

# Review & Outlook

SECOND QUARTER 2025



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## Review and Outlook

The second quarter of 2025 was full of uncertainty, particularly surrounding U.S. policy on trade and tariffs, with an additional dose of geopolitical tension surrounding Iran. The first week of April accelerated the downward sliding markets, resulting in a 10% slump as the U.S. announced tariff rates on imports from countries around the world that were far higher than

anticipated. However, since the low on April 8th, the broad market has had a remarkable run, rebounding close to 25% as of June 30th.

During this past quarter, the Trump Administration pushed tariffs to their highest rates since the Great Depression (see chart below). And this is after much of the highest tariff rates were put into a 90-day pause. The speed with which tariffs were enacted, and the lack of clarity on how tariff rates were being calculated, made it much harder for anyone to know how to respond. That uncertainty, including a renewed fear of inflation, caused major stock indexes to fall roughly 20% between late February and early April. Importantly, bond yields also moved up sharply in the first week of April as the market plunged. Usually during a crisis, the market's "flight to safety" reaction is to purchase U.S. Treasuries, leading to lower interest rates, and a strengthening of the U.S. dollar. But not this time. The combination of the stock market falling and the 10-year treasury rate rapidly increasing was deeply troubling

to the markets and the Trump Administration, motivating the 90-day reprieve.

Following the pause, despite several more escalations like the 145% tariff rate imposed on China, the stock market started moving higher. The market took the significant

tariff reversals, or pauses, as evidence that the Trump Administration was willing to adjust policy if it was having a detrimental effect on the markets. We are now very close to the 90-day July 9th deadline given to negotiate tariff rates, country by country, with no clarity how this will play out. At the time of this writing, the

Trump Administration is saying rates will be set country by country at between 10% and 70%.

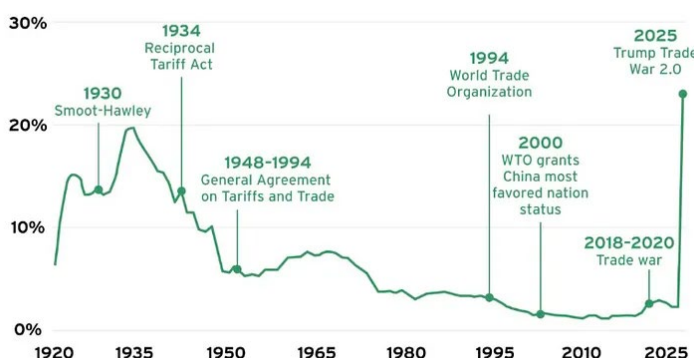
Over the past quarter, we have viewed the stock market rebound with skepticism. The threat of inflation has not gone away, and much of the uncertainty remains. Moreover, stock prices are expensive by historical standards. Forecasts for corporate earnings and interest rates make it difficult to be enthusiastic about current stock price multiples. More specifically, we have remained cautious because stock prices relative to

earnings are in a range only seen during COVID, the Great Recession, and the Dot Com bubble. Simply announcing a pause in tariffs should not send stocks to such frothy levels; the fundamentals just aren't there. The Economist magazine noted on its website on June 25, 2025: "AI

Index Performance Data  
Total Return as of 6/30/2025

Indices <sup>1</sup>	Q2 2025	Trailing 12 Months
CRSP U.S. Total Market Index Total Return	11.00%	15.13%
iShares MSCI ACWI EX-US Total Return	9.90%	14.70%
Bloomberg U.S. Aggregate Bond Index	1.21%	6.08%

## U.S. Effective Tariff Rates



Source: Bloomberg; RSM US LLP

valuations are verging on the unhinged (unless superintelligence is just around the corner)".<sup>2</sup> Noting valuations are high by historical metrics is common in current market commentary. Nevertheless, stock prices have returned to their highs of February.

A resilient stock market is still in tension with a cloudy and uncertain economic forecast going into the second half of the year. Most everyone expects the tariffs will result in higher consumer prices and higher inflation, but it has yet to pick up noticeably. In addition, businesses have put investment and hiring decisions on hold until they have more clarity. Employment numbers still point to an active and relatively healthy job market, but will that continue into the third quarter? Initial and existing unemployment claims are rising, so we think caution is warranted. Recent experience suggests that the lags on inflation showing up in the retail market can be longer than expected as price hikes work through the system.

Economists at the National Association of Business Economists and Vanguard are calling for US GDP to grow by 1.5% to 2% in 2025, with inflation reaching 3%, and unemployment approaching 5%. Those numbers suggest a slower economy than we saw last year, noting that interpreting recent GDP figures requires thinking carefully about imports which lower calculated GDP. The first quarter saw very high imports as people tried to get ahead of anticipated higher tariff rates. For now, most forecasts call for slow growth, where the labor market remains resilient and inflation stays above the target level of 2%, but not so far above as to cause serious problems. There is obviously a lot of tension around that outlook. A recent article published by CNN highlights the lack of inflation in the data, with White House economists claiming victory, and most other economists advising, 'just wait'.<sup>4</sup> Looking back, the tariffs the first Trump Administration imposed on China in 2018 did cause consumer prices to increase. While the most recent tariffs should cause only a one-time bump in inflation, we still expect to see that bump in the coming quarters.

