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Investment Insights Quarterly

From the Desk of Jack Kraft, CFA, Investment Strategist

July 2025

Halftime Check-in: Tariff-ic Returns Amid Tariff Uncertainty

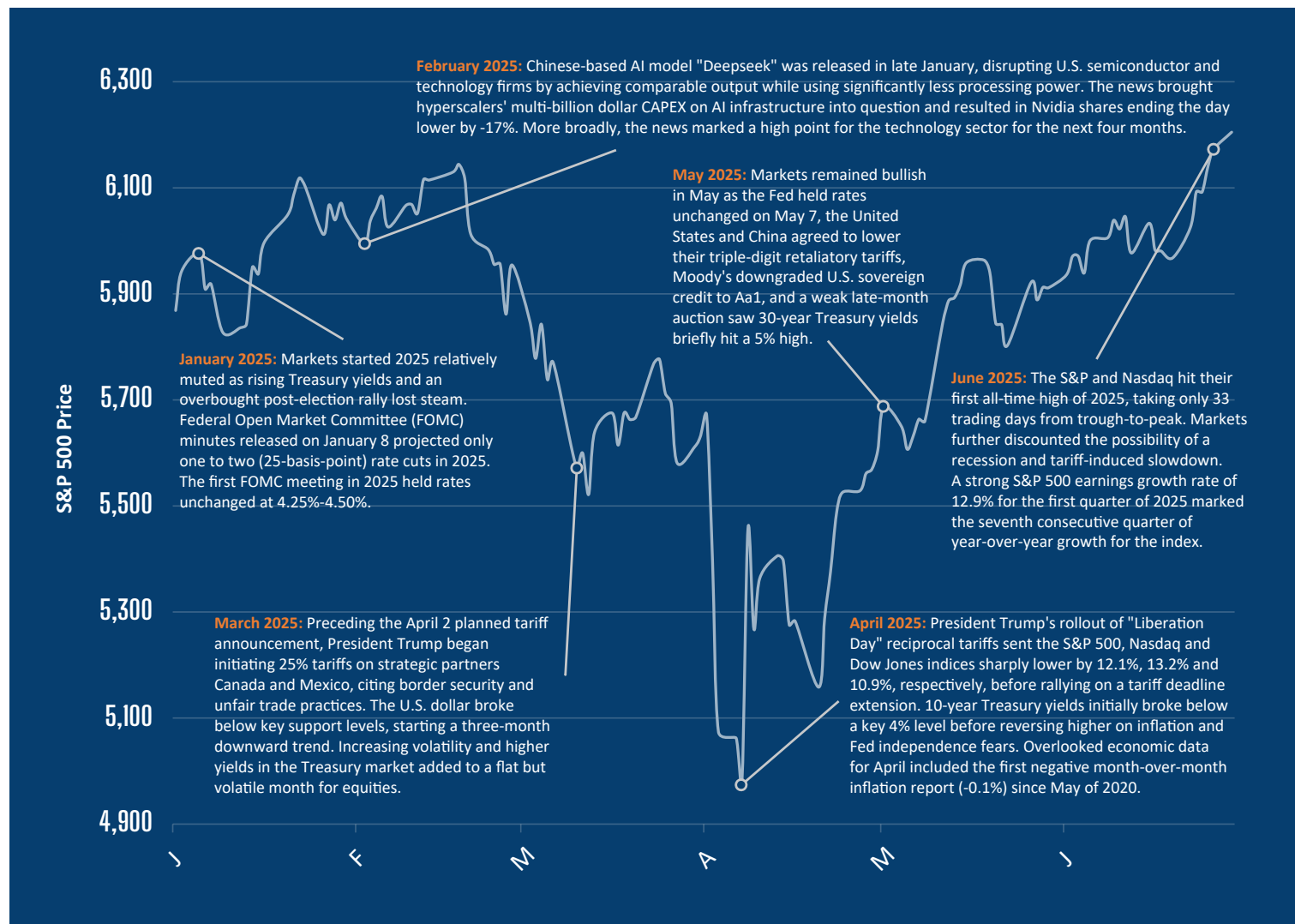
Stocks finished the first half of the year on a high note as investors discounted the likelihood of an economic slowdown and instead doubled down on market catalysts such as artificial intelligence (AI), 2026 earnings growth and prospects for the U.S. Federal Reserve (Fed) to resume cutting its benchmark interest rate. The market appears to be ignoring risks that were highlighted after the Liberation Day tariff announcement, such as inflation and slowing growth. This has made for a volatile first half of the year for the S&P 500, which suffered a dramatic 20% drawdown just to round-trip back to all-time highs in a four-month time frame.

Investors took the opportunity to buy the dip in April, which ended up being an unusually quick drawdown for U.S. equities in the second quarter. The recovery from the

bottom took a total of 33 trading days as tariff exemptions and rollbacks helped investors regain confidence. Additionally, the AI trade helped boost optimism as the mega-cap tech firms reiterated robust capital expenditure plans, reinforcing investor confidence in AI-driven growth. The renewed interest in AI sparked a rebound in related industries, impacting the entire supply chain from chipmakers to companies downstream like industrials, data centers and power producers. Notably, market gains have been narrow, with mega-cap stocks accounting for a larger concentration of major indices. The 10 largest companies in the S&P 500 make up roughly 40% of the overall index, with Nvidia most recently being the first company to eclipse the \$4.0 trillion market-cap threshold.



S&P 500 Events Chart (First Half, 2025)



As of June 30, 2025
Source: Morningstar

Let's take a look at the risks and catalysts to better understand a possible path forward for U.S. equities for the remainder of the year.

Starting with risks, tariff headlines have dominated the news flow for the majority of the year as the Trump Administration tries to reshape U.S. trade policy. Most recently, President Trump announced a 30% tariff rate on Mexico and the European Union

while adding some additional tariffs on goods imported from 21 other countries. Other industry-specific tariffs have been a concern with a duty of 50% on copper, while Trump raised the prospect of 200% tariffs on pharmaceuticals unless companies began manufacturing drugs domestically in the next year and a half. The next key date is August 1, as Trump has indicated that many countries will see duties rise back to levels indicated on April 2.



Overall, the tariff situation is fluid, and it is nearly impossible to predict the outcome of deals across different trading partners. A fair baseline assumption is that the effective tariff rate could land between 15% to 20% by the end of the year, up from about 3% coming into the year and ultimately weighing on growth. Economists expect roughly a 1% drag on gross domestic product growth for every 10% increase in the effective tariff rate. Although growth may slow initially in 2025, the U.S. economy has proven to be able to absorb tariffs better than expected and should see rebounding growth in 2026. Tariffs' one bright spot is that the U.S. government posted a Treasury surplus for the first time in eight years in June, with custom duties bringing a total of \$113 billion through the first half of the year.

Although the underlying import tax is subject to change, the key way to consider the impact of tariffs is how much and how quickly these taxes will be passed on to consumers. The June Consumer Price Index (CPI) came in mixed—core CPI rose 0.2%, with the year-over-year figure accelerating from 2.8% to 2.9%, above the Fed's target, spurring less optimism for a resumption in rate cuts. The Fed will likely want to stay on hold to see the impact on inflation from tariffs being passed through from businesses to consumers, which probably is still a couple months away. The pass-through on tariffs is a double-edged sword that will likely be a gradual one-time lift in prices, with consumers absorbing roughly 50-60% of the cost. This is lower than the estimated pass-through rate during the 2018-2019 Trump trade war, which was about 70%, according to Goldman Sachs. Keep in mind that if companies fail to pass through prices, their margins will take a direct hit and impact earnings growth in the quarters ahead.

Elevated valuations remain another key risk that stands out as stocks look to continue to make higher highs. Currently, the S&P 500's forward price/earnings ratio trades at a 10% premium to its five-year average and 22% above its 10-year mean, underscoring elevated

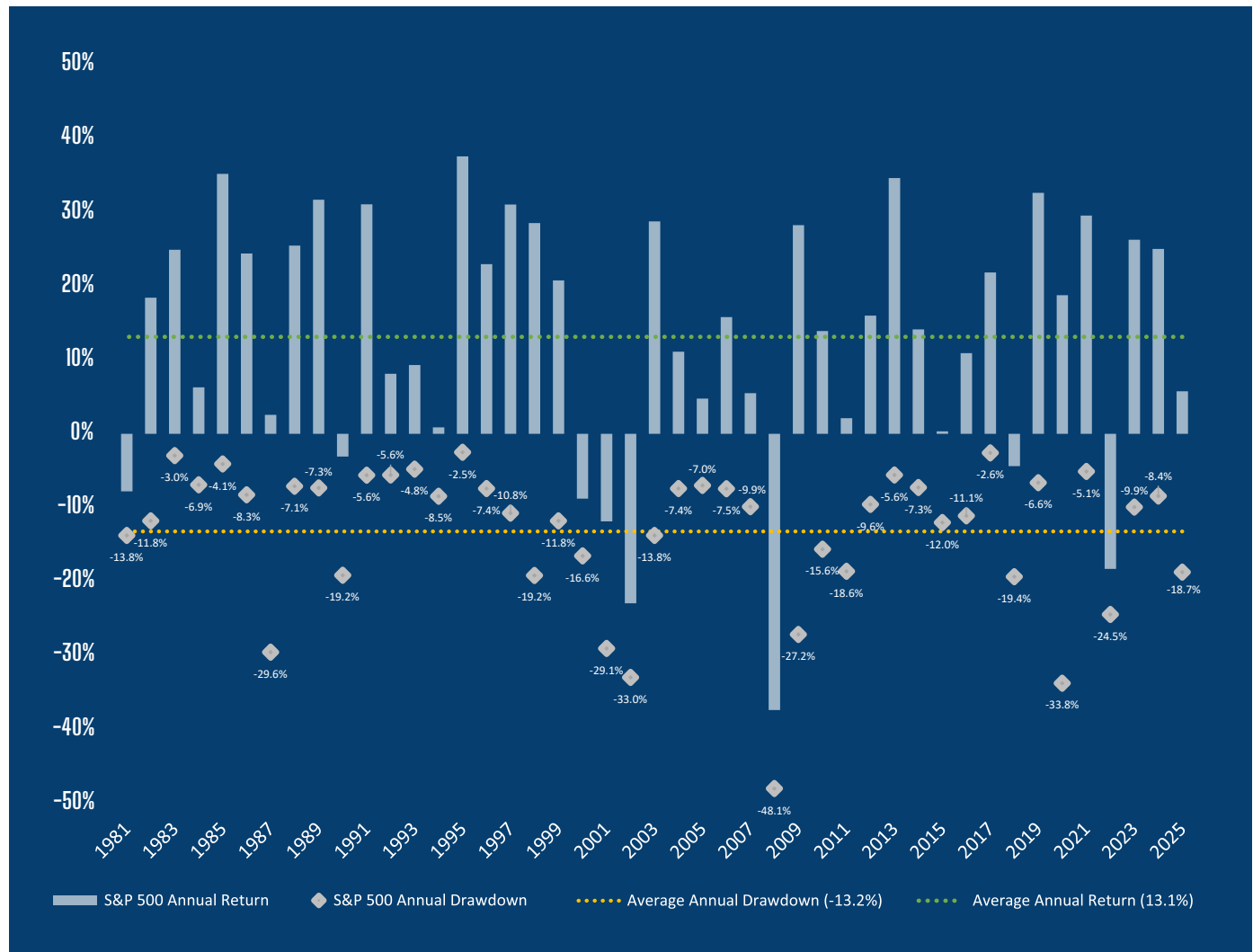
investor expectations. The elevated valuation can be attributed to a few things, including forecasts for strong earnings growth, easing monetary policy and fiscal stimulus/deregulation.

