Fort Washington Investment Advisors, Inc.

A member of Western & Southern Financial Group

MONTHLY MARKET PULSE — JUNE 2025

HIGHLIGHTS

- **Like It Never Happened:** The S&P 500 has completely erased the losses following April 2nd (Liberation Day) and is now in positive territory for the year.
- **Tariff Block:** Trade uncertainty remains elevated as the U.S. Court of International Trade recently blocked the President's reciprocal tariffs. However, the decision was appealed and is likely to go to the Supreme Court.
- **America's Debt Dilemma:** The U.S. has been on an unsustainable path regarding government spending and deficits. The One, Big Beautiful Bill is adding to the problem, and we take a deeper dive in this month's *Spotlight* below.

MONTHLY SPOTLIGHT:

A Fraying Fiscal Foundation

Author: Daniel Carter, CFA

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MACRO INSIGHTS

Fiscal Concerns & Lower Recession Risk Prompt Rate Rise

Equities extended their rebound in May, building on the late-April rally as investor optimism grew that U.S. trade policy would remain aggressive in tone but ultimately fall short of triggering a recession. As recession fears receded, risk assets rallied. The S&P 500 rose more than 6% for the month, led by tech and growth stocks, with the Nasdaq climbing 9.5%. The market priced in a lower probability of Federal Reserve (Fed) rate cuts, lifting 2-year yields by over 30 basis points, while concerns over fiscal sustainability contributed to a rise in long-end rates of 25 basis points (see this month's *Spotlight* for details).

The U.S. trade policy backdrop remains volatile, yet a pattern appears to be emerging: initial announcements of sweeping tariffs are quickly followed by delayed implementation timelines, signaling a preference for negotiation over confrontation. Last week, the Court of International Trade temporarily blocked the administration's "Liberation Day" tariffs, reinforcing the view that trade actions may be moderated by legal and institutional checks. While the ruling is under appeal and alternative mechanisms may be pursued, markets are increasingly discounting the risk that trade policy alone could derail the economic expansion.

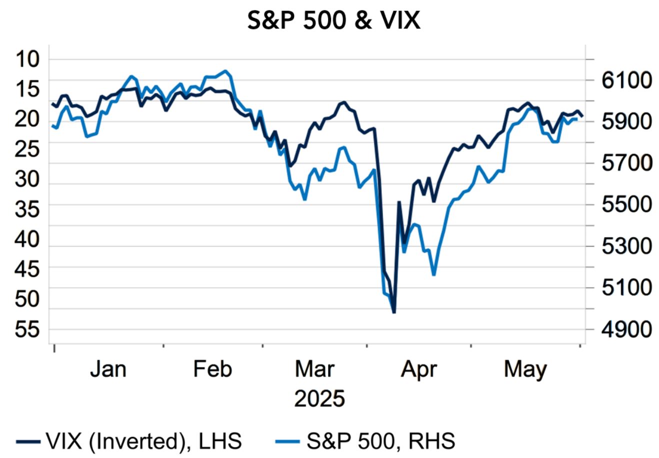
Last month, we flagged concerns that unilateral executive actions were undermining confidence in the U.S. system of checks and balances. With the judiciary now weighing in on the legality of emergency powers, some of that institutional confidence may begin to recover. However, the ongoing legal process, including potential Supreme Court involvement, will likely delay the resolution of trade negotiations as counterparties adopt a wait-and-see approach.

With trade developments in a holding pattern, investor focus is shifting back to macro and company-level fundamentals. First-quarter earnings came in ahead of expectations and printed their second consecutive quarter of double-digit growth, although corporate guidance was limited, given ongoing policy uncertainty. Consumer spending has remained solid based on credit and debit card activity, and sentiment surveys improved in May. However, signs of cooling are emerging in areas like travel, and the housing market remains weak under the weight of elevated mortgage rates. Corporate commentary on tariff pass-through to consumers has been mixed, raising concerns that recent progress on inflation and sentiment could be at risk if prices rise.

With the S&P 500 only 4% below all-time highs and the VIX notably lower, markets reflect confidence that trade tensions will remain manageable and that recession risk is low. Still, with the index trading near 22x forward earnings—a valuation that offers limited cushion—we view the risk/reward as less compelling. Elevated rates and unresolved policy uncertainty leave the market vulnerable to negative surprises.

S&P 500 Nearing Highs as VIX Falls

As volatility due to trade uncertainty has subsided, equities have rebounded quickly.



Source: Fort Washington and Tax Foundation.

Chris Shipley

Senior Vice President, Co-Chief Investment Officer

Fort Washington Investment Advisors, Inc.

WHAT TO WATCH

U.S. consumer and business outlook has softened amid tariff uncertainty. As a result, social media posts and headlines out of the White House are likely to continue driving market volatility. Investors will monitor incoming sentiment and indications for potential impacts on economic activity.

