

Second Quarter Market Update

July 2025

POWER
WEALTH MANAGEMENT

Q2'25 Market Performance, Key Drivers, & Go-Forward Outlook

"May you live in interesting times ."
-Unknown

The current environment reminds us of the old phrase, often misattributed as an ancient Chinese proverb, 'may you live in interesting times'. In our view, there are a number of meaningful cross-currents in the economy and financial markets. The impact of tariffs, recently passed legislation, geopolitical tensions, reduced immigration, and monetary policy, translate to an unusual 'mosaic', contributing to a cloudier than usual economic outlook. In an environment with a wider range of potential outcomes, we reiterate the importance of diversification and careful financial planning.

In the second quarter of 2025, U.S. equities generated a total return of 11.1%, staging a sharp rally after a tariff-related sell-off and subsequent 'pause'. International Developed and Emerging Markets generated total returns of 13.5% and 9.9%, respectively. The U.S. Aggregate Bond Index generated a total return of 1.2%. See **Figure 1.** for total returns in the second quarter and the first half of the year. The year-to-date period has been a bumpy ride and included a ~20% draw-down in the S&P 500. Periods of greater volatility highlight the importance of thoughtful portfolio construction.

Figure 1. Market Performance, Total Return

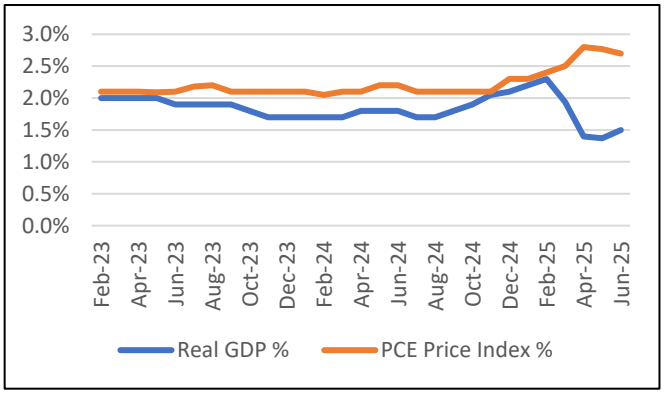
	2nd Quarter	Year-to-Date
Equities		
U.S. Total Market[1]	11.1%	5.7%
International Developed[2]	13.5%	20.2%
Emerging Markets[3]	9.9%	12.4%
Fixed Income		
Aggregate Bond[4]	1.2%	4.0%

Source: Bloomberg; 1. S&P Total Market Index, 2. FTSE Developed ex U.S. Index, 3. FTSE Emerging Index, 4. Bloomberg U.S. Aggregate Bond Index

U.S. Economic Trends

The dramatic increase in tariffs announced on 'Liberation Day', and the pause thereafter, was one of the most meaningful economic changes in recent memory. While tariff rates are still in flux, and we believe there are still 'deals' to be made, JP Morgan recently estimated an effective tariff rate of ~15%, the highest since the 1930's. Most economists expect tariffs to be 'stagflationary', implying weaker economic growth and higher inflation. This can be seen in shifting forecasts for the year-2025. Forecasts for Real GDP have moved lower and forecasts for inflation, as measured by the Personal Consumption Expenditures (PCE) price index, have moved higher. See **Figure 2.**

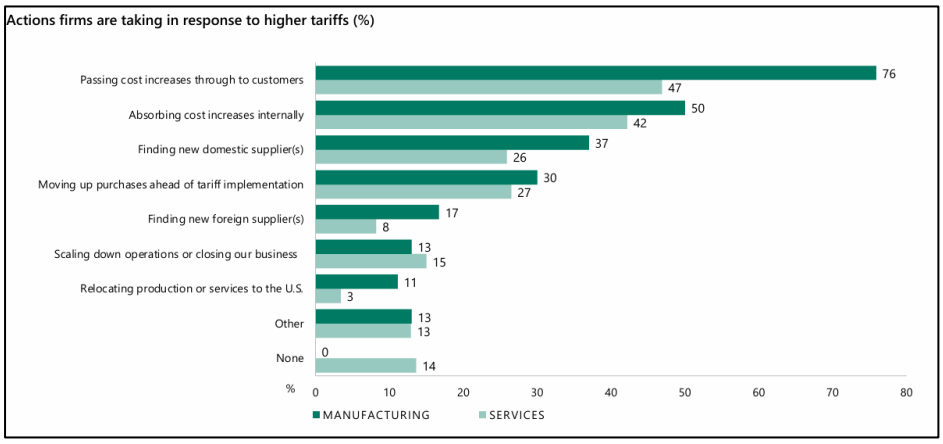
Figure 2. Diverging Consensus Forecasts for GDP and Inflation



