Osprey
PRIVATE WEALTH

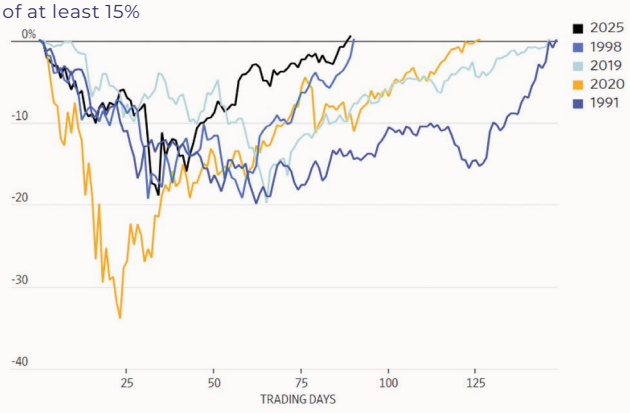
July 2025 Commentary

Investors entered the second quarter on the precipice of the President's so called "Liberation Day" with the S&P 500 at 5,611, 8.7% off the February 19th all-time high of 6,147. With the rapid and dramatic threats of high tariffs on many of our primary trading partners, the S&P plummeted within a week to a low of 4,835 on April 7th, down 21% from the high. This rapid decline of the S&P into Bear Market territory along with the lingering prospects for continued inflation and a slowing economy made for a pessimistic outlook for the market.

Then, just like that, on April 9th with the market under pressure, the President abruptly changed his mind and agreed to delay tariffs, in most cases for a period of 90 days. The S&P rallied nearly 10% from its bottom that day and continued to recoup the tariff selloff ending the month of April, higher than where it began the month.

It was during this time, that investors began to discount the President's tariff threats as one by one he walked back his excessively high tariff threats and signaled that trade deals with the U.K, China, India and many other countries were in the works. Wall Street, always looking for a chance to coin a new phrase, started to refer to the newfound opportunities as the "TACO trade" as in Trump Always Chickens Out. Regardless of how one wishes to think about it, the good news is that the market and investors have learned to have a more muted reaction to the day-to-day announcements of the new administration. The market has continued to climb its wall of worry and now enters the third quarter back in Bull Market territory with the S&P at a new all-time high of 6,200. As you can see from the chart below, this marks the fastest recovery in the history of the S&P 500 from a decline of at least 15%.

S&P 500's quickest recoveries to records following a decline of at least 15%



Source: Dow Jones Market Data

Geopolitics

Just as investors were beginning to think that the worst of the tariff scare was passing, the war in the Middle East took on a new dimension. Israel's decision on June 13th to take preemptive action against Iran under operation "Rising Lion" gave investors something new to worry about, namely the threat of an extended regional war. After the U.S. decided a week later to take decisive action against Iran's nuclear development sites there was concern that the Iranians might try and close the Strait of Hormuz where 20% of the world's oil passes through.

The markets remained resilient throughout the brief war with the exception of the price of oil. WTI crude oil rallied 15% from $68 to $78 per barrel within a matter of days, but then began to settle back down once it became clear that Iran was not going to carry through on its threat to close the Strait of Hormuz.

Enough damage was inflicted on Iran and thankfully, after 12 days, a peace deal was hammered out. It remains to be seen if this could lead to lasting peace or if it will flare up again in the near future.

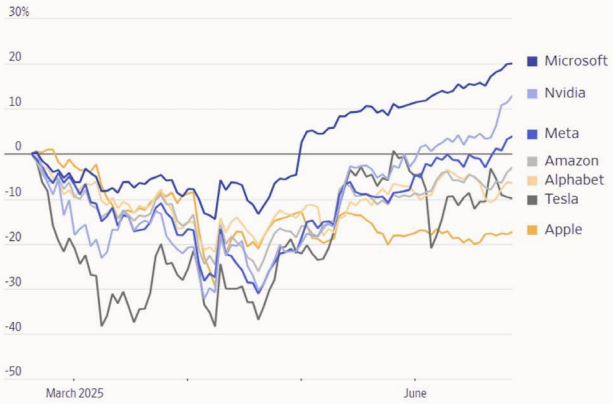
Market Leadership and the Magnificent 7

As is often the case with the beginning of new bull markets there has been some shift in leadership. Market leadership has been led by the Industrial, Communication Services, Consumer Discretionary, Financial, and Technology sectors as investors now expect that the outcome of tariff threats will be milder than originally feared, and therefore a slowdown in the economy will be manageable.

