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Q2 Market Review

Resilience

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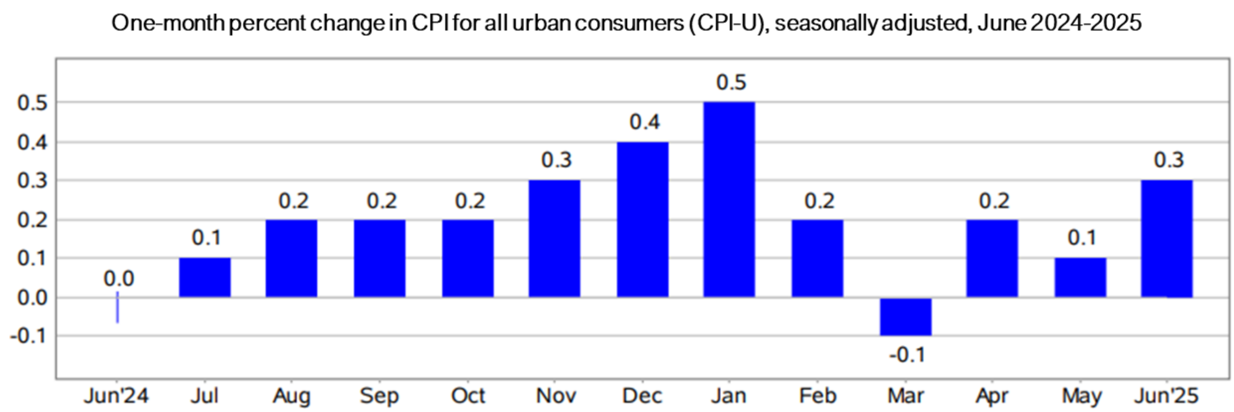
U.S. equity markets began Q2 2025 with their largest drop since 2020 following President Trump's sweeping "Liberation Day" tariffs announcement. Once tariffs were paused on April 9^{th}, however, the market experienced a robust rebound. The S&P 500 reached new record highs by late June, recovering losses and finishing the quarter +10.9%, while the Nasdaq Composite and the Dow Jones Industrial Average finished +17.7% and +5.0% respectively. Although Tech (+22.0%) and Communication Services (+18.8%) were among the rally's leaders, many other sectors participated in the gains including Industrials (+13.1%), Utilities (+7.7%), and Financials (+6.9%). As we enter the third quarter, we may see a continued slowing of economic growth, a modest rise in unemployment, mildly elevated inflation levels, and a steady U.S. consumer. Factors that we will monitor closely as we make our investment decisions include the impact of tariff policy on the U.S. economy, health of the labor markets, inflation, interest rates, consumer sentiment, and corporate earnings projections.

The Economy

After contracting at an annualized rate of -0.5% in Q1 2025, the economy rebounded in Q2. According to the Atlanta Fed's GDPNow estimates, second quarter real GDP growth was running around 3.8% annualized as of mid-June, though it was later revised to a Bloomberg consensus of about 2.1%. The sharp bounce was driven largely by a reversal in trade flows, which added significant growth. Core GDP (excluding volatile trade/inventories) grew by an estimated 1.9% annualized. According to the U.S. Bureau of Labor Statistics, the Consumer Price Index *(Figure 1)* for All Urban Consumers rose 0.3% (seasonally adjusted), and 2.7% over the last 12 months (not seasonally adjusted). The index for all items less food and energy increased 0.2% in June (seasonally adjusted), up 2.9% over the year (not seasonally adjusted). Non-farm payrolls rose by roughly 147,000 in June, closely matching the Q2 monthly average of about 140,000 to 150,000 per month.

