

## Q2 2025: Fireworks - Tariffs, Congress, Markets

*By Peak Trust Company's Chief Investment Officer, Lisa Russell, CFA.*

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### HIGHLIGHTS

- U.S. large-cap stocks ended the second quarter up 10.9%, marking a new record high. U.S. small-cap stocks gained 8.5%, and U.S. intermediate-term bonds ended the quarter up 1.2%.
- The One Big Beautiful Bill includes permanent extensions to the Tax Cuts and Jobs Act, tax relief for middle-income earners, and a new tax cut on tipped income and overtime.
- As the bill moved through Congress, the all-important Treasury market remained calm and credit spreads held steady, as markets signaled their comfort with the ramifications.
- Should yields rise, we would look to credit spreads for that market's view on whether the increase in interest rates ends the economic and fiscal fireworks.

### Overview

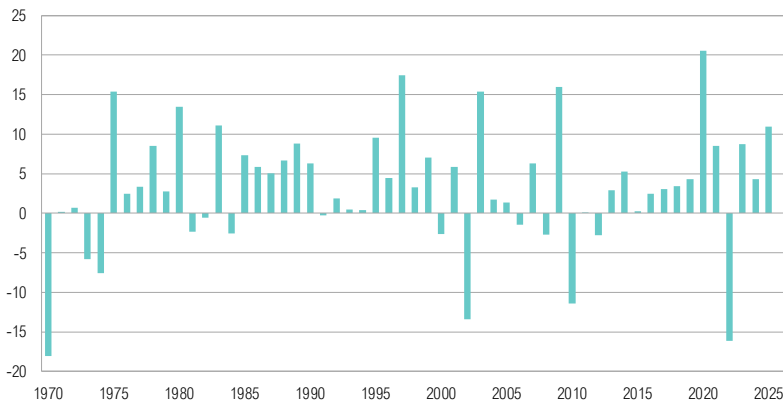
The quarter began not with a fizzle, but with a bang. On April 2, the U.S. government announced sweeping tariffs: a baseline 10% on nearly all imports and higher rates targeting specific countries. This brought the average U.S. tariff rate to 22.5% (from an average of around 2.4%)—the highest level in over a century. On April 9, a 90-day pause on the tariffs was announced. The pause was driven by volatility in Treasury markets: the 10-year Treasury yield saw its largest weekly increase since 2001, rising from 4.0% to 4.5% while the longer-term 30-year yield jumped from 4.4% to 4.9%, its largest five-day increase since April 1987.

Over the quarter, several trade deals were struck between the U.S. and major trading partners. On June 26, an agreement with China focused on the shipment of rare earth minerals to the U.S. as part of a broader effort to resolve ongoing trade tensions. The European Union continues to push for a universal 10% tariff (which has since been set at 15%) on exports to the U.S. while seeking exemptions for pharmaceuticals, semiconductors, and aircraft, among others. In early July, the U.S. announced a trade deal with Vietnam. Under the agreement, the U.S. will place a 20% duty on Vietnamese imports, whereas U.S. exports to Vietnam will not be subject to any tariffs. Vietnam has also agreed to a 40% duty on goods originating in other countries but routed through Vietnam for final shipment to the U.S.—a tactic reportedly used by China.

Despite a 20% drawdown to start the quarter, U.S. large-cap stocks, as measured by the S&P 500 Index, ended June up 10.9%, and closed the quarter at a new record high, marking the best second-quarter return for the index since 2009, aside from 2020. U.S. small-cap stocks gained 8.5% over the quarter. U.S. intermediate-term bonds, as proxied by the Bloomberg U.S. Aggregate Bond Index, ended the quarter up 1.2%.

June marked three years since year-over-year headline inflation reached a four-decade high of 9.1%. Since then, inflation has gradually trended toward the Federal Reserve's official 2% target. In May, headline inflation eased to 2.4% year-over-year, while core inflation held steady at 2.8%. Shelter costs remain the largest contributor to elevated prices. At its June Fed-

**COVID Aside, This Was the Best Q2 for U.S. Large Cap Stocks Since 2009**  
U.S. Large Cap Stocks Q2 Returns (1970 – 2025), %



Source: Bloomberg. U.S. large cap stocks as proxied by the S&P 500 Index (Total Return).

eral Open Market Committee (FOMC) meeting, the Fed reiterated its preference to keep interest rates on hold for now while maintaining expectations of two rate cuts before year end. Markets are currently pricing in the equivalent of two cuts by December 2025.

