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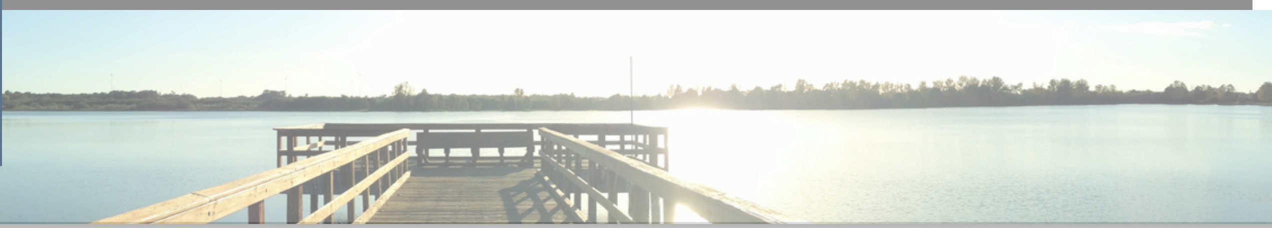

Investment Commentary - Q2 2025

T. Joseph Barger, CRPC®

As we enter the second half of 2025, we wanted to reflect on the first half of the year and compile our thoughts going forward. When we collectively sat down to write this note, we marveled at what a wild ride 2025 has been. A year that began with markets largely ignoring the threat of new tariffs and the potential impact on the global economy made way to steep market declines as investors finally began to digest potential ramifications. Fortunately, the decline was relatively short lived and despite increased geopolitical unrest, the second quarter of 2025 saw markets not only recover but hit new highs. To that end, long-term financial discipline and planning has, and will, prevail.

Here is a state of the markets [1] as the quarter came to a close:

Index	Return
S&P 500 (US Large Stocks)	6.20%
Russell 2000 (US Small Stocks)	-1.79%
MSCI EAFE (Foreign Stocks)	19.45%
MSCI EM (Emerging Markets)	15.27%
Bloomberg US Aggregate (US Bonds)	4.02%

Diversification has been a worthwhile strategy in this volatile market.

Financial markets are not a casino meant for gambling, but can be viewed as potentially a future growth discounting mechanism[2]. Injecting uncertainty can have incredible near-term effects. This is what we saw in back in March and April, when the news of major reciprocal tariffs shook investors, leading the S&P 500 down 19% from its peak.

We know that markets hate surprise and uncertainty, and both were received in megadoses earlier this year. Now, as the market seeks clarity, investors must weigh the impact of pro-market, pro-economic growth policies with tough-talking trade policies.
With the 2 quarter in the rearview, a flurry of consequential changes remains ahead. None more consequential than the newly signed One Big Beautiful Bill Act. We are not here to discuss politics.

Rather, it is our job to cut through the noise and decipher the investment implications of policy. In this case, there is a lot of positive for the near-term as it relates to markets. Lower taxes and other broad stimulus could help lead to higher growth.

At the same time, the dollar has seen declines, making exports less expensive and translating foreign earnings into more dollars (good for reported corporate profits). We believe we could see the start of that benefit when companies begin reporting second quarter earnings in the next several weeks.

Fundamentally, a major risk to equities appears to be interest rates. Should longer term rates break out to the upside (remember that the Fed controls short-term rates, not long term), this could be a headwind to stocks. Otherwise, strong earnings may continue to provide buoyancy to the stock market.

The potential fly in the ointment remains tariff policy. The 90-day reprieve from President Trump's "Liberation Day" reciprocal tariff announcement saw a major stock market recovery. Fundamental conditions remain positive, but any saber-rattling as the August 1 deadline approaches has the potential to cause near-term market volatility.

It is our belief that tariffs in and of themselves are not inflationary (in the same manner that taxes are not inflationary), that inflation is a monetary policy, and structural economic issue. Therefore, we do not expect this to lead to significant spikes in inflation, and thus increasing interest rates. In fact, inflation remains in normal range, on the back of declining energy prices[3]. However, there is still potential economic impact.

If the goal of tariffs is reshoring, the starting point should be to focus on what can be reshored and what is in our nation's best interest. Attempting to get more critical high-tech components made here makes logical sense, and appears to be the end goal of much of the large-scale tariff operation. We believe, as negotiations continue, the shock of blanket reciprocal tariffs becomes overblown in hindsight, and the end-goal becomes more apparent. Clarity gained in this regard should be a positive for financial markets.