Figure 1



Source: U.S. Bureau of Labor Statistics

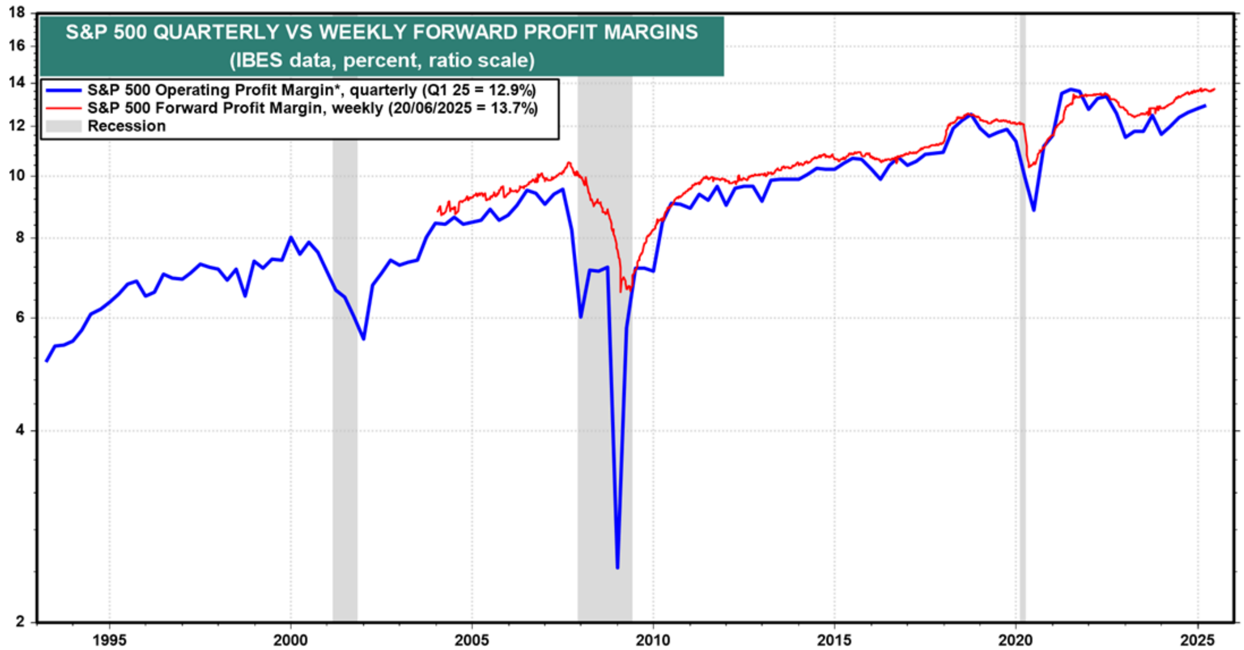
While headline growth remained positive, it softened compared to 2024's stronger pace (168,000 per month), signaling that labor growth is slowing. Overall, the labor market remains "generally healthy," but numerous headwinds – including tariffs, trade uncertainty, and weakening GDP growth – are weighing on hiring. Fed Chair Powell described conditions as "solid" and "at or near full employment," while cautioning that cooling in hiring and rising jobless claims require watchful policy consideration.

Tariffs and Interest Rates

The Congressional Budget Office projected that the 2025 tariffs would raise inflation by an average of +0.4% annually in 2025–26 and reduce GDP growth by about –0.06% per year. At the same time, the Wall Street Journal, JPMorgan, and other analysts all noted that "inflationary pressures from costlier imported materials could drag on business margins and consumer prices." However, the Core CPI (minus food and energy) in

May rose less than expected, suggesting that businesses have begun to absorb some tariff costs. Through the end of the second quarter, it appears that Trump's tariff turmoil had remarkably little impact on the forward profit margin of the S&P 500. Per *Figure 2*, you can see that it has been relatively flat since the start of the year and remains currently close to a record high of 13.7%. This data possibly suggests that investors feel that the tariff issue may be behind us by the end of summer. Regarding interest rates, it appears that tariff uncertainty and inflationary pressures have raised concern among the Fed. In June, the Fed left its benchmark federal funds rate unchanged at 4.25–4.50%, marking the fourth straight hold. Additionally, its dot plot forecasts a median expectation of two quarter-point (0.50%) rate cuts by the end of 2025, with an additional cut projected in 2026. According to Reuters, the odds of a July cut are low with focus shifting to cuts in September and possibly December, assuming inflation cools.

