed the May 12 tariff rates as if they stayed in effect in perpetuity. Adjusted for consumption shifts, the average tariff rate, as of this writing, stands at 15.8%, the highest since 1936.

[2] See 2025 Economic Outlook: Firing on All Cylinders, December 9, 2024.

[3] See https://www.conference-board.org/topics/consumer-confidence.

[4] Sources: Bureau of Economic Analysis, Apollo Chief Economist, as of 2023.

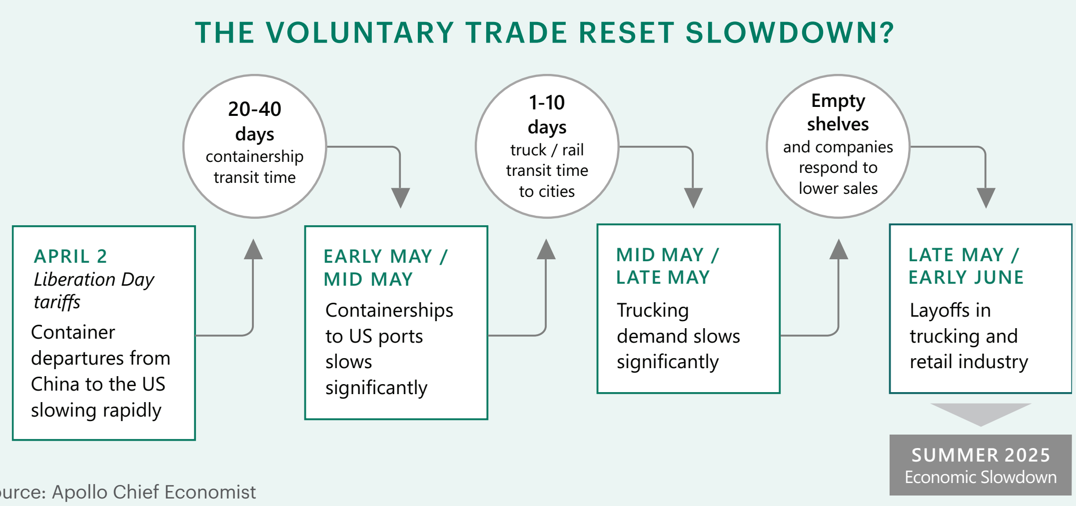
KEY TAKEAWAYS *continued*

- On the supply side, we see significant headwinds to sectors and industries reliant on foreign supply chains. Although tariff levels are currently lower than initially feared, we believe that potential shipping disruptions and higher costs will act as a drag on output and margins. Corporate earnings, already being revised downward, can come under further pressure. Finally, the start of the Israel/Iran conflict in mid-June, and its attendant surge in oil prices, poses yet another stagflationary risk to the economy: As with tariffs, higher oil prices can lead to higher inflation and lower GDP growth. We expect 1.2% GDP growth in the US in 2025.
- Higher US tariffs will also likely have a substantial impact on the world economy, especially because the US is a net contributor to global aggregate demand. This is in contrast to the 1940s, when US tariffs were also high, but the country had a trade surplus due to its dominant industrial position, wartime production, and post-war reconstruction efforts abroad. As a result, we now see global GDP growing 2.6% in 2025 against our pre-tariff expectation of 3%-plus.
- What can this all mean to investment opportunities? We continue to believe that seniority in the capital structure and a sharp focus on businesses able to generate strong cash flow remain paramount. Additionally, we believe that sectors with less impact from tariffs and the uncertainty around the macro environment—i.e., cable/telecom, healthcare, utilities/power, and technology—are preferable to those with higher potential negative impact, such as industrials, energy, and consumer/retail.
- Lastly, a word on the "X-factor" to our forecasts: the US fiscal outlook. As of this writing, the US Lower House has passed what President Trump calls a "big, beautiful bill," which will define the course of the US budget. The bill, as currently proposed, calls for massive tax cuts, as well as spending cuts. On balance, estimates suggest the bill would widen the budget deficit and increase the country's debt-to-GDP ratio over time. If approved by the US Senate and signed by Trump, the impact would be stimulative in the short run (via tax cuts) but could keep further upward pressure on rates and, therefore, the cost of servicing the US debt in the long run.

The corporate response to the April 2 announcement of the administration's reciprocal tariff strategy—referred to by President Trump as "Liberation Day"—has been unambiguous: For companies, new orders have fallen, capex plans have fluctuated, inventories were rising before tariffs took effect, and firms started revising down earnings expectations. For households, consumer confidence has sunk to record-low levels, consumers were front-loading purchases before tariffs began, and tourism has been slowing. In mid-May, Moody's downgraded the US credit rating, increasing borrowing costs for both US consumers and firms.

This voluntary trade reset slowdown (**Exhibit 1**) is a risk to the economic outlook. While both April and May inflation numbers were surprisingly subdued—the consumer price index rose just 2.4% year-over-year in May—the effects of Liberation Day were surely still working their way through the trade pipeline.

Exhibit 1: It takes a minute for major policy changes to show up in the data



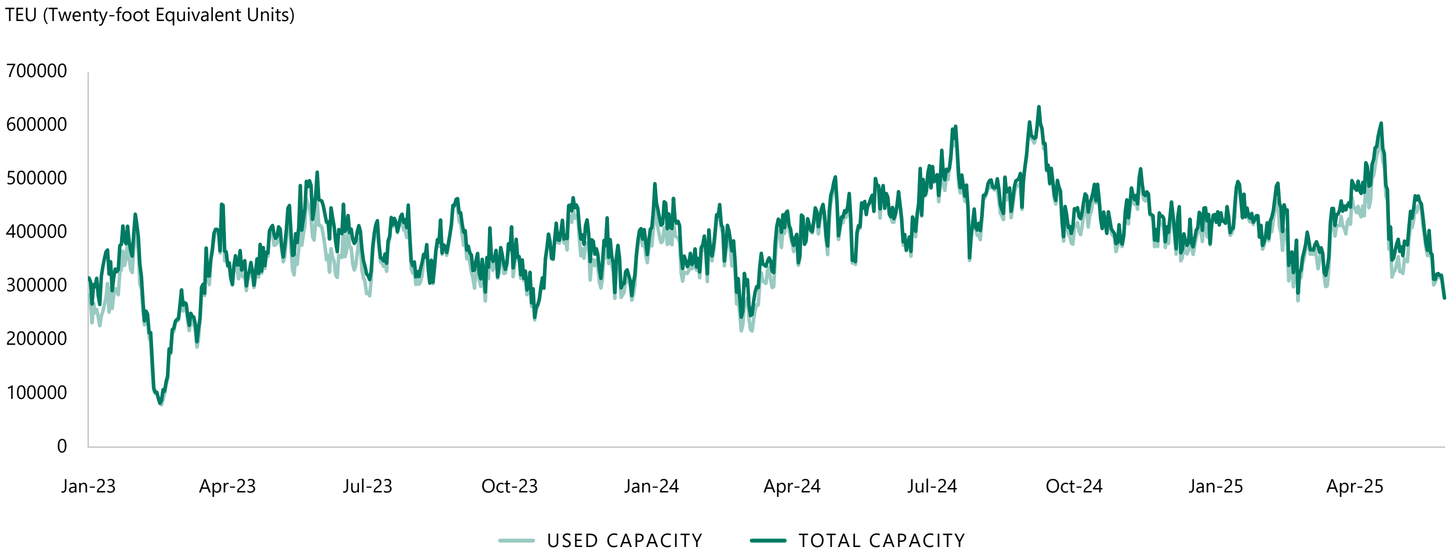
Source: Apollo Chief Economist

Let's walk through how changes in US trade policy can show up: April 2nd was Liberation Day. Tariffs started taking effect on April 9th. It takes about twenty days for a container to get from China to Los Angeles, and forty days for a container to get from China to New York. So that's around thirty days before we would begin to see an impact on the US economy. April 9th plus thirty days brings you to May 9th. That's when we should have begun to see container traffic slow down. And that's exactly what we saw (**Exhibit 2**).

And then, on May 11th, the US and China agreed to a 90-day temporary reduction in tariffs (**Exhibit 3**). As part of the détente, in the US, the 125% tariff on Chinese imports announced April 2nd was reduced to 10%. But the 20% broad tariff on Chinese imports announced February 4th and increased on March 4th remained. China agreed to lower their 125% retaliation list to 10%. The so-called handshake deal made with China in early June suggested the potential for further détente, but was also short on detail.

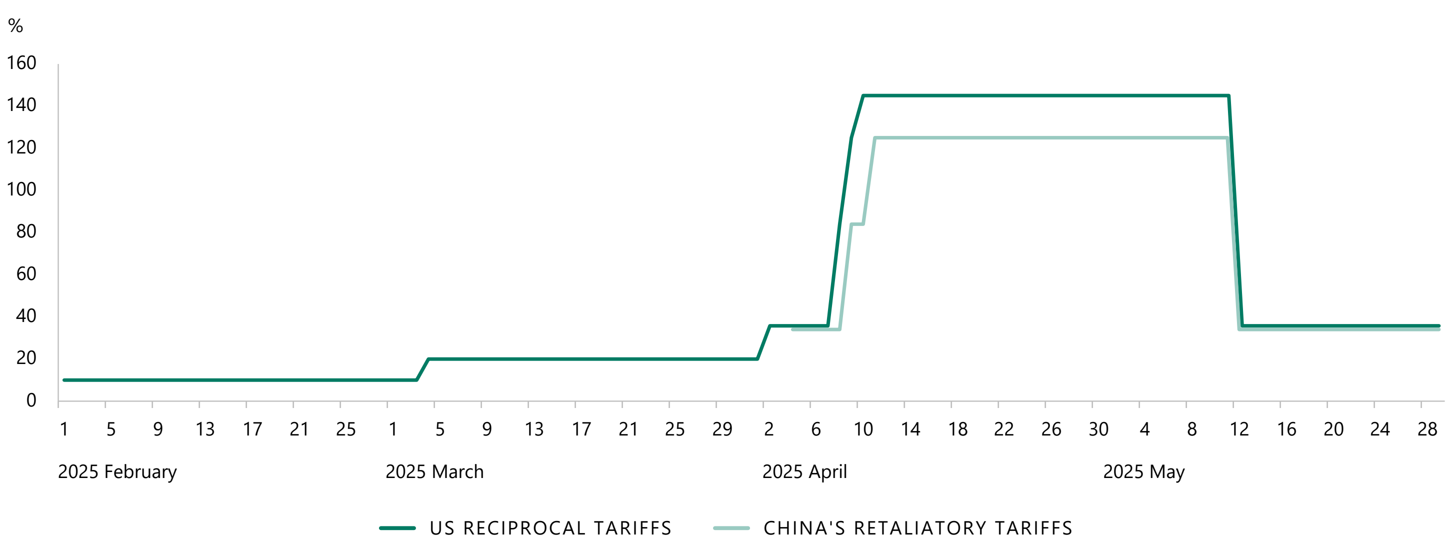
Exhibit 2: There has been a dramatic decline in the number of containers departing China to the US

Container ship tonnage—departures from China to the United States



Data as of May 29, 2025. Note: Represents the aggregated container volume, measured in twenty-foot equivalent units (TEU), of vessels departing China for the United States over a 15-day rolling period. Accounts for the shipping capacity being utilized, irrespective of the number of vessels.
Sources: Bloomberg, Apollo Chief Economist

