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MARKET INSIGHTS

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THE NEW NEXUS OF POWER:

Debt, deals, and the dawning tech epoch

Prologue: The new economic reset

For decades, the American establishment clung to the gospel of globalization, open markets, cheap goods, and the promise of shared prosperity. Yet beneath the surface, this grand experiment hollowed out the nation's industrial heartland, eroded economic security, and fuelled a populist backlash that upended politics from Ohio to Washington. The opioid crisis, the decay of small towns, and the anger of those left behind are not mysterious—they are the predictable fallout of an economic order designed by and for elites, insulated from the consequences of their own policies.

But in 2025, the global reset brought an unexpected twist from north of the border. The surprise for many is how Mark Carney, a veteran central banker turned political outsider with strong capital market experience, decisively moved the Liberal Party and Canada back to the pragmatic centre. Carney, now prime minister, is not only reasserting Canada's independence amid U.S. trade threats but also embracing the nation's vast natural resources as a cornerstone for prosperity in the artificial intelligence (AI) age. In a world hungry for

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“ The factors which really constitute prosperity have not the remotest connection with military or naval power, all our political jargon notwithstanding. ”

- Norman Angell, *The Great Illusion* (1910)

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critical minerals, clean energy, and technological inputs, Canada's resource wealth is being recast as a strategic advantage, not a liability. Deals with U.S. President Donald Trump and Alberta Premier Danielle Smith will come sooner than many expect. The reductions of tariffs towards the U.S. in mid-April signal that Carney is pragmatic and understands the historical significance of the current structural adjustment process. While it is true that Carney's policies may reposition Canada towards a more central and globally integrated financial stance, thereby attracting international capital, I still find myself preferring the U.S. over Canada.

Now, as the post-Second World War order unravels, we face a crossroads. Economic nationalism is surging. Critical supply chains need to be on-shored. Demographics point to a secular bull market. AI is rewriting the rules. A new era of supply-side policies focused on deregulation, specifically in finance and energy—along with tax cuts—provides the foundation to keep the economy from slipping into a recession during this detox transition period. The old model, anchored by U.S.-dollar dominance and ever-deepening integration, has reached its breaking point—exposed by endless deficits, weaponized finance, and growing skepticism towards global institutions. Yes, the global economy needs to rebalance.

Yet, this is not a story of inevitable decline or retreat. U.S. exceptionalism is alive and well. It is the opening act of a generational pivot, one that will be shaped by technological innovation, new regional alliances, and the emergence of a multipolar world. The U.S., with its deep capital markets, technological leadership, and dynamic service sector, remains uniquely positioned to lead—if it has the courage to adapt. The coming reset will challenge entrenched interests and demand honest assessment, but it also offers the chance to build a more balanced, resilient, and prosperous future. The old order is ending. The real question is: who will shape what comes next?

President Trump's bold strategy: The world in structural flux

The global economy is being forced through a crucible of structural adjustment. The era of American financial dominance, easy capital, and the unchallenged petrodollar has fractured. In its place, a multipolar world is emerging, defined by transactional alliances, generational technological disruption, and the inescapable arithmetic of debt. The U.S., still the world's economic engine, now

grapples with the consequences of decades of fiscal profligacy just as it seeks to ride the crest of a new technological and demographic wave.

This new reality was on full display during Trump's whirlwind Middle East tour. The trip, less diplomatic mission and more commercial blitzkrieg plus geopolitical spectacle, yielded more than US\$2 trillion in deals, reflecting a world where economic alliances are no longer tethered to ideological alignment. This included a \$600 billion commitment from Saudi Arabia to U.S. tech and energy firms, Qatar's \$1.2 trillion economic pact, and \$200 billion in deals with the United Arab Emirates (U.A.E.).

But these were not the classic petrodollar bargains of the 1970s (notably, there was no explicit renewal of the 1974 petrodollar pact). Instead, the deals emphasize diversification—Saudi Arabia's investments in AI hubs, Qatar's 250-plane Boeing orders, and U.A.E.-backed carbon capture projects—as well as a broader structural shift. The Gulf states, once passive dollar-recycling petrostates, are now active architects of a multipolar order. This tacitly acknowledges the petrodollar's slow erosion, accelerated by BRICS¹ expansion and central bank gold acquisitions. The dollar remains dominant, but its monopoly is fracturing—a reality underscored by Saudi Arabia's inclusion of yuan-denominated oil trades in 2023. The old world of oil-for-dollars is giving way to a new world of technology-for-influence.

