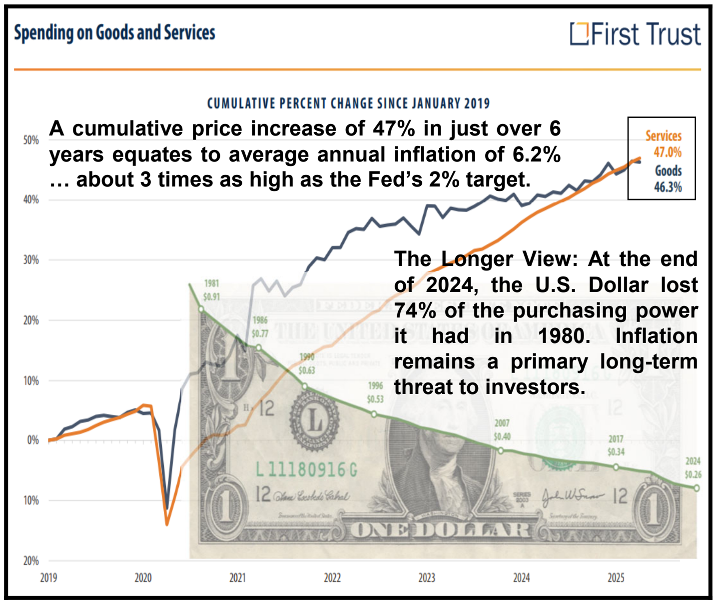
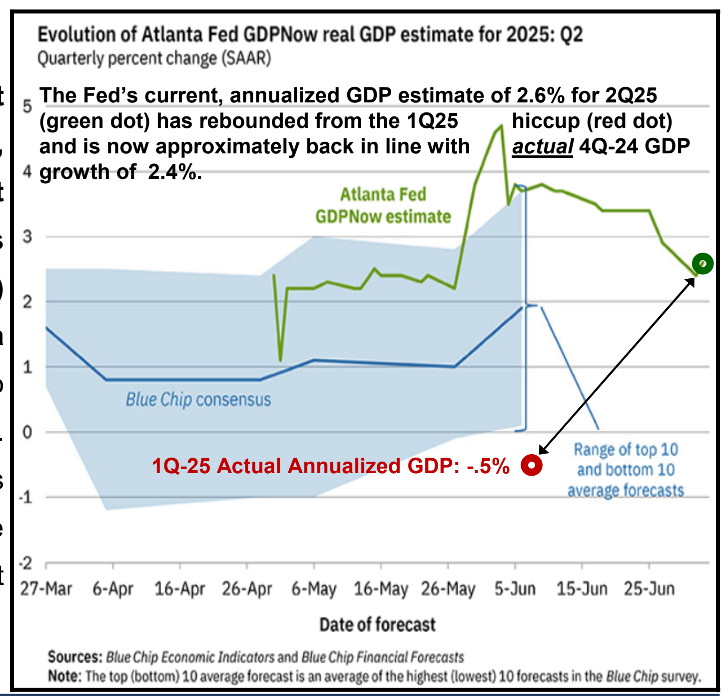
ECONOMY IN A SOLID POSITION DESPITE UNCERTAINTY

Fed Chairman Jerome Powell spoke those words on June 20th after the Fed once again opted to leave its benchmark U.S. interest rate unchanged. He added, " … the unemployment rate remains low, and the labor market is at or near maximum employment." Although President Trump has pressured the Fed to stimulate the economy by reducing rates and although the Fed is certainly eager to foster an environment for economic growth, it is also tasked with the competing objective of combating inflation and the destructive effect it has on the consumer wallet.

The Fed's longstanding inflation target remains 2% per year, but its preferred measure of inflation (the Personal Consumption Expenditures Index) not only continues to remain around a half percent above that target, the Fed expects it to increase further during the balance of the year resulting in total 2025 inflation of approximately 3%. The Fed knows that reducing interest rates in an environment in which it already expects inflation to accelerate would almost certainly exacerbate the issue. The cost of goods and services within the U.S. has risen by about 47% since the beginning of 2019 and the Fed is keen to reduce the rate at which inflation further erodes consumer purchasing power.



