

U.S. Stocks Rebound as Trump Pauses Country-Specific Tariffs

On April 2, the Trump administration signed an executive order imposing a 10% baseline tariff on imports from all countries, with higher rates targeting nations with which the U.S. runs the largest trade deficits. The Trump administration described the measures as “reciprocal,” aiming to counteract foreign trade barriers.

The announcement triggered a sharp selloff in U.S. stocks and bonds, as investors reacted to the heightened risk of a global trade war. Rising Treasury yields added further pressure, prompting the administration to reconsider its approach. In response, President Trump announced a 90-day pause on country-specific tariffs, during which his trade team would seek to negotiate new agreements with key trading partners.

Markets responded positively to the pause. The Standard and Poor’s 500 stock Index rebounded sharply, climbing rose 24% from the depths of April’s tariff-induced downturn to reach new highs. Investor sentiment was further buoyed by robust corporate profit growth, easing inflation, and a resilient labor market.

Bonds: Yield Curve Steepens Amid Policy Uncertainty

U.S. Treasury yields diverged across the curve in the second quarter. Shorter-dated yields declined while longer-term rates edged higher resulting in a modest steepening of the yield curve. The 10-year Treasury yield rose two basis points to end the quarter at 4.23%, reflecting persistent policy uncertainty and inflationary pressures tied to tariffs. In contrast, the two-year Treasury yield dropped 17 basis points to 3.72%, signaling market expectations for rate cuts amid growing concerns of an economic slowdown.

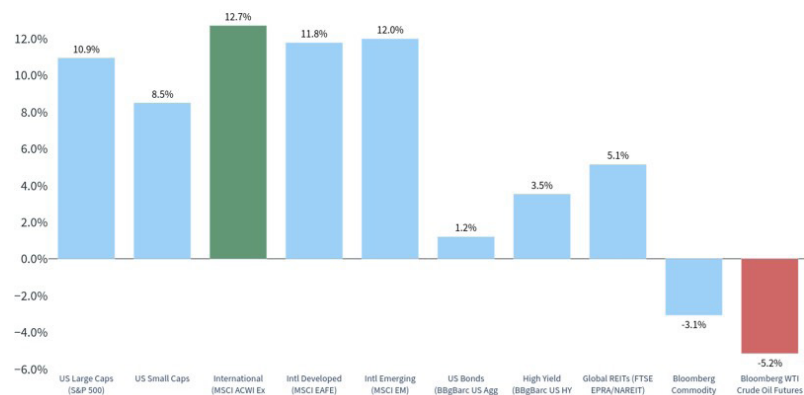
As widely expected, the Federal Reserve (Fed) held its benchmark policy rate within the 4.25% - 4.50% range, extending the pause initiated in December. The unanimous decision by the Federal Open Market Committee (FOMC) reflected confidence in the underlying economic data, which Fed officials characterized as “solid.” By maintaining rates, the Fed signaled a cautious approach, allowing time to assess the evolving impact of fiscal and trade policy developments. While acknowledging progress on inflation, the committee remains vigilant against potential reacceleration, particularly in light of possible new

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Major Index Returns – Quarter-to-date

Global asset class indices, total returns



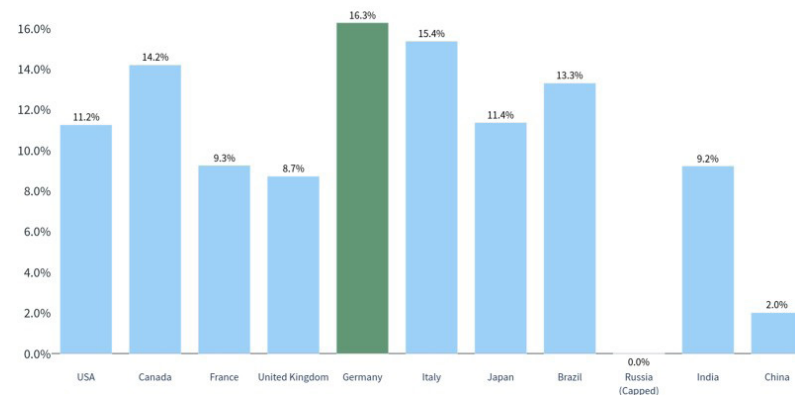
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Global Equity Returns – Quarter-to-date

Major equity market index total returns



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tariffs. Markets are currently pricing in two rate cuts in 2025, broadly aligning with the Fed's guidance.

