

2Q 2025 Summary

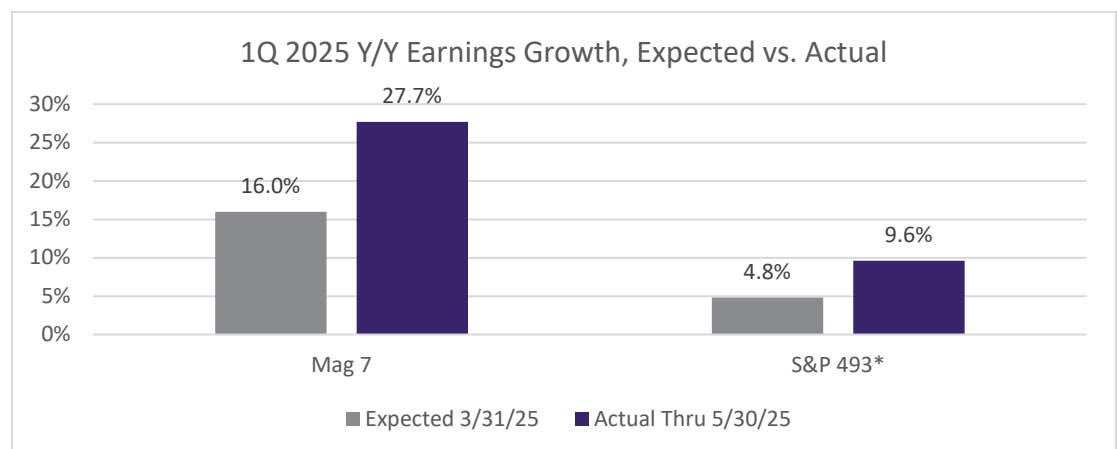
July 10, 2025

SECOND QUARTER REVIEW

Stock markets started the quarter in freefall when the “Liberation Day” announcements sent the S&P 500 down 19%+ from its 2025 highs, followed by a sharp and sustained rally after the Trump administration backpedaled on the reciprocal tariffs, delaying them for at least 90 days but sticking with 10% baseline tariff.

First quarter earnings came in much better than expected, and expectations for second quarter earnings were more mixed than negative, which was a positive surprise given the assumed minimum 10% tariff regime. The “Magnificent 7” (Mag 7)¹ earnings were particularly strong which, coupled with indications that Artificial Intelligence will be adopted by corporations more broadly, helped fuel the rally.

First quarter earnings came in much stronger than expected.



All equity styles – large to small, growth and value – had positive returns.

Concerns of fiscal restraint slowing down the US economy proved ill-founded as DOGE was less successful at cutting costs than advertised and the US budget reconciliation bill looks like it may grow the deficit instead of shrinking it. Any overhang from the conflict in the Middle East appeared largely removed as Iran did not cut off oil and gas shipments through the Strait of Hormuz despite suffering significant damage from Israeli and American military strikes.

All styles (large, small, growth, value) of the market had positive returns in the quarter. First quarter’s largest losers (growth indices) had the strongest gains in 2Q. Gold and bitcoin were up, and interest rates were down slightly.

¹ Magnificent 7 stocks are (name, ticker, % of S&P 500 as of 7/3/25): Alphabet Class A, GOOGL 2.0% & Alphabet Class C, GOOG, 1.6% (3.6% combined); Amazon, AMZN, 3.9%; Apple AAPL, 6.0%; Meta, META, 2.8%; Microsoft, MSFT, 6.8%; NVIDIA, NVDA, 6.6%; Tesla, TSLA, 1.9%; Source – FactSet & State Street.

* S&P 493 are the 493 companies in the S&P 500 excluding the Mag 7.

PSG'S PERSPECTIVES

Timing policy changes was and continues to be a risky maneuver.

Artificial Intelligence is driving market enthusiasm, but winners are not just in the Mag 7.

It is too soon to see any tariff impacts on economy, earnings growth, or interest rates.

We wrote last quarter, in the midst of the 15%+ selloff, that timing market turning points is difficult, and trying to guess policy reversals seemed even riskier. A few days later the policy reversal came, and markets turned dramatically, with some indices moving up ~10% from their intraday lows to intraday highs on the day of the reciprocal tariff “pause.”

The upward momentum continued through earnings season, proving that while markets may not like uncertainty, they love a good story, particularly when there is some proof of earnings growth. First quarter earnings were roughly 2x higher than expected going into the quarter, with the Mag 7 leading the way.

