June provided excellent returns in all markets. The S&P 500 rose 5.1 percent for the month; The Dow Jones Industrial Average gained 4.5 percent; the Russell Mid-cap increased 3.7 percent; and the Russell 2000 climbed 5.4 percent. International stocks also rose with the MSCI EAFE gaining 2.2 percent and the MSCI Emerging Markets increasing 6.1 percent. Bonds also joined the party as rates fell on the back of lower-than-expected inflation data – the Bloomberg Aggregate Bond index rose 1.5 percent for the month.

For the first six months of 2025, despite the April Volatility, performance has been much in line with our January predictions. Bonds are up 4 percent through the first six months and the S&P 500 is up 6.2 percent. As we have noted previously, the big winners on the year are non-dollar assets – through the end of June, the MSCI All Country World Ex-Us gained 18.3 percent; the Bloomberg Global Ex-USD Aggregate Bond index gained 10.0 percent.

So, what caused the robust June performance and where do we go from here? We think two factors contributed. First, inflation was and will likely continue to be much tamer than the market and the average pundit (including Morgan Stanley) thought possible in the wake of the Trump tariffs (our team did predict inflation would surprise to the low side in our previous missives.) Second, the imminent but very likely passage of The One Big Beautiful Bill Act (it ended up passing, under that name, on July 4th) which offered a sizable reduction in the experienced corporate tax rate – much like corporate tax increases or tariff increases often trigger equity sell-offs, reductions in corporate taxes often produce immediate gains as they ultimately put more funds in shareholders' pockets.

Inflation for June as measured by the CPI will likely be in the 0.25 percent range – which would annualize at around 3 percent – which is at the very high end of what the Fed finds tolerable. We had predicted in these messages that the inflation rate would pop up a bit in the early summer. But the Cleveland Fed's Inflation Nowcast for July is back down to .16 percent – which would annualize at around 1.32 percent for a whole year. Why? Because tariff price increase are better conceived of as a one-time jump than as persistent upward price pressure over time. That said, we do think that starting this week, tariffs will get back into the news cycle as the Trump administration's new August 1st deadline approaches. In our view, markets have become a bit too complacent about tariff risks as the Trump administration walked back its initial April 2nd posturing – the reversal was even given a humorous nickname, the TACO trade – Trump Always Chickens Out.

But, in our view, nothing much has changed since we conveyed our feelings about the likelihood of substantial tariffs coming to pass in our March note: "we feel confident the Trump administration plans to use tariffs in an effort to raise revenue for the Federal government, protect US industries in the hope of spurring more domestic manufacturing, and achieve more reciprocity in trade policy." We fully expect further escalations in tariff rates with a great number of countries after the July 9th (now August 1st) deadline. The administration wants to drive wages higher for working class voters; tariffs simultaneously achieve two things. First, they engender dollar weakness which drives US import costs up and US export costs down. Second, they serve to offset less expensive foreign labor – the primary driver of economic trade deficits. We continue to predict dollar weakness and trade-related market volatility for the remainder of the year, though we do not fear the tariff-driven inflation others have forecast. We remain confident that the Fed will begin rate cuts this fall – driving shorter rates lower, steepening the yield curve, and further weakening the dollar.

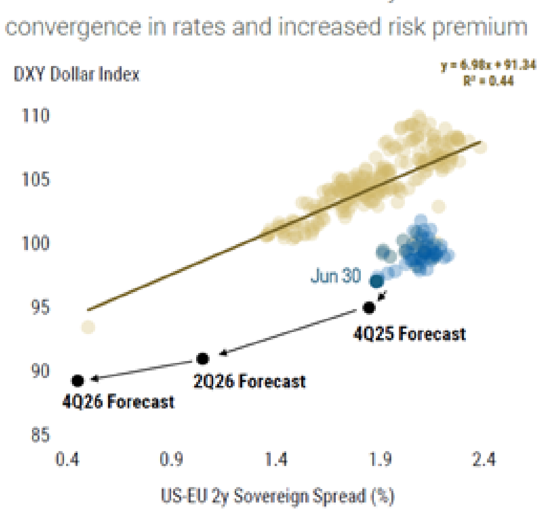
Regarding the One Big Beautiful Bill Act, the primary market effect likely related to corporate tax reductions. As Morgan Stanley's Lisa Shalett wrote on June 30th in her GIC Weekly, "We believe these tax advantages will likely reduce the effective tax rate for S&P 500 companies to about 15% from the current 18% and the statutory 21%. Earnings and cash-flow impacts for shareholders will likely be concentrated in capital- and R&D-intensive sectors like tech, industrials, energy and health care. Morgan Stanley & Co. Research's policy team estimates net stimulus from these "tax breaks" will add 0.5% to GDP in 2026 but ramp down beginning in 2027 as various pay-fors kick in."

So what happens next? Forced to guess, we'd say the current rally takes a break as markets digest The Big Beautiful Bill and gauge inflation and economic growth over the summer. Retail investor sentiment has become quite bullish and stretched – never a good sign from our perspective. That said, we are still optimistic on the full year. We continue to expect an autumn rally – especially in small cap stocks which are very rate sensitive -- as the Fed cuts rates, inflation variability subsides, and the tariff rates stabilize after the next round of increases (Morgan Stanley still thinks rate cuts will be on hold until 2026, but that is not our team's view or the consensus view). We remain optimistic and bullish on 2025 as a whole, though won't be surprised to see a few steps back before the next move up. We also continue to be bearish on the dollar which should support international returns throughout the rest of the year as well.

Exhibit 1: Morgan Stanley forecasts that the USD sell-off is barely half over

Source: Macrobond, Morgan Stanley Research forecasts

Exhibit 2: USD's decline is driven by both a convergence in rates and increased risk premium



Source: Macrobond, Morgan Stanley Research forecasts

Morgan Stanley's Global Investment Committee also remains bullish on the remainder of the year, writing in this month's On The Markets that they continue to "believe that the benchmark index can hit 6,500 this year, suggesting single-digit gains for the rest of 2025. A better outcome than that might be possible, as investors craft a new bull market narrative comprising faith in Federal Reserve easing into a disinflationary "Goldilocks" soft landing; a capex/productivity boom aided by corporate tax cuts; and constructive deregulation supporting credit growth and Treasury issuance. Lower-than-expected oil prices, a weak US dollar and tariff policy that proves nondisruptive are additional potential tailwinds."

Moving away from market predictions and analysis, this month we wanted to provide a link to a Journal of Accountancy article that lists all the tax changes, which are numerous, in The Big Beautiful Bill as it was finally passed and signed into law. There is a lot of noise in the media coverage of the bill that we think makes it hard for clients to actually follow what changed and how it might affect them personally. For the most part, the permanence of the current tax rate regime (both income and estate tax) provided the bulk of the benefits to investors. The majority of the new provisions the news has focused on (no tax on tips, social security, overtime, deductions for car interest, increases in the SALT deduction limitation) phase out pretty quickly for high-income taxpayers.

Morgan Stanley's US Policy Pulse team has already produced a research report analyzing the macroeconomic effects of the bill, entitled A Big Beautiful Guide to the Big Beautiful Bill. We hope to follow up this later month with a separate e-mail that provides the Morgan Stanley research take on all the specific provisions in the bill from the perspective of individual taxpayers/clients. It's a very large piece of legislation that made a lot of tiny incremental changes. So, that work make take a little while to complete.

As always, if you have any questions or concerns, please don't hesitate to reach out to any member of the team.