

Investment⁺ Commentary

Rebound Amid Uncertainty Q2 2025 Market Summary

U.S. stocks staged an impressive rebound in the second quarter following a rocky first quarter that witnessed the worst performance by major indices in nearly three years. The S&P 500 gained 10.6%, the Nasdaq surged 17.8%, and the Russell 2000 rose 8.1%. Q2 brought a welcome mix of diminishing tariff tension, positive earnings surprises, resurgent AI enthusiasm, resilient consumer data, and a series of cooler-than-expected inflation prints.

The rally was notable not just for its strength but also *broadening* participation. While leadership remained tilted toward large-cap growth—primarily technology and AI-related issues—other sectors, such as industrials, financials, and communication services also posted impressive returns. That said, breadth remained uneven. Mid and small-cap stocks continued to lag, and defensive sectors like healthcare, consumer staples, and energy underperformed. Market breadth indicators improved, but participation across the full range of equities remains a work in progress.

International equities extended their leadership in the second quarter, building on the momentum generated earlier in 2025. Through the end of June, developed-market international stocks (as measured by the MSCI EAFE Index) were up approximately 20% year-to-date, while emerging markets gained around 12%.

These advances were buoyed by improving local fundamentals and a weakening U.S. dollar. After a decade of U.S.-centric returns, globally diversified portfolios are finally benefiting from a more balanced landscape—one where relative valuation, currency dynamics, and policy stability abroad are helping tilt performance in favor of international exposure.

Monetary policy expectations at home and abroad also continued to influence markets. The trend of U.S. Treasury yields was mixed. Shorter-term rates declined modestly as investors anticipated Fed easing later in the year. Meanwhile, the dollar fell roughly 7%—its largest quarterly decline since 2022. While some of this move was technical, it also reflected growing skepticism swirling around U.S. policy initiatives and the unwinding of the “U.S. exceptionalism” trade that has defined post-pandemic capital flows.



Financial markets also absorbed a major geopolitical shock with surprising ease. In mid-May, Israel launched strikes on Iranian military targets, prompting retaliatory missile activity and, shortly afterward, a limited U.S. air campaign aimed at disrupting Iran's nuclear weapons infrastructure. Although the situation raised fears of a wider regional conflict, oil prices spiked only briefly before retracing (WTI crude finished the quarter down nearly 9%). With no major supply disruptions and key shipping lanes like the Strait of Hormuz remaining open, investors looked through the headlines and the equity markets continued to climb.