For the U.S. equity market to sustain these elevated multiples, investors will demand above-average earnings growth going forward. Investors seem to be less rattled by the rise in import taxes compared to when the policy was first rolled out, but risks remain. The reality is that tariffs have not fully worked their way into corporate earnings, and this could derail the rally if corporate margins come in lower and lead to below expected earnings growth. This slowdown in growth, combined with the possibility of sticker inflation, is one of the biggest risks to the current equity rally. Second-quarter corporate earnings will be a good indicator to see how well companies can absorb changes in trade policy.

In December, I wrote an Investment Insights article titled "[Navigating High Valuations: A 2025 Market Playbook](#)." Although the piece is dated and market changes have evolved, the core message remains relevant. Valuations are at elevated levels, but it is essential to remember that pullbacks are part of the long-term plan of investing. Investors should view market pullbacks as strategic entry points, particularly for high-conviction, long-duration themes such as AI. Over the past 20 years, a decline of at least 10% happened 50% of the time, with the average pullback being 15%. The chart below shows the impact of these pullbacks, but also the market's ability to rebound by year-end. In closing, remember that when uncertainty spikes, look at it as a terrific opportunity.



S&P 500 Annual Returns and Drawdowns



12/31/1981 - 6/30/2025
Source: Morningstar

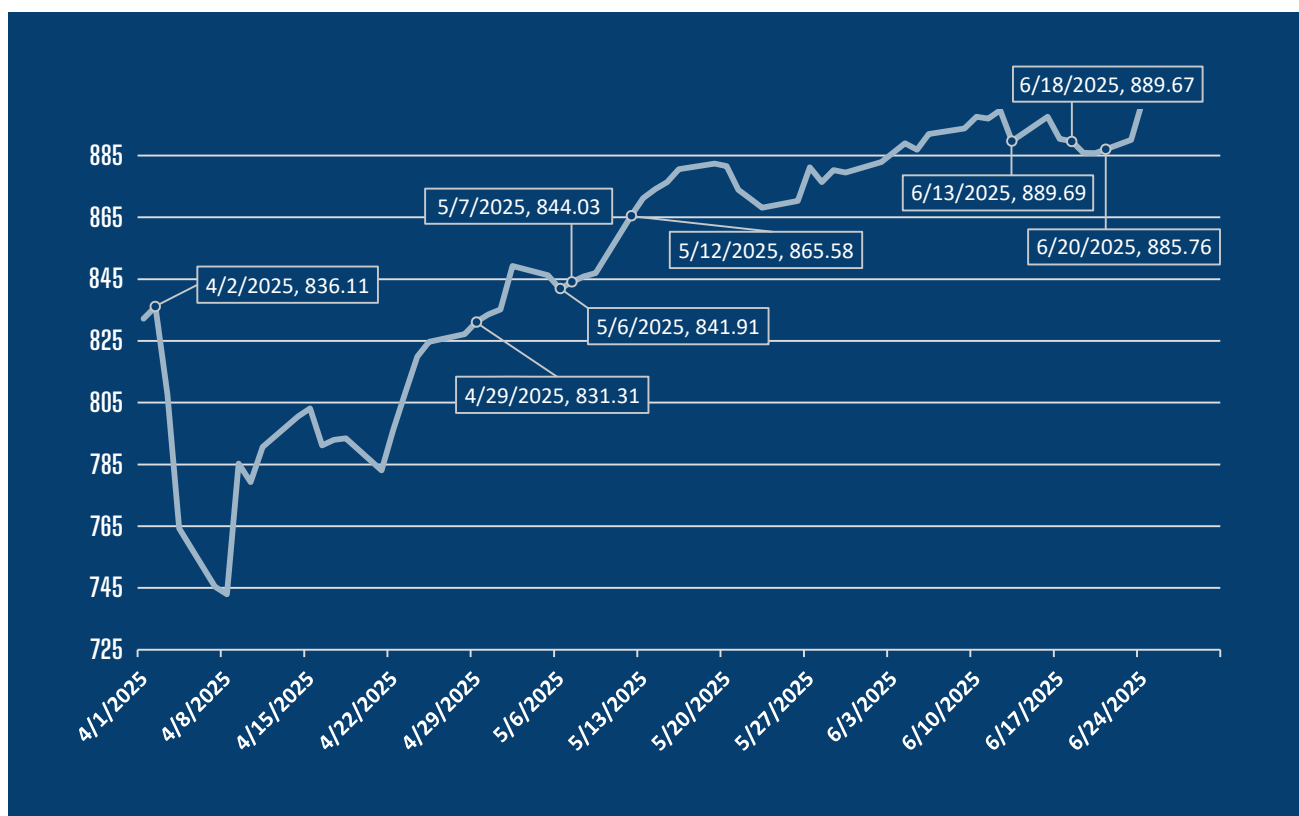


Q2 Key Dates

- April 2 – Liberation Day. President Trump announced broad tariffs on a number of trading partners.
- April 29 – With almost half of first-quarter earnings reported, blended earnings are on track to grow 10% versus last year.
- May 6 – Investors pared gains after a record nine-day win streak in the S&P 500, its longest in two decades.
- May 7 – The Fed held short-term rates steady, with continued signaling from Jerome Powell on data dependence, a balancing act of both inflation and employment, and a fluid fiscal backdrop.
- May 12 – Over the weekend, the United States and China agreed to suspend their triple-digit reciprocal tariffs, with a deadline for resumption July 8. The Magnificent 7 stocks alone added \$821 billion in market cap.
- June 13 – Israel launched drone and air attacks against Iran's nuclear program.
- June 18 – The Fed held short-term rates steady for the fourth consecutive meeting.
- June 20 – The United States conducted Operation "Midnight Hammer," dropping bombs on Iran's nuclear facilities.

Global Stock Market

MSCI ACWI in USD

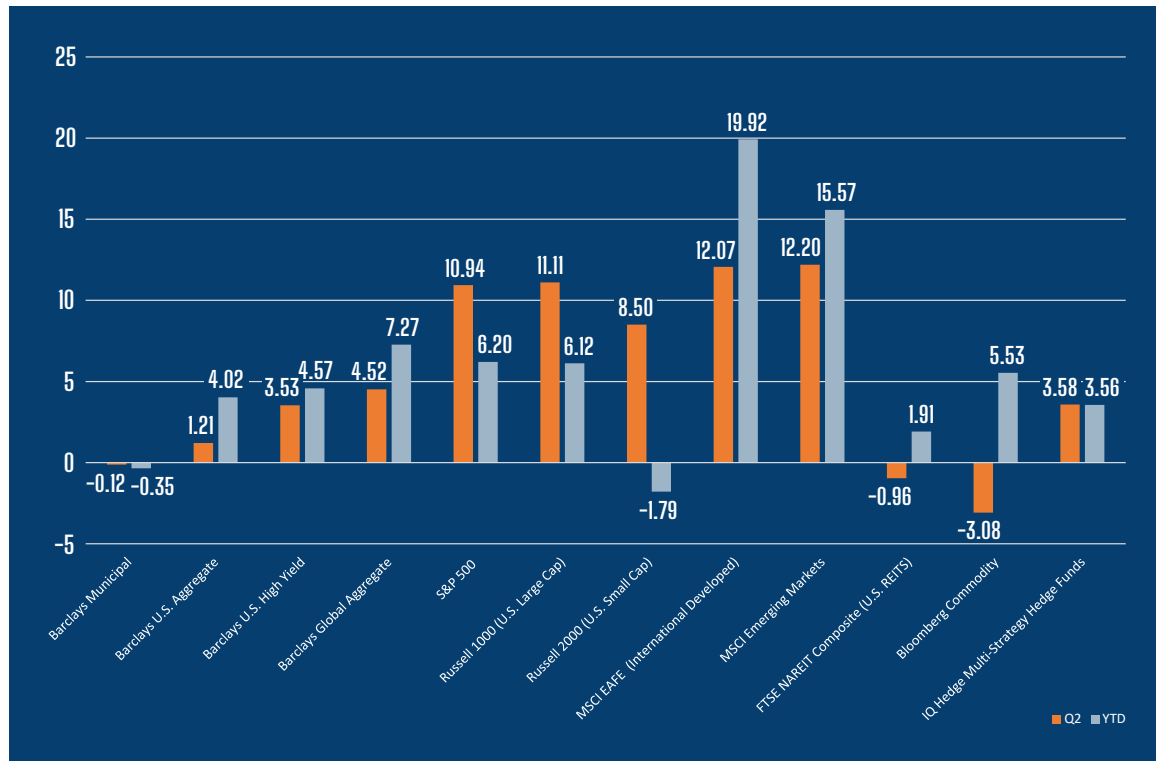


As of June 30, 2025
Source: Bloomberg



Asset-Class Returns

Comparing Recent Quarter and One-Year Total Returns



As of June 30, 2025

Source: Conway

Fixed Income

- Interest rates trended lower throughout June, leading to gains in core fixed income and municipal bonds. After months of poor technical conditions, municipals benefited from better supply-demand characteristics.
- Credit posted another solid month, with investors benefiting from clipping higher coupons.
- The weaker U.S. dollar continued to provide a nice tailwind for non-U.S. assets.

Equities

- U.S. equities ended June on a high note, with strong gains across the board.
- Growth beat value across all market capitalizations, and small caps outpaced large caps for the month.
- Volatility has been very high in 2025, but the S&P 500 has managed to gain 6.2% year to date.
- Developed markets outside the United States posted solid returns last month but underperformed their U.S. counterparts.
- Emerging markets outperformed Europe, Australasia and Far East (EAFE) equities in June, driven by strong gains in Latin America and Eastern Europe.
- Similar to what occurred in the United States, small caps outpaced large caps, and growth beat value.