Exhibit 3: US-China tariffs have been on a roller-coaster ride

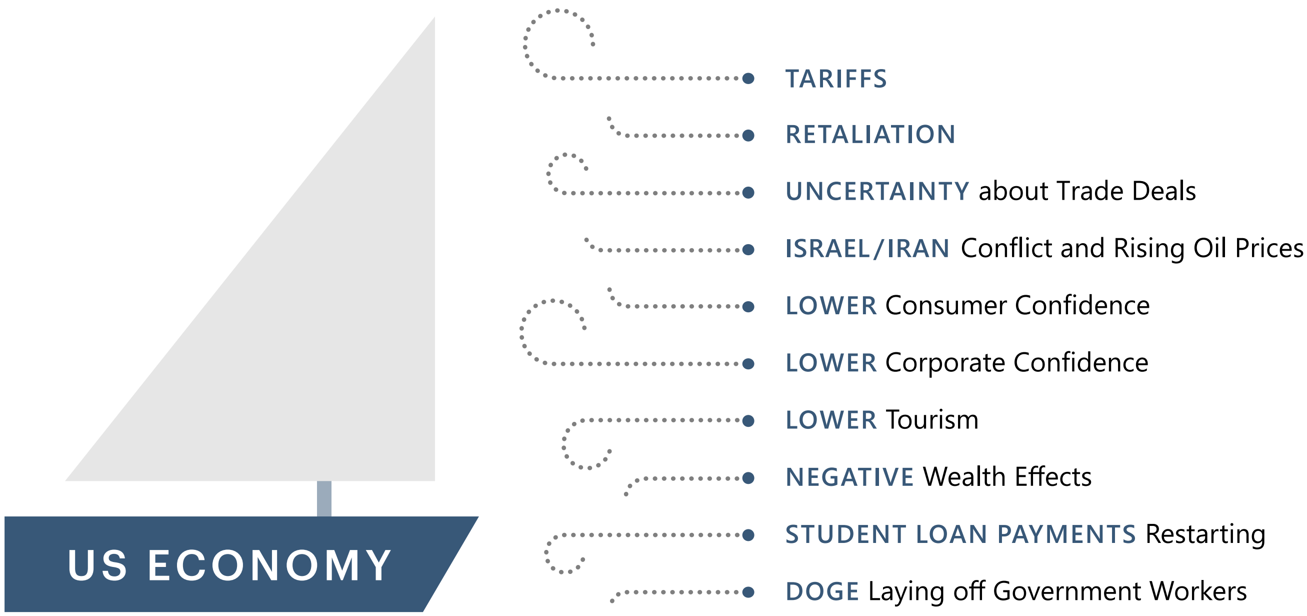


Data as of May 29, 2025. Sources: White House, China Ministry of Finance, Macrobond, Apollo Chief Economist

While progress in China trade discussions allowed the world to take a collective breather, and the probability of a recession in 2025 declined from 90% to about 25%, we are not out of the woods yet. In the US, at the end of May, we were still facing the highest level of tariffs—an average of 15.8%, according to the Yale Budget Lab—in almost a century. Even if the tail risk of a complete collapse in trade between China and the US has been removed, there remain significant challenges to US and global economic growth in 2025.

The US economy is facing more challenges than it has in recent memory. While we do not expect a recession, the recent rise in oil prices has added yet another to an already long list of headwinds to growth. The days of wondering solely about inflation and the Fed's next meeting are over for the time being. The number of considerations continues to climb, and **Exhibit 4** is our attempt to illustrate the many uncertainties ahead.

Exhibit 4: There are several headwinds to US economic growth



Source: Apollo Chief Economist

> The days of wondering solely about inflation and the Fed's next meeting are over for the time being.

The US Economy: Several Headwinds Ahead

The number one issue facing the US economy is higher tariffs. We are already starting to see a significant decline in the earnings revisions ratio since Liberation Day (**Exhibit 5**).

It's not that a trade war with China is necessarily a bad idea. It's simply that the implementation of a new trade regime could probably have been handled more smoothly than it has: Imagine, for example, lifting tariffs with China 1% every month for the next 36 months. In that scenario, companies have the ability to prepare for what's coming. Short of that, we are left with uncertainty—both by being surprised by tariffs and by being unsure about the permanency thereof.

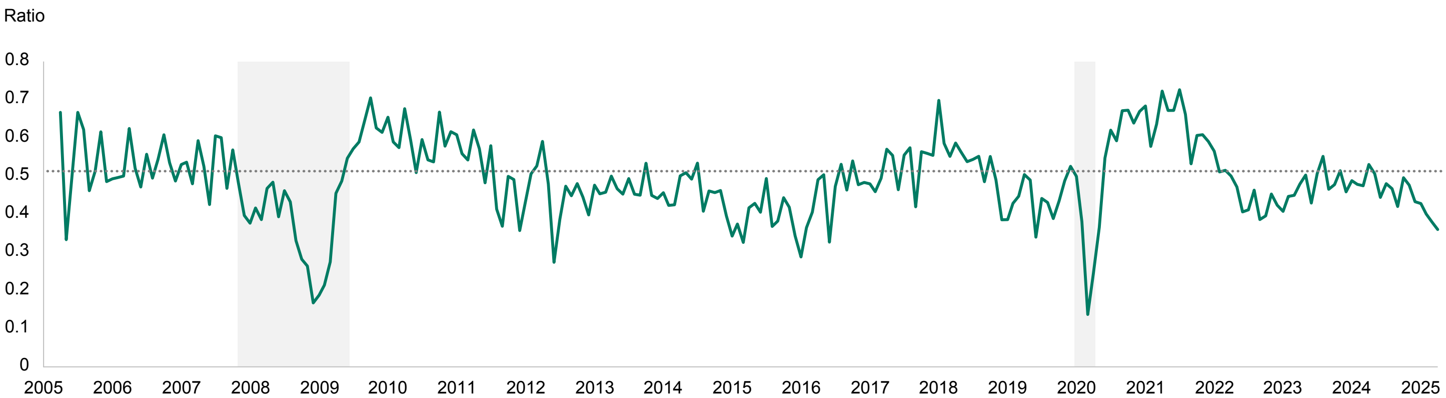
Are Tariffs Here to Stay?

Both small and large businesses have reported significant impacts to their bottom lines as a result of all the confusion. We can see that most clearly by the fact that the number of companies that have been reporting forward guidance has been crashing—that is a warning sign about what's coming, as companies are no longer able to say what they are seeing going forward.

It's always difficult to get a grasp on uncertainty. After all, the reason we are uncertain is that we don't know what may change and what may stay the same. One way to get an understanding of tariff uncertainty, then, is to look at what "economic policy uncertainty" looks like overall (**Exhibit 6**).

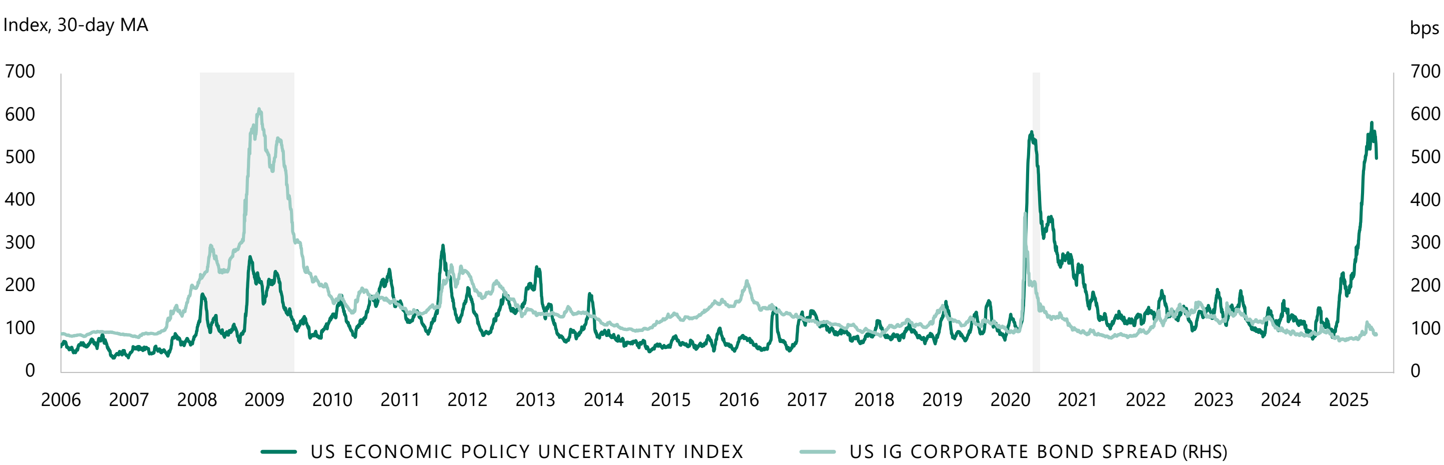
Exhibit 5: Corporate earnings expectations are deteriorating

S&P 500: earnings revisions ratio



Data as of May 1, 2025. Note: Earnings revisions ratio measures how many upward revisions to earnings estimates analysts are making versus downward revisions over a given period. Above 0.5 means more upgrades than downgrades and below 0.5 means more downgrades than upgrades.
Sources: Bloomberg, Apollo Chief Economist

Exhibit 6: Fixed income spreads have disconnected from the economic policy uncertainty index



Data as of May 29, 2025. Sources: Economic Policy Uncertainty, Macrobond, Apollo Chief Economist

The dark green line in **Exhibit 6** shows you economic policy uncertainty. Are we talking more about trade policy at the moment than we do normally? If we are, that line will be above 100. If we're talking about it less, we will be below 100. As you can see, policy uncertainty is extremely elevated at the moment. We are talking about it more than we are talking about anything else.

But the above chart also raises an interesting question: Why are credit spreads—the light green line—not trading wider given the significant amount of uncertainty in the outlook? Perhaps the answer is that the hard data behind the light green line have yet to begin slowing down, whereas the soft data in the dark green line—the way we're talking about things—has deteriorated dramatically because there's so much uncertainty.

One way of looking at **Exhibit 6** is to conclude that the dark green line needs to come down to the light green line—meaning, a clearer and more consistent policy outlook would help ease market uncertainty. Another way of looking at it is that markets will conclude that the current turbulence in policy setting is not going to go away, so the light green line has to rise—credit spreads will have to widen.

Our current view is that credit spreads will widen. We do not believe that the current policy turbulence is going to go away. This is not a political view; it's just a view expressing that policy uncertainty is elevated and is likely to remain so. Such view is built on our constant consultations with market participants and corporate CEOs.