The Bloomberg U.S. Aggregate Bond Index posted a strong 1.5% total return in June, reversing May's losses and lifting the second-quarter performance to 1.2%. Elevated starting yields across core fixed income sectors helped cushion price volatility and provided steady income. With yields still elevated relative to recent history, yield carry remains a key driver of returns in the second half of the year.

Investment-grade corporate bonds returned 1.8% in the second quarter, supported by steady demand and attractive yield carry. Corporate bond spreads tightened by 11 basis points over the quarter, ending at +83 bps, as April's volatility — driven by geopolitical events such as Liberation Day — faded. The tightening of spreads and solid returns reflected improved investor sentiment toward high-quality credit.

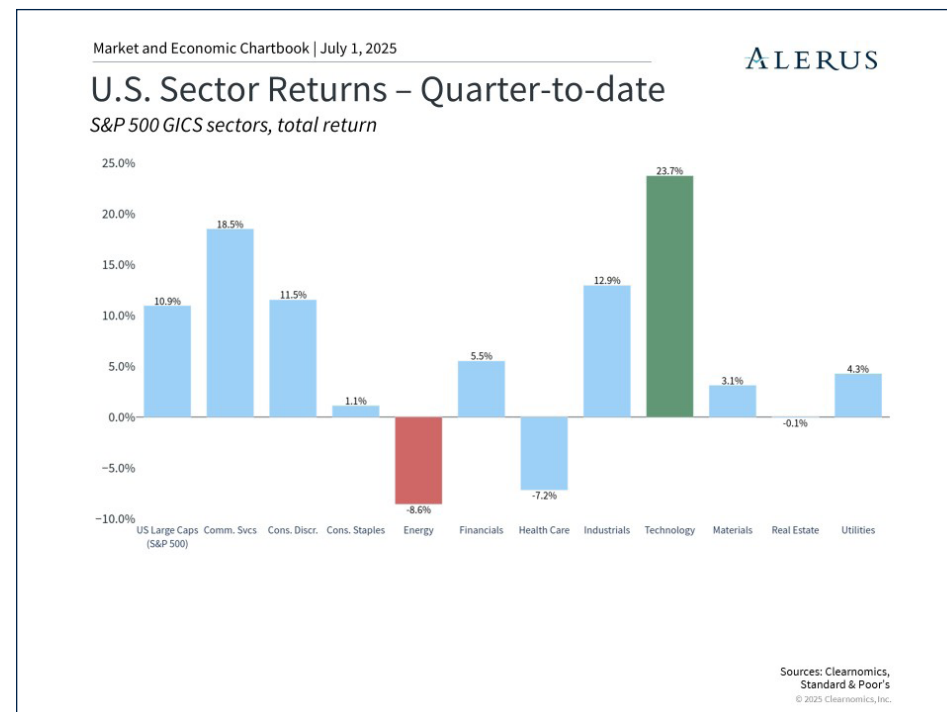
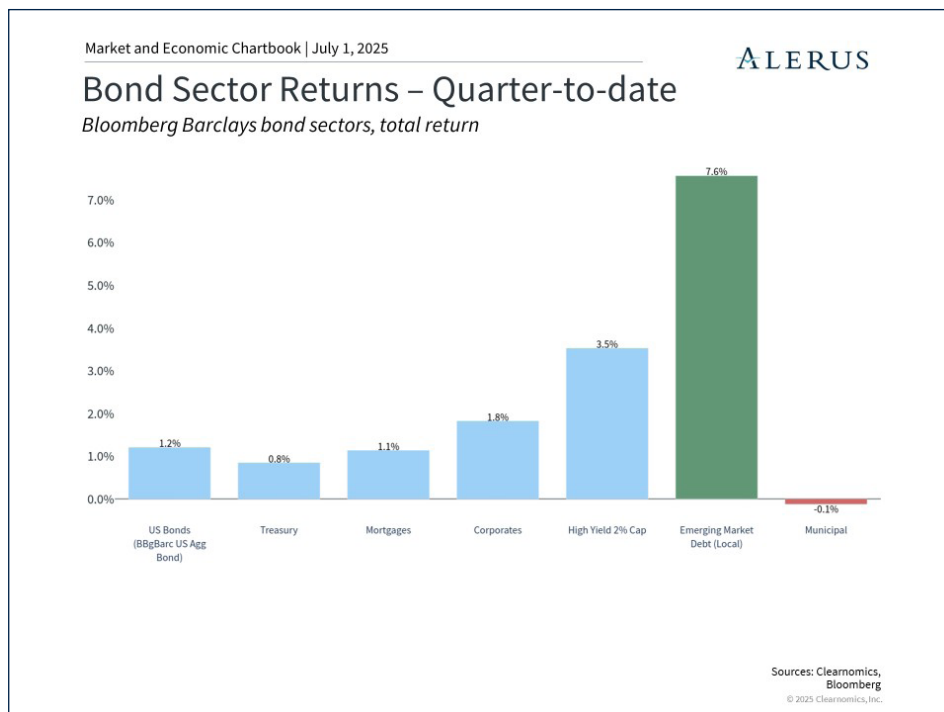
High-yield corporate bonds also performed well, delivering a 3.5% total return. Spreads narrowed by approximately 57 basis points to end the quarter near +290 bps. The rally was underpinned by low default rates, resilient corporate fundamentals, and consistent inflows. Higher-quality BB-rated names led performance, though CCC-rated names also posted gains amid improving risk sentiment.

