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Market Overview

All three major averages experienced second quarter advances. However, it was the Nasdaq Composite Index[1] that outperformed, followed by the S&P 500[2], and the Dow Jones Industrial Average[3]. The S&P 500 rebounded with a V-shape recovery from the April 7th lows as market participants ascertained the tariffs were not going to be as bad as feared. The Nasdaq led the second quarter stock gains, finishing up 17.96%, with the S&P 500 Index and the Dow Jones Industrial Average gaining at 10.94% and 5.46%, respectively.

During the second quarter of 2025 technology was the best performing sector, gaining 22.84%, followed by industrials at 12.89%, and communication services by 12.79%. The best performing sectors year to date at the end of the second quarter were communication services, finishing up 12.70%, followed by industrials at 12.64%, and lastly, utilities which finished in the green up 9.40% at the end of the quarter. After the April 7th lows the Nasdaq and S&P 500 proceeded on a historical run to close at the quarter at all-time highs on both indexes.

The Federal Reserve ("the Fed") decided to pause interest cuts throughout the quarter. At the May and June meetings, the Fed left interest rates unchanged, leaving the effective federal funds rate at 4.25% to 4.50%. The Fed Chair, Jerome Powell, reiterated his cautious stance on inflation since the impact of tariffs could lead to an uptick in inflation data. After the June meeting, the fed chair stated he would've cut rates if it weren't for the tariffs being implemented by the president. During the second quarter of 2025, the 10-year Treasury yield reached a high of 4.63% on 05/22/2025 and a low of 3.86% on 04/04/2025. Yields fell at the beginning of the quarter as investors ran to bonds in a flight to safety and again at the end of the quarter due to cooling inflation and slightly weaker economic indicators.

Turning to global markets, international and emerging markets experienced second quarter gains. The continued decline in the U.S. dollar and a broadening global bull market allowed international and emerging markets to continue their upside outperformance. Turning to commodities, gold continued its march higher during the quarter, almost hitting $3,500 per ounce at the peak and consolidated for the remainder of the quarter. Continued weakness in the U.S. dollar and increased geopolitical risk allowed for further gains in gold. Oil started the quarter sinking where it bottomed around $56 a barrel. Then the Israel and Iran conflict led to an oil price shock, which drove the price of oil up to $77 a barrel. After the cease fire was announced, oil experienced a material price decline, closing the quarter at just under $65 a barrel.

Mark L. Blom, CFP® — Brent Miller, CFA® — Kirk Masci

U.S. Equity Returns Table Source: Tamarac			U.S. Treasury Yield Table Source: Treasury				Other Indices Table Source: Morningstar		
Index	Q2 2025 Returns	2025 Returns		06/2025	06/2024	06/2023		Q2 2025 Returns	2025 Returns
Dow Jones	5.46%	4.55%	3 month	4.41%	5.48%	5.43%	Gold (GLD)	5.79%	25.90%
S&P 500	10.94%	6.20%	2 year	3.73%	4.71%	4.87%	Brent Oil (BNO)	-6.17%	-2.54%
NASDAQ	17.96%	5.85%	5 year	3.83%	4.33%	4.13%	U.S. Dollar Index (UUP)	-5.82%	-8.63%
Russell 2000	8.50%	-1.78%	10 year	4.29%	4.36%	3.81%	Int'l Equity Markets (EFA)	11.26%	20.27%
MSCI World	12.30%	18.32%	30 year	4.78%	4.515	3.85%	Emerging Equity Markets (EEM)	11.44%	16.45%

1643 E Bethany Home Road, Phoenix, AZ 85016

Phone (602) 997-8882 Toll Free (888) 997-8882 Fax (602) 997-8887

Website: www.bfsg-az.com

How Are Markets Adjusting to the New Trade Regime?

Q2 2025 was a period of significant recovery for U.S. equity markets, following a turbulent start to the period marked by trade tensions and economic uncertainty. After bottoming out on 4/7/25, both the S&P 500 and Nasdaq Composite rebounded strongly, surging by 28.3% and 37.8%, respectively, to close out the quarter and reaching new all-time highs in the process. This sharp recovery was driven by the promise of more favorable tariff rates, easing geopolitical tensions, resilient corporate earnings, and expectations of Federal Reserve rate cuts in the back half of the year.