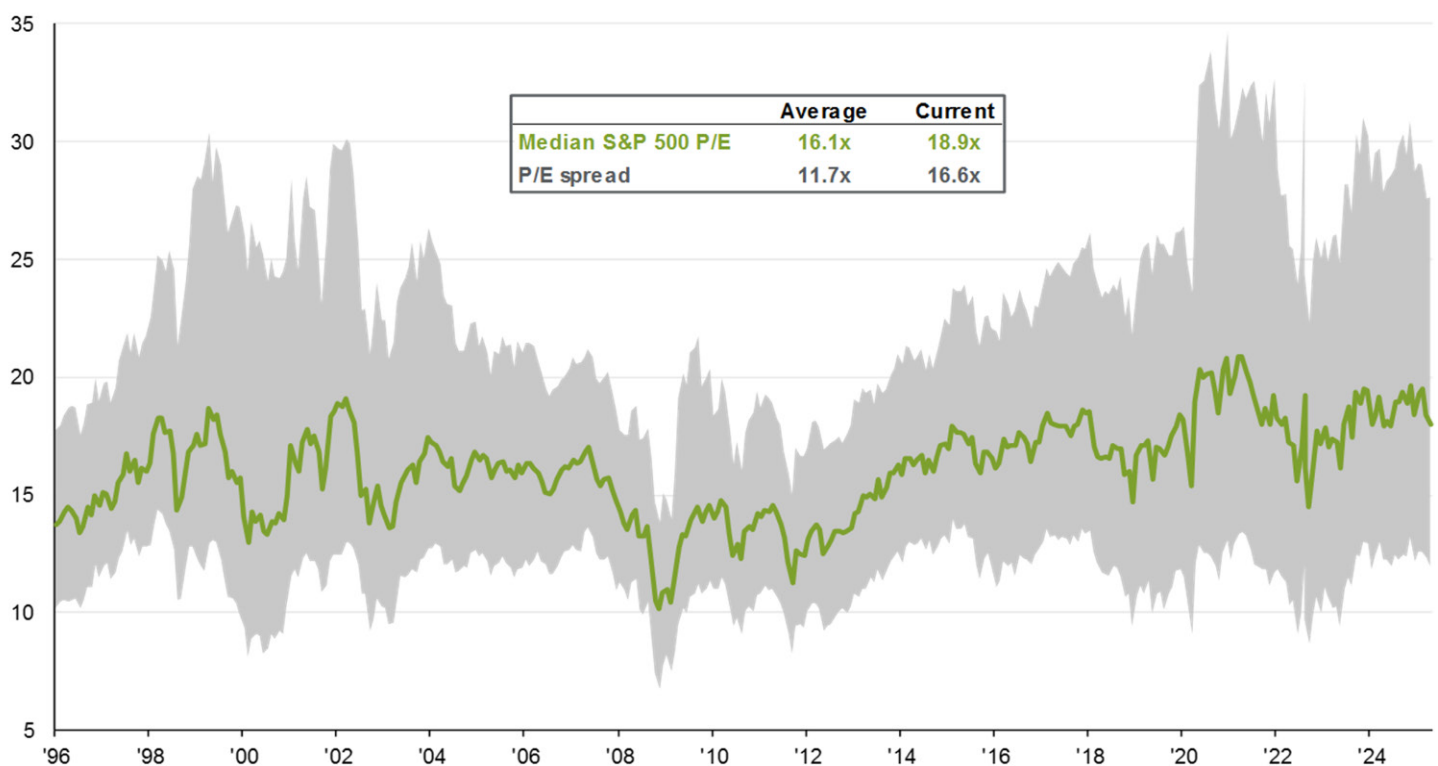
The quarter was also bookended by tariff drama. On April 2nd, markets were rattled by the surprise announcement of across-the-board 10% tariffs along with the threat of higher reciprocal rates on over 60 trading partners, some as high as 50%. This marked a sharp pivot in tone and policy direction, suggesting tariffs were no longer just a negotiating tool, but a core economic strategy. However, as the quarter progressed, several trade-related "off-ramps" emerged: exemptions were

granted for electronics and auto parts, a temporary pause was applied to the EU deadline, and a détente was reached with China. The market found reassurance in the elevation of Treasury Secretary Bessent's role in the trade negotiations and the marginalization of hawkish voices like Commerce Secretary Howard Lutnick.

Still, trade policy uncertainty lingered and weighed on sentiment. Effective tariff levies remained elevated—the highest since the 1930s—and the costs to consumers are only beginning to show up in the inflation data. Corporate earnings calls revealed continued concern over inventory stockpiling, pricing uncertainty, and global supply chain friction. Adding to the noise, Trump reignited criticism of the Federal Reserve and repeatedly floated the possibility of replacing Chair Powell and preannouncing his successor. While that risk appeared to diminish by quarter-end, the drumbeat of political interference kept monetary policy uncertainty alive. Wall Street abhors all threats to the central bank's independence.

Valuation Dispersion

Dispersion between the forward P/E of S&P 500 stocks in the 20th and 80th percentile



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management. Guide to the Markets - US Data are as of June 30, 2025



Underlying all of this was the passage of the so-called “One Big Beautiful Bill”—a sweeping fiscal package that was signed into law in early July after clearing both chambers of Congress. The legislation includes a series of temporary tax cuts, many of which apply retroactively to the start of 2025, including enhancements to the standard deduction, child tax credit, and SALT cap. Supporters hope these measures will inject short-term stimulus into the consumer economy, particularly when refunds are issued next spring. However, the bill relies heavily on sunset provisions and optimistic revenue projections, raising longer-term concerns about fiscal discipline. Moody’s cited this dynamic in its recent downgrade of U.S. sovereign credit from Aaa to Aa1, underscoring growing scrutiny of the national debt and Washington’s willingness to pass deficit-financed stimulus even at a time of elevated interest costs.

Against this backdrop, corporate earnings remained a bright spot. S&P 500 profits rose 12.7% year-over-year in Q1 (reported during Q2), significantly outpacing forecasts. Businesses leaned on resilient consumer demand, elevated margins, and early benefits from AI-driven productivity tools. Share buyback activity remained strong, supported by record authorizations and robust cash flow.

Q2 offered a clear reminder that markets tend to climb a wall of worry—but not without friction. Beneath the

strong headline returns lies a more nuanced story: one of shifting leadership, rising dispersion, global rebalancing, and unresolved policy risk.

