Market Update: Q2 2025

As investors who have been around the block a few times, we recoil when the prevailing wisdom says "this time it's different." Generally, this happens when the markets are behaving irrationally. Over very short periods, headlines and policy proposals can move markets. The market pendulum tends to swing too far in both directions. How we choose to react, or not react, reflects on our core principles. The second quarter was a case study in those core principles of patience and focus on high-quality investments, especially in the face of historic market volatility.

Key Takeaways

- Tariff-driven volatility defined the quarter, but markets rebounded strongly
- Sentiment swung from extreme pessimism in April to excessive optimism in late June
- International and emerging markets outperformed amid a sharp dollar decline
- U.S. economic data remains solid, with low recession risk and steady inflation

INDEX	Q2	YTD	TRAILING 12 MOS.
S&P 500	10.9%	6.2%	15.2%
Russell 2000 Small Cap	8.5%	-1.8%	7.7%
MSCI EAFE - International	12.1%	19.9%	18.3%
MSCI Emerging Markets	12.2%	15.6%	16.0%
Bloomberg US Agg Bond	1.2%	4.0%	6.1%

SOURCE: BLOOMBERG

Markets Recover and Grind Higher

Without question, the first half of the year was unique. After a relatively calm first quarter, markets were whipsawed in the second quarter by broad and sweeping proposed tariffs advanced by the Trump Administration. The depth and breadth of scheduled tariffs caught the market by surprise, creating uncertainty around their effects on earnings and leading to a 19% drop in the S&P 500 from the February peak.

The market tariff tantrum subsided after the administration paused implementing most tariffs. This set up a dramatic recovery in stock prices that culminated in an all-time market high at the end of the quarter.

Strategas Research noted the 55 trading days from the April 8th low to the new high on June 27th mark the fastest roundtrip for the S&P 500 index following a 15% correction in history.

Our models of Trading Sentiment (see NDR Trading Sentiment Composite on the following page) reached near record-high levels of pessimism in early April on the introduction of potential tariffs - only to move quickly to levels now reflecting excessive optimism. The market seems to be looking past the geopolitical and policy upheavals and showing confidence in the prospects for the economy and corporate profits.

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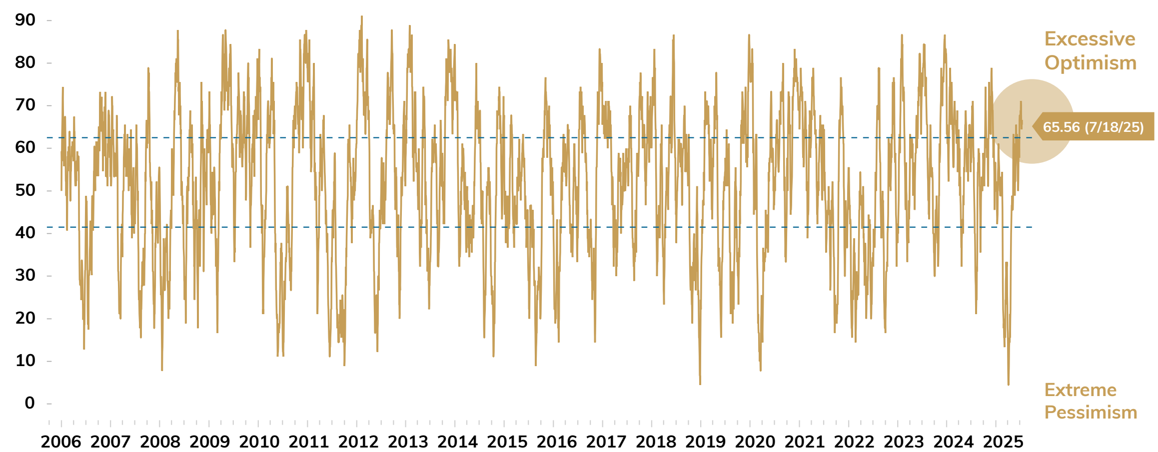
NDR DAILY TRADING SENTIMENT COMPOSITE JAN. 1, 2006-JULY 18, 2025

S&P 500 PERFORMANCE
(12/30/94-07/18/25)

NDR DAILY SENTIMENT COMPOSITE IS	% GAIN/ ANNUM	% OF TIME
Above 62.5	-4.89	28.72
41.5-62.5	8.93	44.62
Below 41.5	26.13	26.65
Buy/Hold=8.94% Gain/ Annum		



SOURCE: NED DAVIS RESEARCH

Shifting Policy Sands

Shifting trade policy creates uncertainty; but the market has become less sensitive to tariff considerations since early April and 'Liberation Day'. It's understood that at some level, this administration grades itself by where the stock market is trading – and it is taking its cues from market reactions to each new trade policy proposal.

