

MORSE ASSET MANAGEMENT, INC.

23 Old Kings Highway South, Suite 200, Darien, CT 06820

July 21, 2025

2025 Q2 Market Commentary

U.S. markets ended the second quarter of 2025 at new highs, with the S&P 500 +6.2% for the year but was marked by significant volatility across financial markets. The period was notably impacted by chaotic tariff policies, heightened geopolitical tensions, ongoing uncertainty surrounding budget and tax negotiations, and persistent concerns about the deficit and inflation. However, positive economic data persisted, keeping trends intact, and sentiment quickly improved as tariff fears subsided, supporting one of the strongest rebounds on record. The path of least resistance continues to be higher.

The quarter began with a dramatic market decline in early April, following the announcement of new tariffs on "Liberation Day". The S&P 500 briefly entered bear market territory, down ~20% from its February peak, as emotional recession calls mounted and sentiment crashed. However, the administration suspended the most severe tariffs (a negotiating tactic) on April 9th, leading to a record-breaking 9% single-day rally as it became clear the worst-case scenario would not play out. The rapid recovery since the April low was the second fastest in 75 years, with U.S. markets recovering to new highs in only 2.6 months (Chart 1). Empirically, a move of this magnitude is supportive of further upside (Chart 2). Positive momentum continued through May and June as uncertainty waned with the administration reporting progress on trade deals, the quick resolution of the Iran-Israel conflict, and the passage of the budget and tax bill.

The U.S. economy continues to be resilient despite a noisy period of data. The economy appeared to be just as volatile as equity markets in the first half of the year due to unusual patterns around impending tariffs. U.S. GDP in the first quarter declined at a 0.5% annual rate, but industrial production expanded at a 4.5% annual rate during the same quarter. These divergent data points were caused by tariff induced front-running. Excluding the surge in imports, economic activity continues to grow on trend. Manufacturing and Services PMI have not diverged and continue to be supportive of expansion, and the NFIB Small Business Optimism Index remains steady. The Atlanta Fed's GDPNow model is now back on trend, estimating for real GDP of +2.4% (Chart 3).

The labor market remains stable. The U.S. unemployment rate is 4.1% and remains in a tight range since last June. Expected disruptions from immigration policy have not had a major impact. The 4-week average of initial jobless claims continues to hold at ~220k and nonfarm payrolls ~140k. Job openings have begun to tick up and are holding above pre-Covid levels. Average wages continue to outpace inflation, and spending has rebounded as consumer confidence recovers. Retail sales also remain positive, surprising to the upside in June, following volatility around the tariff announcements.

The resolution of the U.S. budget and passage of the One Big Beautiful Bill Act removed a significant policy uncertainty for the market. It should provide a meaningful tailwind and drive economic activity. Provisions such as accelerated depreciation, increased incentives for capital expenditure, and further deregulation are likely to stimulate significant private sector investment. The 2017 tax cuts have also been made permanent, avoiding an otherwise significant increase in income tax next year. This shift has the potential to move the engine of growth away from government-driven stimulus toward the more productive private sector, supporting both near-term recovery and longer-term economic vitality.

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The Federal Reserve has maintained a cautious stance on interest rates, keeping the federal funds rate unchanged at a target range of 4.25%-4.50%. Admittedly, their current policy is restrictive, but the Fed emphasized their data-dependent approach has not yet reached levels supportive of cutting despite positive trends in inflation. In addition, they have taken the position that tariffs could be inflationary, despite being a one-time adjustment, and thus are following an unpopular “wait and see” approach. Powell is unlikely to resign despite ongoing political pressure for this stance. But his replacement at the end of his term next year will likely mark a significant turning point for monetary policy. For now, we expect the Fed to stick to their dot plot indication of 0.5% of cuts later in the year.

For Q2 2025, according to FactSet’s July 19th *Earnings Insight*, the estimated year-over-year earnings growth rate for the S&P 500 is +5.6%, up from a low of +4.9% at the end of the first quarter. Downward revisions driven by tariff and policy fears have lowered the bar and will likely become a tailwind as analysts slowly come around. For companies that have reported thus far, both the percentage above expectations and the magnitude of the beats are well above the 10-year average. Expectations continue to support acceleration through the rest of the year and into 2026 (Chart 4).

