Financial Markets

The second quarter was another roller coaster for stocks, though one that ended far higher than it began. In early April, the Trump Administration's tariff initiatives shocked financial markets and led to steep declines. But a pause in those tariffs provided a reprieve, and stocks quickly responded, rallying to an all-time high. All told, the S&P 500 Index rose by 10.9% for the quarter, and year-to-date gains now stand at 6.2%. Though the rally was widespread, market dynamics rhymed with those of the last couple of calendar years in which a handful of technology-related companies fueled a disproportionate share of the Index's gains.

Total Returns through June 30, 2025		
US Stocks	**2nd Quarter**	**Year-to-Date**
Standard & Poor's 500	10.9%	6.2%
Russell 2000®	8.5%	-1.8%
International Stocks		
MSCI World Ex-US	12.0%	19.0%
MSCI Emerging Markets	12.0%	15.3%
US Fixed Income		
Bloomberg Gov't/Credit	1.2%	3.9%
90-Day Treasury Bill	1.1%	2.1%

International stocks fared even better than domestic shares. Global stocks did well in their local markets, but the falling dollar amplified returns for US-based investors. The MSCI World ex-US Index gained 12.0% for the quarter.

Bond yields generally held steady. The yield on the 10-year Treasury ended the quarter at 4.23%, nearly unchanged from its starting point. Accordingly, broad-based bond index returns largely reflected interest income earned, with some additional gains for corporate bonds due to credit spread tightening.

Investment Perspectives

In the second quarter, government policies were the dominant forces affecting economic forecasts and market prices, as the Trump administration advanced its agenda on multiple fronts. Below, we address trade, fiscal, and monetary policy, as well as another related macroeconomic variable: the dollar.

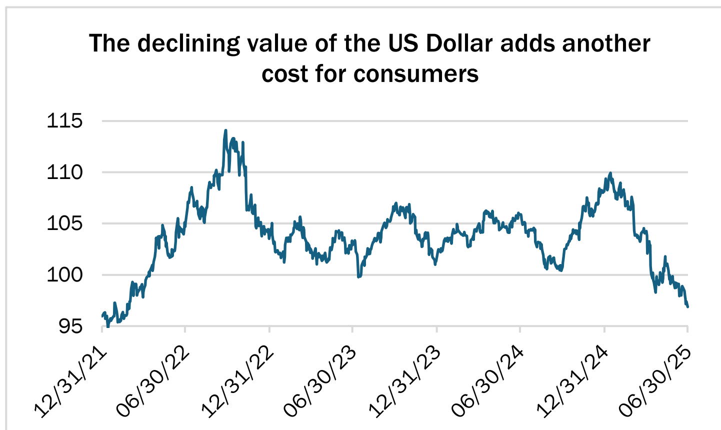
Trade Policy and Its Impacts

The beginning of the second quarter saw Liberation Day: the introduction of sizeable tariffs on virtually every US trading partner. But roughly a week later, after witnessing a steep market sell-off, the Trump administration paused those tariffs. To be sure, the Administration left in place the previously established 10% tax on nearly all US imports (and higher rates on some goods and countries) in an attempt to recalibrate the US economy and its trading relationships. The rationale offered for the pause was to allow new bilateral trade deals to be struck, but we have yet to see virtually any formal pacts, and the tariff pause is set to expire soon. Though the stock market has generally shrugged off these concerns in recent weeks, the lack of deals and the prospective reinstatement of the reciprocal tariffs remain a significant source of economic uncertainty.

Tariffs have already had tangible effects on economic activity. US imports surged in the first quarter, as businesses rushed to secure additional inventory of foreign goods ahead of tariffs taking effect. The heightened imports inflated the first quarter trade deficit, resulting in negative GDP growth (imports are subtracted when calculating a country's GDP). Conversely, as imports fell sharply in the second quarter once tariffs took effect, the trade deficit shrank; accordingly, we expect outsized GDP growth to be reported for the second quarter. Despite the effects on GDP, it is important to keep in mind that these issues represent short-term fluctuations rather than the true health of the economy. On that score, underlying consumer and business spending has remained at solid levels overall, but underlying shifts bear watching. For example, consumers are spending less on discretionary goods, including autos, in favor of less extravagant but necessary items, such as household staples and healthcare. It is challenging to extrapolate major economic shifts from slight changes in trends, but it is plausible that elements of uncertainty are beginning to impact consumer behavior and psyche.

Though some tariffs are in force, we have yet to see their impacts in inflation data. This is in part due to temporary measures like the channel stuffing done before they came into effect; however, some large retailers (e.g., Walmart) have shared their intentions to begin passing along tariff-associated cost increases. The Trump administration has met such announcements with outrage, but economists expect retailers both large and small to begin passing along higher costs should tariff rates persist or increase. The extent to which businesses can pass on the added costs of tariffs will directly affect corporate profits and stock prices.

Input cost pressures are not limited to the explicit tariffs on imported goods. The falling value of the dollar is also adding to the cost of imports. The US Dollar Index (a measure of the currency's worth vs. a handful of other developed market currencies) fell 7% during the quarter and sits at its lowest level in over three years. Economic theory posits that tariffs would strengthen the value of the dollar, offsetting some if not all the cost impact of the taxes themselves, but that has not come to pass. Rather, global investors have become less enamored with US-based investments. Consequently, US businesses and consumers are facing the double whammy of needing more dollars to buy the same imported goods, while also paying tariffs to bring them into the US. Both factors contribute to the latent risk of rising inflation.