Alternatives

- Real estate investment trusts (REITs) had a difficult quarter but remained higher for the year.
- Commodities rebounded in June but had a rough quarter overall. Standout performers in the quarter included gold, silver, natural gas and coffee, while gas, cotton and orange juice lagged.



The Dollar

U.S. Dollar Index

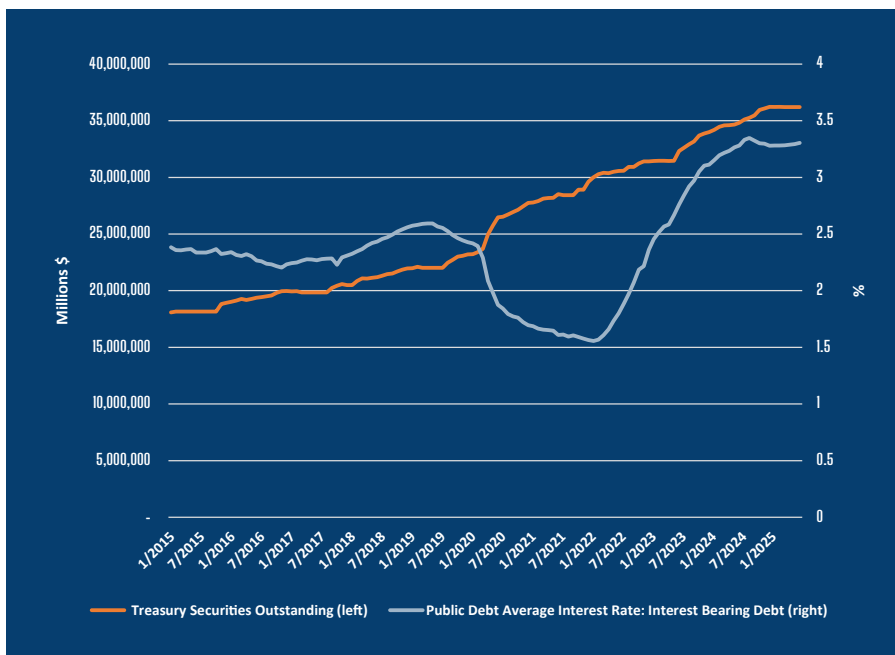


As of June 30, 2025
Source: Bloomberg

- Deficit and tariff concerns have led to one of the worst first halves of the year for the U.S. currency.
- The dollar is down 10.7% through the second quarter, providing a strong tailwind for international investing.
- The ICE U.S. Dollar Index measures the dollar against a basket that includes the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc.

Budget/Deficit Concerns

Public Debt Outstanding and the Average Interest Rate



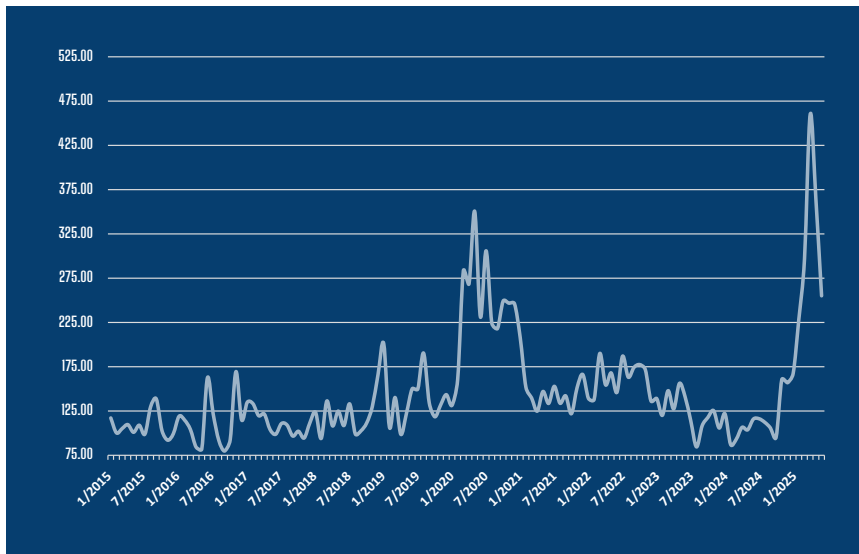
As of June 30, 2025
Source: Haver

- Government debt outstanding is at record high levels, and debt-to-GDP for the United States currently stands at 121%. This is below the peak experienced during COVID-19 (133%).
- Interest on the public debt is at/near the highest levels since 2010.
- The combination has raised concerns among deficit hawks.
- Interest on the public debt is now the second-largest expenditure, behind Social Security and tied with Medicare.



Tariffs and Uncertainty

Economic Policy Uncertainty



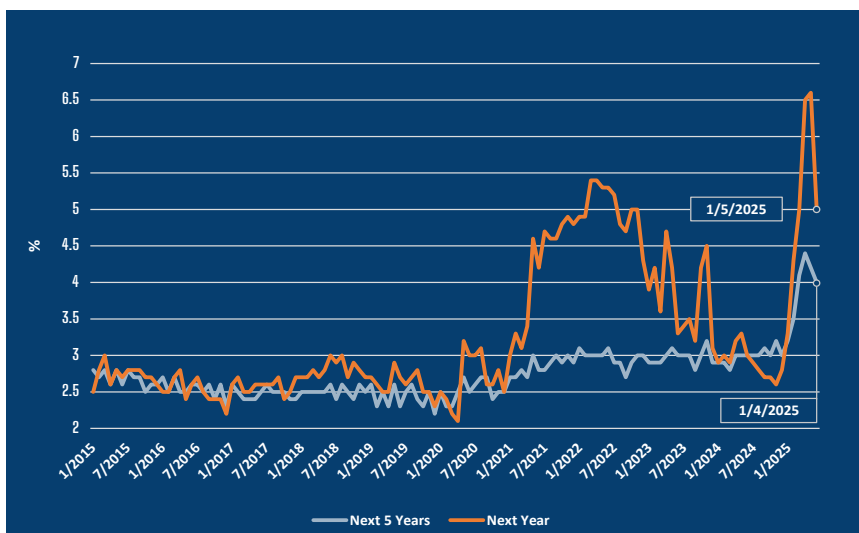
As of June 30, 2025
Source: Haver

- The monthly Economic Policy Uncertainty Index is made up of three components. One component quantifies newspaper coverage of policy-related economic uncertainty. A second component reflects the number of federal tax code provisions set to expire in future years. The third component uses disagreement among economic forecasters as a proxy for uncertainty.
- Uncertainty fell sharply in the second quarter as tariff fears receded. All categories declined except for sovereign debt/currency crisis concerns.

Inflation Expectations

University of Michigan Expected Inflation Rate

Next One and Five Years



As of June 30, 2025
Source: Haver

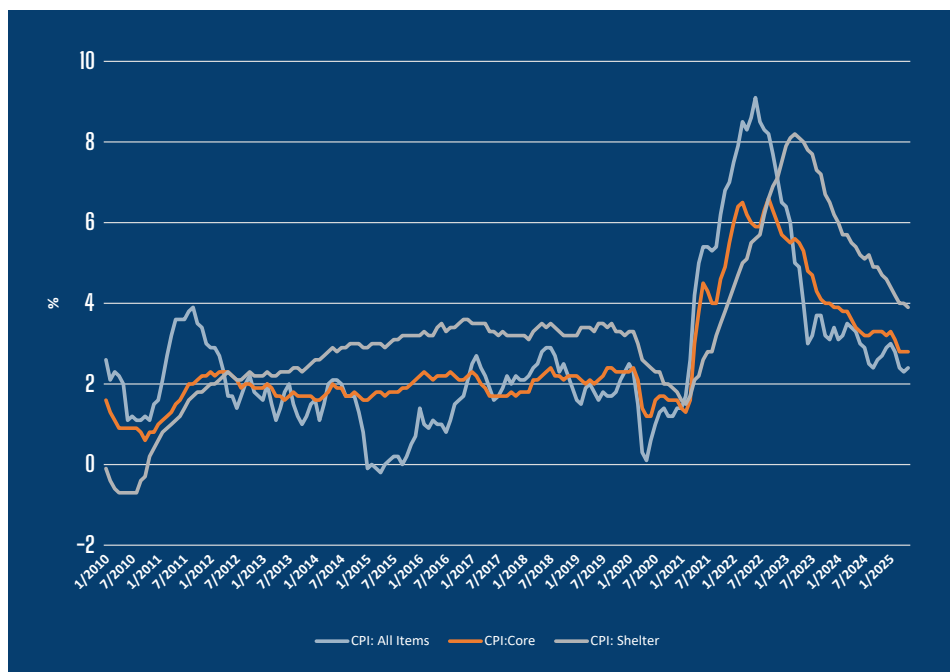
- As the tariff rhetoric has cooled slightly, both inflation and inflation expectations have fallen.
- The five-year expected inflation rate hit a 30-year high in April but fell in May and June.
- Inflation expectations are important to the Fed, but Fed Chairman Powell has discounted the recent increase in this survey as “transitory.”
- Higher inflation expectations can ultimately impact consumer behavior.



Inflation

Consumer Price Index (CPI), Year-over-Year % Change

Overall, Core and Shelter CPI

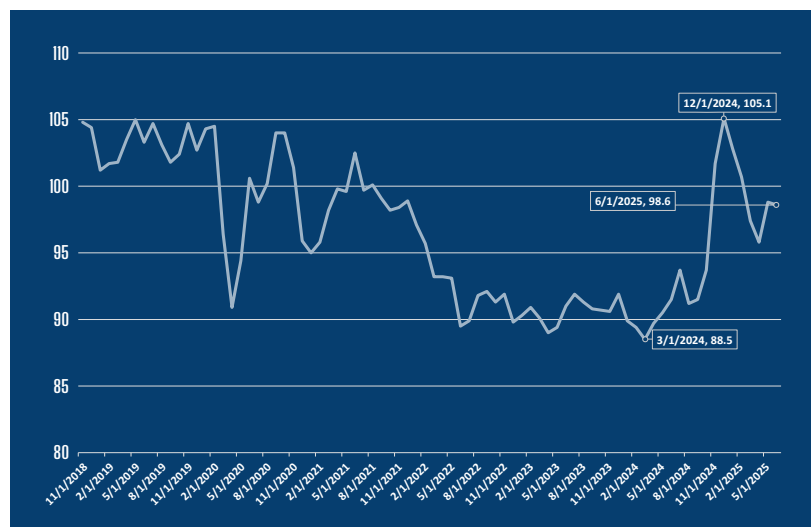


As of June 30, 2025
Source: Haver

- Inflation continues to drift lower, but core inflation remains above the Fed's stated target of 2%.
- Shelter is the largest part of the CPI at 35% and is typically a lagging indicator.
- Shelter inflation fell below 4% for the first time since late 2021 during the second quarter.

