



2H2025 OUTLOOK

# Peak Policy Uncertainty

FOR INSTITUTIONAL USE ONLY

INNOVATORETFS.COM | 800.208.5212



## Executive Summary: Peak Policy Uncertainty



Policy uncertainty dominated markets in the first half of 2025 (“1H 2025”), with a whirlwind of headlines around tariffs, tax cuts, and fiscal stimulus creating significant noise for investors. As we move into the second half of 2025 (“2H 2025” or “2H”), we believe policy uncertainty is peaking, with fewer major legislative catalysts remaining on the near-term docket.



In our view, the recently passed House reconciliation bill—dubbed the “Big Beautiful Bill”—adds significant fuel to an already deteriorating fiscal picture. The U.S. is on track for a ~\$2T deficit in FY2025, with estimates suggesting the bill could add another \$3.3–\$5.2T to the national debt over the next decade.



As debt levels rise, so do interest payments, which have nearly doubled since pre-pandemic levels. Rather than a sudden crisis, we expect these pressures to build gradually, showing up in stickier inflation, rising Treasury risk premiums, and deteriorating investor confidence.



In this environment, we believe investors should prepare for a potential reacceleration of inflation and continued rate volatility. We favor reducing long-duration fixed income exposure, cautiously increasing equities, and leaning into alternative stores of value like gold and Bitcoin.



While long-term U.S. outperformance has shaped investor biases, leadership rotates in cycles. If the current international equity outperformance regime extends to the median historical length, they could maintain leadership for another 12–18 months.



A key catalyst has been the narrowing of forward earnings growth expectations, with Europe, Australasia, and the Far East (“EAFE”) and emerging markets (“EM”) catching up to the U.S. after starting the year at a sharp disadvantage. Policy coordination and structural tailwinds suggest the trajectory outside the U.S. may now be more favorable.



Help inflation proof low risk dollars by tying them to the upside of the equity market. Reduce the reliance on rates for risk management as higher inflation poses the threat of higher yields.

## BALT

*Innovator Defined Wealth Shield ETF*

BALT offers upside exposure to the S&P 500 ETF up to a quarterly cap of 2.4% and a built-in 20% buffer against losses.

## ZJUL

*Innovator Equity Defined Protection ETF® - 1 Year July*

Offers upside exposure to the S&P 500 ETF up to a cap of 7.0%, while seeking to provide 100% downside protection, before fees and expenses.

## QBF

*Innovator Uncapped Bitcoin 20 Floor ETF®*

Offers uncapped upside exposure to Bitcoin price returns with an upside participation rate of 74% and a built in, quarterly floor against losses over 20%.

## Peak Policy Uncertainty: What Comes Next?

Policy headlines out of Washington have dominated market sentiment through the first half of 2025. From new tariffs and sweeping tax cut proposals to unpredictable commentary from President Trump and even Elon Musk, investors have been whipsawed trying to assess the net effect of a flurry of activity coming out of the administration.

As we look ahead to the second half of the year, we believe policy uncertainty is nearing its peak. Beyond ongoing tariff negotiations and the finalization of the House reconciliation bill, the Republican agenda appears relatively thin. While policy impacts will still ripple through markets, much of the initial shock factor is likely behind us.

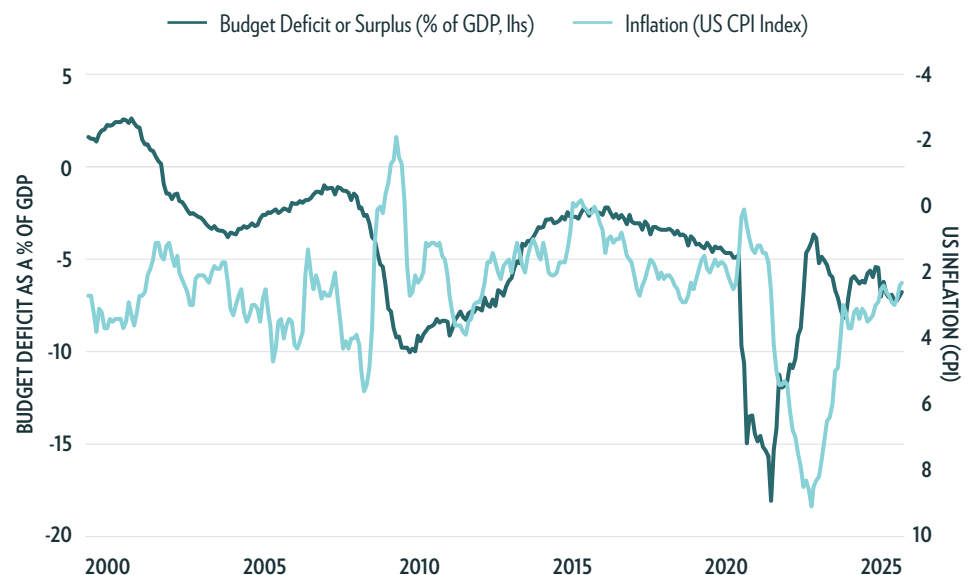
The key question now is: what is the lasting effect of these policies—particularly the fiscal expansion—on markets and portfolios?

