Economic Overview

Steve Scranton, CFA, SVP, Economist

Second quarter economic growth could best be described as the quarter of reversals. After the distortions that impacted economic growth in the 1st quarter, the 2nd quarter saw those distortions being reversed. As a result, after seeing economic growth decline by 0.5% in the 1st quarter due to distortions, the current forecast for 2nd quarter economic growth is for a rebound. There is clearly uncertainty over economic growth as the different forecasting sources show a wide variance.

- The median forecast from economists surveyed by Bloomberg calls for 1.9% annualized growth in the 2nd quarter.
- The Atlanta Federal Reserve's GDPNow model is forecasting 2.5%.
- The New York Federal Reserve's Nowcast model is forecasting 1.7%.
- The St. Louis Federal Reserve's Real GDP Nowcast model is forecasting 1.0%.

The driver of economic growth remains the US consumer, and the consumer was part of the distortions. Personal income rose a strong 0.7% in April only to fall 0.4% in May. This was due to a one-time increase in Social Security payments that caused Government Transfer Payments to rise 6.9% in April and then fall 7.3% in May. The core source of income for most consumers is their wages. Wage growth was stable in April and May as the Wages & Salaries category rose 0.4% each month. On a year-over-year basis personal income still rose more than 4% as April's rate of growth was 5.3% and May was 4.5%. Consumer spending also saw a reversal of a 1st quarter distortion. Spending surged for motor vehicles in March as consumers rushed to lock in a price before the threatened tariffs announcement in April. Motor vehicle sales rose 10.3% for the month of March. They fell 6.0% in May. On a year-over-year basis, consumer spending remained above 2% but slowed from the 2.8% rate in March to 2.2% in May. Overall, the consumer continues to see their income rise and continues to use that income to spend. The net result is a positive contribution to growth from the consumer.

Business activity also reversed some of the distortion from the 1st quarter. Imports surged in the 1st quarter as businesses rushed to stockpile inventory in the face of potential tariffs in April. As a result, spending on inventory fell in the 2nd quarter as May inventory was lower than March. Construction spending fell in both April and May as uncertainty and higher raw material costs impacted demand. Manufacturers also showed mixed results depending on what region of the US you examined.

We will not get the first official estimate of Real GDP growth until the end of July. Based on the currently available data, it appears that growth clearly rebounded from the 1st quarter. The question is, what was the size of the rebound?

Strategy Review

Derrick Wilson, CIMA®, VP, Portfolio Manager

The 2nd quarter ended strong, though not without periods of volatility and uncertainty. It opened with "Liberation Day" on April 2, marked by the US announcing broad new tariffs on a wide range of countries. Markets reacted sharply — equities and fixed income both declined — as the scope of tariffs raised concerns about rising inflation. However, in typical fashion it seems, the White House paused the tariffs a week later for 90 days, which helped markets rebound.

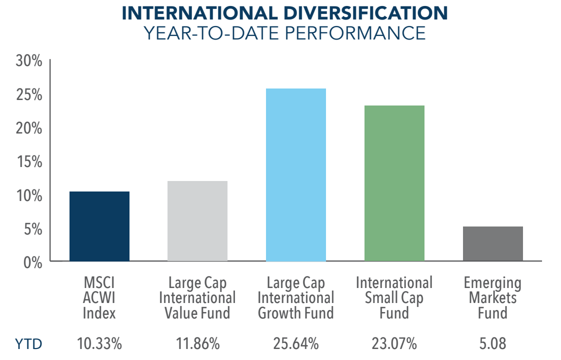
Toward the end of the quarter, attention shifted from trade to geopolitics as tensions escalated between Israel and Iran. A series of missile and air strikes between the two nations raised fears of broader conflict. A US-negotiated ceasefire helped ease those concerns heading into quarter-end.

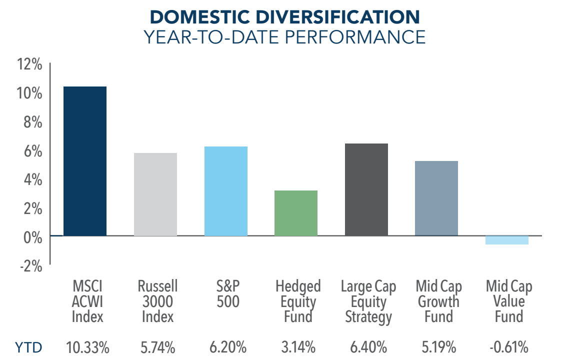
Despite headline risks, global equities returned over 11.5%. US stocks were in correction before staging a strong recovery. International equities once again outperformed US stocks, although that gap narrowed from the 1st quarter. A 7% decline in the US dollar, driven by inflation fears and rising government debt, supported overseas returns. Within international markets, emerging markets edged out developed, gaining 12.0% vs. 11.8%, respectively.

