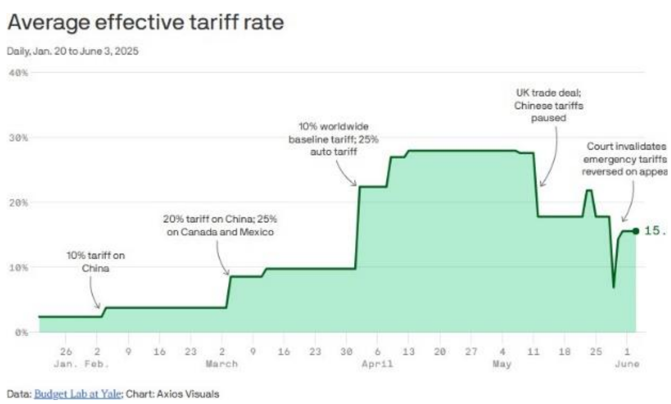
Associated Bank
Private Wealth

Market Review

SECOND QUARTER 2025



The second quarter saw markets and the economy grappling with and attempting to process the consequences of the significant shift in global trade. On April 2, dubbed "Liberation Day," President Donald Trump unveiled the full scope of a sweeping tariff regime aimed at fundamentally restructuring the global trading system and reducing the U.S. trade deficit. Tariffs remain the dominant concern for businesses and financial markets. However, several developments during the quarter suggested the upward march of tariffs may be slowing. On April 9, Trump announced a 90-day pause on retaliatory tariffs; short-term trade agreements were reached; and lawsuits challenging the legality of the new tariffs raised questions about the policy's future—pending a final ruling by the Supreme Court.

By the end of June, the average effective tariff rate on U.S. imports reached approximately 15%, according to the Yale Budget Lab. Tariff levels are expected to remain volatile as existing pauses expire and trade negotiations either progress or collapse. While uncertainty remains elevated, the focus is now shifting toward the economic fallout. Although economic theory suggests that tariffs reduce growth and raise prices, the economy and markets have shown notable resilience—at least for now.

Economic growth slowed in the first quarter, with Gross Domestic Product (GDP) shrinking by 0.5%. What appeared to be an economic contraction was, in fact, mostly a result of businesses and consumers significantly increasing their purchases of imports to get ahead of anticipated new tariffs. Real final domestic demand remained strong, growing nearly 2%, confirming that demand simply shifted toward imports. The second-quarter GDP is expected to rebound as consumers pivot back to domestic producers.

There is reason for optimism that consumers can continue to support growth through the remainder of the year. As of May, real wage growth (adjusted for inflation) rose by 1.4% year-over-year. Although spending decelerated through the second quarter, this likely reflects a combination of lower gasoline prices and a "pull-forward" effect from pre-tariff purchases. In the meantime, higher wages are putting more money in consumers' pockets, potentially leading to a resurgence in spending once tariff-related distortions normalize.

That said, several signs of concern persist. Homebuyers remain under pressure, as the income needed to afford a median-priced home exceeds the national median. This affordability

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challenge is primarily attributable to elevated interest rates, which are not fully captured in traditional inflation indices. Additionally, delinquency rates on consumer loans continued to rise gradually throughout the quarter. Notably, student loan balances more than 90 days past due climbed sharply following the resumption of credit reporting after a five-year pause.

Geopolitical risks also loom over the economic landscape. Tensions between Israel and Iran escalated in June, as Israel launched strikes on more than a dozen sites within Iran. As with any major international conflict, concerns emerged around potential disruptions to global trade. The largest economic concern was oil supply, evoking memories of the oil crisis of the 1970s. While crude oil prices briefly spiked from $62 to $74 per barrel, they quickly retraced their gains. Bond yields and equity markets showed limited reaction, reflecting investor confidence that the conflict would not cause lasting economic disruption.