Reawakening the Global Opportunity

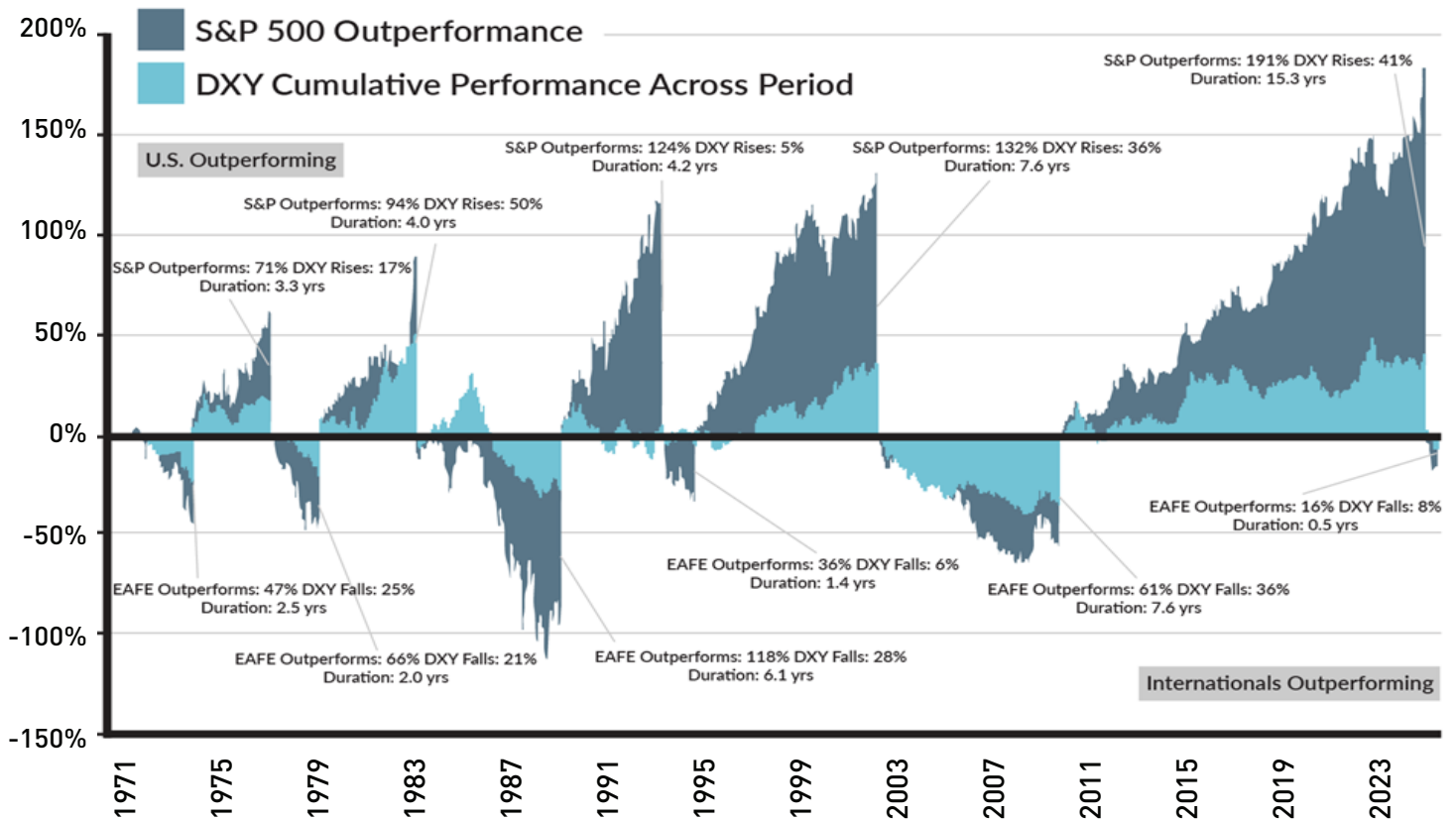
After more than a decade of U.S. equity dominance, 2025 is shaping up to be a reminder that diversification works—even if it does not always work right away.

The U.S. dollar has weakened significantly this year, declining nearly 11% during the first half—its steepest drop since the end of Bretton Woods in 1973. While currency fluctuations can be noisy in the short term, this decline may be indicative of a deeper shift. Mounting fiscal concerns, persistent policy volatility, and fading confidence in the “U.S. exceptionalism” narrative have contributed to growing investor unease. The dollar’s strength was a defining feature of the post-financial crisis era; its retreat may prove equally defining in the years ahead.

