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2025 H2 Outlook: Looking Through the Chaos

"***Politics** is the art of the possible, the attainable—the **art of the next best**.*" – **Otto Von Bismark**

"*Life is what happens when you are busy making other plans.*" – **John Lennon**

"***The truth about the world is that anything is possible.** Had you not seen it all from birth and thereby bled it of its strangeness, it would appear to you for what it is: A hat trick in a medicine show. A fevered dream. A trance bepopulate with chimeras having neither analogue nor precedent. An itinerant carnival. A migratory tentshow **whose ultimate destination after many a pitch in many a muddied field is unspeakable and calamitous beyond reckoning**.*" – **Cormac McCarthy**

"***Headline-driven** markets suck.*" – **Walter Deemer**

"*'Too Late' **Jerome Powell** is costing our Country Hundreds of Billions of Dollars. He **is truly one of the dumbest, and most destructive, people in Government**, and the Fed Board is complicit.*" – **Donald Trump, Truth Social – June 19, 2025**

EXECUTIVE SUMMARY

- Despite the event-driven H1, underlying equity, fixed income and commodity trends outlined in our 2025 Outlook remain intact.
- H1 turbulence reset sentiment... Technicals are overwhelmingly bullish and AI adoption points to a productivity boom.
- Non-linear economic deceleration is the primary H2 risk, but we continue to expect a "muddle through" or "soft landing" environment.

Asset Performance by Year (% Change)

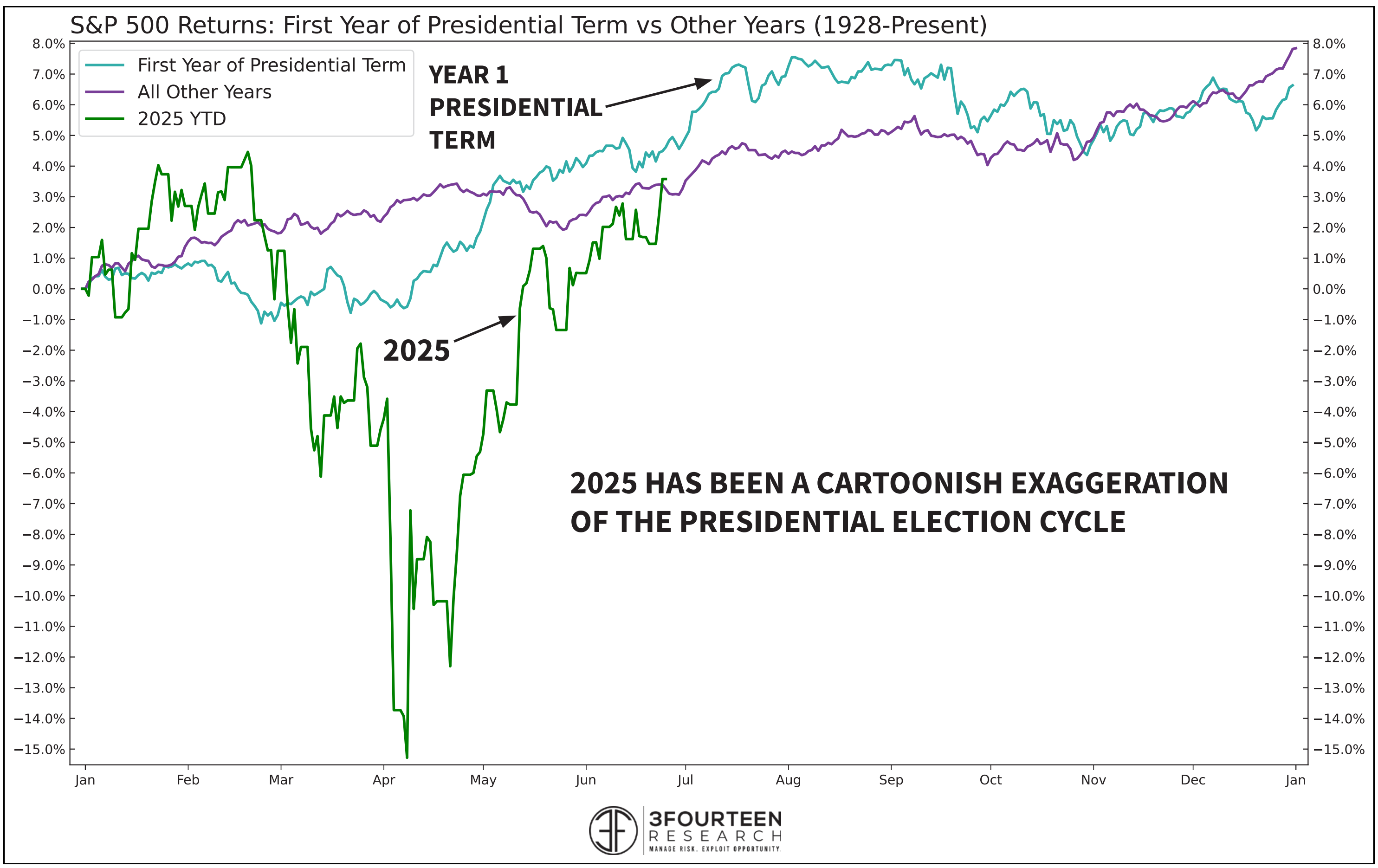
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gold	-2	1	-5	-21	-0	-0	-5	2	25	19	6	18	23	31	6	24
Bitcoin																
Commodities	11	13	6	-18	-24	46	27	-31	39	11	19	39	0	41	-43	50
Real Estate	3	15	35	20	-18	-5	26	14	4	37	32	12	35	-16	-38	28
Small Cap	-2	28	16	22	-3	21	-3	2	-20	47	18	5	18	-2	-34	27
Nasdaq	-3	41	23	22	40	86	-39	-21	-31	51	10	2	11	11	-40	45
S&P 500	1	38	23	33	29	21	-9	-12	-22	29	11	5	16	6	-37	26
Value	-2	38	22	35	16	7	7	-6	-16	30	16	7	22	-0	-37	20
EAFE	8	11	6	2	20	27	-14	-21	-16	39	20	14	26	11	-43	32
Emerging Markets								-3	-6	56	26	34	32	39	-53	79
LT Treasuries	-8	31	-1	15	13	-9	20	4	17	3	8	7	2	10	23	-12
TIPS					4	2	13	8	17	8	8	3	0	12	-2	11
Corp. Bonds	-3	18	4	10	9	-1	12	8	10	4	4	2	4	7	5	6
High Yield	-1	19	11	13	2	2	-6	5	-1	29	11	3	12	2	-26	58
EM Bonds	-14	23	28	13	-12	23	14	1	12	27	12	12	10	5	-15	34
* 60/40	-0	30	15	24	21	12	-1	-3	-9	19	8	4	11	6	-22	18
* Core RAA Model	-5	34	16	19	16	31	4	1	5	30	9	9	12	11	-13	20
* Simple RAA Model	-2	29	16	18	23	35	-5	1	3	24	8	10	9	10	-13	19
Fed Funds BPs Δ	250	0	-25	25	-75	75	100	-475	-50	-25	125	200	100	-100	-400	0

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025 YTD
Gold	30	10	7	-28	-1	-10	8	14	-2	18	25	-4	-0	13	27	27
Bitcoin		1317	218	5428	-58	36	120	1375	-74	95	305	60	-64	157	120	15
Commodities	20	2	0	-2	-34	-25	28	11	-15	17	-6	37	9	-12	3	-1
Real Estate	28	8	20	3	28	3	9	9	-4	29	-5	41	-25	11	5	1
Small Cap	27	-4	16	39	5	-4	21	15	-11	26	20	15	-20	17	12	-4
Nasdaq	18	-1	18	40	15	7	9	30	-3	37	45	22	-33	45	30	4
S&P 500	15	2	16	32	14	1	12	22	-4	31	18	29	-18	26	25	4
Value	16	0	18	33	13	-4	17	14	-8	27	3	25	-8	11	14	4
EAFE	8	-12	17	23	-5	-1	1	25	-14	22	8	11	-14	18	4	17
Emerging Markets	19	-18	18	-3	-2	-15	11	37	-15	18	18	-3	-20	10	8	15
LT Treasuries	9	29	4	-12	25	-1	1	9	-2	15	18	-5	-29	3	-6	2
TIPS	6	14	7	-9	4	-1	5	3	-1	8	11	6	-12	4	2	4
Corp. Bonds	7	8	4	-2	6	1	3	4	0	9	8	-2	-13	6	1	4
High Yield	15	5	16	7	2	-4	17	8	-2	14	7	5	-11	13	8	4
EM Bonds	13	7	18	-4	5	1	10	8	-2	13	7	-2	-15	9	7	4
* 60/40	12	5	11	18	11	1	8	14	-2	22	15	16	-16	18	15	4
* Core RAA Model	13	4	12	17	9	-2	11	17	-3	23	20	19	-10	16	19	3
* Simple RAA Model	14	-1	8	16	8	1	8	17	-0	23	22	17	-8	16	18	6
Fed Funds BPs Δ	0	0	0	0	0	25	25	75	100	-75	-150	0	425	100	-100	0

The first half of 2025 has been…eventful. Each month, a new story bursts into the headlines—commandeering the market's full attention. Since Trump's inauguration, there have been surprise tariffs aimed at Mexico and Canada. Then, the Liberation Day fiasco. This led to existential dread among investors questioning whether those odd poster boards had marked the end of American Exceptionalism. Next, Trump backtracked and turned his focus to the Big, Beautiful Bill. Finally, Israel attacked Iran and, last weekend, the U.S. joined the fray dropping bombs on subterranean Iranian enrichment facilities. **Over just the last quarter, macro investors have feverishly worked to understand the nuances of tariffs, CBO scoring, and, most recently, maritime warfare in the Middle East (i.e. can Iran blockade the Strait of Hormuz).** Among veteran market watchers, there is a timeless truism: Event-driven markets suck. And, 2025 has been the most event-driven market in our memory. The truism has held. It is not atypical for the first year of a new President to have a rocky post-inauguration period, but 2025 has been a cartoonish version of the "typical" Presidential cycle (chart below).

Why does this type of market bring fatigue? Well, from our perspective, these events knock you out of your investing rhythm. They are impossible to model. As is so often the case, investors must learn to operate in the face of uncertainty. There is no way to fully escape this dilemma. However, the best solution is to lean heavily on technicals. **As Stan Druckenmiller is famous for saying "*the guts of the market is the best economist*" he knows. Similarly, the market is our best shot at seeing through event-driven volatility. This remains our strategy.** In today's report, we review the technical evidence supporting a bullish H2 outlook for equities. Moreover, we catalogue the major risks facing markets and judge how serious they are.