Fiscal policy and deficit spending also remain on our radar. In fiscal year 2023 and 2024, the federal deficit was over 6% of GDP[4]. The Big Beautiful Bill is not likely to decrease deficit spending much in the near term, with a slight 2026 decline expected. However, there is an argument to be made that increased economic growth decreases the deficit over time, as some spending cuts are also enacted. Treasury Secretary Scott Bessent talks of his goal for 3% GDP Growth, 3% Inflation and 3% Deficits to GDP over time. Should this bill, and AI innovation help lead to enhanced productivity, this is a realistic possibility.

(continued on page 2)

[1] Source: Morningstar, data as of 6.30.25
[2] https://www.investopedia.com/terms/d/discounting-mechanism.asp#:~:text=The%20discounting%20mechanism%20principle%20is,their%20fair%20value%20on%20exchanges.

Investment Commentary (cont'd)

Beyond policy, we are witnessing a shift in the broad macro environment. The post tech-bubble investing world has seen consistent long-term macro-level pillars. These have been reliable guideposts through bull and bear stretches, structuring financial markets. Muted inflation, low long-term borrowing rates, confidence in major financial institutions, and global trade network efficiency have all underpinned long-term asset allocation seeking to provide a roadmap to investing success.

But the past several years has seen major transformational change. Geopolitical fragmentation, AI and other forces are reshaping the global economy, and these trends can lead to a myriad of outcomes. Given the array of potential outcomes over the next several months, investors should prepare for continued uncertainty and volatility.

We believe now, more than any time in the recent past, is the time for disciplined and consistent active portfolio management. We cannot simply rest on what worked in the past, but must look forward for opportunities.

Productivity gains from fiscal policy and innovation can help support economic growth and thus higher multiples in the stock market. The labor market is healthy, albeit restrictive monetary policy is beginning to slow things here. Household balance sheets are strong, with the lowest level of household leverage since the 1970s, according to JPMorgan and the BEA[5]. There is definitive reason for fundamental optimism.

Broad stock market valuations are stretched, but earnings expectations continue to increase, potentially justifying multiples[6]. Opportunities continue to present themselves outside of the big-name themes we've seen over the past several years.

Low relative valuations in small and mid-cap stocks appears to be a long-term opportunity. Healthy credit markets are supportive, and any future declines in yields (rate cuts) could help catalyze an asset class that has had its worst performance relative to large-caps since the tech-bubble.

International equities remain attractively valued relative to the US as well. While they have outperformed year-to-date, there may still be room for multiples to expand. Fundamentally, we believe the US has superior growth-drivers, but these assets remain compelling; especially as Europe's disinflationary trend exceeds the US, leaving room for further European Central Bank policy action.

Additionally, enduring themes like AI, data-transmission & storage and energy production become important long-term opportunities. The US, and the world, needs more electrical capacity[7]. We have to modernize and continue to build more generation. These are themes that are being captured within our equity investment strategies.

As we write this, the 10 Year Treasury yield sits at 4.37%[8]. We anticipate yields volatile, rising up and down in a range-bound fashion until Fed policy gives an remaining opportunity for the bond market to front-run. But bonds are paying investors to wait, with yields in excess of inflation. Spreads are fairly tight, but credit markets are healthy and default rates remain low[9].

All in, there is reason for cautious optimism. We fully expect plenty of bumps in the road, and pockets of fear and anxiety. Yet a resilient US economy, strong corporate earnings, wide margins, supportive fiscal policy and a still-healthy consumer all underpin this optimism.

As always, we thank you for your continued trust and confidence in us as stewards of your hard-earned assets.

We are always available if you have any questions, concerns or comments, and will continue to be in touch as major events shift the landscape in which we operate.

[3] https://www.bls.gov/cpi/
[4] https://www.crfb.org/blogs/fy-2024-ends-18-trillion-deficit
[5] https://www.dailychartbook.com/
[6] https://resources.carsongroup.com/hubfs/Midyear-Market-Outlook-Carson-Group-2025.pdf
[7] https://www.iea.org/news/growth-in-global-electricity-demand-is-set-to-accelerate-in-the-coming-years-as-power-hungry-sectors-expand
[8] https://finance.yahoo.com/
[9] https://professionals.eatonvance.com/media/public/5265.pdf?PDM

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

All investing involves risk including loss of principal. No strategy assures success or protects against loss.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Stock investing includes risks, including fluctuating prices and loss of principal.

The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

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410-824-0781

Home Office:
1447 York Road
Suite 801
Lutherville, MD 21093