Economic Overview

July 2025

Tariffs Sew Uncertainty, Tax Bill Could Lead Rebound

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Review of 2Q 2025

The S&P 500 rose 10.52% in the second quarter of 2025 and is up 6.20% on a year-to-date basis. Stocks rebounded strongly from their recent lows and are up over 24% from their early April lows. During the second quarter the Trump administration continued to push new tariffs on the United States' largest trading partners. On April 2 they announced new reciprocal tariffs on all U.S. trading partners. These tariffs included a 10% baseline tariff plus a reciprocal tariff ranging from 10% to 49%. The reciprocal tariffs were calculated by taking the U.S. trade deficit with the specific country and dividing the amount by the value of goods trading. The Trump administration eventually added a 125% tariff on China on April 9 due to Chinese rhetoric, and then the administration paused the tariffs as negotiation began in Switzerland on a trade deal. The Trump administration was able to complete a trade deal with the U.K.

As of quarter end there have been no new announcements of completed trade deals. The administration is currently pushing to complete several trade deals by a self-imposed deadline of July 9, which the administration extended to Aug. 1. The countries involved are: European Union, India, Vietnam, Japan and South Korea. The negotiations are proving complex and difficult, and if permanent deals are not reached, the higher reciprocal tariffs will apply. We do not know why the Trump administration led with tariffs, as they are highly disruptive.

The markets rebounded as the White House tariff stance softened from punishing our trading partners led by Peter Navarro to a more moderate stance led by Treasury Secretary Scott Bessent. Despite the economic challenges that the tariffs present, the amount of money collected so far has been impressive. In April the U.S. Treasury collected $16.3 billion, and in May they collected nearly $23 billion. On May 11 the Secretary Bessent announced a reduction in tariffs imposed on China and the opening of a negotiation period where the two countries would hammer out a permanent trade deal.

At quarter end news indicated that both China and the U.S. have agreed to a framework to lower the trade barriers of both countries, but China continued to withhold rare earth material used in the manufacturing of electric motors, loudspeakers, lithium-ion batteries and other common items.

We believe that the U.S. has complicated other trade negotiations by rolling back tariffs so aggressively to China. China is a poster child for state subsidized exports and has the largest trade deficit with the United States. We expect the EU to ink a deal by the deadline but believe that other countries will want more time, and the deadline will be pushed out. The May advance goods trade balance was reported higher than expected. The reality of the tariffs is that both middlemen and retailers are paying the duty, and most purchase patterns have remained the same despite producer price index wholesale prices moving higher by over 3.5% since December.

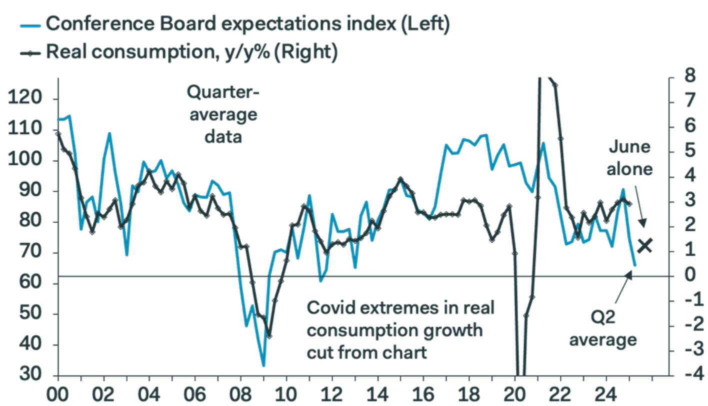
As we discussed last quarter, the effect of all these actions is that consumer confidence and sentiment has continued to decline as prices have moved higher. Consumer spending continues to slow as the combination of high prices and high interest rates are causing U.S. economic growth to continue to slow. The labor market continues to weaken, and we expect the U.S. unemployment rate to move up to 4.6% by the end of the year, from 4.3% at quarter end.

The number of job openings continues to decline, as many S&P 500 companies continue to curtail hiring plans and announce layoffs as business conditions are not optimal. Personal income declined in May through a combination of higher retail prices and falling pay due to weakening in the labor market.