The U.S. economy *__contracted__* during the first quarter of this year at an annual rate of .5%, mostly as a result of a rush of imports aimed at beating expected tariffs. However, the Fed's estimate of annualized economic growth (GDP) for the second quarter of the year stood at a relatively healthy 2.6% in early July. As shown to the right, the Fed's growth estimate for the U.S. economy has rebounded sharply (arrow). This rebound removes some immediate pressure for the Fed to stimulate the economy via an interest rate cut that would almost certainly push inflation higher.



CONFERENCE BOARD NO LONGER EXPECTS A RECESSION

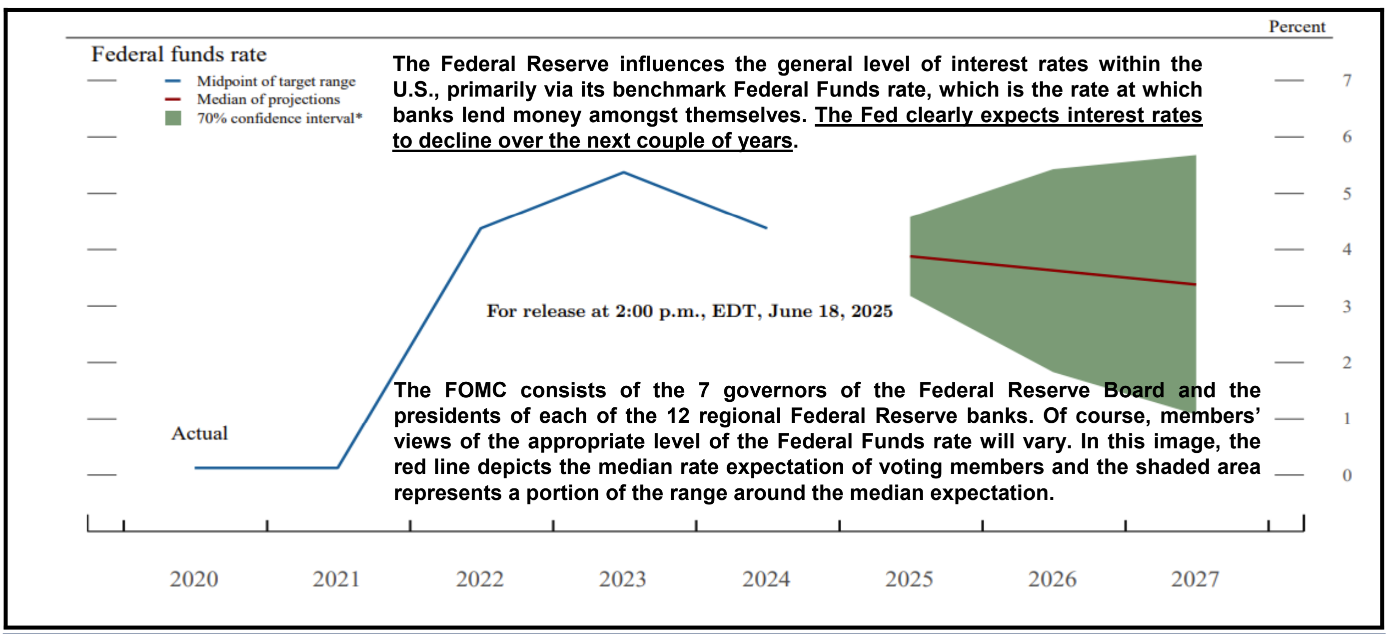
The Leading Economic Index®, which is published by the Conference Board, is intended to provide an early indication of significant turning points in the business cycle. In May, the Conference Board's analysis warned of an impending recession. However, **it stated in a June 20th press release that it actually does *not* anticipate recession, but that it does "expect a significant slowdown in economic growth in 2025** compared to 2024, with real GDP growing at 1.6% this year and persistent tariff effects potentially leading to further deceleration in 2026."

As was the case with the recent rebound in the Fed's growth estimate for the second quarter of this year, the recession signal that appeared in the Conference Board's analysis for May appears to no longer be operative. **Whereas the Fed's 2.6% estimate for GDP growth shown on the previous page pertains to the annualized rate of growth for the *second quarter of this year*, the Conference Board's GDP expectation of 1.6% pertains to the *entire* year**.

TAIL WIND FROM RATE CUTS APPEARS TO BE ON ITS WAY

Interest rate cuts are inherently stimulative to an economy. That alone, can drive stock valuations higher, but lower interest rates also serve to mathematically push most asset values higher. **It is less important to know how or why lower interest rates tend to push most asset values higher than it is to know that they do**.