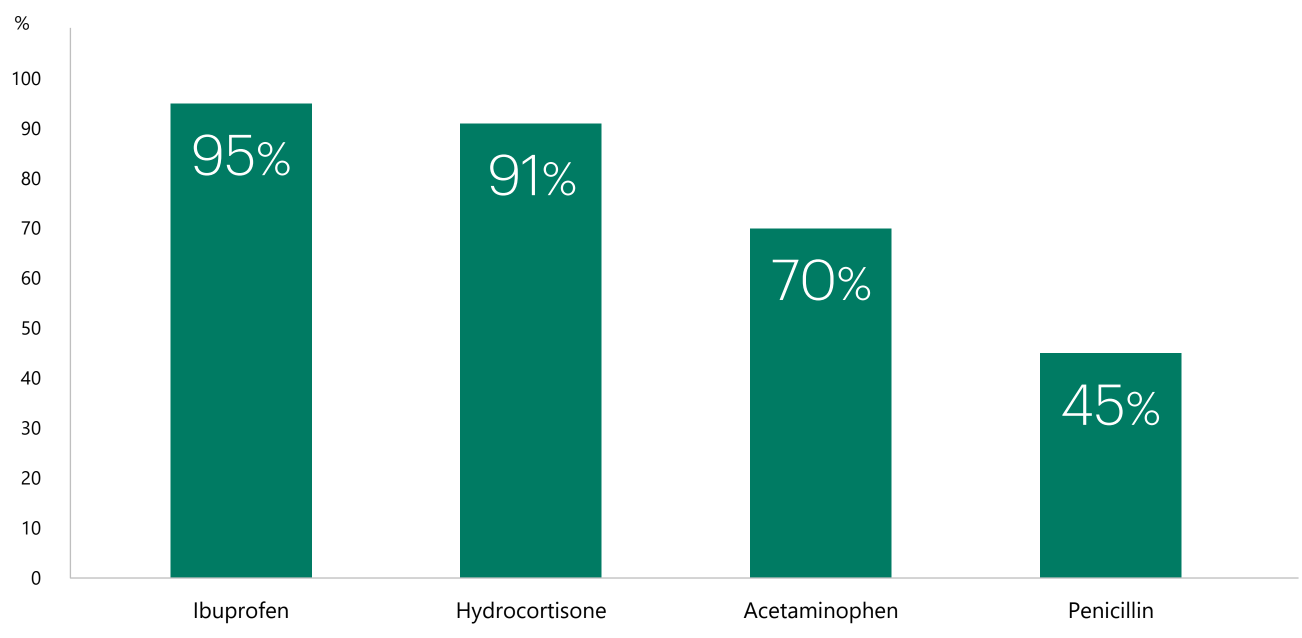
Also, the Yale Budget Lab is doing a good job in modelling the current uncertainty, in our view. The Lab's model tries to estimate the effects of all US tariffs as well as foreign retaliation. Assuming that the June 16 tariff rates stay in effect in perpetuity—it's hard enough to model this stuff as it is, so you have to make assumptions like this—the Lab sees GDP growth 0.6 percentage points lower through 2025 and the unemployment rate 0.3 percentage points higher by year-end.

Trade War Retaliation Risk

While the reduction in standoffishness in the US-China trade talks is cause for optimism, there remains the risk of trade war retaliation in the months ahead. What shape or form that may take remains to be seen, but consider, for example, trade in prescription drugs (**Exhibit 7**).

Exhibit 7: China is a key source of pharmaceutical drugs in the US

Share of pharmaceutical drug imports that come from China



Data as of 2021.

Sources: Skyrocketing Pharmaceutical Imports to the U.S. Endanger National Security | Coalition For A Prosperous America, The geography of prescription pharmaceuticals supplied to the USA: levels, trends, and implications—PMC, Apollo Chief Economist

There were very significant imports of pharmaceuticals into the US in April. Why? Because 90% of the prescription drugs consumed in the US are produced outside the US, and many of them come from China: 95% of US Ibuprofen comes from China, 91% of Hydrocortisone, 70% of Acetaminophen, and 45% of Penicillin. Imagine, for a moment, if the US population lacked access to antibiotics. What would happen then?

Uncertainty Around Trade Deals

Despite waning trade tensions, we still see significant headwinds to sectors and industries reliant on foreign supply chains. Although tariffs are lower than initially expected, potential shipping disruptions and higher costs will likely act as a drag on output and margins. Corporate earnings will also come under further pressure.

It's possible that we will get the dozens of trade deals promised by the Trump Administration. But, as shown by **Exhibit 8**, it normally takes months, if not years, to launch, sign, and implement trade deals in the US.

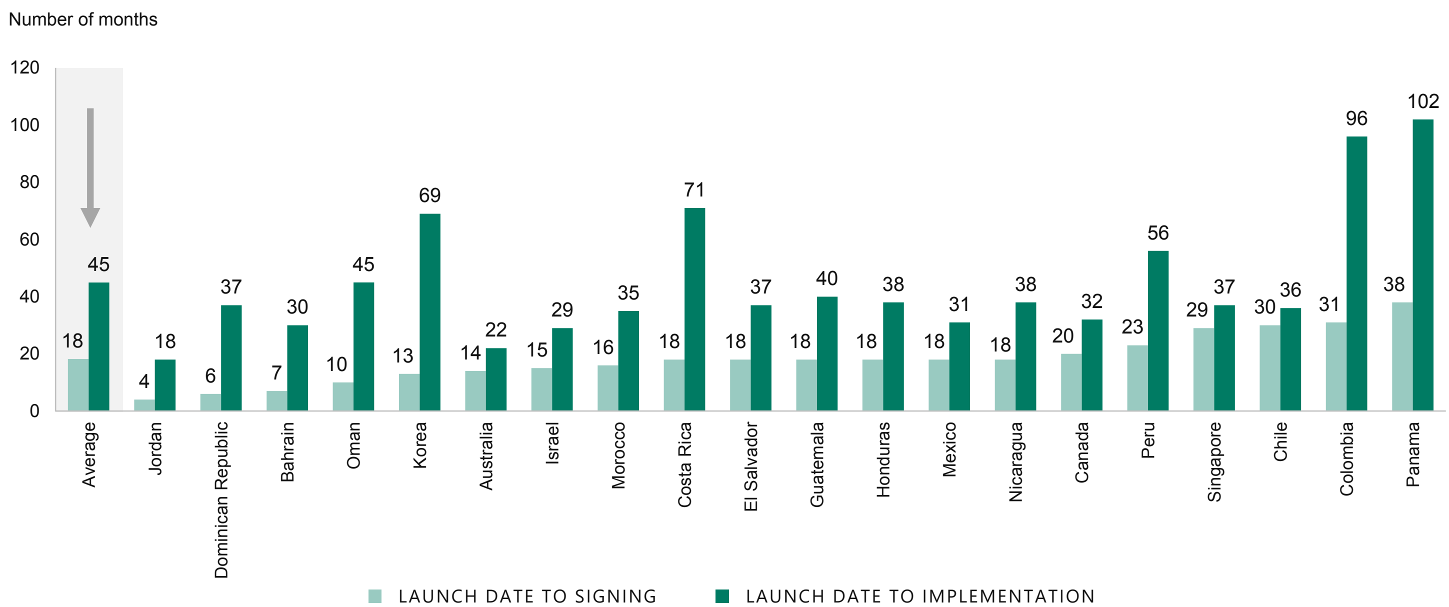
From the launch date of trade negotiations, it takes an average of 18 months to get a deal signed. That's because trade deals are not just about headline tariffs, but about other things that go into trade, namely nontariff barriers, services, labor standards, environmental standards, anti-dumping, government procurement, and more. But negotiation is just the beginning. It also takes an average of 45 months before actual implementation.

Israel/Iran Conflict

The conflict between Israel and Iran may have long-term geopolitical consequences, but in the short-term, from an economic perspective, it adds to stagflationary concerns: Higher oil prices—after touching $63 in late May, the price of Brent crude was at $72 as of the time of this writing—can lead to both higher inflation and lower economic growth.

Exhibit 8: It takes time to get trade deals done

Duration of US trade negotiations

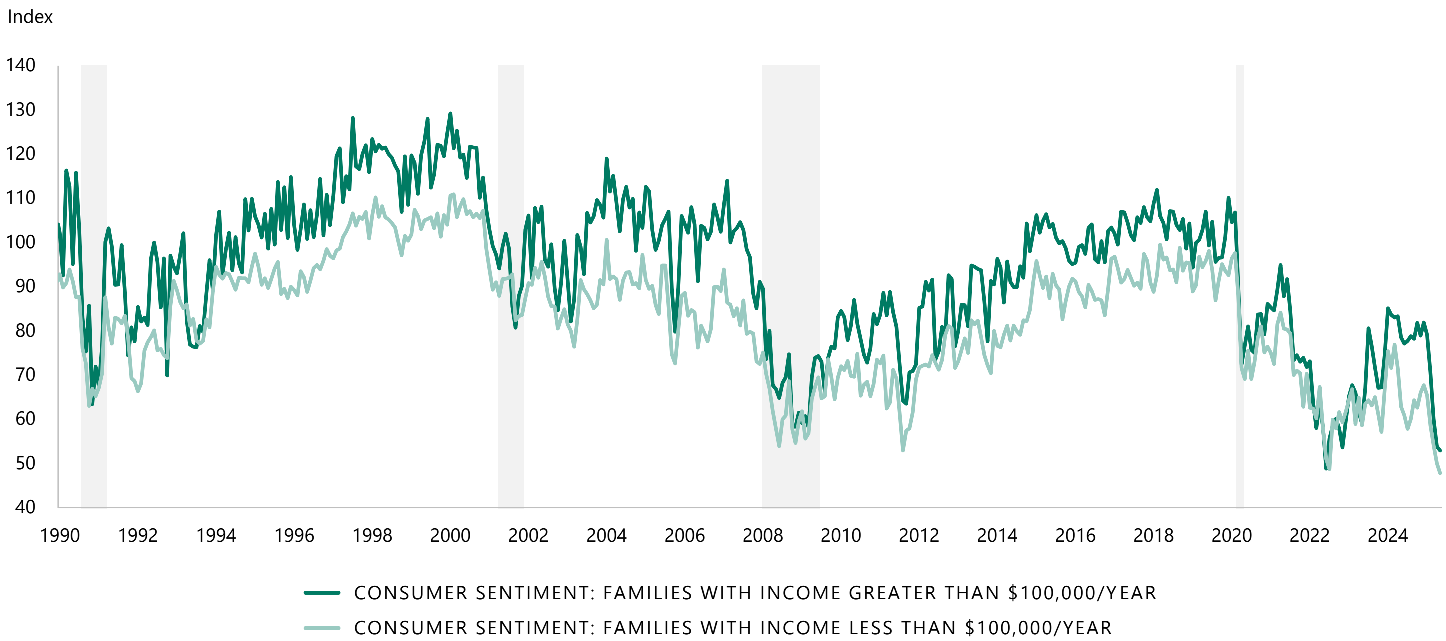


Sources: PIIE (Freund and McDaniel), Apollo Chief Economist

Historically Weak Consumer Confidence

While the Conference Board did report an increase in consumer confidence in May after five consecutive months of decline, it continues to be challenged in the US, according to University of Michigan polling, both for households making more and less than $100,000 (**Exhibit 9**). The number of consumers worried about losing their jobs is at levels normally seen during a recession (**Exhibit 10**), and a record-high share of consumers think business conditions are worsening (**Exhibit 11**).