## The House Reconciliation Bill: A Tipping Point for the Fiscal Picture

There's nothing new about the U.S. running deficits—but the pace and scale of deterioration is alarming. For fiscal year 2025, the federal government is projected to run a \$2 trillion deficit, representing more than 6% of GDP. That's in line with levels last seen during the depths of the 2008–2009 financial crisis—but with one major difference: today, unemployment is near 4%.

This is the fiscal backdrop as we head into the passage of what President Trump has dubbed the “Big Beautiful Bill.”

### BUDGET DEFICIT INCREASING DESPITE RECORD LOW UNEMPLOYMENT



Sources: Bloomberg, Innovator. LHS = U.S. Budget Deficit (-) or Surplus (+) as a percentage of Gross Domestic Product (“GDP”). RHS = U.S. Consumer Price Index (“CPI”) 12-month percentage change. Data from 12/31/1999 to 4/30/2025.



“

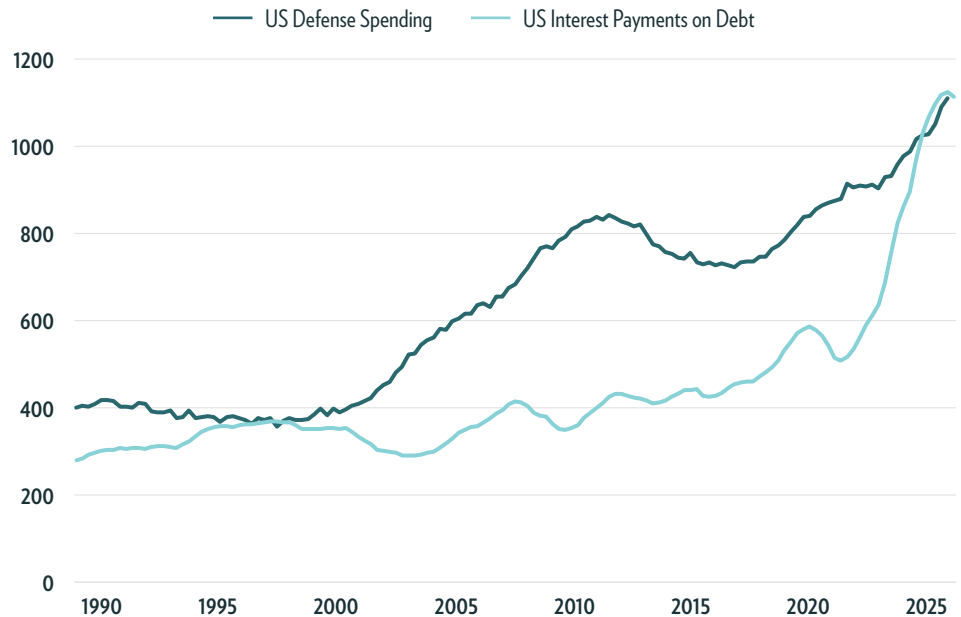
*“I have come to the perhaps obvious conclusion that accelerating GDP growth is essential. DOGE has and will do great work to postpone the day of bankruptcy of America, but the profligacy of government means that only radical improvements in productivity can save our country.”*

-Elon Musk

Estimates from the Committee for a Responsible Federal Budget (“CRFB”) suggest the bill could add \$3.3 trillion (6.9% of GDP) to U.S. debt over the next decade<sup>1</sup>—or as much as \$5.2 trillion if provisions are made permanent. The resulting increase in annual interest expense could range from \$580 billion to \$750 billion.

While many investors continue to ask when U.S. debt levels become problematic, we believe the compounding effect of interest payments is accelerating the timeline. Interest costs have already jumped from ~\$600 billion pre-pandemic to ~\$1.3 trillion today—a staggering increase.

## US INTEREST PAYMENTS ON DEBT VS DEFENSE SPENDING



Source: Bloomberg, Innovator. US Defense Spending = GDP\$DEF Index; US Interest Payments on Debt = FGGCRINPY Index. Data from 1/1/1990 to 3/31/2025.