For investors, a weaker dollar has tangible implications. When the dollar falls, returns on international equities tend to look stronger in U.S. dollar terms—and that dynamic has played out clearly this year. While currency tailwinds certainly boosted relative international out-performance, the story is not merely about exchange rates. In key international markets, inflation has mod-

S&P 500 vs MSCI EAFE Outperformance and DXY Index

Historic relationship between USD strengthening and US equities outperforming



Source: Johnson Financial Group, Bloomberg. Data as of June 6, 2025

erated, economic growth has stabilized, and corporate earnings have proven more resilient than expected.

Valuation has also played a noteworthy role. U.S. equities continue to trade at a roughly 35% premium to international developed markets—about double the historical average. This valuation gap has persisted for years, but relative performance is shifting. Investors are beginning to reexamine how much of their portfolio allocation should remain concentrated in the U.S. In short, the case for global diversification is no longer theoretical. It is creeping into returns.

It is worth noting that Withum Wealth clients have remained globally diversified through the challenging periods. Headlines have questioned the relevance of international investment; however, our discipline is now paying rewards. The “revenge of diversification” is not just a clever phrase; it reflects an evolving atmosphere

where patience, price discipline, and global balance are beginning to outperform more concentrated strategies.

Of course, international exposure still comes with risks. Currency swings, geopolitical stress, and uneven policy coordination remain part of the equation. Nevertheless, select overseas markets offer decent relative value in contrast to an historically expensive U.S.

Diversification has always been all about the long game. And for the past decade, staying close to home was not just comfortable, it outperformed. The tide appears to be turning.

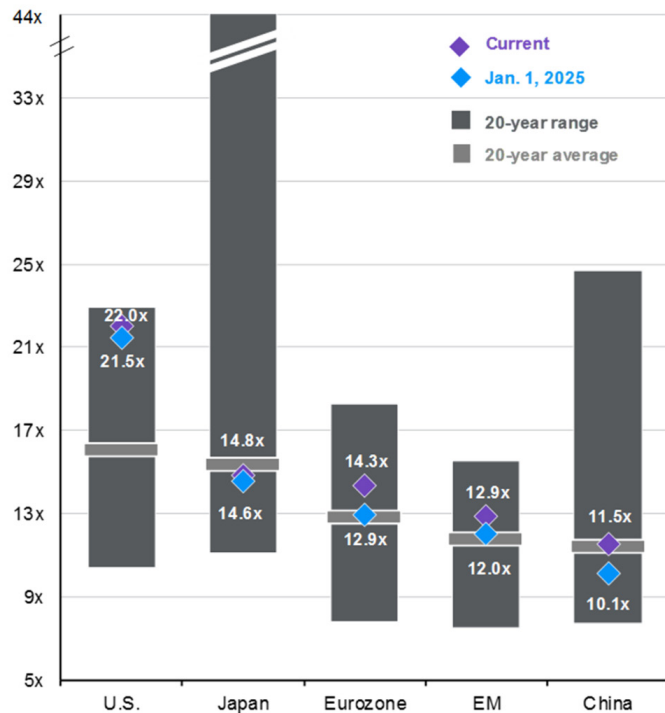
Still Walking the Inflation Tightrope

Even as markets regained their footing in the second quarter, the outlook for inflation, and by extension, monetary policy has grown more complicated. For