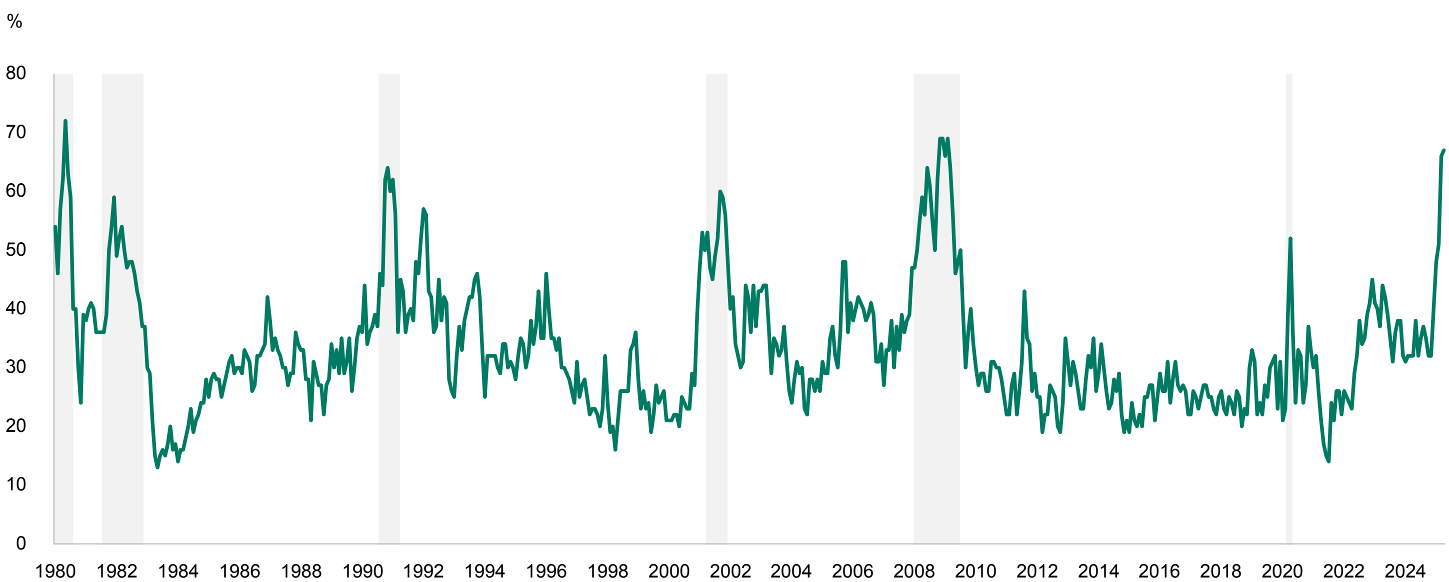
Exhibit 9: Consumer sentiment is declining across income groups



Data as of May 2025. Sources: University of Michigan, Haver Analytics, Apollo Chief Economist

Exhibit 10: Consumers are worried about losing their jobs

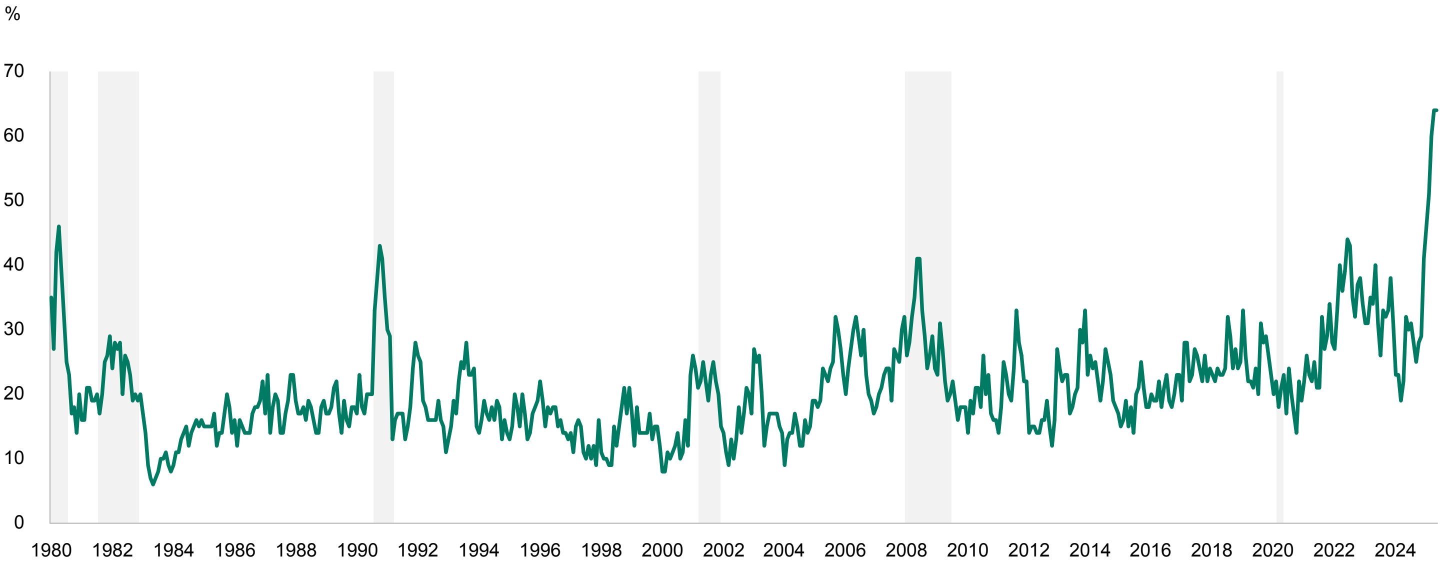
12-month economic expectations: more unemployment (%)



Data as of May 2025. Sources: University of Michigan, Haver Analytics, Apollo Chief Economist

Exhibit 11: A record-high share of consumers are pessimistic about the economy

Expected business conditions in 1 year: worse (%)



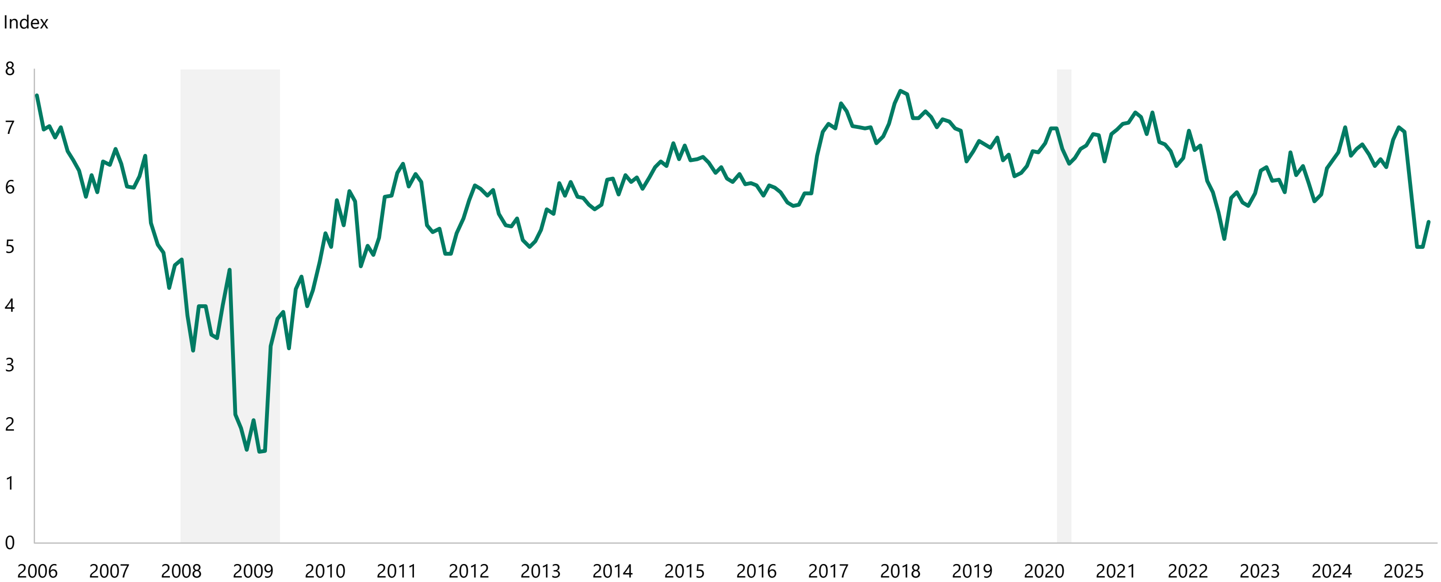
Data as of May 2025. Sources: University of Michigan, Haver Analytics, Apollo Chief Economist

High Uncertainty for Business Planning and Weak Corporate Confidence

Corporate confidence has been declining in lock-step with the consumer outlook. Fluctuating trade policies have created an unpredictable business environment, causing companies to delay investment and reevaluate supply chains. A number of surveys have already shown a contraction in new orders, and a sharp reversal in US corporate capex plans. CEO Confidence has already declined sharply (**Exhibit 12**).

Exhibit 12: CEO confidence has dropped as uncertainty has risen

CEO confidence index: confidence in the economy 1 year from now



Data as of May 1, 2025. Sources: Chief Executive Magazine, Bloomberg, Macrobond, Apollo Chief Economist

We can also see a lack of confidence in the softness in new orders in **Exhibit 13**, which tallies replies to regional Fed offices asking businesses in their districts the following question:

What does your order book look like?

This is data telling you many firms are saying we're having fewer orders, which of course is not good.

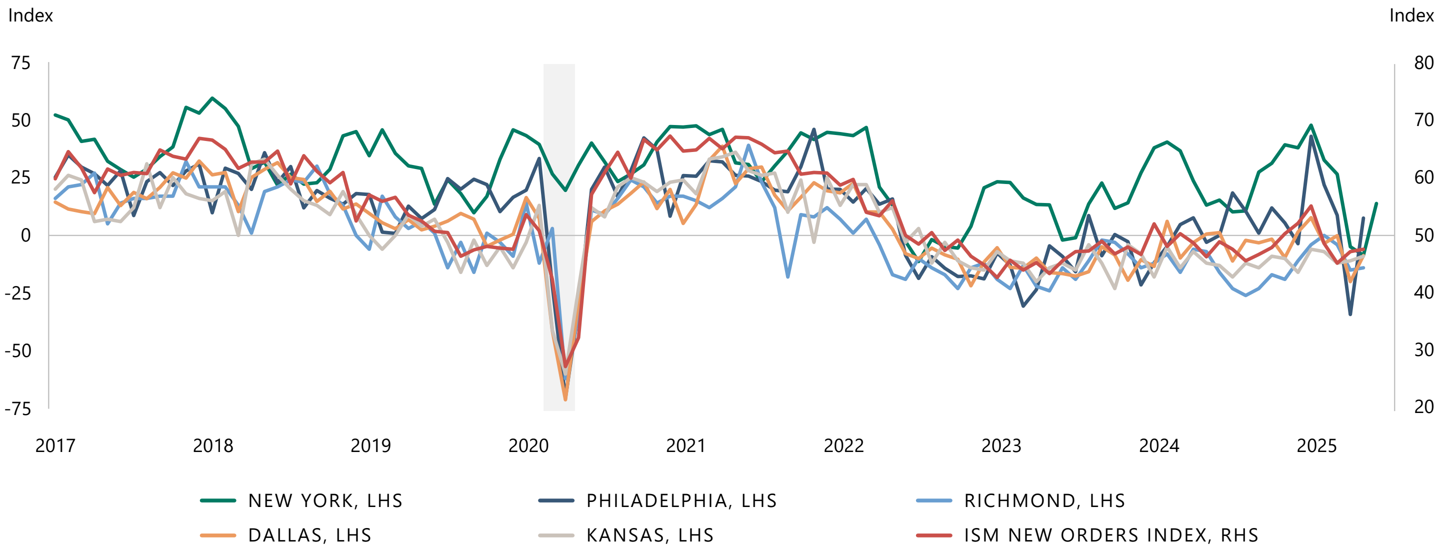
Lower Tourism

Tourism makes up 10% of the GDP (**Exhibit 14**). That means that any slowdown in tourism is going to be bad for the economic outlook. All-told, the tourism industry projects a $12.5 billion drop in spending by international visitors in 2025, from $181 billion last year to less than $169 billion this year.[5]

[5] See https://wttc.org/news/us-economy-set-to-lose-12-5bn-in-international-traveler-spend-this-year.