The labor market remains resilient, supporting the Fed's preference to hold off on rate cuts. Over the past three months, the U.S. economy added 449,000 new jobs, and the unemployment rate remains near historic lows at 4.1%. Wage growth remains above pre-pandemic levels, increasing by 3.7% year-over-year in June. The most recent JOLTS (Job Openings and Labor Turnover Survey) showed that vacancies in May rose to the highest level since November 2024 and well above pre-pandemic levels.

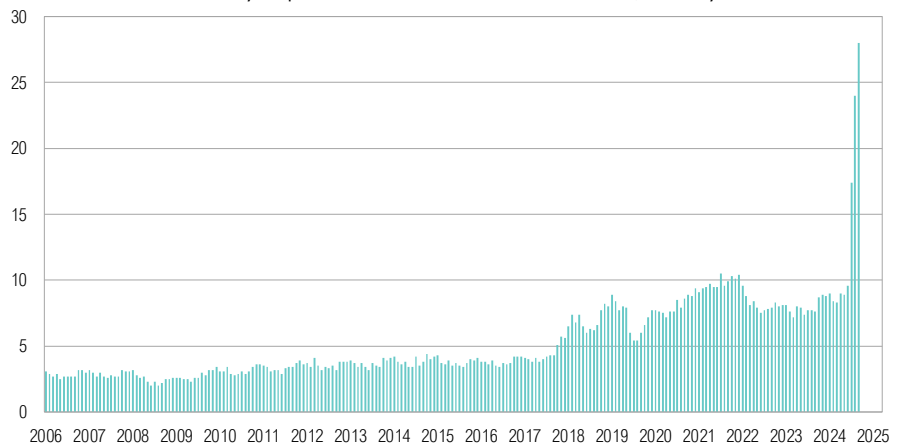
## Fireworks

One of the key motivations of the tariff hikes was to boost government revenue. June saw a record \$28 billion collected in customs and excise taxes. In the first half of 2025, the U.S. has collected \$97 billion in tariff revenue, already matching the total annual revenue from tariffs in 2024. The cost of extending the Tax Cuts and Jobs Act (TCJA) provisions, which are set to expire at the end of the year, could increase the fiscal deficit by between \$4 and \$4.6 trillion over the next decade. Tariff revenue, which the Penn-Wharton budget model estimates could exceed \$200 billion annually, might offset nearly half the estimated cost of extending the TCJA, which has been a key priority for the government. Failing to extend the TCJA would result in higher taxes and leave households with less disposable income.

The TCJA forms a central part of the One Big Beautiful Bill, a budget reconciliation package that permanently extends nearly all major provisions of the TCJA, while also cutting taxes on tips and Social Security payments and cuts to Medicaid. The One Big Beautiful Bill (OB BB) was passed in Congress on Thursday, July 3, and signed into law on Friday, July 4. The Congressional Budget Office (CBO) estimates that the bill would add \$3.3 trillion to the federal deficit over the next decade. Lawmakers from both political parties have pushed back on the CBO's estimates: Republicans argue that it understates growth (the CBO estimates 1.8% year-over-year GDP growth) and overstates the deficit impact, whereas Democrats insist the methodology is too generous toward temporary provisions and doesn't fully reflect long-term fiscal risks.

**Tariff Revenues Surged Over the Past Three Months**

U.S. Treasury Deposits: Customs & Certain Excise Taxes, Monthly \$Bn



Source: Bloomberg. As of 6/30/2025.

Medicaid cuts are one of the largest offsets in the spending bill. Estimates project that it could reduce the cost of extending the TCJA by nearly \$1 trillion. Between 2020 and 2023, Medicaid spending surged by 42%. Experts caution that the most significant impacts could emerge around 2028. Other offsets to the spending bill are changes to student loan repayment rules and the phase-out of Inflation Reduction Act tax credits (which are expected to reduce the cost of the OBBB by over \$500 billion over the next decade).

