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Market Newsletter
Second Quarter 2025

EXECUTIVE SUMMARY

- The second quarter was marked by sharp market volatility driven by aggressive tariffs and geopolitical tensions in the middle east. However, by the end of the quarter, stocks recovered most of their losses before making new highs.

- The market's reaction prompted the government to change trade policies later in the quarter. Tariffs are expected to settle at the highest rate since the 1930's.

- As a result of the ever-changing trade policy, there is considerable uncertainty in the economy. Companies are swinging into action, proactively restructuring their supply chains to mitigate tariff impacts. Earnings are expected to continue growing but at a slower pace than previously expected.

- The Federal Reserve is in a difficult spot, having to decide between controlling prices and supporting employment. They have indicated that, depending on economic data, they will gradually lower interest rates.

- This quarter showed the importance of focusing on long-term results and the futility of trying to forecast events such as trade policies or expectations of recessions.

Table 1: Market indices

(Returns include dividends reinvested)	**Quarter to date**	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
S&P 500	10.94%	6.20%	15.16%	19.71%	16.64%
S&P Mid Cap 400	6.71%	0.20%	7.53%	12.83%	13.44%
S&P Small Cap 600	4.90%	-4.46%	4.60%	7.65%	11.68%
MSCI Emerging Markets	12.20%	15.57%	15.97%	10.23%	7.26%
MSCI EAFE	12.07%	19.92%	18.33%	16.57%	11.72%
Vanguard Total Bond Market Index	1.26%	4.03%	5.90%	2.47%	-0.86%
Investment Grade Credit	1.79%	4.20%	7.06%	4.47%	0.36%
Non-Investment Grade Credit	3.57%	4.50%	10.28%	9.85%	6.01%
Bloomberg Commodity Index	-3.08%	5.53%	5.77%	0.13%	12.68%
Dollar Index	-7.03%	-10.69%	-8.49%	-2.55%	-0.52%
10 Yr. Rate	4.23% 06/30/2025	4.57% 12/31/2024	4.34% 06/30/2024	2.97% 06/30/2022	0.64% 06/30/2020

Source: S&P Dow Jones, St Louis Fed, MSCI.com, Morningstar, Bloomberg, Yahoo Finance

Table 2: Vanguard Life Strategy (Asset Allocation) Funds

	Quarter to date	**Year to date**	**1 Year**	**3 Year Annualized**	**5 Year Annualized**
Income (20% stocks)	3.52%	5.00%	8.31%	5.63%	2.27%
Conservative Growth (40% stocks)	5.66%	6.49%	10.51%	8.47%	5.11%
Moderate Growth (60% stocks)	7.65%	7.89%	12.53%	11.28%	7.92%
Growth (80% stocks)	9.58%	9.23%	14.51%	14.09%	10.75%

Source: Vanguard

Table 3: Recent Major US Economic Releases (These indicators have a significant impact on the stock market)

As of 07/03/2025			
	Latest Release	Recent Trend	Notes
Non-Farm Employment	147,000	Positive	Overall employment situation continues to be reasonably strong. However, the latest data indicates private sector hiring has been slowing down with softness in manufacturing, wholesale trade, and business services hiring.
Weekly Claims for Unemployment Insurance	236,000	Negative	There are signs that the labor market is softening as initial claims are trending up. Continuing claims are at the highest level since November 2021.
ISM Manufacturing Index (over 50 indicates growth)	49	Negative	Manufacturing activity continues to be weak as the index is hovering below the crucial level of 50. Companies have been cautious in hiring and with capital spending because of the uncertainty in the economy.