Source: Apollo, Bloomberg, Bloomberg Consensus Estimates

The impact to inflation thus far has been limited, but we are hesitant to sound the 'all-clear'. Many companies stock-piled goods ahead of tariffs, and logically, like a 'pig through a python', it takes time for containerships to move new product to the United States, and for those products to reach store shelves. The Federal Reserve Bank of Dallas recently asked firms about their actions in response to higher tariffs. 76% of manufacturing respondents indicated they would pass increased costs along to consumers. See **Figure 3.**

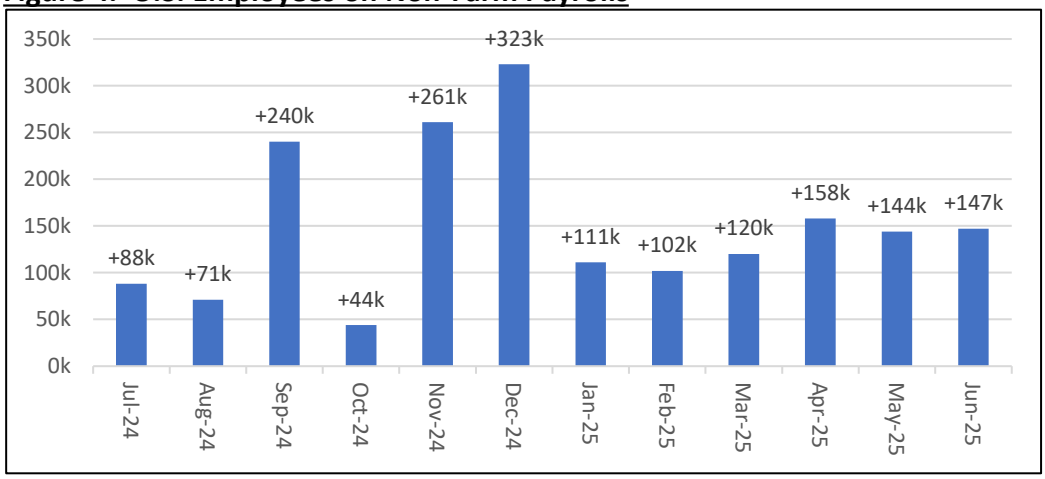
Figure 3. Actions Firms Taking In Response to Higher Tariffs



Source: Apollo, Federal Reserve Bank of Dallas, Survey of Texas Business Executives

While soft data (e.g., surveys of CEO's, surveys of consumers) has been weaker, hard data has continued to be strong. Last week, the Bureau of Labor Statistics announced that the U.S. economy added 147k jobs in June, exceeding the Bloomberg consensus estimate of 106k. See **Figure 4.** Importantly, S&P 500 earnings are also expected to grow in the high-single digits this year.