- The next Federal Open Market Committee (FOMC) meeting is June 18th. Markets are pricing in a low probably (<10%) of a rate cut.
- The next Consumer Price Index (CPI) report will be available on June 11th, and Personal Consumption Expenditures (PCE), the Fed's preferred inflation gauge, will be available on June 27th. Separately, import prices are June 17th, which may offer tariff insights.
- Following softer sentiment, investors will watch for weaker consumer behavior. As a result, retail sales will be in focus on June 17th.

MONTHLY SPOTLIGHT

DANIEL CARTER, CFA
Managing Director,
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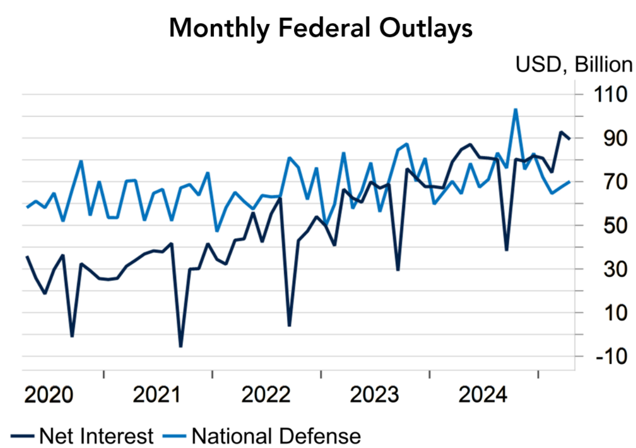
A Fraying Fiscal Foundation

Despite a growing and resilient economy, the United States' fiscal foundation is quietly eroding. The country has been running deficits at a scale rarely seen outside of recessions, and interest costs are becoming an outsized component of the federal budget. Layered onto this are fresh spending proposals, a rating agency downgrade, and deepening political dysfunction—all of which signal that fiscal sustainability is sliding down Washington's priority list. Although these issues are not all new, we anticipate their importance to grow as we approach a tipping point.

At the heart of the U.S. fiscal outlook is the inherent structural deficit. The U.S. is projected to run annual deficits of $2 trillion or more over the next decade before accounting for current proposals, according to the Congressional Budget Office. Importantly, this is occurring without the pressures of war or economic crisis when large fiscal deficits would be expected. Typically, we would expect deficits to shrink while the economy is strong and doesn't require fiscal intervention; however, the U.S. government has been doing the opposite. A key problem is that the drivers of our current situation are largely cemented: demographic trends are pushing entitlement spending higher, and interest payments to service current debt are growing. Furthermore, the government now spends more on interest than it does on national defense—a shift that underscores how past borrowing is impacting future discretionary spending.



The current reconciliation bill going through Congress highlights the prevailing mindset. While the bill touches a range of topics, at a high level, it reduces potential income by extending expiring tax cuts and increases discretionary spending without a budget offset. It's emblematic of the broader fiscal posture: continued incremental spending without an emphasis on long-term sustainability. Even where there is bipartisan agreement, such as strengthening critical industrial supply chains, for example—it is rare to find a balanced approach. However, we acknowledge that tariffs and DOGE (Department of Government Efficiency) cuts have the potential to offset some of the proposed imbalance, which is not factored into the CBO's (Congressional Budget Office) forecast.

This backdrop was most recently vocalized by Moody's, which stripped the U.S. of its last AAA rating, citing rising interest burden, persistent deficits, and repeated debt ceiling brinksmanship. While mostly symbolic, following downgrades by S&P in 2011 and Fitch in 2023, it emphasizes the problem is not improving and reflects a broader erosion of confidence in the U.S. political system's capacity to manage long-term fiscal risks.

We don't believe the U.S. is on the brink of a fiscal calamity. However, absent meaningful reform—or perhaps the monetization of national assets—the current trajectory points toward an eventual reckoning. The country's ability to respond to future shocks is already limited. For the past decade, markets absorbed rising debt levels because borrowing costs were negligible. That dynamic is gone. If fiscal uncertainty persists, the U.S. risks weakening the very credibility that underpins the dollar's global role and could keep rates higher, furthering the negative feedback loop.

Source: Fort Washington, U.S. Treasury, and Bloomberg.