Agency mortgage-backed securities returned approximately 1.1% in the second quarter, supported by strong yield carry and declining rate volatility. Despite continued runoff from the Fed's balance sheet and subdued bank demand, spreads remained steady, reflecting investor comfort with prepayment risk.

Municipal bonds underperformed other fixed income sectors, weighed down by record supply and uncertainty surrounding tax policy. Early-quarter concerns about potential changes to the tax-exempt status of municipal debt dampened sentiment. However, confidence improved late in the quarter after both House and Senate budget proposals excluded provisions that would materially impact municipal tax treatment.

Stocks: Trump's Partial Tariff Rollback Fuels Market Rally

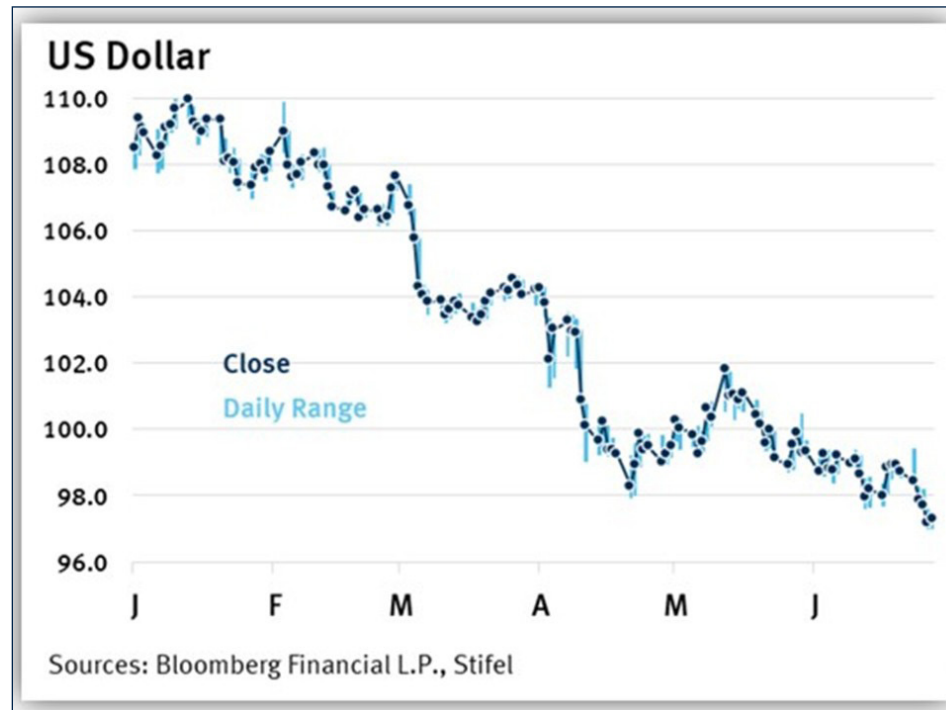
U.S. equities experienced sharp early losses in the second quarter following the Trump administration's announcement of sweeping tariffs on all countries on Liberation Day, April 2. Markets had already declined in the first quarter in anticipation of the announcement, which proved more severe than expected. However, as bond yields spiked in response to these high tariff levels, Trump announced a 90-day pause to country-specific tariffs. This move, along with efforts to negotiate lower tariffs with key trading partners such as the U.K., China, and India, helped stabilize investor sentiment. The Standard and Poor's 500 stock index rebounded strongly, returning 10.9% for the quarter reaching an all-time high.