One Big Beautiful Bill

At the close of the quarter, Republicans in Congress were striving to pass what is likely to be President Trump's signature piece of legislation. The so-called Big Beautiful Bill is purportedly focused on taxes and immigration, but is likely to have widespread impacts on energy, healthcare, and defense sectors as well. As of this writing, the Senate has passed its version of the bill, but it still needs to be passed by the House through the process of reconciliation. As Washington continues its work, we can provide some broad-stroke commentary.

First, much of what is achieved in this bill is simply extending the personal income tax cuts of the 2017 Tax Cuts and Jobs Act that are due to expire at year-end. It's notable that the absence of this legislative action would amount to a tax hike for US taxpayers. Inaction to extend the lower rates would likely have a negative impact on consumer spending. In addition to extending personal tax cuts, the new bill also includes some new corporate tax cuts. The 2017 law permanently lowered the corporate tax rate; the new bill's effects on corporate taxes are far more modest, but some provisions, such as the deduction of certain research and development expenditures, may marginally improve corporate profits.

But these tax cuts come at a cost, with expectations for a ballooning deficit and the need for increasing debt issuance by the Treasury. Federal debt interest payments have already reached historical levels and are poised to continue to climb even without this bill. Citing the continued lack of fiscal responsibility across administrations, Moody's became the last of the three major debt rating agencies to downgrade the credit rating of the US Treasury below their highest AAA rating. Debt markets did not move materially on the news, but the announcement highlights legitimate concerns about the federal government's long-term fiscal path.

The prospective law also appears poised to eliminate incentives and tax breaks for renewable energy generation and related infrastructure that were enacted during the Biden administration. Aside from climate concerns, such elements could slow investment in new electricity generation, or at least make that investment more costly. This could present a problem for the growing electricity needs of Artificial Intelligence applications. Data center construction, and other IT infrastructure buildout vital to the growth of AI, was a meaningful driver of US GDP growth in the first quarter of the year.

The Fed's Predicament

The Federal Reserve cut short-term interest rates by a percentage point last year as pandemic-related inflation finally declined, but it has held pat since January. Economic data has remained stable, and Fed Chairman Jerome Powell has argued that further cuts are not yet necessary. This is especially so, according to Powell, given that the Fed expects current and prospective trade tariffs to lead to renewed inflation pressure. However, the tariffs are also expected to slow growth, which could call for lower rates to support the economy, thereby putting policymakers between a rock and a hard place. President Trump has been outspoken in his displeasure with the Fed's reluctance to cut interest rates to stimulate the economy. Chairman Powell has borne the brunt of these criticisms, and it is virtually certain that Trump will appoint a new Fed Chair. The timing of that announcement, potentially well ahead of Powell's term ending in May 2026, adds the prospect of a "shadow Chair," in which markets are not only reacting to the Fed's decisions and commentary, but also that of the prospective Chair. The key question from Fed watchers is whether the new Chair will fight for Fed independence, as has been the norm for decades, or will pander to the administration. These continued elements of uncertainty notwithstanding, market consensus continues to see lower rates in the offing: Fed futures now indicate expectations for at least two rate cuts by the end of the year.

Outlook and Positioning

Many forces are buffeting financial markets as we enter the second half of the year. There are several reasons to be optimistic, not the least of which is a domestic economy that has maintained its footing, including enduring labor market strength and continued consumer spending. Going further, rising investment in Artificial Intelligence technologies and its adjacent ecosystem of infrastructure is powering near-term growth, and could lead to material long-term gains for the economy through higher productivity.

However, uncertainty abounds. Economic data, though generally good, has not been as uniformly robust as it has been in recent years, suggesting we might be close to the peak of this economic cycle. At the same time, investors are trying to handicap multiple major policy outcomes, and the prospect of continual uncertainty regarding policy and its effects on the economy and markets looms for the next few years. And outside the country's borders, geopolitical concerns have grown, with the US getting involved in the conflict between Israel and Iran, Russia's ongoing incursion in Ukraine, and China's continued maneuvering in its quest for increasing stature on the world stage.

At the height of economic and policy uncertainty earlier this year, investors appropriately turned toward companies that offered more predictable business outlooks. However, recent market dynamics demonstrate many investors' willingness to once again take on more risk, especially regarding valuation. We remain steadfast to our discipline, favoring sustainable businesses that are growing steadily but do not sport valuations that imply unreasonable expectations of future growth. While some investors are willing to chase momentum, we believe inflated expectations carry downside risk amid growing uncertainty.

We continue to favor reasonably valued stocks in multi-asset portfolios, yet fixed income securities present as an enticing diversifier. High quality bonds provide attractive yields on funds earmarked for short-term liquidity, while also offering portfolios ballast for those periods when conditions deteriorate and the market declines.

Sources: FactSet, Standard & Poor's, US Bureau of Labor Statistics, US Customs and Border Protection, US Bureau of Economic Analysis
Chart Sources: FactSet