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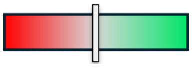
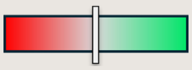
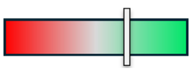
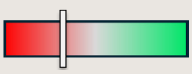
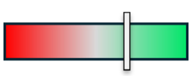
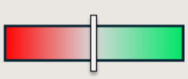
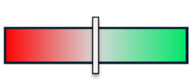
CURRENT OUTLOOK

Topic	View	MoM Change	Commentary
Macroeconomic Views			
Economic Growth		–	▸ **Uncertainty remains elevated** amid shifting trade policy and geopolitical tension. Even though, recent trade deals and tariff pauses have offered some relief. ▸ U.S. economic **growth is expected to slow following weaker sentiment**, potentially forecasting weaker consumer spending and business investment. ▸ Spending and inventory building ahead of tariffs are creating volatility in economic data.
Inflation		–	▸ Market forecasts for inflation have increased due to tariffs; however, the **impacts are expected to be short-term** as investors do not expect the effects to be persistent. Longer-run inflation estimates remain largely grounded. ▸ While service inflation should remain stable over the coming months, tariffs create elevated uncertainty around goods inflation. ▸ **Further upside risks remain** from retaliatory tariffs or a breakdown in trade negotiations.
Monetary Policy		–	▸ The Fed has kept rates unchanged so far this year. Investors are pricing **a low probability of a cut at the June meeting**. Changing growth estimates and tariff concerns have resulted in volatile expectations for rate cuts in 2025. ▸ FOMC members have articulated **patience** and a “wait and see” approach as they remain **data-dependent**. ▸ Investors anticipate two rate cuts in 2025, with current pricing implying a terminal rate of around 3.2%.
Fiscal Policy		–	▸ The budget reconciliation passed in the House before the Memorial Day recess and is now in the Senate, where a few changes are expected to increase the deficit impact. The bill increases defense and border spending as well as extends 2017 tax cuts, but the sticking points have been related to the expansion of the SALT deduction and the timing of cuts (IRA and Medicaid). ▸ Flexibility within fiscal policy remains low as federal debt levels continue increasing and **higher interest costs** consume a larger portion of government outlays.
Market Valuations			
Rates		↑	▸ Yields increased during the month as recession fears subsided and fiscal concerns worried investors. ▸ We anticipate the **magnitude of expected rate cuts will remain volatile**, with new economic data and developments around executive branch policies presenting opportunities for tactical adjustments. ▸ Long rates are toward the higher end of our expected range and exhibit attractive value at current levels, especially real yields.
Credit		–	▸ Credit **spreads tightened during May** and ended well inside the widest levels seen shortly after Liberation Day (April 2nd). Due to the continued rally, spread levels are tight of historical medians. ▸ We believe the **risk/reward is more balanced** at current levels, but downside risks remain elevated. ▸ Investment grade spreads (10-year BBB Industrials) ended the quarter at their 18th percentile and high yield (single B corporates) at their 12th percentile since the 1990s.
Equity		–	▸ The **S&P 500 continued its rally** in May, up 6.3% and ending the month positive for the year. The index ended May up 19% from the April lows and is 4% below the February highs. ▸ Uncertainty over market leadership (Magnificent 7) has increased this year, although these companies have outperformed since early April. ▸ Valuations for equities improved briefly but are now back to levels comfortably **above long-term averages**. ▸ The market is likely to remain susceptible to headline risk until investors have more clarity around longer-term trade policy.

MARKET DATA & PERFORMANCE | AS OF 05/31/2025

U.S. Snapshot	Current	6 Months Prior	1 Year Prior
Core Inflation (YoY%)	2.5	2.8	2.7
Unemployment Rate	4.2	4.2	4.0
Real GDP (YoY%)	2.1	2.7	2.9
Retail Sales (YoY%)	5.2	3.9	2.6
30-Year Mortgage Rate	6.9	6.8	7.0
10-Year Treasury	4.4	4.2	4.5
US Corporate IG Yield	5.2	5.1	5.5
US Corporate HY Yield	7.5	7.1	8.0

TOTAL RETURNS

Asset Class	MTD	QTD	YTD	1 Year	3 Years*	5 Years*
Equity						
Russell 3000 Index	6.3%	5.6%	0.6%	13.1%	13.8%	15.3%
S&P 500 Index	6.3%	5.6%	1.1%	13.5%	14.4%	15.9%
S&P Midcap 400 Index	5.4%	3.0%	-3.3%	2.2%	7.8%	12.9%
Russell 2000 Index	5.3%	2.9%	-6.8%	1.2%	5.0%	9.6%
MSCI World Index	6.0%	7.0%	5.2%	14.2%	13.7%	14.7%
MSCI World Excluding US	4.8%	9.7%	16.7%	14.7%	11.7%	12.3%
Fixed Income						
Bloomberg US Aggregate	-0.7%	-0.3%	2.4%	5.5%	1.5%	-0.9%
US Corporate Investment Grade	-0.1%	0.0%	2.4%	5.6%	2.7%	0.1%
US Corporate High Yield	1.7%	1.7%	2.7%	9.3%	6.8%	5.8%
Emerging Market Debt	0.9%	1.0%	3.1%	8.8%	5.9%	1.8%
US Treasury (7-10 year)	-1.3%	-0.3%	3.3%	5.3%	0.1%	-2.6%
Cash	0.4%	0.7%	1.8%	4.8%	4.6%	2.8%

Source: Fort Washington and Bloomberg. *Returns longer than 1 year are annualized. Past performance is not indicative of future results.

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