Figure 4. U.S. Employees on Non-Farm Payrolls



Source: Bloomberg, Bureau of Labor Statistics

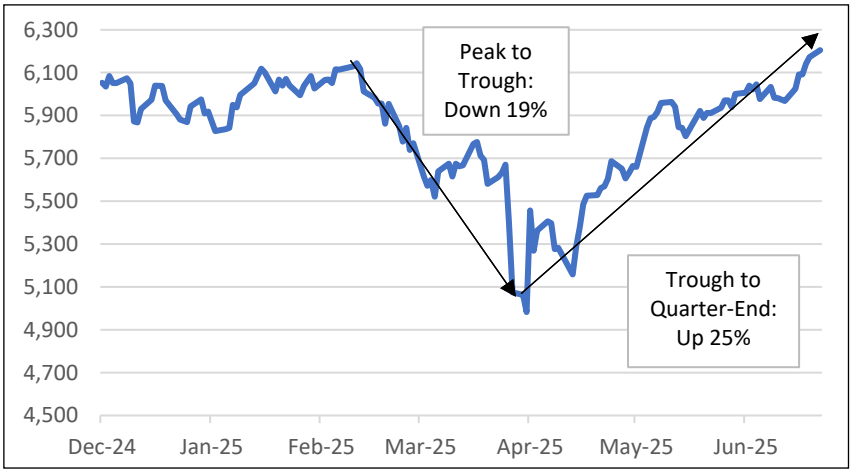
Additionally, the recently passed 'One Big Beautiful Bill Act' may serve to further stimulate the economy, particularly in relation to tax cuts. On the other hand, the bill is projected by the Congressional Budget Office (CBO) to increase the budget deficit, and as a result, expand the issuance of Treasuries, which may be an incremental negative for fixed income. As widely publicized, the administration rejects the CBO's estimates and points out that the budget deficit may be partially offset by tariff revenue. In one interpretation, tariffs can be thought of simply as an 'import tax'.

In the unusual 'mosaic' of factors driving the economy currently, we would be remiss to not mention the Federal Reserve. As a reminder, the Fed has a dual mandate to promote maximum employment and stable prices. A 'stagflationary' environment, should it come to pass, puts the Fed in a difficult position. Higher inflation suggests the Fed should raise rates, while weaker economic growth suggests the Fed should cut rates. Since monetary policy has 'long and variable lags', meaning it can take ~12-18 months for actions to filter into the real economy, the Fed is proceeding with caution. As noted above, the labor market remains healthy, and particularly given the potential stimulative impact of recent legislation, the Fed should have additional leeway to hold rates steady for longer. As recently as last week, consensus expectations among economists called for two cuts by the end of the year. We think this may prove to be optimistic.

U.S. Stocks

The second quarter and year-to-date periods saw the U.S. Total Stock market generate 11.1% and 5.7% total returns, respectively. That said, the ride has been bumpy. See **Figure 5.** for a line chart of the S&P 500 price performance year-to-date. In a reminder to 'not check the market daily', the first half saw a meaningful draw-down, in large part driven by the anticipation and announcement of tariffs, before staging a rally back to an all-time-high.

Figure 5. S&P 500 Price Performance, Year-to-Date



Source: Bloomberg

Underneath the surface, there was a large divergence in performance by size (e.g., small vs. large) and style (e.g., value vs. growth). See **Figure 6.** for further details. The difference between large growth and small value in the second-quarter was an enormous nineteen percentage points. AI stocks rebounded, and by sector, many 'defensives' did better than 'cyclicals'. While we caution against market timing, we remain convinced there is an opportunity for small and value to 'snap-back', particularly on the heels of stronger economic growth. We also think 'higher for longer' rates sets up negatively for growth stocks. This is mathematically represented in a discounted cash flow analysis, a tool used in valuation. As discount rates move higher, far out cash flows are valued less.

