

BULL & BEAR *Bulletin*

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400 East Water Street
Elmira, NY 14901
607-734-2665

447 East Water Street
Elmira, NY 14901
607-733-9022

www.valicenti.com

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Intermission for the Markets - 2025

Year-to-date stock and bond market returns through July have been very constructive. With five months remaining in the year, the S&P 500 Index was up 8.6% on a total return basis, while the Bloomberg Barclays Aggregate Investment Grade Bond Index was up 3.8%. Moderating views on the business cycle, greater tax policy certainty, contained geopolitical tensions, a modest disinflation trend, increasingly dovish rate expectations, and a well-received Q2 earnings season have all likely contributed to these results so far in 2025.

It is dubious to assume we can always anticipate what lies ahead. We know that the past is not necessarily a predictor of future outcomes. However, we can assess what may be the focus for investors throughout the remainder of the year. With the S&P 500 Index trading above 6,400 in mid-August, it is priced at over 22 times the forward aggregate earnings expectation. This level may be viewed as elevated, given that the average forward multiple over the past 25 years has been closer to 17. As such, valuation through a fundamental lens, may be one factor market participants consider.

Furthermore, the price level for goods and services in the real economy, after an inflation surge in 2021 and into 2022, has since experienced disinflation. While prices have not declined, the rate of price increases has indeed slowed. It is important to note that this figure is historical—it reflects what inflation was over the previous 12 months and does not indicate what it will be 12 months from now. Whether inflation remains at a manageable level is another key issue the market will likely seek to understand.

Rates lower, regulatory relief, tax certainty, broader risk on sentiment

Bulls are likely to argue, at this moment in time, that the environment is changing and simultaneously becoming more certain with regard to tax policy, regulatory relief, and expected future monetary policy. If business conditions persist in some areas of the economy and improve in others, then real economic growth could help justify a scenario in which the S&P 500 appears ahead of itself. In such an environment of stronger growth, the market may be able to grow into its valuation more easily.

Coinciding with this argument is the possibility that the disinflation trend persists and interest rates normalize slightly lower across the curve relative to current levels. In this scenario, it is likely that small and mid-sized firms (i.e. those more sensitive to interest rates) could begin to perform better. Caution may still be warranted, however, as earnings expectations for these firms were noticeably reduced following the most recent quarter. In contrast, the outlook for S&P 500 earnings, which is more representative of larger, well-capitalized firms, was only slightly lowered.

Tariff headwinds, mild inflation impulse, sluggish parts to consumer and business space, more narrow risk sentiment

