## Summary

The second quarter of 2025 was characterized by significant policy uncertainty, a slowing economy, and geopolitical events, leading to fluctuating market conditions. Despite initial tariff concerns causing market downturns, the quarter ended with all-time highs for stock markets, indicating a complex interplay of factors influencing economic sentiment and growth.

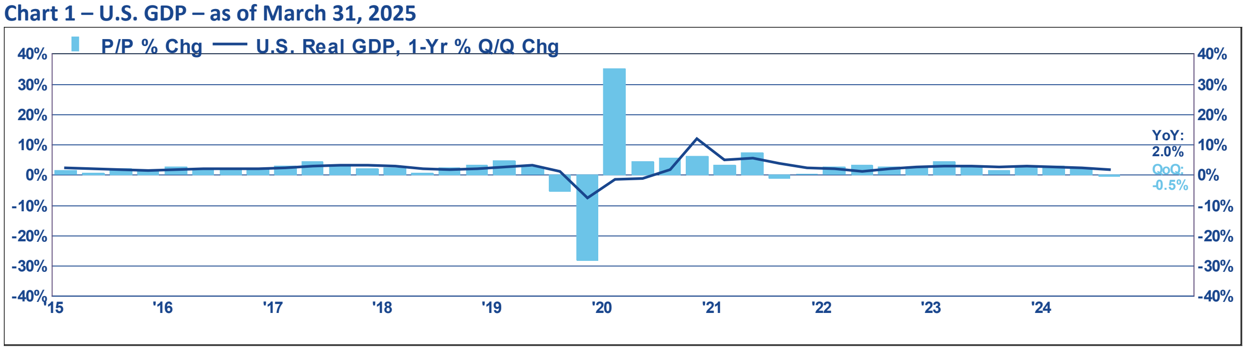
- **Tariff Announcements Impact:** The quarter began with President Trump's announcement of aggressive tariffs on April 2nd, aimed at reshaping U.S. trade policy, which initially shocked investors and caused a market sell-off.
- **Market Recovery in April:** By the end of April, market sentiment improved as a 90-day pause on higher tariffs was announced, leading to mixed stock performances but a recovery in bond yields.
- **Positive Developments in May:** The S&P 500 experienced a nine-day winning streak, driven by easing trade tensions and a temporary agreement on tariffs between the U.S. and China, prompting economists to revise growth forecasts.
- **Federal Reserve's Caution:** The Fed held rates steady in May and June, signaling concerns about rising unemployment and inflation due to trade policies, while also indicating a potential for future rate cuts depending on economic data.
- **Geopolitical Tensions in June:** Events such as Israel's airstrikes on Iran and subsequent U.S. interventions influenced market behavior, with stocks rising despite geopolitical and other risks.
- **Overall Market Resilience:** Despite various uncertainties, stocks and bonds showed resilience, with the S&P 500 and NASDAQ reaching all-time closing highs by the end of June.

## April

The quarter began tumultuously as President Trump on April 2nd unveiled “Liberation Day” which were a sweeping set of reciprocal tariffs aimed at reshaping U.S. trade policy. He framed the tariffs as a means to boost domestic manufacturing, bolster national security and readiness, reduce reliance on foreign goods, and address perceived economic exploitation by trading partners. The unexpectedly aggressive tariff and trade measures caught investors by surprise, elevating uncertainty and speculation about their impact on the global economy and inflation.

Stock markets sold off sharply, reaching quarterly lows on April 8th and bond yields started to press higher on inflation fears. Market strategists began to cut economic and earnings growth forecasts and raise outlooks on inflation and the likelihood of recession. Moreover, Federal Reserve (Fed) officials cited the increasing possibility of slower growth, higher inflation, and the potential policy dilemma of balancing these risks. Indeed, the first estimate of 1Q25 U.S. GDP showed the economy contracted -0.5% with imports surging (+41.3%) as companies front-loaded inventory in anticipation of tariffs.

**Chart 1 – U.S. GDP – as of March 31, 2025**



As April progressed, market sentiment began to improve as the Administration announced a 90-day pause on higher-level reciprocal tariffs except for China, and although trade tensions remained high, there were positive signs emerging that progress was being made on trade de-escalation, potential agreements, and industry specific tariff relief. Stocks finished the month mixed with international markets higher and domestic markets modestly lower. Bonds also finished the month mixed as yields retreated from intra-month highs. Improved market sentiment carried over into the month of May.

