From The CIO's Desk

Market Commentary | Q3 2025

Quarterly Market Perspective

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In the second quarter, the markets moved in stark contrast to what transpired during the first quarter of 2025. After experiencing a sudden selloff following the April 2nd tariff announcements, equities rebounded following a delay in the implementation of reciprocal tariffs. Stocks provided steady gains throughout the remainder of the quarter as concerns around trade policy gradually abated and investor risk appetites returned. The S&P 500 index finished the quarter up +10.8%, having rallied +25% from its low on April 8th.[1]

While we saw the recovery in markets as a reasonable response to policy de-escalation, we enter the second half of 2025 believing that markets are pricing in smooth sailing ahead. Expectations are that trade deals will be signed in the near term. Inflation is contained, and prices will only experience a one-time move to reflect higher tariffs. Furthermore, corporate earnings forecasts suggest that companies will be able to pass through tariff costs without impacting margins. Lastly, economic projections imply that consumers can weather the one-time shift in higher prices without a notable drop-off in consumption. While these expectations have merit, we acknowledge there may be bouts of volatility should the path forward not be as seamless as markets imply.

Looking at broader trends, U.S. economic data has been on a course toward moderation. Conditions remain positive, but successive data releases have begun to indicate that the pace of economic growth is slowing. The economic reports during the second quarter pointed to an economy that held up better than we had expected; however, we believe the deceleration is in the early stages, with rising inflation, restrained labor markets, and deferred capital spending likely to come in the months ahead. This is supported by survey data, such as the University of Michigan's Consumer Sentiment and National Federation of Independent Business, which point to consumers and small business owners expecting to be more cautious in their spending going forward.

Given this backdrop, we expect a gradual and continued softening of the U.S. economy in the back half of 2025. We don't see any signs of a recession at this point, but we expect more stagnant growth. Should the uncertainty associated with the new administration's policies remain, it could drag out this period of economic malaise. However, progress around tax policy, initial indications on some regulatory changes, the prospect for interest rate cuts, and continued progress on trade deals throughout the summer could remove some of the uncertainty, enabling corporations and consumers to make more informed economic decisions.

In early July, the One Big Beautiful Bill was passed by Congress and signed into law by President Trump. Key elements of the bill, such as tax cuts on tips, social security, and overtime pay, will serve as catalysts to stimulate the economy. Moreover, proposals to allow for accelerated depreciation of capital expenditures could incentivize an acceleration of corporate investment spending, especially if policy uncertainty is removed.

A follow-on risk stemming from the One Big Beautiful Bill is the impact on the U.S. fiscal deficit and, more explicitly, a lack of change in the level of deficit spending. At 6-7% of GDP, the deficit level will lead to continued rising in the nation's debt-to-GDP ratio, a key measure used by bond investors to gauge a government's health. From an investment lens, the deficit level presents a risk as it could drive U.S. borrowing costs higher, with a greater potential for higher yields among longer-dated Treasury bonds. If this transpires, it could adversely impact valuation multiples across asset classes and temper returns. We are managing this risk by having less exposure to longer-term bonds and preferring higher-quality corporate bonds.

CONCLUSION

As we put these pieces together, we could see an environment where economic activity softens in the near term, but accelerates, and potentially in a meaningful way, beginning in 2026. Applying this perspective to our approach for managing portfolios leaves us cautious in the near term, partially in recognition that there remain several policy-related uncertainties. Therefore, we must be conscious of managing risk while also positioning for opportunities ahead. As we look out over a multi-year horizon, there are compelling opportunities to invest in underappreciated market segments, such as international equities. In addition, we remain enthusiastic about the ability to opportunistically position portfolios toward long-term thematic trends such as interest rates remaining higher for longer, energy infrastructure, artificial intelligence, and realignment of global supply chains.

The environment in 2025 has been one of greater uncertainty but also increasing opportunity. As global economic conditions shift, investment opportunities are evolving. We will continue to share our perspective as markets and the economy progress.

[1] Source: https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview