

Whiplash

In a pattern reminiscent of the Covid panic of 2020, but not as severe, equity markets saw a stunning reversal in the second quarter with the major U.S. indices closing at record highs, an outcome many would have thought unthinkable just a quarter ago. Like in 2020, markets collapsed after gains early in the year, then appeared to be on the brink of disaster in early April, only to be reassured by the policymakers best positioned to provide stability:

S&P 500 YTD Return



Source: Y-Charts

Given the economic resilience to date, markets seem unlikely to despair again until there is hard evidence that the tariff turmoil is indeed steering the economy to recession

- » In Q2 2020, it was the U.S. Federal Reserve and other global central banks coordinating to flood the Covid-halted economies with liquidity to demonstrate their resolve to keep the global economy functioning.
- » In Q2 2025, it was the very policymakers who created the volatility demonstrating that they also valued market stability as they pursued their reshaping of global trade.

Having averted the near-immediate economic collapse that markets feared with the eruption of a global trade war, markets appear increasingly desensitized to trade/tariff volatility, accepting it as the “new normal”. Markets seem emboldened that not only can economies withstand an effort to reduce globalization, but they may even continue to prosper. Given the economic resilience to date, markets seem unlikely to despair again until there is hard evidence that the tariff turmoil is indeed steering the economy to recession, although their next test may come soon with the July 9 expiration of the pause on reciprocal tariffs.

Is the stock market recovery extremely overdone or is it a sign that the underlying fundamentals of our services-based economy and the economic prospects for an A.I.-based productivity boom are so strong that even a trade war can't impede them? Only time will tell, and the data should begin to take shape in the coming quarter, but the one thing Q2 did convincingly demonstrate is the unpredictability of markets and the risk in trying to predict their behavior.

Why the strong recovery in equities?

Despite a steep one-week dive on the heels on President Trump's April 2 reciprocal tariff announcements, equity markets staged a historic recovery from their April 8 lows to post a very strong quarter.

U.S. Equities

Index	Q2 2025	Apr 8– Jun 30	YTD
S&P 500	10.9%	23.0%	6.2%
Equal-Weighted S&P 500 Index	5.5%	17.2%	4.8%
Dow Jones Industrial Average	5.5%	16.6%	4.5%
Nasdaq Composite	18.0%	30.8%	5.9%
Russell 2000 (Small Caps)	8.5%	20.6%	-1.8%

Source: Morningstar

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- » Where is the feared economic recession?
- » Where is the feared inflation?
- » Are markets shrugging off tariff-related concerns like they did in 2018-2019?

We think it is much too early to answer these questions as tariff levels are still in flux and the impacts of tariffs have not yet had enough time to work their way through to hard economic data, but once President Trump calmed markets with his 90-day pause on reciprocal tariffs before they were to take effect on April 9, the markets seemed reassured that the president still valued the ultimate performance of the stock market as a barometer of his performance.

While other global policymakers and their constituents may be angered by the new American protectionism, they also realize that yielding on trade terms is preferable to a recession in their home country. With their countries so much more reliant on trade than the U.S., that choice appears to be the one with which many are faced, and foreign policymakers have been demonstrating a commitment to successful trade talks that will keep international commerce flowing.

Until markets see hard evidence of economic damage, we think the markets will remain optimistic that a mere economic slowdown rather than a recession is the most likely result of the new tariffs. We think the drivers of this optimism are some of the major themes we've discussed in the last two quarterly newsletters:

At year-end, we discussed three economic tailwinds that have been contributing to surprisingly strong growth for the U.S. economy:

- » **U.S. economy increasingly fueled by the services sector:** As it has become dominated by the services sector, the U.S. economy has become less cyclical and more stable.
- » **Massive capital investment in artificial intelligence:** A.I.-related capital expenditures continue to add fuel to the economy; just the “Magnificent Seven” tech companies will account for hundreds of billions in capital spending themselves.
- » **Fiscal policy:** The Trump administration plans to continue running record peacetime budget deficits with tariffs intended to offset some of the additional cost of the newly legislated domestic policy agenda.

After the first quarter, we commented on a couple of factors that we thought should reassure investors amidst the chaos of tariff announcements that, at times, were quickly reversed and appeared to present a threat to trade and the economy:

- » **The U.S. will still need to import most goods sourced from abroad:** As a services-based economy with very low unemployment, the U.S. does not have the manufacturing labor resources to revert to a manufacturing-based economy, so most of the current trade will continue despite the tariffs, although the dance partners may change in some cases, particularly with respect to goods currently produced in China.
- » **The apparently chaotic approach to tariff announcements may have been partly negotiating tactic:** We theorized and are increasingly convinced that the administration’s erratic announcements around tariffs in Q1 were partly intended to frighten trading partners and establish a stronger negotiating position for the U.S.; as trading partners have realized that most trade will continue with simply a tax on the importers and consumers, retaliatory tariffs are generally being withdrawn, calming fears of an escalating trade war.