Figure 6. Morningstar U.S. Equity Style Box Performance

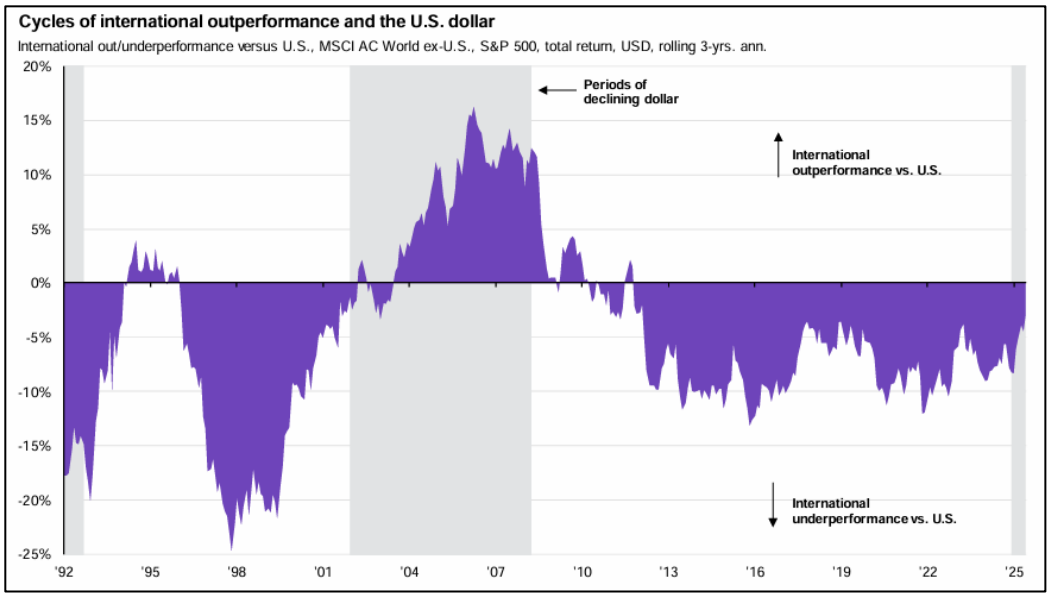
	Q2 2025			Q1 2025			1-Year		
	Value	Blend	Growth	Value	Blend	Growth	Value	Blend	Growth
Large	0.89	9.04	23.05	5.95	-3.57	-7.53	13.25	14.07	26.65
Mid	2.04	5.78	15.96	2.15	-3.01	-6.27	11.58	10.91	23.53
Small	4.01	5.32	13.13	-3.74	-6.25	-8.43	10.67	5.47	12.83

Source: Morningstar

International Stocks

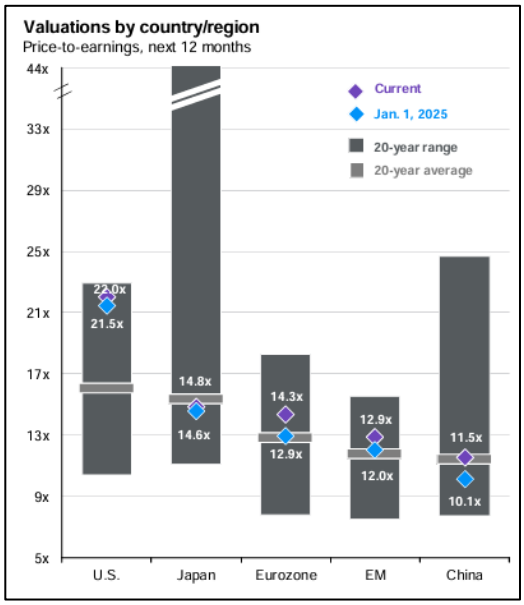
In the second quarter, International Developed and Emerging Market stocks generated total returns of 13.5% and 9.9%, respectively. In the year-to-date period, they generated 20.2% and 12.4%, respectively, and outperformed the U.S. by a wide margin. Periods of U.S. and International outperformance can occur in long, multi-year, cycles. Additionally, periods of International outperformance often coincide with a declining U.S. Dollar. See **Figure 7.** for the MSCI All Country World Index (ACWI), excluding the U.S. vs. the S&P 500 on a three-year rolling basis. The U.S. Dollar has declined year-to-date, which may be driven in part by a repatriation of foreign assets.