	Latest Release	Recent Trend	Notes
ISM Non Manufacturing Index (Over 50 indicates growth)	50.8	Negative	The index shows that the services sector (~80% of the economy) has resumed growth after a brief period of contraction, however the sector has been growing at a slower pace for several months now.
Consumer Prices (Month over month change)	0.1%	Positive	Tariffs are yet to have a meaningful impact on prices. Lower gas and egg prices kept inflation lower than expected. Inflation rose 2.4% over the last 12 months.
Producer Prices (Month over month change)	0.1%	Positive	Wholesale prices were lower than expected anchored by lower air fares. Producer prices rose 2.6% over the last year. Economists expect Tariffs to raise prices in the near future.
Retail Sales (Month over month change)	-0.9%	Negative	Despite improving sentiment, consumers spent less last month. Retail sales was dragged down by uncertainty about the economy. Excluding items such as gas, autos and building materials, sales increased 0.4%.
Consumer Confidence (Conference Board)	93	Negative	Consumer confidence has continued to deteriorate since the start of the year with worries about lack of jobs and inflation.
Durable Goods Orders (Month over month change)	16.4%	Positive	It was the highest increase in 11 years but skewed because of large Boeing orders. Stripping out transportation, core capital goods was up 0.5% in May and is up 2.3% since last year.
Industrial Production (Month over month change)	-0.2%	Negative	This is the second drop in three months impacted by lower output from utilities, mines and factories. Muted but slightly positive manufacturing output did not help. Companies are being cautious in the face of Tariffs and policy uncertainty.
Capacity Utilization	77.4%	Negative	This is a measure of how fully firms are using their resources. It is 2.2 percentage points below its 1972–2024 average indicating some slack in the economy.
Housing Starts	1.256 Million	Positive	Homebuilding activity dropped in May as starts in the single-family segment remained weak, and activity in the multifamily sector retreated for the first time in 4 months. Elevated mortgage rate and economic uncertainty have dampened homebuilder sentiment.
Home Prices (Case-Shiller Home Price Index- Year over Year)	3.40%	Negative	The rate of growth in home prices slowed for the third straight month. The annual growth rate was the slowest since August 2023.
GDP (Real, Annualized)	-0.5%	Positive	First quarter GDP slowed more than expected because companies rushed to import more goods before Tariff increases. 2025 GDP is expected to increase by 2.5% as per Atlanta Fed.

Source: Bloomberg, www.federalreserve.gov, www.bls.gov, www.ismword.org, www.nahb.org

The second quarter was eventful, marked by evolving trade policies, financial market turbulence and heightened tensions in the Middle East.

Early in the quarter, President Trump's tariff campaign created market chaos and diplomatic tensions before ultimately settling into a mixed landscape of partial rollbacks and ongoing negotiations. The administration's aggressive trade strategy began with 25% tariffs on Canada and Mexico in February, followed by sweeping 10% baseline and additional reciprocal tariffs on most countries by April. Most notably, China faced escalating duties reaching 145% after implementing retaliatory measures.

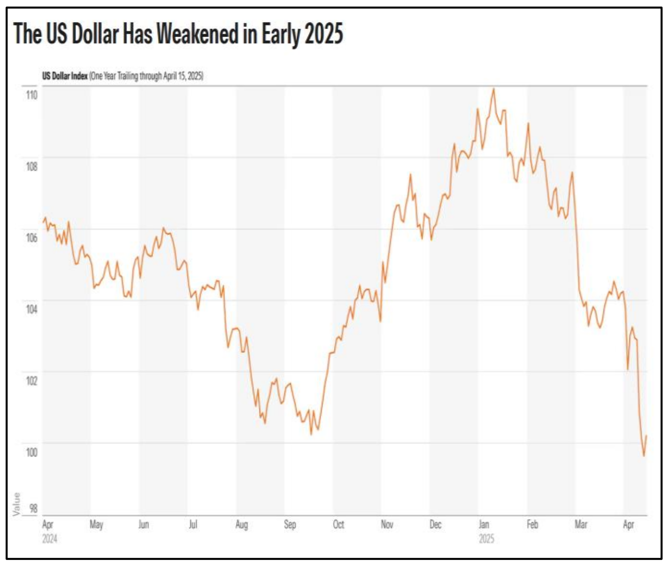
Financial markets reacted with historic severity to the tariff announcements. The S&P 500 plummeted over 12% in four trading days following the April rollout, while global markets experienced widespread selloffs. The VIX, which measures volatility in the stock market, spiked over 140% in 4 days, the third largest move since 1990 (See Fig 1). The bond market delivered the strongest rebuke, with 2-year Treasury yields spiking 0.3 percentage points in the largest intraday move since 2009. Safe-haven assets like gold and the Japanese Yen surged, while the US dollar unexpectedly depreciated (Fig 2). Foreign investors dumped dollar-denominated assets, raising questions about the currency's reserve status. The market turmoil was so intense that several analysts credited it with forcing Trump's subsequent policy reversals.