The tariffs and immigration policy have resulted in some additional economic headwinds. A combination of taking offence to the tariff policies and concern about increased and aggressive customs and immigration activities at the

border are discouraging foreign visitors to the U.S. For example, the number of foreigners visiting and shopping in the U.S. is down sharply from last year. According to the World Travel & Tourism Council, the U.S. will likely see a decrease of at least \$12.5 billion in international visitor spending in 2025. This contrasts with every other one of the 184 countries surveyed, which will see an increase in international tourist spending.<sup>4</sup> More broadly, recent data from for April and May are starting to show some weakness. Both the real disposable personal income, and personal expenditure data are appearing to stall. The coming quarter will be important.

Finally, few official or published outlooks mention the upcoming budget bill. Tax cuts and increased government spending could provide a near-term boost to the economy and financial markets, but there will be some risk to higher long-term interest rates and a continued decline in the U.S. dollar if ongoing and increased budget deficits persist, pushing the debt-to-GDP ratio well above 100%.

### In Focus

As we finish this edition of our newsletter, the President will be signing a budget reconciliation bill containing tax and spending targets for the coming years. The Congressional Budget Office predicts the House-passed bill would add \$3 trillion to the U.S. debt over the next ten years.<sup>5</sup> This comes from an estimated \$300 billion to \$600 billion in additional, unfunded, government spending each year.

The annual deficit is the difference between what the government spends in a year and what it brings in from taxation. This piles onto an existing annual budget deficit that is over 6% of Gross Domestic Product (GDP). Running an annual deficit this high outside of some kind of crisis, such as the 2008 Financial Crisis, COVID, or WW II, is unprecedented. It is also unsustainable, as the rising deficit, and overall debt, is financed by borrowing money.

While there is much uncertainty about the exact timelines, at some point lenders to the U.S. government will demand higher interest rates to buy more treasuries, if they are willing to lend at all. There has been much discussion and speculation in the media about this, and how the deficit and debt will affect interest rates.

There is much packed into the phrase “interest rates” and we think it might be useful to focus on this particular detail, and how it relates to the cost of borrowing money for the US government. Everyone has probably heard about the Federal Reserve Bank making a decision to maintain, raise, or lower interest rates. It is important to understand that the interest rate the Fed adjusts is a very short-term rate for loaning funds to major U.S. banks. It sets the price, or cost, of banks accessing more capital. This is a very short term, low risk loan, and the Fed has a great amount of control over setting this interest rate. This rate also tends to be very close to what the market demands in interest for loaning short term funds to the U.S. government.

However, this rate is potentially quite different from what the government needs to pay for longer dated debt, which is subject to a broader market of potential lenders. As such, there is not a single government interest rate, but rather a string of different rates as one lengthens the duration of the loan. Remember that when the U.S. government issues debt, like 20-year Treasury bonds, they are effectively taking out a loan. The current interest rate on a one-month T-Bill is usually different than the interest rate on a 20-year Treasury bond.

From the lenders’ perspective, loaning money for 20 years is far riskier than loaning for a day or two. A lot can happen in 20 years. The borrower may become less able to pay back the funds, increasing risk of repayment when the bond matures. Or, in the case of high inflation or a weakening currency, the value of the dollars you are paid back with are diminished, perhaps not even making up for the interest you have been paid over the years.

If people and institutional investors start worrying more about the magnitude of U.S. borrowing, including whether the U.S. might have trouble repaying some of its debt, they could demand higher yields to offset the higher perceived risk. Similarly, if people and institutional investors choose other options and buy fewer U.S. bonds because they are worried about the U.S. debt, interest rates rise. Importantly, many key lending rates, like mortgage rates, are set around longer-term interest rates, not the short-term Fed rate. So, if concerns about the magnitude of U.S. debt is starting to push up longer dated rates, this can push mortgage rates up, even if the short-term rate remains relatively low. While the Fed can control short-term rates, it is possible it could lose some control of the longer dated rates.

For now, the U.S. dollar remains the most desired currency in the world, dominating the settlement of global exchange. And when governments, companies, and people from around the world end up with dollars, perhaps from exports they sent to the U.S., they often become lenders to the U.S. government, buying U.S. bonds. However, this global hegemonic position with respect to currency is not set in stone. We don’t know when the ever-increasing debt will cause problems for our financial markets. The fear is that it may come about as one of Hemingway’s characters responded to being asked how he went bankrupt, “Two ways. Gradually, then suddenly.”

While we think we are still well within the “gradually” phase of things, we remain defensive in our clients’ bond portfolios. We are continuing to favor short-term, high-quality debt. Money market funds continue to perform well, especially as the Fed continues to delay lowering rates in the face of uncertainty around tariff-induced inflation.

1. Index performance data provided by ICE Data Services, and calculated by Black Diamond, an SS&C Advent company.
2. The Economist Newspaper. (2025, June 25). Ai valuations are verging on the unhinged. The Economist. <https://www.economist.com/business/2025/06/25/ai-valuations-are-verging-on-the-unhinged>
3. Goldman, D. (2025, June 20). So, has anything actually gotten more expensive because of Trump’s tariffs? | CNN business. CNN. <https://amp.cnn.com/cnn/2025/06/20/business/tariff-price-increases-inflation-explained>
4. World Travel & Tourism Council. (2025, May 14). U.S economy set to lose \$12.5bn in International Traveler spend this year. World Travel & Tourism Council (WTTC). <https://wttc.org/news/us-economy-set-to-lose-12-5bn-in-international-traveler-spend-this-year>
5. CBO estimates \$3 trillion of debt from house-passed obbba. Committee for a Responsible Federal Budget. (2025, June 4). <https://www.crfb.org/blogs/cbo-estimates-3-trillion-debt-house-passed-obbba>

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