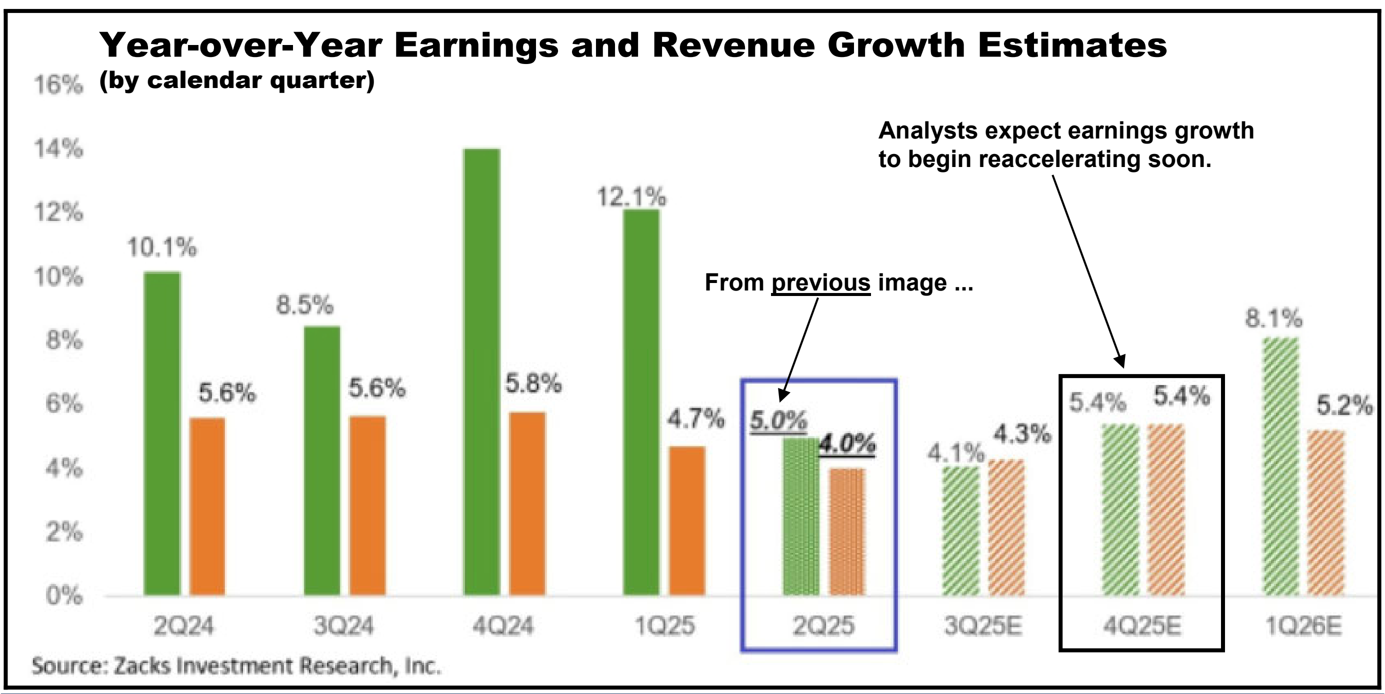
As of early July, the consensus seems to be that the Federal Reserve's Open Market Committee (FOMC) may implement two interest rate reductions before year-end, with **investors being relatively confident that the first rate cut will occur in September**. Of course, asset values have tended to rise not just as rate cuts are implemented, but as investors become increasingly confident that future rate cuts are also likely.