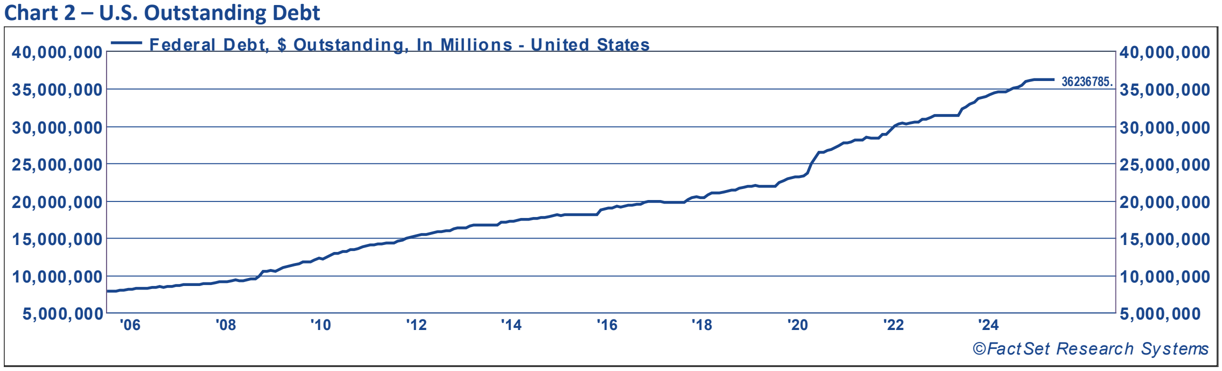
**May**

Improving market sentiment propelled the S&P 500 to a nine-day winning streak in early May. Easing of trade tensions between the United States and China was the biggest catalyst as the two countries came to a temporary agreement. The agreement was more aggressive than expected, with the U.S. tariff rate on Chinese goods being cut from 145% to 30%, while the China tariff rate on U.S. goods came down from 125% to 10%. The reductions took effect for 90 days as the two sides worked towards a broader deal. Furthermore, it was announced that the U.S. and U.K. reached a trade deal, Following the agreements, many economists and market strategists reversed course, raising their U.S. growth forecasts, cutting inflation projections, and seeing less risk of recession.

Another significant development came from the Fed's FOMC meeting in which they, as expected, held rates steady. Chair Powell's press conference statement added that trade policies are likely to increase risks of rising unemployment, higher inflation, and a slowdown in economic growth. During the press conference, Chair Powell offered little on a possible rate cut in June. He noted they have not seen tariff impacts in the data yet, though the shock is still yet to come. Powell noted there are cases in which rate cuts would be appropriate this year, though he cannot confidently know the appropriate rate path. With the Fed stressing patience and caution, consistently noting that incoming data will ultimately decide the rate path forward, the bond market dialed back rate-cut expectations for 2025.

Speaking of the bond market, yields came under pressure with the downgrade of U.S. Treasury debt from Moody's. Moody's was the last major credit rating agency to downgrade U.S. debt. Moody's downgrade from AAA to AA1 reflects deep concerns about rising debt ($36 trillion and growing), persistent deficits ($1-2 trillion annually), and growing annual interest costs (now $1 trillion due to higher rates), compounded by a lack of effective fiscal policy responses. During the month, the yield on the 10yr Treasury rose from 4.15% to 4.39% and reached intra-month high of 4.58%.

**Chart 2 – U.S. Outstanding Debt**




Moody's decision, supported by detailed projections and aligned with other major rating agencies, underscores the urgency of addressing U.S. fiscal challenges. The long-term implications are clear: continued fiscal expansion without credible efforts to stabilize debt could eventually impact borrowing costs and economic flexibility. Standard & Poor's and Fitch Ratings already downgraded U.S. debt back in 2011 and 2023, respectively, citing similar concerns about debt-ceiling brinkmanship and lack of structural reform.