Is this enthusiasm justified? On the surface, recent economic data appears to show cracks forming in the health of the U.S. consumer, which had proven to be remarkably resilient despite headwinds ranging from inflation to the prospect of more protectionist trade policies. However, the May 2025 Personal Income and Outlays report released by the U.S. Bureau of Economic Analysis on 6/27/25[3] showed a 0.1% *decline* in personal consumption, with a modest 0.1% uptick in services spending failing to offset a material 0.8% decline in goods spending.

However, nearly the entire decline in goods spending came from a drop in motor vehicles and parts, a category where consumers picked up spending to front-run the tariffs and have since pulled back as tariffs went into effect. In addition, lower gasoline prices brought down consumer outlays in the energy sector. Absent the $49.3 billion drop in motor vehicles and parts consumer spending and the $19.8 million decline in gasoline and other energy goods, personal consumption would have *increased* by 0.3% rather than the 0.1% posted decline. Consequently, **while we believe concerns about a marked deterioration in personal consumption will prove to be overblown, we will anxiously await incremental data points that may support or refute our cautious optimism**.

On 7/3/25, the U.S. Bureau of Labor Statistics (BLS) released of the June nonfarm payrolls report.[4] Nonfarm payrolls increased 147,000 in June, beating the consensus expected 106,000. In addition, the unemployment rate ticked down to 4.1% from 4.2% in May. While the headline numbers were certainly encouraging, we note that private sector payrolls rose by a comparatively fewer 74,000 workers and were revised down 16,000 for prior months, bringing the net gain to just 58,000. In sum, the unemployment rate ticked down due to government payroll gains and a decline in the labor force, which fell by 130,000 in June. **While labor market trends appear favorable at present, private sector payroll growth will need to rebound as it is highly unlikely that persistent sluggishness in private sector job growth will continue to be offset by declining labor force participation and material government payroll additions.**

On the inflation front, the May Personal Income and Outlays report also provided an update on the U.S. Federal Reserve's ("the Fed") preferred inflation metric, the Consumption Expenditures (PCE) Price Index. This report indicated that the overall PCE deflator (consumer prices) increased by 0.3% in May and 2.3% over the trailing 12-month period. The "core" PCE deflator, which excludes the more volatile food and energy categories, rose 0.2% in May and is up 2.7% in the past year.

While inflation appears to be making slow and steady progress towards the Fed's 2.0% target, the inflationary impact of tariffs remains to be seen. Thus far, while higher tariffs have not reignited inflation, this may have stemmed from 1) consumers temporarily shifting consumption patterns away from goods most impacted by the tariffs (in part due to "frontrunning" prior to tariff implementation), or 2) an initial reluctance of companies to pass these costs on to their customers due to the negative impact on demand. **While we are encouraged by the progress on the inflation front in recent months, if the inflationary impact of tariffs is not mitigated by other factors going forward, we could see progress stall, or in a worst-case scenario, a resumption of the accelerating inflation trend we observed a few years ago.**

Moving on to domestic monetary policy, the Federal Reserve ("the Fed") kept the federal funds rate unchanged at 4.25%–4.50% at both the May and June 2025 Federal Open Market Committee ("FOMC") meetings with Fed Chair Jerome Powell emphasizing a cautious approach despite recent disinflation trends, citing uncertainties around tariffs and their potential inflationary impact. In keeping with this cautious commentary, the June Summary of Economic Projections showed a consensus expectation of two rate cuts in the second half of 2025.[5] **We believe that the Fed will require definitive data-related proof that tariffs have not stymied progress on inflation before cutting rates, making the scenario of two 25 basis point rate cuts, with the first probable cut occurring in the September FOMC meeting, the most likely scenario.**

How Are Markets Adjusting to the New Trade Regime? (continued)

Putting all of this together, I have revisited the three basis economic scenarios I introduced in my prior quarterly update.

