

- **Markets delivered strength, not certainty — Strong YTD gains masked narrowing leadership, rising concentration, and a market still wary of what comes next.**
- **The Fed's pause is not a pivot — Inflation has cooled, but not convincingly. Policymakers remain data-dependent, and rate-cut hopes face a higher bar than headlines suggest.**
- **Consumers are spending—carefully — Travel and services remain strong, but credit stress is creeping in. Retail sales are slowing, and the savings buffer is nearly gone.**
- **Two economies, one divergence — Service sectors grind forward while manufacturing contracts under the weight of tariffs, weak demand, and global uncertainty.**
- **Opportunity is hiding in plain sight — AI enablers, small caps, and select international markets may lead the next leg—if liquidity on the sidelines finds a reason to return.**

Halfway Point, but Far from Settled

The first half of 2025 has been anything but linear. After starting the year on solid footing, markets have weathered a cocktail of geopolitical shocks, policy uncertainty, and mixed economic signals—yet the S&P 500 keeps grinding higher. As of July 11, the S&P 500 is up 6.4% year-to-date, supported by persistent enthusiasm around AI, a still-resilient consumer, and expectations of a Fed policy pivot later this year. The Nasdaq has performed likewise, up slightly higher to 6.6% YTD, though recent market breadth has narrowed uncomfortably, with most gains concentrated in a small cluster of mega-cap stocks.

Quarter-to-date, however, the tone has shifted. June's data revealed pockets of cooling—

particularly in the labor market and manufacturing—just as geopolitical headlines ramped up. In early July 2025, a joint U.S.–Israeli military strike targeted Iranian nuclear assets, marking one of the most direct escalations in the region in over a decade. The event triggered a short-lived but sharp spike in oil prices, reflecting market fears of broader Middle East instability and potential disruptions in energy supply routes through the Strait of Hormuz.

- WTI crude jumped to an intraday high of \$68.91 on July 8, before pulling back.
- Brent crude rose above \$70.66 during the same window.
- Futures markets reflected a 15%–20% implied risk premium, with near-term volatility on crude options spiking.

However, the price surge quickly faded after diplomatic channels calmed fears of a wider war, and Iranian retaliatory threats appeared restrained. Within three trading days, oil prices settled back toward prior levels.

Market Takeaway

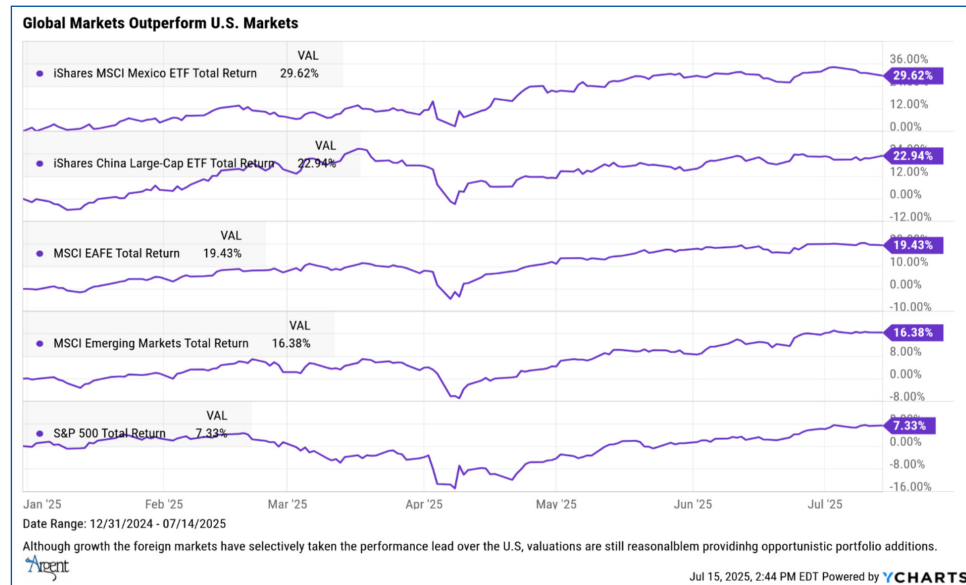
The episode highlighted geopolitical fragility but did not result in sustained supply disruption. Investors treated it as a volatility event, not a trend changer.

