

# From The CIO's Desk

Market Commentary | August 2025

## Economic Mirage

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In recent weeks, the picture around tariff agreements has become clearer. A 15% tariff on imports from Japan and the European Union indicates the Trump Administration is likely on pace to be ahead of our expectation for an across-the-board 10% tariff on imports, excluding China. On top of greater clarity on tariffs, the July 4th signing of the One Big Beautiful Bill Act (OBBBA) also puts into color the stimulative side of the Trump economic agenda. What was considerably opaque four months ago has now become more well-defined.

However, the impacts of these policies have yet to materialize. Recent economic data points to elements of a slower pace of economic growth. However, 3% growth in U.S. Gross Domestic Product (GDP)<sup>1</sup> during the second quarter, an ultra-low 4.2%<sup>2</sup> unemployment rate, and a modestly above target inflation rate of 2.7%<sup>3</sup> collectively indicate that economic conditions remain better than feared four months ago. Markets have cheered this with stocks notching all-time highs in late July, corporate bond spreads are near all-time tights, and yields on Treasury bonds have eased.

We see current market sentiment as masking the mirage of what will likely be more challenging economic conditions in the back half of 2025, followed by what we view as an improving likelihood of a more optimistic economic climate in 2026. Heading into this past week, economic data was holding steady, not improving, but not showing signs of material weakness either. The exclamation point on this was the release of the 2nd quarter GDP report, which stated the U.S.

economy grew at a 3%<sup>4</sup> annualized rate. Quite a strong number, the data behind it explains that the economy grew due to fewer imports (as a result of tariffs). The second quarter's strength was really an offset to the abnormally weak 1st quarter GDP data, when the U.S. economy contracted by -0.5%<sup>5</sup> due to accelerated import buying in advance of new tariff policies. If you combine the two quarters, the U.S. economy grew by a rather pedestrian +1.25% in the first half of the year.

A notable jolt to the economic picture came on Friday, when the July employment report showed fewer new jobs created than expected. While somewhat surprising, a significant (downward) revision to job growth for May and June caught investors and economists off guard. The total revision accounted for 260,000 fewer jobs than previously reported during these two months, a level that was nearly four times the number of jobs created in July.

Looking beyond the economic data, what we are hearing from 2nd quarter corporate financial results is that price increases are on the way. Many executives are electing to keep their tactics private. Still, we suspect we will see companies reflect tariffs through multiple price adjustments, assessing the sensitivity of their customers to the price increases along the way. The timing of higher prices has come a little later than we had initially expected; however, it reflects the sizable amount of inventory companies built up ahead of the Trump tariff policies. As this older inventory has worked through corporate income statements, businesses impacted by tariffs are now looking to raise

prices to reflect the higher inventory cost. Given that the average tariff rate has gone from 3% to over 15% thus far in 2025, we expect those impacted by tariffs to pass on as much as double-digit price increases, likely spread out over time. All in, the economy-wide inflationary impact as tariffs are passed on is likely to be 1% or more.

As we piece this together, we believe the market is too focused on current data and is not looking ahead to what is inevitably going to be a slowdown in economic growth. Raising tariffs by over 10% will have an economic impact, if not on prices, then on corporate margins. Moreover, the uncertainty in business conditions is leading to a tighter labor market, which

up to this point has not been troublesome, given more restrictive immigration policies that lead to a more balanced supply and demand for labor.

We expect the exuberant markets that began on April 9th to temper down as more investors recognize the reality of the policy transition on economic activity. We saw this transpire on Friday, August 1st, when the weak July employment report resulted in a stock sell-off and a pronounced rebound in bond prices as Treasury yields fell. A weakening of the U.S. dollar also led to international stocks outpacing domestic stocks. Such an example demonstrates the power of portfolio diversification in the current climate.

## ➤ CONCLUSION

As we look beyond the second half of 2025, we are optimistic about the stimulative impacts of the OBBBA and how it may incite economic growth in 2026. More specifically, incorporating bonus depreciation of capital expenditures, alongside the immediate recognition of R&D expenses (versus over 15 years previously), could spur corporate investment and accelerate the economy. Should the Federal Reserve elect to lower interest rates next year, which is far from a certainty, the stimulative impact could further support economic growth, albeit at the risk of igniting inflation.

As economists and investors adjust to this new economic state, we expect market emotions (sentiment) to be more dramatic, moving from excitement to concern. Investors should maintain a longer-term mindset, look past near-term market emotions, and embrace the merits of diversified market exposures. We expect challenges along the way, but we remain confident in our constructive multi-year outlook.

1 Source: Bureau of Economic Analysis. As of July 30, 2025; 2 Source: Bureau of Labor Statistics. As of August 1, 2025; 3 Source: Bureau of Labor Statistics. As of July 15, 2025; 4 Source: Bureau of Economic Research. As of July 30, 2025; 5 Source: Bureau of Economic Research. As of July 30, 2025



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