Business Sentiment

National Federation of Independent Businesses: Small Business Optimism Index



As of June 30, 2025
Source: Bloomberg

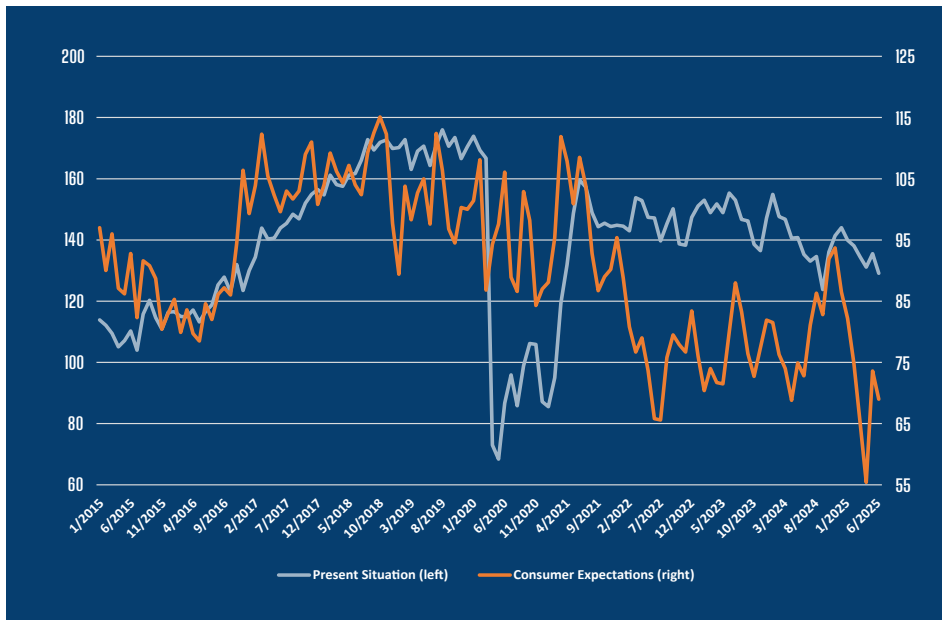
- Small business optimism rebounded during the second quarter, and uncertainty declined.
- The data on the overall health of respondents' businesses showed substantial deterioration, with declines in the percentages reporting that their business was in excellent or good health. When asked to rate the overall health of their business, 8% reported excellent (down six points), and 49% reported good (down six points). Thirty-five percent reported the health of their business was fair (up seven points), and 7% reported poor (up three points).



Consumer Confidence

Conference Board Consumer Confidence

Present Situation and Consumer Expectations



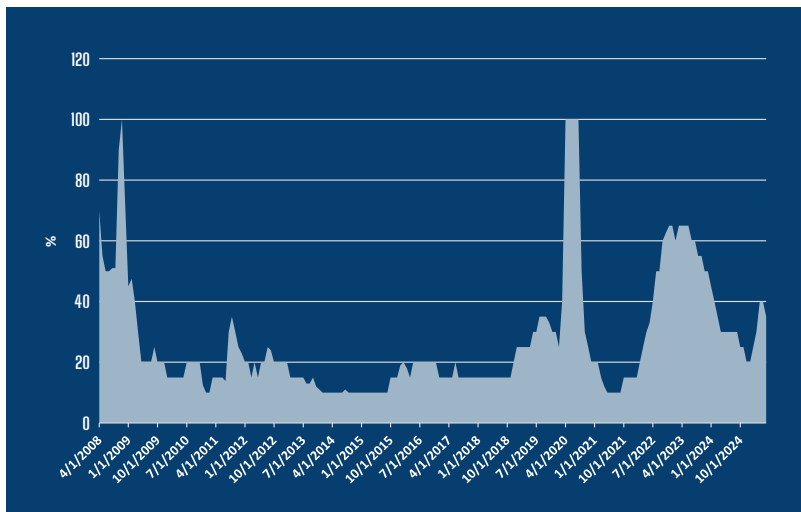
As of June 30, 2025
Source: Haver

- Consumer confidence has fallen sharply post election.
- Expectations, based on consumers' short-term outlook for income, business and labor market conditions, rebounded in the second quarter after hitting its lowest level in more than a decade. Despite the rebound, it remains in recessionary territory.

Recession Concerns

United States Recession Probability Forecast

Bloomberg Consensus



As of June 30, 2025
Source: Bloomberg

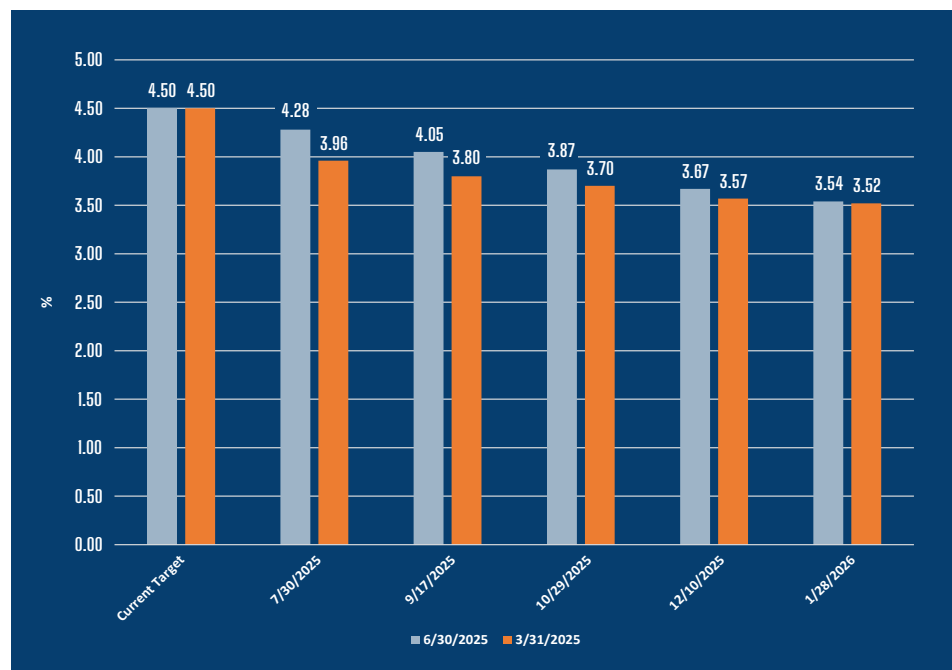
- Recession odds decreased in the second quarter.
- The current Bloomberg consensus probability of a recession in the next 12 months is 35%.
- There are 57 respondents in the latest poll, and the range of recession probabilities was 0% to 60%.



Monetary Policy

Fed Funds Futures Implied Policy Rates

3/31/2025 vs. 6/30/2025



- The Fed's next move is widely expected to be an additional 25-basis-point cut.
- The timing of the next cut continues to be pushed further into the future (higher for longer).

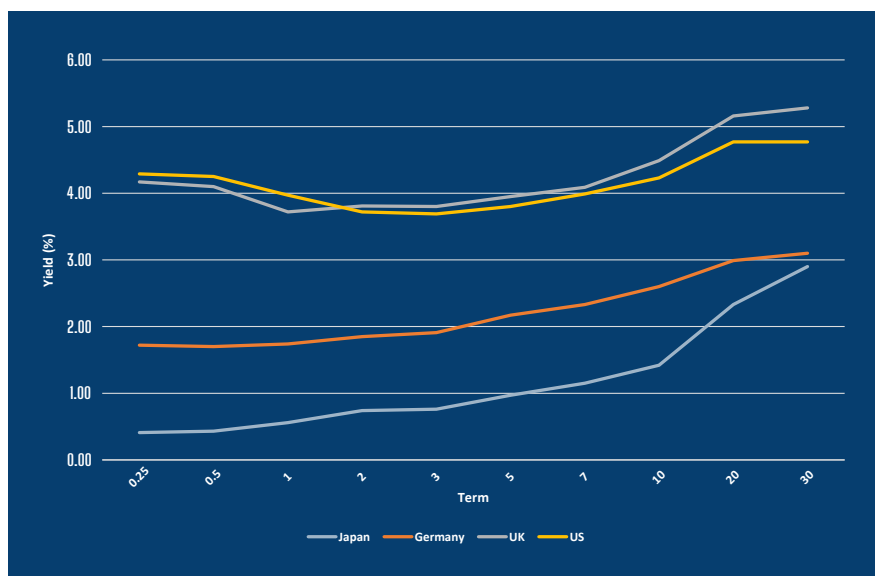
As of June 30, 2025
Source: Bloomberg

Government Bond Curves

Global developed country bond yields were mixed in the second quarter but remain relatively stable for the year.

Global Government Bond Yield Curves

End of Q2 2025



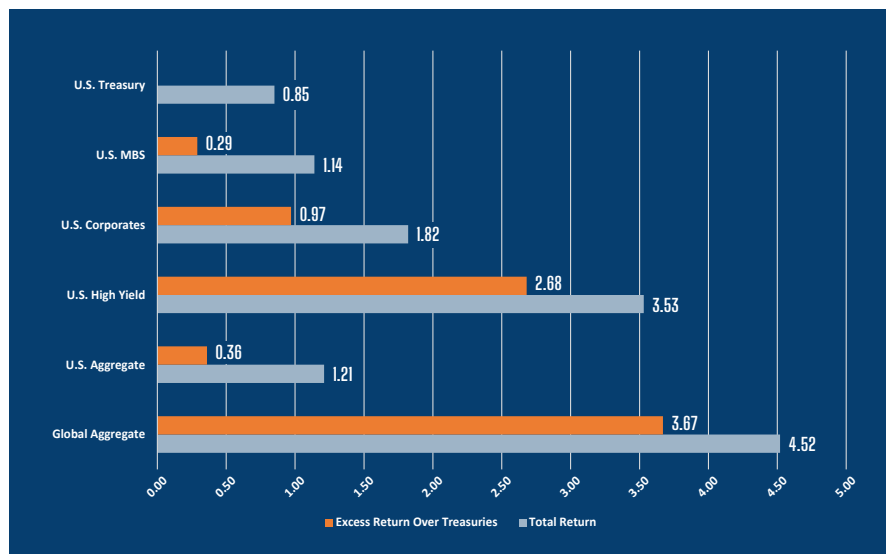
As of June 30, 2025
Source: Bloomberg



Fixed Income Performance (Q2)

Falling benchmark Treasury yields provided a strong tailwind for U.S. fixed income sectors. The U.S. dollar weakness led to strong gains for international bonds.