Adding to market unease are renewed concerns around global trade. The White House and European Commission are weighing retaliatory tariffs on Chinese EVs, semiconductors, and solar exports. Trade policy has re-emerged as a bipartisan flashpoint, with politicians across the spectrum signaling a tougher stance on foreign subsidies and domestic manufacturing incentives.

A number of international equities have surpassed the U.S. considerably. The MSCI EAFE Index is up nearly 20% YTD, with a few of the emerging markets posting better relative performance in Q2, led by strength in Latin America. MSCI Latin America is up nearly 22%, and Mexico is up 29%; however, volatility remains high.

On the economic front, the U.S. continues to outperform expectations. First-quarter GDP was revised downward to 0.5% growth, primarily related to an increase in imports (pre-

tariff impact) and a decrease in government spending, and the Atlanta Fed's GDPNow model is tracking second-quarter growth near 2.4%. That figure reflects ongoing strength in consumer services and business investment, even as exports, inventories, and manufacturing show signs of slowing. Yet, with economic growth holding steady, the real pivot point may now rest with inflation—shaping expectations for both monetary policy and market behavior in the second half of 2025.



Disinflation, but Far from Done

Inflation has been on a broad downward trend since its peak in mid-2022—but the path to price stability remains uneven, and policymakers aren't celebrating just yet. Headline CPI, which peaked at 9.1% in June 2022, has since dropped to 2.7% year-over-year as of June 2025. Core CPI, which excludes food and energy, has proven stickier—down from 6.6% in 2022 to 2.9% in the latest reading. The Fed's preferred gauge, the Core Personal Consumption Expenditures (PCE) Index, now sits at 2.3%.

This steady disinflation has been driven largely by falling goods prices, particularly in energy, used vehicles, and apparel—while services inflation continues to run hot. Categories like shelter, healthcare, and insurance have kept core readings elevated. According to the Bureau of Economic Analysis, housing services alone still account for over 35% of the total CPI Index. The result is a frustratingly mixed picture: progress, yes—but not enough to warrant victory laps.

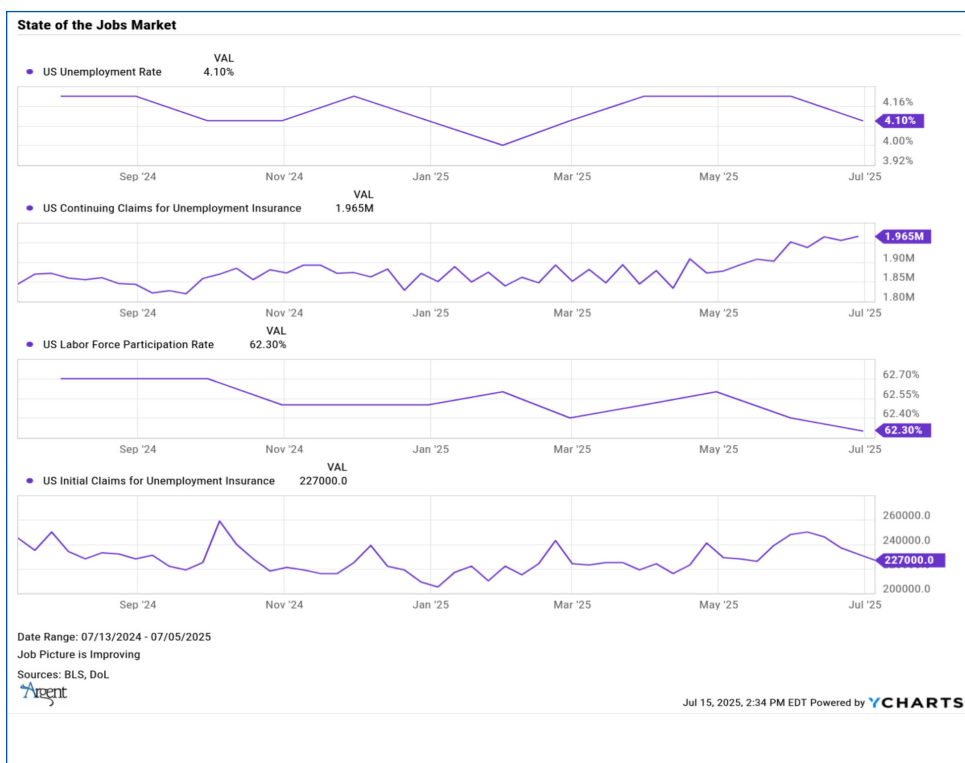
Consumers have felt this tug-of-war in their wallets. While gas prices are down 10–12% from a year ago, and in select states car insurance is up between 8% and 30% due to both inflation pressures and tariff-related car parts. Groceries have barely budged in price in 2025 after surging for two years straight—eggs, meat, and baked goods remain well above pre-pandemic levels. Restaurant prices have continued to rise, in part due to elevated wage costs. Airfares, which spiked in 2022 and 2023, briefly softened but are now trending higher again amid a strong travel season. Relief is relative—and for many households, the “new normal” still feels like a squeeze.