The absolute level of earnings growth from the Mag 7, almost triple the rest of the S&P 500, is driven by continued growth in Artificial Intelligence. Technology companies have been the earliest adopters, but the increasing capabilities of AI has led many companies to exploring its potential uses. This is driving more investment, which, unlike the internet investment boom of the late 1990s, is being made by companies with cash flow to support the buildout. We believe it will continue, though the biggest winners may be found outside of the Mag 7 as investors begin to focus less on the infrastructure builders and more on software developers and AI adopters. New innovation winners usually emerge not from incumbents but from small and mid sized companies, as well as private equity. In the meantime, AI adoption across industries (not just tech) should create higher profitability. Diversified equity portfolios continue to seem prudent to us.

The impact from tariffs will take time to be flow through to consumers and earnings. While first quarter earnings were surprisingly strong, they were likely supported in part by “pulling forward” economic activity and building inventories before the tariffs hit. Evidence can be seen in the 50%+ increase in imports in the first quarter. If orders were pulled forward, we may see more significant slowing in the coming quarters from lower order volume and the anticipated impact of higher prices from the tariffs. Markets do not seem too concerned as the S&P 500 reached a new all-time high on June 30.

Looking forward, we remain concerned about the impacts of tariffs (assuming just 10%). We believe they will slow economic activity and cause a short-term spike in inflation unless lower gasoline prices mute the shock. The influence of tariffs on long-term interest rates remains to be seen. We have high confidence that higher interest rates would be negative for bonds and stocks. Should slower growth or other policy changes cause long-term interest rates to fall significantly, we could see a resurgence in the languid real estate market (both residential & commercial) and stronger economic activity and stock prices, thereby offsetting the negative impacts of tariffs. We do not have enough conviction either way to alter overall asset allocations or bond portfolio compositions.

Numerous commentators have reported international investors have become more cautious investing in the United States. There are few places outside the US which offer more attractive alternatives and deep, liquid capital markets to safely move large sums of money. There are also few countries outside of China that have significant companies developing AI. That said, we recognize the valuation disparity between US and international indices, and there are signs of more shareholder friendly behavior in countries like Japan and Korea. While we continue to believe that international exposure is best expressed primarily through US based firms as ~40% of S&P 500 revenues come from outside the US, modestly increasing exposure to international from very low levels seems warranted.

DEEPER DIVE

THE BIG THING: Earnings Trump Trump

- 🌿 First quarter earnings were surprisingly strong.
- 🌿 The number of companies offering higher guidance than expected was unusually high, despite tariff overhang.
- 🌿 Earnings growth expectations for 2025 and 2026 are 9.1% and 13.8%, respectively.

QUARTERLY & YTD REVIEW

EQUITIES

2nd Quarter - All Styles Up, Growth Lead

- 🌿 Mid Cap Growth and Large Cap Growth were up 18% in the quarter, followed by Small Growth, up +12%.
- 🌿 The S&P 500 was up 11%.
- 🌿 The “Magnificent 7” (Mag 7), which make up 32% of the S&P 500, recovered in the quarter after posting strong earnings and positive outlooks.
- 🌿 Large Value, last quarter’s best performer, lagged but still finished +4%.
- 🌿 International indices were up 12%.
- 🌿 Gold continued to rally +5%, while Bitcoin recovered 1Q losses and then some, +29%.

Year To Date – Large Up, Small Down

- 🌿 Large Cap styles all up 6%+, including the S&P 500 +6.2%.
 - The non-Mag 7 contributed 80% of the S&P return.
- 🌿 Mid Cap Growth did best, +10%.
- 🌿 All Small Cap styles had negative returns; Small Cap Value is the laggard (3%).
- 🌿 International stocks lead US indices; Developed Int’l +20%, Emerging Markets +16%.
- 🌿 Gold leads all asset groups, +25%, and Bitcoin closed the first half +14%.

BONDS

2ND Quarter & Year To Date

- 🌿 Interest rates were volatile in the quarter around the tariff announcements but ended the quarter little changed. (*See Table 1, next page.*)
- 🌿 Moody’s downgraded US debt from AAA to Aa1 on May 16, becoming the last of the three largest rating agencies to do so. Interest rates rose slightly the following week but ended the quarter lower.
- 🌿 The Federal Reserve indicated little interest in changing the Fed Funds rate in the near term, continuing to take a wait and see approach to the impact from tariffs.
- 🌿 There continued to be little stress in corporate bond markets with interest rates on high quality investment grade bonds only marginally higher than US Treasuries.
- 🌿 Interest rates for most maturities remain lower compared to the start of the year, but are still significantly higher than a few years ago.

Growth led in the quarter, large out-performed small year to date.

Bonds ended the quarter with positive returns despite tariff drama and Moody’s downgrade.