Fig 1: The VIX had the third biggest jump since 1990

Biggest 4-day $VIX Spikes			
End Day	Start $VIX	End $VIX	$VIX Spike
8/24/2015	13.79	40.74	195%
2/5/2018	14.79	37.32	152%
4/8/2025	21.51	52.33	143%
8/25/2015	15.25	36.02	136%
2/27/2020	17.08	39.16	129%
2/6/2018	13.54	29.98	121%
8/5/2024	17.69	38.57	118%
4/7/2025	21.77	46.98	116%
8/21/2015	13.02	28.03	115%
2/7/2018	13.47	27.73	106%
4/4/2025	22.28	45.31	103%
5/7/2010	20.19	40.95	103%
12/18/2024	13.92	27.62	98%
2/25/2020	14.38	27.85	94%
8/8/2011	24.79	48.00	94%
2/8/2018	17.31	33.46	93%
3/12/2020	41.94	75.47	80%
2/27/2007	10.20	18.31	80%
2/26/2020	15.56	27.56	77%
8/5/2019	13.94	24.59	76%
Average (20 Biggest 4-Day Spikes)			

Source: Sarsi, LLC

Fig 2: The US dollar has weakened considerably

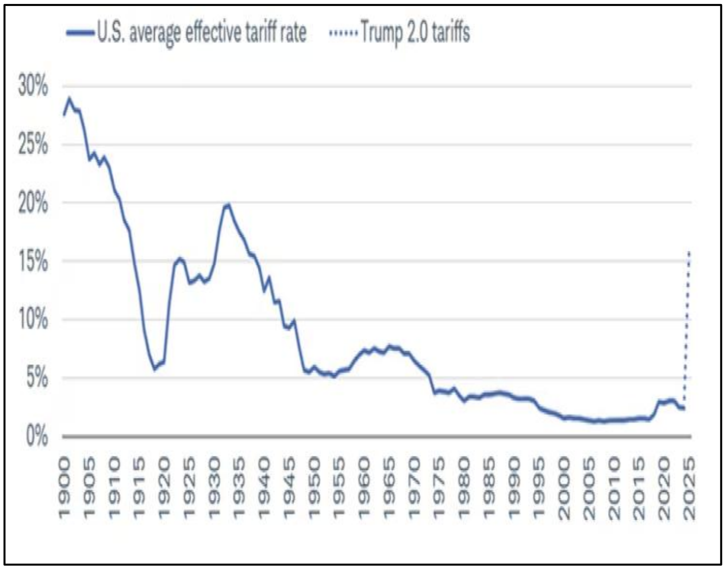


Source: Morningstar

Facing mounting economic pressure, Trump executed a U-turn within a week, announcing temporary rollbacks and 90-day negotiation pauses for non-retaliating countries. The administration framed this as strategic positioning rather than a retreat, though most observers viewed it as market-driven damage control.

