The Only Easy Day Was Yesterday

Q3 2025 Market Outlook

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"But I'm not crazy, I'm just a little unwell/ I know right now you can't tell/ But stay a while and maybe then you'll see/ A different side of me./ I'm not crazy, I'm just a little impaired/ I know right now you don't care/ But soon enough you're gonna think of me/ And how I used to be." – Matchbox 20, Unwell

Q2 has been Dickens-esque – the best of times and the worst of times – all in the span of 90 days. While the net overall movement in most markets has been benign, it hides the vast amount of volatility and angst suffered during this quarter. A blink-and-you-missed-it bear market (on an intra-day basis) as well as continued shifting of policy sands has transformed 2025 from a comfortable bull market to navigating a mine field. We remain cautiously bullish, but wary of knee jerk reactions to policy announcements. Buried beneath the tweets are corporations still growing earnings and it's hard to have a full recession while corporate profits are still growing.

Investing in markets like this takes grit and mental toughness. Having the fortitude to stay the course, and take the short-term pain is taxing and difficult. The siren song of selling out sings loudest during the most brutal selloff days and can be hard for even seasoned investors to avoid. As we look to turn the page towards Q3 and the second half of the year, we will draw from some of the most tough and mentally strong out there: the US Navy Seal. As they like to say, *the only easy day was yesterday.*

<u>Investing Like a Navy Seal:</u>

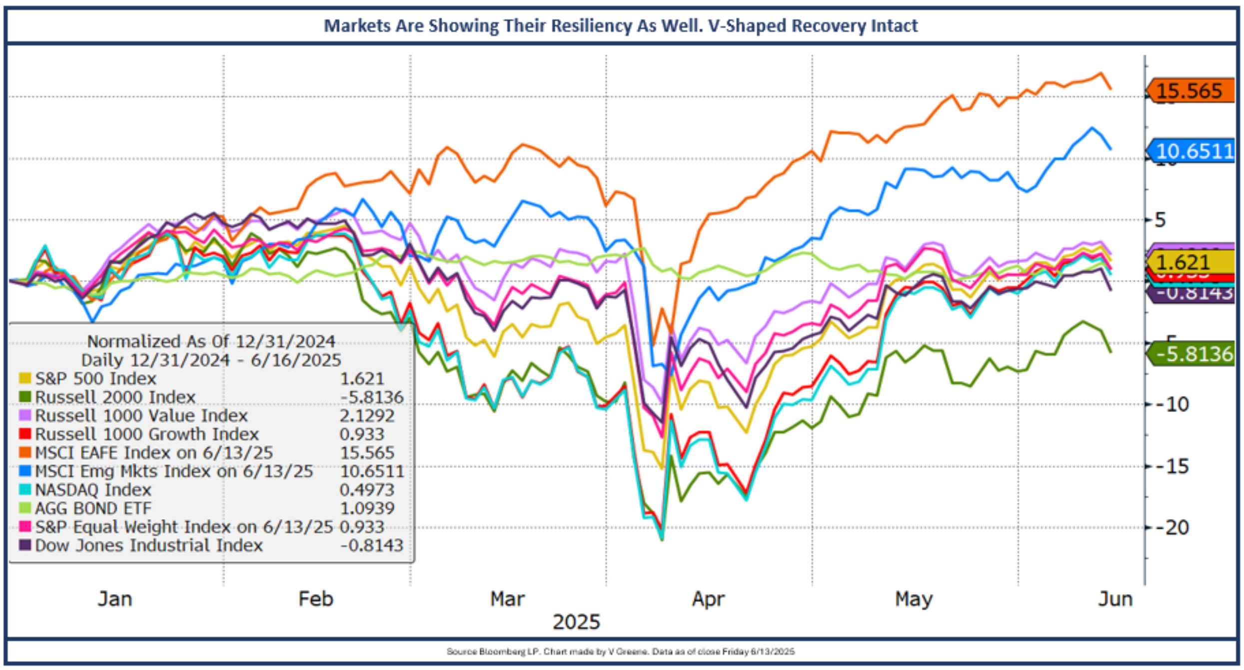
1. **Don't Ring the Bell**: Never quit. Don't panic and capitulate to relieve short term pain.
2. **One evolution at a time**: Don't let the what ifs/future/totality of everything overwhelm you.
3. **Embrace the suck**: Buy the dip, be a buyer while others panic.
4. **It pays to be a winner**: What you own matters. Be judicious in your holdings.
5. **You might end up a sugar cookie**: News might jerk you around. You might get beat up for no real reason- not driven by macro or fundamental. Be comfortable being uncomfortable.