Exhibit 13: New orders have slowed down

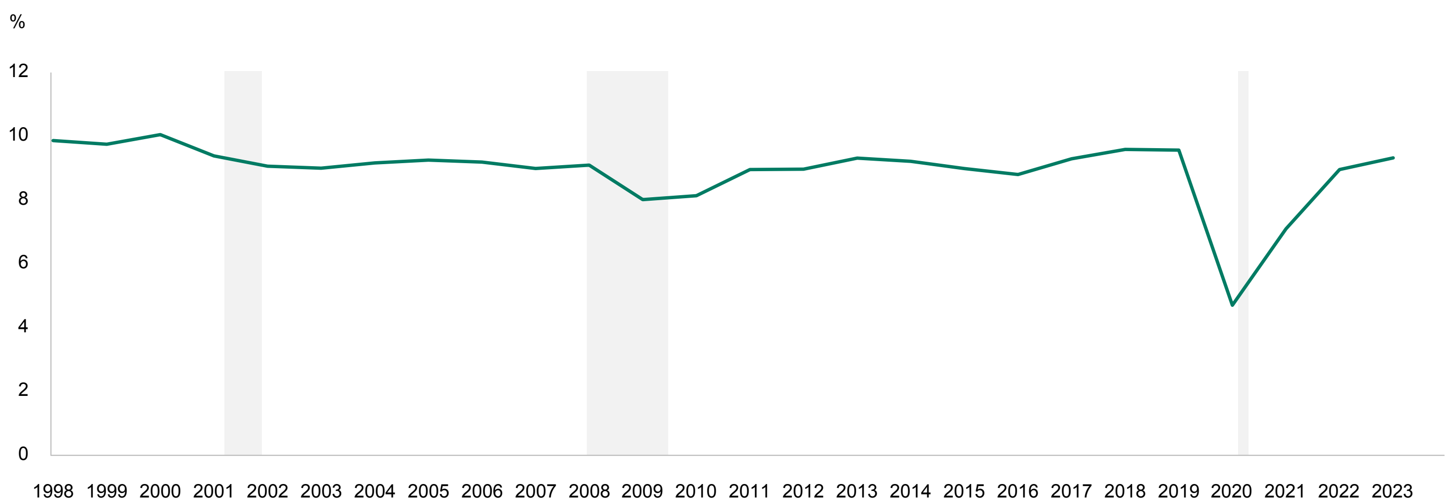
Manufacturing survey: new orders outlook



Data as of May 1, 2025. Sources: Federal Reserve Bank of Kansas City, Federal Reserve Bank of Richmond, Federal Reserve Bank of Dallas, Federal Reserve Bank of Philadelphia, Federal Reserve Bank of New York, Institute for Supply Management (ISM), Macrobond, Apollo Chief Economist

Exhibit 14: Tourism matters to the US economy a lot

Travel and tourism as % of US GDP



Data as of 2023. Note: The series is calculated using tourism-related output as % of GDP. Tourism related output includes the direct output from tourist spending as well as the indirect and induced effects captured through input-output multipliers. Sources: Bureau of Economic Analysis, Apollo Chief Economist

The US is the only country analyzed by the World Travel & Tourism Council that is forecast to see a drop in international visitors in 2025.

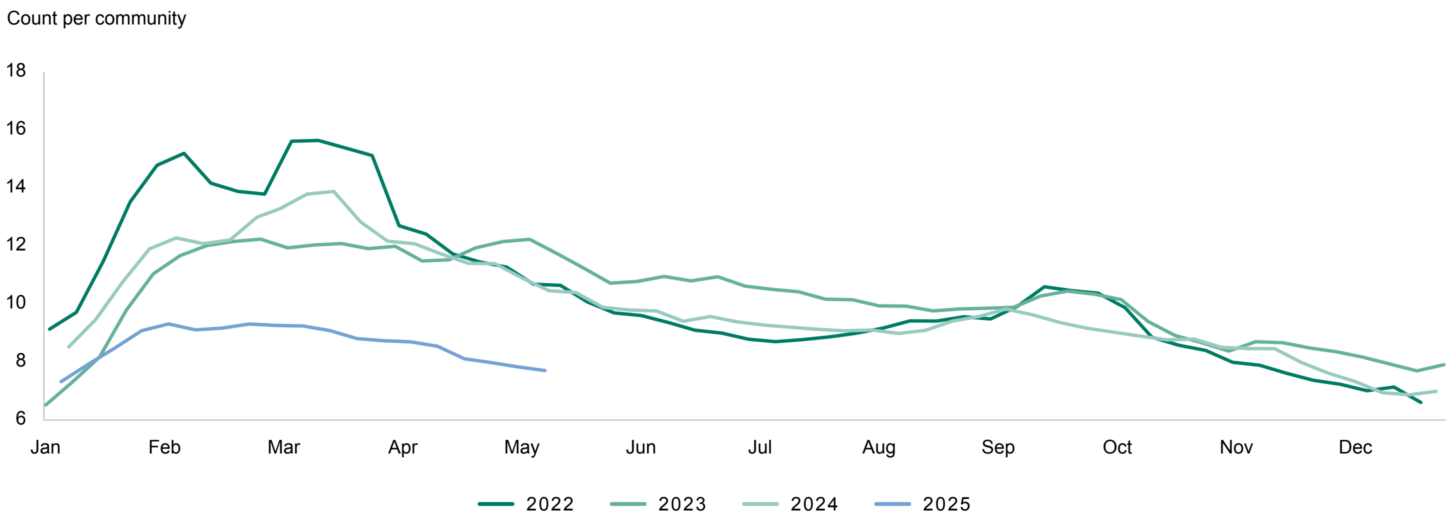
If Trump reverses on tariffs, the downward pressure on tourism may be somewhat mitigated. But it is still unlikely that we will see a boom in tourism any time soon.

Housing Demand Is Weakening Because of Higher Mortgage Rates

Weekly data for homebuilder traffic (**Exhibit 15**) points to a weak spring selling season driven by mortgage rates near 7%, record-low consumer confidence, and a rising inventory of homes for sale.

Exhibit 15: The 2025 spring selling season is weaker than in previous years

Homebuilder traffic



Data as of May 11, 2025. Sources: Zonda, Apollo Chief Economist

> The US is the only country that is forecast to see a drop in international visitors in 2025.

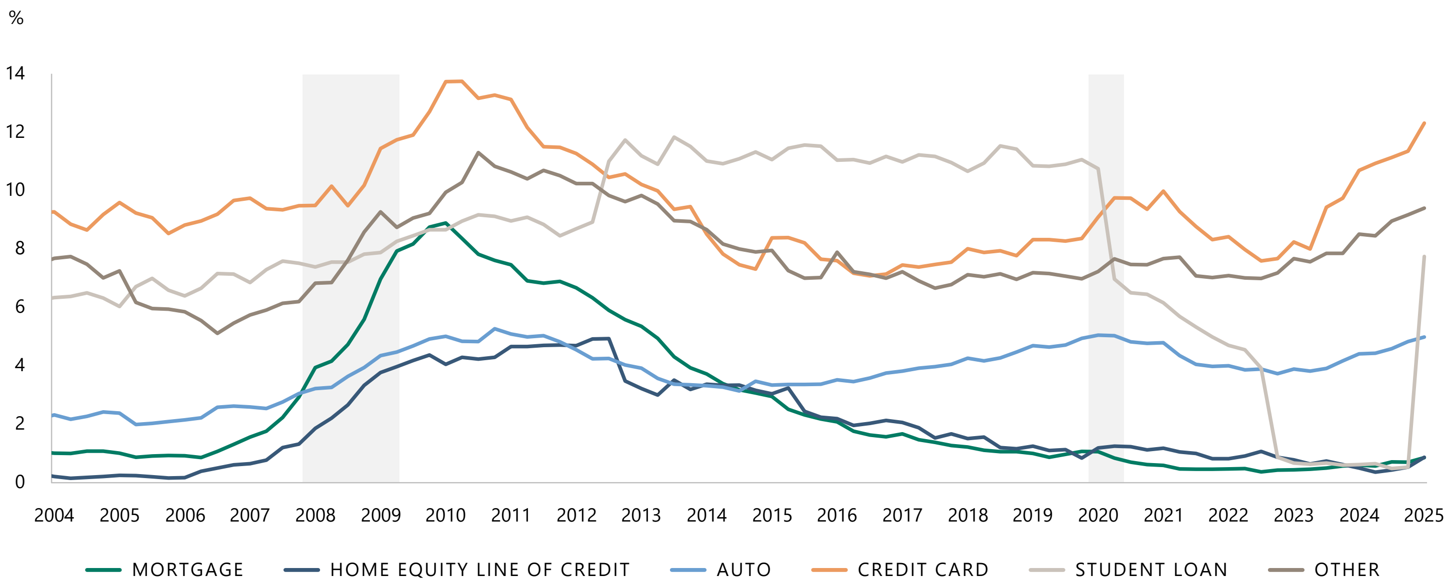
Student Loan Repayments

While tariffs are obviously top-of-mind, we feel obligated to remind readers about an issue that has nothing to do with any of the above, but, purely by coincidence, is happening in the background. Nine million student loan borrowers enjoyed a moratorium after President Biden gave them the opportunity to not pay back their student loans and have it not impact their credit scores.

As of early May, that reprieve was no longer, and a lack of student loan repayments will now impact credit scores (**Exhibit 16**). FICO scores could go down roughly 65 points on average, with up to 10% of US households facing a steep decline in their credit score.[6] This could impact their ability to get new loans to finance the purchase of a car, a house, or new furniture.

Exhibit 16: The pause on reporting delinquent federal student loans has ended

Percent of balance 90+ days delinquent



Data as of January 2025. Sources: Federal Reserve Bank of New York, Macrobond, Apollo Chief Economist

DOGE Laying off Government Workers

President Donald Trump created the Department of Government Efficiency (DOGE) in January 2025, tasking it with advising the White House on improving efficiency and reducing bureaucracy. Trump appointed Elon Musk to run DOGE, who at the time set at an ambitious cost-savings target of $2 trillion in annual savings.

As of this writing, DOGE has clocked just $150 billion in reductions, although estimates of his team's precise impact have fluctuated. Additionally, the department had laid off roughly 260,000 federal government employees as of the end of May. Musk has since left DOGE to focus on running his private enterprises, including Tesla and Space X.

Regardless of its precise impact, we see DOGE's cost-cutting as having a negative impact on the economic outlook due to continued uncertainty with government workforce reductions.

[6] See https://6abc.com/post/student-loan-borrowers-default-could-see-credit-scores-plummet/16369131/

Capex Outlook: Down

In our last outlook, we said the US economy was "firing on all cylinders." Today, those thrusters are in reverse. Things are not looking particularly great at the moment. Setting politics aside, let's just look at what has happened to corporate capex spending in recent years.

Exhibit 17 shows corporate capex plans, both for large businesses (CEO Economic Outlook Survey) and small business (NFIB). Under Trump 1.0, we had a huge boom in capital expenditures. Businesses were spending a lot of money because we had tax cuts, deregulation, and political support for increased energy production. It was all very bullish for the economy.

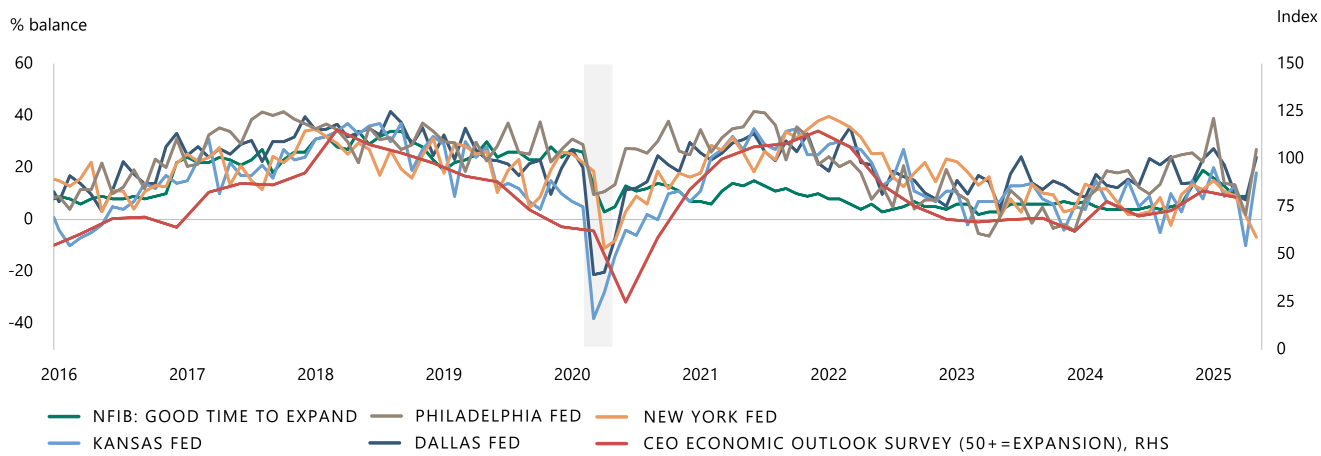
Under Biden, capex sort of went sideways. And then, when Trump won reelection, we saw an increase in capex plans in December and January of this year. The expectation was that we would see more tax cuts, more deregulation, and lower energy prices. But that changed dramatically when the trade war began. Corporate capex spending plans have been quite erratic since.