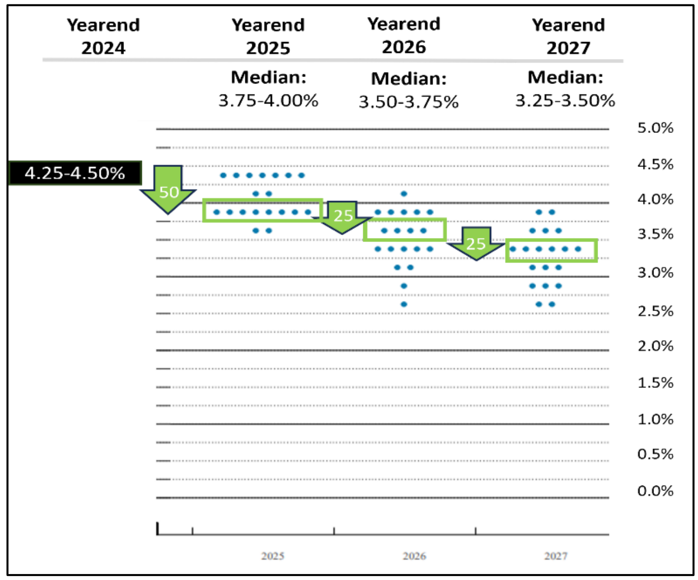
Current negotiations remain fluid as the July 9 deadline approaches for several key trading partners. A framework agreement with China emerged from high-level London talks in June, though final approval remains pending. Meanwhile, steel and aluminum tariffs have intensified, doubling to 50% in June. The administration continues wielding tariff threats as negotiating leverage, creating uncertainty for business planning. The next quarter will determine whether this aggressive trade approach yields lasting agreements or further market volatility. As of now, the average effective tariff rate is expected to be more than 15% which is the highest tariff rate since the late 1930s Great Depression era. (Fig 3)

Fig 3: Tariffs are at the highest level since the 1930's



Source: Charles Schwab

Fig 4: The Fed 'dot plot': expected future interest rate



Source: The Federal Reserve

The Federal Reserve found itself in an increasingly difficult position throughout Q2, with Chair Jerome Powell delivering his starkest warnings yet about tariffs' economic consequences. Powell cautioned that the tariff levels were "significantly larger than anticipated" and could create "more persistent" inflation while slowing growth, putting the Fed in a bind between controlling prices and supporting employment.

The FOMC maintained its benchmark rate at 4.25%-4.5% throughout Q2, holding steady at both the May and June meetings. The Committee noted that "uncertainty about the economic outlook has diminished but remains elevated" and decided to keep rates unchanged. The Fed's closely watched "dot plot" revealed a more cautious outlook, with members still expecting two quarter-point cuts by year-end but reducing expectations for 2026 and 2027 by one cut each. (Fig 4) This reflects the challenging balance between tariff-induced inflation pressures and potential economic slowdown.

Tensions between Trump and Powell escalated when Powell warned that tariff burdens "would be paid by the public," prompting Trump's public anger over the Fed chair's comments. By late April, Trump defused speculation about firing Powell, helping stabilize markets. The Fed maintains its "wait-and-see" mantra, setting it on a collision course with President Trump who has pressured for more aggressive rate cuts to offset tariff impacts on the economy.

Middle East tensions compounded economic uncertainty throughout Q2, with escalating Iran-Israel conflict creating additional headwinds for markets and monetary policy. Oil price spikes represent "a negative supply shock for the global economy, lowering growth and boosting inflation, creating further challenges for central banks that are already trying to navigate the risks from tariffs". Recent U.S. attacks on Iranian nuclear sites triggered investor rushes to safety and oil price jumps, while geopolitical risk premiums have elevated market volatility beyond tariff-related concerns. However, markets rebounded sharply after Iran's restrained missile response to Qatar, with the Dow gaining 375 points and oil prices falling over 7% as investors welcomed signs that Iran would not disrupt global oil flows.