Valuations are again stretched in relation to current expectations as the rise in stock prices has outpaced conservative earnings estimates and sentiment. The forward 12-month P/E ratio for the S&P 500 is now 22.22. In the short term, a subsequent move higher for the market will depend on an improving earnings tailwind and sufficient worry to keep exuberance in check (Chart 5). The 12-month, bottom-up target for the S&P 500 is now 6799, 8.0% above Friday’s closing level of 6297.

Performance in the quarter was led by Technology, Communications, Industrials and Consumer Discretionary; primarily sectors weighted to AI infrastructure, services, reshoring and improving tariff outlooks. With recession calls behind us, cyclicals and Financials have also rallied. Weakness continues in Healthcare, primarily due to regulatory reform and supply chain issues, and Energy, due to weakness in oil prices. Large Caps continue to outperform Small, but breadth continues to improve.

Important themes we are following are AI investment (infrastructure/energy/software/semis/equipment) (Chart 6), emerging AI beneficiaries, semiconductors, reshoring of industry and supply chain shifts, financial deregulation and M&A. In addition we are following emerging stablecoin policy, and tariff, tax and deregulatory policy impacts.

Our playbook continues to focus on significant secular, cyclical, and structural trends. We favor high-quality growth at reasonable prices and businesses with stable free cash flow and healthy balance sheets. We will continue to balance growth and value and are prepared to shift defensively if needed.

We remain in a secular bull market, supported by the weight of evidence. Economic growth, strong balance sheets and earnings, a stable labor market, ample liquidity, and a tailwind of pro-growth tax policy continue to support a broadening of equity market returns and positive performance.

Robert B. Morse

Chief Investment Officer

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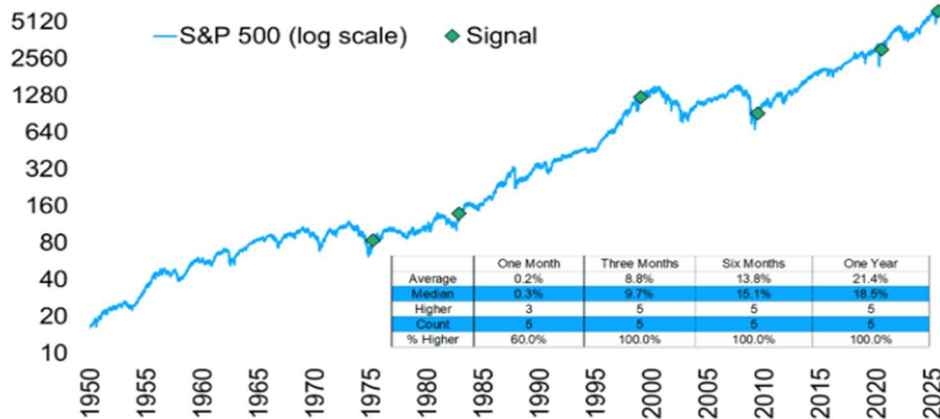
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1.