From the Fed's standpoint, the question is no longer whether inflation is coming downhill but whether it is falling fast enough and broad enough to justify cutting rates. The Federal Open Market Committee (FOMC) last raised the federal funds rate to its highest target range of 5.25%–5.50% in July 2023. Since then, the Fed has slowly brought rates down, with the latest reduction in December 2024 to the current range of 4.25%–4.50%.

The market continues to debate when and how many cuts may come. As of now, futures pricing reflects a 70% probability of one rate cut by the September FOMC meeting and a second by year-end. But Fed officials remain cautious. In a June speech, Fed Governor Christopher Waller noted, “There is no rush to cut rates. We need to see sustained improvement in inflation—especially core services—before we act.” Similarly, San Francisco Fed President Mary Daly emphasized, “The last mile is the hardest. We must be resolute, even if the economy is holding up better than expected.”

The Labor Market's Conundrum: Sturdy but Stretched

If there's one word that defines the post-pandemic labor market, it's imbalance. On paper, the jobs picture looks steady—yet the details reveal a system still recalibrating from the COVID shock. The U.S. unemployment rate stands at 4.1%, although this most recent number risks an upside surprise. Labor force participation has improved modestly since its post-pandemic low but remains below pre-COVID levels. In February 2020, the participation rate stood at 63.3%; as of June 2025, it sits at 62.3%—better, but still indicative of lost workforce potential. The average wage gain over the past 12 months was 3.7%.



warehousing—industries hit hardest by COVID. Today, the trend has shifted toward healthcare, professional services, and government employment. In fact, public sector hiring has quietly become a larger force: government jobs accounted for nearly 20% of total new payrolls added in the first half of 2025, up sharply from an average closer to 12% in the pre-pandemic decade. Much of this reflects expanded state and local staffing, particularly in education, public safety, and administration. June's total government jobs added were 73,000, which was the largest contributor to overall payroll gains.

Private sector hiring has cooled but remains positive. Healthcare continues to be a consistent source of job creation, driven by aging demographics and increased demand for outpatient services. Construction, especially infrastructure and energy-related projects—has seen strength tied to federal incentives and reshoring efforts. Tech hiring has stabilized after widespread layoffs in late 2022 and early 2023 but remains selective. Meanwhile, cyclical industries such as manufacturing and retail have softened, echoing broader signs of economic deceleration.

Job growth has slowed but hasn't stopped. The U.S. economy added 147,000 jobs in June. Initial jobless claims have begun to drift higher, recently averaging just above 235,000 over a four-week moving average, a level that's not alarming, but one that suggests employers are becoming more cautious. Continued claims have also ticked up, pointing to a longer job search period for those displaced.

This evolving labor market matters not just for payroll data but for how consumers behave. Slower wage growth, elevated cost pressures, and creeping job insecurity are beginning to show up in how households spend—and borrow.

Employment gains have also shifted beneath the surface. During the early recovery phase of 2021–22, job growth was led by leisure and hospitality, transportation, and

