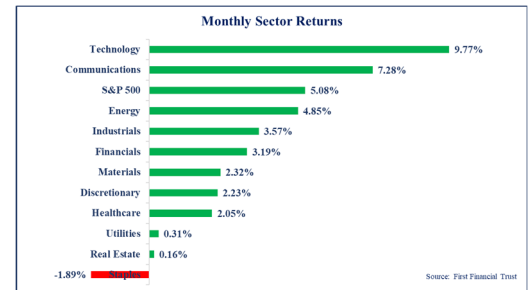


EQUITY MARKET UPDATE

As of 6/30/25 | Volume 14, Issue 6 | FFTAM.com

Stocks rose to new all-time highs in June despite a mixed picture of economic data, increased military conflict with Iran, and looming tariffs. Investors were excited about second-half-of-the-year prospects that include tax certainty from the passage of the One Big Beautiful Bill, the likelihood of de-escalation in the tariff fight as more countries agree to new trading terms with President Trump, and the potential for lower interest rates as signaled by the Fed's dot plots. Enthusiasm about the buildout of artificial intelligence continues to draw investor money as well. Collectively, the bet on Wall Street is that economic data will soften but avoid a recession, while corporate earnings reaccelerate from lower interest rates, tax and tariff certainty, and the introduction of AI into daily business tasks.

The S&P 500 gained 5.08% in June. Ten of the eleven economic sectors were positive. Consumer staples was the sole loser, dropping 1.89%. Investors reverted to past habits by piling into technology (+9.77%) and communications (+7.28%). These sectors are home to the top tech companies known as the Mag 7. Last month, Microsoft, NVIDIA, Meta Platforms, Broadcom, Amazon, and Oracle were responsible for over 50% of the gains. Year-to-date, the S&P 500 is up 6.20%. Defensive sectors like staples and utilities are among the leaders, along with economically sensitive areas like financials and industrials. Even though more areas of the market are participating in the rally in 2025 compared to last year, results are still skewed by the major artificial intelligence companies with Microsoft, NVIDIA, Meta Platforms, and Broadcom accounting for over 60% of the money made.



The Dow Jones Industrial Average rose 4.47% for the month. Declines in McDonald's and Sherwin Williams weighed on results. Year-to-date, the Dow is up 4.55%. Overweight positions in United Healthcare, Apple, and Salesforce have negatively impacted returns compared to the S&P 500.

The NASDAQ experienced the best return in June, gaining 6.64%. Strong returns from Microsoft, NVIDIA, Broadcom, Meta Platforms, and Netflix lifted the index. Despite the good month, the NASDAQ is underperforming the S&P 500 in 2025. Declines

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in large holdings like Apple and Tesla, along with elevated valuation and the lack of interest rate cuts, have made this area of the market ripe for profit-taking. Year-to-date, the NASDAQ is up 5.86%.

Mid and small-sized stocks also saw monthly gains. The S&P 400 Mid Cap (+3.58%) and S&P 600 Small Cap (+4.04%) indexes rose on better-than-expected inflation data, which sparked hope that the Fed would consider lowering interest rates at future meetings. Passage of the One Big Beautiful Bill also provided tax and regulatory certainty. Unfortunately, these factors have not been enough to lift these stocks that continue to lag their large-cap peers with year-to-date returns of 0.19% and -4.48%, respectively.

Given the seismic shift to global commerce from President Trump's tariff announcements, along with tax policy negotiations in Congress, economic data remains resilient. The US economy has clearly softened in recent months, but nothing indicates a recession is at the doorstep. Consumer spending is firm, but it continues to come primarily from higher-income households. For months, many metrics have shown financial stress building among lower-income households, and recent consumer sentiment surveys indicate the potential for higher prices from tariffs is front-of-mind. Labor, which has been the bright spot for the past two years, appears to be returning to more normalized conditions. June payrolls showed that another 147,000 jobs were created; however, half of the new jobs came from state and local governments, which historically is not sustainable. Unemployment fell to 4.1%. Wages were up 3.7% from one year ago, an amount that continues to exceed both the Fed's expectations and the pay raises seen pre-COVID; however, it is trending toward normalization. The labor market is tight, but competition to recruit and retain employees has obviously waned. Lack of immigration is also weighing on employment growth. The JOLTS report showed that there are 7.77 million jobs open but unfilled, which equates to 1.1 job openings for every unemployed person. This is below the levels seen pre-COVID, and it indicates that getting a new job is becoming harder for people on unemployment. Weekly reports on the number of new people filing for unemployment have also increased, but the overall level is still manageable.

Consumer inflation took another step towards reaching the Fed's target, with prices increasing 2.4% from one year ago. Core inflation that removes food and energy held steady at 2.8%. PCE data, the Fed's preferred measure of inflation, showed total prices climbing 2.3%, while prices ex-food and energy rose 2.7%. These statistics were in line with expectations, and market participants continue to see a Fed rate cut by September. The large unknown is how much room the Fed has to lower interest rates, especially if the threatened tariffs push prices higher. However, we are three months removed from the Liberation Day announcement, and there is still no concrete evidence of widespread inflation materializing.