Rather than a sudden crisis, we believe the fiscal reckoning is likely to unfold gradually, and through several key channels:



Sticky inflation and structurally higher bond yields (with inflation likely re-accelerating to 3-3.5% by late 2025).



Rising risk premiums on U.S. Treasuries.



Diminishing investor confidence, driven by runaway deficits, tax cuts, and ongoing political polarization.

**That said, we do see a silver lining.** The reconciliation bill’s fiscal impulse should support positive GDP growth in the near term, with the CBO projecting the bill would increase real GDP to 0.9%<sup>3</sup>—acting as a counterweight to the drag from higher rates and policy uncertainty.



## Tariffs: The “Beautiful” Burden

We’re in the late stages of a 90-day pause on reciprocal tariffs, but the ultimate outcome remains fluid. While there’s potential for partial rollbacks and deal-making, especially with key allies, we believe the post-negotiation landscape will likely feature materially higher tariffs, particularly against China.

Despite market hopes for full-scale tariff rollbacks, we believe the end game is clear: a more protectionist, production-focused regime, with tariff rates reaching levels not seen in a century. The goal, as articulated by the administration, is a revitalization of U.S. manufacturing—not free trade.

President Trump has repeatedly framed tariffs as “the most beautiful word in the dictionary”—and we believe his conviction on this front should not be underestimated.

“

*“The most beautiful word in the entire dictionary of words is the word tariff...I love tariffs. I think they are beautiful. It’s gonna make us rich.”*

-Donald Trump

“

*“We have been ripped off for decades by nearly every country on Earth, and we will not let that happen any longer. Other countries have used tariffs against us for decades, and now it’s our turn to start using them against those other countries.”*

-Donald Trump

“

*“The United States of America is going to take back a lot of what was stolen from it by other countries and, frankly, by incompetent U.S. leadership. We’re going to take back our wealth, and we’re going to take back a lot of the companies that left.”*

-Donald Trump

If the effective tariff rate settles around 13%, as we believe is reasonable, the drag on the U.S. economy could be meaningful. In isolation, that level of protectionism could:



Reduce household incomes



Squeeze corporate margins



Increase unemployment



Shave 0.5%–1.0% off GDP, according to various economic models

We are already seeing early evidence of these effects building. Trump’s tariffs amount to an average tax increase of nearly \$1,200 per US household in 2025<sup>2</sup>, while the weakening dollar compounds these pressures by making imported goods more expensive. (Immigration restrictions could remove 3.3 million construction workers and 470,000 agriculture workers from the labor force, driving compensation costs up 3.6% annually. If tariff rates reach the anticipated 13% level, these impacts will only intensify). However, tariffs do not exist in a vacuum. In our view, robust fiscal stimulus, tax relief, and continued deregulation should be more than enough to offset the near-term economic drag.



## Investment Implications

As policy uncertainty crests, the focus shifts to positioning for what comes next—particularly the inflationary effects of expansive fiscal policy and persistent trade frictions.

**We continue to view the following portfolio adjustments positively heading into 2H 2025:**

- » Reduce exposure to long-duration fixed income, given risks of higher yields and sticky inflation
- » Maintain a cautious but constructive stance on equities, with a preference for real assets and cyclical sectors
- » Lean into stores of value, including gold and Bitcoin, as hedges against further erosion in purchasing power

For investors looking to capitalize on continued momentum in international equities, while managing the historically elevated volatility.

### IBUF

*Innovator International Developed 10 Buffer ETF™ - Quarterly*

Designed to offer upside exposure to the MSCI EAFE ETF up to a quarterly cap of 2.89% with a downside buffer of 10%.