EARNINGS GROWTH TO SAG, THEN REACCELERATE

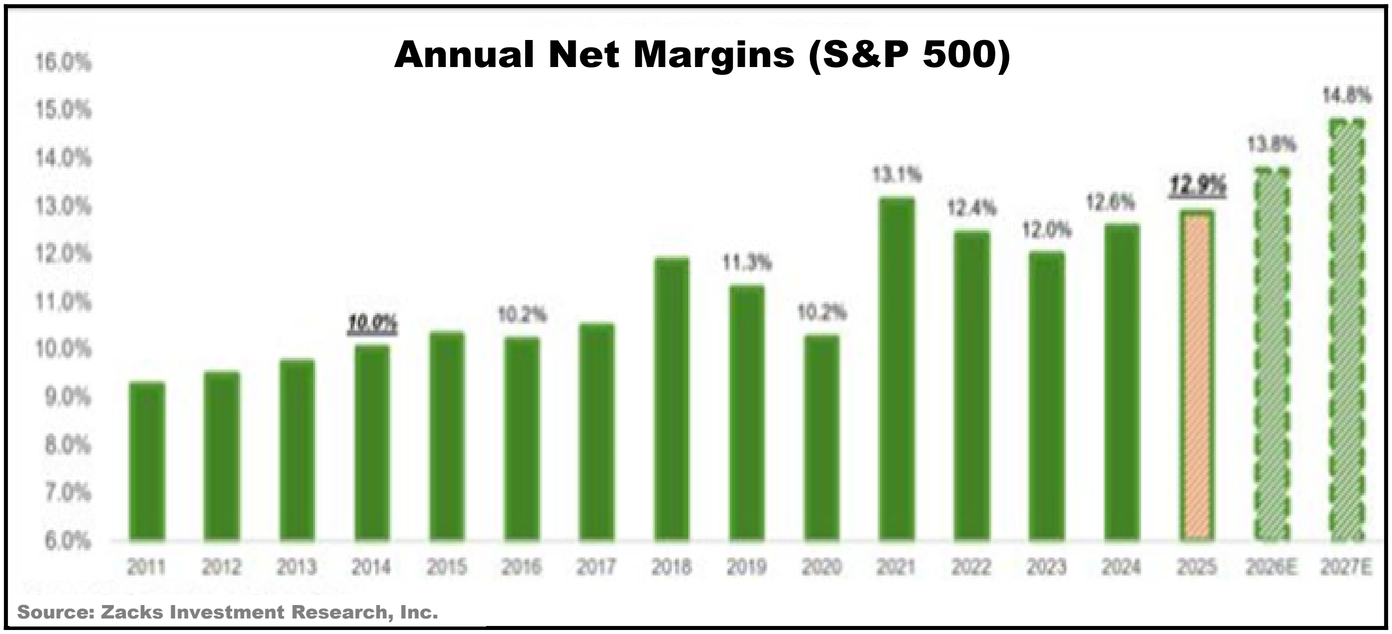
According to Zacks Investment Research, analysts continue to trim their earnings growth estimates for the second quarter of this year, as shown below.

Because the second quarter of the year is now over, earnings estimates for that quarter are largely baked into current valuations. This next image allows you to see the 5.0% second quarter earnings growth shown above in the context of analysts' consensus earnings growth expectations for the next three calendar quarters. The green bars continue to represent earnings growth, whereas the orange bars represent revenue growth.