Technology was the top-performing sector, driven by renewed investor enthusiasm for artificial intelligence (AI). Nvidia's announcement of a \$500 billion AI infrastructure investment further fueled the tech-led rally. Despite some uncertainty in May — sparked by an April jobs report showing slowing job creation but firm wage growth — markets found support in a softer-than-expected April Consumer Price Inflation report. This surprise helped lift growth-oriented sectors such as technology, communication services, and consumer discretionary.

Energy lagged despite escalating geopolitical tensions in the Middle East as rising supply was met with signs of slowing global economic growth. Healthcare also posted negative returns over investor concerns over potential budget cuts to Medicaid and the Affordable Care Act.

Large-cap stocks outperformed small caps, as investors anticipated that higher-for-longer interest rates and elevated tariffs would weigh more heavily on smaller companies' earnings. Large-cap growth surged 18.1% in the quarter, significantly outperforming other style factors. In contrast, large-cap value rose just 2.0%. The rally mostly benefited riskier stocks, rather than those known for steady dividends or strong balance sheets.

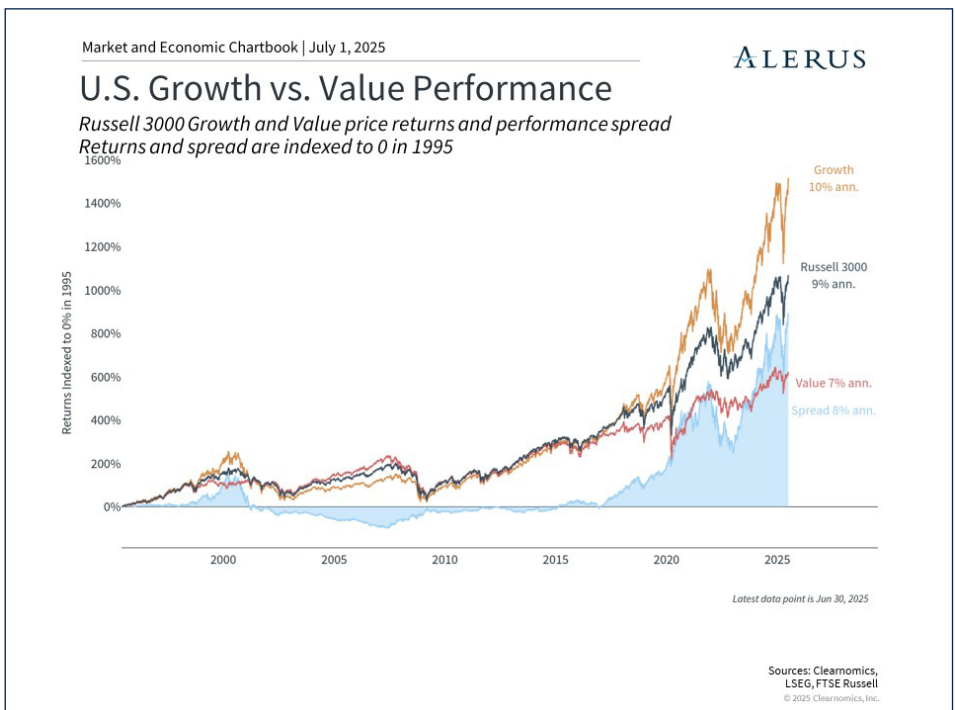


International equities continued to outperform U.S. markets in the second quarter. European stocks benefited from increased defense spending in support of NATO and growing expectations of rate cuts by the European Central banks (ECB). Emerging markets also advanced, led by strong performance in India, Brazil, and South Korea, all of which gained from the dollar's decline and improving domestic fundamentals.