Fixed Income Performance Q2 2025

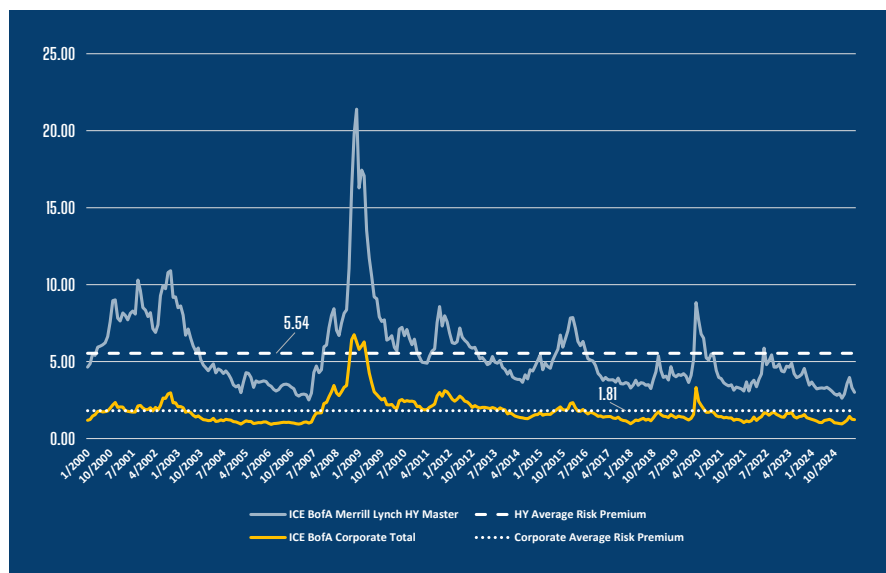


As of June 30, 2025
Source: Bloomberg

Credit

Credit spreads narrowed slightly during the quarter and remain at historically tight levels.

Investment-Grade and High-Yield Credit Spreads



As of June 30, 2025
Source: Haver



Municipal Bonds

Municipal bonds continue to offer a yield advantage for high tax bracket investors. Municipal valuations became more attractive during the second quarter.

Term	AAA General Obligation	U.S. Treasury	Municipal % of Treasury
1	2.57	4.02	63.9%
2	2.60	3.70	70.1%
3	2.64	3.68	71.7%
4	2.65	3.73	71.1%
5	2.70	3.80	70.9%
7	2.86	3.99	71.6%
10	3.19	4.25	75.1%
15	3.71	4.64	80.0%
20	4.12	4.84	85.0%
25	4.36	4.89	89.0%
30	4.47	4.78	93.4%

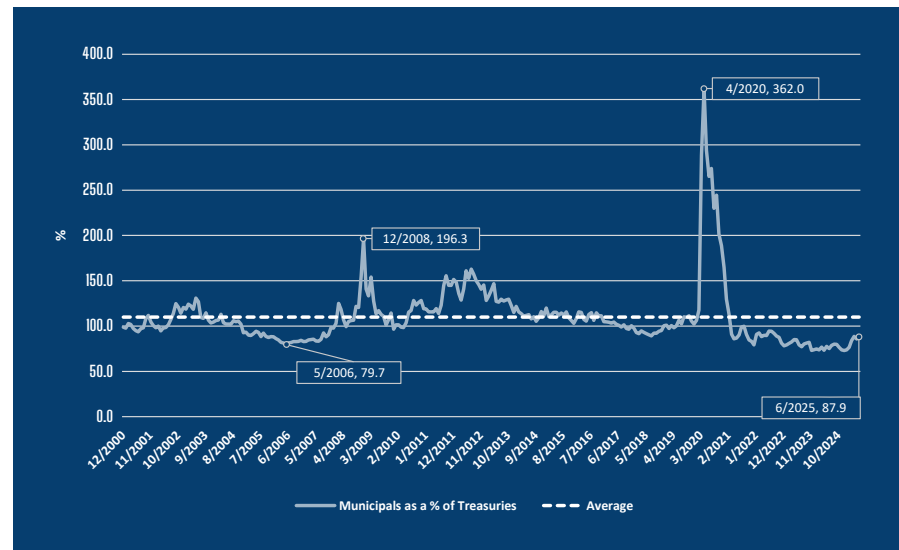
As of June 30, 2025
Source: Bloomberg

Municipal Bonds

Municipal bond credit quality remains strong, and municipals still make sense for higher tax bracket investors.

Municipal Yields as a Percentage of Treasury Yields

ICE/Bank of America Municipal Master/10-Year Treasury



As of June 30, 2025
Source: Haver

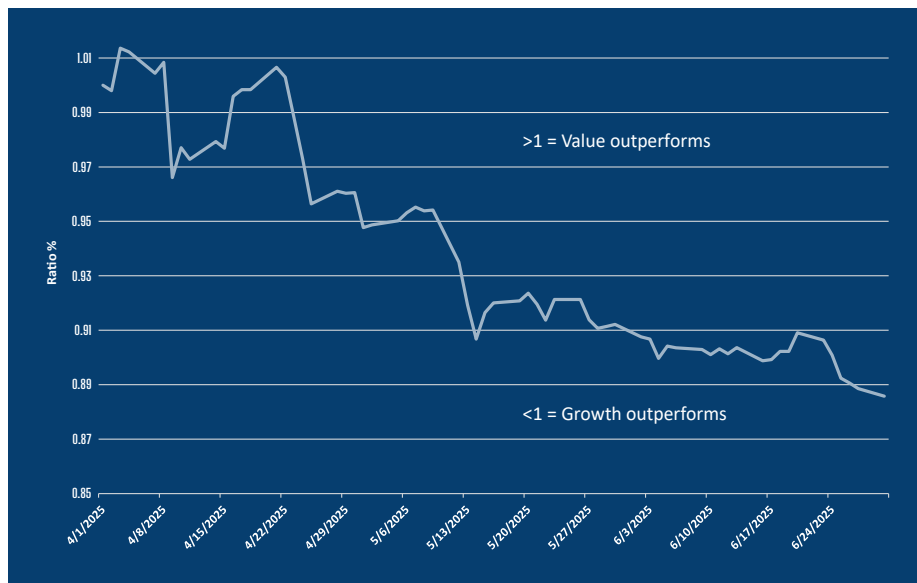


Equity – Value vs. Growth

Growth outperformed value in the second quarter.

Large Cap Value/Large Cap Growth - Q2 2025

Russell 1000 Value/Russell 1000 Growth



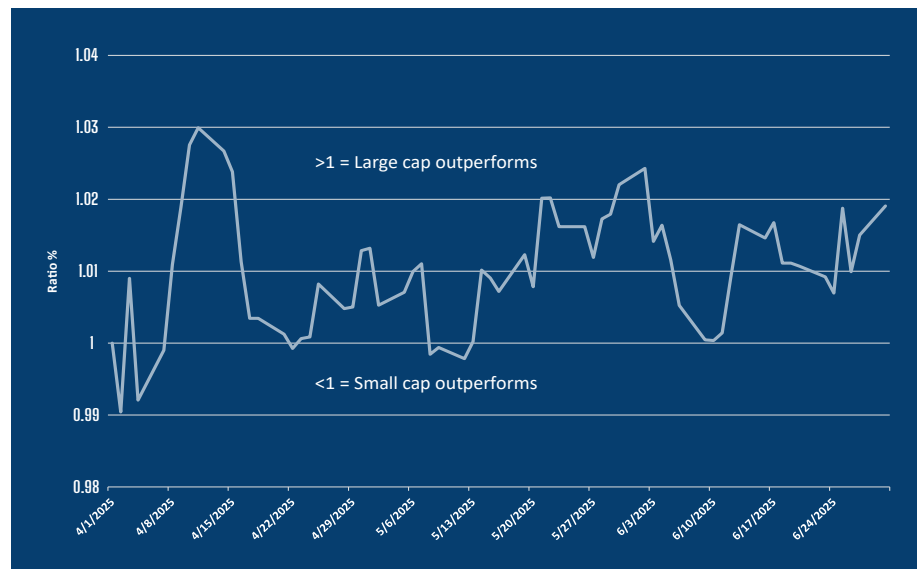
As of June 30, 2025
Source: Bloomberg

Equity – Large vs. Small

Large cap outperformed small cap during the second quarter.

Large Cap/Small Cap - Q2 2025

S&P 500/Russell 2000



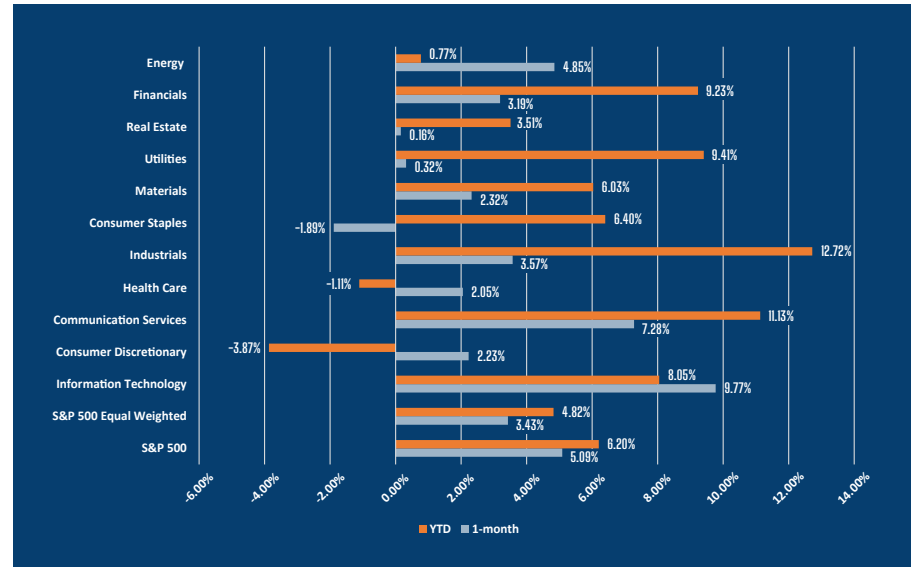
As of June 30, 2025
Source: Bloomberg



U.S. Equities – Return by Sector

Markets rallied sharply off the April lows with broad-based strength. Tech led in June, while year to date, industrials were the strongest sector.