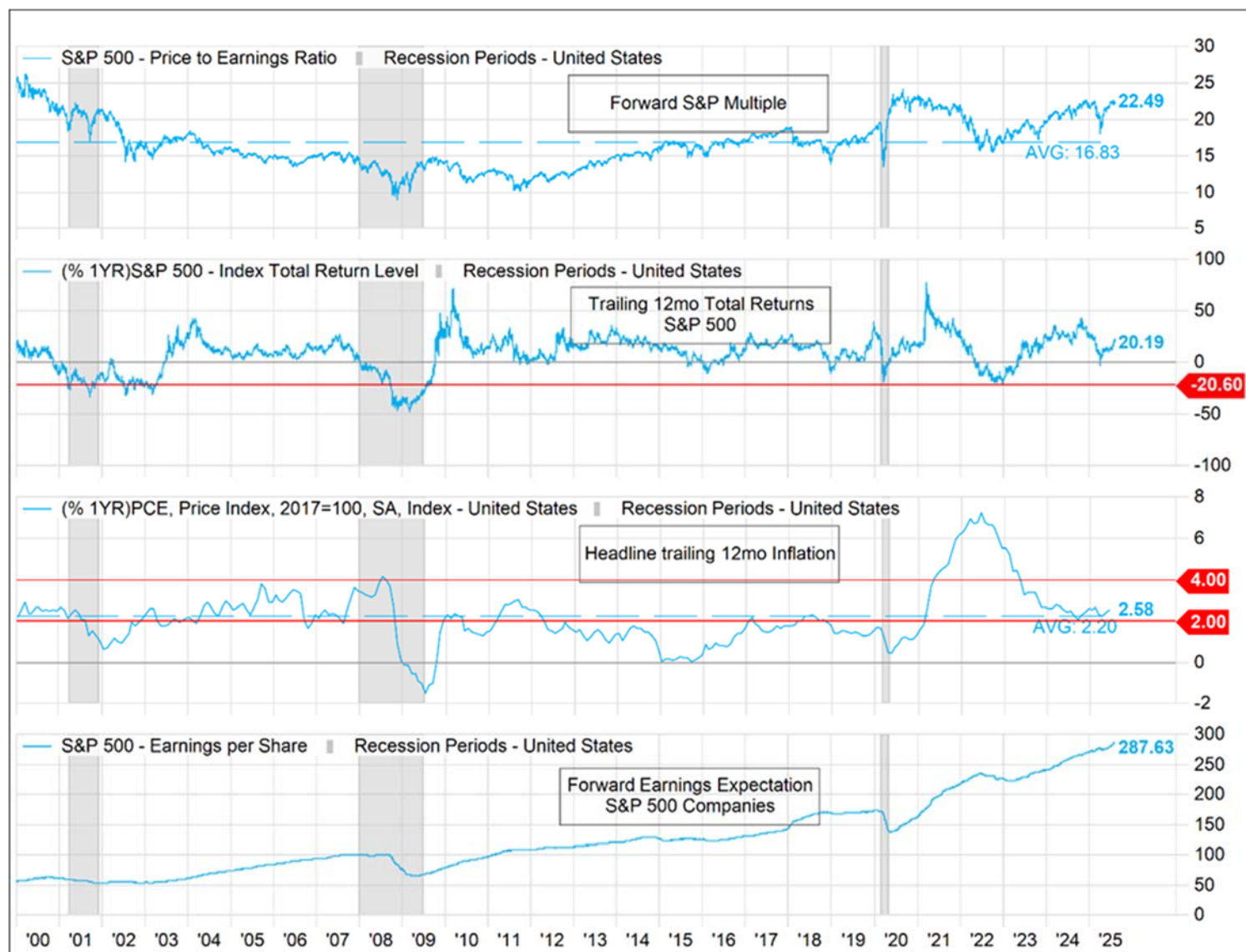
Bears are likely to advocate for a more cautious approach to the market as we move through this period, because while the environment is indeed changing, the takeaways may be different. For example, the global trading landscape may be shifting, and with that could come one-off price adjustments in certain parts of the economy. In other words, what comes next is likely to be an adjustment to new realities and incentives.

This environment, therefore, may not serve as an immediate tailwind for equity and bond markets, but rather a necessary digestion period in response to these significant changes. Alongside this argument may be the persistence of higher and stickier interest rates, particularly at the long end, and driven by a mild inflationary impulse rather than a disinflationary one. Interest rate-sensitive sectors of the economy may remain under pressure and may need to adjust through slower hiring or reduced headcount.

The monetary policy that will shape the next six months is already in place, and rate cuts take time to filter through the broader economy. Recognizing and acknowledging these types of outcomes could lend credibility to concerns around market valuations, and earnings may be downgraded from current expectations as both consumers and businesses adjust to these new conditions.

Conclusion

One thing that both bulls and bears may agree on regarding their respective views for the next several quarters is that the risk of a hard downturn may be lower than previously thought. This outlook is supported by the absence of a major inflationary threat, a continued-yet repurposed fiscal impulse, strength from an ongoing technology investment cycle, and resilient, if not thriving, consumption patterns. As always, we will continue to monitor the environment to better understand the backdrop for asset prices.



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