### EBUF

*Innovator Emerging Markets 10 Buffer ETF™ - Quarterly*

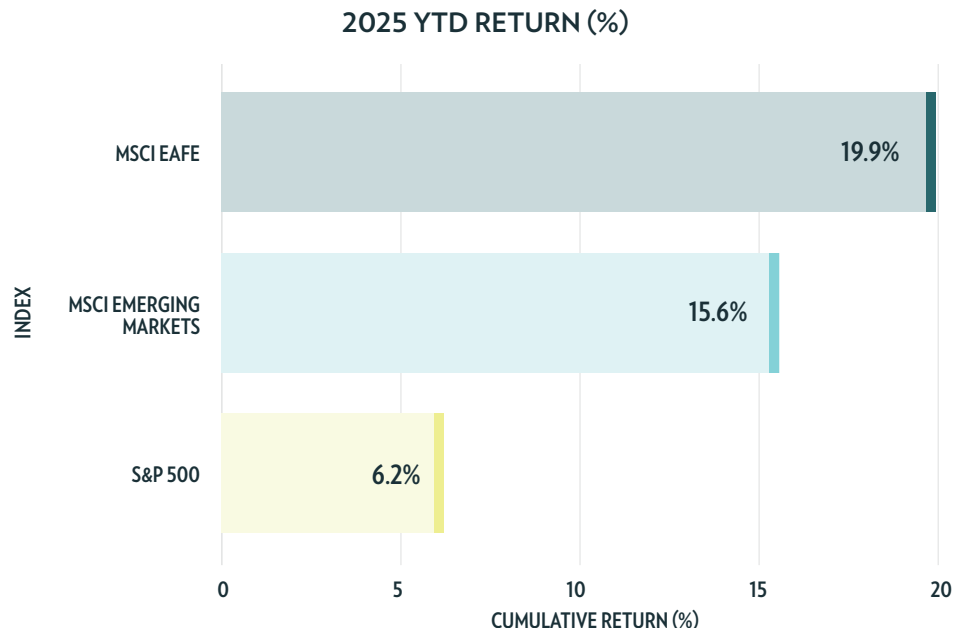
Designed to offer upside exposure to the MSCI Emerging Markets ETF up to a quarterly cap of 2.63% with a downside buffer of 10%.

## International Equities: A Quiet Comeback

Regional equity performance in the first half of 2025 has defied consensus expectations. The MSCI EAFE Index (“MSCI EAFE”) and MSCI Emerging Markets Index (“MSCI Emerging Markets”) have outpaced U.S. equities, catching many investors off guard. Coming into the year, sentiment around international markets was tepid at best—but a mix of accommodative central banks, rising defense budgets, and broad-based U.S. dollar weakness helped fuel a surprisingly strong start for ex-U.S. equities.

The question now is whether this relative strength can be sustained into the second half of the year. While fundamentals have improved in select regions, and valuations remain attractive relative to the U.S., we believe continued outperformance will likely require a sustained period of dollar softness, further easing from global central banks, or a significant shift in investor risk appetite.

Put simply, the bar for international outperformance has been raised.



Source: Bloomberg, Innovator. Data from 12/31/2024 - 6/30/2025. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.

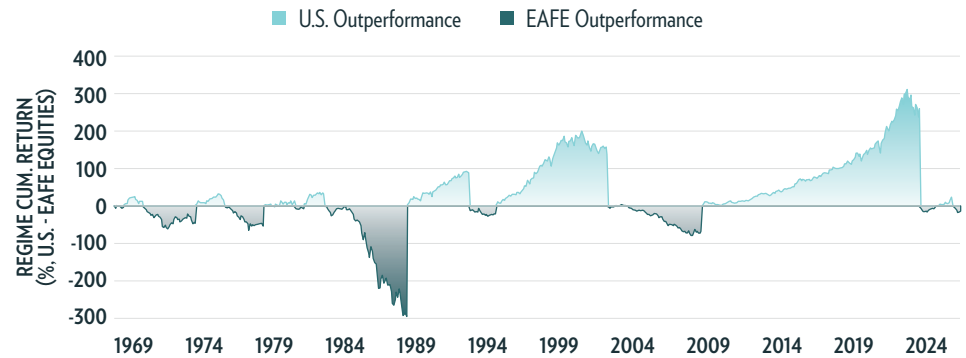




The prolonged run of U.S. equity outperformance since the Global Financial Crisis (“GFC”) led many investors to believe that the U.S. was the only game in town. Over nearly 15 years, U.S. equities outpaced their international counterparts by more than +260% on a cumulative basis. That extended regime shaped investor biases and portfolio positioning alike.

Historically, however, market leadership has been cyclical. The last meaningful international equity leadership phase—sandwiched between the Dot-com Bubble and the onset of the GFC—lasted just over six years, with the MSCI EAFE outperforming by +67%. When we evaluate historical cycles, no consistent pattern emerges in terms of the length or magnitude of regional outperformance. However, if the current EAFE-led regime were to extend to the median duration of past cycles, we could expect another 18 months of international equity leadership.