S&P 500 Sector Returns Q2 2025

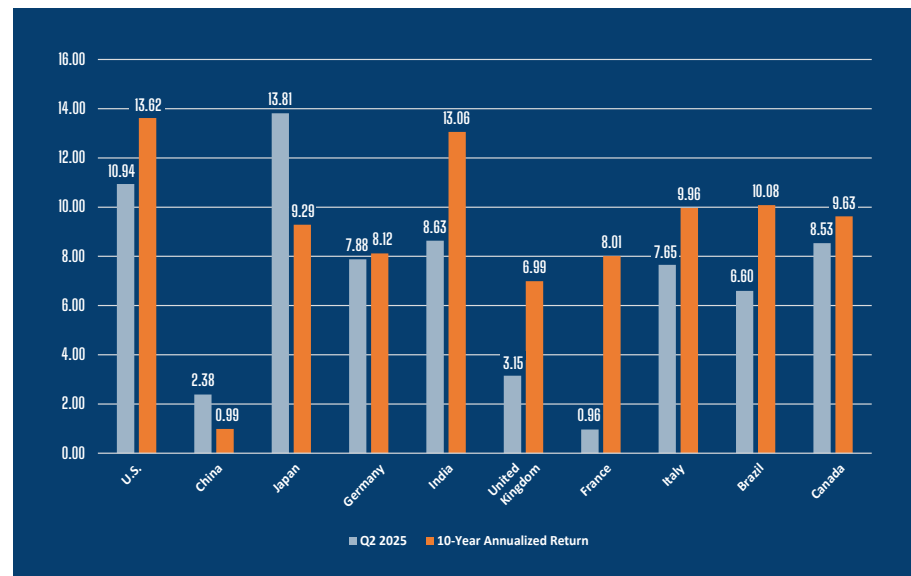


As of June 30, 2025
Source: Conway

Country Total Returns (%) – 10 Largest Economies

Global equities were very strong in the second quarter, and all of the major international markets were positive for the quarter as well as the trailing 10-year period. The weaker U.S. dollar helped domestic investors in international stocks.

Country Total Equity Market Returns



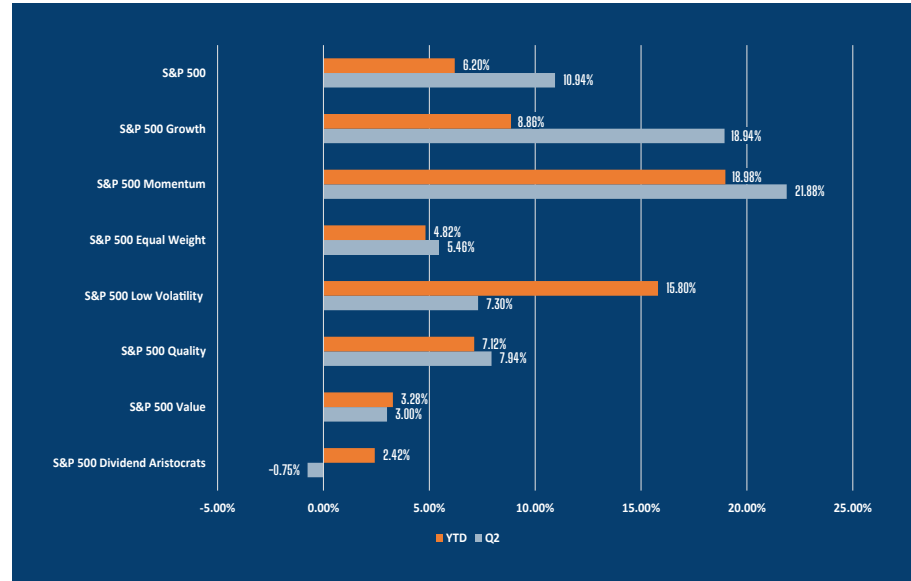
As of June 30, 2025
Source: Bloomberg



U.S. Equity Factors – Total Return (Q2)

Momentum (often associated with growth and tech) led the rebound in the markets from the April lows.

Total Return: Core Factors Q2 2025

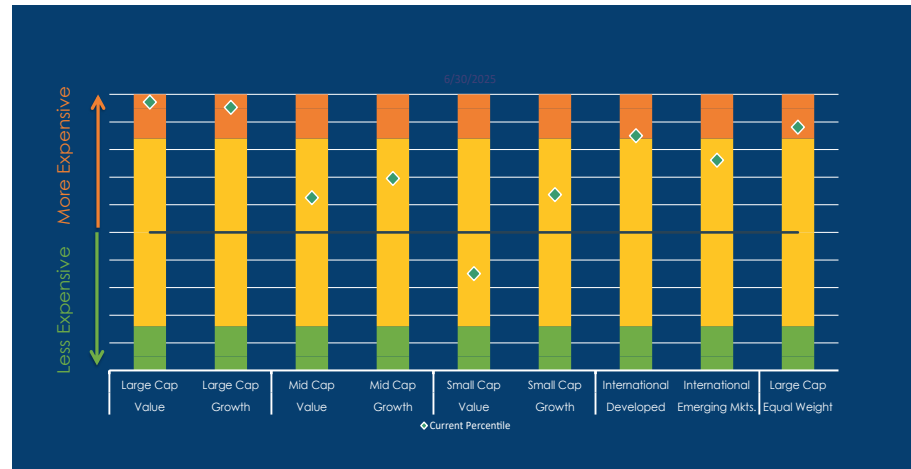


As of June 30, 2025
Source: S&P

Valuations

Large-cap stocks remain expensive relative to history and the most expensive part of the market. Valuations (except for small-cap value) remain above long-term averages.

Equity Asset Classes Value Rank to Own History



As of June 30, 2025
Source: Benjamin F. Edwards, Bloomberg



Valuations

U.S. large-cap stocks remain expensive relative to history. Tech, industrials, telecom, consumer discretionary and financials remain the most expensive sectors.

S&P 500 Composite: Forward Price-to-Earnings Estimate

(Current + Three Quarters)



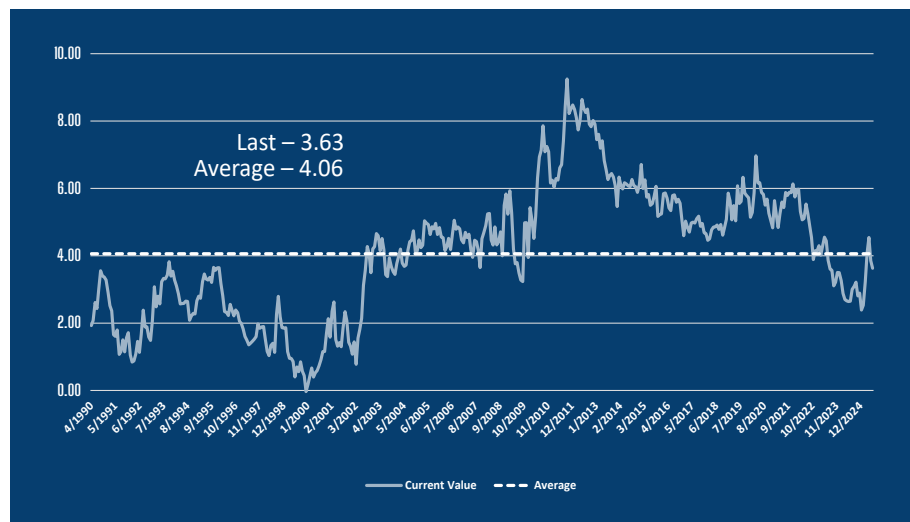
As of June 30, 2025
Source: Haver

Equity Risk Premium

The equity risk premium (ERP) is a valuation metric showing an “expected” return for stocks over bonds. The shifts in the market during the second quarter have resulted in the ERP below long-term averages.

Equity Risk Premium

Earnings Yield (1/S&P 500 P/E ratio) less Real 10-year Yield
(10-Year-Expected Inflation)



As of June 30, 2025
Source: Benjamin F. Edwards



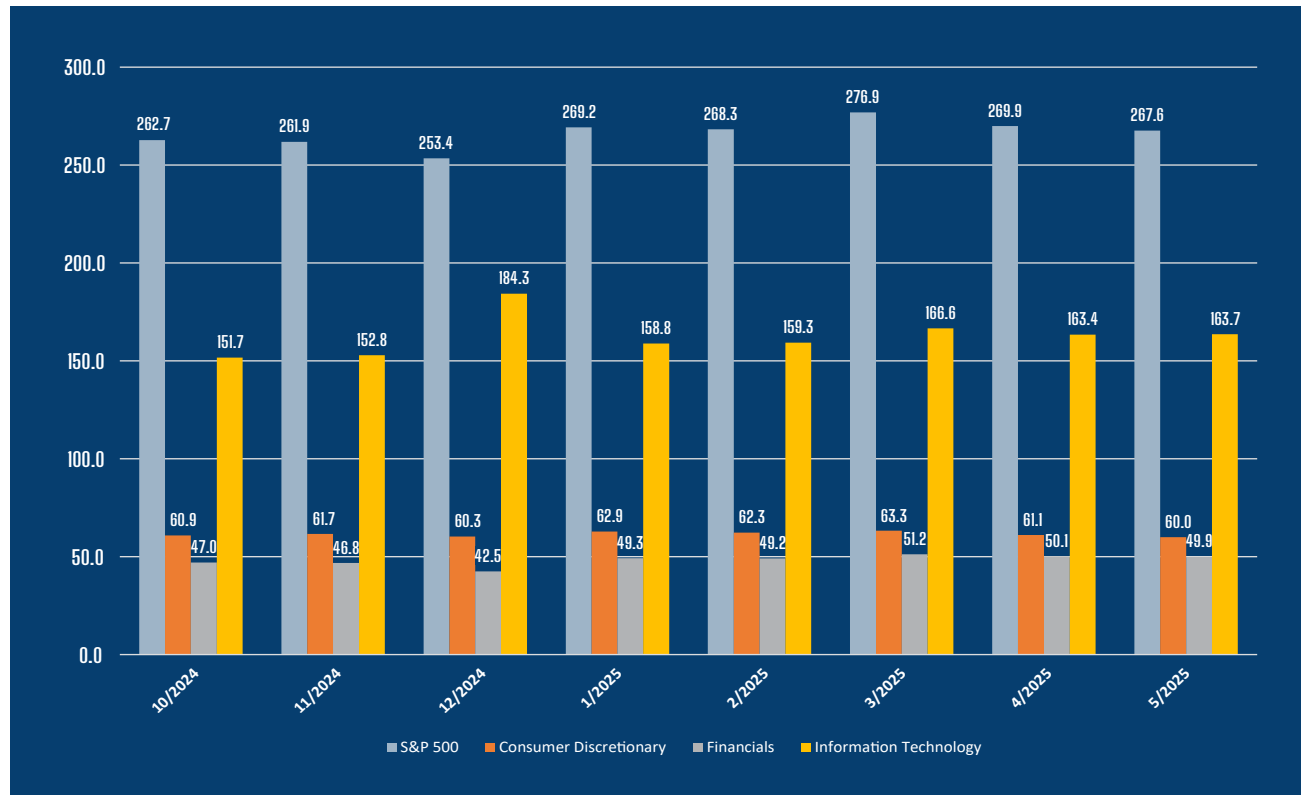
Earnings Prospects

After peaking in March, earnings estimates have declined slightly. Second-quarter earnings growth is expected to fall below the first quarter.