1. Upside with Episodic Volatility (Base Case):

- **Scenario**: Trade negotiations yield tariff détente with key partners, reducing supply chain disruptions. The labor market remains relatively strong and the Federal Reserve continues to signal two rate cuts by year-end, supporting economic growth. Corporate earnings remain resilient. The market remains somewhat news driven, with economic policy developments and trade announcements driving episodic bouts of both upside and downside volatility.
- **Market Impact**: The S&P 500 could rise 5% to 7% from current levels, targeting 6,600–6,700, while the Nasdaq Composite may gain 8% to 10%, potentially reaching 22,500. Volatility persists due to trade news and key economic developments, but strong fundamentals drive gains.
- **Likelihood**: Moderately high, supported by consumer resilience, a stable labor market, and progress in trade talks.
- **Implications**: Bullish for equities, particularly in technology, communication services, and other growth stocks associated with the artificial intelligence/data center trade. Bonds may face pressure due to an elevated likelihood of rising yields as the probability of recession falls and international bond investors zero in on rising U.S. debt levels.

2. Trade-Driven Volatility with Stagnant Growth (Most Likely Downside Scenario):

- **Scenario**: The 90-day grace period on higher reciprocal tariffs expires without meaningful progress on negotiations with key trading partners.[6] Trade disputes lead to retaliatory tariffs, increasing costs and slowing business investment. Consumer spending and the labor market both soften, and inflation remains above 2.5%, limiting the Fed's ability to cut rates.
- **Market Impact**: The S&P 500 and Nasdaq may decline 10% or more from current levels, with heightened volatility along the way. Defensive sectors such as utilities and consumer staples outperform the broader market.
- **Likelihood**: Moderate, as trade negotiations could falter, but consumer strength may mitigate downside.
- **Implications**: Moderately negative for equities, with selective opportunities in undervalued and/or defensive sectors. Bonds benefit from safe-haven demand, pushing yields down.

3. Stagflation Risk (Outlier Downside Scenario):

- **Scenario**: Tariff-induced price increases drive inflation above 3%, while economic growth slows due to reduced consumer spending and business investment. The labor market begins to show signs of weakening, with the unemployment rate ticking up and private sector job growth stagnating. The Fed maintains restrictive monetary policy and may even consider raising rates to combat inflation.
- **Market Impact**: Bearish for both equities and bonds. The S&P 500 and Nasdaq could see contractions in excess of 20% from current levels. High yield bond spreads widen due to stagflation environment, signaling stress in the bond market.
- **Likelihood**: Low, but could increase materially if trade disputes escalate and inflation accelerates due to tariff-related impacts.
- **Implications**: Negative for most asset classes, with limited safe havens outside cash, certain commodities (e.g. gold), and select defensive equities.

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How Are Markets Adjusting to the New Trade Regime? (continued)

As the above analysis makes clear, the Q3 2025 outlook hinges on the trajectory of trade policies and their economic impacts. While our base case anticipates a sustained recovery driven by trade détente and consumer resilience, risks of volatility, slowing growth, and stagflation remain. Our growth at a reasonable price ("GARP") strategy aims to capitalize on growth opportunities while providing a buffer against potential downside, leveraging undervalued segments and maintaining a balanced portfolio.

Within our GARP stock selection process, we continue to place an emphasis on identifying companies with pricing power, strong balance sheets, and secular demand drivers. In addition, while the Q2 rally has reduced some valuation opportunities, we believe selective segments of the market remain attractive from a growth and value perspective. Consequently, we continue to believe that our diversified GARP portfolios are well-positioned to navigate periodic volatility while also providing opportunities for outperformance if the market continues to climb the proverbial "wall of worry."

Brent J. Miller, CFA® – Senior Portfolio Manager

[1]The Nasdaq Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock exchange. The composition of the NASDAQ Composite is heavily weighted towards companies in the information technology sector.

[2]The market cap weighted S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxyfor the U.S. stock market performance.

[3]https://www.bea.gov/news/2025/personal-income-and-outlays-may-2025

[4]https://www.bls.gov/news.release/empsit.nr0.htm

[5]https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20250618.pdf

[6]The most recent pronouncements from the Trump Administration indicate that the 90-day grace period will expire on 8/1/25 rather than the 7/9/25 date implied by the expiration of the initial 90-day window.

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