First, we must force ourselves to remember the predictions made in our 2025 Outlook. To quote: "*Our high-level view of next year: Inflation falls hard. Growth concerns—emanating from the housing market—re-emerge in H1. The Fed will have to cut more than the consensus expects (100 bps). Aggressive Fed action will pull down longer-term yields and keep the soft landing intact. The S&P 500 will have another strong year (6,800 end-year target), but suffer a 10% correction in H1 (late Q1 is a risk window).*"



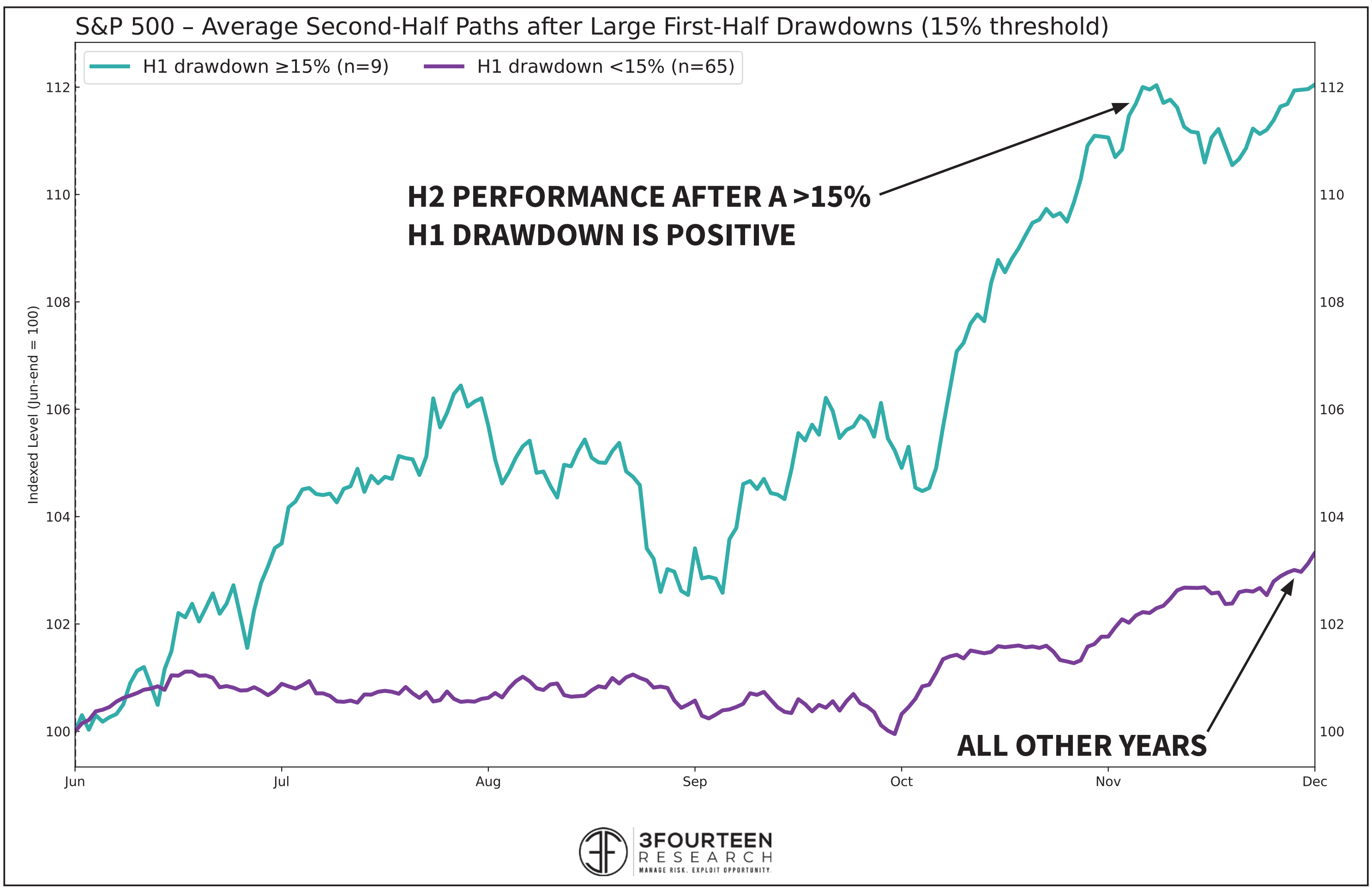
Going back to our 2025 Outlook, there was one glaring omission: Tariffs. We underestimated the role they would play in the 2025 path. More specifically, we underestimated the magnitude of the proposed rates and the chaotic rollout. It is hard to imagine how the Administration could have flubbed the rollout more badly. Those April 2nd poster boards shook investor confidence and caused everyone to question the economic literacy of the Administration.

The Fed was always going to stage a mini-revolt against the new Administration and its protectionist policies. However, the Liberation Day misstep has exacerbated the Fed's "recalcitrance." **Ultimately, the various events of 2025 have dominated the headlines and investor headspace. But, under the surface, most of the macro themes we laid out back in December remain intact.** Recall, we foresaw:

- **A strong disinflationary impulse** coming from housing, oil and labor markets. Despite the recent geopolitical pop, all of these factors remain.
- Decelerating economic growth that would propel the Fed to continue cutting after an H1 "hawkish pause."
- **A bullish H2 for equities after a +10% H1 correction reset (worrisomely) optimistic sentiment.**

Zooming out, these major themes are still with us. Despite noise from tariffs, disinflation continues. The Fed has pushed against the Administration but is starting to reckon with the necessity of multiple H2 cuts. And, housing is suffering under the weight of 7% mortgage rates. **Cutting through the event-driven noise, the macro cycle is mostly unchanged.** With that in mind, let's look ahead to the second half.

What does the H1 correction/bear market mean for H2 performance? It is typically positive. The chart below plots the average H2 performance of the S&P 500 in the years where the Index suffered through a +15% drawdown during the first half. In general, these years see a rebound in the back half of the calendar year. Somewhat surprisingly, there are only nine years (post WWII) where the S&P 500 declined by >15% in the first half. Of those, seven had positive H2 returns and six posted >15% H2 returns. Notably, 2025 is only the third year to suffer such a deep H1 drawdown but post positive returns going into H2 (1980 and 2009). Usually, this level of intra-year volatility is associated with a recession or the recovery from a recession.



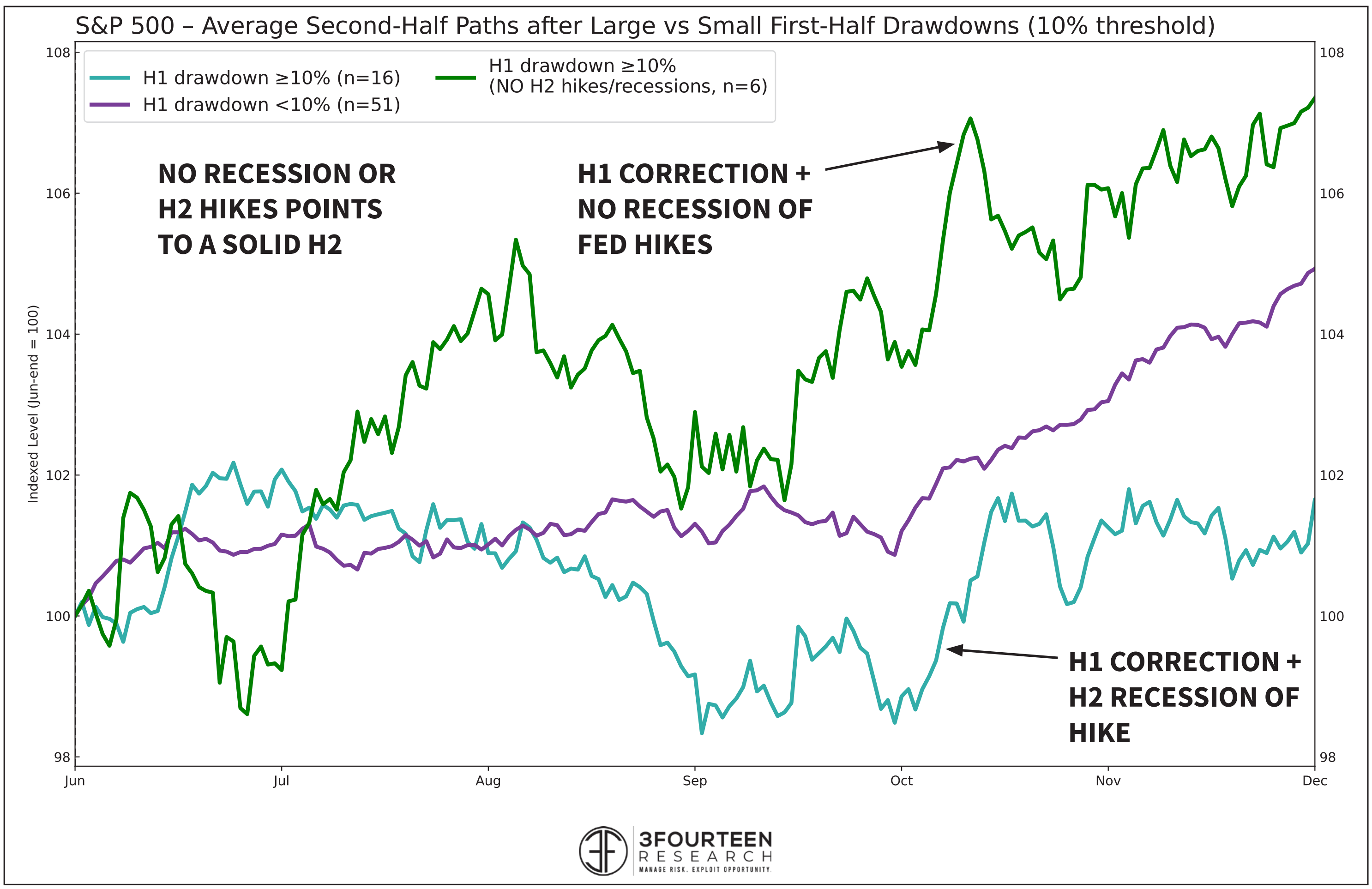
H2 GOALS: AVOID RECESSION + FED MISTAKE

The chart below expands the historic analysis. Here, we dig into calendar years where the S&P 500 suffers a >10% correction in the first half of the year. In these cases, there's a dichotomy between those years where H2 avoids Fed tightening or a recession (green line) and those years where either a recession or tightening occur (blue line). **The sample size is small but those years where the market corrects in H1, but avoids recession/ tightening, go on to enjoy the best second half performance. This helps narrow our focus. Do we expect a Fed tightening? No. What about a recession? No...but there is more risk here. Thus, our expectation is that the market should more closely approximate the path of the green line.** From a risk management perspective, this defines two broad risks for us to monitor heading into H2: A Fed mistake + recession.

Before discussing risks, we must recap the many bullish signals recorded over the past couple months. The table to the right lists eight that we have highlighted in our research this year.