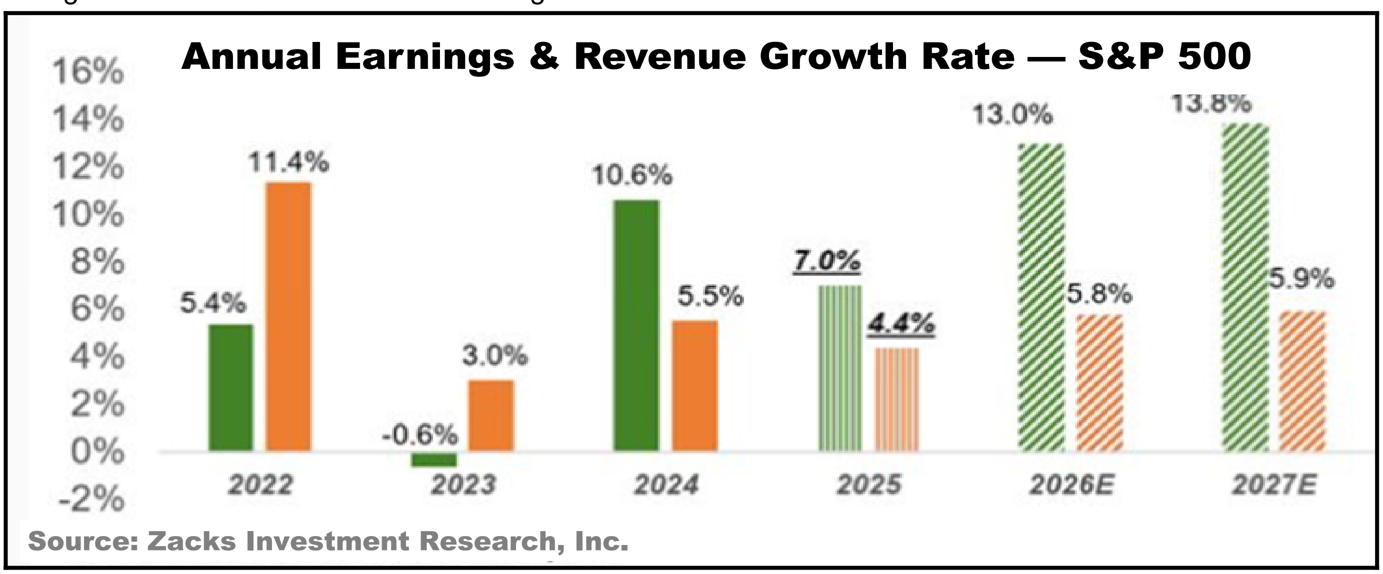


CORPORATE PROFIT MARGINS EXPECTED TO IMPROVE

Elevated input costs (inflation) weighed on profitability in 2022 and 2023, but those headwinds have eased. Analysts expect margins to improve further over the next couple of years, as shown in this next image.



The following image suggests that analysts, as a whole, expect 2025 to be a "sag" year for both earnings growth (green bars) and revenue growth (the orange ones) with earnings and revenue growth to accelerate during 2026 and to further accelerate during 2027.

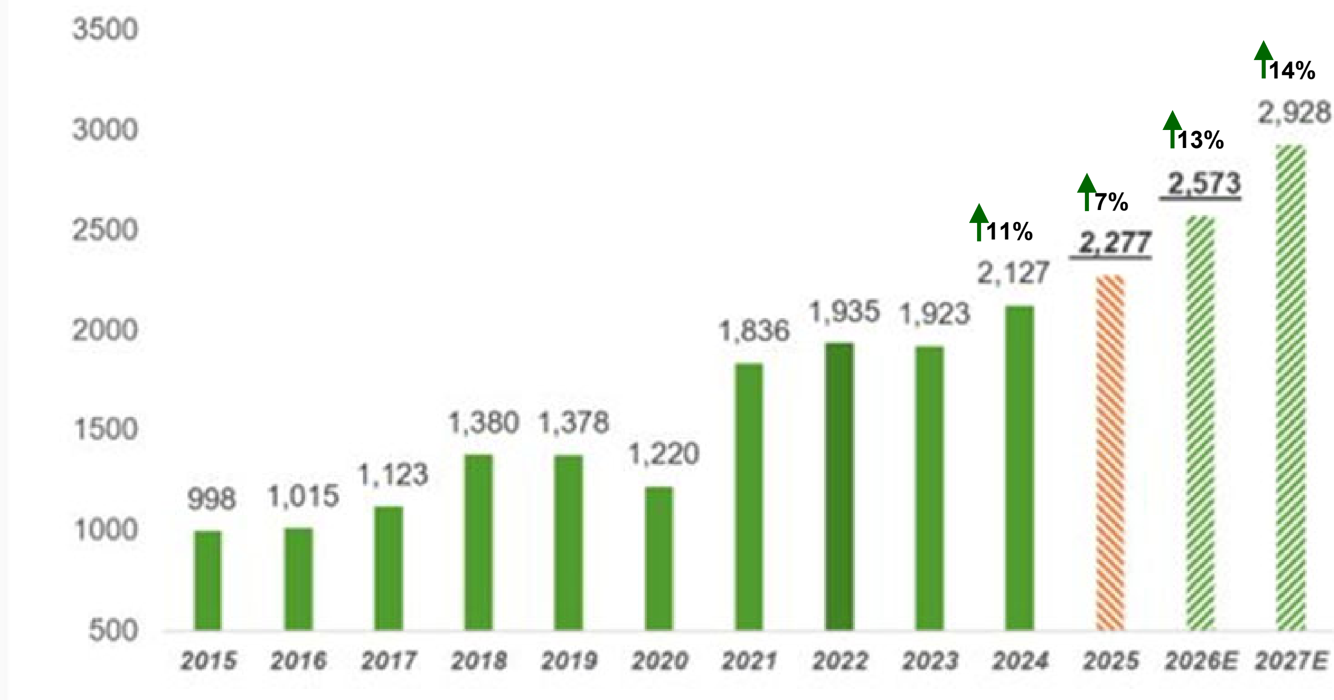


Historically, analysts have tended to be overly optimistic, so I would not be surprised if these estimates decline over time. **For now, the outlook for corporate profit margins, revenues, and earnings is promising.**

THE BIG PICTURE — ACCELERATING CORPORATE EARNINGS

This final earnings-related image allows you to see the combined impact improving profit margins and accelerating revenue growth are expected to have on overall corporate earnings over the next couple of years. Analysts not only expect earnings for the 500 largest U.S. companies to rise, they expect them to *accelerate*.