One unique feature of the OBBB is its elimination of federal taxes on tipped income and overtime pay. It is estimated that between 2.5 and 5.2 million tipped workers stand to benefit, potentially boosting their collective income by \$39 billion over the next decade. The benefits are currently set to expire in 2028. They do not apply to individuals earning more than \$150,000 per year and are capped at \$25,000 in total deductions. The OBBB also allows certain workers to claim a tax deduction for qualified overtime pay, subject to limits similar to those applied to tipped income. According to the Social Security Administration, the OBBB “ensures that nearly 90% of Social Security beneficiaries will no longer pay federal income taxes on their benefits.”

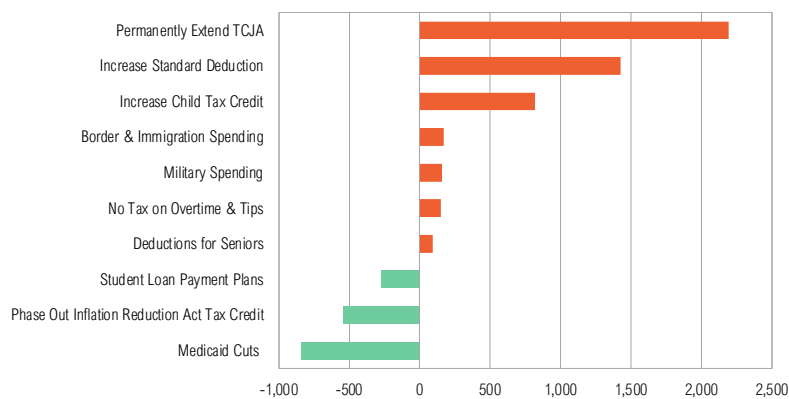
The OBBB also includes broader tax relief. Individuals earning between \$30,000 and \$80,000 per year are likely to see tax bills reduced by nearly 15%, and the child tax credit is set to be permanently increased to \$2,200. The OBBB will also make the small-business tax deduction permanent, and provisions such as immediate expensing for new domestic factories and

support for manufacturing are aimed at boosting domestic investment and job creation. Companies will benefit from expanded provisions around itemization and expenses, including a return of 100% bonus depreciation, allowing businesses to deduct the full cost of investments upfront, rather than spreading it out over three years.

Bond markets have largely taken the progression of the bill in their stride. Treasury yields remained relatively contained throughout June as the bill moved through the House and Senate, potentially suggesting less concern with the bill’s fiscal impact. Credit markets responded similarly, with credit spreads remaining stable, ending the quarter at 2.9% (after spiking to 4.5% on April 8).

#### Certain OBBB Components May Offset Some of the Increased Spending

Estimated Impact on the Deficit Over the Next 10 Years (2025 – 2035), \$Bn



Source: Congressional Budget Office, Washington Post, New York Times, Joint Committee on Taxation. Estimates based on the Senate version of the bill passed on 7/1/2025 and are subject to differ from the bill signed on 7/4/2025.

## Markets

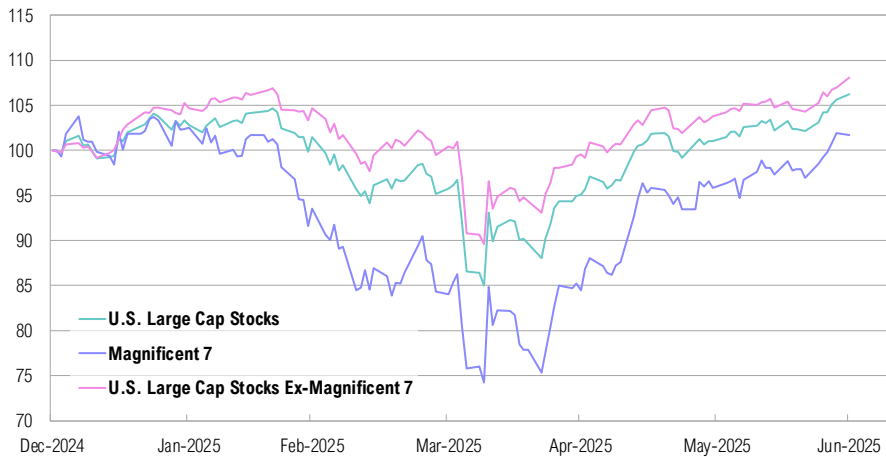
International equity markets outperformed their U.S. counterparts in the second quarter, resuming the trend we saw in the first quarter. International developed market large-cap stocks ended the quarter up 12.1%, while U.S. large-cap stocks gained an impressive 10.9%, which is notable considering the S&P 500 experienced a 20% drawdown in the opening days of the quarter. U.S. small-cap stocks ended June up 8.5% and remain in the red year-to-date (down 1.8%).