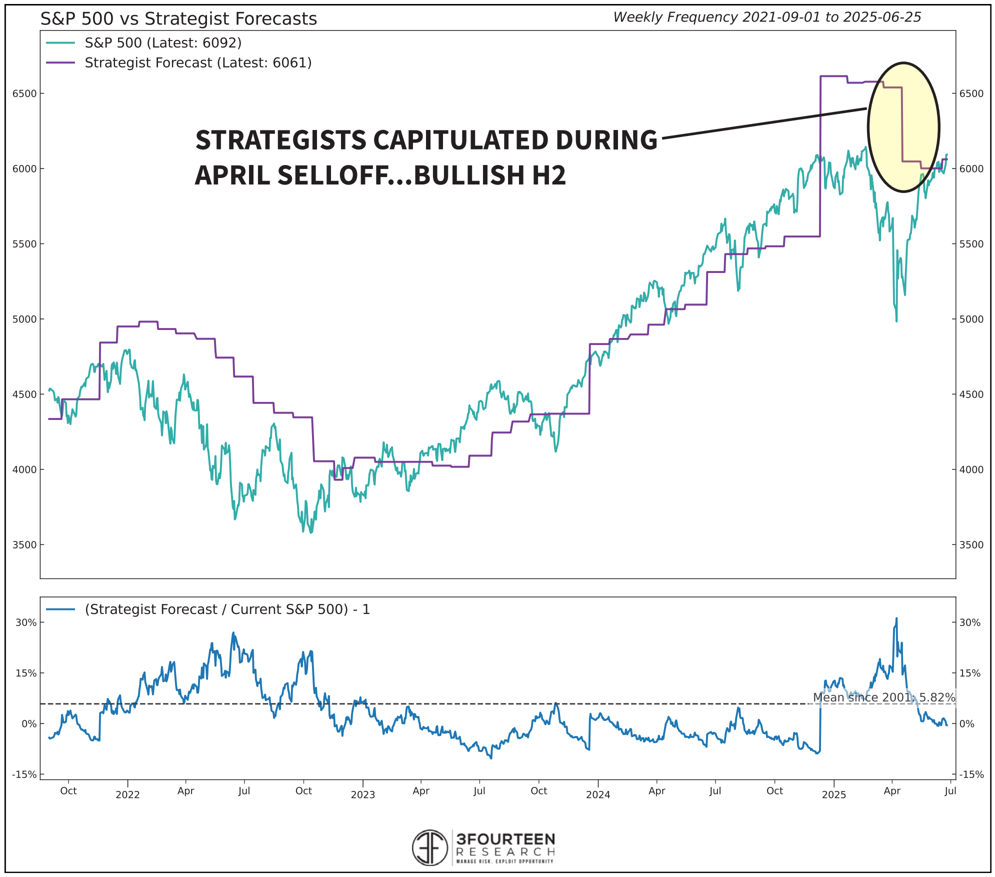
POST LIBERATION DAY BULLISH TECHNICAL EVIDENCE

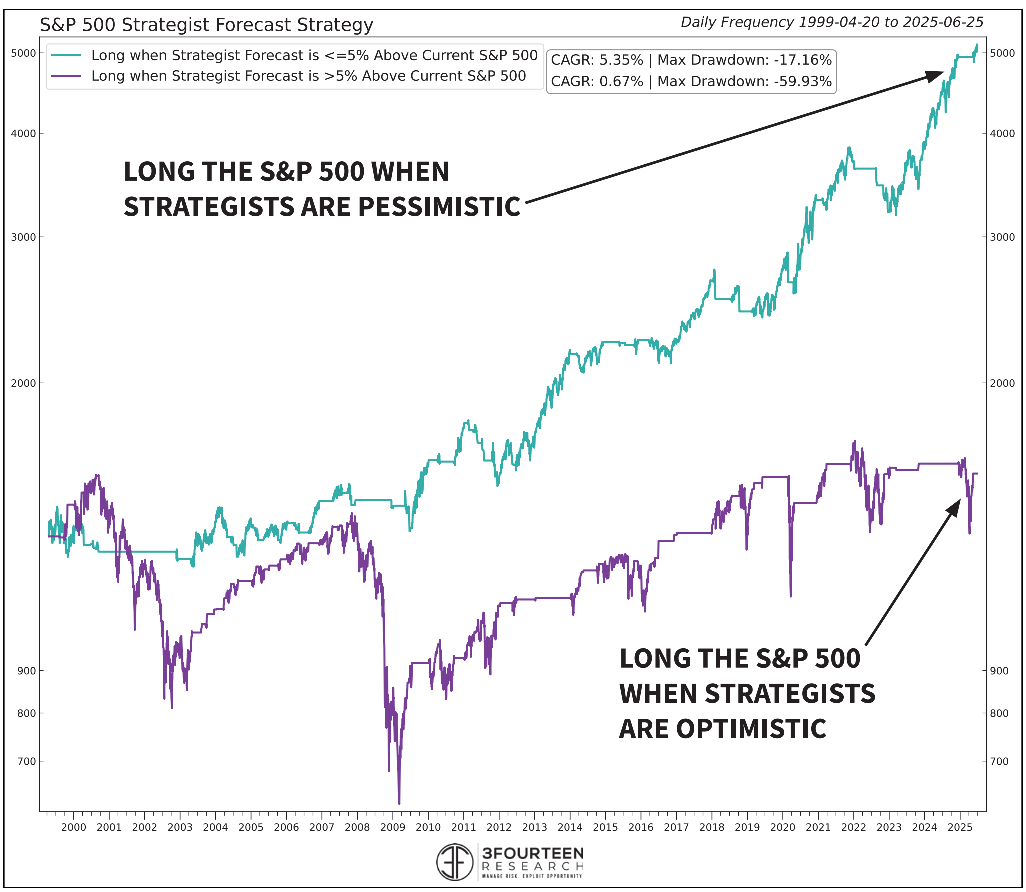
INDICATOR (SHORT NAME)	DATE & 3FOURTEEN REPORT
Breadth Thrust Combo (ZBT + DeGraaf)	15 May 2025 – To The Limit
NYSE A/D-line 42-day high	15 May 2025 – To The Limit
Momentum thrust – S&P +20 % in 28 days	29 May 2025 – From Deflation to Debasement
Momentum + Sentiment double trigger	12 Jun 2025 – Economic Mirage or Oasis?
Vol-target "re-risk" trigger	12 Jun 2025 – Economic Mirage or Oasis?
CTA / inverse-ETF capitulation	17 Apr 2025 – Twilight of the Empire?
Strategists cutting targets	1 May 2025 – Surviving the Pause
Forward EPS at / near ATH	12 Jun 2025 – Economic Mirage or Oasis?



SENTIMENT: H1 RESET FUELS H2 GAINS

"*SENTIMENT = EARLY-YEAR HEADWIND*" – Thus began the heart of our 2025 Outlook. Coming into the year, Strategists had abandoned their multi-year bearishness in dramatic fashion. To quote from the Outlook: "*For 2025, strategists are calling for a ~11% gain. After two straight 20% years, no one wants to be labeled a bear.*" Our view was that there would need to be some first-half turbulence to reset this sentiment extreme and late-Q1/early-Q2 presented a window of weakness. The Liberation Day market crash accomplished this reset. **Amidst the late-April panic, Strategists capitulated, bringing their median year end S&P 500 target down by almost 10% (from 6,600 to just above 6,000 - chart right).**

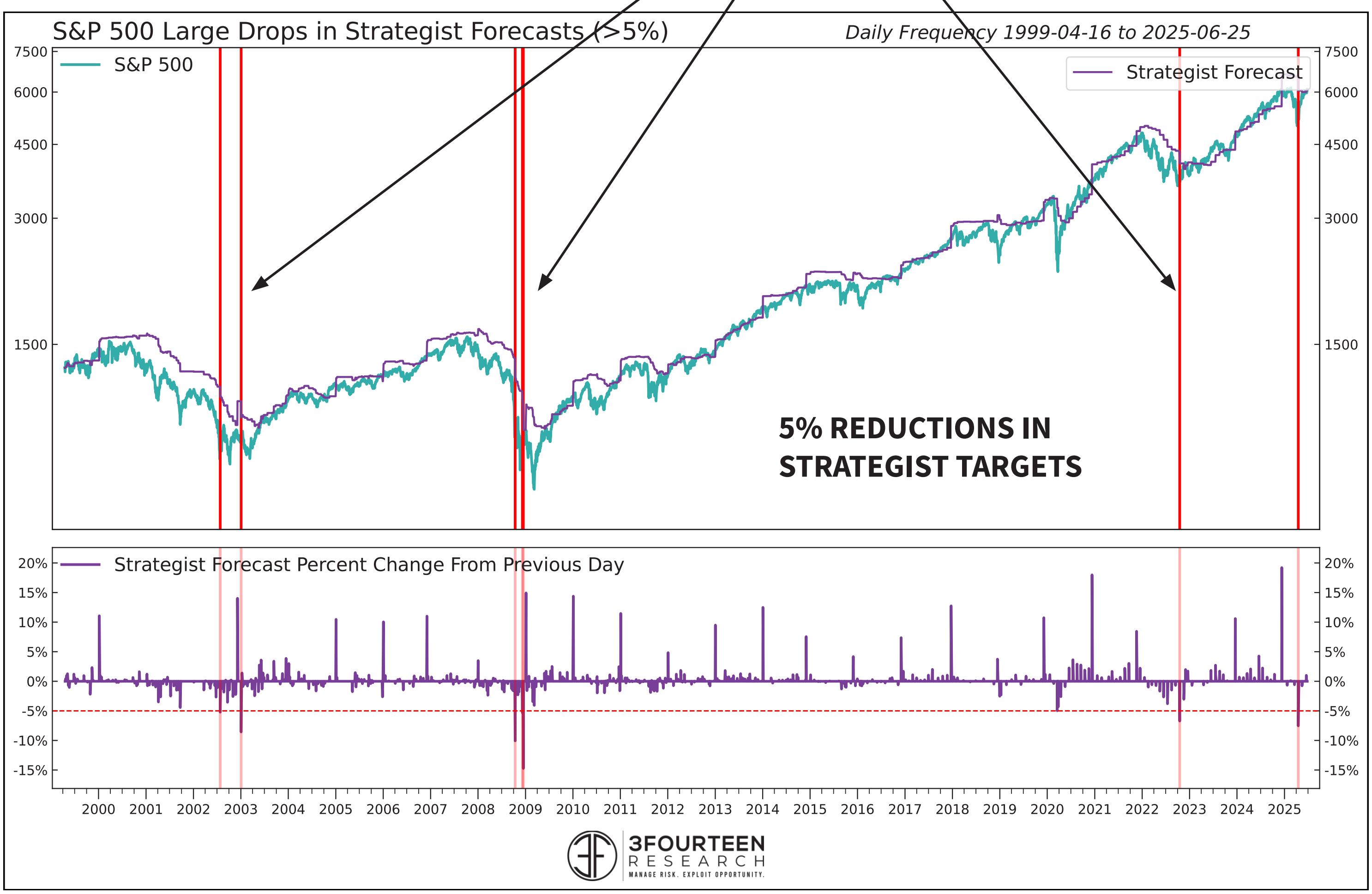




Now, the S&P has climbed to ~6,100—just above the median year-end strategist target. As we have shown in the past, this is a bullish condition. The chart to the left turns these strategist forecasts into an S&P trading strategy that goes long the market when the median year-end target is <5% (pessimism) above the current market price (blue line). When targets are >5% (optimism) above the current market price (purple line), the S&P 500 underperforms. **The bottom line: When Wall Street strategist targets imply a very conservative return, as they do now, it is positive for the S&P 500. As strategists fall behind, they are forced to increase their targets and chase the market higher. The early-year selloff took these targets from an optimistic extreme (implying a +10% year-end return) to a pessimistic extreme (implying losses from here).**