S&P 500 Total Return - Largest Drawdowns (1950 - 2025)							
(Note: -19% Drawdown or More from All-Time High)							
Drawdown Period	NBER Recession?	Length of Bear Market (Months)	% Decline	New High Month	Months: Prior High to New High	Months: Low to New High	% Gain: Low to New High
Feb 2025 to Apr 2025	?	1.6	-19%	Jun 2025	4.2	2.6	23%
Jan 2022 to Oct 2022	No	9.4	-24%	Dec 2023	24	14	32%
Feb 2020 to Mar 2020	Yes	1.1	-34%	Aug 2020	5.8	4.7	51%
Sep 2018 to Dec 2018	No	3.2	-19%	Apr 2019	6.8	3.6	24%
Oct 2007 to Mar 2009	Yes	17	-55%	Apr 2012	55	37	123%
Sep 2000 to Oct 2002	Yes	26	-47%	Oct 2006	75	49	90%
Jul 1998 to Aug 1998	No	1.5	-19%	Nov 1998	4.3	2.8	24%
Jul 1990 to Oct 1990	Yes	2.9	-19%	Feb 1991	7.0	4.1	24%
Aug 1987 to Oct 1987	No	1.8	-33%	May 1989	21	19	49%
Nov 1980 to Aug 1982	Yes	21	-20%	Oct 1982	23	1.9	25%
Jan 1973 to Oct 1974	Yes	21	-45%	Jul 1976	43	22	81%
Nov 1968 to May 1970	Yes	18	-33%	Mar 1971	28	9.8	48%
Feb 1966 to Oct 1966	No	8.0	-20%	Mar 1967	14	5.6	25%
Dec 1961 to Jun 1962	Yes	6.5	-27%	Apr 1963	16	9.8	37%
Jul 1957 to Oct 1957	Yes	3.3	-20%	Jul 1958	13	9.4	25%
Average		9	-29%		23	13	45%
Median		7	-24%		16	9	32%

2.

S&P 500 Returns After A Three Month Gain Of >25% (1950 - Current)



Source: Carson Investment Research, Factset 07/10/2025 (1950 - Current)

@ryandetrick



S&P 500 Returns After A Three Month Rally >25%

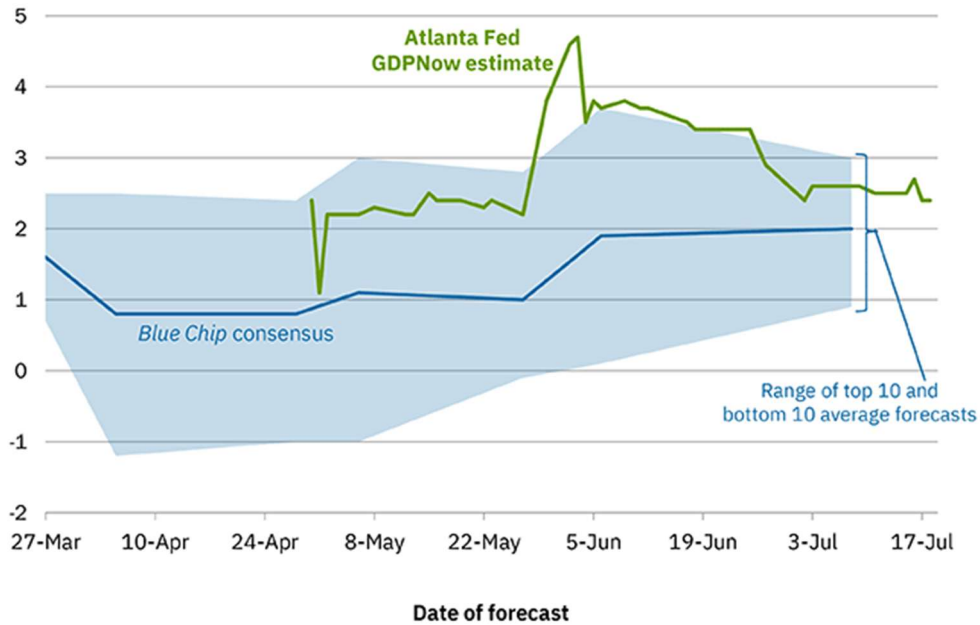
S&P 500 Future Returns				
Date	1 Month	3 Months	6 Months	12 Months
3/7/1975	-3.9%	9.7%	1.6%	17.6%
10/21/1982	-1.5%	5.2%	15.1%	19.9%
1/5/1999	0.3%	6.6%	12.1%	12.4%
5/29/2009	0.9%	12.2%	20.8%	18.5%
6/15/2020	5.2%	10.3%	19.5%	38.5%
7/10/2025	?	?	?	?
Average	1.2%	8.6%	16.9%	22.3%
Median	0.6%	8.5%	17.3%	19.2%
% Higher	75.0%	100.0%	100.0%	100.0%

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3.