The Resilient, but Stretched, American Consumer

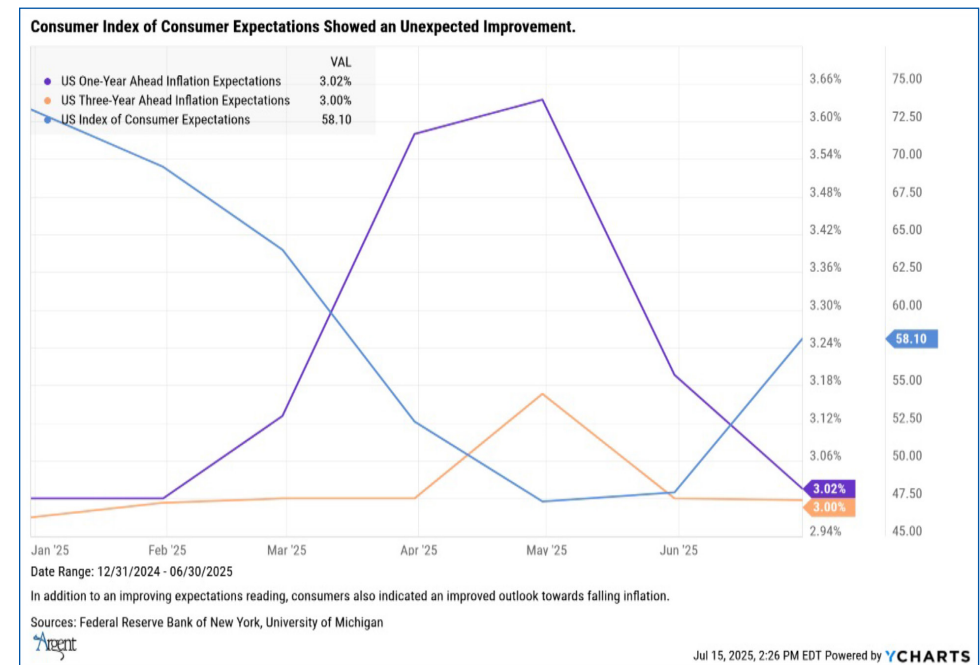
Consumers have been the backbone of the U.S. economy since the post-pandemic recovery began—and while they're still standing in 2025, the signs of strain are becoming harder to ignore. Year-to-date, retail sales are up a modest 2.3% through June, but the pace has cooled noticeably. Adjusted for inflation, real retail sales are effectively flat over the past six months, reflecting a slowdown in discretionary categories such as apparel, furniture, and electronics. Food services and travel-related spending remain positive, but gains are being driven more by price than volume.

Compared to the pre-pandemic baseline, total retail sales are still 24% higher than February 2020—but the composition has changed. Consumers are spending less at big-box retailers and more on experiences. Health and personal care, travel services, and digital subscriptions have gained share, while goods categories like home furnishings and department stores have stagnated. Much of this reflects a rebalancing away from the pandemic-era "goods binge," but also a shift in how households prioritize amid elevated prices.

Fuel prices, once a major drag on sentiment, have moderated. National average gas prices are down about 15% from this time last year and nearly 30% from their 2022 highs. That's offered some breathing room for household budgets, but the savings are being redirected—not pocketed. Travel demand remains strong, with hotel occupancy rates hovering just under 65% nationally, compared to a pre-COVID baseline closer to 66%–68%. Air travel has fully recovered, with TSA checkpoint volumes in June exceeding 2.7 million passengers per day—above 2019 levels. However, airfare prices have resumed climbing, partly due to labor and fuel costs, limiting further discretionary expansion.

What has changed more meaningfully is the consumer's credit position. Household debt is at an all-time high, with the New York Fed reporting a total of \$17.7 trillion in outstanding consumer credit. Credit card balances have risen nearly 14% over the past year, and delinquency rates—while still below crisis levels—are climbing steadily, particularly among younger borrowers and subprime segments. Auto loan delinquencies are at a near 15-year high, and personal savings rates have dipped back below 4.5%, suggesting more households are leaning on credit to sustain spending.

Despite this, consumer sentiment has held up reasonably well. The University of Michigan's Consumer Sentiment Index showed a modest uptick in July, reflecting optimism about inflation and job stability. But sentiment remains below long-term averages, and any economic hiccup—job losses, oil shocks, or rising rates—could quickly undermine confidence. Households may be treading water successfully, but the margin for error is shrinking.