We expect to see the overall amount of trade to generally continue and retaliatory tariffs to remain muted as the marketplace increasingly realizes that tariffs are essentially replacing one tax on the American economy with another. If, as we have discussed, the overall level of imports is a structural necessity and is unlikely to change, then it presents a stable stream of potential tax revenue. Rather than having income taxes revert to pre-2017 levels, that tax revenue will instead be expected to come from tariffs, effectively a “consumption tax”, as the U.S. needs that trade for all the goods that we are unable to produce economically.

Update on the “Magnificent Seven”

The “Magnificent Seven” mega-technology stocks have been key drivers of S&P 500 returns in recent years, and the rebound in their stocks highlights the stark reversal in market risk sentiment since the April 8 low-point for stocks.

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Magnificent Seven

Stock	Q2 2025	Apr 8–Jun 30	YTD
Apple Inc	-7.5%	13.2%	-17.9%
Tesla Inc	22.6%	36.2%	-21.3%
Alphabet Inc Class A	14.1%	20.2%	-6.7%
NVIDIA Corp	45.8%	61.8%	17.7%
Meta Platforms (Facebook)	28.2%	43.1%	26.2%
Microsoft Corp	32.7%	39.3%	18.4%
Amazon.com Inc	15.3%	25.2%	0.0%

Source: Morningstar

With the exception of Apple, which has consistently underperformed the S&P 500 over the last few years, each of these stocks climbed more than 20% from the April 8 low.

International Equities

While Q2 showed that the reported demise of “U.S. exceptionalism” may have been greatly exaggerated, international markets have continued to shine.

International Equities

Index	Q2 2025	Apr 8–Jun 30	YTD
MSCI EAFE (Developed Markets)	11.8%	25.2%	19.4%
MSCI Emerging Markets	12.0%	23.1%	15.3%

Source: Morningstar

With every other major economy much more reliant than the U.S. on global trade to fuel their GDP and most political leaders making it clear that they would negotiate to avoid the harshest tariffs, investors again turned to sources of optimism for investing abroad.

- » **U.S. dollar weakness:** Despite consensus expectations that tariffs would strengthen the dollar, it has weakened thus far in 2025, largely due to concerns over the ballooning U.S. federal debt and the continuation of record peacetime budget deficits.
- » **Remilitarization of Europe:** Realizing that the U.S. no longer intends to provide their military umbrella, Europe has undertaken a remilitarization that should provide economic stimulus for the next decade or longer.
- » **Trade will continue:** Without a much larger manufacturing labor force in the U.S., the total amount of global trade is unlikely to be drastically reduced, with the biggest changes simply coming in the identity of immediate trading partners.

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Stagflation?

While we have seen many headlines criticizing Fed Chairman Powell for not cutting interest rates, the markets seem to be voting solidly in support of the Fed's "wait and see" approach to whether monetary policy should be further eased. Inflation has stubbornly persisted above the Fed's target of 2 percent annualized, and, as we mentioned earlier, the impact of tariffs has simply not had time to work its way through to economic data. As long as the U.S. economy remains steady, we agree the prudent course of action is to "wait and see".

After three rate cuts in 2024 brought the Fed Funds rate to a target range of 4.25-4.50% from 5.25-5.50% for the purposes of moving from a policy intended to "restrict" the previously high-inflation economy to one that would be more "neutral" in its economic impact, the Fed is faced with the following situation regarding its dual mandate of promoting full employment while controlling inflation:

- » **The U.S. economy remains at full employment:** The previously overheated job market that was stoking wage inflation has been reigned in, but largely through a reduction of job openings rather than job cuts. At still historically low 4.2% unemployment, the current status of the labor market is very healthy.
- » **Inflation remains stubbornly above the Fed's 2% target:** Core PCE, the Fed's preferred inflation measure, was most recently reported at an annualized inflation rate of 2.7%.

It is difficult to assess what the inflationary impact of tariffs will be because businesses accumulated massive inventories to stockpile ahead of tariffs, enabling them to delay the need to pass through price increases to consumers.

Unless there is significant weakening in the employment picture, the markets' consensus expectations are that there will not be any rate cuts until September, and before considering that a given, it is worth noting that the economy's surprising strength over the last couple of years has meant that the economy has consistently needed less fuel than market consensus anticipated.

Fixed Income

Index	Q2 2025	Apr 8– Jun 30	YTD
Bloomberg US Aggregate Bond Index	1.2%	1.5%	4.0%
Bloomberg Global Aggregate Bond Index	1.4%	1.7%	4.3%
Bloomberg Municipal 5-Yr Index	1.3%	2.0%	2.3%

Source: Morningstar

What does this mean for client portfolios?