Wall Street analysts have been cautious, but remain constructive in their forecasts. Consensus earnings estimates for 2025 moved slightly lower, but still project growth for the calendar year. We have not seen companies rush to cut earnings guidance or downplay expectations in the press in the face of tariff uncertainty. Economic data is solid with inflation holding steady; and the odds of a recession are subsiding. Finally, large technology companies have reasserted their market leadership and continue to invest aggressively in growth initiatives.

Importantly, 'The Big, Beautiful Bill' has eliminated the uncertainty around corporate tax rates and the favorable tax treatment of certain corporate capital expenditures. The permanent lower corporate tax rates should offset some of the impact of higher input costs due to tariff policies.

Decline of the Dollar

Among the notable trends in the first half of 2025 has been the decline of the dollar. The dollar experienced the worst first-half decline since the end of the Bretton Woods System in 1973, falling over 10% relative to a basket of other currencies. There are a myriad of factors that contribute to the rise and fall of the dollar. It should not be construed as a referendum on the U.S. economy.

In dollar terms, international stock indexes have fared very well in the first six months of the year. The broad MSCI EAFE index was up 19.5% in US dollar terms. However, taking out the effect of a falling dollar, that index would have been up 7.8% in local currency terms, roughly in line with the S&P 500.

In general, we have long favored U.S. stocks over international stocks. We place emphasis on the profitability and execution of companies without regard to the location of corporate headquarters. However, a U.S.-centric portfolio does not mean our clients lack exposure to the global economy. On a portfolio-weighted basis, approximately 45% of the annual revenues earned by the companies we own are earned outside the US. As a result of the weaker dollar, we could see a near-term earnings tailwind from companies with significant international revenue.

Process and Principles

It is not our intention to minimize the challenges facing markets. The market has been heavily influenced by policy changes and political outcomes. We freely acknowledge that handicapping those changes and outcomes is not where our expertise lies. We could not have predicted the course of events in the first half of the year any more than we can predict the second half. By now, our clients understand we stay fully invested. It would have been tempting to trade in and around the volatility in the quarter – but at the margin we chose to simply add to current positions that become oversold in April. Diversification is important, but not an insurance policy - and many investors sacrifice growth by being over diversified. We always take the long-term view.

One of our core principles when faced with market volatility is to focus on companies first. Listen to CEO's and industry experts that have unique insight and experience. Reaffirm conviction in the portfolio holdings and gauge how the market is incorporating new information. We have a productive track record of leaning into volatility, being opportunistic when the market sells off sharply. As Warren Buffet says, "Be fearful when others are greedy and greedy when others are fearful." We were careful not to overreact or get caught up in issues that are tangential to our core principles and process. This discipline served our clients well in the first half of 2025.

The Outlook

Today there is a lot of love in the air for stocks, and especially the stocks that performed well in the technology, financial and industrial/defense areas over the first half of the year. Excessive optimism can translate into uninspiring near-term stock performance. Plus, the third quarter can be seasonally punky for stock returns.

Still, company earnings are coming in strong and recession risks are low – so we see clear economic skies ahead. Inflation ticking slightly higher might reflect the early effects of certain tariffs; but the data could just as easily reflect seasonal elements in a strong economy. We don't see an obvious need for the Fed to cut rates – and we would prefer they didn't since we see interest rates in line with prevailing inflation levels.

Narrow stock market participation and leadership concerns us, as it has for several years – but as we've discussed, these market leaders are producing an outsized percentage of the market earnings to justify their growing valuations.

We remain constructive on the market looking out through the end of the year and remain fully invested relative to our individual investment policy guidelines across the firm.