Showing grit in Q3 and being mentally prepared for difficulties may allow you to navigate choppy waters successfully. While we feel markets can keep climbing the wall of worry, it may not be smooth sailing and come with some uncomfortable bouts of volatility and market dops.

Where we are today (6/15):

At one point in mid-April, multiple major indices were in a bear market, off more than -20% from their highs. But a rollback in tariffs spurred a furious rally, pulling most major indexes back up in the green on the year led by the technology sector, international and emerging markets. The S&P 500 hit a high of 6,144.15 on 2/19/25 and then logged 3 straight negative months (-1.42% Feb, -5.75% March, -0.76% April). And while the market was pulling back in March the selloff accelerated after Liberation Day 4/2, with the S&P falling -21.35% from intra-day high to intra-day low on 4/7. We have now clawed back over 95% of those losses in a span of just 41 trading days in a strong V-shaped rally.

The one laggard is the much-maligned small caps segment, who just can't catch a break being pressured by debt and interest costs as well as concerns on slowing sales and higher inflation and input costs. For now, we believe the large caps and cyclical sectors such as technology, discretionary and communications sectors will continue to lead us out.



One interesting note is that Emerging Markets and Developed International Markets are vastly outperforming US markets this year for the first time since what feels like forever (MSCI EAFE technically outperformed the S&P 500 during 2022). Over the last 10 years, the S&P 500 has averaged 12.21% per year while the MSCI EAFE averaged a paltry 3.25% and MSCI Emerging markets 2.57%. But that tide has shifted dramatically this year, led by China and Europe. The Hang Seng Index (Hong Kong) has risen more than 20% and the MSCI China Index is up almost 16% on the year. On a local stock performance basis, China is not losing the trade war so far as their markets are outperforming US markets. The last time that EM and developed international markets outperformed the US markets for an extended period was post tech-bubble burst from 2002-2007 when the MSCI EAFE and the MSCI Emerging Markets Indexes outperformed the S&P 500 for 6 years straight. During the 2000's decade, Emerging Markets outperformed the S&P 500 8 out of 10 years, but since then have lagged 12 out of the last 15 years. Is this the start of a new run of international assets relative to the S&P 500?

During the 2000's, coming off the tech bubble, the S&P 500 underperformed their Developed International and Emerging Markets peers by a significant and constant amount (-205% cumulative over the decade vs EM). This was driven by the tech bubble hitting US assets and economy harder than international assets as well as China pushing into a new era of productivity and manufacturing.

S&P 500 vs. MSCI EAFE and MSCI EM 2000's

Will International and EM start a run like the 2000's Relative to SPX?

Year	S&P 500	MSCI EAFE	MSCI EM	S&P vs. EAFE	S&P vs. EM
2000	-10.14%	-15.21%	-31.80%	5.07%	21.66%
2001	-13.04%	-22.61%	-4.91%	9.57%	-8.13%
2002	-23.37%	-17.52%	-7.97%	-5.85%	-15.40%
2003	-26.38%	35.28%	51.59%	-61.66%	-77.97%
2004	8.99%	17.59%	22.45%	-8.60%	-13.46%
2005	3.00%	10.86%	30.31%	-7.86%	-27.31%
2006	13.62%	23.47%	29.18%	-9.85%	-15.56%
2007	3.53%	8.62%	36.48%	-5.09%	-32.95%
2008	-38.49%	-45.09%	-54.48%	6.60%	15.99%
2009	23.45%	27.75%	74.50%	-4.30%	-51.05%
2010	12.78%	4.90%	16.36%	7.88%	-3.58%

Data from Bloomberg LP. Data Listed is Price Return only, not total return

But this trend reversed in 2011, with the S&P 500 outperforming EAFE by 369% and EM by 471%.