Annual S&P 500 Earnings — Aggregate Dollar Totals (billion $)



Source: Zacks Investment Research, Inc.

IMPLICATIONS OF THE ISRAEL/U.S.-IRAN CONFLICT

After the U.S. struck Iranian nuclear facilities, one might have expected investors to shy away from equities in favor of U.S. Treasury securities and other safe haven assets. However, the capital markets have remained largely composed since then. Concerns remain that a prolonged conflict could further destabilize the Middle East and disrupt global trade routes and energy prices. In a June 23rd article found on *AInvest.com*, a Morgan Stanley analyst's assessment of this conflict is that unless there is further escalation, it is **unlikely to have a long-term impact on the global economy** and, in an article published by Zacks Research on June 24th, the director of Wedbush Securities expects this conflict is likely to remain isolated to Israel/Iran region.

STRAIGHT OF HORMUZ *NOT* EXPECTED TO CLOSE

The Strait of Hormuz is geopolitically significant because it is the only sea passage that connects the Persian Gulf to the open ocean and because about a fifth of the world's daily supply of oil and liquefied natural gas passes through this strait. The passage is quite narrow, so it could serve as a chokepoint if it were sabotaged.

In response to U.S. strikes on Iran's nuclear facilities, Iran's parliament approved a motion to close the Strait of Hormuz. However, the final decision as to whether to close the strait rests with Iran's Supreme National Security Council. **Iran has a history of threatening to close this strait, but it has never done so.**

While experts seem to agree that Iran has the ability to disrupt global energy supplies by sabotaging the Strait of Hormuz, there is a question as to whether it is capable of entirely closing the strait. Possibly more importantly, **if Iran were to try to impede shipping through this strait, experts believe it would damage its own economy while also triggering a strong response from the U.S.**

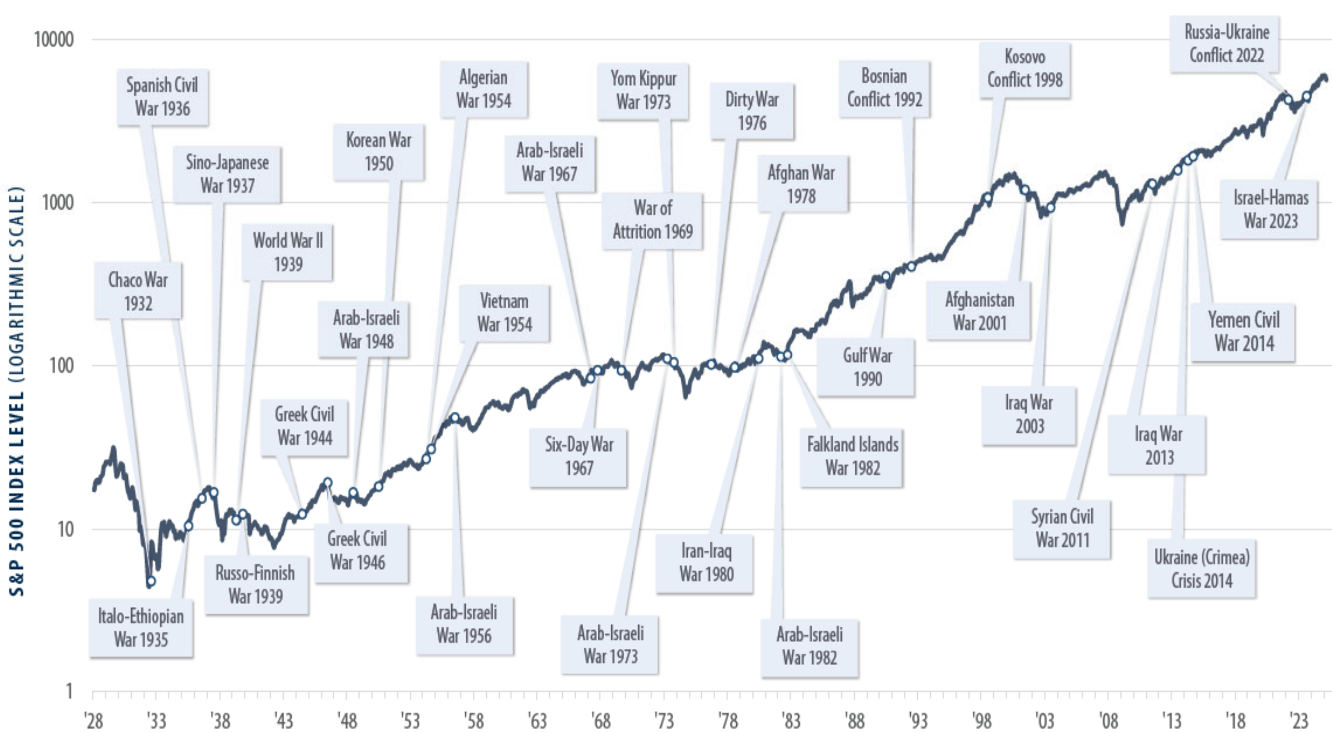
Market strategists seem to concur that unless this conflict widens, it is unlikely to derail returns generated by the capital markets on a longer-term basis and, as shown below, history suggests strategists are correct.