Although the technology sector has played an important part of the market rebound, we do see a divergence in the performance of the "Magnificent 7" names.

Not Universally Magnificent

Share price change since Feb. 19 market high



Source: FactSet

As you can see from the chart above, a split within the Magnificent 7 names has emerged. Microsoft, Nvidia and Meta are all at or near new highs as they continue to be seen as clear beneficiaries of the AI revolution.

Amazon's Web Services division is benefiting but this is somewhat offset by the slowing economy which impacts the online sales of their traditional business. Google has also faced some headwinds as its search business has been declared monopolistic by the U.S. court system even though their dominance in search faces potential threats from AI. Offsetting this to some extent is solid growth in their significant data center business along with their leadership in autonomous driving through their ownership of Waymo.

In addition to the reputational impact of Elon Musk's brief involvement with the Trump administration, Tesla has been negatively impacted by the likely elimination of electric vehicle (EV) incentives by the government at a time when competition has dramatically increased, specifically from Chinese manufacturers. While Tesla faces daunting challenges in the retail EV market, they should benefit over time from the introduction of robotaxis and the launch of their Optimus humanoid robots in 2026.

Apple is currently the least favored of the Magnificent 7. Within the group, they face the highest risk to a trade war with China, and they have been slow in rolling out an AI upgrade to Siri. Many analysts are now calling on Apple to use their $48.5 billion (3/31/25) cash hoard to buy an up-and-coming AI company such as privately held Perplexity AI. The strength of the Apple ecosystem will buy them time, but they will need to demonstrate significant progress on the AI front in order to hold onto their competitive advantage.

AI, Drones, and other New Tech

Within technology, investors have shifted their attention to younger companies that hold the promise of rapid innovation in the areas of AI, drones, cybersecurity, autonomous driving, and robotics. There is much excitement in these areas, and here are a few examples of companies that have caught our attention:

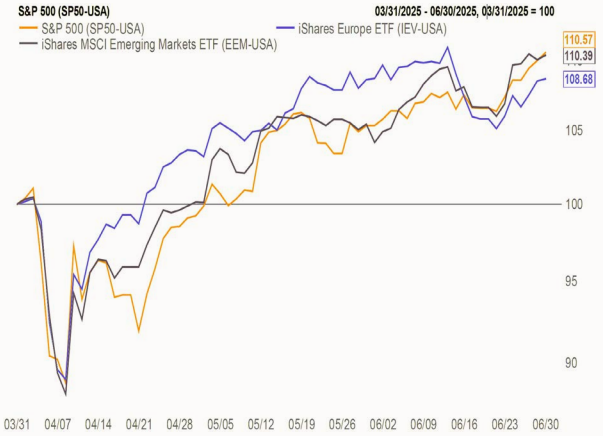
- Tempus AI (Medicine)
- D-Wave Quantum (Quantum Computing)
- CoreWeave (Cloud Computing Power)
- AppLovin (Digital Advertising)
- AeroVironment (Drones)

While investors (particularly retail investors) are eager to purchase these stocks and other similar names, we are also focused on the fundamentals. Many of these types of companies either have no earnings, or if they do, they are trading at valuations that we find hard to justify.

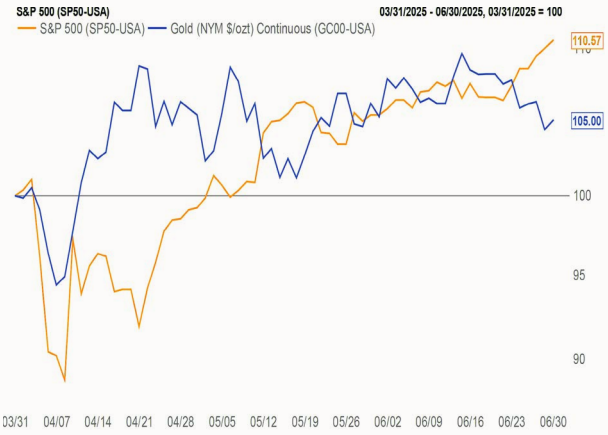
Our strategy is to identify the best companies in these rapidly developing technological areas so that we are ready to act should we get significant price corrections due to a broader market pullback. We choose to remain patient as the S&P 500 is currently trading at a high multiple of twenty-two times this year's earnings and many of the technology companies we already own (namely Nvidia, Microsoft, Google, Meta) are leaders in their own right.