In addition to tariffs, the Trump Administration's other top priority has been finalizing and passing a comprehensive tax reform package. Among its many provisions, the reduction of the corporate tax rate and the introduction of accelerated depreciation (i.e., full expense of capital expenditures) are particularly notable. These measures are expected to boost productivity and potential GDP growth, while significantly lowering the effective corporate tax rate well below the statutory 21%.

Despite increased cost pressures from tariffs, employment trends have remained relatively stable. Rather than engaging in widespread layoffs, employers have shown a measured approach—hiring more selectively while retaining existing staff. The unemployment rate held steady between 4.1% and 4.2% during the quarter. Wage growth, however, has begun to slow, with average hourly earnings rising just 0.2% month-over-month in June, compared to a 3.7% annual pace one year ago.

The Federal Reserve remained largely unmoved by political pressure from the Trump Administration to cut interest rates. Strong labor market data and persistent inflation suggest that maintaining elevated rates remains appropriate for now. However, the real concern lies in the potential for a sudden spike in unemployment or inflation. At the beginning of the year, markets had priced in two to three quarter-point rate cuts. As of now, expectations have moderated, with markets anticipating approximately two rate cuts by year-end.

From a market perspective, the quarter began on shaky footing due to anxiety over the April 2 "Liberation Day" tariff announcements. Fears of a trade war led to heightened concerns that weaker consumer spending and widespread job losses would create a broad economic slowdown. This triggered a sharp market selloff that persisted through much of April before reversing significantly in May and June.

During the peak of market volatility, high-growth sectors that outperformed in 2023 and 2024 underperformed relative to their value-oriented, income-generating counterparts. Large-cap international companies and dividend-paying stocks held up comparatively well, while smaller, growth-focused companies lagged. However, the rebound was swift. By the quarter's end, growth stocks had reclaimed their leadership position.

The S&P 500 gained 10.9% while the NASDAQ rose 17% during the quarter, both reaching new all-time highs after falling more than 10% by mid-April. Much of the rebound was driven by renewed enthusiasm for growth sectors, particularly those tied to artificial intelligence, which continues to attract substantial investor flows. Through the first four months of the year, many companies cut their earnings growth estimates to incorporate higher tariff expectations.

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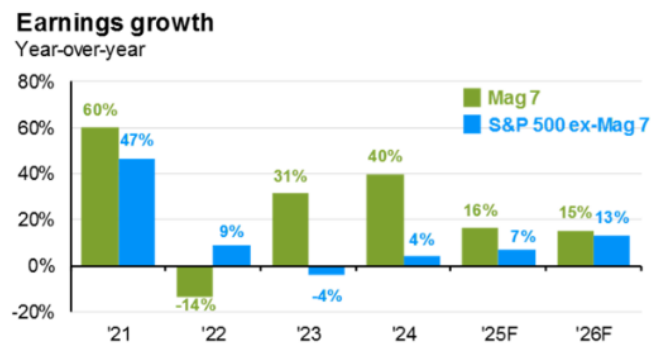
Despite these cuts the S&P 500 is still expected to grow earnings by nearly 9% this year. With the resurgence of equity markets, valuations for large-cap U.S. equities returned to historically elevated levels.

Meanwhile, the equity market's strength overshadowed mixed performance in fixed income. In one of the quarter's more dramatic developments, Moody's downgraded U.S. sovereign debt, sparking a brief selloff in long-dated Treasuries and pushing yields higher. Treasury markets ultimately shrugged off the news and the 10-year U.S. Treasury yield remained range-bound for the quarter, fluctuating between 4.2% and 4.6%.

Tariffs will continue to attract significant attention because they remain a major priority for the Trump Administration with real economic consequences. A strong economic base is crucial when facing disruptions like tariffs. The U.S. economy's resilience is a testament to its strong position.



Source for Charts:

Tariff chart:
https://www.axios.com/2025/06/05/trump-tariff-rate-volatility

Earnings Growth Chart:
https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/