## A REGIME SHIFT IN THE MAKING?



### U.S. REGIMES

Start	End	Outperformance (%)	Length (years)
Aug 1970	Oct 1971	12.3	1.2
May 1975	Feb 1977	16.8	1.8
Oct 1979	Oct 1981	13.8	2.0
Jun 1982	Sep 1983	33.0	1.3
Mar 1989	Mar 1993	88.8	4.1
Jan 1995	Apr 2002	137.9	7.4
Jul 2008	Oct 2022	259.9	14.5
Nov 2023	Nov 2024	24.2	1.0

### EAFE REGIMES

Start	End	Outperformance (%)	Length (years)
Dec 1969	Jul 1970	3.3	0.6
Nov 1971	Apr 1975	46.0	3.5
Mar 1977	Sep 1979	53.3	2.5
Nov 1981	May 1982	6.8	0.5
Oct 1983	Feb 1989	294.5	5.4
Apr 1993	Dec 1994	20.6	1.7
May 2002	Jun 2008	66.7	6.2
Nov 2022	Oct 2023	4.9	0.9
Dec 2024	Jun 2025	13.6	0.5

Source: Bloomberg, Innovator. U.S. performance represented by the MSCI USA Index. EAFE performance represented by the MSCI EAFE Index. Monthly data from 12/31/1969 - 6/30/2025. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.

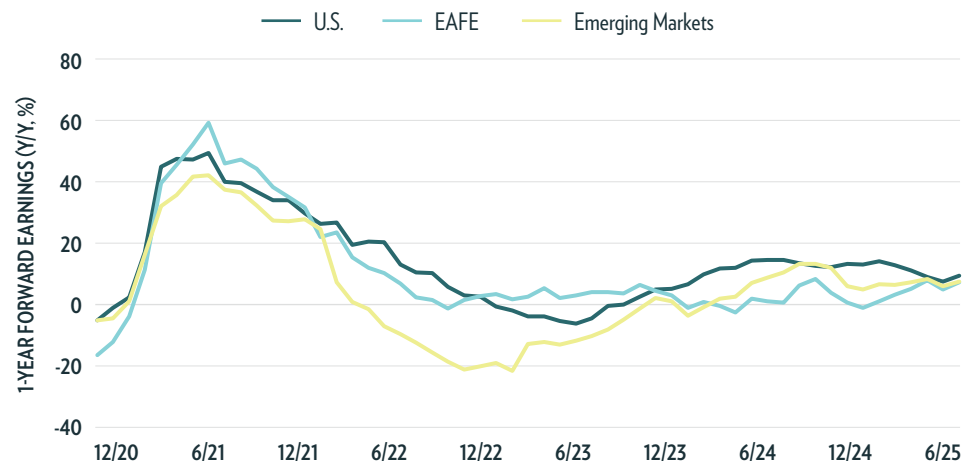
## What's Driving the Shift?

### 1 A Closing Earnings Gap

Entering 2025, forward earnings growth expectations were tilted sharply in favor of the U.S. S&P 500 earnings were projected to grow 13.2% versus -1.3% for MSCI EAFE and 4.7% for MSCI Emerging Markets. Six months later, that spread has narrowed meaningfully, with all regions converging around 7%, and momentum appears to be tilting in favor of ex-U.S. markets.

Part of that improvement can be traced to Europe's increased fiscal coordination, especially as the U.S. shifted more of the burden of Ukraine-related defense spending to European allies. The longer the conflict persists, the more likely it is that sustained defense spending acts as a tailwind for European equities.

## GLOBAL EARNINGS EXPECTATIONS CONVERGING



Source: Bloomberg, Innovator. Monthly data from 12/31/2019 - 6/30/2025. Year-over-year change in 1-year forward earnings expectations measured on the MSCI USA Index (U.S.), MSCI EAFE Index (EAFE) and the MSCI Emerging Markets Index (Emerging Markets). Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.



## 2 Easier Monetary Policy Outside the U.S.

While the Federal Reserve remains hesitant to cut rates amid persistent inflationary pressures and political scrutiny, central banks outside the U.S. have been more aggressive in easing policy.

- » The European Central Bank (ECB) has cut rates in seven consecutive meetings, bringing its main policy rate to 2.15%.
- » The People's Bank of China (PBOC) has lowered key rates, reduced the Required Reserve Ratio, and implemented targeted liquidity support alongside fiscal stimulus to boost domestic consumption.

This divergence in policy stances has created a more accommodative backdrop for international equities, particularly in regions where both monetary and fiscal levers are being pulled in tandem.