International Markets

Many international markets continue to put up strong numbers for the year with Europe (IEV) +21% and Emerging Markets (EEM) +15%. However, performance was much more evenly distributed amongst indexes during the second quarter as some of the economic uncertainty facing the United States started to dissipate.



Source: FactSet



Source: FactSet

As you can see from the chart above, the S&P 500 (Blue) and the Emerging Markets (Green) were both up approximately 10% for the quarter while Europe (Orange) was up a more modest 8.5%.

The performance of the S&P 500 relative to international markets for the remainder of the year will depend greatly on the outcome of U.S. tariff policy along with the continued resilience of the U.S. economy, inflation, and interest rates.

Gold

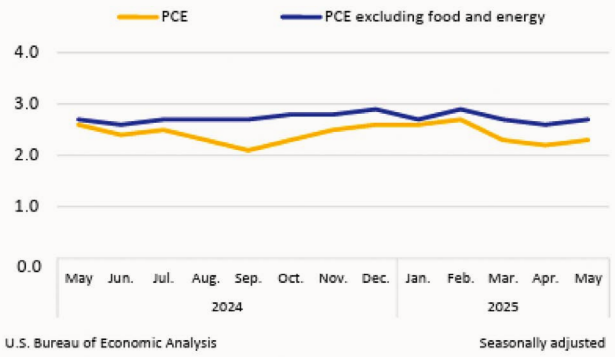
Gold has been on a winning streak over the past couple of years but has recently sold off approximately 6% since mid-April as the threat of tariffs dissipated somewhat and inflation stabilized in the high 2% range.

The chart above shows the performance of gold (Blue) and the S&P 500 (Orange) during the second quarter. As you can see, the S&P actually outperformed gold during the second quarter. It is far too soon to tell if the gold trade is over but recently it looks as though it is potentially starting to roll over.

Trump vs. Powell

The ongoing verbal back and forth between Trump and Powell continues to heat up. Chairman Powell continues to espouse the Fed's two mandates, specifically to try and keep inflation at a reasonable level, currently targeting 2%, and to keep unemployment in equilibrium at around 4%. With the latest unemployment rate report from May showing unemployment at 4.2%, the Fed is more focused on inflation.

Percent Change in PCE Price Indexes
from Month One Year Ago



U.S. Bureau of Economic Analysis Seasonally adjusted

As you can see from the chart above, inflation as measured by the Personal Consumption Expenditures (PCE) index remains stubbornly above the Fed's 2% target with the latest reading, excluding food and energy, coming in at 2.7%. It is for this reason that Powell believes it is best to continue to wait for inflation to subside further before entertaining the idea of lowering the Fed Funds Rate.

President Trump on the other hand believes Chairman Powell is relying on backward looking data instead of looking forward at an economy that has been slowing. In the first quarter GDP contracted at a 0.5% annual rate, and growth for the second quarter is currently expected to bounce back temporarily to a 2.9% annual growth rate. President Trump has gone so far as to nickname Chairman Powell "Too late Powell" partly due to the fact that the Fed was late in raising rates when inflation picked up a few years ago.

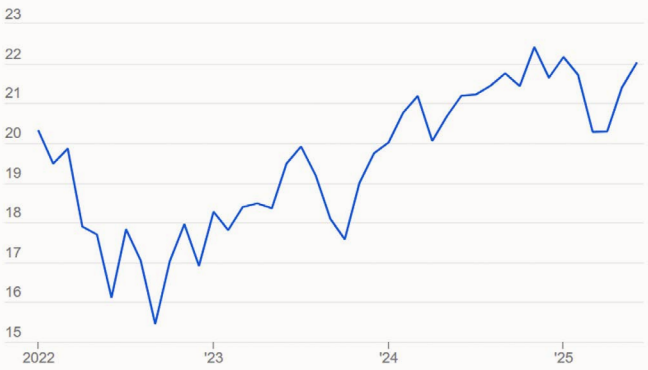
Another reason President Trump wants lower interest rates is because the U.S. government needs to refinance approximately one third of our $36 trillion in debt over the course of the next year or so. Lower rates would dramatically reduce the yearly cost of financing this debt, which would leave the budget in a better position to accommodate his "One, Big, Beautiful Bill" that he hopes will soon get through Congress.Although the technology sector has played an important part of the market rebound, we do see a divergence in the performance of the "Magnificent 7" names.