U.S. GDP Estimates

'24E	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25 Est.	'26 Est.	'27 Est.	'26 Est.
2.7%	-0.2%	1.0%	1.4%	1.6%	1.0%	1.5%	1.7%	1.3%

U.S. Conference Board Expectations Index

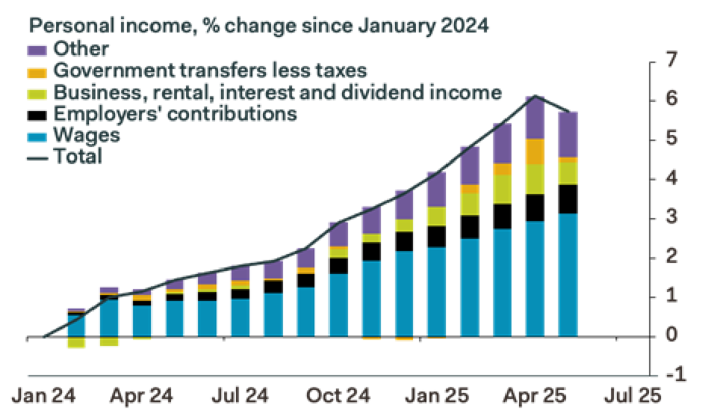


U.S. Core PCE YoY

Act.	Est.	'25E	'25E	'25E	'25E	Est.	Est.
2.9%	2.9%	2.6%	2.5%	2.5%	2.4%	2.5%	2.3%

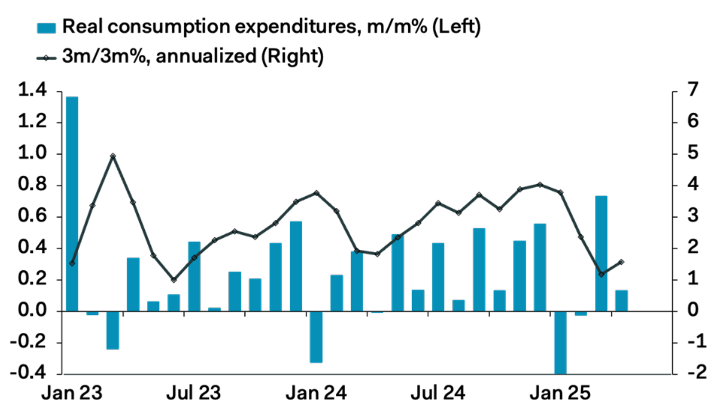
Real consumer spending continues to decline, but the tariff announcements created some short-term demand for automobiles and other imported durables ahead of the tariffs becoming effective. Despite all the weakness, long term Treasury rates have moved higher during the quarter as fiscal spending concerns have been remained in the headlines and the media has been focused on the potential cost of the Trump tax and spending bill.

U.S. Personal Income Percentage Change



Source: Pantheon Economics

Real Consumption Expenditures MoM Through May '25



Source: Pantheon Economics

Economic Outlook

Our outlook for the balance of 2025 is positive. We are hopeful that the administration is successful in inking several trade deals, which could set up the second half of the year to have higher GDP growth, but we remain concerned about the sub two percent GDP growth projections for 2026 and 2027. Prior to the tariff rollout, street numbers expected GDP growth of 2.4% and 2.6% respectively. In late April more data that confirmed our belief that economic growth was continuing to slow. First quarter GDP was initially reported at -0.4%, and then revised to -0.2%. We remain concerned that GDP growth continues to slow and that the FOMC should be cutting rates sooner rather than later. We view the FOMC's current stance as flawed, they to remain hawkish, which presents additional economic risks, and Powell has remarked publicly that rates would have been cut earlier this year if not for the tariff situation.

The Federal deficit was $1.8 Trillion in 2024, and the gap between spending and revenue continues to grow. The total amount of Treasury bonds outstanding is approximately $29 Trillion. The 10-year Treasury bond yield moved from 3.9% in early April and peaked at over 4.6% in late May. But long yields fell as forecasters became more bullish on the economic outlook. Treasury yields are heavily influenced by the economic outlook and investor expectations for short term rates set by the FOMC. Unfortunately, the Treasury auctions have been larger than needed due to Janet Yellen's decision to issue more short bonds during the Biden administration. This choice is also having an impact on the cost of financing the deficit. M2 is finally growing despite the FOMC's continued quantitative tightening. At quarter end M2 stood at $21.94 Trillion.

The Trump tax cut bill was signed into law in early July. If the Trump administration is successful in reaching advantageous trade deals, this combination, along with deregulation, will cause GDP growth to accelerate and deficits to decline in real terms. The recession fears have subsided in the short term. In making Trump's first term tax cuts permanent, Congress increased the state and local tax deductions. The bill also included additional restrictions and requirements on Medicare, and a reduction in clean energy tax cuts. The bill provided for a campaign promise of no taxation on tipping for incomes below $150,000 but will not eliminate taxes on social security. The bill also has provisions for further acceleration in capital expenditures which will be beneficial to U.S. businesses.