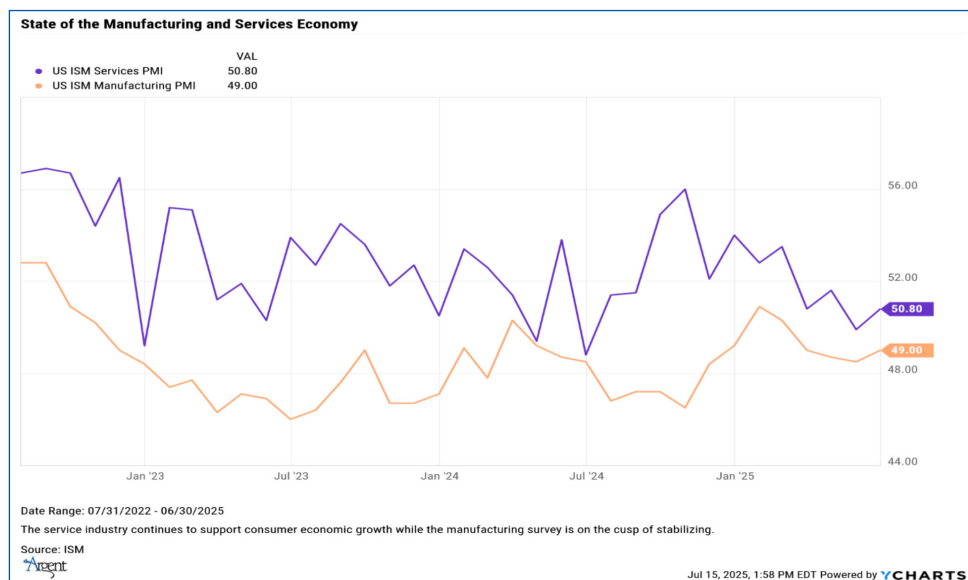


The outlook for the back half of 2025 hinges on whether that resilience persists—or whether borrowing capacity and psychological fatigue start to take their toll. For now, the consumer remains afloat, but the current is beginning to pull a little harder.

Two Economies, One Headline: Manufacturing Stalls While Services Grind On

If the U.S. economy were split in two, the services sector would be comfortably jogging forward while manufacturing continues to drag its heels. The divergence between the two has become a defining feature of the current economic cycle, with most of the post-pandemic strength clustered in services, healthcare, travel, and professional services—while goods production remains weak and uneven.

The June ISM Services Index rose to 50.8, rebounding from a soft May reading and marking just one month of contraction. Demand for services like travel, tech consulting, outpatient care, and logistics remains steady, if not spectacular. By contrast, the ISM Manufacturing Index slipped to 48.5 in June, its fourth consecutive month in contraction territory. New orders and backlogs both declined, and factory employment remained flat.



This split is echoed in sentiment surveys. The Conference Board's Leading Economic Index (LEI), a broad gauge of future economic activity, ticked down by 0.1% in May after

declining 1.4% in April. The indicator, though, has fallen 2.7% over the prior six-month period, quicker than the -1.4% contraction over the previous six months.

Similarly, the latest Duke CFO Global Business Outlook survey found that over 40% of CFOs expect a slowdown in capital spending over the next 12 months, with manufacturing executives especially cautious. While hiring plans remain stable, confidence in margin expansion has softened, especially in export-oriented industries. In a separate question regarding additional impacts of tariffs, about 40% of CFOs also noted that they have or will pass tariff-related cost increases through to customers. Among the firms that reported they were passing along tariff-related costs, the median firm indicated that they plan to pass through 100% of tariff-related cost increases.

Within manufacturing, the picture is highly segmented. Aerospace, semiconductors, and energy infrastructure components continue to show growth, supported by government incentives and longer-cycle project pipelines. On the other end of the spectrum, textiles, basic chemicals, and consumer durables—like appliances and furniture—have been in persistent decline. The weakness reflects both global demand softness and the tail end of the COVID-era inventory overbuild.

Tariff threats have only added to the uncertainty. The Trump administration's June proposal to hike tariffs on key Chinese imports—EVs, solar components, and semiconductors—has raised concerns among manufacturers with global supply chains. While the direct cost impact remains modest for now, the fear of retaliatory measures has chilled investment in some trade-sensitive sectors. Overseas partners have responded cautiously, with the EU initiating its own review of Chinese green tech subsidies and the risk of tit-for-tat trade actions rising.