Mean Estimates of Earnings Per Share

Current + 3 Quarters

U.S. \$/Share



As of June 30, 2025

Source: Haver

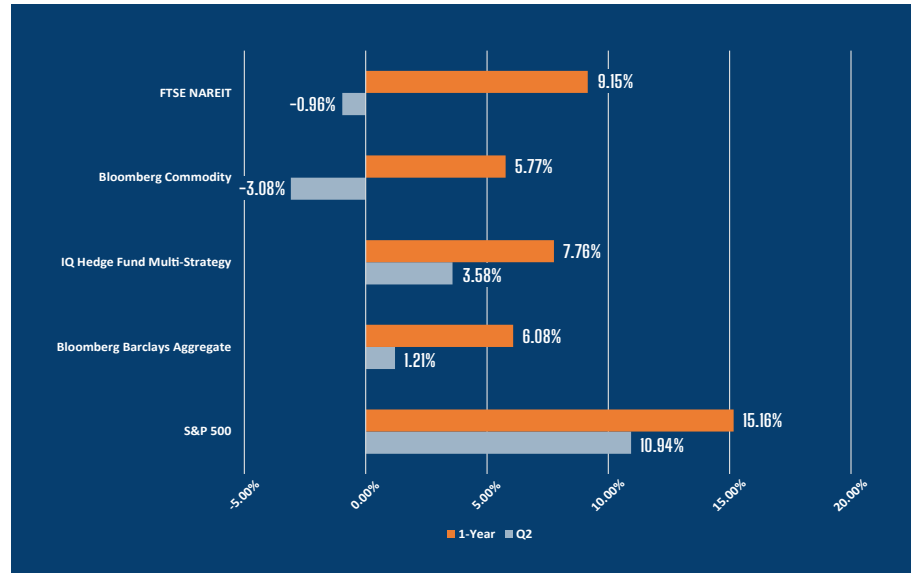


Alternative Returns

Alternative strategies and asset classes have strong trailing one-year returns, while commodities and real estate struggled during the second quarter.

Alternative Returns

Q2 2025



As of June 30, 2025

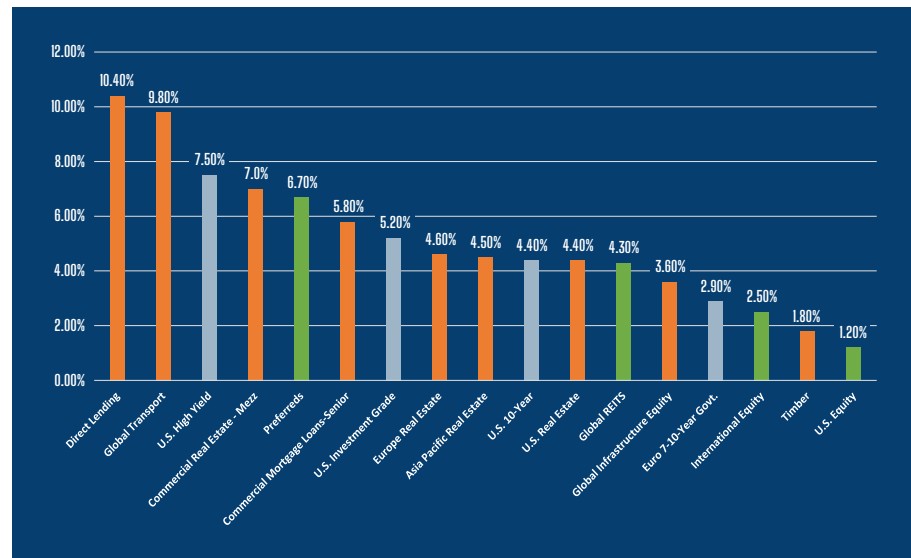
Source: Conway

Alternatives

Alternatives can offer significant yield enhancement.

Asset Class Yields (%)

Q2 2025



As of June 30, 2025

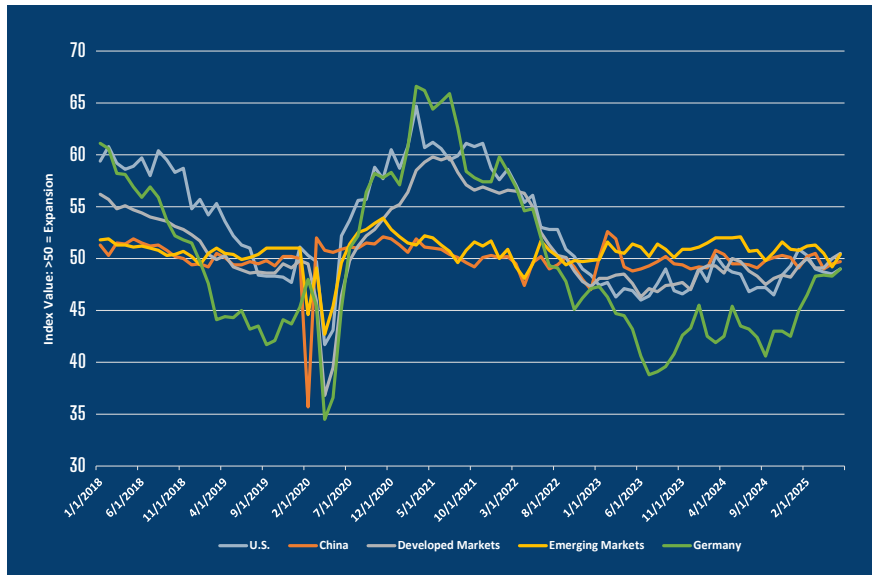
Source: Conway



PMI Composites

The Purchasing Managers Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector. Readings >50 equal expansion and <50 contraction. By this measure, global growth remains muted.

Global Manufacturing Surveys



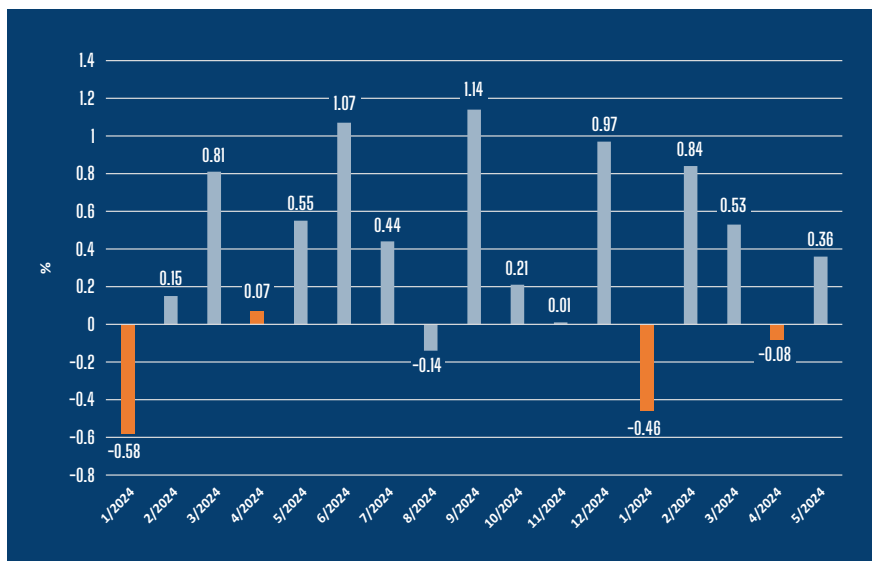
As of June 30, 2025
Source: Bloomberg, Haver

Consumer Spending

- Core retail sales continue to cool from 2024 and pre-Liberation Day levels.
- This metric is a strong indicator of economic health and is used to gauge whether the economy is contracting or expanding.

Core Retail Sales

Retail Sales and Food Services Excluding Auto, Gas Stations and Building Materials
% Change Period to Period



As of June 30, 2025
Source: Haver



Capital Goods Orders

- Capital goods were very weak in April on tariff uncertainty before rebounding in May on pent-up demand.

Manufacturers' New Orders: Nondefense Capital Goods Excluding Aircraft

% Change Period to Period

Seasonally Adjusted, \$



As of June 30, 2025

Source: Haver

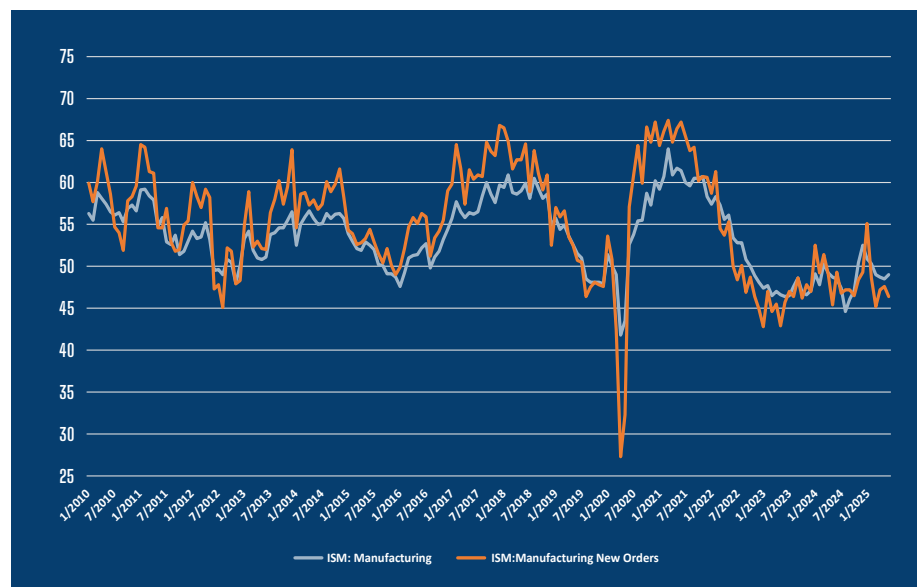
Manufacturing

After a better start to the year, manufacturing has reverted back to a slightly below neutral growth rate, which is also reflected in new orders.