Despite the complete reversal of market sentiment since last quarter, we still think it is too early to tell what the ultimate impact of a new world trading order will be on economies and markets. In addition, while the focus has been on tariffs and their implications for inflation and interest rates, there have been numerous other sources of potential volatility brewing, including:

...the ultimate question of valuation still hangs over investors' heads as the S&P 500 has returned to historically lofty levels

- » **Geopolitical conflict:** The war in Ukraine continues to drag on with four NATO member countries on Ukraine's border; the geographic scope of conflict in the Middle East is spreading, and even the U.S. has taken a role in attacking Iranian nuclear capabilities.
- » **High technology (A.I.) stock valuations:** While the quarter has seen continued adoption of A.I. technology across industries, and markets are relieved at the stock market recovery, the ultimate question of valuation still hangs over investors' heads as the S&P 500 has returned to historically lofty levels.
- » **Ballooning Federal debt:** As the U.S. auctions record levels of new debt issuance in 2025 at the same time foreign central bank buying is falling, there is the potential for upward pressure on longer-term interest rates as more rate-sensitive, domestic investors will need to digest the supply.

A mixture of potentially high risk and/or high return outcomes affirms our commitment to constructing what we call "durable portfolios" for clients – diversified in a way intended to lessen the impact of market volatility while remaining prepared to generate attractive yet sustainable long-term returns. Allocations to international equities, private markets, and alternatives have been beneficial this year, and we continue to search for opportunities in other asset classes that can offer long-term risk/return improvements to portfolios.



Dennis Follmer
Chief Investment Officer
July 9, 2025

MONTIS COMPANY NEWS

We're pleased to share a new addition to our team and a recent opportunity to support our local community.



WELCOME CHRIS CIRI We're excited to welcome Chris Ciri as our new Manager of Client Services. Chris brings more than 30 years of experience in client service and operational leadership within the financial services industry. He will play an important role in enhancing the client experience and supporting the continued growth of our firm.

GIVING BACK TO THE COMMUNITY Giving back is a meaningful part of who we are at Montis. Last month, we had another opportunity to support our neighbors through

Healthy Waltham's food distribution program. From organizing food donations to distributing them directly to families, our team was proud to lend a hand in making



fresh food more accessible to the Waltham community. We're grateful to Healthy Waltham for the important work they do and look forward to continuing our involvement.

What the “One Big, Beautiful Bill Act” Means for Your Financial Plan

As of July 4, President Trump signed into law what is now known as the “One Big, Beautiful Bill Act,” or OBBBA. Much of the new law made permanent the changes made in the 2017 Tax Cuts and Jobs Act (TCJA), most of which were due to expire at the end of this year. The current income tax rate structure has been made permanent. The removal of uncertainty in the income and estate tax space will make it easier to plot a financial path forward.

But OBBBA made some changes to the law that may affect you. Some go into effect in 2026; others in 2026. Going over all the changes is beyond the scope of this article, but we want to highlight a few of those changes that may affect you:

1) SALT limitation increased

In 2017 the TCJA limited deductibility of state and local taxes (SALT) as an itemized deduction to \$10,000. The new law has increased that limit to \$40,000 for 2025-2029, adjusted 1% annually for inflation. This increase will likely benefit those people in high tax states. Keep in mind that this change is temporary: the limitation will drop back down to \$10,000 beginning in 2030. A phase out of the increase also starts beginning at \$500,000 of AGI and falls to the original \$10,000 limit at \$600,000 of AGI.

2) Gift and Estate tax unified credit increases made permanent

The TCJA effectively doubled the unified credit for individuals for gift and estate tax purposes, and that increase was due to expire. The increase is not subject to a sunset any longer, and in 2026 the law also slightly increases the exemption amount to \$15 million per person. Each year the amount will be adjusted 1% for inflation.

3) “Enhanced” deduction for seniors

Currently, seniors age 65 and older can claim an extra standard deduction of \$2,000 for single filers (or \$1,600

per person if filing jointly, totaling \$3,200). You must use the standard deduction to claim this additional amount. But, beginning this year, seniors age 65 and older will receive an additional \$6,000 deduction per person. Note that unlike current law, this new deduction can be claimed whether you use the standard or itemized deduction. It was intended to offset the taxation of Social Security benefits for seniors. This extra deduction, however, only lasts until 2028, and begins phasing out at \$75,000 for single filers, and \$150,000 for married filing jointly.

4) “Trump” accounts (and more)

Beginning in 2026, a Trump account can be opened for any child under the age of 18. Contributions of up to \$5,000 per year are allowed. There is an option where employers can contribute up to \$2,500 into an account per year and exclude it from income. But there are limitations on how the funds can be invested (low-cost U.S.-based indices only), and with few exceptions there are no distributions until the child turns 18. The earnings would be taxed at the child’s income tax rates, using a pro-rata rule (like non-deductible IRA distributions).

Another change is an increase in the Child Tax Credit, increasing from \$2,000 to \$2,200 for each qualifying Child beginning in 2025.

5) Say goodbye to Clean Energy credits

The 30% federal tax credit given to those people who put into service residential energy efficiency improvements or solar panel systems into use have until the end of 2025 to make that happen. The law eliminates the federal tax credit for these improvements beginning in 2026.

As always, your Montis Advisor will help you navigate through these changes and make sure your financial plan is working toward accomplishing your goals.

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