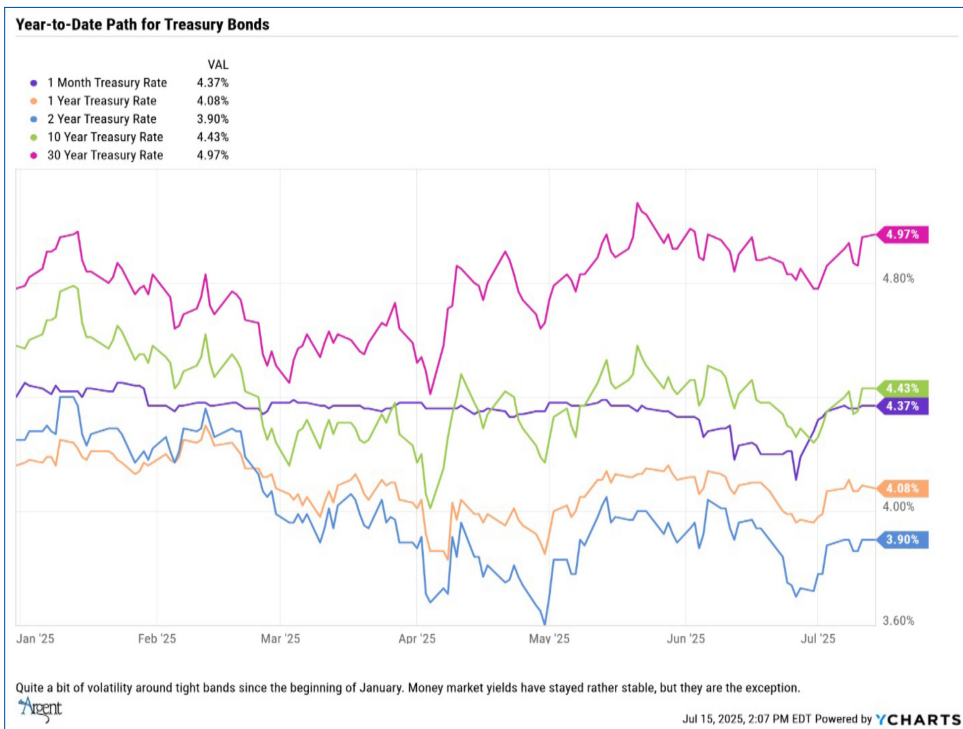
Supply chains, which had largely normalized by late 2023, are once again flashing amber. Freight volumes on major U.S. trucking routes have declined in recent months, and rail cargo data shows a slowdown in intermodal traffic. At the global level, ocean shipping has held up better, but tanker and container rates have shown volatility amid rising energy prices and port congestion in Southeast Asia. These disruptions remain relatively contained but could reaccelerate if geopolitical risks intensify.

Taken together, the data suggests an industrial sector that's functional—but fragile.

Manufacturing is no longer in free fall, but it's far from healthy. Services, meanwhile, continue to prop up overall growth, though the momentum is more subdued than it was earlier in the recovery. As the global trade environment becomes more complex and domestic demand rotates further toward services, this divergence may become a longer-lasting structural feature of the post-pandemic economy.

Cracks, Rotation, and Sideline Cash: What the Market's Internals Are Telling Us

For all the smooth gains in equities this year, the underlying market signals are more complicated—and, in some cases, conflicted. Treasury yields have moved in tight but volatile ranges year-to-date, with the 10-year note hovering around 4.43% as of mid-July, down from 4.57% at the start of the year. Meanwhile, short-term yields remain stubbornly elevated: the 2-year maturity sits near 3.9%, also down in unison from January's 4.25%.



High-yield credit spreads tell a similar story. Spreads over comparable Treasuries have narrowed slightly, ranging between 250–300 basis points, signaling no acute credit fear. Investment-grade issuance remains steady, and default rates in speculative credit remain well below long-term averages. The bond market is cautious—but not distressed.