Real Consumption Expenditures MoM Through May '25

Source: Bloomberg

The U.S. dollar has been a headwind for the economy since March of 2022 when the FOMC first started tightening rates. The dollar has continued to weaken throughout 2025, and a weaker dollar is helpful in making U.S. goods more competitive overseas. That should be accretive to GDP in the second half of the year. We believe that the dollar should strengthen in the second half as trade deals get signed and international backlash against the U.S. fades.

The FOMC has been "waiting for additional clarity" before they cut rates. We believe that the continued tension between President Trump and Jerome Powell has impacted the FOMC's downward path on rates, resulting in a more hawkish FOMC. Several Federal Reserve governors have come out in support of rate cuts sooner rather than later. The sticking point is a fear that the inflation data that has recently been released has been benign and does not show the effect of the tariffs. The longer the FOMC waits the greater the risk is that they will get behind the curve and hurt GDP growth and employment. We expect the FOMC to cut the Federal Funds rate by 0.5% in 2025. We expect them to cut by an additional 0.75% in 2026. We see the neutral rate on Federal Funds to be around 3%. This would equate to a 6% prime rate.

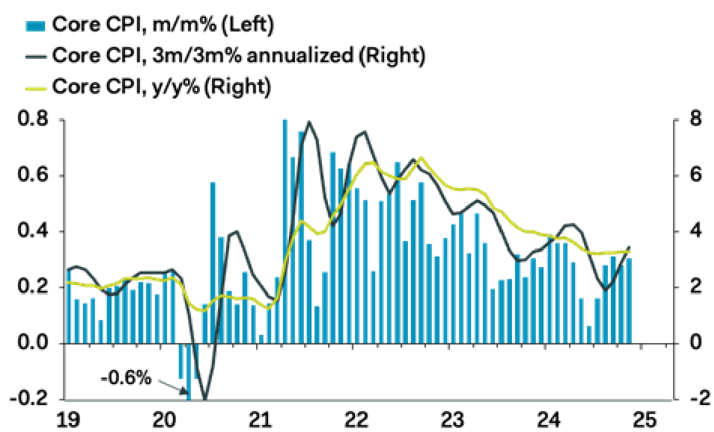
The volatility within the Treasury market has made predicting the number of FOMC cuts difficult. At quarter end the Federal Funds Futures expect the FOMC to cut rates by 0.71% in the second half of 2025. Currently the Federal Funds futures show that there is a 20% of a July cut, 91% for September, 71% in October and 72% chance in December. The labor market continues to soften, which should be concerning to the committee.

The Trump administration needs to move past tariffs and focus on stimulating growth in the second half of 2025. Several other initiatives that would improve the economic performance of the country, including medical transparency, energy independence, and deregulation. If the republicans want to maintain control of the house and senate past next year's mid-term elections, we believe it is essential that the U.S. get GDP growth up to a level around 2.5% so that in real terms there will be a reduction in U.S. debt levels.

Unemployment Rate

'24 Act.	1Q '25E	2Q '25E	3Q '25E	4Q '25E	'25 Est.	'26 Est.
4.2%	4.2%	4.3%	4.4%	4.6%	4.5%	4.6%

Core PCE Month-to-Month



Source: Pantheon Economics

Portfolio Strategy

At quarter end the S&P 500 traded at 24.3x earnings up from 22.9x in the first quarter. The index is currently estimated to be trading at 20.8x 2026 earnings. We have raised our 2025 S&P 500 earnings projection due to stronger than expected earnings growth. Our new estimate is $255 up from $240, which should provide a positive backdrop for the second half of the year. We expect 2025 to be a good year with equity prices rising 8%-10%. We expect volatility to continue.

The best performing sectors for the quarter were Information Technology up 22.54%, Communications up 17.30%, and Industrials up 12.26%. The worst performing sectors for the quarter were Energy down 9.09%, Healthcare down 5.53%, and Real Estate down 0.18%.

The best performing sectors year to date were industrials up 12.72%, Communications up 11.13%, and Utilities up 9.41%. The worst performing sectors year to date were Consumer Discretionary down 3.87%, Healthcare down 1.11%, and Energy up 0.77%.

The S&P 500 sectors currently trading below the S&P 500 at the end of the second quarter were: Energy 15.7x, Financials 19.1x, Utilities 19.4x. The most expensive sectors at quarter end were Real Estate 42.9x, Information Technology 40.5x, and Consumer Discretionary 20.2x.