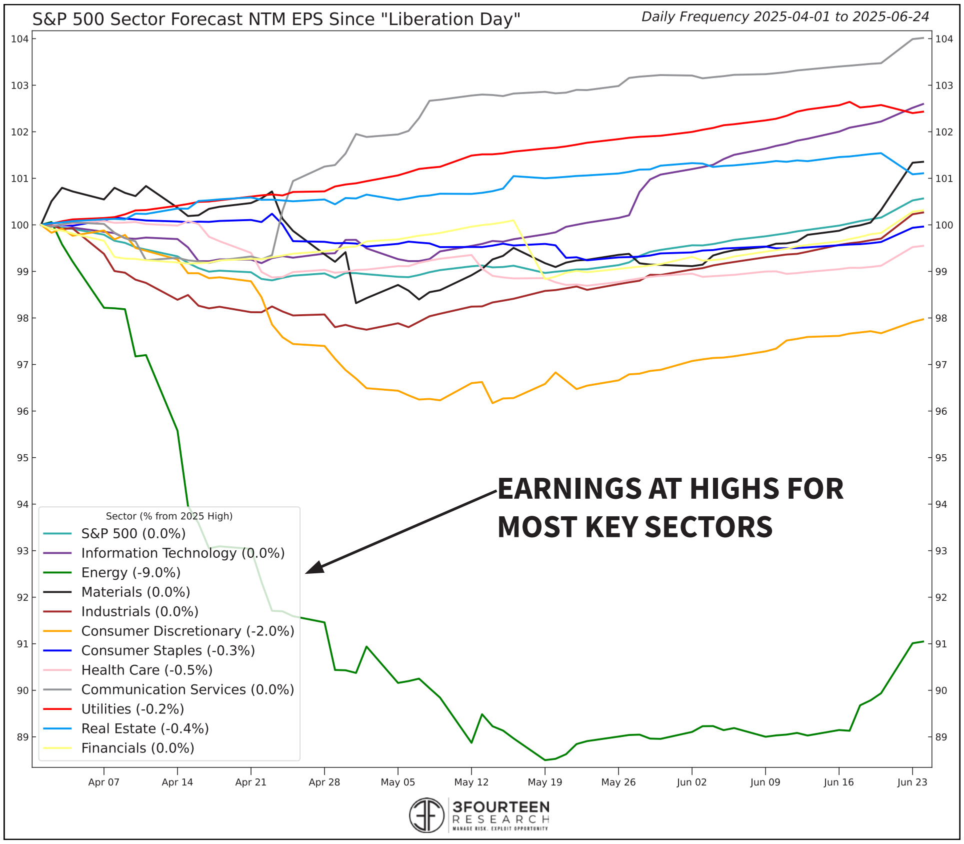
So, strategists have retracted back to their cautious 2023-2024 posture. This bodes well for forward equity returns. For those still wondering if the bottom is in, these sharp target reductions coincide with equity bottoms. The charts on this page show how rare (and bullish) it is to see year-end S&P 500 targets come down by 5% or more.

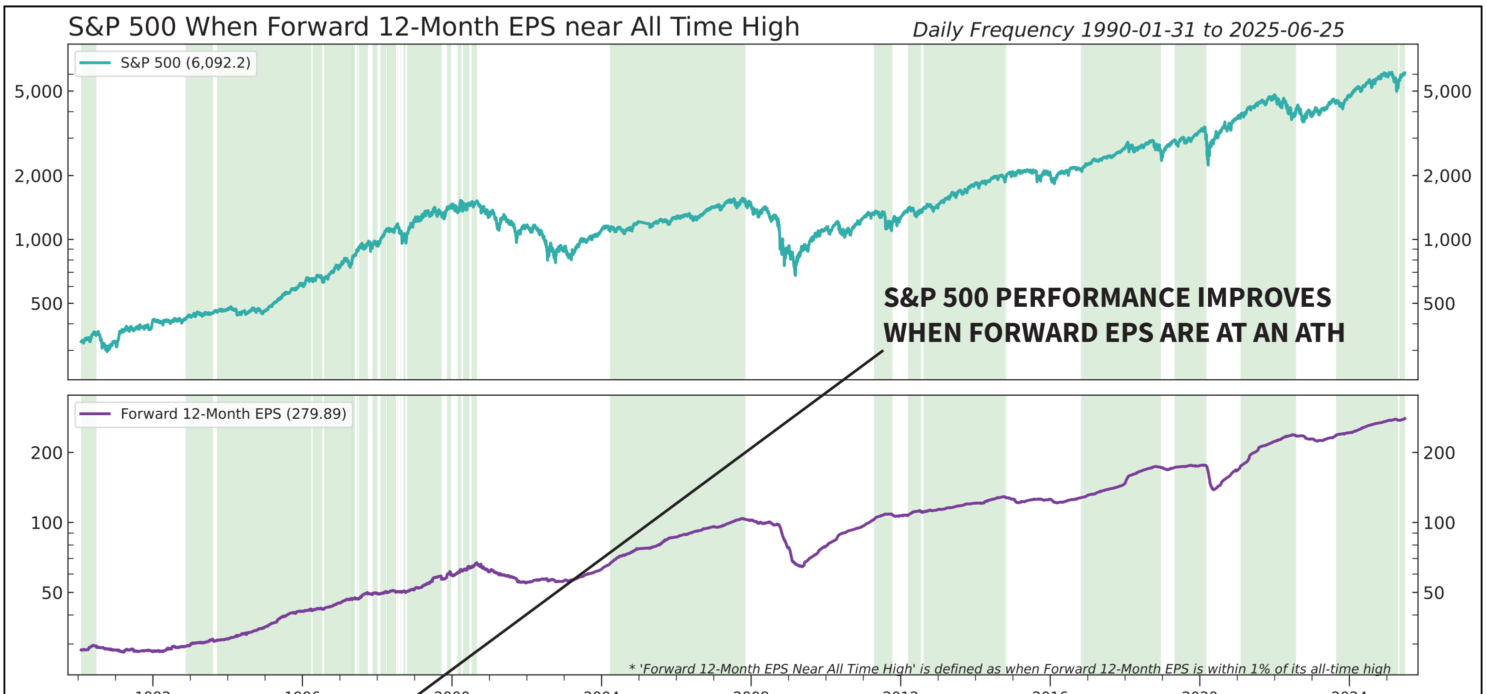
Turning back to the table on page 4, scared strategists are only one piece of the bullish puzzle. As we noted two weeks ago, vol-target funds have begun adding back the equity positions they shed during the April selloff. Multiple breadth and momentum thrusts have triggered buy signals. The A/D line is at an ATH. In the page 4 table, we list each report where we discussed each indicator. We incorporate those bullish studies into this Outlook by reference.



The bullish evidence is not only technical. Forward S&P 500 EPS has broken out to a new ATH. When forward EPS is at an ATH, S&P 500 returns increase and drawdowns decrease (chart below). Earnings growth is relatively broad-based. Six sectors have forward EPS within 1% of an ATH: Tech, Industrials, Financials, Comm Services, Health Care, and Utilities (chart right). If you are a bull, this is the fundamental leadership you want to see.

The upshot: With forward earnings increasing and the index roughly flat for the year, the market's multiple has contracted slightly. As we pointed out in our year ahead Outlook, multiple expansion is more likely when the Fed is cutting rates (see bottom chart next page). Cuts are coming in H2.