Global Equity Valuations

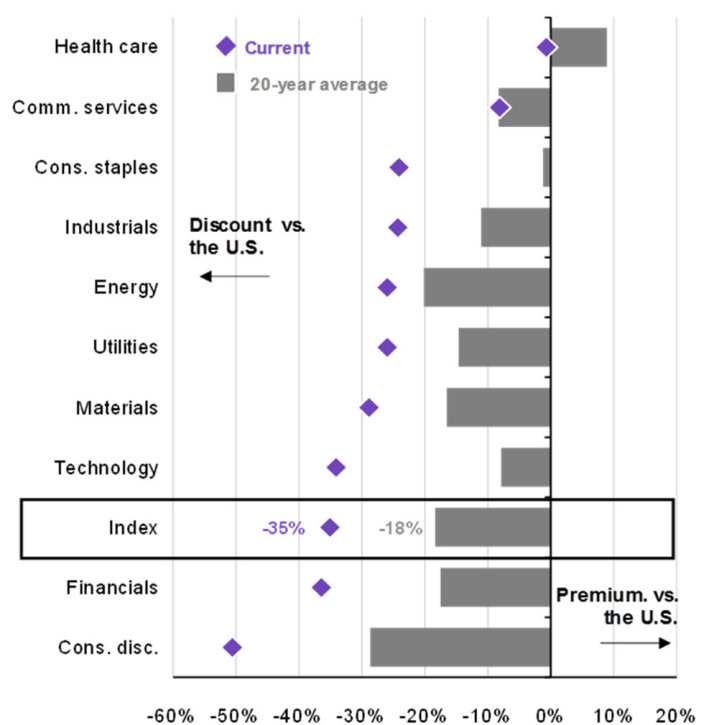
Valuations by country/region

Price-to-earnings, next 12 months



Relative valuations by sector

Price-to-earnings, next 12 months, MSCI ACWI ex-U.S. divided by S&P 500



Source: Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Countries are represented by their respective MSCI country index except for the U.S., which is represented by the S&P 500. (Right) International DM banks = MSCI EAFE / Banks Index. J.P. Morgan Asset Management. Guide to the Markets - US Data are as of June 30, 2025

much of the recent past, investors have debated when the Federal Reserve would resume cutting the Fed-funds rate. Future inflation data will provide the answer.

The new variable in this equation is trade policy. Tariff hikes announced earlier this year are still working their way through the system. While markets initially shrugged off the April announcement of broad-based tariffs—helped by temporary exemptions, delayed implementation, and subsequent diplomatic off-ramps—the reality is that tariff-related price increases tend to appear gradually. Goods imported before the effective dates are only now entering warehouses and supply chains, and pricing pressure typically emerges as newer inventory cycles through to consumers. The result is that inflation data in the months ahead may begin to reflect this delayed effect, particularly in the core goods categories.

At the same time, a major fiscal policy shift is now officially underway. Many of the aforementioned tax provi-

sions in the “One Big Beautiful Bill” apply retroactively to January 1, 2025, meaning households could see their benefits when filing taxes next spring. In theory, that could provide a boost to consumer spending in the first half of 2026. But those benefits will arrive well after the inflationary effects of tariffs begin to take hold. As J.P. Morgan Asset Management’s Chief Global Strategist Dr. David Kelly recently noted, “Over the fourth quarter of this year, we believe the taxes taken out of consumers’ pockets via tariffs will exceed the tax break in the bill.” That dynamic may reverse with the arrival of refunds in 2026—but by then, much of the near-term drag may already be felt.

This presents a difficult balancing act for the Fed. The central bank is obligated to maintain its “dual mandate” of both price stability and full employment. While inflation is trending lower, it remains above the 2% Fed’s target, and the full impact of tariffs has not been felt yet. At the same time, the labor market has been showing signs of softening (last week’s strong June jobs report



notwithstanding). Job creation has slowed, unemployment claims have ticked higher, and indicators such as retail sales suggest that demand is cooling. Though total employment is still growing modestly, the unemployment rate could drift higher—potentially toward 4.5% by year-end—even as slowing immigration limits labor supply growth.

Against this backdrop, the Fed is likely to remain patient. A rate cut in July seems unlikely, but easing later in the summer remains on the table, contingent on upcoming data. The challenge lies in navigating a scenario

where inflation picks up just as labor market momentum fades. That tension between mandates could lead to a more reactive policy adjustment than markets currently anticipate.

For now, investors are still pricing in at least one cut this year, and risk assets continue to trade near cycle highs. History has shown how quickly sentiment can shift in response to inflation surprises. If markets are leaning too far into the rate-cut narrative, volatility could return abruptly.

Conclusion

With the U.S. stock market at or near record highs, inflation data evolving, and policy uncertainty lingering, investors might be tempted to initiate aggressive portfolio moves in anticipation of what might occur next. But in an environment such as today's, staying rational and disciplined matters more than ever.

Rather than trying to predict an unknowable future, we at Withum Wealth will continue to focus on building portfolios that can withstand a range of outcomes. That means emphasizing quality—companies with durable earnings and strong balance sheets—and maintaining thoughtful diversification across sectors and geographies. It also means avoiding overexposure to any one theme or narrative, no matter how dominant it may seem in the moment.

As always, we remain committed to helping our clients navigate complexity with clarity—and to ensuring portfolios are positioned, not just for what is probable, but for what is possible.

On behalf of our Withum Wealth team, we hope that you enjoy a happy, healthy, and relaxing summer. Thanks, as always, for your confidence and encouragement. ■

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WEALTH MANAGEMENT

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