S&P 500 vs. MSCI EAFE and MSCI EM 2011-Current

Or Will International and EM Revert Back to Recent Status Quo

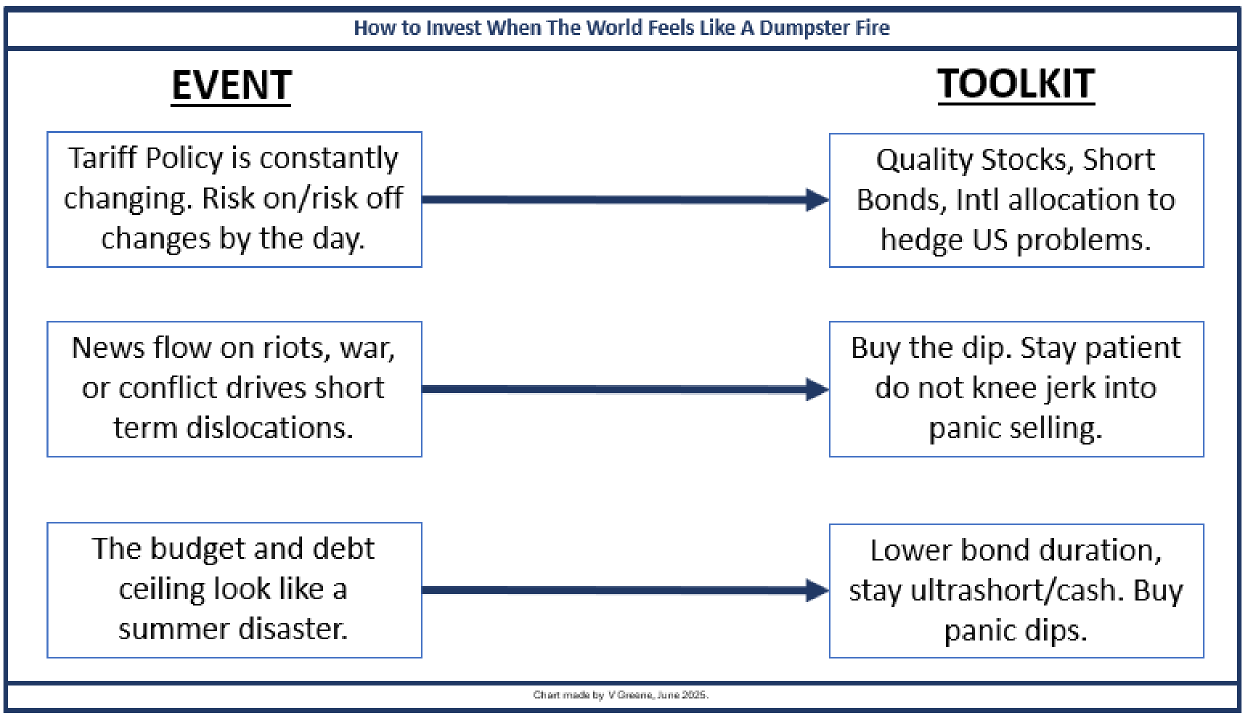
Year	S&P 500	MSCI EAFE	MSCI EM	S&P vs. EAFE	S&P vs. EM
2011	0.00%	-14.82%	-20.41%	14.82%	20.41%
2012	13.40%	13.55%	15.15%	-0.15%	-1.75%
2013	29.60%	19.43%	-4.98%	10.17%	34.58%
2014	11.39%	-7.35%	-44.63%	18.74%	56.02%
2015	-0.73%	-3.30%	-16.96%	2.57%	16.23%
2016	9.54%	-1.88%	8.58%	11.42%	0.96%
2017	19.42%	21.78%	34.35%	-2.36%	-14.93%
2018	-6.24%	-16.14%	-16.63%	9.90%	10.39%
2019	28.88%	18.44%	15.42%	10.44%	13.46%
2020	16.26%	5.43%	15.84%	10.83%	0.42%
2021	26.89%	8.78%	-4.59%	18.11%	31.48%
2022	-19.44%	-16.79%	-22.37%	-2.65%	2.93%
2023	24.23%	15.03%	7.04%	9.20%	17.19%
2024	32.31%	1.15%	5.05%	31.16%	27.26%
YTD	2.14%	15.78%	9.99%	-13.64%	-7.85%

Data from Bloomberg LP. Data Listed is Price Return only, not total return. Data YTD as of close 6/6/2025

As one of my favorite early 2000's band croons *"I'm not crazy, I'm just a little impaired" (Matchbox 20, Unwell)*, the US economy and stock market isn't broken, it's just unwell. While we are doing our darndest to break it, for now the resilience of the US consumer and US corporate base are shining through the crazy. We do not anticipate any smoother sailing in Q3 and believe there is a high likelihood of trade, tariffs, budget deficits, and the debt ceiling all biting the markets at some point in the coming months. But as long as corporate profits continue growing, we see potential this market can climb the wall of worry and log positive returns on the year.