Currencies: Dollar Weakens Amid Tariff Uncertainty

The U.S. Dollar Index extended its decline in the second quarter, ending the first half of the year nearly 11% lower against a basket of major currencies. The dollar entered the year overbought, as investors had expected the Trump administration to prioritize pro-growth policies like tax-cuts and deregulation. Instead, the administration's continued focus on tariffs — and the resulting uncertainty around their impact on inflation and economic growth — prompted many investors to reduce or hedge their dollar exposure.

Investor confidence took a significant hit following the sweeping tariff announcement in April and failed to recover meaningfully. While the Fed's reluctance to cut interest rates and a brief flight to safety during the Iran conflict provided some temporary support, the dollar's downtrend persisted. The euro, in particular, strengthened against the dollar, buoyed by announcements of increased defense spending by EU nations.



Outlook 2025: Murky — Uncertainty Rises as Tariff Pause Ends

As the Trump administration's tariff pause expires, we expect upward pressure on import prices, contributing to near-term inflation. Over the medium-term, however, these tariffs are likely to act as a tax on the economy, dampening growth. Additional policies — such as restrictions on immigration and reductions in federal government employment — could further slow economic momentum.

That said, certain pro-growth elements of the One Big Beautiful Bill, particularly corporate tax cuts, may help offset some of the slowdown. We now anticipate the U.S. economy to slow in the second half of 2025 but avoid a recession. The bill's business-friendly provisions should lower effective corporate tax rates, improve cash flow, and support capital investment.

Given this backdrop, we anticipate the Fed will hold off on rate cuts until inflationary pressures from tariffs subside and clearer signs of economic slowing emerge. Our base case is for the Fed to begin easing in the fourth quarter of 2025 at the earliest.

We maintain an overweight position in government-backed mortgage securities, which offer attractive yields and carry no credit risk due to their explicit government guarantees. Limited issuance — driven by high mortgage rates and subdued refinancing — continues to support valuations and technical stability. This strategic position is funded by an underweight in U.S. Treasuries, where relative value remains less compelling.

We also remain overweight in investment-grade corporate bonds, supported by strong yield and carry characteristics, even with spreads near historical tightness. Our view reflects confidence in the sector's income potential credit stability. In contrast, we hold a neutral stance on high-yield bonds. While recent performance has been strong, current spread levels offer less relative value.

The third quarter of 2025 presents a nuanced environment for equities, shaped by evolving policy dynamics and macroeconomic uncertainty. Tariffs and potential Fed rate cuts are likely to be the key market drivers in the second half of the year. While overall valuations remain slightly elevated, they are supported by a resilient economy, strong corporate earnings supported by recent tax cuts, the budget, and the administration's ongoing deregulatory agenda. We continue to favor domestic and developed international equities. A soft-landing scenario could create opportunities to broaden exposure to value, high-dividend, and small-cap stocks. We maintain our overweight positions in the technology and financial sectors, while remaining cautious on consumer stocks, which are more vulnerable to tariff-related cost pressures. We also remain underweight in healthcare, which faces budget cuts and potential tariff impacts on imported pharmaceuticals.

We anticipate continued weakness in the U.S. dollar, which should support international equities — particularly in Europe and emerging markets. Increased defense spending in the EU and a more accommodative ECB further enhances the outlook abroad. In this uncertain environment, with risks ranging from stagflation to a hard landing, we continue to favor large companies over small caps. We also see gold as a valuable hedge, with potential to perform well amid persistent inflation and geopolitical uncertainty.

Risks

- Persistent policy uncertainty
- U.S. economy enters recession
- Tariff-driven inflation



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Sources: FactSet, Jefferies, Morning Star, Morgan Stanley, Goldman Sachs, Wall Street Journal, Bloomberg, Financial Times

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