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Quarterly Market Recap – Q2 2025

To Our Clients,

Market volatility spiked in the second quarter as the S&P 500 dropped sharply in early April following the announcement of sweeping reciprocal tariffs, although those initial losses were slowly and steadily recouped over the remainder of the quarter as initial tariff rates were reduced while economic growth proved resilient and inflation stayed low, allowing the S&P 500 to hit a new all-time high and finish the quarter with a strong gain.

Q2 Review

The second quarter started with a proverbial thud as, on April 2nd, President Trump announced sweeping and substantial tariffs on virtually all U.S. trading partners. The tariff amounts were significantly larger than markets expected and their announcement sparked fears of a trade-war-driven economic slowdown. A week after reciprocal tariffs were announced, the administration declared a 90-day delay where tariff rates on most trading partners would be just 10%, far below most reciprocal tariff rates. That delay was then followed by more steps to reduce the tariff burden, including important exemptions for key imports such as smartphones, semiconductors, pharmaceuticals and computers. The delay in reciprocal tariff rates and key category exemptions gave investors some confidence that the trade war would not automatically cause a recession, and that optimism combined with a solid first quarter earnings season to help the S&P 500 rally throughout the remainder of April.

The market rebound accelerated in May as Treasury Secretary Scott Bessent announced he would be meeting with Chinese trade officials in Geneva early in the month. That boosted investor expectations for more tariff relief and those hopes were fulfilled as the meeting resulted in a dramatic reduction in tariffs on Chinese imports. That tariff reduction combined with still-solid economic growth further eroded investor concerns that tariffs would cause a recession and the S&P 500 extended its rebound. Earnings also contributed to the rally thanks to strong results from the tech sector, which reminded investors of the growth potential of artificial intelligence (AI). Finally, in late May, the Court of International Trade ruled the administration's tariffs were illegal under the law used to justify the duties. The case was appealed immediately and a decision should come in the third quarter, but the initial ruling raised the prospect that tariffs could be eliminated almost entirely by the courts in the coming months.

The rally continued in June although trade headlines, which had driven market moves for the first two months of the quarter, took a back seat to geopolitical concerns after Israel launched a massive attack on Iranian nuclear and military facilities. The hostilities between the two rivals caused oil prices to temporarily spike and that halted the rally in mid-to-late June, as investors again had to consider the prospect of rising oil prices hurting economic growth and boosting inflation. However, that volatility was limited, as following U.S. strikes on Iranian nuclear facilities, a ceasefire was agreed to between Iran and Israel and oil prices dropped sharply, turning negative for the quarter. That decline, combined with rising expectations for rate cuts in the second half of the year, pushed the S&P 500 to new all-time highs in the final days of June.

In sum, the stock market completed an impressive rebound from the steep declines of early April, as steps by the administration to ease the tariff burden helped to boost investor confidence while corporate earnings remained strong and economic growth proved resilient, yet again, even in the face of geopolitical uncertainty and elevated policy volatility.

Q3 Market Outlook

The markets begin the third quarter following an impressive first half performance, as the S&P 500 hit a new all-time high despite much-larger-than-expected tariffs on U.S. imports, a dramatic increase in policy volatility and more hostilities in the Middle East.

While investors expected tariffs and a tougher stance on trade from the new administration, the moves taken in the first half of 2025 exceeded the vast majority of expectations as tariffs were both higher and more far reaching than most analysts expected. But moves by the Trump administration to ease the tariff burden combined with the court decision invalidating reciprocal tariffs boosted market confidence that neither the administration nor the courts would allow tariffs to derail economic growth. That belief helped stocks look past what is still a dramatic increase in tariffs.

Importantly, tariffs matter to the markets primarily because, if not properly executed, they could cause an economic slowdown, or worse, stagflation, where growth slows but inflation rises. Fears of a tariff-induced slowdown or return of stagflation were contributing factors behind the April decline in stocks. Positively, economic data remained mostly resilient throughout the second quarter and there are no major economic indicators pointing to a material slowing of growth or a sudden rise in inflation. That resilient data in the face of tariffs and geopolitical turmoil contributed to the market rebound in the second quarter.

Finally, geopolitical risks undoubtedly rose with direct conflict between Israel and Iran (including U.S. involvement in the war) and no progress on a ceasefire on the now three-year-long war between Russia and Ukraine. However, the market views these conflicts as largely isolated and not at risk of spreading into a larger regional war that could disrupt oil production or the global economy. Because of that, markets largely ignored the increase in geopolitical tensions during the quarter.

However, while the market was impressively resilient over the past three months, it would be a mistake for investors to become complacent in this environment, because there remain a lot of risks facing the economy and markets.

First, while the market has assumed that tariffs won't rise substantially from current rates, there's no guarantee of that. To that point, the deadline for the reciprocal tariff delay is July 9th and if that deadline is not extended, we could see tariff rates on major trading partners surge once again. Regardless, the reality is that global tariff rates are at multi-decade highs and it's still uncertain how that will impact the economy in the months ahead (so risks of a tariff-induced slowdown or rise of stagflation can't be dismissed).

Turning to geopolitics, while the various conflicts have not negatively impacted global markets, risks remain elevated. If Iran takes steps to disrupt global oil production or transit, that will boost oil prices and create a new headwind on markets. Similarly, if these isolated conflicts begin to spread into larger regional conflicts that will also lift oil prices and weigh on stocks and bonds.

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Finally, investors still expect two interest rate cuts from the Federal Reserve between now and year-end; however, the unknown impact from tariffs on economic growth and inflation make rate cuts in 2025 far from certain. If the Federal Reserve does not cut rates in the coming months, that will increase concerns about an eventual economic slowdown and that could weigh on markets.

Bottom line, markets have been impressively resilient so far this year, but as we start the second half of 2025 there remain numerous, potentially significant risks to the markets and the economy and we will not let the market's resilience create a sense of complacency.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

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