Inflation Outlook: Up

The last part of this discussion is about the prices companies are paying for inputs into their production (**Exhibit 18**) and the prices paid by consumers at the register. Both are rising.

Exhibit 17: Corporate capex spending plans have been erratic since the start of the year

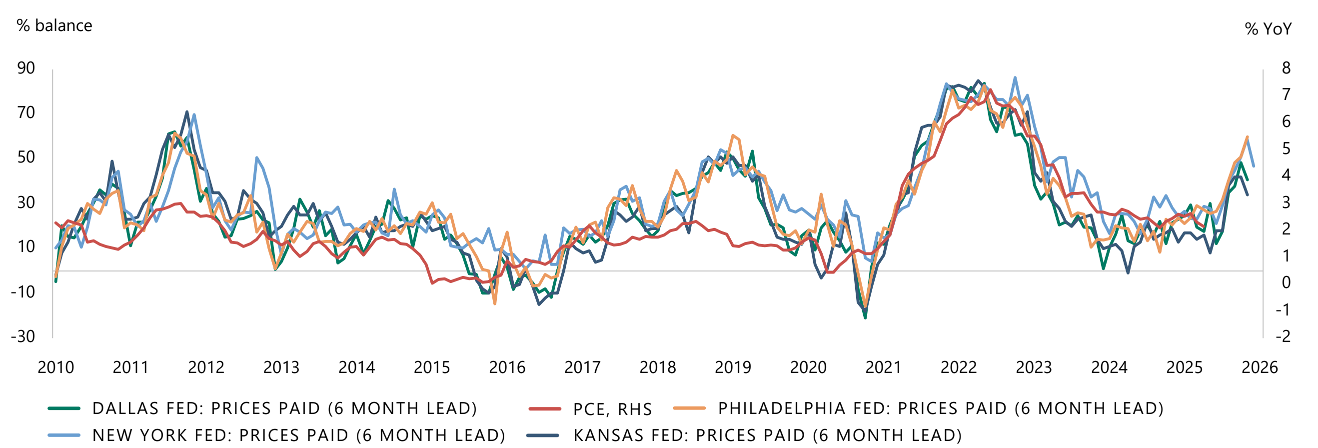
US corporate capex plans



Data as of May 2025. Sources: National Federation of Independent Business, Federal Reserve Bank of Dallas, Federal Reserve Bank of Kansas City, Federal Reserve Bank of New York, Federal Reserve Bank of Philadelphia, Business Roundtable, Macrobond, Apollo Chief Economist
Note: % balance refers to the balance of companies reporting increases, decreases or no change for capex plans.

Exhibit 18: Tariffs have led to upward pressure on PCE inflation

Fed manufacturing surveys prices paid vs PCE



Data as of May 2025. Sources: Federal Reserve Bank of Dallas, Federal Reserve Bank of Kansas City, Federal Reserve Bank of New York, Federal Reserve Bank of Philadelphia, US Bureau of Economic Analysis (BEA), Macrobond, Apollo Chief Economist
Note: % balance refers to the balance of companies reporting increases, decreases or no change for prices paid.

When the Federal Reserve Bank of Dallas asked firms what actions they were taking in response to higher tariffs (**Exhibit 19**), the top response is that they are passing cost increases through to consumers.

In this light, if there is any risk to inflation, it is to the upside. Our year-end inflation expectation has moved up to 3.0%, a significant increase from our pre-Trump-tariff estimate of 2.4%.

US Economic Outlook: Stagflation Risk

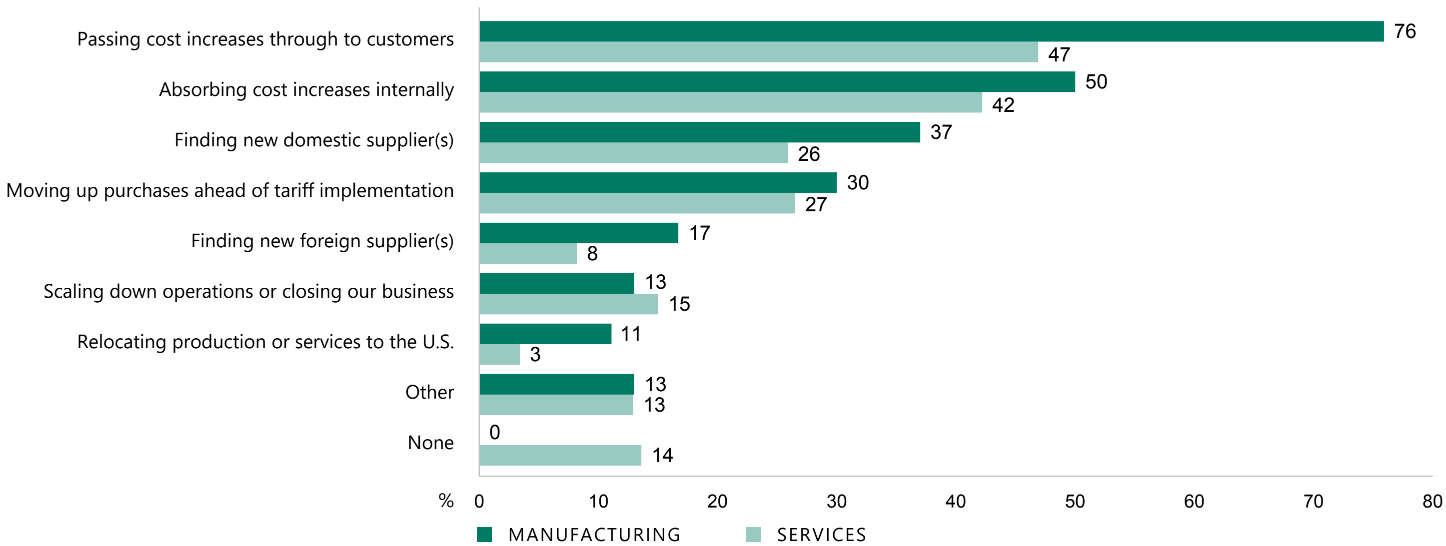
Tariffs hikes are stagflationary—they increase the probability of an economic slowdown while putting upward pressure on prices. This time is no different. Just six months ago, we concluded that there would be no recession in 2025. We now see a 25% chance of US recession over the next 12 months.

In June, Fed officials downgraded their estimates for economic growth this year while lifting their forecasts for unemployment and inflation. This is the consensus forecast for 2025: GDP will be lower, and inflation will be higher. That is the definition of stagflation (**Exhibit 20**).

Also: Even if we don't necessarily see two consecutive quarters of negative GDP growth (the classic definition of a recession), the overall economic impact of current policy will likely be—and feel—stagflationary. We expect just 1.2% GDP growth in 2025, and the unemployment rate to rise to 4.4%, and then to 5% or more in 2026.

Exhibit 19: Firms may pass their costs on to consumers

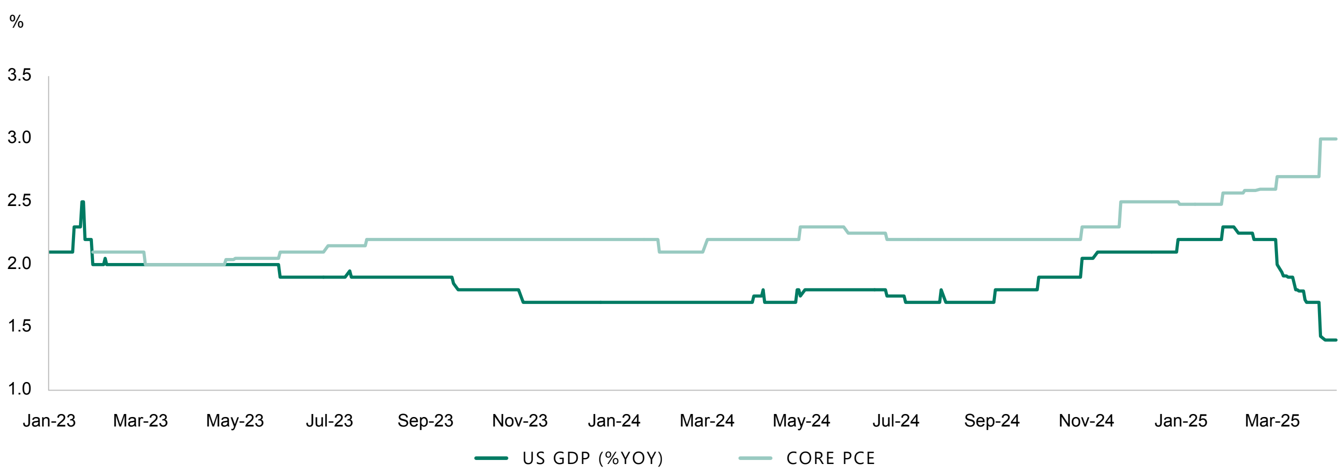
Actions firms are taking in response to higher tariffs (%)



Data as of May 2025. Sources: Federal Reserve Bank of Dallas, Apollo Chief Economist

Exhibit 20: Consensus forecasting GDP down, inflation up

Bloomberg consensus forecast for 2025



Data as of May 5, 2025. Sources: Bloomberg, Apollo Chief Economist

Global Economic Outlook: Weakening

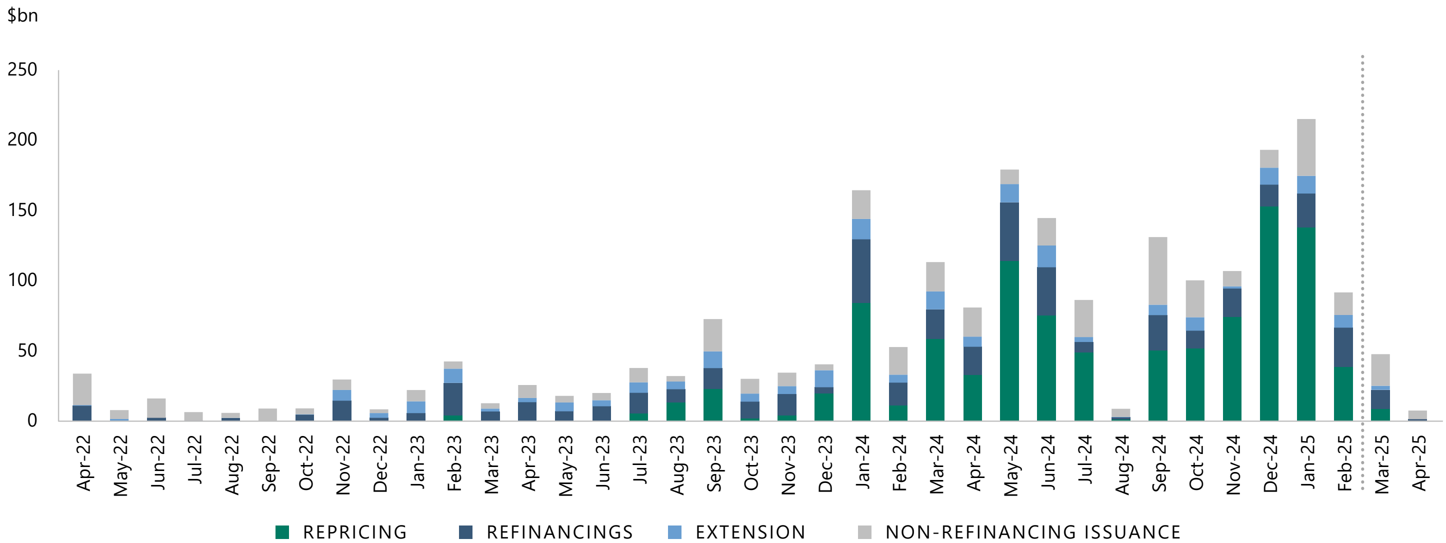
Higher US tariffs will also have an impact on the world economy in 2025, especially because the US is a net contributor to global aggregate demand. This is in contrast to the 1940s, when US tariffs were high, but the country ran a trade surplus due to its dominant industrial position, wartime production, and post-war reconstruction efforts abroad. We see global GDP growing 2.6% in 2025 against our pre-tariff expectations of 3%-plus.