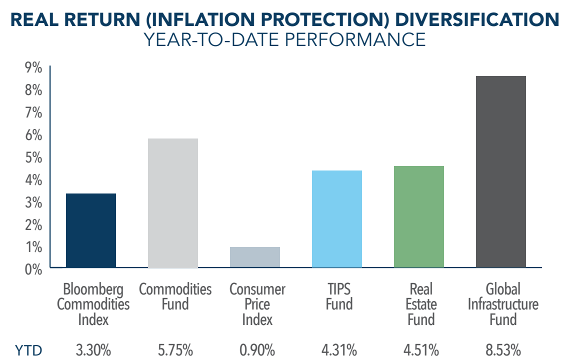
Fixed income markets experienced some volatility but ended the quarter with gains of 1% to 3%. The yield curve steepened, as short to intermediate yields fell while long-term yields moved higher. High yield bonds returned closer to 3%, while short-term investment-grade bonds gained around 1%.

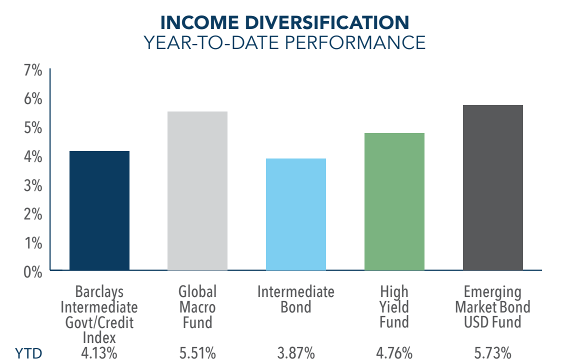
Commodities reflected the quarter's inflationary and geopolitical pressures. Gold rose over 5%, driven by safe-haven demand. Oil fell more than 17% in April but recovered much of that loss in May and June as Middle East tensions escalated. For the full quarter, WTI oil declined over 5%. Overall, the broad basket of commodities fell just over 3%.

In the end, diversification worked. Though investor emotions were tested, staying invested through the noise proved beneficial. The quarter served as a reminder that patient, long-term positioning tends to outperform short-term, reactive moves. Minor adjustments may be warranted at times, but large shifts based on headlines rarely deliver favorable outcomes over time.









Second Quarter 2025 – Wealth Management Insights

Domestic Equities

Gayle Sprute, VP, Senior Portfolio Manager

The 2nd quarter was tumultuous and got underway with stocks and investor psychology under pressure. Between February 19 and March 13, "corrections" (a decline of over 10% but less than 20%) were put in for some indices, sectors and individual stocks. This sharp sell-off was fueled by a rise in concern about how President Trump's surprise escalation in tariff policy might impact inflation, interest rates, global trade, consumer spending, and the economy.

"Liberation Day" at the beginning of the quarter (April 2nd) brought another downdraft in stock prices after President Trump announced reciprocal tariffs for various countries. Several were worse than anticipated and reports of retaliation by some countries did not help. By April 8, the Nasdaq Composite and Russell 2000 entered "bear market" territory (a decline of 20% from the recent high), along with some sectors and stocks. The Dow Jones Industrial Average (Dow) and S&P 500 held in "correction" territory, down 15.4% and 18.7%, respectively.

However, a sharp reversal commenced on April 9, after President Trump announced a 90-day pause on the reciprocal tariffs for countries that had not taken retaliatory actions and had reached out to negotiate. This was the beginning of an ongoing, albeit rocky, de-escalation in tariff gamesmanship – and an increase in negotiations. The turn of events triggered a stunning but volatile comeback. Although speculation, concern and hopefulness ebbed and flowed about the ultimate path for tariffs, between April 8 and June 30 the indices rocketed higher: Dow +17.6%, S&P 500 +24.9%, Nasdaq Composite +33.6%, Russell Mid Cap +23.3%, and Russell 2000 +24.0%. On June 30, both the Nasdaq Composite and S&P 500 set new record highs. The S&P 500 closed at 6,204, beating the February 9 high water mark of 6,144. This spectacular rally also carried previously beaten-down sectors and stocks significantly higher.

Overall 2nd quarter performance for the indices was as follows: Dow +5.5%, S&P 500 +10.9%, Nasdaq Composite +18.0%, Russell Mid Cap +8.5%, and Russell 2000 +8.5%. At the sector level, leadership came from information technology +23.7%, communication services +18.5%, and industrial +12.9%. Laggards were energy -8.6%, healthcare -7.2%, and real estate -0.4%. Growth outpaced value, rising by 18.9% versus a value's 3.0% gain.

Looking ahead, there are a number of topics on the radar screen, including: 1) the outcome of tariff negotiations and whether the July 9 reciprocal tariff deadline will be extended; 2) whether implemented tariffs will push inflation higher; 3) the composition of the reconciliation bill being crafted by Congress; 4) the Federal Reserve's updates regarding interest rate policy; 5) fresh data on the health of the labor market, consumer spending patterns, and the economy; and 6) outlooks from corporate America during 2nd quarter earnings season. There are lots of moving parts for equity investors to ponder.

Fixed Income

Callen Young, VP, Portfolio Manager

The first half of 2025 has been a wild ride for markets, marked by trade policy shifts, escalating geopolitical conflicts, and notable volatility. Despite these headwinds, the fixed income market held up well, with most indices showing year-to-date returns between 2% and 4%.