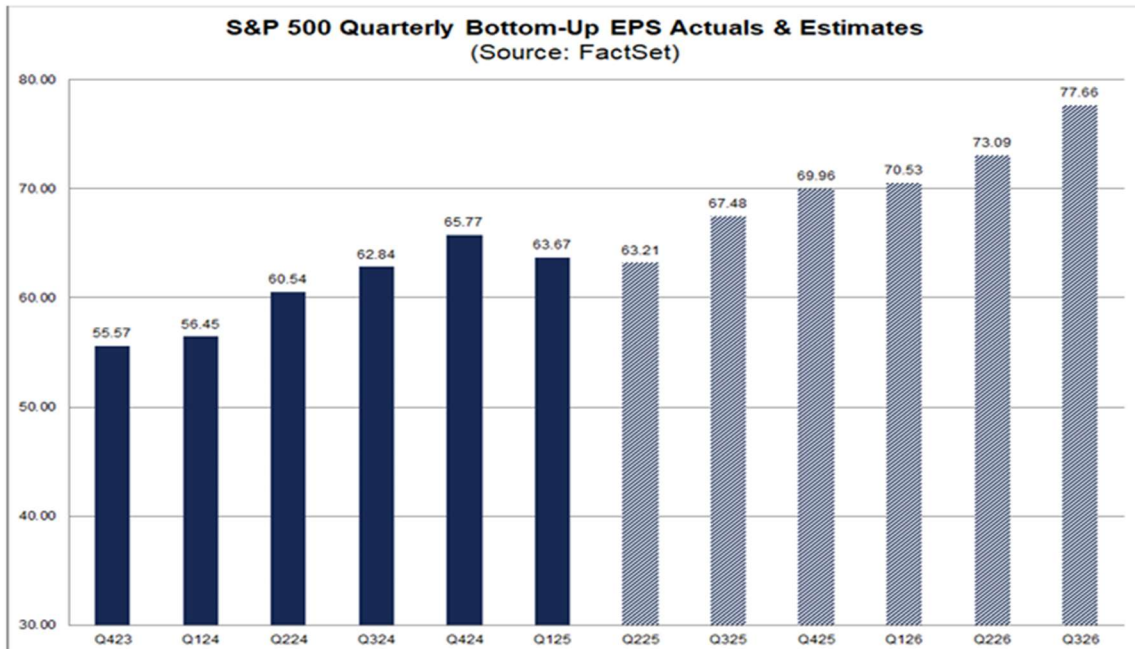
Evolution of Atlanta Fed GDPNow real GDP estimate for 2025: Q2
 Quarterly percent change (SAAR)



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

4.