Capital Markets Outlook: Mixed

All of the above have impacts on financial markets. In the wake of Trump's election victory, loan issuance was very high. Capital markets were exuberant. But with the rise in policy uncertainty, loan issuance has gone down (**Exhibit 21**). The IPO market wobbled (**Exhibit 22**) and M&A volumes fell sharply (**Exhibit 23**).

Exhibit 21: When policy uncertainty went up, loan issuance went down

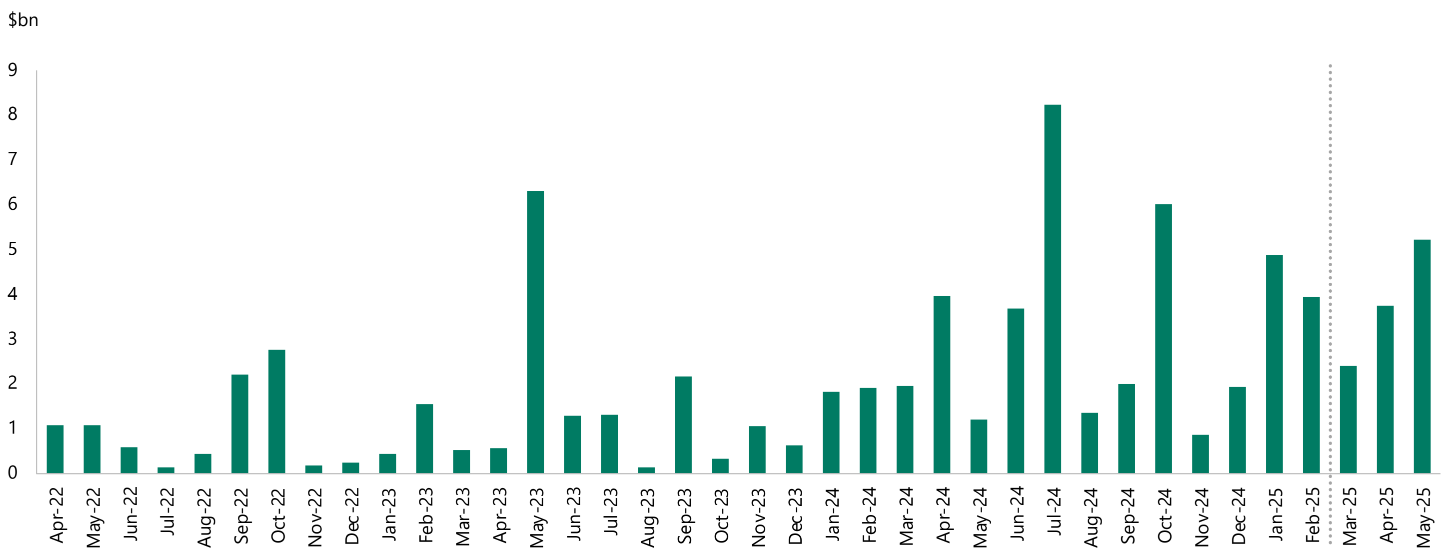
US institutional loan activity



Data as of April 2025. Note: Reflects repricings and extensions done via an amendment process only. Sources: Pitchbook LCD, Apollo Chief Economist

Exhibit 22: When policy uncertainty went up, IPO activity took a hit but rebounded

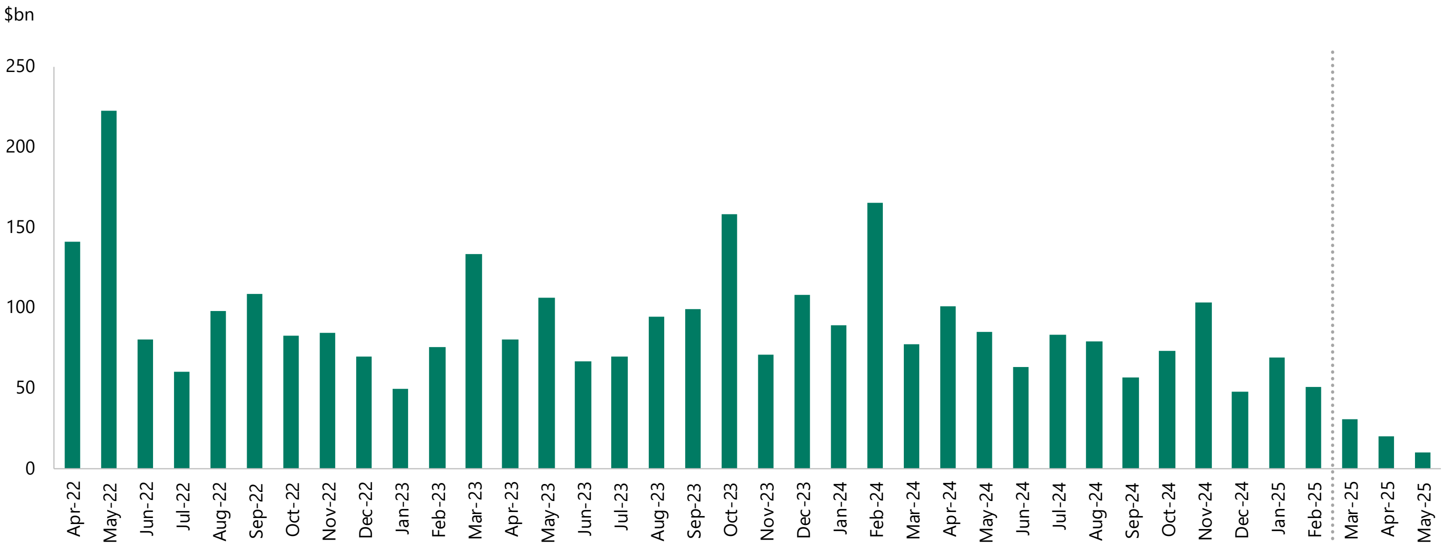
US IPO transaction value



Data as of May 2025. Note: Data shows completed IPO transactions. Sources: S&P CapitalIQ, Apollo Chief Economist

Exhibit 23: When policy uncertainty went up, M&A activity went down

US M&A transaction value



Data as of May 2025. Note: Data shows completed M&A transactions. Sources: S&P CapitalIQ, Apollo Chief Economist

From where we sit over at Apollo, one interesting result of the above is that private credit is having a moment. The broadly syndicated loan market is not functioning at full speed, and capital markets are also constrained. Private credit is stepping into the breach.

Rates Outlook

As of this writing, we see the Federal Reserve cutting rates only once in 2025, with a year-end fed funds-rate target range of 4.00% to 4.25%. We believe that Fed Chairman Jerome Powell will take a conservative approach to easing policy to safeguard against fears of runaway inflation.

Potential Investment Implications

What can this all mean to investment opportunities? We continue to believe that seniority in the capital structure and a sharp focus on businesses able to generate strong cash flows remain paramount.

We also believe that sectors with less impact from tariffs and the uncertainty around the macro environment—i.e., cable/telecom, healthcare, utilities/power, and technology—are preferable to those with higher potential negative impact, such as industrials, energy, and consumer/retail (**Exhibit 24**).

Exhibit 24: Tariffs impact different sectors differently

Sources: Bloomberg, Apollo Chief Economist

If, for example, one were running a long-short trading strategy around tariffs, you could argue that they would be short those sectors to the right—consumer goods makers, retailers, even energy. Energy is generally at risk because we trade a lot of energy with different countries and tariffs will be disruptive to that trade. Industrials are also at risk. Why? Because 37% of imports from China[7] go to industrial customers—auto parts components, airplane components, washing machine components. Why is media on the right? Because digital advertising is the first thing to decline in a recession.

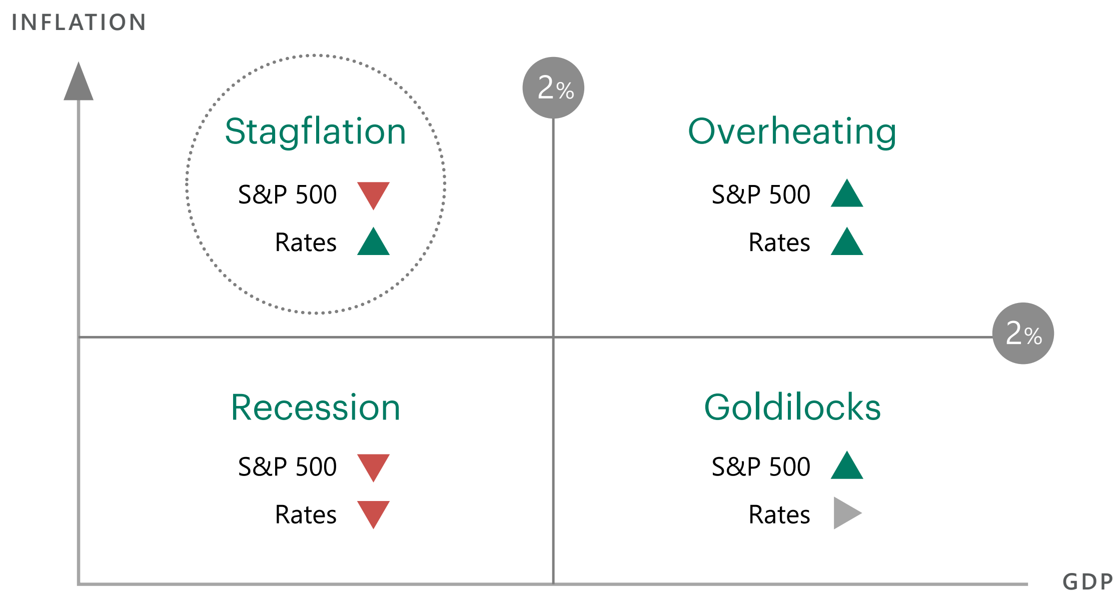
Long positions in this strategy would be on the left. Tariffs don't really play into your need for healthcare. We will still get sick. (On the other hand, medical devices will be impacted.) Regarding cable and telecom, our mobile and internet subscriptions won't really be affected by tariffs. (Mobile phones themselves, on the other hand, will be.)

What can it all mean for investors? Consider four possible macroeconomic scenarios (**Exhibit 25**).