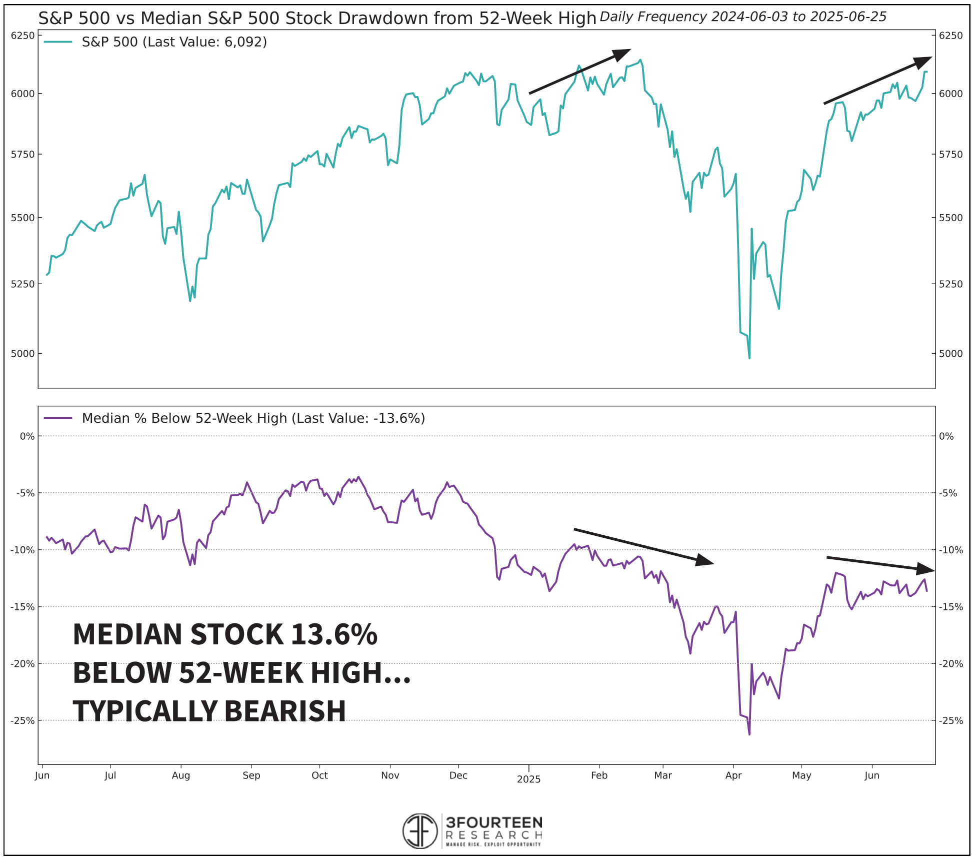


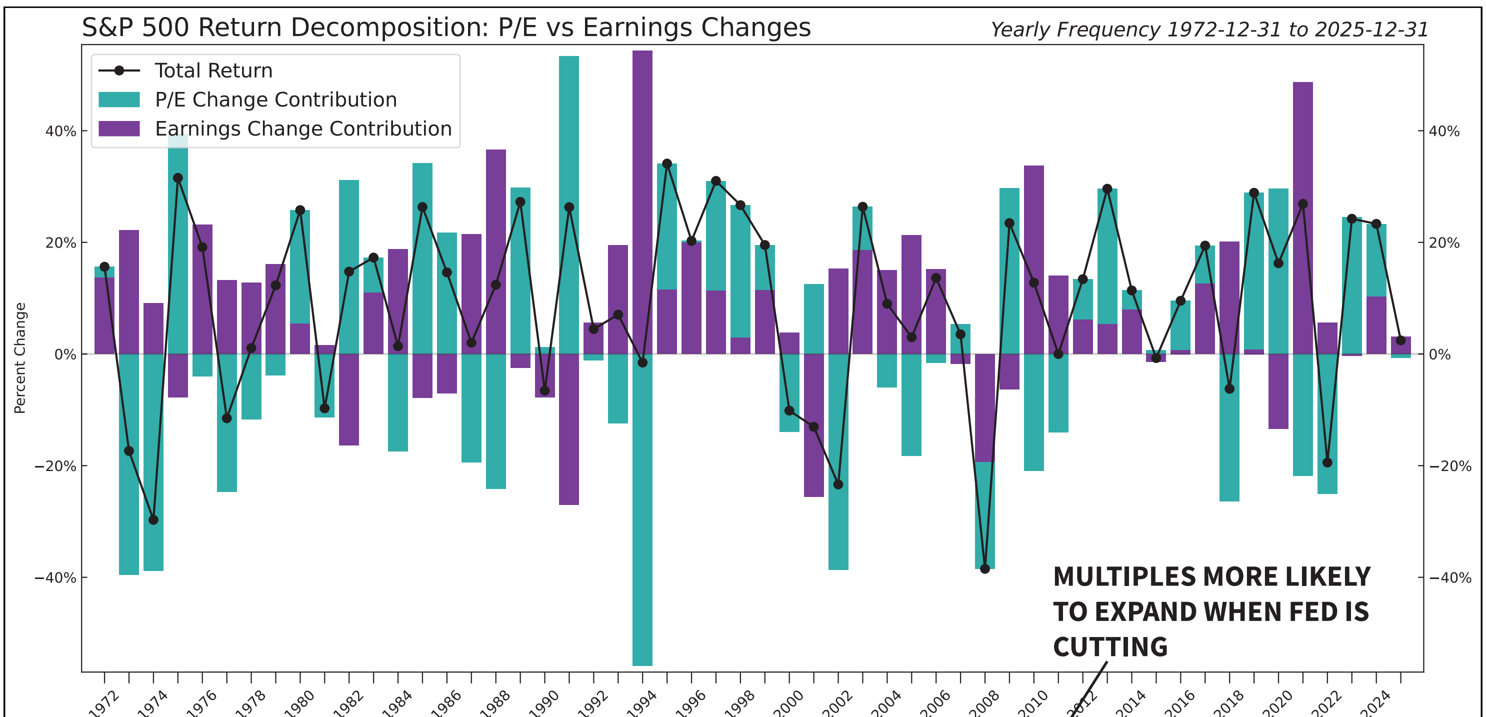


Mode*	CAGR	Max Drawdown	Sharpe Ratio	Percent of Time
Forward 12-Month EPS ATH	12.3%	-23.6%	0.90	55.5%
Forward 12-Month EPS Not ATH	4.3%	-71.2%	0.30	44.5%
Buy and Hold	8.7%	-56.8%	0.55	100.0%

BREADTH CONCERNS?

In sum, the technical picture is overwhelmingly bullish. No single technical study that we have catalogued is compelling on its own. However, taken together, they push us to a strong default bullish path. Before moving onto the "risks" facing the market, are there any technical concerns? Since this mega-cap-led bull market began in 2023, "weak breadth" has been a common criticism of each move higher. We covered breadth issues in mid-2023, early-2024, and mid-2024. Once again, these issues are raising eyebrows. The chart to the right plots the distance the median S&P 500 stock is from a new 52-week high. With the index <1% from new highs, the median stock is still 11% away from a new 52-week high.

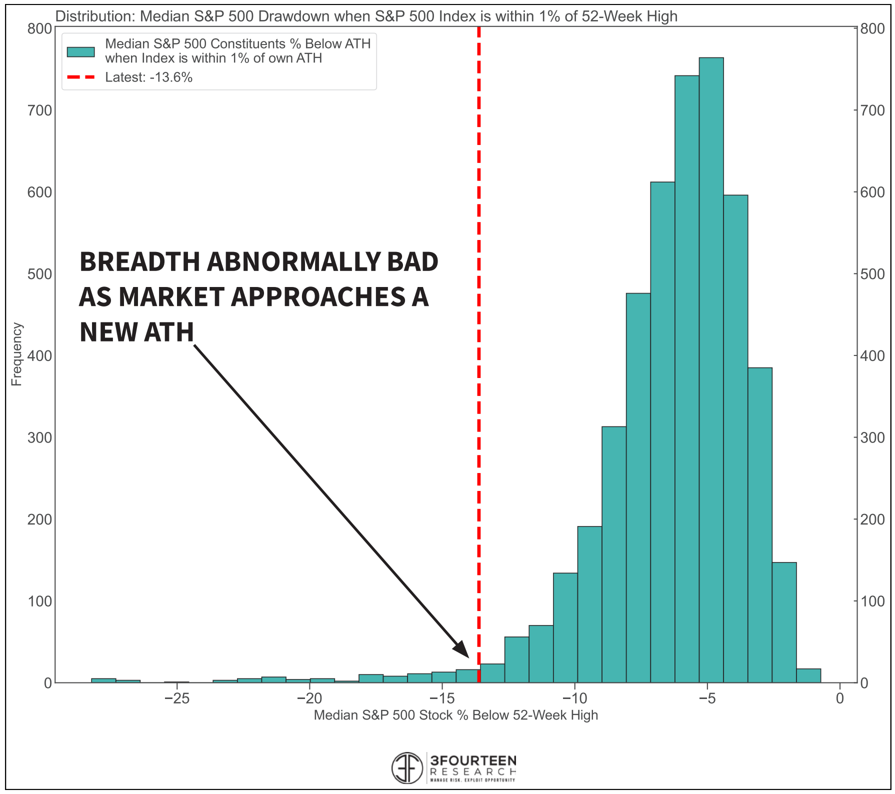


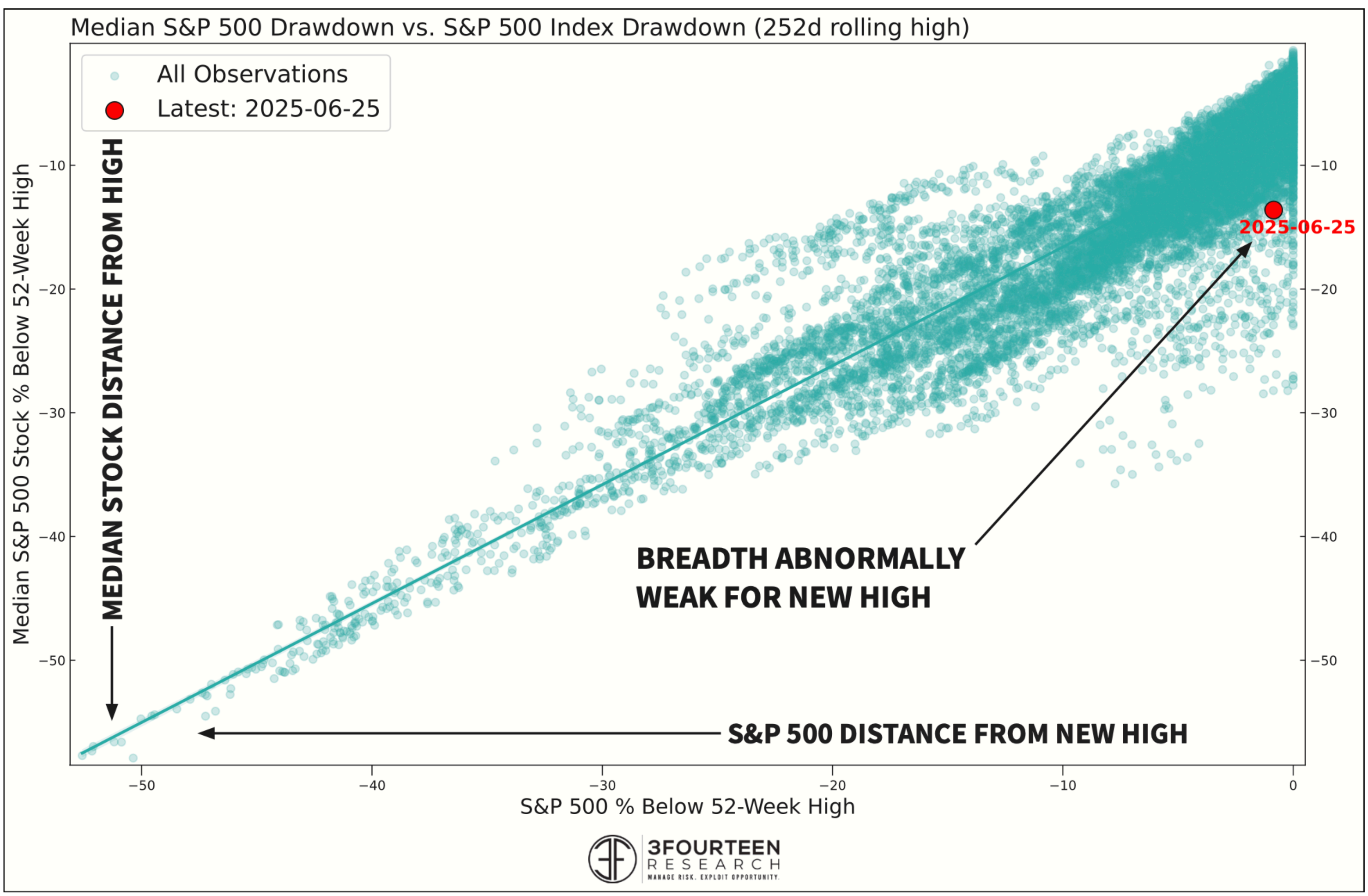


Years with	Avg P/E Contribution	Avg Earnings Contribution	Year Count
Rising Rates	-7.7%	15.0%	23
Falling Rates	7.1%	3.6%	31

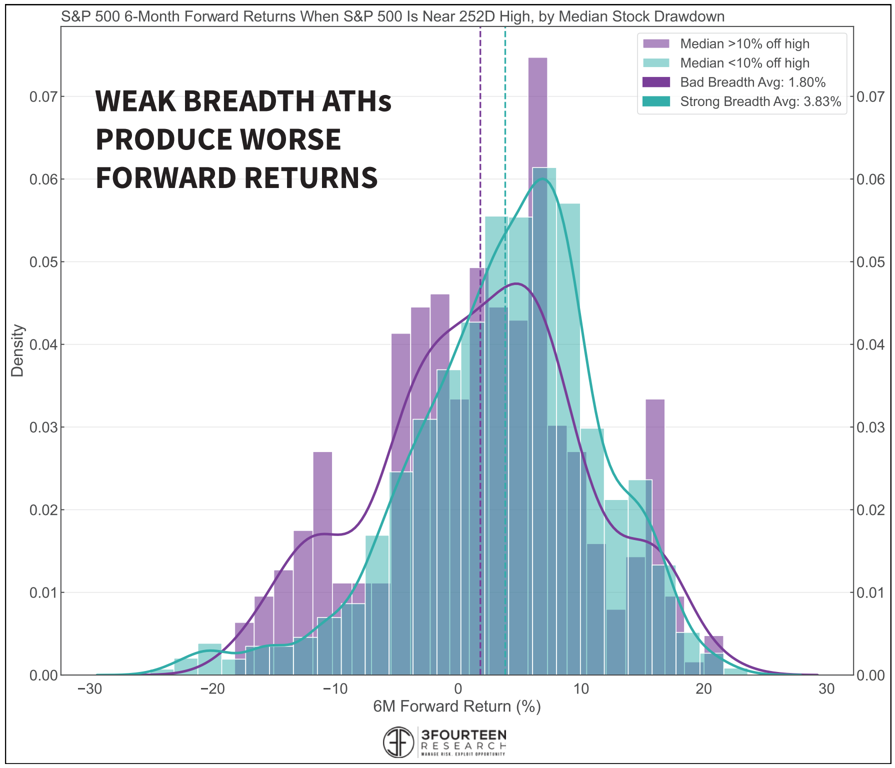
This is a historically odd market condition. The scatter plot below compares the distance the S&P 500 is from a new high (x-axis) to the median stock's distance from a new high (y-axis). The current point is colored red. The histogram to the right drives the point home. Here, we plot the distribution of the median stock's distance from new highs when the S&P 500 is at (or within 1% of a new ATH). The bottom line: The current divergence is extreme.