<u>Beware the Policy Boogeyman</u>

We came into the year arguing that policy error was a major risk to the bull market, and somehow that might have actually underestimated how much policy would drive US market returns. At this point, we feel confident that the uncertainty and erratic (and sometimes social media driven) policy coming out of the White House will continue. That does not mean the US markets will be fully derailed, but one should be ready for disruptions.



Policy will likely change rapidly over the summer. At some point, either we hit the 90-day mark (7/8) for the reciprocal tariff pause, or we start getting trade deals done. Other than the framework for the UK trade deal, we have not seen any actual trade deals inked. For American exceptionalism to rise again, we need more stable policy, respect for our allies and trading partners, and continued excellence in science, technology, and innovation. While the iPhones are not made here, the idea was. Our economy grew by selling our vision to the world – from putting a Starbucks by Tiananmen Square, to Nikes on everyone's feet, and an iPhone in every hand. We will lead through innovation, invention, AI, and technological leadership. But those need the framework of a stable, working governance to support and attract both foreign and domestic investment in businesses.

The three main risks we see headed into the summer are:

1.) **Trade and tariffs move negatively again.** We move back to "bad cop" and big reciprocal tariffs get slapped back on China, the EU, and other major trading partners. We start ratcheting up rhetoric for higher tariffs and trade wars that could be a major drag. This may be complicated further by the need for tariff revenues to offset deficits from the planned tax cuts, which means baseline higher taxes are here. In May, the US collected $22.3B in "Customs and Certain Excise Taxes" up 78% y/y, but with the significant Chinese tariff rollbacks, that number may not be as strong going forward. Mexico (15.2%) and Canada (10.7%) are our top trading partners with China coming in at number 3 with 9.2% of total imports to the USA[1]. As tariff policy adjusts, so too will tariff revenues. And if the goal of tariffs is to drive long term investment in the USA, it is likely tariffs are going to have to stay high. One of the most successful manufacturing growth stories was China in the 1990's. Per a Bloomberg article[2], they did this by attracting foreign investment, lowering barriers, and creating a network of giant industrial hubs. Shenzhen is now seen as the world's center of electronics production and contains massive knowledge concentration and a large, flexible workforce. In 2023, China installed 51% of the world's industrial robots, while the US is at 7%. In the 1990's, China used the carrot to become a world leader; here in 2025 we are working with the stick method.

2.) **Inflation starts moving up and employment drops.** For now, the hard data (CPI, PPI, PCE, US Employment) have been extremely resilient. This allows the Fed to hold steady at a moderately restrictive policy rate of 4.25-4.50%, however more than 1 cut this year is unlikely. While soft data is showing stress, with auto loan defaults rising, credit card delinquencies higher, and overall sentiment fairly poor, the hard data is not showing the stress yet. The ADP private payrolls report has been consistently weaker than the US Employment report and we are still seeing issues in the manufacturing sector with a net loss of 8,000 jobs in May, even as the total US Labor force grew. Will we start to see the stress of tariffs and economic uncertainty in inflation and labor? The Q1 negative -.3% GDP print likely does not continue in Q2, as Q1 was driven by a rush of imports which accounted for the bulk of the negative drag.

3.) **Debt Ceiling showdown goes badly.** A lot is riding on the BBB (Big Beautiful Bill), which the Senate has indicated they plan on making major changes. The BBB only passed the House by 1 vote and SALT and other niche carveouts are key to holding onto the majority. The Senate right now is indicating they do not like the bill in this form with major opposition from Johnson, Haley, Paul and Scott. However, the Trump administration has shown skill at whipping votes, which may be necessary. There are 33 Senate seats up for reelection in 2026 (13 D and 20 R), but only Georgia, Maine, Michigan, Minnesota, New Hampshire, North Caroline, and Ohio are seen as remotely competitive. Without passage of the spending bill, the debt ceiling may have to be voted on separately, which is a highly contentious issue. The Treasury has the "X" date where we will run out of money in August. Both chambers typically go on recess all of August, as well as a full week off for 4th of July. Additionally, the House is off the last week in July, putting pressure on the Senate to get their version done by 7/21 to give it time to get through the House. Lots of work to be done in under 4 weeks' time.

