

Q2 2025 Stock Market Update

Sweeping Fear Under the Rug

What a difference a couple months makes! Markets managed a remarkable comeback in the second quarter. While the S&P 500® Index's 10.9% return for the quarter is very impressive, even more notable is its stunning 24% rally since the closing low on April 8th. The S&P is now up 6.2% year-to-date, which is probably hard for some to believe given widespread investor angst just a few months ago. Remember, it wasn't long ago we penned an update in response to "Liberation Day" (April 2nd) and the threat of massive tariffs being imposed on trading partners. The market had declined 12% in just four days and was down roughly 18% from its highs at one point. What's more, the CNN Fear & Greed Index stood at 5 out of 100, suggesting "extreme fear" among market participants. Now, the S&P is sitting at new all-time highs.

Many feared tariffs would cause significant inflation and send us spiraling into recession. President Trump quickly became sensitive to the market's worries and policy was delayed and/or softened (depending on the country). While tariffs would presumably have a lagged effect, there has been scant evidence of rising prices so far and the threat has quickly faded into the background. Indeed, investors are almost acting like nothing ever happened. Remember the Department of Government Efficiency (DOGE)? The same seems to have happened here. After posing a perceived economic threat and eliciting spirited debate, DOGE quickly became yesterday's news and is hardly mentioned in the headlines.

Most recently, all eyes have been on the Middle East. Following a skirmish between Israel and Iran, the United States decided to intervene by bombing Iran's primary nuclear installations. This attack quickly gave way to anticipation of retaliation and escalation. There were also fears of a crippling spike in oil prices should Iran choose to impede the Strait of Hormuz, the primary channel for oil exports from the Middle East. But, a preliminary ceasefire between Israel and Iran was announced shortly thereafter. Since the bombing, the S&P 500 is up 4% and oil prices are actually down about 12.2%. Once again, fears were quickly swept under the rug.

What is the market telling us? Why are investors thumbing their noses at these risks? Perhaps the mind-numbing speed of the Trump news cycle lulls investors into a sense of complacency or impairs their long-term memories. Or maybe these risks simply haven't had time to fully manifest themselves. Most likely, in our view, is that the worst-case scenarios were never really viable and are now off the table. Such scenarios are typically overstated by advertising-hungry media networks and often represent more noise than signal for investors. In the absence of doomsday outcomes, it could be that the setup for both the economy and equities is actually okay.

There are indeed some positives to consider. Thus far, corporate earnings growth has remained resilient and doesn't seem poised to slow meaningfully. Some of this growth is supported by the rapid evolution of artificial intelligence (AI) within the tech sector, which has resumed market leadership. Also, inflation has come down significantly. This is providing a supportive backdrop for the Federal Reserve to lower interest rates, which should stimulate the economy. While the Fed is being patient and waiting to see any impact from tariffs, it has signaled an intent to lower benchmark interest rates later this year (there's certainly no shortage of pressure from our Commander in Chief!). Then there's fiscal stimulus and Trump's "Big Beautiful Bill". While it entails a higher budget deficit, this legislation promises lower taxes, economic incentives and a boost in domestic manufacturing. We don't want investors to become too de-sensitized to prevailing risks, but there are definitely reasons for optimism.

All told, this rally has taught us yet again that kneejerk reactions to political curveballs or headlines rarely make sense. That said, the pace of the market's recovery has indeed been a little surprising and stocks certainly appear more fairly valued post rally. We note, however, that a wide spread remains between the market's winners and losers, many



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of which fall into more cyclical or consumer-oriented areas where recession fears were most pronounced. This has afforded us the opportunity to lean into select situations where we see value. While we still expect returns to moderate from the torrid pace of 2023/2024 (and the pace of the last couple months!), we think we can generate solid returns with manageable risk and we will try our best to not pander to headlines. Enjoy the rest of your summer and we look forward to reporting back in a few months. We're sure there will be no shortage of new headlines to discuss!

Sincerely,



George L. Smith III, CFA®
Chairman, Investment Policy Committee

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