

Quarterly Market Outlook

July 2025

All's Well that Ends Well?

On April 2, 2025, President Trump announced sweeping tariffs on imports from over 180 of America's trading partners. These included “reciprocal tariffs” of 25% on goods from Canada and Mexico, 20% on the European Union (with the potential to rise to 50%), 46% on Vietnam, and a cumulative tariff of over 50% on China. A baseline 10% tariff was also imposed on all other countries, alongside a doubling of steel and aluminum tariffs from 25% to 50%.¹

The scale and scope of the tariffs shocked markets. The S&P 500 fell 12% and Treasury yields jumped 30 bps over the days that followed amid concerns over growth, inflation, global stability, and foreign demand for U.S. assets. But on April 9, President Trump announced a 90-day reprieve on tariffs above the 10% baseline for all countries except China, and markets rebounded sharply, with the S&P 500 surging 9.5% in a single day and ultimately reaching new highs.²

Markets Recover

Despite the tariff turmoil, markets have largely looked through the noise. U.S. equities ended Q2 up 11% despite the initial selloff and are now up 6% year to date. International developed and emerging markets each gained 12% in Q2, bringing year-to-date returns to 19% and 15%, respectively. This outperformance is largely attributable to an 11% year-to-date decline in the dollar, which has pushed international equity prices higher in dollar terms. Fixed income was fairly flat in Q2: 10-year Treasury yields ended the quarter roughly unchanged, 30-year yields rose, and credit spreads tightened. Oil fell 9% despite a 12-day war between Israel and Iran, while gold rose 6% and is now up 26% on the year – buoyed by geopolitical and tariff uncertainty, central-bank demand, and concerns over U.S. deficit spending and the dollar. Finally, in signs speculative fervor has returned, retail equity trading and inflows have broken new records this year, and bitcoin and AI stocks like Nvidia recently surpassed their prior peaks.³

Risks to Growth Are Mounting

U.S. GDP growth has held up, tracking 2.6% annualized in Q2, driven by solid consumer spending and corporate earnings, strong tech-related capex, and a rise in net exports, as the drag from import stockpiling in Q1 reversed. Meanwhile, inflation has remained in the mid-2% range, close to the Fed's 2% target. But with the Fed in wait-and-see mode, downside risks to growth are increasing. High interest rates, slowing wage growth, and the increasing tariff burden could dampen consumption, and tariff uncertainty and cost pressures are already impacting corporate margins, capex planning, and foreign demand. On July 7 and 9, the Trump administration unveiled new tariff rates on 22 countries, effective August 1, which would bring the average effective tariff rate to 18% – the highest since 1934 and far above the 2-3% average during Trump's first term. That said, the Fed has room to ease if disinflation continues, which could help cushion the economy in the event of a slowdown.⁴

One Big Beautiful Bill

While tariffs remain a headwind, they may be partly offset by the stimulative impact of the One Big Beautiful Bill Act (“OBBB”), which President Trump signed into law on July 4. The OBBB permanently extends many provisions of the 2017 Tax Cuts and Jobs Act, including lower individual and corporate tax rates, bonus depreciation, and the Qualified

Business Income deduction. It also raises the State and Local Tax (SALT) deduction cap to \$40,000 through 2029 and introduces new, temporary tax breaks on tips, overtime pay, and auto-loan interest, and a \$6,000 deduction for seniors through 2028. In addition, the Act increases spending on defense and border security, scales back Inflation Reduction Act tax credits, and reduces outlays for Medicaid and the Supplemental Nutrition Assistance Program.⁵

While the OBBB is expected to boost near-term growth modestly via tax relief and demand stimulus, it largely preserves the status quo. The Act is also expected to add \$3.4+ trillion to the deficit over a decade, much of that front-loaded. U.S. growth is more dependent than ever on deficit spending – now over 6% of GDP and set to rise – and the world’s willingness to finance it.⁶