The Liberation Day tariff announcement on April 2 sparked a sharp spike in market volatility. Benchmark 10-year Treasury yields surged from 3.99% to 4.49% in the week following the President's announcement. However, the administration soon softened its stance, pausing reciprocal tariffs for 90 days and agreeing in principle to a trade deal with China. This calmed investor concerns, and the Bloomberg Treasury Index finished the quarter up approximately 0.85%.

While short-term Treasury yields were little changed in Q2, the yield curve steepened meaningfully as markets digested the implications of the "One Big, Beautiful Bill Act." Projections suggest the bill could add $3 to $5 trillion to federal debt over the next decade, raising questions about fiscal sustainability and foreign demand for Treasuries, especially following Moody's May downgrade of US credit from Aaa to Aa1.

Volatility in Treasuries spilled over into municipal bonds. Early drafts of the One Big Beautiful Bill had raised concerns that it could limit issuers' ability to offer tax-exempt debt, prompting a rush of issuance during the first half. However, the most recent version keeps current tax brackets and preserves the muni tax exemption, calming those fears. Higher inflation has also pushed infrastructure costs higher, increasing funding needs. 2024 saw $515 billion in new municipal issuance – the highest since at least 2002 – and 2025 is on pace to exceed that with $285 billion issued through June.

Corporate bonds performed well, reflecting continued confidence in the US economy. The Bloomberg Credit Index returned 1.82% for the quarter. After a brief spike early in the quarter, credit spreads tightened again, with the Bloomberg US Aggregate Index ending at just +82 basis points – less than 10 basis points wider than its tightest levels in the past 25 years.

The Federal Reserve remains at the forefront of market attention as investors and policymakers alike await expected rate cuts. Thus far, the Fed has kept its key rate steady at 4.25%-4.50%, signaling a cautious, data-dependent approach. Most Fed officials expect two rate cuts by year-end, although tariff-related inflation remains a complicating factor.

The 2nd quarter proved as bumpy as the first. Policy uncertainty remains a key source of volatility, and while markets digested the immediate impact of new tariffs, their full economic effects will likely become clearer in the second half of the year. We continue to believe that the most probable path for short-term rates is lower, making high-quality fixed income an attractive opportunity for investors.

International

Matthew Clarke, CIMA®, VP, Senior Client Portfolio Manager

International equities outperformed US equities once again, but not without drama at the start and a few additional geopolitical bumps near the end as tensions in the Middle East escalated.

Fear gripped the markets in April following President Trump's "Liberation Day" tariffs. The news clouded expectations and panic ensued. A subsequent and welcome reprieve from the Trump administration in the form of a 90-day pause helped to ease investor concerns. Still, global concerns about America's ability to balance a budget fostered what is now known as the "sell America trade". This was reinforced in May, as Moody's downgraded US debt for the first time to Aa1 from Aaa, **which continued to put downward pressure on the US dollar, forcing the US dollar index (DXY) to slide another 7% over the quarter.**

When the dollar weakens, foreign currencies strengthen, and the value of their stocks rises when converted back to the dollar. **Emerging markets stocks were a major beneficiary as a weaker dollar helped to draw in new investors,** helping the MSCI Emerging Markets index return 12.2% (total return USD) over the quarter. In dollar terms, Taiwan, Mexico and Brazil happened to be standouts. Taiwan on strength in AI-driven demand, Mexico on stronger Peso and "nearshoring" trends, which could become a stronger story over the coming years, and Brazil on a stronger Brazilian real and improved sentiment. China was a bit of a laggard as the Shanghai Composite returned only 5.60% in dollar terms, weighed down by concerns about slowing economic growth and mounting trade tensions with the US.

The developed international markets were also a bright spot. The MSCI Europe, Australasia, and the Far East (EAFE) index returned 12% (USD) on the combination of the weaker dollar, promise of easier monetary policy, and improvements in economic sentiment. South Korea and Japan were major contributors as South Korea realized a rebound in exports (strong semiconductor sales) and Japan benefited from stronger economic growth and a rebound in manufacturing.

Across Europe, easing inflation and weaker economic data in several countries **allowed for the European Central Bank (ECB) to deliver two 25-basis point cuts,** bringing the total to eight since they began cutting rates last year. Their main deposit rate is now at 2%, prompting some to question whether they are at or near their neutral rate – where policy is neither stimulative nor restrictive. Either way, rate cuts from the ECB contributed to European government bonds outpacing US treasuries and Japanese government bonds.

As the second half of the year unfolds, there is good reason to believe that the drama is far from over. Trade policy remains a key wildcard. Any escalation threatens global growth as well as the direction for inflation. Of course, central bank policy will continue to shape market expectations, while geopolitical tensions continue to simmer in the background. **We encourage you to remain disciplined, diversified and focused on the long-term.**

Additional and expanded information to this newsletter discussion may be obtained by contacting your relationship manager. We will be happy to expand our discussion with you to meet your individual requirements as a client of Wealth Management & Advisory Services.

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