The rally in U.S. equities no longer appears to be driven solely by the Magnificent Seven, as gains among U.S. large-cap stocks have broadened, pushing the market to new highs. Year-to-date, the S&P 500 has outperformed the Bloomberg Magnificent 7 Index (Apple, Alphabet, Amazon, Microsoft, Meta, Nvidia, and Tesla) by 5%, with the former gaining 6% year-to-date and the latter ending the first six months of 2025 up 2%.

Full-year S&P 500 earnings growth estimates declined over the quarter, falling from 11% to 9%. The technology (+18%) and communication services sectors (+15%) are expected to lead earnings growth in 2025. The consumer staples sector is experiencing an interesting confluence of growth expectations and valuation metrics. Growth expectations remain modest:

### U.S. Large Cap Stocks Have Fared Well With or Without Mega Cap Tech

Growth of 100 (12/31/2024 – 6/30/2025)



Source: Bloomberg. U.S. large cap stocks as proxied by the S&P 500, the Magnificent 7 as proxied by the Bloomberg Magnificent 7 Index and U.S. large cap stocks ex-Mag 7 as proxied by the BITA U.S. 500 ex Magnificent 7 Index.

revenue in the sector is projected to increase by a total of 8.2%, and earnings per share by 10.6% over the next two years. This puts forward-looking valuations in the sector close to the highest levels seen in at least a decade. In contrast, the technology sector is expected to post significantly better results, with revenue projected to rise by 24.6% and earnings by 37.1% over the next two years. This divergence is perhaps best illustrated with an example: Nvidia, with a forward price-to-earnings (P/E) ratio of 32x, is cheaper than Walmart, which is currently trading at a forward P/E of 36x

U.S. intermediate-term bonds gained 1.2% in the quarter. After rising to 4.6% in mid-May (following Moody's U.S.

credit downgrade), the 10-year U.S. Treasury yield ended June at 4.2%. The spread between the 10-year and 2-year Treasury yields remained positive throughout the quarter, ending June at 0.5%.

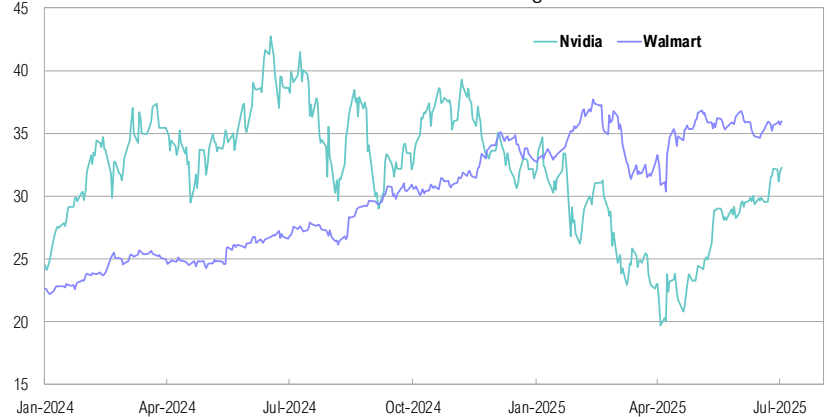
The second quarter was affected by more than one geopolitical conflict. Trade wars aside, conflict in the Middle East escalated in June after Israel launched an attack on Iran's nuclear program. The conflict raised geopolitical risk in the region, which is home to key oil producers and a critical part of the global energy supply. Oil prices jumped 8% on June 13, reaching \$74 per barrel. On June 24, after nearly two weeks of fighting, a ceasefire between Israel and Iran was brokered by the U.S. after Washington bombed Iranian nuclear sites and subsequently applied diplomatic pressure to de-escalate the conflict.