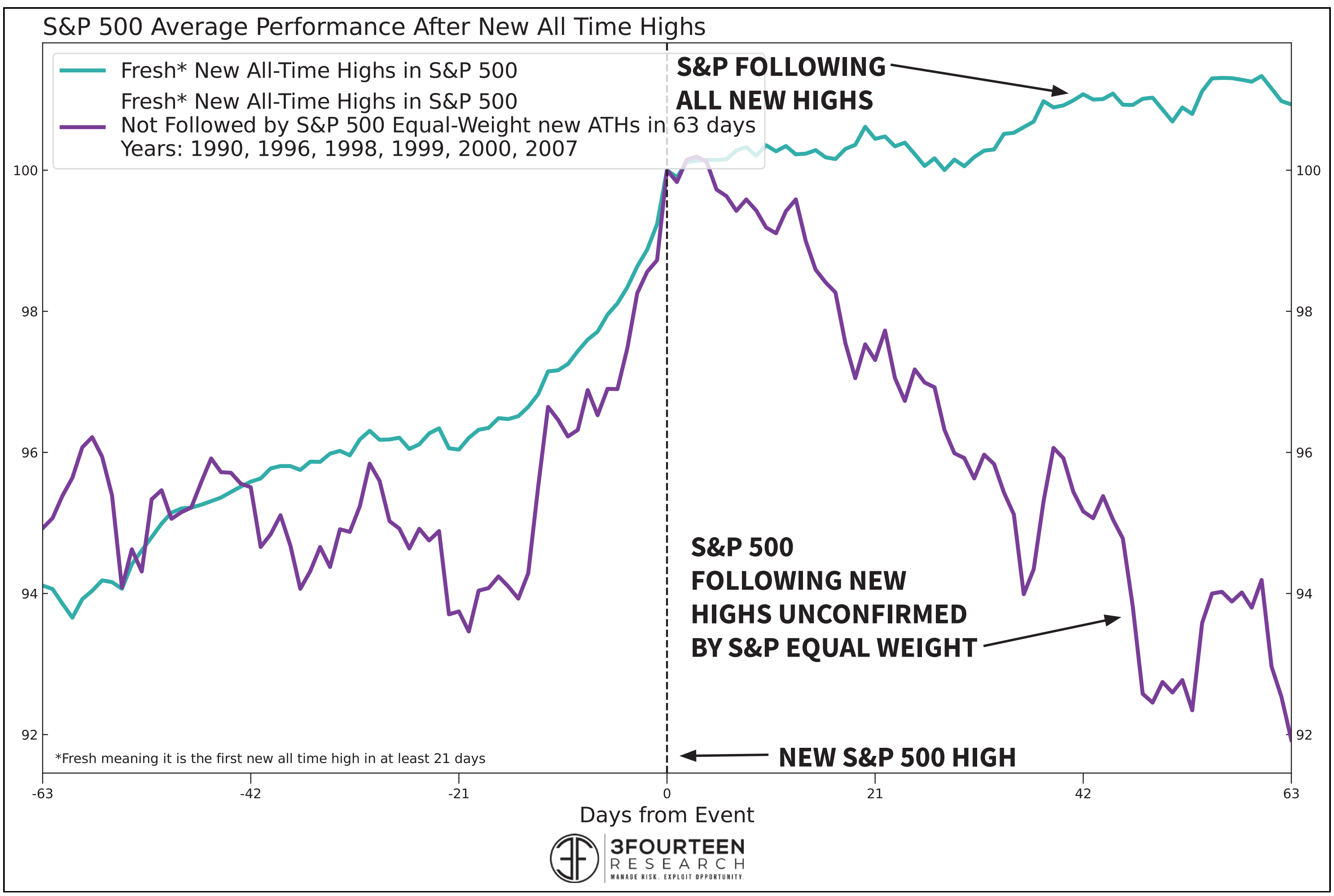
The histogram on the next page compares forward six month returns for the S&P 500 following new highs that occur with weak breadth (median stock >10% away from highs) versus normal highs with more participation. **The conclusion: When the S&P 500 makes a new ATH with weak breadth, forward returns are lower on average.**





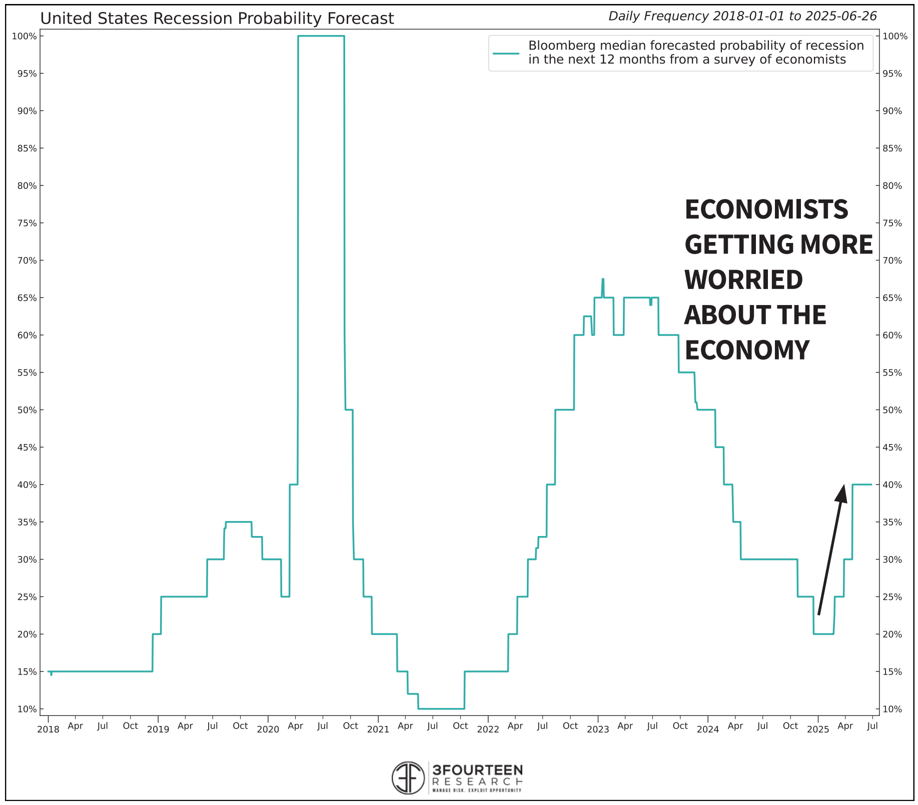
Does the weak breadth concern us? In short, no. When the largest stocks are the leaders (Mag 7), new highs will occur with weak breadth. The pattern of the past 2.5 years, though, has been for these stocks to break out and then the rest of the market to follow as the rally broadens out. We observed this last year coming off the market's choppy Spring. Back then we showed the below study, which plots the path of the market after making new ATHs where the S&P Equal-Weight (SPW) confirms with its own high (blue line) versus those cases where the SPW does not go on to hit new highs of its own within three months (purple line). **Bottom line: Entering H2, technicals are overwhelmingly bullish. Some point to weak breadth as a concern. However, this issue has been a mostly innocuous feature of this bull market since 2023.**