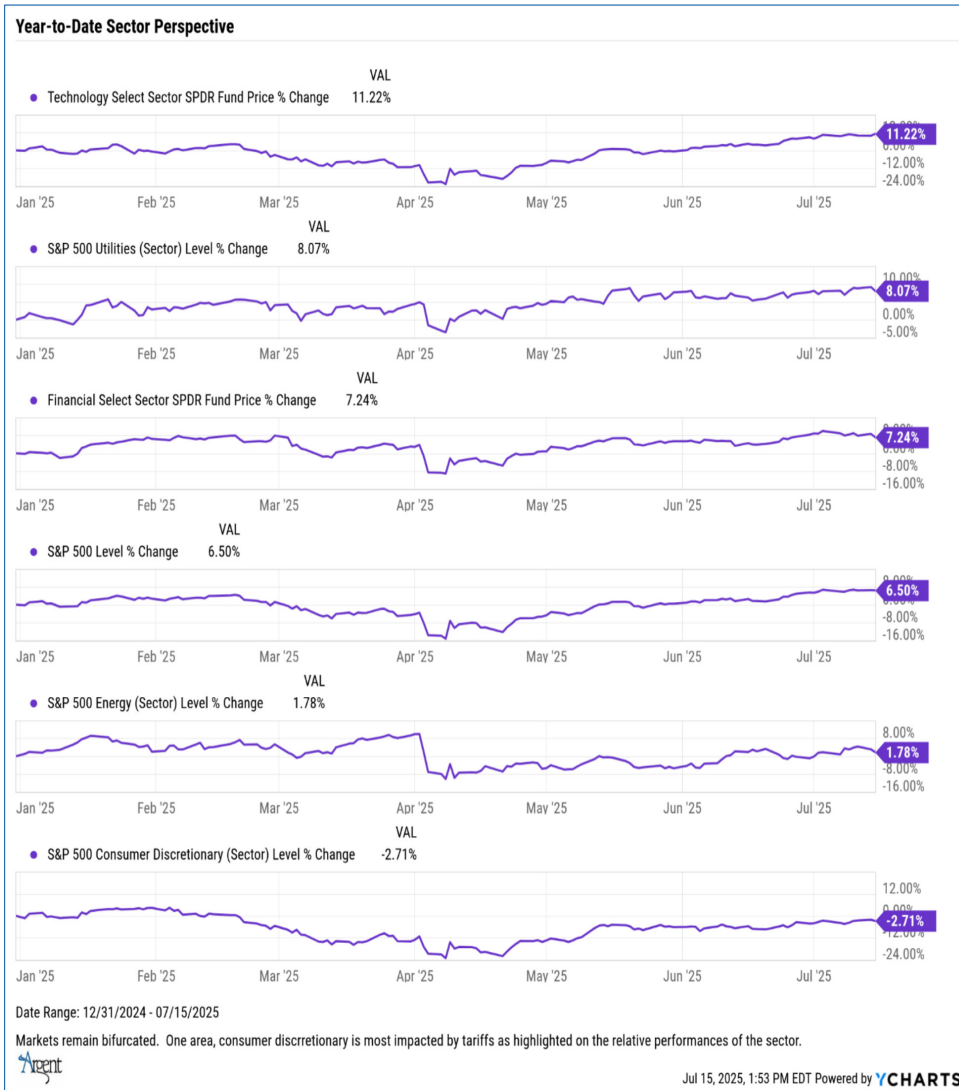
Equities, meanwhile, continue to climb—but not in unison. Over the past 12 months, the top-performing sectors have been Information Technology, Communication Services, and Industrials—driven by AI infrastructure, software resilience, and large-scale manufacturing and defense orders. Year-to-date, Tech remains on top (+11%), followed closely by Utility Services with YTD gains in excess of 8% and Financial Services delivering returns of over 7%. On the other end of the spectrum, Energy and Consumer Discretion have lagged in relative terms.

Notably, gold is up just under 11% year-to-date, trading near \$3,322/oz—a sign that inflation-hedge demand remains intact, especially among global investors wary of currency devaluation and debt overhang. Bitcoin, by contrast, is up around 30% for the year and at a new high this week. Crypto now appears to be tracking more as a speculative asset than a safe haven—while gold holds its traditional place in portfolio hedges.

Looking ahead, capital is quietly beginning to rotate. Fund flows over the past six weeks have favored Technology, Energy, and Financials—sectors benefiting from cash flow durability, dividend strength, or long-cycle capex themes. By contrast, defensive sectors have seen outflows as investors recalibrate expectations for both inflation and interest rate paths. Bank of America's latest fund manager survey found increasing appetite for U.S. equities, particularly in large-cap growth and value-blend areas; but also noted rising interest in Japan and emerging markets.

Perhaps the most important capital trend isn't in equities or bonds—it's in cash. Money market fund balances remain near record highs at roughly \$7 trillion according to the Investment Company Institute. Some of that reflects temporary positioning and yield hunting in T-bill ladders, but a large portion is strategic sidelining—waiting for a better entry point or more clarity on Fed policy. Institutional allocators remain cautious, and retail flows have only partially returned to equities despite strong YTD performance.