## 3 A Weaker U.S. Dollar

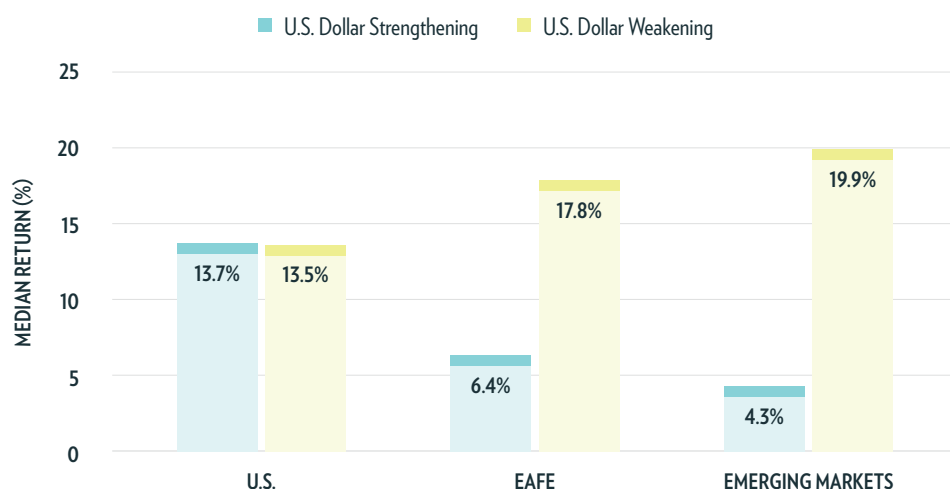
Another significant tailwind for ex-U.S. equities has been the sharp decline in the U.S. dollar. The U.S. Dollar Index (DXY) has fallen roughly 11% year-to-date, and structural pressures—including rising deficits, political polarization, and renewed inflation risks—suggest that further weakness may lie ahead.

**Historically, U.S. dollar cycles have played a powerful role in shaping relative regional returns:**

- » In periods of dollar weakness, U.S. investors holding international equities have enjoyed significant currency tailwinds—outperforming U.S. equities to the tune of 11.4% for the MSCI EAFE and 15.6 for the MSCI EM, at the median average.
- » Meanwhile, a falling dollar has historically eroded returns for foreign investors in U.S. markets. For example, while the S&P 500 has recovered from its earlier ~19% drawdown, currency-adjusted returns for Chinese investors are roughly flat (CNY), and European investors are still down about ~8% (EUR).

In our view, the combination of a weaker dollar and tighter U.S. monetary policy may discourage international capital flows into U.S. assets, while prompting greater allocation to international markets—particularly among global investors seeking diversification and more favorable currency exposure.

### EX-U.S. EQUITIES HAVE PERFORMED BETTER IN WEAKER U.S. DOLLAR ENVIRONMENTS



Source: Bloomberg, Innovator. Monthly data from 12/31/1969 - 6/30/2025 for U.S. equities (MSCI USA Index) and EAFE (MSCI EAFE Index). MSCI Emerging Market data from 12/31/1987 - 6/30/2025. Performance analyzed over 12-month rolling periods and has been stated in USD terms. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.



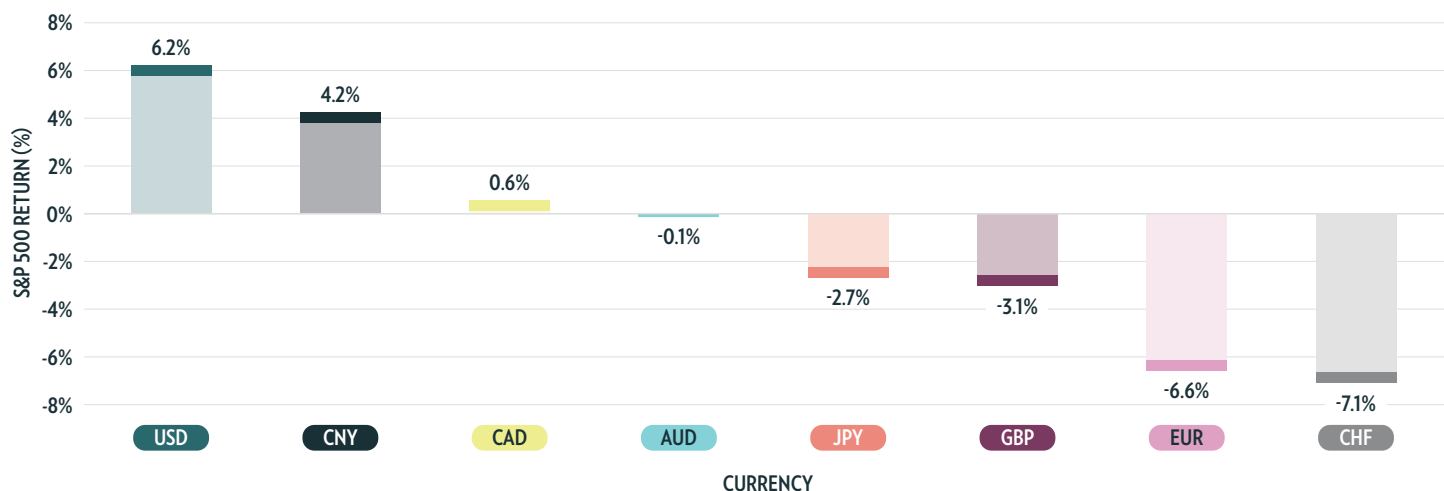


## Investment Implications

With supportive catalysts including more accommodative monetary policy, improving earnings momentum, structural fiscal support, and a softening dollar, we believe the case for international equities has meaningfully improved. While U.S. markets remain structurally strong, the return of regionally diversified leadership is no longer a theoretical discussion—it's already happening.