Global capital markets reacted mutedly to the conflict, suggesting it was considered more as an isolated affair and short-term energy price shock rather than a broader systemic risk to global economic growth. West Texas Intermediate (WTI) crude oil prices ended the quarter back at \$65 per barrel. The lack of response from U.S. markets also highlighted the U.S.'s advantage as a net exporter of energy, exporting more energy than it imports overall. (It does still import crude oil and remains connected to global energy markets.)

Gold, which ended the quarter up 5%, reached a record high of \$3,448 on June 16, following the Israel-Iran conflict, reaffirming its safe-haven status. Despite conflict in the Middle East, WTI crude oil prices declined by 9% over the quarter, dropping from \$71.5 to \$65.1 per barrel by the end of June.

### Nvidia is Cheaper than Walmart

12-Month Forward Price-to-Earnings Ratio



Source: Bloomberg

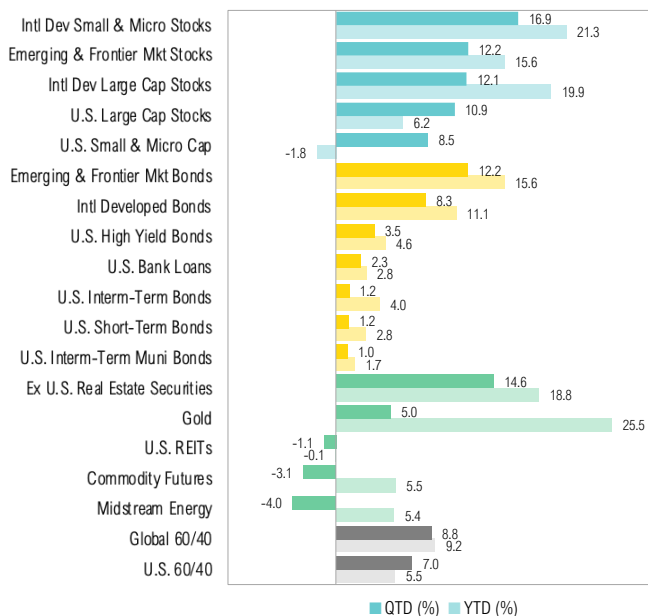
## Looking Forward

The quarter sure gave us a ton of volatility, with U.S. large-cap stocks entering the quarter with a 20% draw-down and many preparing for an impending bear market. However, just as fast as these equities went down, they snapped right back up and then reached all-time highs, demonstrating the dangers of market timing. With all this excitement, a U.S. 60% equities/40% fixed income still only ended up the quarter up 5.5%. This shows why diversification, such as adding international equities and Gold to portfolios, can really make a difference in smoothing out returns.

We've often pointed to fixed income and credit markets as the best lens for interpreting today's unusual policy mix. That mix is increasingly defined by near-record fiscal deficits, which have helped support growth and boost risky assets. Our view has been that as long as bond yields remain contained, this backdrop can persist.

It is possible that bond yields could rise somewhat without significantly impairing the economy. Should Treasury yields rise, we would look to credit spreads for that market's view on whether the rise in interest rates ends the fiscal and economic fireworks.

Q2 2025 Key Market Total Returns



Source: Bloomberg

## About Lisa

Lisa Russell started with Peak Trust Company in 2003 and currently serves as Chief Investment Officer. Lisa brings over 25 years of investment experience to the Peak team. She specializes in designing unique investment programs for high-net-worth clients and trust accounts. She is highly attuned to the tax consequences of investment actions.

Lisa holds a Master of Business Administration in Finance from Emory University and a Bachelor of Science in Business Administration from the University of Southern California. Lisa holds the designation of Chartered Financial Analyst (CFA), and is a member of the CFA Institute and the CFA Society of Seattle.



**LISA RUSSELL, CFA**  
Chief Investment Officer

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