War Times & The Stock Market

S&P 500 Index

First Trust

Wars and conflicts have been a constant throughout history, however recent events might cause us to look at how the stock market has performed during past times of war. The chart below shows the S&P 500 Index level since 1927 and several of the major wars and conflicts since then. Though uncertainty may temporarily shape the market, we believe seeing the market's overall resiliency can help maintain a long-term perspective.



Source: First Trust, S&P CapIQ, Bloomberg. Monthly index levels from 1928 - 3/31/2025. **Past performance is no guarantee of future results.** This chart is for illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index.

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In my last note, I mentioned that tariffs function as a tax on imported goods that result in reduced revenues for exporters and higher prices for consumers in the importing country unless and until substitutes can be found. In short, I made the case that although tariffs have legitimate uses, they tend to result in economic loss.

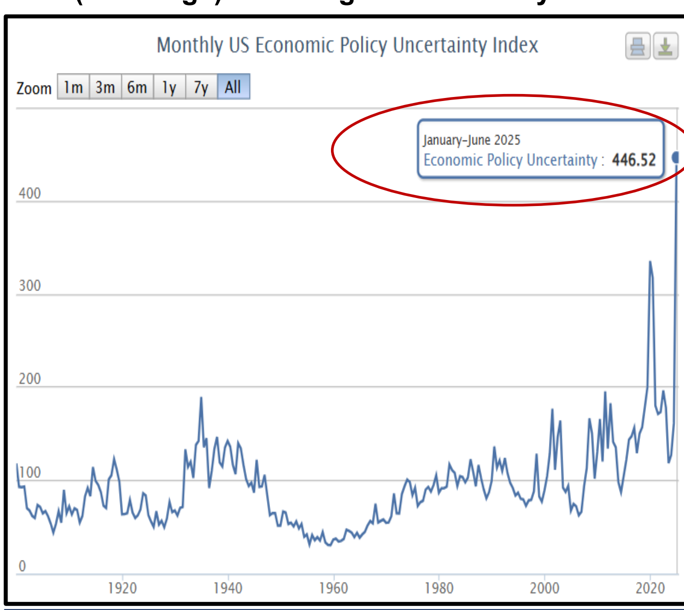
90-DAY "LIBERATION DAY" TARIFF PAUSE TO EXPIRE IN JULY