Despite wage growth and relatively low unemployment, clouds are forming over select segments of the consumer population. Personal income fell 0.4% in June. Total spending declined 0.1%, while retail sales dropped 0.9%. Consumers have increasingly funded their expenditures with the use of debt. Credit card balances are at record amounts, and debt delinquency has climbed from one year ago in both credit cards and auto loans, especially among people with lower credit scores. Until President Trump provides greater details on his economic policies, monthly job reports and weekly unemployment claims are vital pieces of information to watch to gauge the strength of the consumer.

Business investment remains mixed. The ISM Manufacturing PMI Index was 49.0. This index has contracted 29 of the last 32 months. Employment data (45.0) contracted once again. Manufacturing jobs have fallen in 25 of the last 29 months, something

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that historically happens only during recessionary periods. New orders (46.4) weakened and are entrenched in contractionary territory. This data, along with erratic movement in the trade deficit the past six months, is providing skeptics with fuel that businesses are merely ordering products and components as a reaction to proposed tariffs. Unfortunately, prices paid (69.7) remained at their highest level since June 2022, adding to fears that inflation from proposed tariffs could be lurking under the surface of more widely followed economic metrics. A recent report from Morgan Stanley highlighted that the weakness in manufacturing has been coming from consumer goods, while investment in capital goods is very strong, signaling the reshoring efforts from President Trump's trade policies are in the early innings of taking shape as companies bring production back to the US. They believe this explains why the prices paid component of PMI is appearing inflationary as the mix between consumer and capital goods has tilted so heavily towards the more expensive capital goods component of the equation. Services have been the engine powering the economy, but it too has slowed in recent months. The ISM Service PMI Index slightly improved from the previous month with a reading of 50.8. Service employment (47.2) fell, while new orders (an indicator of future demand) jumped to 51.3 after last month's weak reading. Just like its manufacturing cousin, prices paid for services (67.5) were very hot.

Collectively, the data shows the Fed is winning the battle with inflation, although as stated above, the proposed tariffs from President Trump insert a high degree of uncertainty for future prices. The FOMC held interest rates steady at 4.25% to 4.50%. Dot plots indicate the central bank believes rates will be between 3.75% and 4.00% by the end of 2025, implying rates will be cut twice in the back half of 2025. The Fed is holding on to its wait-and-see position throughout the summer given the uncertainty surrounding the President's threatened use of tariffs against major trading partners.

The rally last month pushed the valuation of the S&P 500 to 22.2x forward earnings estimates. This is more than one year ago (21.1x), and it is above the 5-year (19.9x) and 10-year (18.4x) averages despite the higher interest rate environment. The equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds remains thin.

We are on the brink of another earnings season. Analysts are forecasting 5% growth in year-over-year profits. If this comes to fruition, it would be a major step backwards from the first quarter results and the lowest growth in earnings since the fourth quarter of 2023. Much of the weak forecast is likely due to several companies suspending their forward guidance after the first quarter given the uncertainty surrounding tariffs. Six of the eleven sectors are projected to report yearly profit growth, led by Communications and Technology. On the other hand, five sectors are predicted to report a drop in annual earnings, led by energy. Drilling down further, much of the forecasted earnings growth is believed to come from margin improvement and share buybacks, which are deemed to be lower quality than top line increases. The consensus forecast currently calls for full-year 2025 earnings growth of 9.1%, a sharp decline from the 11.3% growth estimate just three months ago.



With the market trading above valuations of the past decade, stocks are vulnerable to headline risk from the White House. All major economic reports are also being closely scrutinized for signs of weakness. Coming into 2025, the S&P 500 experienced two years in which returns exceeded profit growth, resulting in back-to-back years of PE multiple expansion. This told us investors were fully convinced that inflation and interest rates would be coming down while overall demand for goods and services would

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remain intact (i.e., soft landing or “Goldilocks” scenario). This view has become clouded due to the lack of clarity from President Trump on the use and implementation of tariffs, along with higher long-term interest rates in reaction to the CBO’s estimate that the One Big Beautiful Bill would increase the nation’s deficit. We would not be surprised to see the market consolidate or trade sideways for the remainder of the summer given elevated valuation, along with the size and speed of the rally since the Liberation Day sell-off.

For months, we have written about the large difference in valuation between the big tech companies at the top of the index and everybody else. Currently, if you equal weight the names inside the S&P 500, the forward PE ratio drops from 22.2x to 17.7x. It appeared the wide margin was poised to close significantly after tech performed so poorly in February, March, and April; however, the rally in AI-related stocks from the Liberation Day lows has reopened the gap to the widest level seen in years. After adding to our technology exposure in April and May, we are now cautious once again given the steep valuations assigned to this area of the market even when you factor in future growth opportunities. We remain bullish on financials, utilities, and parts of healthcare. Finally, our preference for quality companies with strong balance sheets and growing dividend streams to enhance performance remains strongly intact.

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