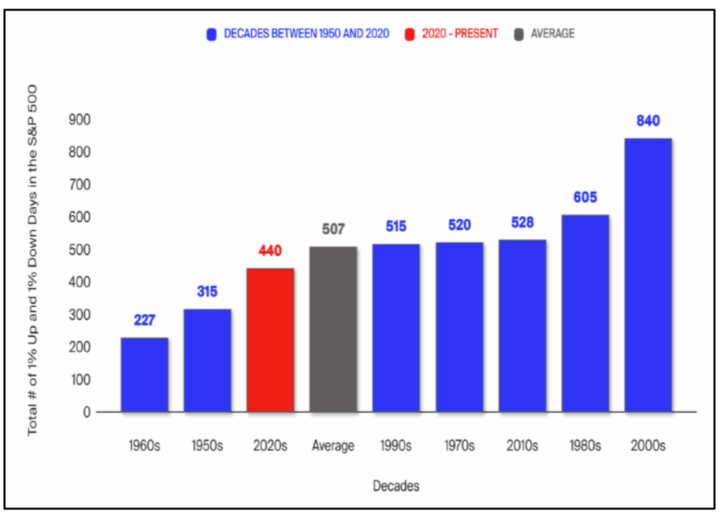
U.S. companies are expressing unprecedented concern about tariffs. FactSet reports that 91% of S&P 500 companies mentioned "tariff" or "tariffs" during their Q1 earnings calls—the highest percentage in a decade. However, these concerns have not yet impacted actual results. The S&P 500 delivered robust Q1 2025 earnings growth of 13.4%, marking seven consecutive quarters of increases. Performance exceeded expectations significantly: 78% of companies beat estimates (above both 5- and 10-year averages), with aggregate earnings surpassing estimates by 8.5%—higher than the 10-year average.

Looking ahead, uncertainty is dampening expectations. FactSet projects Q2 2025 earnings growth will slow to 4.9%, down from the original 9.3% forecast, with larger-than-average EPS cuts particularly affecting the Energy sector. Companies are swinging into action, proactively restructuring their supply chains to mitigate tariff impacts. For example, Apple is accelerating plans to shift 15-20% of production to India and Vietnam by 2026, while Ford Motor Co. is increasing reliance on Mexican suppliers. Walmart has reduced Chinese imports by 10% in 2024, favoring Vietnam and Thailand sourcing. The trend toward nearshoring and reshoring is accelerating. A Deloitte study predicts 40% of U.S. companies will relocate portions of their supply chains to North America by 2026. Additionally, companies are stockpiling goods to avoid rising tariffs and potential shortages.

Stocks during uncertain times

With all this uncertainty in the economy and geopolitics, investors would be forgiven for thinking that stocks were down, not up for the year. As we have discussed previously, volatility is the price that investors pay for long term returns. In fact, this decade is on pace to be one of the most volatile in the last eight decades based on the number of days the stock market was up + or – 1%. (Fig 5) Looking back, it is not surprising why stocks have been so volatile – we had Covid in 2020, then a surge in inflation and interest rates in 2022 and policy and economic uncertainty caused by Tariffs in 2025. You may be tempted to think that avoiding these events may lead to better investment performance, however, as noted in our previous newsletter, (SEE HERE) market prices incorporate the aggregate expectations of investors. When events are in line with expectations, they are already priced in by the market. A dramatic example of this is the performance of the Israeli stock market that is up over 20% for the year and recently made an all-time high (Fig 6) even as war and conflict rages on in the middle east. The country's currency, the shekel, has soared against the dollar in recent weeks. The country has some very well-run global companies, and the economy has been strong, however, one would think that with all the uncertainty, Israeli stocks would be down. Investors are ostensibly betting that a radical transformation of the middle east will lead to a new era of peace and prosperity. They also are relieved that a major war is not breaking out in the middle east.