Figure 7. Global Equity Performance and the U.S. Dollar



Source: JP Morgan Asset Management, FactSet, MSCI, Standard & Poor's

Figure 8. Global Equity Valuations



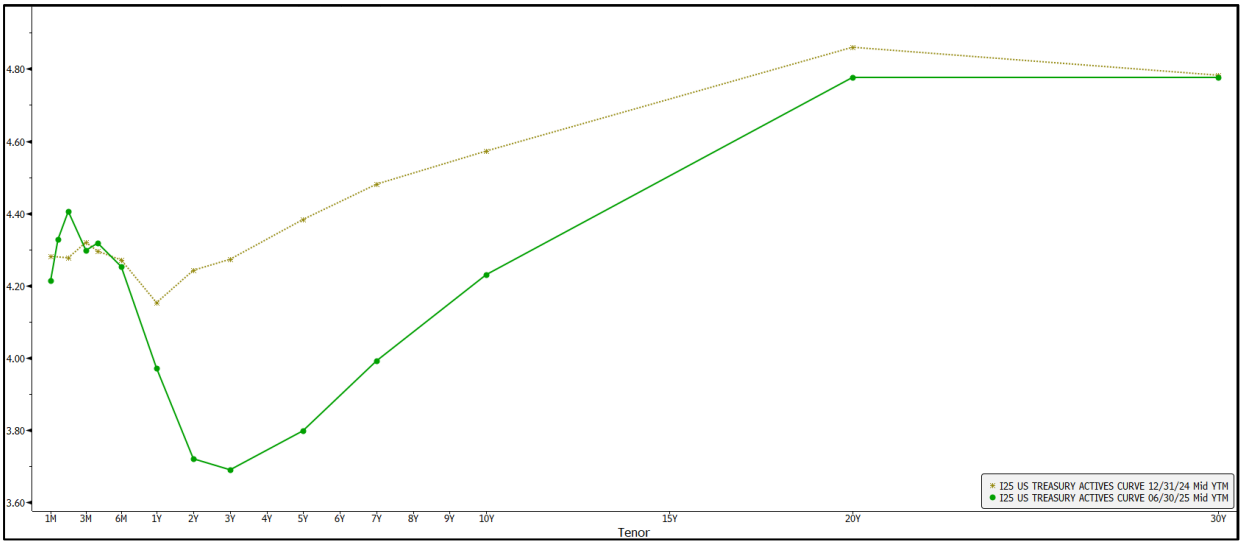
Despite the recent outperformance, international stocks remain much cheaper than U.S. stocks, both on an absolute basis, and relative to their own histories. See **Figure 8.** for forward price-to-earnings multiples for the United States, Japan, the Eurozone, Emerging Markets and China. U.S. stocks remain valued well-above their 20-year average, while international stocks remain modestly below to modestly higher. We also continue to think international stocks play an important role in portfolio diversification.

Source: JP Morgan Asset Management, FactSet, MSCI, Standard & Poor's

Fixed Income

The U.S. Aggregate Bond Index generated a 1.2% total return in the second-quarter and a 4.0% total return in the year-to-date period. The year-to-date period has seen the yield curve steepen with the short-end of the U.S. Treasury curve declining faster than the longer-end. See **Figure 9**.

Figure 9. U.S. Treasury Yield Curve, 12/31/24 & 6/30/25

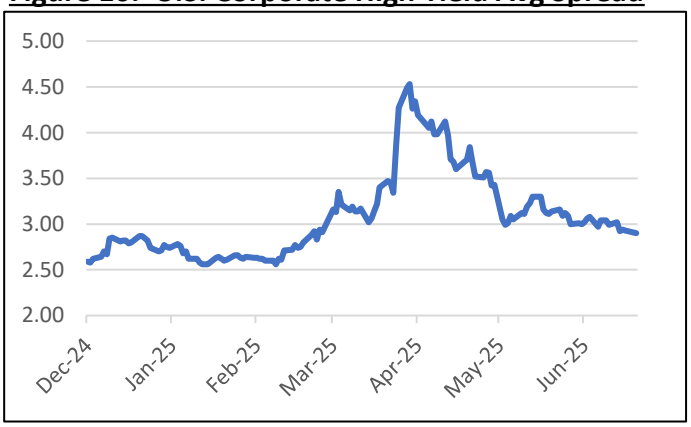


Source: Bloomberg

We believe there are a few factors at play. The short-end of the curve is declining with expectations for the Fed to cut rates, while the longer-end of the curve is impacted by expectations for higher inflation, concerns regarding higher deficits and a greater issuance of U.S. Treasuries, as well as less demand from select buyers (e.g., Fed reversing QE and shrinking their balance sheet, foreign buyers stepping away). Encouragingly, client portfolios are mostly underweight duration (i.e., less sensitive to the long-end of the curve) relative to the U.S. Aggregate Bond Index. That said, we believe some level of duration is an important part of portfolio diversification, since longer duration securities tend to outperform in recessions.

Credit spreads (e.g., the extra yield to compensate investors for default risk in riskier fixed income securities) spiked, albeit less than expected, and retreated year-to-date. Credit spreads are a measure of perceived risk. See **Figure 10.** for U.S. Corporate High Yield Spreads. Spreads remain well below long-term averages.

Figure 10. U.S. Corporate High Yield Avg Spread



Source: Bloomberg

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