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MARKET SIGHT LINES





Navigating Crosswinds: The Struggle Between Risk and Resilience

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Some investors and other market watchers are laser-focused, watching for signs of trouble – the headwinds – that can weaken the economy and drive markets lower. Others are focused on the positives – the tailwinds – like the stimulative potential of the most recent spending bill and the resilience of corporate profits and company earnings. We've shared our modestly positive view of the second half of 2025. In this Sight|Lines, we share updates on key headwinds and tailwinds and explore how these forces create crosswinds that may shape the path forward.

THE TAKEAWAY: WE SEE RESILIENCE DESPITE A FOCUS ON THE HEADWINDS

Headwinds and tailwinds in the current environment are opposing forces that can create crosswinds that can affect the environment going forward. In summary:

- New tariff threats, and the related uncertainty, may be cooling *Animal Spirits* – the emotions and instincts that drive economic growth and market behavior.
- The Federal Reserve (Fed) has been cautious about rate cuts given tariff uncertainty and any related inflation.
- At the same time, the very solid labor market is showing some cracks, which is in focus at the Fed… and may lead to rate cuts later this year.
- Mixed second quarter GDP results may be signaling a slowdown.
- These concerns for a slowdown are being amplified by negative consumer confidence and some evidence of the potential for slowing business services.
- But other business services gauges are signaling continued growth.
- Some are optimistic about the stimulative effect of the recently passed spending bill.
- Many companies are also optimistic about artificial intelligence (AI), both the investment opportunities and the use of AI to improve business operations.
- When it comes to company results, the tailwinds appear to be dominating the headwinds, as profit and earnings forecasts for 2025 remain quite positive.

IN-DEPTH: CORPORATE PROFITS AND COMPANY EARNINGS REMAIN RESILIENT, DESPITE SO MUCH FOCUS ON HEADWINDS LIKE INFLATION AND A SOFTENING JOB MARKET

The various headwinds and tailwinds we see in the current environment are opposing forces, which can create tensions and crosswinds that may affect the environment meaningfully going forward. Going deeper:

- New tariff threats, like 100% on semiconductors and 200% on pharmaceuticals, are adding to uncertainty and may be cooling *Animal Spirits*.
- Since November's election there have been seven Fed meetings:
    - In the official minutes of those meetings, the word "tariff" was mentioned 82 times.
    - In the post-meeting press conferences, the word was mentioned 158 times.
    - The Fed has been slow to cut rates given tariff uncertainty and related inflation worries.
- The very solid labor market is showing some cracks, which may lead to a Fed rate cut:
    - Nonfarm payrolls rose to only 73,000 in July, with the prior two months revised lower.
    - The unemployment rate rose from 4.1% to 4.2%.
- After removing components affected by tariff worries (imports and inventories), the advanced estimate of second quarter GDP shows annualized growth of 1.1%, signaling a slowdown.
- Slowdown worries are being amplified by negative data about the consumer and business services:
    - The Conference Board Expectations Index, a consumer confidence reading, rose to 74.4 in July, still below 80, a threshold historically associated with a recession.
    - The ISM Services PMI unexpectedly fell to 50.1 in July; a level associated with almost no growth.
- Despite these headwinds, many tailwinds are present:
    - In contrast to the ISM Services readings, the July S&P Global U.S. Services PMI rose to 55.7, signaling continued growth.
    - The recently passed spending bill is estimated to add 0.3%-0.5% in GDP growth this year and next.
    - Companies are also optimistic about AI, with big tech firms expected to invest about $350 billion in 2025 in related infrastructure to meet surging AI demand.
- When it comes to company results, the tailwinds appear to be dominating the headwinds:
    - The combined profit margin for the S&P 500 companies in 2025 is estimated at 13%, a very positive number.
    - In turn, S&P 500 earnings are expected to grow about 10% in 2025.

CONCLUSION

We recently shared our modestly positive view of the second half of 2025. In the current environment, there are tensions between headwinds, like tariff uncertainty, inflation risk, and some labor market cooling, and tailwinds, like a still-active consumer, AI optimism, strong company profits, and improving earnings forecasts. Together, these opposing forces create a kind of crosswind, making the path forward more challenging as we navigate the rest of the year and consider the implications for the economy and markets into 2026.

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