Trump's deals are as much about outfoxing China as they are about economic growth. The White House's willingness to lift restrictions on advanced semiconductor sales to Gulf partners is a direct play to keep these nations in the U.S. orbit, even as Beijing remains their biggest fossil-fuel customer. The administration's focus is clear: secure Gulf capital, ensure the petrodollar system remains intact, lock in American tech leadership, and ensure the U.S. remains the indispensable partner in the region's transformation.

Yet beneath the surface optimism lies a critical problem—the U.S.'s unsustainable debt trajectory. Moody's recent downgrade of U.S. sovereign debt—citing not just fiscal arithmetic but also political dysfunction—has sent tremors through global markets. The timing, coming as Trump's flagship supply-side bill was being debated in Congress, has fuelled accusations of political interference. While no serious voice denies the need for debt sustainability, the assumptions, timing, and motives behind the downgrade are hotly debated in Washington and on Wall Street.

¹ Organization of ten nations including Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Indonesia, Iran and the U.A.E.

The debt dilemma: Sustainability vs. political theatre

Over the past few years, we've been warning about the unsustainable fiscal situation and false narrative of economic growth. We correctly identified inflation as being misdiagnosed, with the U.S. Federal Reserve raising interest rates in response to supply shocks and excessive government spending, which has been hammering the interest rate-sensitive private sector. The warning was that, with interest payments on debt surpassing military spending, a reckoning was inevitable. Now, Moody's has finally downgraded U.S. debt as Trump's "Big, Beautiful Bill" negotiations are underway. As the saying goes, there are no coincidences.

Moody's recent downgrade of the U.S. credit rating from Aaa to Aa1 has thrust America's \$36 trillion debt into the spotlight. The agency cited "successive administrations' failure to address rising deficits and interest costs," projecting debt-to-gross domestic product (GDP) to hit 156 per cent by 2055. Yet the downgrade landed amid acute political friction: Trump's \$4 trillion supply-side "Big, Beautiful Bill" was initially met by Republicans splintering over fiscal priorities. Interest costs now consume 10 per cent of federal revenue and are set to double by 2035. With rates sticky at over four per cent, refinancing could soon eclipse defence spending. However, warning that deficits will balloon to nine per cent of GDP by 2035, while at the same time ignoring revenue gains from tariffs or the cost savings from DOGE, does hint at a less than objective analysis.

The White House dismissed Moody's decision as "politically timed," while economists warn the downgrade may raise borrowing costs by 30–50 basis points. The core contention is not whether debt must be made sustainable—everyone agrees it must—but how and when. Trump's team champions supply-side reforms—tax cuts, deregulation, and AI-driven growth—to inflate away debt. Critics argue this ignores structural drivers: entitlement programs and a tax code that shrank revenue to 16.5 per cent of GDP.

History offers a proven escape route. After the Second World War, the U.S. reduced its debt-to-GDP ratio from 125 per cent to 35 per cent by 1974 through a combination of growth, primary surpluses, and financial repression—a policy of capping interest rates below inflation to erode debt burdens. Real interest rates averaged negative three per cent during this period, allowing the U.S. Treasury to deleverage without austerity. Today's Federal Reserve has rejected this wisdom. Instead, it has allowed real

rates to hover near two per cent, prioritizing theoretical inflation guards over pragmatic debt management. We are currently in a transition period similar to coming out of the Second World War—a growth scare should be expected, but no recession.

The Fed: From solution to problem

The U.S. fiscal outlook is perilous, and the Federal Reserve's recent policies threaten to worsen the crisis. Once praised for stability, the Federal Reserve now appears to exacerbate the very risks it aimed to mitigate. With the federal funds rate at 4.25–4.5 per cent, well above the estimated natural rate (r^*) of 2.75 per cent, the central bank is late to adjust and is tightening into a slowing economy, risking a full-blown fiscal crisis.

Despite clear signals—cooling inflation, a softening labour market, and negative GDP growth—the Federal Reserve remains stubbornly restrictive, ignoring historical lessons that high debt can coexist with growth if policy is appropriately calibrated. Interest rate hikes since 2021 swung from underreaction to overcorrection, culminating in an abrupt freeze in late 2024 amid mounting uncertainty.