[1] https://www.census.gov/foreign-trade/statistics/highlights/topcm.html

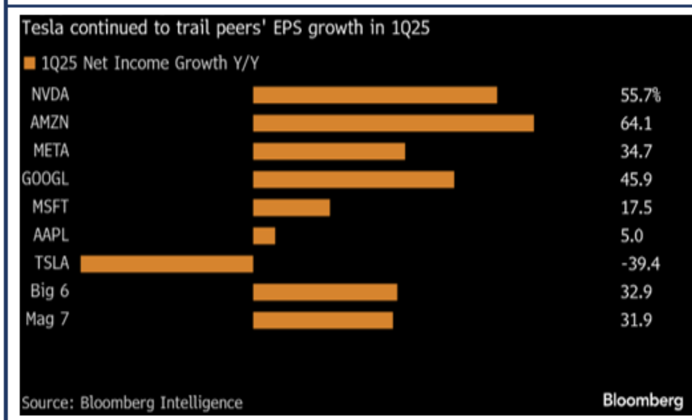
[2] Bloomberg Businessweek, "Tariffs Won't Reindustrialize America" by Dan Wang and Ben Reinhardt pg. 31-33 June 2025.

EPS and Profit Growth Is Key

Consumers may be the fuel that keeps the economy growing, but that fuel is consumed and used by US corporations to grow profit, expand businesses, and hire more workers. Growth in the US stock market is not being driven by manufacturing, but by the technology sector. YTD through 6/13/25, the top performing stock in the S&P 500 was PLTR – a software data analysis company. And technology has been the leading sector since liberation day 4/7, up a whopping 30.9% vs. 18.79% on the S&P 500. While YTD the returns are more balanced, and sectors such as industrials and communications are also leading, there is no denying that this recovery off the lows has been driven by technology.

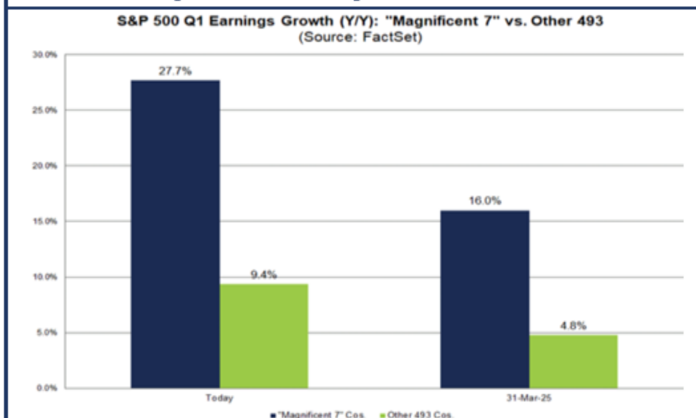
The Magnificent 7 (AAPL, AMZN, META, MSFT, NVDA, TSLA, GOOGL) have once again become market leaders and not just due to FOMO and AI frenzy, but because their profit growth is superior to the broad markets, their balance sheets are strong, and their earnings are projected to continue to grow faster than most peers. As a reminder, GOOGL and META are technically communications stocks (though they get talked about in the "techy" bucket) and AMZN And TSLA are consumer discretionary stocks – even if their hearts and souls are technology.

Ex-TSLA The Magnificent 7 Had a Magnificent Q1.



Source: Bloomberg LP: *Tesla's Expensive Valuation is a Risk for Magnificent Seven.* By Tatiana Darie

