Market Review
Second Quarter 2025

In the second quarter of 2025, stocks improbably rallied, largely recovering from the initial tariff policy shock.

During the period, the S&P 500 Index returned 10.94% while the Russell 2000 Index increased 8.50%. Those gains, however, only tell half of the story. In less than three months, the same indices rallied 24.53% and 23.53%, respectively, from their April lows.

While everything bounced, the composition of performance was consistent with the well-established trend. Large fared better than Small. Growth trounced Value on both ends of the market capitalization spectrum. It was also a momentum-driven market; the MSCI Momentum Factor ETF gained 18.89%. The result was a narrow advance in Large Cap, propelled by exceptional returns in the Mega Cap Growth stocks, and a more speculative surge in Small Cap.

The quarter got off to an inauspicious start. On April 2nd, President Trump announced a comprehensive tariff proposal on his self-ascribed “Liberation Day”, which proved much more punitive – and broad-reaching – than anyone expected. This pushed an already sagging market firmly into collapse. The S&P 500 declined 10.53% in the balance of the week and the Russell 2000 fell 10.67%, marking the worst two-day plunge for stocks since March 2020.

But while the trade sparring continued, the story thereafter was of implausible recovery. The initial catalyst for stocks was the President’s announcement of a 90-day pause in the implementation of the more extreme reciprocal tariffs. This was followed by significant tariff cuts, and a de-escalation in trade tension between the U.S. and China in mid-May.

Although these headlines helped to mend sentiment, there were two additional developments that we expect will have a more profound impact on the sustainability of recovery. First, the investment in artificial intelligence (AI) has persisted despite concerns that China-based DeepSeek’s more cost-effective model could overhaul industry spending priorities and tact. Second, the prospects for lower interest rates have improved considerably. In addition to signs of strain in the labor market, there is a growing contingent within the Fed that seems to view the implementation of tariffs as more of a one-time reset for pricing than a precursor to runaway prices. The hope is that the lower cost of borrowing can help to reinvigorate the domestic economy as business adjusts to the dislocation from trade.

At this point, the question for investors is if you manufacture an economic crisis, is a (clumsy) de-escalation really cause for celebration and new record highs? Unfortunately, our bias is “no”. The team still views the enactment of tariffs as extremely disruptive for business. We are also disheartened by the slow, bilateral approach to negotiations. While the full impact of policy has yet to be seen, there are already signs of slowing and deterioration.

More specifically, Q1 GDP contracted 0.5%. The combination of supply chain challenges, affordability issues, and high interest rates has arrested activity in early cycle industries, including housing and autos. Manufacturers continue to struggle with anemic orders and higher prices. There are also increasing signs of strain in the labor market; in June, (continuing) jobless claims increased to the highest levels since 2021. Despite these trends, however, there has been a considerable rise in optimism with “bullish sentiment” increasing to 51% in the latest Investor’s Intelligence poll.

As we look ahead, the team is wary that recent stock market gains are inconsistent with the unsettled global economic picture. As a result, the surest prediction is for continued volatility. Although it has been hard to stay in sync with the fluctuations in policy and sentiment, we have been encouraged by the resilient earnings growth of our investments, which is always our primary objective. We also remain confident that our profitability-focused, conservative growth process will help us to weather the near-term uncertainty while we scour for investment opportunity in fickle markets.

Sources: *FactSet, GICS Sector Classification, U.S. Bureau of Economic Analysis, U.S. Census Bureau, ISM Manufacturing, Investors Intelligence*

Gross Domestic Product (GDP) – Gross Domestic Product includes consumer spending, government spending, net exports, and total investments. It functions as a comprehensive scorecard of a country's economic health.

Indices are provided for comparative purposes only. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. An investor cannot invest directly in an index. This is an actively managed strategy that does not invest in all of the securities of an index, and will have some associated concentration risk. Comparisons have limitations because indices may have volatility, investment and other characteristics that may differ from an investment account strategy to which it is compared. Indices are unmanaged, include the reinvestment of dividends, and do not reflect transaction costs, management, or other fees. See the following for a description of each index used in this material.

The S&P 500 is widely regarded as the best single gauge of U.S. large cap equities. The index includes 500 leading companies spanning all sectors of the U.S. stock market. It covers approximately 80% of the U.S. equity market capitalization and over 50% of the global equity market.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 7% of the total market capitalization of that index, as of the most recent reconstitution. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small cap opportunity set.

The MSCI USA Momentum Index is based on MSCI USA Index, its parent index, which captures large and mid cap stocks of the U.S. market. It is designed to reflect the performance of an equity momentum strategy by emphasizing stocks with high price momentum, while maintaining reasonably high trading liquidity, investment capacity and moderate index turnover.

Index Definition Sources: *Standard & Poor's, FTSE Russell, MSCI*

Investment Statistic Definition Source: *Investopedia*