

ECONOMIC OUTLOOK

Summary

Government policy and uncertainty around tariffs have distorted U.S. economic data, clouding the economy's true state as the second quarter concludes. Businesses front-loaded imports before April's tariff announcements, which skewed first-quarter GDP, now revised down to -0.5%. Those imports, calculated into GDP immediately upon arrival in the U.S., lowered first-quarter growth by nearly five percentage points. Yet, many of those goods didn't count toward inventory growth in the GDP calculation since that requires businesses to have physically received the goods. This timing mismatch over quarter-end suggests first-quarter economic activity was likely much stronger than the GDP contraction implies.

Conversely, second-quarter GDP projects a significant rebound, with the Atlanta Fed's GDPNow estimating 2.9% growth as of late June. First-quarter imports are now likely providing a tailwind through inventory growth, potentially inflating second quarter GDP beyond its fundamental strength. However, some consumer indicators are starting to show cracks. In June, personal income data declined by 0.4% and personal spending fell 0.1%, both missing estimates. Retail sales fell by 0.9%, which marked the second consecutive month of contraction. Consumer sentiment and surveys remain depressed, reflecting the persistent uncertainty.

In reality, economic activity during the second quarter likely decelerated compared to the first quarter, despite the projected GDP rebound. These quarters represent different sides of the same coin and averaging their data would likely better gauge the economy's true trajectory as both distortions stem from tariff-driven import timing.

Surprisingly, inflation has emerged as a relative bright spot. Despite widespread fears of tariff-induced price spikes, both headline and core CPI rose just 0.1% in June, marking the fourth consecutive month below estimates. Tariff collections by the government during the first five months of 2025 nearly match 2024's full-year total, suggesting that either businesses have absorbed additional costs or consumers have strategically reallocated spending toward essentials while reducing discretionary purchases to keep aggregate price pressures contained.

The labor market, on the other hand, presents mixed signals. Continuing jobless claims have been rising steadily throughout June, indicating challenges in finding work once unemployed. Yet, weekly initial jobless claims remain within the normal range. June's non-farm payrolls report was more robust than expected, but the labor force participation rate dropped slightly.

Monetary policy remains restrictive, balancing inflation prevention against potential growth constraints. The Federal Reserve has emphasized waiting for additional data to assess tariffs' inflationary impact, making employment trends increasingly critical for future policy decisions. Following the strong June payroll report, it is unlikely a rate cut is on the table for the July meeting. If future employment data softens or revises lower while CPI remains tame, expect more September rate cut speculation as the Fed may prioritize averting slower growth.

Positives

Durable goods orders materially outperformed expectations (16.4% vs. 8.5% est.)

Existing home sales (MoM) surprised to the upside (0.8% vs. -1.3% est.)

CPI data (inflation) has come in lower than estimates for four consecutive months

Negatives

First quarter GDP was revised lower from -0.2% to -0.5%

Retail sales (excluding Auto and Gas) missed expectations (-0.1% vs. +0.3% est.)

ISM manufacturing remains in contractionary territory (49.0)

EQUITY OUTLOOK

Summary

U.S. equity markets continue their furious rally off an early-April low caused by uncertainty around trade, economic growth and geopolitical risks. The S&P 500 Index climbed 5.1% in June and finished the second quarter up 10.9%. Growth once again led the way with the Russell 1000 Growth Index rallying 6.4% outpacing the 3.4% gain in the Russell 1000 Value Index.

Trade negotiations continue to drag out, but equity markets seem to have gotten comfortable with quieter rhetoric at least for the moment. Conflict between Israel and Iran quickly boiled up but began to simmer just as quickly following U.S. involvement. Softer inflation data and solid economic releases recently have also helped to comfort equity investors. The FOMO (fear of missing out) trade also appears to have returned with reckless abandon.

Still, investors should approach bears and bulls with a bit of caution. A large amount of uncertainty remains and this market could turn on a dime. Consensus second-quarter earnings estimates have been drifting lower, the Middle East is still a powder keg and inflation data is not likely yet reflecting the impact of recent tariffs.

Once again, we remind readers the stock market is a discounting mechanism that attempts to calculate the probability of future variables that may impact market prices. Today that mechanism is telling us the uncertainty that

weighed in the first quarter was overblown. It is also telling us a recession is unlikely and the Federal Reserve is more likely to cut rates before they tighten again. And lastly, the market is telling us forthcoming innovation is a more powerful force than fiscal deficits. That seems to be a little too optimistic and equity markets may need to catch their breath.

Positives

Recession appears avoidable

No notable slowdown in AI/tech spending

Negatives

Equity valuations are lofty

Investor optimism may be too positive

Unknowns

Federal Reserve bracing for more challenging decisions

Trade deals being negotiated but many bumps lie ahead

FIXED INCOME OUTLOOK

Summary

Treasury yields drifted lower in June, declining 15 to 20 basis points (bps) across the curve. A handful of economic readings were cooler this month as retail sales, new home sales and ISM indexes were all lower than expected. Additionally, inflation data from May's Consumer Price Index (CPI) was lower than anticipated on a month-over-month basis, coming in at 0.1%. The combination of softer than expected inflation and economic data moved yields lower in June.

The Federal Reserve held a Federal Reserve's Open Market Committee (FOMC) meeting in June. The FOMC voted to keep the overnight rate unchanged with the upper bound at 4.50%. The June meeting also provided investors with an updated release of the FOMC's Summary of Economic Projections (SEP). The last SEP was released in March, which was before the tariff announcement on "Liberation Day" in early April. June's SEP read more hawkish as committee members attempted to forecast how the new tariffs will impact inflation, growth and interest rates in the coming years. Importantly, the Fed's median projection of interest rate cuts in 2025 remains at two. Chairman Jerome Powell stated the committee is monitoring tariffs to see if they will have an adverse impact on inflation. He believes the overnight rate remains moderately restrictive and the economy is on solid footing. It appears the consensus view at the Fed is to wait and see what impact, if any, the tariffs will have on inflation before lowering the overnight rate.

Shifting gears from monetary policy to fiscal policy. The market continued to monitor the progress of the "One Big Beautiful Bill" as it made its way through Congress. Bond investors are particularly interested in how the bill will impact the federal deficit over the next few years. Larger deficits equate to more treasury issuance which can require a higher yield to attract investors. Treasury rates could experience volatility in the coming weeks as the final details in the bill are digested by the market.

June was a light month for corporate bond new issuance. For the first time this year, corporate bond indexes shrank as the number of bonds leaving the index was greater than newly issued bonds entering the index. Credit spreads traded in a narrow range throughout June and ultimately tightened by nearly 4 bps, finishing the month at 84 bps. The decline in yields across the curve resulted in most bond indices posting a positive return for June.

We are maintaining our neutral duration policy and continue to favor corporate bonds over Treasuries. However, the recent spread tightening decreases the appeal of corporate bonds and we are unlikely to materially increase our credit exposure at current levels.

Positives

Tariffs will likely continue to create economic and market disruptions

Inflationary pressures have eased even in the face of new tariffs

Negatives

GDP forecasted to bounce back from negative first quarter

The budget bill could increase deficits requiring more Treasury issuance

Unknowns

Escalation of trade tensions

Resolutions of Russia/Ukraine war