And the Mag7 Continue To Drive Higher Growth Than the Broad Market



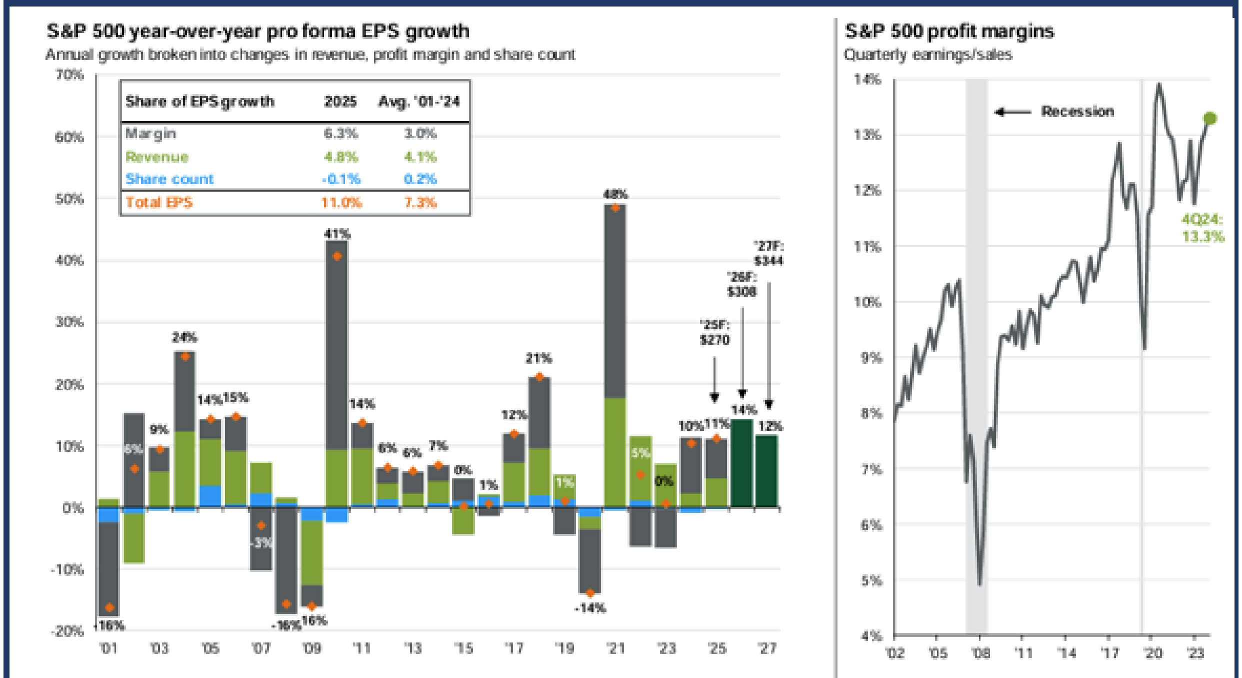
Source: FactSet "Magnificent & Companies Reported Earnings Growth Above 25% For Q1. By John Butters, 6/2/25

These 7 stocks are also crucial for US growth. They plan on spending a combined $300B this year in capex on expanding their AI capabilities and building massive data centers. This includes a forecast of $75B from GOOGL, $80B MSFT, $100B AMZN, and $65B META. These projects drive broad economic growth by building and staffing new divisions and new expansions. Construction is good for overall US economic health. Once capex starts to slow, earnings also can turn, which is a bad sign for markets. But for now, earnings are estimated to have grown 4.9% in Q2 (with over 95% of companies reporting) following a robust 12.9% earnings growth in Q1. While that growth rate has moderated, earnings are still growing despite headwinds. If markets can weather tariffs and still grow earnings, it's a strong indicator that future market growth can continue. Per Factset[3] in Q1, 78% of companies reported a positive EPS surprise showing that going into Liberation Day, the market was humming along just fine. Now, tariffs have been priced in some for Q2 as expectations have dropped from 9.3% down to 4.9% growth, which would be the slowest since Q4 2023. A lower bar to beat.

[3] https://insight.factset.com/earnings-insight-infographic-q1-2025-by-the-numbers

Stock prices go up driven by one of (or a combination of) 4 main sources: multiple expansion, margin expansion, profit expansion, and dividends/share buybacks. Multiple expansion means investors are willing to pay more (say 23x P/E vs. 20x) for a share, margin expansion means the company is retaining a higher percentage of each dollar of revenues, profit expansion is the "E" in the P/E equation, and dividends and share buybacks are directly returning capital to shareholders. AI should allow for more profit margin expansion by reducing headcount and increasing efficiencies – companies can do more with less and drive higher profits. For now, all 4 ways for stocks to grow are still pointing in a positive and growing direction.

If Profit Margins can continue to Expand and Revenue Grows, Stocks Can Rally Further



Source: JP Morgan https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/economic-and-market-update/

One key assumption of a positive market outlook is that the worst tariffs are behind us. If we go back to 145% on China, or slap 50% on the EU, and start fights again with Mexico and Canada, we will certainly expect a market stumble again. But as President Trump stated when he was defending against the TACO label (Trump-Always-Chickens-Out), "You call that chickening out? It's called negotiation." Lawyers will often tell you in a negotiation, you want to start out at unreasonable so eventually when you compromise you get something more than reasonable. The market is assuming the worst of the unreasonable is behind us, and more rational and reasonable tariffs and trade policies will headline the second half of the year.

Betting on rationality does seem like a bold move in these modern times, but it's been a winning wager the last 150+ years. While this may be a more chaotic rational, if markets can see a path forward for growth, capitalism tends to find a way. The only easy day was yesterday! Tomorrow is yet to be written.