



“Reflexive Buying” Market Commentary – July 2025

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. decreased at an annual rate of 0.5% in the first quarter of 2025. This is less than the advance estimate of -0.3% and the second estimate of -0.2%. Q1 was skewed by abnormal economic activity in anticipation of tariffs, so it will take a couple more quarters for the noise to settle down. On June 18, the Federal Reserve updated its economic projections that were last released in March. It now sees GDP growth of 1.4% in 2025, 1.6% in 2026, 1.8% in 2027, and 1.8% in the “longer run” (beyond 2027). It projects inflation to be 3.0% in 2025, 2.4% in 2026, 2.1% in 2027 and 2.0% in the longer run (Consumer Price Index was only 2.4% in May). As for unemployment, the Fed expects 4.5% in 2025, 4.5% in 2026, 4.4% in 2027, and 4.2% in the longer run (it ranged from 4.0% to 4.2% between June 2024 and May 2025). Economists warn of economic doom due to President Trump’s use of tariffs to negotiate more favorable trade practices, but so far such doom has not materialized.

On June 18, the Federal Open Market Committee (FOMC) maintained its target range for the federal funds rate at 4.25% to 4.5%. The Fed itself projects two 0.25% cuts to the federal funds rate in 2025 and a total of five to six 0.25% cuts for this cycle. Fed funds futures project a total of five 0.25% rate cuts, with the first happening by October 2025 and the fifth by September 2026. The market expects the Fed to cut rates at a faster pace than the FOMC is currently telegraphing. Meanwhile, the Fed’s balance sheet had \$6.662 trillion in assets on June 25, down only \$11 billion from May 28 (much less than the Fed’s monthly reduction target of \$40 billion). The next FOMC decision on monetary policy is scheduled for July 30.

At Banyan Asset Management, our fundamental models rely heavily on a discount rate to discount future cash flows to present value in order to calculate the fair value of a stock. We utilize the Capital Asset Pricing Model for the discount rate: risk-free rate + (beta * equity risk premium). For the risk-free rate, we use the 10-year U.S. Treasury note, which we assume today is 4.5%. We calculate the equity risk premium to be 7.11%. This means that a stock with a beta of 1.0 will have a discount rate of 11.61%. We allow the discount rate to fluctuate between 8.0% and 12.0% for betas different than 1.0. Our discount rate for 2025 is the highest we have used from 2009-2025. The lowest in that period (for a beta of 1.0) was 7.47% in 2020. Higher discount rates result in lower fair values for stocks.

Technical factors of the market are bullish (more demand than supply), while fundamentals are fairly priced – therefore, we are mildly bullish on the market. The Standard & Poor’s forecast for S&P 500 operating earnings per share (EPS) through June 30, 2026 is \$276.94, which implies a price-to-earnings (P/E) ratio of 22.4 with the S&P 500 at 6,205. The earnings yield (E/P) of 4.46% represents fair value relative to the 10-year U.S. Treasury note yield of 4.24%. The yield spread is only 0.22%. Seven of the nine largest companies in the S&P 500 make up \$18.0 trillion of the \$55.0 trillion index market capitalization with a weighted P/E of 35.2. If 32.7% of the index has a P/E of 35.2, then 67.3% of the index has a P/E of 16.2 for the overall P/E to be 22.4. A P/E of 16.2 is an E/P of 6.18%, which is fairly priced compared to the 10-year Treasury note yield of 4.24% (a yield spread of 1.94%).

The S&P 500 took out its old closing high of 6,144 from February 19, 2025 and closed today at 6,205, a new all-time closing high. Indexes (like stocks) hitting all-time highs have no technical resistance above, although fundamental valuations eventually become too stretched for the bulls, a short-term peak is reached, and a new resistance area is formed. Major support should be around 5,830 (50-day and 200-day moving averages); 5,775 (late-March peak); and 5,500 (mid-March trough). Mega-cap tech stocks lagged in 2025 Q1, but they surged back in 2025 Q2. Investors have been conditioned to “buy the dip”, especially with the mega-cap tech stocks. The sharp decline in April and whipsaw rally to new highs has only reinforced this behavior. This is an eerie example of George Soros’ theory of reflexivity, where positive feedback loops between price and expectations continue until disequilibrium...and the market crashes.