Table 1

US Treasury Yields (source- FactSet; numbers may not sum due to rounding)

Maturity	12/31/24	3/31/25	6/30/25	2Q25 Yield Change	1H 2025 Change
3 Month	4.3%	4.3%	4.3%	(0.0%)	0.0%
2 Year	4.2%	3.9%	3.7%	(0.2%)	(0.5%)
5 Year	4.4%	4.0%	3.8%	(0.2%)	(0.6%)
10 Year	4.6%	4.3%	4.2%	(0.1%)	(0.4%)
30 Year	4.8%	4.6%	4.8%	+0.2%	0.0%

TARIFFS, LEGISLATION, & ECONOMICS

Tariffs

- 🌿 Tariffs have increased from an average level of 2.3% from the end of 2024 to 14.3%.²
 - Excluding China, tariffs have moved from 1% to 10.4%.
- 🌿 Baseline of 10% tariffs are in place for ~80% of imported goods.
 - Pharmaceuticals, crude and refined oil, semiconductors, and other products are exempt (for now).
- 🌿 Reciprocal tariffs were paused for 90 days, and now through at least August 1.
- 🌿 We believe tariffs will have negative consequences for earnings in the near term.

One Big Bill Is Certain, Beauty Remains in the Eye of the Beholder

- 🌿 The “One Big Beautiful Bill” was passed and signed.
- 🌿 While both parties position the bill as the best or worst thing which has ever happened in the history of the United States, the full impact from the bill will not be known for some time.
- 🌿 The US budget deficit was expected to expand by \$2.4 trillion over the next 10 years as a result of the bill, according to the Congressional Budget Office (CBO).³
- 🌿 **Lifetime gift and estate tax exemption was permanently raised to \$15 million (starting in 2026) and adjusted for inflation thereafter.**
 - This makes estate planning for affluent individuals more certain.

Jobs Growth Continues

- 🌿 Tariffs have not yet had an impact on the job market.
- 🌿 The unemployment rate fell to 4.1% in June.
- 🌿 We do not yet know how the 95% decline in border crossings from the 4Q 2023 peak nor fear of deportation has impacted the job market.
- 🌿 Weekly unemployment claims are still quite low, though the recently unemployed are taking longer to find new jobs.

Tariffs are significantly higher for most imported goods.

Lifetime gift & estate exemption was raised to \$15 million starting in 2026.

Unemployment remains quite low.

² JPMorgan, Global Data Watch, 6/12/2025.

³ [CBO OBBB Estimate](#) These estimates are always controversial. This excludes potential impacts from higher interest rates and ignores potential positives impacts from higher economic growth.

Economic Data Muddled

- ✿ Goods imported to the US leapt over 50% in the first quarter as businesses tried to get ahead of tariff announcements.
 - The net impact was to drag down 1Q GDP growth by 2%,⁴ resulting in 1Q economic “contraction” of 0.5%.
 - Much of this impact will be unwound in coming quarters, complicating government statistics.
- ✿ Economic surveys of consumers and business leaders continue to be at or near five year lows but spending by businesses and consumers continues to be robust.
- ✿ We continue to believe the most important economic indicator is the weekly initial jobless claims number, which continues to be quite low (and therefore a positive sign).

SUMMARY

Diversified portfolios had a smoother ride in the first half of the year.

If the first report or statement you opened this year was on June 30, it might look like a boring year. Anyone scrolling financial news feeds or watching cable news would beg to differ as investors were subject to 19% and 24% declines in the S&P 500 and NASDAQ, respectively, from February 19th through April 8th before recovering. Diversified portfolios had smoother returns in the first half as value stocks lost less and are up for the year, while growth stocks lost more but roared back as their earnings came through. It is emotionally normal to feel the urge to sell when things appear bleak, but rarely correct. The first six months are a reminder than staying the course with a prudent asset mix and diversified equity exposure works for most people most of the time.

FUN FACTS

- ✿ Microsoft announced one division of their company generated \$3 billion in revenues in the first quarter from Artificial Intelligence, up from ~\$0 in the 4th quarter 2022.
- ✿ JPMorgan is using AI 400 different ways in day-to-day operations, such as fraud detection, credit risk management, and legal operations.⁵
- ✿ Energy was the worst performing sector in the second quarter, returning (8.7%), despite direct attacks on Iran, the world’s 7th largest oil producer.

DISCLOSURE

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⁴ Net imports/exports detracted 4.6% from GDP, but corresponding rise in inventories added 2.6%, resulting in a net 2% impact.

⁵ [Financialexpress.com - AI gets a seat at the big table at JP Morgan Chase](https://www.financialexpress.com/ai-gets-a-seat-at-the-big-table-at-jp-morgan-chase/), June 12, 2025