Fig 5: +1/-1% days for the S&P 500 each decade



Source: A wealth of commonsense

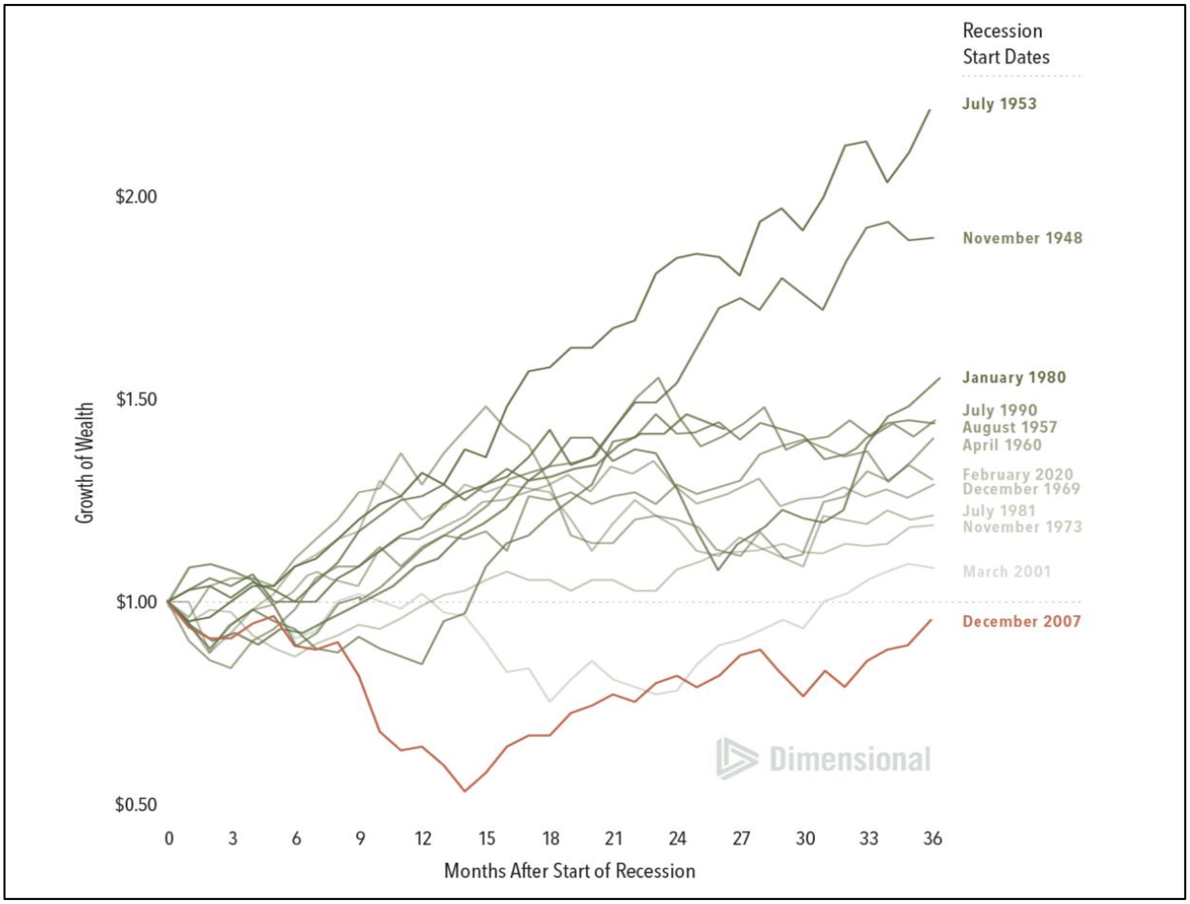
Fig 6: Tel Aviv 125 Index is at an all-time high

Source: MarketWatch

The futility of forecasting big events and especially the stock market's trajectory before, during and after such events is also exhibited around recessions. As discussed in our September 2022 newsletter (CLICK HERE), "What you will conclude …is that the cause of any recession, its duration, and how stocks perform during each recession are all very different, making it next to impossible to forecast one, let alone make investment decisions based on the forecast. What you also see is that through all these recessions, the stock market has continued to reward patient investors". Furthermore, The National Bureau of Economic Research identifies recessions after the fact, so we will not know we are in a recession until after it has begun. The forward-looking market usually reacts before we see lower economic growth show up in the macroeconomic data. This also means that expected stock returns are positive, even when the economic outlook is weak.

As a result, a dollar invested at the start of a recession saw positive returns after three years in 11 out of 12 past recessions. The average of the three-year returns after the start of a recession was 43.2%, which is identical to the 41.8% average return of all three-year periods from 1947 to 2024. (Fig 7). In other words, historically stock performance during recessions was on average similar to its performance during other times.

Fig 7: Stock performance during recessions



Source: Dimensional Fund Advisors