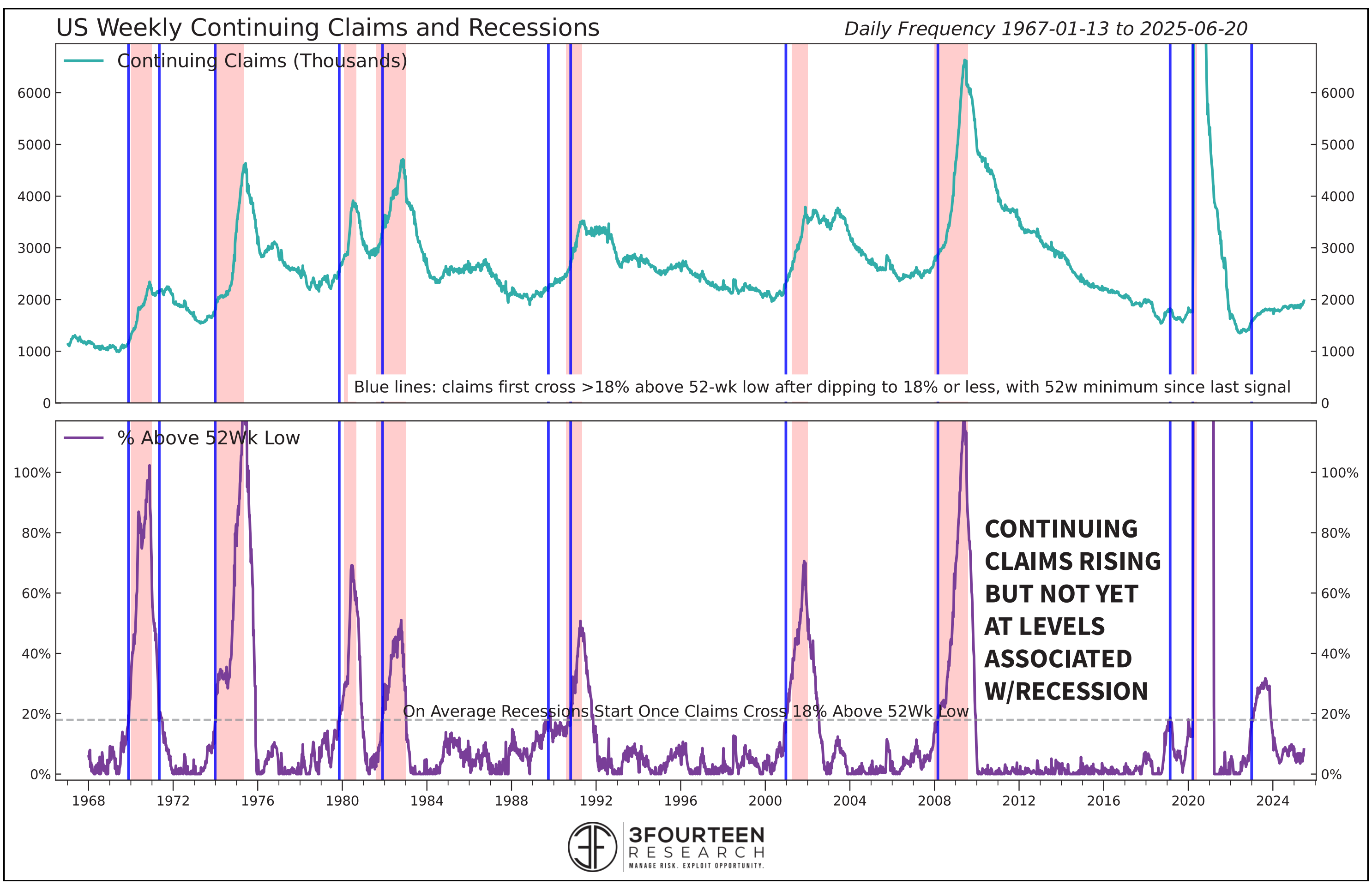




RISKS: RECESSION

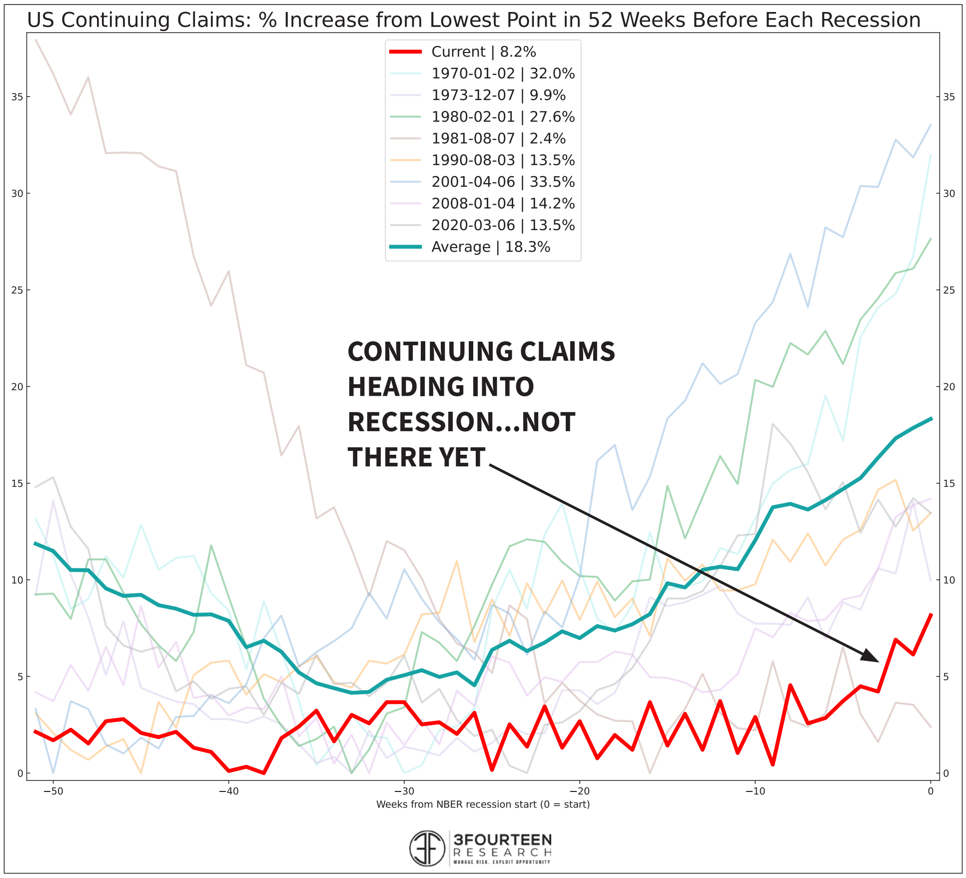
Price action is positive. Sentiment has reset. And, forward earnings are making new highs. Yet, plenty of risks remain. Coming into the year, growth was our number one concern. To quote: "*The economy is more tenuous today than at any point since the pandemic. Without more Fed support, job losses will begin in the cyclical areas of the economy and then spread to the core*." Heading into H2, this assessment has not changed. The economy's slow deceleration continues. For now, we still consider this consistent with a "muddle through" or "soft landing" backdrop. Fiscal support from the "Big, Beautiful Bill" along with imminent Fed cuts (see Fed section of this report) should keep the economy from drifting into recession. However, growth remains our number one concern. Consensus is beginning to share our concerns (chart right).

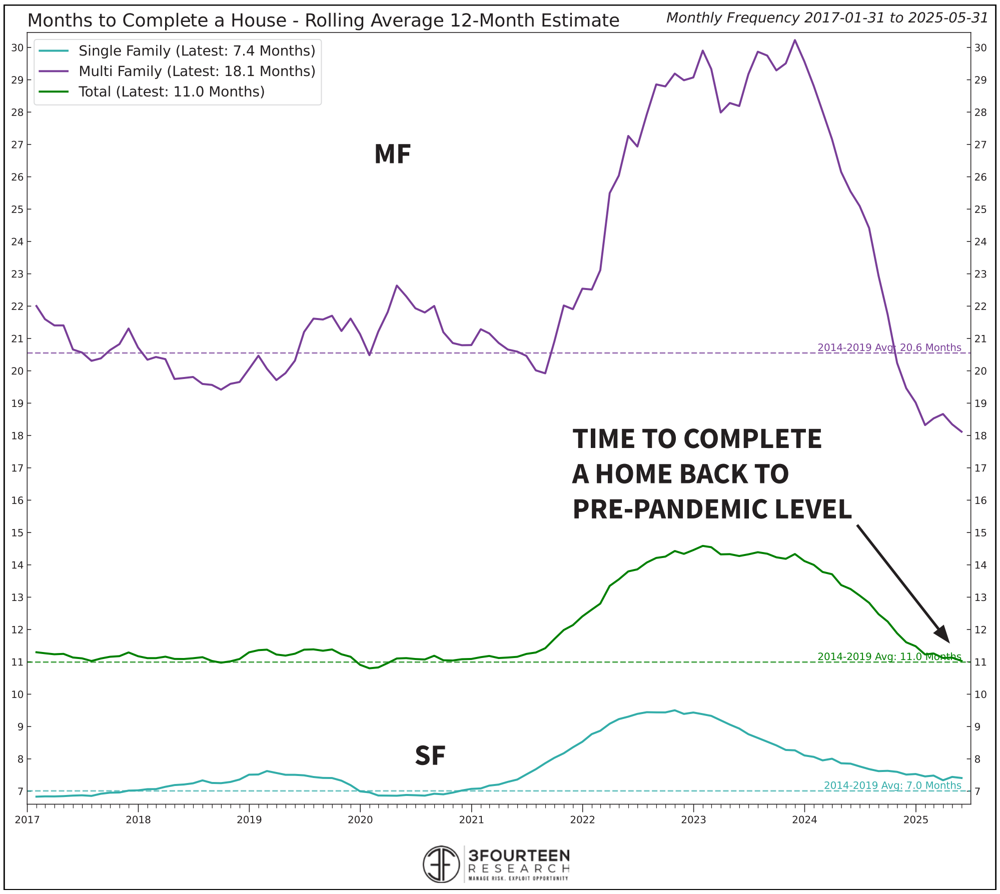




CONTINUING CLAIMS

For equity investors, the labor market remains the epicenter of growth concerns. Eventual job losses are the most likely way to stop the perpetual motion machine that is the S&P 500. Understandably, the weekly jobless claims data has become a market-moving datapoint. Despite a mild rise in continuing claims, though, we are a long way from levels traditionally associated with a recession. The bottom chart on the previous page looks at continuing claims over a long-term horizon. The chart right zooms into how claims behave heading into a recession. So far, continuing claims have risen 8% from the cycle trough. This is well below the recessionary average of 18%. We could explain this away (like many bears do) through the "gig economy" or something else. But, the claims data does not yet support a recession call.



