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SECOND QUARTER 2025 ECONOMIC AND FINANCIAL MARKETS REVIEW

The stock and bond markets do not like uncertainty, and the second quarter was filled with unpredictability surrounding global trade, the national debt, and military conflicts, leading to financial market volatility. Despite the uncertain environment with a significant drop in the stock market early in the quarter, the S&P 500 Index finished the first half of the year up 5.50%, while the Dow Jones Industrial Average was up 3.64%. Bonds saw some volatility during the first half of 2025 as well, but the Bloomberg Intermediate U.S. Government/Credit Bond Index increased 4.13%.

The stock market plunged at the beginning of the second quarter due to President Trump's April 2nd tariff announcement, which was even more aggressive than anticipated. Investors were concerned that the tariffs on imported goods could raise prices for U.S. consumers, adding to already-existing inflation pressures. Alternatively, corporations could absorb the tariffs rather than raise prices, but that could harm their profits. Additionally, other countries imposed retaliatory tariffs on U.S. goods, which investors feared would negatively impact the future earnings of U.S. corporations that sell goods overseas. Many worried that these trade wars between the U.S. and other nations could result in a weakened global economy or even a recession. In addition to trade wars, military conflict in the Middle East at the end of the quarter led to additional concerns in the global financial markets.

Just one week after imposing large-scale tariffs on other countries, the Trump administration temporarily reduced or paused tariffs on various countries and began negotiating independent trade deals. This made investors confident that the tariffs would not last as long as originally anticipated, leading to a stock market rebound. Since then, there have been many announcements by the President of special tariffs on specific countries and companies. Tariffs have also been implemented for particular materials and products, such as steel and semiconductors. The stock market will likely continue to be impacted by evolving news regarding U.S. trade policy.

In addition to trade war concerns, financial markets have been uneasy due to worries regarding the nation's debt. This anxiety began when Moody's credit rating agency downgraded U.S. credit by one level due to rising budget deficits and growing debt. Lower credit ratings and rising national debt can lead to higher interest rates in the U.S. Treasury bond market, as investors demand a higher interest rate on their bonds for lending money to the United States. This potential elevated interest cost, in addition to fears that other countries may be less likely to buy U.S. debt, is sparking fears about the future of U.S. economic growth.

In the meantime, the Federal Reserve Board was expected to lower interest rates numerous times this year to help the economy through these policy changes. However, the Fed has indicated that they are not comfortable lowering rates until inflation conditions continue to improve further. Because of this, the Fed is now only expected to lower interest rates one or two times in the second half of this year. When the Fed lowers interest rates, it is generally positive for the economy and the stock market, so this could balance out some of the concerns regarding future economic growth and corporate earnings.

We expect the second half of this year to be much like the first half for stocks and bonds as tariff, debt, and military conflict concerns continue. We are not expecting a global recession this year, but stocks will likely remain volatile if economic figures released by the government show that consumer spending and business activity slow due to economic uncertainty. Declines in consumer and business confidence and an increase in inflation expectations could lead to lower corporate earnings, directly impacting stock prices. However, we anticipate that even one interest rate cut by the Fed will lead to some support for the stock market.

We continue to overweight large company stocks, which tend to be less volatile than smaller-sized stocks during economic uncertainty. We have started allocating more money to foreign stocks for investors with a relatively high risk tolerance because they are generally undervalued versus U.S. stocks after having underperformed U.S. stocks for many years. We still prefer short-term bonds over long-term bonds as the best combination of risk and reward in fixed income.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on July 1, 2025.*