Figure 2



Source: LSEG Datastream and Yardeni Research

The Consumer

In May, the University of Michigan Consumer Sentiment Index (*Figure 3*) was down to 52.2 from April's similar level, reflecting one of its lowest readings in decades. It rose sharply in June to 60.7 – a +16% jump – marking the first gain after six consecutive drops. Sentiment, however, remained 11% below the June 2024 level. Drivers of the Q2 2025 rebound included a cooling in trade tensions, stable prices, and easing tariff concerns. Despite the increase, broader apprehension persisted, including inflation expectations and

Figure 3

	Jun 2025	May 2025	Jun 2024	M-M Change	Y-Y Change
Index of Consumer Sentiment	**60.7**	52.2	68.2	+16.3%	-11.0%
Current Economic Conditions	**64.8**	58.9	65.9	+10.0%	-1.7%
Index of Consumer Expectations	**58.1**	47.9	69.6	+21.3%	-16.5%

Source: University of Michigan, Consumer Sentiment Survey, June 2025

geopolitical uncertainty. The University of Michigan hints at a tentative shift toward optimism, though not yet strong enough to signify fully recovered consumer morale. Historical trends show sentiment measures don't always align perfectly with spending—indicating these readings are important, but not always definitive in predicting consumption.

The U.S. Stock Market

The S&P 500 delivered a strong performance in Q2 and had a significant rebound from Q1's decline. The Technology sector (+22.0%)—led by the Magnificent 7—delivered the strongest gains. Communication Services (+18.8%) paced growth stocks, benefitting from both AI enthusiasm and the momentum of the Tech sector. Consumer Cyclicals (+10.9%) rounded out the Top 3 best performing sectors with a broadening of the rally beyond the mega-caps. Other notable performers were Utilities (+7.7%), providing defensive exposure with tailwinds from data-center energy, and Financials (+6.9%), which benefitted from deregulation hopes and rising rates. The 3 worst performing sectors were Energy (-7.7%), Healthcare (-6.1%), and Real Estate (-.43%). Overall, Q2 2025 marked a remarkable turnaround in U.S. equities. Despite an April tumble, the quarter closed on a high note with record-setting moves and a well-balanced, broad-based rally. Policy clarity—especially around trade and the Fed's interest rate path—helped sustain the rally and calm volatility.

Figure 4

Name	Q2 2025
Basic Materials	3.52
Communication Services	18.79
Consumer Cyclical	10.91
Consumer Defensive	1.14
Energy	−7.66
Financial Services	6.89
Healthcare	−6.06
Industrials	13.08
Real Estate	−0.43
Technology	21.95
Utilities	7.69

Source: Morningstar

Earnings Outlook

According to FactSet, blended S&P 500 earnings growth for Q2 2025 is tracking at +5.6% year-over-year, up from the +4.9% estimate at quarter-end June 30th. This +5.6% rate would mark the lowest YoY growth since Q4 2023 (+4.0%)—but still the 8th straight quarter of earnings growth. FactSet's report shows upward estimate revisions since quarter-end in seven sectors, reflecting stronger-than-expected earnings surprises. Financials are outperforming expectations—boosted by firms such as JPMorgan, Goldman Sachs, Citi, and Wells Fargo—with sector growth near +8.6%. Technology and Communication Services sectors lead growth, while Energy continues to drag earnings, down around -25% year-over-year. Among the "Magnificent 7" (Big Tech), earnings are expected to grow by +14.1% year-over-year, substantially above the broader index. Wall Street analyst and President of Yardeni Research, Ed Yardeni, remains more bullish than the analysts' consensus and expects earnings growth somewhere in the 7-10% range given the following tailwinds:

- Healthy earnings fundamentals can be an indicator of continued earnings strength
- Tariff easing, GDP growth and analyst underestimation could lead to surprise performance
- Market context shows modest consensus with upside surprise potential

Nevertheless, several known risks remain—including tariff volatility, macroeconomic headwinds, consumer weakness, and trade disruptions—that could temper outcomes. As for the remainder of the year, FactSet forecasts +7.4% EPS growth in Q3 and +6.8% in Q4 2025, with full-year 2025 growth around +9.3%.

Bottom Line

The U.S. equity market has shown steadfast resilience over the past several months and all three stock indices (S&P 500, Dow Jones Industrials and NASDAQ) have achieved all-time highs. We believe it's the solid underpinnings of the economy and corporate earnings growth that have enabled the equity market to withstand the turbulence caused by geopolitical events and ever-changing U.S. tariff policies. In our opinion, the positive outlook for further economic and corporate earnings growth will continue to benefit the U.S. stock market. Nevertheless, we will stick with the fundamentals, remain mindful of ongoing risks, and take advantage of any market declines to make attractive individual stock changes in our client portfolios.

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*GIPS Composite Data and Verification Information Available Upon Request