[7] Source: https://www.apolloacademy.com/how-are-imports-from-china-used-in-the-us/

Exhibit 25: It all depends on what quadrant you're in

Market performance under different macroeconomic scenarios



Source: Apollo Chief Economist

Goldilocks is a straightforward economic scenario. In this environment, risky assets, including the stock market, tend to do well because neither inflation nor interest rates are a problem. This is actually quite easy as an investor—just buy risky assets. In particular, the stock market will likely do well because you have high GDP and low inflation, and business is good.

Overheating is also quite straightforward. In this scenario, the S&P 500 goes up, but rates are higher for longer. An overheating GDP means high inflation. The consequence of that is that now you need to be up in quality. Higher rates bite on companies that have weak credit fundamentals, in particular those with low coverage ratios. If you're low in quality, you run the risk that companies will struggle if interest rates are higher for longer. Investor opportunities in this scenario are best found amid high quality credit—investment grade, first-lien senior-secured, top of the capital structure.

Recession is also a simple investment scenario, because here you could just buy long-term government bonds. Rates will decline in a recession, so buying long-term Treasuries, for example, could be an effective strategy.

But where are we today?

We are facing **Stagflation**, which has a unique combination of earnings going down and interest rates going up. We are quite worried about the overall economic outlook. But that does not mean we should be sitting on our hands. There are a number of things that we can do in the stagflation quadrant. In this type of environment, we believe three ideas could be considered.

First, keeping an eye out for quality. When rates are higher for longer, investment grade credit may provide opportunities. The same goes for high quality equities in public and/or private markets.

We would expect investors to be staying away from growth equity and growth credit, favoring higher-quality credits and companies with earnings to protect against the downside risk of a recession.

Short interest in small-cap companies is at the highest level seen in many years. This is not surprising as 40% of companies in the Russell 2000 have negative earnings, and middle market and small-cap companies could be hit by the triple whammy of higher tariffs, slower growth, and higher rates because of inflation staying higher for longer.

Second, considering dislocation funds, especially secondary funds, because speculation tends to be associated with volatility. In a time of stagflation, it's possible to buy distressed credit away from where it would normally be trading. In that scenario, you will often have distressed sellers as well. There tends to be a lot of private equity assets in secondary markets, with sellers selling not because they have a different view of the economic outlook, but because they're forced to do so.

Third, seeking out themes that are as far away from the trade war as possible. Those include infrastructure, data centers, climate, and energy transition. While mostly far away from the trade war, these sectors may nevertheless offer interesting entry points simply because of the turbulence in the market.

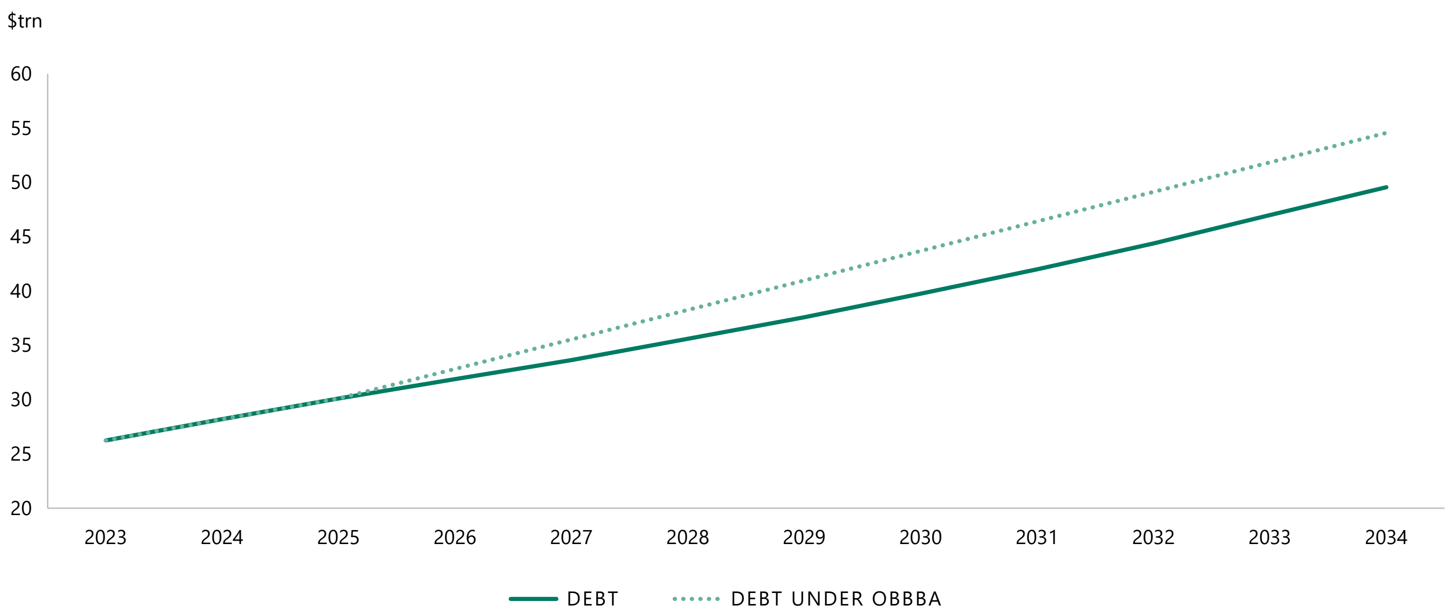
The X-Factor to Our Outlook: The Fiscal Deficit Issue

On May 22, the US Lower House passed the "One Big Beautiful Bill Act," or OBBBA, which will define the course of the US budget. The bill, as currently proposed, calls for significatnt tax cuts as well as spending cuts.

A preliminary analysis of an earlier version of the bill, by the non-partisan Congressional Budget Office, estimated that the legislation would add roughly $5 trillion to the national debt over the next decade, widening the budget deficit and increasing the country's debt-to-GDP ratio over time (**Exhibit 26**). If it passes the Senate and is signed by the President, the impact of the bill would be stimulative in the short run (via tax cuts) but could keep further upward pressure on rates and, therefore, the cost of servicing the US debt in the long run.

The fiscal deficit continues to be a major issue: The levels of debt that we're seeing in the government are totally unprecedented back to the year 1800. The fiscal risks are significant. We currently have debt to GDP at 100%. According to the CBO, that percentage will rise to 129% by 2034, and the fiscal challenges will be even bigger than they already are today.

Exhibit 26: Debt under the OBBBA is expected to increase to $55 trillion, or 129% of GDP, by 2034



Data as of June 2025. Sources: US Congressional Budget Office (CBO), Macrobond, Apollo Chief Economist

The Rest of the World

The rest of the world still holds a significant amount of US financial assets (**Exhibit 27**).

Why do they do that? Because when China sells more goods to the US than the US buys from China, China gets more dollars and invests those dollars in various assets. That's why the rest of the world owns $18.5 trillion in US equities—about 20% of the market. Foreigners also own about $7 trillion in Treasuries—about 30% of that market—and roughly $5 trillion in credit—also 30% of that market.

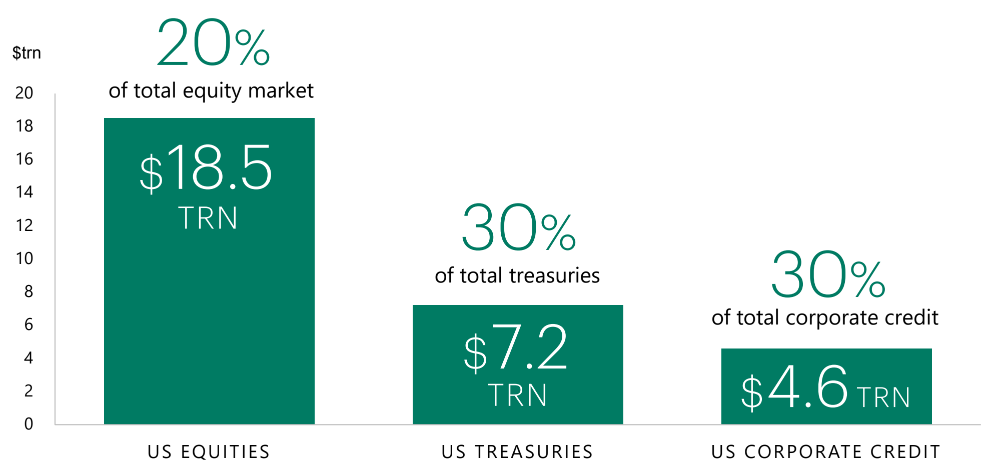
What's the concern here? If the rest of the world starts losing its appetite for US assets, they may begin to sell. At the very least, they may stop buying. Indirect bidding in Treasury auctions refers to bids submitted on behalf of foreign institutions. These bidders don't participate directly, but instead have their bids placed by intermediaries—hence "indirect." Looking at foreign participation in 30-year Treasury auctions (**Exhibit 28**) shows a downward trend in recent months.

Combining these two risks—the enormous fiscal challenges and the fact that the rest of the world holds a lot of our assets—that presents a unique vulnerability to the US economic system. We don't actually think that foreigners will sell US assets in a fire sale. We continue to think the US is exceptional, despite the Moody's downgrade, both in terms of our economy and capital markets. But the question of our future role in those global capital markets is an important one.

Looking ahead, the key issue for markets is to monitor the speed with which confidence is restored among consumers, corporates, and foreigners. Are trust and confidence going to rebound quickly, or are they going to take several quarters or several years? Today, we see few tailwinds and many headwinds—downside risks—to both confidence and, as a result, US economic growth.

Exhibit 27: Foreigners own a lot of US assets

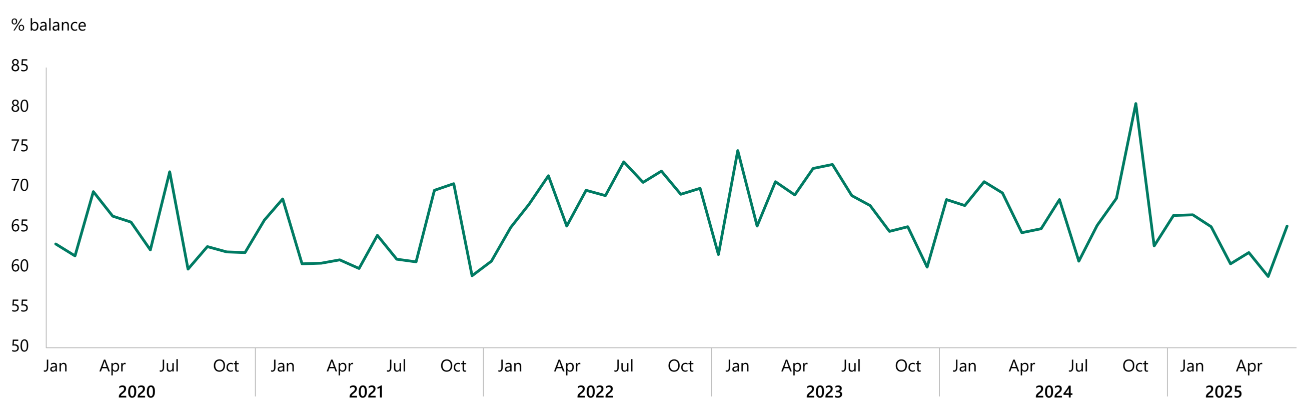
Total foreign holdings, by instrument



Data as of May 2025. Sources: Federal Reserve, Macrobond, Apollo Chief Economist

Exhibit 28: Foreign participation in Treasury auctions (indirect bidding) is trending down

US 30-year bonds bidder participation for % of indirect bidder amount accepted



Data as of June 1, 2025. Sources: Bloomberg, Macrobond, Apollo Chief Economist

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Torsten Sløk joined Apollo in August 2020 as Chief Economist, and he leads Apollo's macroeconomic and market analysis across the platform. He is also an Apollo Partner.

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