High Expectations

U.S. equities ended the quarter at record highs, even as earnings expectations have moderated and may fall further. This puts the S&P 500 at over 22x forward earnings – comparable to levels seen during the Covid stimulus boom (when expected earnings were weak) and, before that, in the early 2000s dot-com bust. International markets have rallied but remain cheaper, with developed and emerging equities at 15x and 13x multiples, respectively. While global real GDP is expected to grow 3% annually, analysts forecast 15% long-term annualized earnings growth for both U.S. and global equities – despite headwinds from higher interest rates, rising goods and labor costs, and softening demand due to tariffs and related uncertainty. Other asset classes are also sanguine: corporate spreads are near all-time tights, and the market’s expectation for 10-year U.S. inflation is 2.3%, leaving little margin for inflation shocks – whether from tariffs, geopolitical developments, or demographic shifts.⁷

Building Resilient Portfolios

Despite peak valuations, elevated policy risk, and slowing fundamentals, portfolios remain heavily concentrated in equities, and particularly U.S. equities. The risks of concentration have grown, while the rewards have arguably narrowed. We believe that resilient portfolios should diversify across asset classes and geographies and account for the possibility that growth may disappoint, inflation may reaccelerate, and sentiment may shift. We continue to seek out skilled, low-correlation active managers that can potentially add value across different environments – regardless of how equities perform. And we favor select private-market alternatives, where top managers in less efficient markets can add value through their differentiated sourcing, underwriting, and operational capabilities.

Notes

All data as of 6/30/2025.

¹ [Trump's Tariffs: Where Things Stand After the Latest Pause – WSJ](#); [US-China Tariff Rates - What Are They Now?; Fact Sheet: President Donald J. Trump Declares National Emergency to Increase our Competitive Edge, Protect our Sovereignty, and Strengthen our National and Economic Security – The White House](#).

² [How the stock market made back all its losses after Trump escalated the trade war | AP News](#); Bloomberg (SPX Index, USGG10YR Index).

³ Source: Bloomberg (SPX Index, NDDUEAFE Index, NDUEEGF Index, USGG10YR Index, USGG30YR Index, LBUSTRUU Index, LF98TRUU Index, XAU Curncy, CL1 Comdty, BCTUSD Curncy, NVDA US Equity); [How the stock market made back all its losses after Trump escalated the trade war | AP News](#); [Gold price latest: tariff shift slows gold's rally | MoneyWeek](#); [Gold ETFs drew largest inflow in five years during first half of 2025, WGC says | Reuters](#); [Investors traded a record \\$6.6 trillion worth of stock in the first half of 2025 – MarketWatch](#); [AI race powers the market forward despite tariffs](#).

⁴ [GDPNow – Federal Reserve Bank of Atlanta](#); [State of U.S. Tariffs: July 7, 2025 | The Budget Lab at Yale](#); [Greg Jensen: An Update on the Big Forces Shaping Markets Today | observatory.bwater.com](#); Bloomberg (CPI YOY Index, CPI XYOY Index); [Taking Stock of US Tariffs After President Trump's Letters | observatory.bwater.com](#).

⁵ [The Implications of the "One, Big, Beautiful Bill" | observatory.bwater.com](#); [One Big Beautiful Bill Act Tax Policies: Details and Analysis](#); [The One Big Beautiful Bill Passed: Learn What's Changing | TaxAct](#).

⁶ [Trump Signs 'Big, Beautiful Bill' Into Law in July Fourth Ceremony – WSJ](#); [CBO Estimates \\$3 Trillion of Debt from House-Passed OBBBA-2025-06-04](#); [Wall Street Worries as Crisis-Level Deficits Become the Government's Default Mode – WSJ](#).

⁷ [Stock Market P/E Ratios - Yardeni Research](#); [Forward P/Es - Yardeni Research](#); [LTEG, STEG & STRG - Yardeni Research](#); [OECD Economic Outlook, Volume 2025 Issue 1 | OECD](#); [ICE BofA US Corporate Index Option-Adjusted Spread \(BAMLC0A0CM\) | FRED](#); [St. Louis Fed](#); [10-Year Breakeven Inflation Rate \(T10YIE\) | FRED](#); [St. Louis Fed](#).

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