The May 2025 statement epitomizes this inertia: acknowledging risks but refusing to pivot, even as GDP contracts and core inflation approaches target levels. This rigidity risks deepening the debt crisis—federal debt at 125 per cent of GDP and interest costs consuming 10 per cent of revenue mean every additional basis point of rate tightness adds billions in borrowing costs, fuelling a dangerous fiscal spiral. Moody's recent downgrade underscores these vulnerabilities.

Adding to the concern, inflation metrics themselves suggest the Federal Reserve's policies are contributing to the problem. Shelter costs now account for nearly 60 per cent of the Consumer Price Index (CPI), and are heavily influenced by the central bank's aggressive rate hikes. These higher rates have inflated mortgage costs and housing prices, further fuelling shelter inflation. Meanwhile, the job market is only marginally balanced; the number of unemployed for 27 weeks or more continues to rise, indicating underlying weakness rather than strength.

At best, the Federal Reserve should be at its estimated natural rate (r^*), but due to lags in monetary policy effects—often exceeding two years—it is significantly behind the curve. This delay ensures the central bank is effectively shooting itself in the foot, tightening into a weakening economy and risking a self-inflicted downturn.

Critically, the Federal Reserve's inaction raises questions: Is this incompetence, or political bias? The framework review, criticized by former central bankers, seems overly rigid, prioritizing hypothetical inflation fears over tangible fiscal stability. With escalating trade tensions and fiscal disputes under the Trump administration, there's suspicion that the Federal Reserve is overcompensating with hawkish rhetoric to avoid appearing lenient.

In sum, the Federal Reserve is late, overly cautious, and out of sync with a slowing, increasingly deflationary environment. We are entering a period of sluggish growth and rising global liquidity—a necessary transition, but one that demands more nuanced, timely policy responses.

Comparing the 2025 correction to the late 1990s

The S&P 500's 19.7 per cent peak-to-trough correction in early 2025, triggered by Trump's tariff threats, invites comparison to the 1998 Long-Term Capital Management (LTCM) crisis and the Asian Financial Crisis of 1997–98. Both eras saw sharp selloffs, but their causes, resolutions, and implications for long-term growth reveal critical lessons.

The 2025 correction was a policy shock, not a structural failure. When Trump announced 10 per cent global tariffs on April 2, markets recoiled at the spectre of a trade war. The S&P 500 plummeted 10.5 per cent in two days—its fifth worst two-day drop since 1950—and volatility (VIX) spiked to 45.31. By contrast, the 1998 LTCM crisis stemmed from financial leverage and geopolitical contagion. Russia's debt default in August 1998 triggered a liquidity crunch that erased 19 per cent of the S&P 500's value over three months.

The speed of these collapses differed starkly. In 2025, algorithmic trading and retail panic accelerated the selloff, compressing into weeks what took months in 1998. Yet the rebound was equally swift: the S&P 500 recovered almost 14 per cent within a month of its April low, versus a three-month slog post-LTCM. This reflects modern markets' liquidity depth—a \$9 trillion pool of private credit and institutional capital that acts as a shock absorber.

Both corrections exposed vulnerabilities, but their sectoral footprints diverged. The 1998 crisis hit financials hardest, as banks faced \$3–5 billion in LTCM-linked losses. The 2025 selloff was broad-based, with technology stocks falling about 30 per cent peak-to-trough and even defensive sectors like utilities and consumer staples falling 12–15 per cent. However, the

strongest rebound was also seen in the tech sector as investors shifted their focus back to the narrative of exceptional spending on AI infrastructure—a dominant theme that was further supported by Nvidia's earnings beat in the last week of May.

Demographics as destiny

Beneath these macroeconomic shifts lies a demographic tide. Millennials are entering family formation in a world where AI personal assistants curate education, CRISPR² therapies extend lifespans, and hybrid work erases geographic boundaries. Their economic impact—as consumers, investors, workers, and innovators—will dwarf the boomer wave, reshaping sectors from health care to real estate. This trend is the underlying force of a secular bull market until the next decade. Moreover, investors should recognize boomers went through this phase in the 1990s. Yes, history rhymes.