- » European equities stand to benefit from defense spending, monetary easing, and a closing earnings gap.
- » Emerging markets appear positioned to gain from China's fiscal-monetary coordination, progress in AI infrastructure, and supply chain realignment—with countries like India seem increasingly attractive to multinationals diversifying away from China.
- » China, now less reliant on exports to the U.S. than it was during Trump's first term, appears better positioned to weather renewed trade disruptions.

S&P 500 YTD RETURN BY CURRENCY (%)



Source: Bloomberg, Innovator. S&P 500 Index performance in the currency noted along the X-axis shown. YTD returns through 6/30/2025. Past performance is not necessarily indicative of future results. One cannot invest directly into an index. Index performance does not account for fees and expenses.



In short, unless investors have exceptionally high conviction in a renewed cycle of U.S. outperformance, we believe the case for increasing international equity exposure in 2H 2025 is strong—with both macro tailwinds and relative valuations supporting a more global approach.



<sup>1</sup> Committee for a Responsible Federal Budget (“CRFB”), *Adding Up the House Reconciliation Bill*. <https://tinyurl.com/3d44f4vs> [Retrieved 6/4/2025].

<sup>2</sup> Tax Foundation, *Trump Tariffs: Tracking the Economic Impact of the Trump Trade War*. <https://tinyurl.com/mr3mty68> [Retrieved 6/25/2025].

<sup>3</sup> The Congressional Budget Office (“CBO”) estimates that the bill would increase real GDP by 0.9% in 2025. CBO, H.R. 1, *One Big Beautiful Bill Act (Dynamic Estimate)*. <https://tinyurl.com/4bt538h4> [retrieved 7/7/2025].

The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets excluding the United States and Canada. The MSCI USA Index is designed to represent the performance of large and mid-cap segments of the U.S. equity market. The MSCI Emerging Markets Index (“MSCI EM”) is designed to represent the performance of large and mid-cap securities in emerging market countries. The U.S. Dollar Index consists of the geometric average of six currencies weighted against the U.S. dollar.

**The Funds have characteristics unlike many other traditional investment products and may not be suitable for all investors. For more information regarding whether an investment in a Fund is right for you, please see “Investor Suitability” in the prospectus.**

The Funds face numerous market trading risks, including active markets risk, authorized participation concentration risk, buffered loss risk, cap change risk, capped upside return risk, correlation risk, liquidity risk, management risk, market maker risk, market risk, non-diversification risk, operation risk, options risk, trading issues risk, upside participation risk and valuation risk. For a detailed list of Fund risks see the prospectus.

**Buffer ETFs™ Risk.** Fund shareholders are subject to an upside return cap (the “Cap”) that represents the maximum percentage return an investor can achieve from an investment in the Funds for the Outcome Period, before fees and expenses. If the Outcome Period has begun and the Fund has increased in value to a level near to the Cap, an investor purchasing at that price has little or no ability to achieve gains but remains vulnerable to downside risks. Additionally, the Cap may rise or fall from one Outcome Period to the next. The Cap, and the Fund’s position relative to it, should be considered before investing in the Fund. The Funds’ website, [www.innovatoretfs.com](http://www.innovatoretfs.com), provides important Fund information as well information relating to the potential outcomes of an investment in a Fund on a daily basis.

The Funds only seek to provide shareholders that hold shares for the entire Outcome Period with their respective buffer level against reference asset losses during the Outcome Period. You will bear all reference asset losses exceeding the buffer. Depending upon market conditions at the time of purchase, a shareholder that purchases shares after the Outcome Period has begun may also lose their entire investment. For instance, if the Outcome Period has begun and the Fund has decreased in value beyond the pre-determined buffer, an investor purchasing shares at that price may not benefit from the buffer. Similarly, if the Outcome Period has begun and the Fund has increased in value, an investor purchasing shares at that price may not benefit from the buffer until the Fund’s value has decreased to its value at the commencement of the Outcome Period.