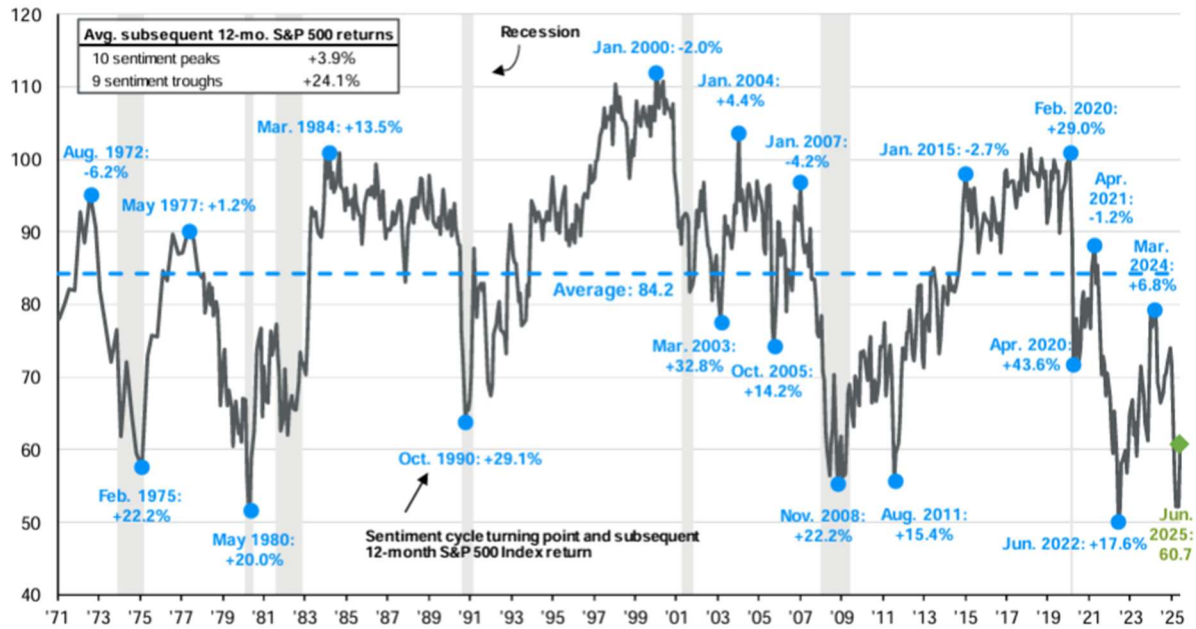


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5.

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



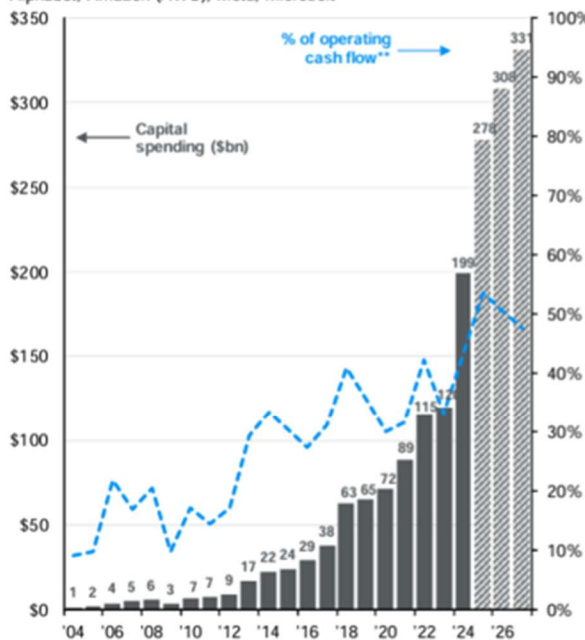
Source: FactSet, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.

6.

Artificial Intelligence: Investment and implementation

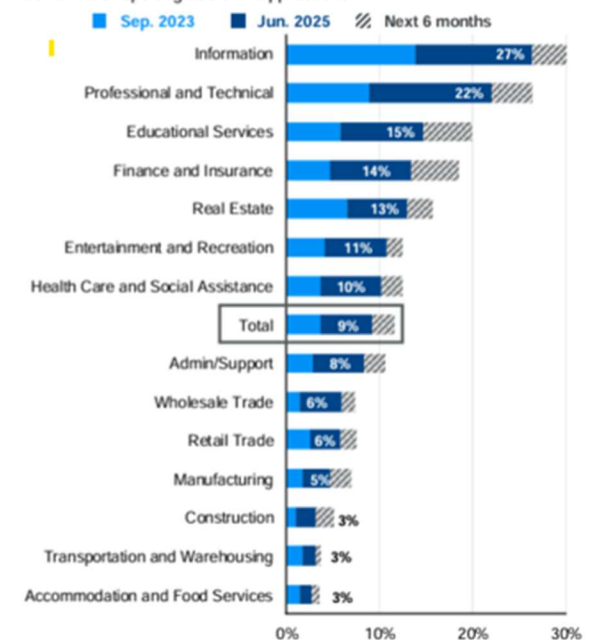
Capex from the major AI hyperscalers*

Alphabet, Amazon (AWS), Meta, Microsoft



Businesses using AI to produce goods and services

% of all firms reporting use of AI applications



Source: J.P. Morgan Asset Management; (Left) Bloomberg; (Right) Census Business Trends and Outlook Survey (AI Supplement).