The President has recently floated the idea of making an early announcement on his Fed Chairman nomination for next year, creating a "Shadow Fed Chairman" to increase the pressure on Powell. While we view much of this as simply distasteful politics, our concern is that this political tug of war could be perceived as undermining the Fed's independence, thereby creating uncertainty about the direction of interest rates and the economy in the eyes of both consumers and investors.

The current thinking by economists is that the economy will continue to demonstrate a slow rate of growth, inflation will hopefully continue to moderate over the coming months, and this will permit the Fed to cut interest rates twice before year end, with the first cut potentially in September.

Market Valuation

The S&P 500's forward price/earnings ratio



Source: FactSet

With the market's recent rebound to all-time highs, the S&P 500 now trades at a multiple to earnings that is nearly back to its 2024 high.

As you can see from the chart, the S&P 500's price-to-earnings multiple (also known as P/E ratio) has been climbing ever since we exited the pandemic. The market can remain in this state as long as conditions remain favorable, but it is also vulnerable to pullbacks should the economic environment deteriorate.

"One, Big, Beautiful Bill"

As we enter the third quarter, the President is actively trying to coax the Republicans into passing his signature bill that covers many of his policy goals. Although the 940-page bill has too many provisions to cover here, some of the main economic attributes are as follows:

- Makes permanent the reduced 2017 income tax rates
- Maintains the current estate tax exemption of $13.99 million per person
- Increase in state and local tax (SALT) deductions from $10 thousand to $40 thousand
- No tax on tips up to $25 thousand per year
- No tax on overtime up to $25 thousand per year for couples filing jointly $6,000 deduction for seniors over 65 provided income below $75 thousand for single filers and $150 thousand for couples filing jointly
- Tax benefits for manufacturing and small businesses

Those opposed to the bill include a few financially conservative Republicans and Democrats in general who worry about adding to the deficit. The Congressional Budget Office (CBO) estimates that the bill will add $3.3 trillion to the deficit by 2034. Democrats are also concerned about the proposed cuts to green energy tax subsidies, Medicare, and the SNAP food program along with the assertion that most of the tax cuts merely benefit the wealthy.

While we will let everyone draw their own conclusion, for better or worse, we would expect passage of the bill to be well received by the equity market and likely stimulative to the economy. Like many folks, we are quite concerned about the effects of an ever-growing national debt and the financing burden that it places on future generations.

Q3 Outlook

Investors faced a barrage of negative events during the second quarter from the possible imposition of high tariffs on our trade partners to the threat of a broader regional war in the Middle East. Yet despite these challenges, the market overcame a significant pullback in early April and was able to set new highs by the end of the quarter.

The market's resilience in the face of adversity is comforting and new highs are a bullish sign for the market from a technical perspective. From a valuation perspective, the market is fully valued and so any further upside in the market will depend on some favorable developments for the economy. We are cautiously optimistic as we enter the second half of the year and believe that the market can grind higher provided that a few things go right. The President will have to delay the imposition of most tariffs while further trade negotiations take place, and the economy will need to continue to bounce back from its April loss of confidence.

Inflation must either remain at these levels or preferably continue to settle down closer to the Fed's 2% target. This would have the added benefit of allowing the Fed to cut rates later in the year if necessary to further stimulate the economy.

Additionally, it will be important for margins to remain stable and for earnings to continue to grow at least at a high-single-digit percentage rate.

There is still a higher-than-normal degree of uncertainty about world events and the direction of the economy. Therefore, we expect volatility in both directions to remain elevated throughout the rest of the year. In this environment our focus on stock selection, corporate developments, and earnings results will remain as important as ever.

~ The Team at Osprey

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