"Whiplash"
Market Commentary – June 2025

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The second 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 0.2% in the first quarter of 2025. This is higher than the advance estimate of -0.3%, but less than +2.4% in 2024 Q4. The negative reading is skewed because of an abnormally large negative net exports value, seemingly due to Americans buying foreign goods ahead of tariffs. This may be a volatile statistic as 2025 progresses and the tariff situation evolves, skewing future GDP readings. The Consumer Price Index (CPI), which measures inflation in consumer prices, was 2.3% in April. This is the lowest reading since February 2021. Unemployment measured 4.2% in April, compared with a range of 4.0% and 4.2% over the past 12 months and a low of 3.4% in April 2023. So far, inflation and unemployment are stable.

On May 7, the Federal Open Market Committee (FOMC) maintained its target range for the federal funds rate at 4.25% to 4.5%. In its statement, the FOMC wrote: "Although swings in net exports have affected the data, recent indicators suggest that economic activity has continued to expand at a solid pace." It further noted that the unemployment rate has stabilized, but "inflation remains somewhat elevated". The Fed is further worried that tariffs are inflationary and a lower federal funds rate will add fuel to the inflation fire. Fed funds futures now predict the next 0.25% cut by October 2025, a second 0.25% cut by December 2025, and a total of 1.0% in rate cuts by August 2026. The balance sheet continues its diet with $6.673 trillion in assets on May 28, down $36 billion from April 30 (near the Fed's monthly reduction target of $40 billion). The next FOMC decision on monetary policy is scheduled for June 18.

The annual update of our universe of stocks uncovered potentially interesting companies, some of which have not appeared on our radar for many years. We analyzed a total of 1,385 companies with a cumulative market capitalization of $54.5 trillion. Our research identified "our universe", which is comprised of stocks we believe to have the best risk/reward prospects (based on a combination of low valuation, low beta, low debt to market cap, and high dividend yield). This year, 85 companies made the cut (versus 85 companies in 2024, 82 in 2023, 73 in 2022, and 65 in 2021). Our stocks have the following market cap ranges: <$1B (21 stocks), $1B to $5B (17 stocks), $5B to $20B (18 stocks), $20B to $100B (20 stocks), and >$100B (9 stocks). More opportunities seem to be in the smaller companies.

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 March 31, 2026 is $267.33, which implies a price-to-earnings (P/E) ratio of 22.1 with the S&P 500 at 5,912. The earnings yield (E/P) of 4.52% represents fair value relative to the 10-year U.S. Treasury note yield of 4.41%. The yield spread is only 0.11%. Seven of the nine largest companies in the S&P 500 make up $16.7 trillion of the $52.6 trillion index market capitalization with a weighted P/E of 35.3. If 31.8% of the index has a P/E of 35.3, then 68.2% of the index has a P/E of 16.0 for the overall P/E to be 22.1. A P/E of 16.0 is an E/P of 6.26%, which is fairly priced compared to the 10-year Treasury note yield of 4.41% (a yield spread of 1.85%).

Investors encountered a serious case of whiplash as the S&P 500 tanked in April, only to launch back up through the end of May. One theory for the significant rally off of the early April low is that market participants simply bought the S&P 500 index to gain equity exposure in a "fast moving market", rather than pick individual stocks. Supporting this theory is the outperformance of the mega-cap technology stocks from the April low. Moving forward, resistance should be encountered around 6,150 (all-time high). Support levels include 5,775 (200-day moving average and late-March peak); 5,600 (50-day moving average); and 5,500 (mid-March trough). Absent significant tariff or other news, a trading range with an upward bias seems likely. Given the wide range of potential outcomes in these volatile times, it is prudent to maintain a balanced portfolio so that there are plans for the market rising, falling, and staying flat.