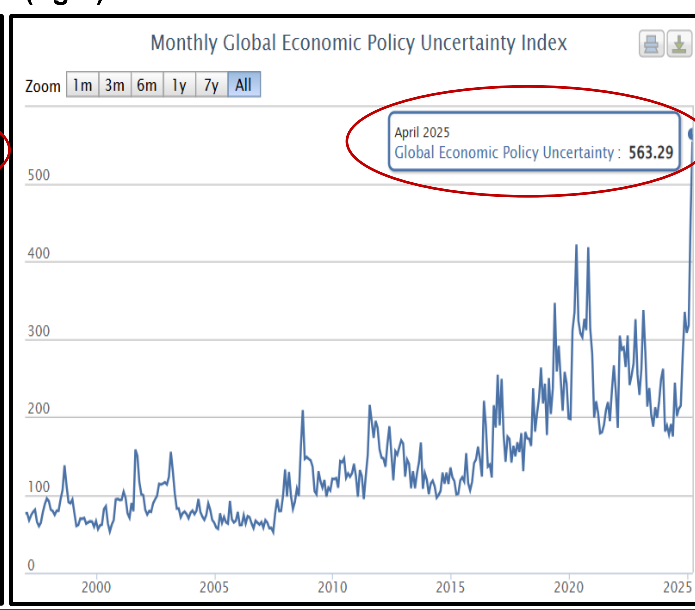
Liberation Day tariffs refers to new tariffs imposed by the Trump administration on April 2nd targeting nearly all U.S. trading partners. The tariffs were implemented under the International Emergency Economic Powers Act (IEEPA) and consist of a 10% baseline tariff on all imports, with additional, country-specific "reciprocal" tariffs as high as 50%, on 57 nations deemed to be trade offenders. These tariffs are intended to address trade imbalances and protect U.S. industries by increasing the cost of imported goods.

THE WILDCARD — ECONOMIC & TRADE POLICY UNCERTAINTY

The initial tariff announcement resulted in the S&P 500 losing about 12% of its value and Treasury yields drifting, to the surprise of some, higher. In response, President Trump announced a 90-day pause on the implementation of his tariffs. Unless something changes, that pause will expire July 9th. White House Press Secretary Karoline Leavitt recently announced that the deadline was "not critical" and could be extended. However, President Trump has stated that he does *not* intend to extend the pause for most nations and he has indicated that letters detailing new trade penalties, or tariffs, will be issued to certain countries. These letters will likely outline specific tariff rates for each country, potentially ranging as high as 70%. **It is unclear whether these tariff rates will take effect in July, August, or some other time**. However, it appears that **some countries could face tariffs that are significantly higher than those proposed on Liberation Day**.

As can be seen in the two images below, **economic policy uncertainty is at historical highs for both the U.S. (left image) and the global economy as a whole (right)**.





REVIEW YOUR ASSET ALLOCATION TARGETS & RANGES

As shown on page 6, investor reaction to volatility that manifests as a result of geopolitical shock has been well-tested, and even extreme events such as World War II didn't stall stock market progress for more than half a decade or so. However, the repercussions of **heightened and/or prolonged economic policy uncertainty represent a more vexing problem inasmuch as it can blindside businesses and consumers alike by drastically altering the fundamental rules of economic engagement *after* the economic chips have been played**. The resulting potential to create arbitrary winners and losers is not part of the standard recipe for a smoothly running economy, and **this uncertainty elevates investment risk**.

If you're not already aware of what your asset allocation targets and ranges are, please contact us.

FINAL THOUGHTS

Corporate earnings have historically been the primary driver of advancing stock prices and, for now, they offer reason to remain committed to equities. The annual run rate of inflation is not too far above the Fed's target of 2%, but it's worth noting that the effect of the Liberation Day tariffs and their potential to exacerbate inflation is only somewhat reflected in the current economic stew. The Fed has clearly signaled its desire to implement one or more interest rate reductions which, if implemented, are likely to be well received. **However, if the Fed does implement a series of rate cuts, it is likely to do so more cautiously in an environment of tariff uncertainty than it otherwise would** unless or until the Fed sees recession as the primary economic threat.

Low interest rates are an economic stimulant and they also serve to push most asset prices higher. The federal government has a strong incentive to keep rates low within the U.S. since low rates will help make the interest on the $36 trillion of debt the U.S. has so far accumulated less burdensome.

BONUS INSERT — TARIFFS & INTERNATIONAL TRADE

Trying to assemble disparate pieces of data and news into a general understanding of a topic that's as complex as international trade approaches the impossible for all but the most dedicated data unraveler. If you'd like to have a high level overview of the international trade landscape as it pertains to the U.S., analysts at First Trust have assembled a mountain of tariff and trade-related data into a series of easy-to-grasp images that we've assembled in the enclosed insert. Or, use those extra pages to roast a marshmallow.

REMINDER — THIS IS NOT A SALES OFFICE

Unlike much of the financial services industry, we do not schedule routine meetings that are then used to sell products and services to you. I function as a fiduciary 100% of the time. Investment-wise, we post independent (objective) research for most positions we hold directly on our website to allow you to look over our shoulders. However, **if you would like to discuss some financial aspect of your life or if you are concerned about outliving your money, please contact us**. — Glenn Wessel