The implication is that liquidity exists—but is hesitant. The next leg of market direction may depend not just on earnings or inflation prints but on whether that cash begins to re-enter risk assets or stays parked until 2025.



A Narrow Market Can Still Be a Risky One

Despite impressive headline returns from the major indexes this year, market breadth has quietly deteriorated. Roughly 60% of S&P 500 constituents are currently trading above their 50-day moving averages versus one-month earlier. In contrast, over 80% of year-to-date index gains have been driven by fewer than ten stocks—largely in the AI infrastructure, semiconductor, and cloud ecosystems. This level of concentration is not unprecedented, but it does raise questions about sustainability.

Mega-cap tech names like Nvidia, Apple, and Microsoft have become dominant contributors to index-level performance, while many mid-cap and cyclical names continue to tread water. This crowding effect has amplified volatility on individual earnings days and raised valuation pressures for the “AI complex.” As one institutional strategist recently put it, “This is not the dot-com bubble—but it rhymes.”

At the sector level, the divergence is just as stark. Energy, Industrials, and Financials have seen relatively balanced flows and earnings growth—while Real Estate, Utilities, and Consumer Staples have lagged both in price and investor interest. This suggests a market that’s rewarding forward cash flow, not just thematic excitement.

Market technicians note that until breadth improves, rallies will remain vulnerable to rotation shocks or profit-taking. For allocators, this may argue for broader diversification or a more selective approach within outperforming sectors. Concentration works—until it doesn’t.

The Second Half Set-Up: Promise, Pressure, and Positioning

As we cross into the second half of 2025, the investment landscape is defined by tension: between growth and caution, liquidity and leverage, opportunity and overexposure. U.S. equities have delivered strong gains year-to-date, but they've done so against a backdrop of narrow leadership, stretched valuations, and rising uncertainty around monetary and geopolitical policy.

At just over 21x forward earnings, the S&P 500 trades above historical norms, supported by robust margins in tech and communication services, but less so in financials, cyclicals, or defensives. That leaves little room for error in a market where concentration remains a key driver and earnings breadth has yet to fully materialize.

Still, opportunity exists. The AI buildout is not a fad—it's a secular trend, and while the largest beneficiaries have already run, second- and third-tier enablers remain under-allocated. Infrastructure, data-center logistics, and software automation could continue to benefit from enterprise spending, even in a softening macro environment.

Small caps may also present a contrarian opportunity. The Russell 2000 now trades at a relative discount to large caps not seen in years, and while some of that reflects quality dispersion, improving credit conditions and potential rate cuts could unlock upside in capital-intensive or rate-sensitive areas. Overseas markets—particularly Japan, India, and Latin America—have drawn renewed interest as investors look for valuation support and structural reform tailwinds. Europe remains challenged, but selected sectors (luxury goods, industrial automation) show relative strength.

That said, risks remain elevated. The U.S. debt load continues to grow, with interest expense now crowding out discretionary spending and Treasury issuance running at a historic pace. Interest rate volatility, while lower than in 2022, remains an underappreciated factor for leveraged companies, banks, and housing. The Fed's reluctance to cut until clear evidence emerges of core disinflation may also delay relief for credit markets and keep cash sidelined longer than expected.

Tariff threats are another underappreciated headwind. Renewed trade friction with China—and a growing alignment between U.S. and EU policy on industrial subsidies—may inject volatility into supply chains and pricing models in the second half. While direct cost impacts may be modest in the near-term, the behavioral and capital allocation effects are harder to quantify—and likely more lasting.

For investors, the second half of 2025 will be less about chasing winners and more about managing participation. Selectivity, patience, and balance may matter more than thematic conviction alone.

Closing Thought: Selectively Positioned, Cautiously Optimistic

Markets have rewarded resilience so far in 2025, but resilience doesn't always mean strength. It means flexibility. It means adaptation. As we move through the second half, the most successful investors may not be those who predicted macro outcomes perfectly, but those who were nimble in response.

Opportunities exist—in innovation, in valuation gaps, in global rotation, but they exist alongside fragilities: crowded trades, credit dependence, political headline risk, and economic fatigue.

Households have stretched. Companies have leaned. Central banks have paused, but not pivoted. And markets, for all their optimism, are quietly waiting for leadership beyond the top 10 stocks. The path forward will not be linear, but it will reward the prepared.



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