ISM Manufacturing vs. ISM Manufacturing New Orders

<50 = Contraction

>50 = Expansion



As of June 30, 2025

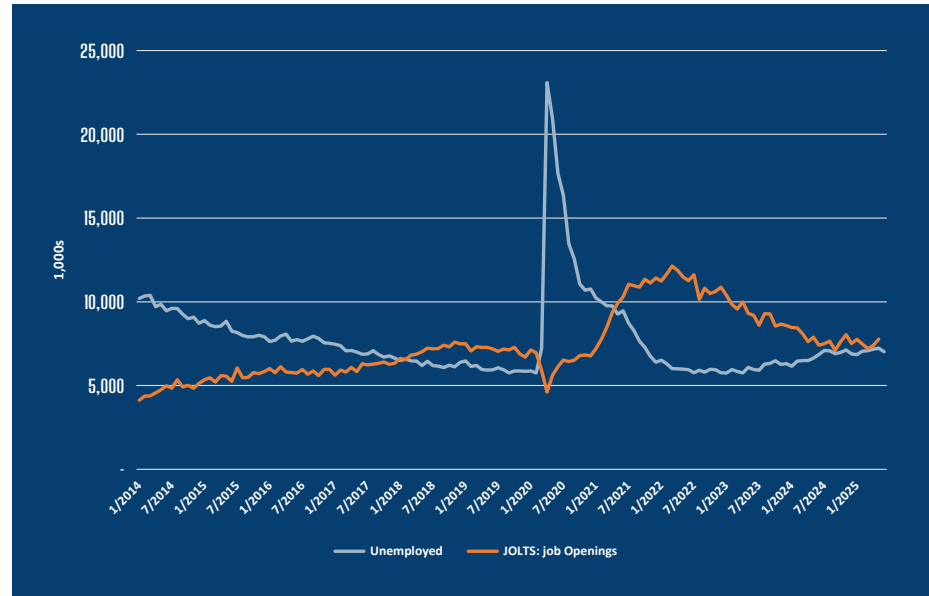
Source: Haver



Employment

Job openings continue to gradually fall but remain in excess of the number of unemployed.

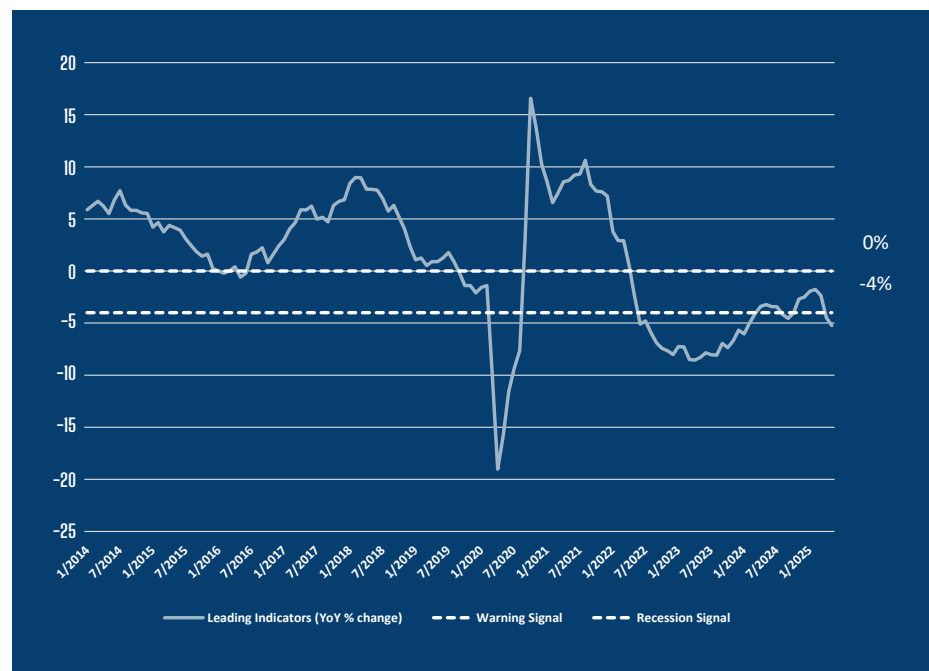
Job Openings vs. Number of Unemployed



Leading Indicators

The index of leading indicators is back into ranges consistent with a recession. Consumer expectations, building permits and non-defense new orders were some of the key contributors to the weakness over the past six months.

Composite Index of 10 Leading Indicators 6-Month % Change-Annual Rate

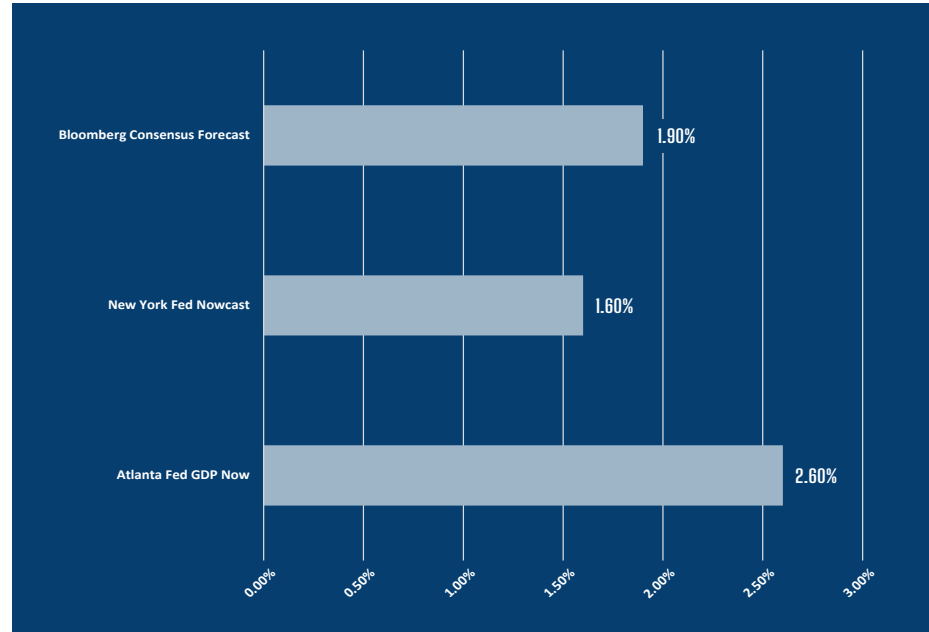




Growth

Growth forecasts have improved as the markets have become more comfortable with tariffs.

Current Quarter (Q2) GDP Forecasts



As of June 30, 2025

Source: Bloomberg, Atlanta Fed, New York Fed



June 30, 2025	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.34%	1.07%	2.13%	4.75%	4.66%	2.82%	1.97%
Bloomberg Municipal	0.62%	-0.12%	-0.35%	1.11%	2.50%	0.51%	2.20%
Bloomberg US Govt/Credit Intermediate	0.64%	1.27%	2.92%	5.94%	3.75%	1.58%	1.84%
Bloomberg U.S. Aggregate	1.54%	1.21%	4.02%	6.08%	2.55%	-0.73%	1.76%
Bloomberg U.S. High Yield	1.84%	3.53%	4.57%	10.29%	9.93%	5.97%	5.38%
Bloomberg Global Aggregate	1.89%	4.52%	7.27%	8.91%	2.75%	-1.16%	1.17%
U.S. Equity Indices							
DJ Industrial Average	4.47%	5.46%	4.55%	14.72%	14.99%	13.52%	12.06%
S&P 500	5.09%	10.94%	6.20%	15.16%	19.71%	16.64%	13.65%
NASDAQ Composite (Price)	6.57%	17.75%	5.48%	14.87%	22.69%	15.16%	15.11%
Russell 1000	5.06%	11.11%	6.12%	15.66%	19.59%	16.30%	13.35%
Russell 1000 Growth	6.38%	17.84%	6.09%	17.22%	25.76%	18.15%	17.01%
Russell 1000 Value	3.42%	3.79%	6.00%	13.70%	12.76%	13.93%	9.19%
Russell Mid Cap	3.73%	8.53%	4.84%	15.21%	14.33%	13.11%	9.89%
Russell 2500	4.61%	8.59%	0.44%	9.91%	11.31%	11.44%	8.39%
Russell 2000	5.44%	8.50%	-1.79%	7.68%	10.00%	10.04%	7.12%
Russell 2000 Growth	5.89%	11.97%	-0.48%	9.73%	12.38%	7.42%	7.14%
Russell 2000 Value	4.95%	4.97%	-3.16%	5.54%	7.45%	12.47%	6.72%
Non-U.S. Equity Indices							
MSCI World	4.35%	11.63%	9.75%	16.76%	18.87%	15.09%	11.23%
MSCI ACWI	4.53%	11.69%	10.33%	16.69%	17.91%	14.18%	10.55%
MSCI ACWI Ex-U.S.	3.45%	12.30%	18.32%	18.37%	14.59%	10.68%	6.64%
MSCI EAFE	2.22%	12.07%	19.92%	18.33%	16.57%	11.72%	7.03%
MSCI EAFE Growth	2.67%	13.71%	16.22%	11.74%	13.93%	8.24%	7.08%
MSCI EAFE Value	1.77%	10.52%	23.53%	25.13%	19.23%	15.08%	6.73%
MSCI Europe	2.08%	11.80%	23.69%	19.13%	17.95%	13.08%	7.43%
MSCI Japan	1.73%	11.39%	11.95%	14.29%	15.46%	9.15%	6.45%
MSCI AC Asia	4.61%	12.22%	13.79%	16.36%	11.78%	7.65%	6.01%
MSCI EAFE Small Cap	4.39%	16.86%	21.32%	23.09%	13.85%	9.78%	6.95%
MSCI ACWI Ex-U.S. Small Cap	4.96%	17.16%	18.05%	18.94%	14.03%	11.26%	6.99%
MSCI Emerging Markets	6.14%	12.20%	15.57%	15.97%	10.23%	7.26%	5.23%
MSCI EM Asia	6.41%	12.63%	14.24%	15.60%	9.94%	6.94%	6.06%
MSCI China	3.75%	2.08%	17.46%	34.11%	3.27%	-0.83%	2.28%
MSCI EM Eastern Europe	6.56%	17.40%	50.61%	36.70%	33.91%	-11.12%	-2.99%
MSCI EM Latin America	6.13%	15.42%	30.22%	13.97%	12.23%	11.61%	4.11%
MSCI EM Small Cap	5.79%	17.33%	10.99%	8.89%	14.37%	14.40%	6.39%
MSCI Frontier Markets	5.56%	11.35%	20.28%	24.46%	11.30%	9.69%	4.83%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	1.71%	3.58%	3.56%	7.76%	7.78%	4.12%	3.18%
Real Assets Indices							
FTSE NAREIT Composite	0.07%	-0.96%	1.91%	9.15%	3.37%	6.67%	6.44%
Alerian MLP	2.56%	-4.91%	7.06%	13.16%	26.11%	27.96%	5.60%
Bloomberg Commodity	2.41%	-3.08%	5.53%	5.77%	0.13%	12.68%	1.99%
S&P Global Infrastructure	1.97%	10.40%	15.48%	27.75%	12.51%	13.12%	7.74%
Other							
Oil Price Brent Crude	5.81%	-7.61%	-8.44%	-21.76%	-16.18%	10.44%	0.61%
CBOE Market Volatility (VIX)	-9.91%	-24.91%	-3.57%	34.49%	-16.47%	-11.28%	-0.85%

Source: Morningstar



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