These Funds are designed to provide point-to-point exposure to the price return of the Reference Asset via a basket of Flex Options. As a result, the Funds are not expected to move directly in line with the Reference Asset during the interim period.

Investors purchasing shares after an Outcome Period has begun may experience very different results than each Fund’s investment objective. Initial Outcome Periods are approximately 3-months, 6-months, 1-year, or 2-years beginning on the Fund’s inception date. Following the initial Outcome Period, each subsequent Outcome Period will begin on the first day of the month the Fund was listed. After the conclusion of an Outcome Period, another will begin.

**The Outcomes that the Funds seek to provide may only be realized if you are holding shares on the first day of the Outcome Period and continue to hold them on the last day of the Outcome Period. There is no guarantee that the Outcomes for an Outcome Period will be realized or that the Funds will achieve their investment objective.**

**FLEX Options Risk.** The Funds will utilize FLEX Options issued and guaranteed for settlement by the Options Clearing Corporation (OCC). In the unlikely event that the OCC becomes insolvent or is otherwise unable to meet its settlement obligations, the Funds could suffer significant losses. Additionally, FLEX Options may be less liquid

than standard options. In a less liquid market for the FLEX Options, the Funds may have difficulty closing out certain FLEX Options positions at desired times and prices. The values of FLEX Options do not increase or decrease at the same rate as the reference asset and may vary due to factors other than the price of reference asset.

**BALT Risk:** Although the Fund targets a 20% buffer, it may fall into a range of 15-20%; there is no guarantee that the buffer will be within this range or that the Fund will provide the buffer.

**QBF Risk.** The Fund will not participate in the entirety of gains experienced by the bitcoin price and Fund shareholders will forfeit any gains in the bitcoin price that exceed the Participation Rate. The Fund will experience the losses of the bitcoin price on a one-to-one basis prior to the Floor. An investment in the Fund is only appropriate for shareholders willing to bear those losses. The Fund does not directly invest in bitcoin.

**Non-U.S. Securities and Emerging Markets Risk.** These securities are subject to higher volatility than securities of domestic issuers due to possible adverse political, social or economic developments, restrictions on foreign investment or exchange of securities, lack of liquidity, currency exchange rates, excessive taxation, government seizure of assets, different legal or accounting standards, and less government supervision and regulation of securities exchanges in foreign countries.

This material is provided for informational purposes only and is made available on an “as is” basis, without representation or warranty. This information is only current as of the date indicated and may be superseded by subsequent market events or for other reasons. Innovator is not providing this information as investment advice. Readers should consult with their investment and tax advisers to obtain investment advice and should not rely upon information published by Innovator. The information herein represents an evaluation of market conditions as of the date of publishing, is subject to change without notice, and is not intended to be a forecast of investment outcomes. Innovator specifically disclaims all warranties, express or implied, to the full extent permitted by applicable law, regarding the accuracy, completeness, or usefulness of this information, including any forecasts or price targets contained herein, and assumes no liability with respect to the consequences of relying on this information for investment or other purposes.

Certain information herein contains forward-looking statements such as “will,” “may,” “should,” “expect,” “target,” “anticipate,” or other variations of these statements. Forward-looking statements are based upon assumptions which may not occur, while other conditions not taken into account may occur. Actual events or results may differ materially from those contemplated in such forward-looking statements. The forward-looking statements contained herein do not constitute, and should not be relied upon as, investment advice. Such forward-looking statements are not necessarily based upon explicit criteria and assumptions, but rather, represent the opinions of the authors stated herein.

*The Funds’ investment objectives, risks, charges and expenses should be considered carefully before investing. The prospectus and summary prospectus contain this and other important information, and it may be obtained at [innovatoretfs.com](http://innovatoretfs.com). Read it carefully before investing.*

Investing involves risks. Loss of principal is possible. Innovator ETFs® are distributed by Foreside Fund Services, LLC.

The following marks: Accelerated ETFs®, Accelerated Plus ETF®, Accelerated Return ETFs®, Barrier ETF®, Buffer ETF™, Defined Income ETF™, Defined Outcome Bond ETF®, Defined Outcome ETFs™, Defined Protection ETF®, Define Your Future®, Enhanced ETF™, Floor ETF®, Innovator ETFs®, Leading the Defined Outcome ETF Revolution™, Managed Buffer ETFs®, Managed Outcome ETFs®, Step-Up™, Step-Up ETFs®, 100% Buffer ETFs™ and all related names, logos, product and service names, designs, and slogans are the trademarks of Innovator Capital Management, LLC, its affiliates or licensors. Use of these terms is strictly prohibited without proper written authorization.

Copyright © 2025 Innovator Capital Management, LLC. All rights reserved.