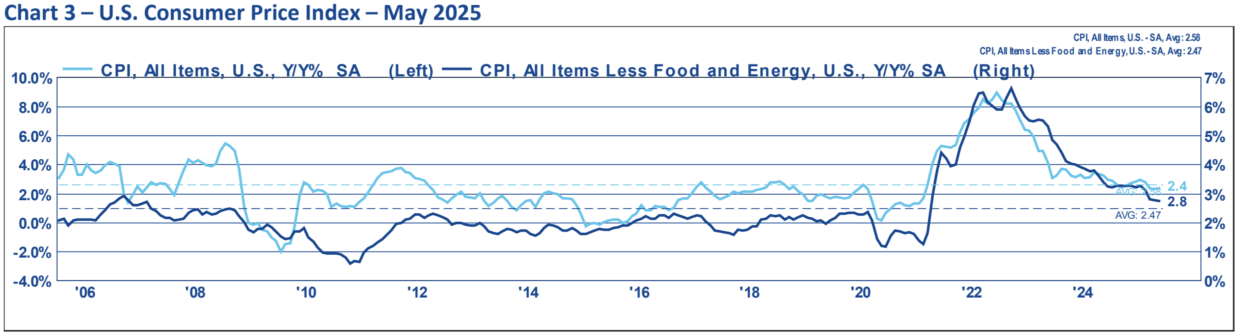
The last week of May saw stocks continuing to rise, finishing sharply higher for the month. The S&P 500 and NASDAQ posted their best finish since November 2023. Bonds ended lower as higher yields reduced bond prices. Bond yields and prices are inversely related.

**June**

Despite widely held tariff-related inflation concerns, like in April, inflation in May came in lower than expected. The U.S. Bureau of Labor Statistics reported that consumer prices rose by a modest +0.10% in May (+0.20%), with annual inflation at +2.4%, lower than expected (+2.5%) due to cheaper gasoline offsetting higher housing costs, signaling muted underlying price pressures. The pundits quickly framed the reasons for the lower reading.

The framing included pre-tariff stockpiled goods before tariffs were imposed, allowing them to sell pre-tariff inventory at lower prices. Falling prices in volatile sectors like gasoline and energy, along with declines in airfares, clothing, and used cars, have counteracted tariff-related price pressures in other areas like appliances and toys. The full effect of tariffs takes time to filter through supply chains, and it will take businesses months to adjust pricing strategies. Finally, softer demand, driven by economic uncertainty and recession fears, has restrained price increases, particularly in services. Over the next few months, if inflation does not meaningfully materialize, expect the Fed to become much more dovish and cut rates.

**Chart 3 – U.S. Consumer Price Index – May 2025**




Released in early June, the Fed's Beige Book, which summarizes economy activity from 12-Fed Regional Districts, indicated that the U.S. economy experienced a slight decline in activity since the previous report in April 2025. Economic activity declined modestly across most of the districts, with half reporting slight to moderate declines, three reporting no change, and three noting slight growth.

All districts highlighted elevated economic and policy uncertainty, leading to cautious business and household decisions. Prices increased at a moderate pace, with widespread expectations of faster cost and price increases due to tariffs. Many businesses reported passing tariff-related cost increases to customers. The Fed certainly expects inflation to rise later in 2025 as they have raised their 2025 year-end inflation projection twice from 2.5% in December to 3.0% in June.

With inflation within arm's reach of the Fed's target, the economy continues to gradually weaken, which begs the question, is the Federal Reserve (Fed) once again late to the party? During the inflation surge of 2021-2022, The Fed initially labeled rising inflation as "transitory," attributing it to supply chain disruptions and stimulus spending. It maintained near-zero interest rates and quantitative easing into 2022, despite inflation climbing above 7%. By the time the Fed began aggressive rate hikes in March 2022, inflation had reached a 40-year high of +9.1% (June 2022). Now, as inflation moves closer to the Fed's long-term target of +2.0% and the economy clearly continues to weaken, the Fed is reluctant to cut rates due to potential tariff-related inflation. Perhaps the Fed is once again late to the party, with only the mess to clean up.

The other major event in June was Israel's airstrikes on Iran's nuclear facilities and Iran's retaliatory actions, which drove oil prices to around $74 per barrel and bolstered safe-haven assets like bonds, with U.S. Treasury yields dipping below 4.4%. Even with this significant development, stocks essentially treaded water for about a week or so. This was followed by the weekend U.S. bombings on Iran's nuclear facilities. Astonishingly, stock futures moved higher that Monday morning and then by the end of the day moved sharply higher as the U.S. brokered a peace agreement between the long-time adversaries. Just goes to show you how desensitized the markets are to conflict.