The peace dividend paradox: From the fall of the U.S.S.R. to Trump's new bet

Trump's critics warn that sidelining conflicts like Gaza and Ukraine risks long-term instability, but his team argues that economic strength and technological leadership offer a more lasting security.

This echoes the “peace dividend” concept of the 1990s when the collapse of the Soviet Union allowed the U.S. and Europe to cut defence spending and redirect resources to growth and innovation. That dividend, however, proved temporary as new threats emerged and military budgets rose again.

Trump is now pursuing a peace dividend for the AI era. His strategy: reduce defence spending by making global security depend on economic interdependence and American technological dominance. While the Congressional Budget Office, Moody's, and Wall Street obsess over debt and defence outlays, they largely ignore the fiscal potential of a true peace dividend.

By embedding Gulf capital in U.S. tech and energy and anchoring global supply chains in American innovation, Trump aims to make prosperity itself a deterrent to conflict. If major powers are invested in the U.S.-led system, open war becomes less likely, allowing for real defence reductions without sacrificing security. Whether this new peace dividend will endure where the last one faded remains Trump's bold wager—and one that traditional analysts have yet to price in.

² Clustered Regularly Interspaced Short Palindromic Repeats is a technology that allows for DNA editing.

Investor's playbook: Calm, conviction, and the long game

Amid the market panic of early April 2025, as the S&P 500 plunged 19.7 per cent and pundits prophesied economic collapse, a singular mantra prevailed for seasoned investors: "Stay calm. This is the playbook." The Trump administration's tariff gambit, while disruptive, was never a death knell for growth but a negotiating tactic straight from *The Art of the Deal*. As markets churned, the fundamentals of a secular bull market—demographic vitality, technological disruption, and structural realignment—remained intact. The path to 7,000 is not derailed; it is being recalibrated.

Trump's tariff announcement, though jarring, followed a familiar script—maximalist demands to anchor negotiations, followed by strategic concessions. The 90-day tariff suspension, paired with backchannel assurances to Beijing and Brussels, mirrored his 2018–2019 trade war playbook. Then, as now, the goal was not economic suicide but leverage, forcing trading partners to the table on U.S. terms.

The critical difference in 2025 lies in the stakes. With AI supremacy and energy transition hanging in the balance, the administration is not merely haggling over steel and soybeans but redrawing supply chains for the 21st century. Yes, the post-Second World War era needs to structurally change. In Trump's new multipolar world, a \$600 billion Saudi tech pact and Riyadh AI hub are early fruits of this strategy—securing capital and partnerships to offset Chinese dominance in critical sectors.

Conclusion: The decade of adaptation

The 2020s will reward those who embrace structural change over short-term noise. As in the 1990s, the intersection of demographics, technology, and policy audacity will forge new fortunes, and new paradigms. The S&P 500 7,000 target is not a static number but a symbol of this transition—a future where growth is engineered, not inherited.

But investors need to prepare for many surprising twists to our journey. Expecting a drawdown of 10 per cent each year is the norm. This is not a market for the faint of heart, but for those who understand that volatility is the price of progress. As Trump himself might say: "We're not just making deals. We're making history." For investors, the choice is clear: adapt or abdicate. For now, it's risk on until the mid-terms.

Epilogue: The Canadian angle – Resourceful adaptation

For Canada, these global shifts are not a distant drama, they are a direct test. As the U.S. redraws supply chains and forges new tech alliances, Canada faces a stark choice: adapt, or risk irrelevance. The Canadian economy, long reliant on U.S. demand and commodity exports, must now compete for capital, talent, and technological relevance in a world where proximity is no longer enough. The surprise for many—Canada is moving back to the centre, embracing its natural resources, and renewing and strengthening its economic integration with the U.S. For investors, expect global capital to flow back to Canada.

Canadian policymakers can no longer count on the old playbook of riding America's coattails. The AI revolution, the energy transition, and the fracturing of global trade demand a new strategy—one that leverages Canada's strengths in resources, education, and immigration—but also invests aggressively in next-generation industries. For Canadian investors, the message is even clearer: diversify beyond the banks, pipelines and railroads, embrace volatility, and recognize that the next decade will reward those who think globally and act boldly.

The new nexus of power is being forged in real time. Canada's place on that nexus will be determined not by geography, but by vision and resolve.

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