There were many moving parts in June including trade related volatility, fiscal policy, eroding consumer sentiment, lower-than-expected inflation, weakening economic data, geopolitical risk, and of course, the Fed. Despite it all, stocks finished sharply higher for the month while bonds posted solid gains as well. The S&P 500 and NASDAQ posted all-time closing highs to end the month and quarter.

## Capital Markets

Amidst significant policy uncertainty from tariffs, geopolitical tensions and volatility, stocks and bonds exhibited resilience in the second quarter of 2025. Similar to the first quarter, clients benefited from diversified portfolios, as risks were mitigated through exposure to a range of asset classes with divergent performances, reducing overall volatility and enhancing risk-adjusted returns. This strategic approach underscores the enduring value of diversification in navigating complex and volatile market environments.

**Table 1 – Equity and Fixed Income Total Returns – period ending June 30, 2025**

| Equity | 1-Month | 3-Month | YTD | 1-Year | 3-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|---|---|
| MSCI Developed | 2.20 | 11.78 | 19.45 | 17.73 | 15.97 | 11.16 | 6.51 |
| MSCI Emerging | 6.01 | 11.99 | 15.27 | 15.29 | 9.70 | 6.81 | 4.81 |
| S&P 500 | 5.09 | 10.94 | 6.20 | 15.16 | 19.71 | 16.64 | 13.65 |
| NASDAQ | 6.64 | 17.96 | 5.85 | 15.68 | 23.66 | 16.03 | 16.20 |
| Dow Jones Industrial | 4.47 | 5.46 | 4.55 | 14.72 | 14.99 | 13.52 | 12.06 |
| S&P 400 | 3.58 | 6.71 | 0.20 | 7.53 | 12.83 | 13.44 | 9.25 |
| Russell 2000 | 5.44 | 8.50 | -1.79 | 7.68 | 10.00 | 10.04 | 7.12 |
| **Fixed Income** | **1-Month** | **3-Month** | **YTD** | **1-Year** | **3-Year** | **5-Year** | **10-Year** |
| Bloomberg High Yield | 1.84 | 3.53 | 4.57 | 10.29 | 9.93 | 5.97 | 5.38 |
| Bloomberg Inter Gov't/Credit | 1.07 | 1.67 | 4.13 | 6.74 | 3.57 | 0.64 | 2.04 |
| Bloomberg U.S. Aggregate | 1.54 | 1.21 | 4.02 | 6.08 | 2.55 | -0.73 | 1.76 |
| Barclays Michigan Muni | 0.53 | -0.13 | -0.06 | 1.11 | 2.62 | 0.53 | 2.33 |
| Bloomberg Municipal | 0.62 | -0.12 | -0.35 | 1.11 | 2.50 | 0.51 | 2.20 |

## Asset Allocation

The U.S. economy is forecasted to rebound in the second quarter from the first quarter decline. According to consensus estimates, the economy is projected to grow +1.5% in 2Q25 and the Atlanta Fed GDPNow indicator has growth pegged at +2.6%. For calendar year 2025, consensus looks for growth of +1.5% which is down from the 2024 pace of +2.8%. The likelihood of a recession this year is low and would not be surprised if economic and earnings growth estimates start to move higher.

Earlier this year, due to the uncertainty and lack of precedence surrounding tariffs, eroding business and consumer confidence, and declining economic and earnings growth rates, we reduced our stock exposure from Overweight to Neutral. As we enter the third quarter, there is improving clarity on many underlying fundamental factors and geopolitical risks which are shifting our outlook to cautiously optimistic. For bonds, we continue to expect the yield curve to steepen and spread relationships to normalize between the short and long end of the yield curve.

**Prepared by Perry Adams – SVP & Director – West Shore Bank Wealth Management – July 4, 2025**

Sources: FactSet, Federal Reserve, U.S. Department of Labor, U.S. Bureau of Labor Statistics, Moody's, Federal Reserve Bank of Atlana, FactSet Earnings Insights, The Conference Board