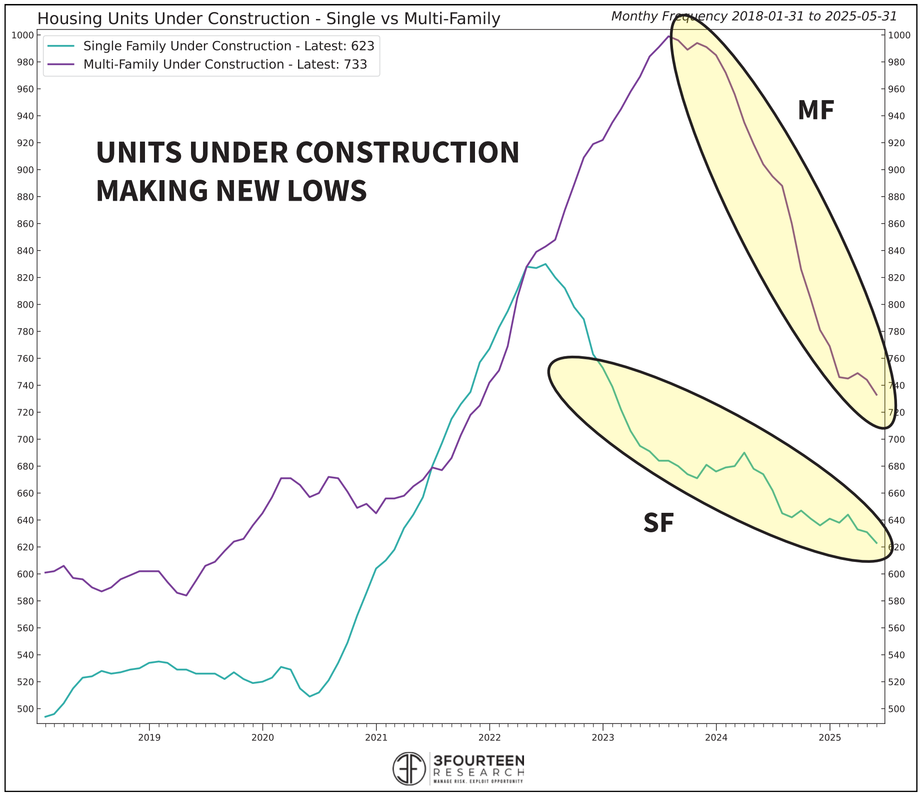


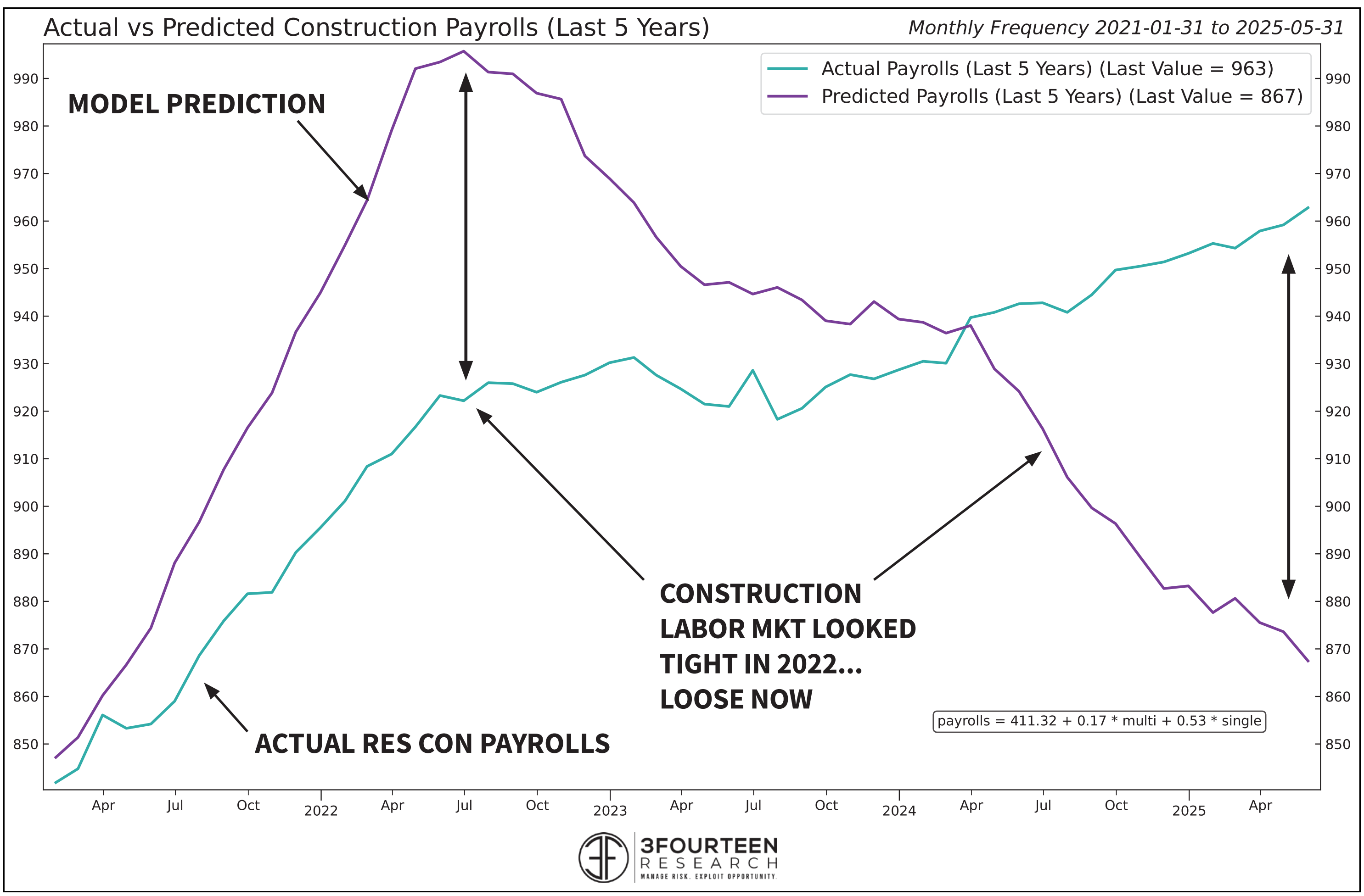
HOUSING = SOURCE OF TRUTH

As always, housing is our economic "source of truth." Our oft-stated view is that residential construction payrolls will decline ahead of the broad economy. For now, housing construction jobs remain at a cyclical high. But, under the surface, the fundamentals are weakening. Housing starts continue to trend lower. Simultaneously, the time it takes to build a home has finally normalized from the post-pandemic bottleneck (chart left).

When completions outpace starts, units under construction fall. This is the workload that supports the housing construction labor force. Both single-family (SF) and multi-family (MF) units under construction are making new multi-year lows (top chart, next page).

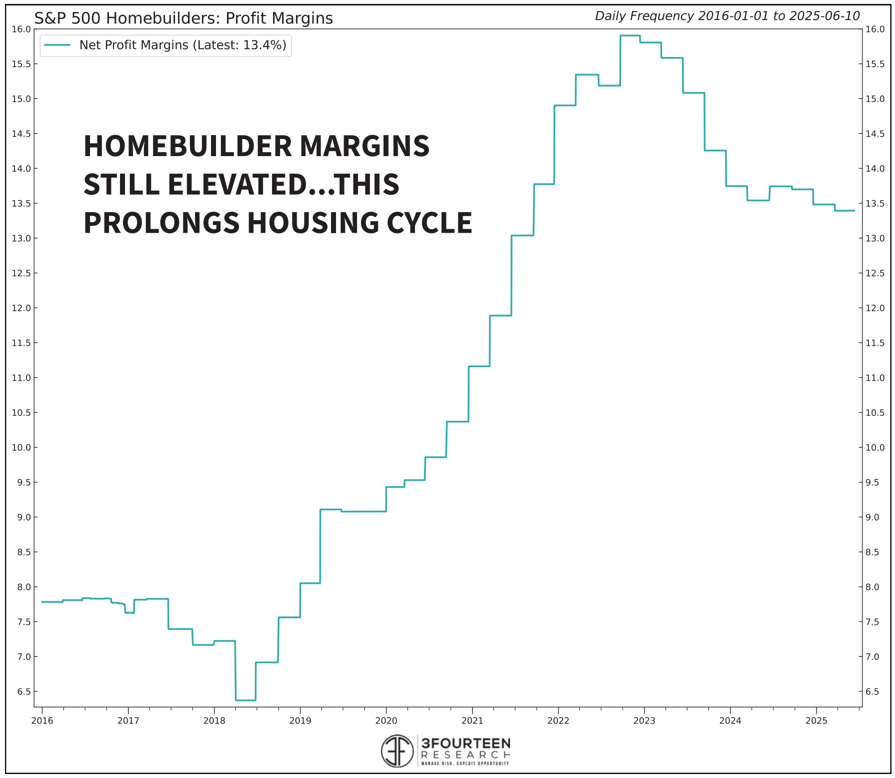
The chart below is our model that predicts residential construction payrolls based on units under construction (accounting for the labor intensity differential of SF and MF projects). When we wrote our 2025 Outlook, there were 957k residential construction workers. Our model suggested that this was about 70k too many. **Now, although residential construction payrolls have ticked higher (963k), the model suggests that there are ~100k excess residential construction jobs. In short, this leading area of the economy—our source of truth—is flashing warning signs.** It is a concerning situation. [However, we do not anticipate a leading indicator.] Labor hoarding, which could ramp due to immigration policy, and fat builder margins (top chart next page) have made this a historically slow-moving housing market. Our best guess is that this will continue into H2.

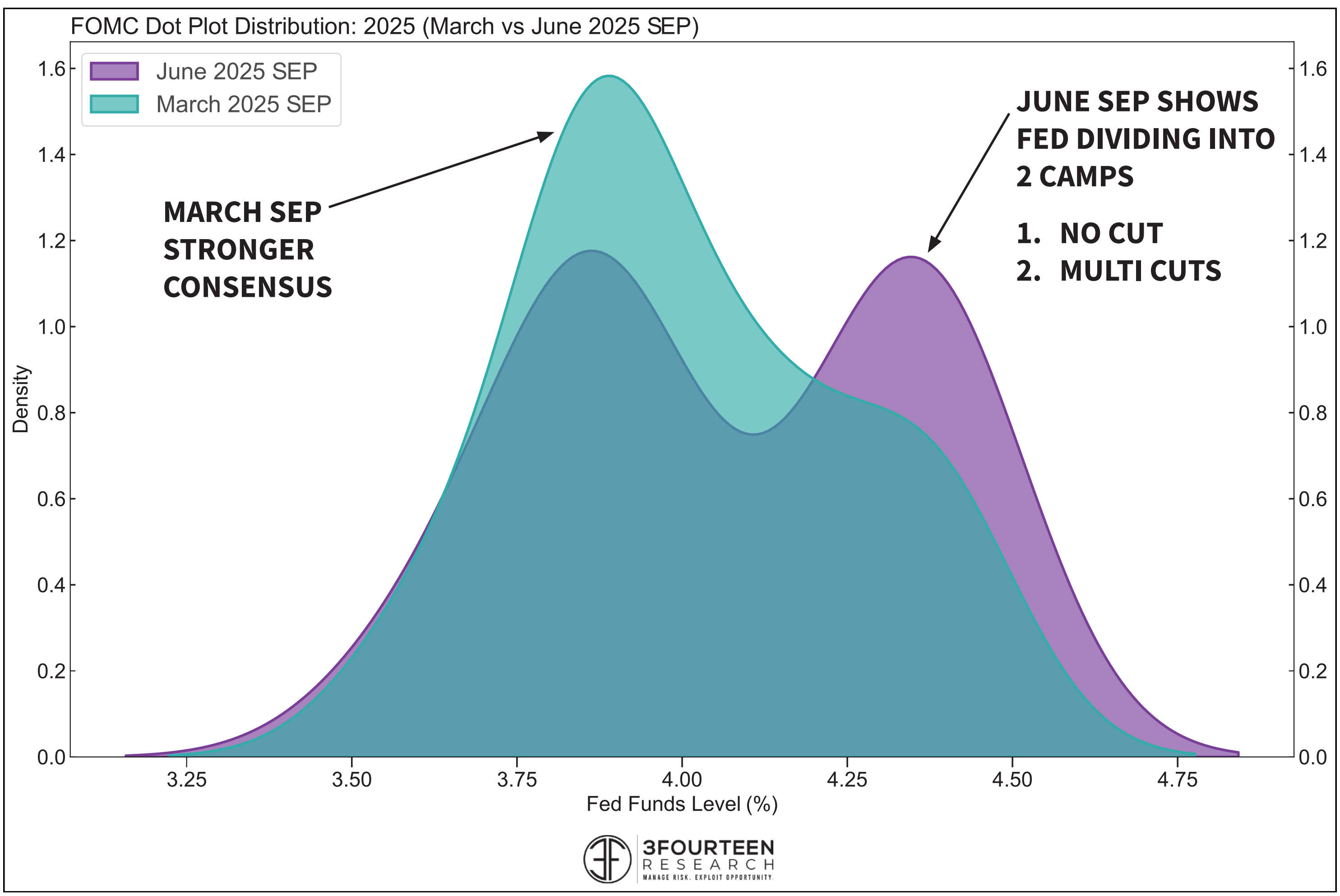




RISKS: RECALCITRANT FED

Is the Fed late? According to President Trump, the answer is a resounding yes. Earlier this month, he referred to Fed Chairman, Jerome Powell as a "*very stupid person*" (the President loves his adverbs). Another, more austere, way to ask the question is whether policy is restrictive. Given what is happening in the housing market, it is hard to argue that current rates are not restricting activity. Yet, there are plenty of folks at the Fed who believe they should not cut rates at all in 2025. This was the most interesting revelation of the June Summary of Economic Projections (SEP). The histogram below paints the picture of an evolving fight within the Fed. Here, we plot the distribution of dots for the 2025 rate forecast (FFR at end of year).



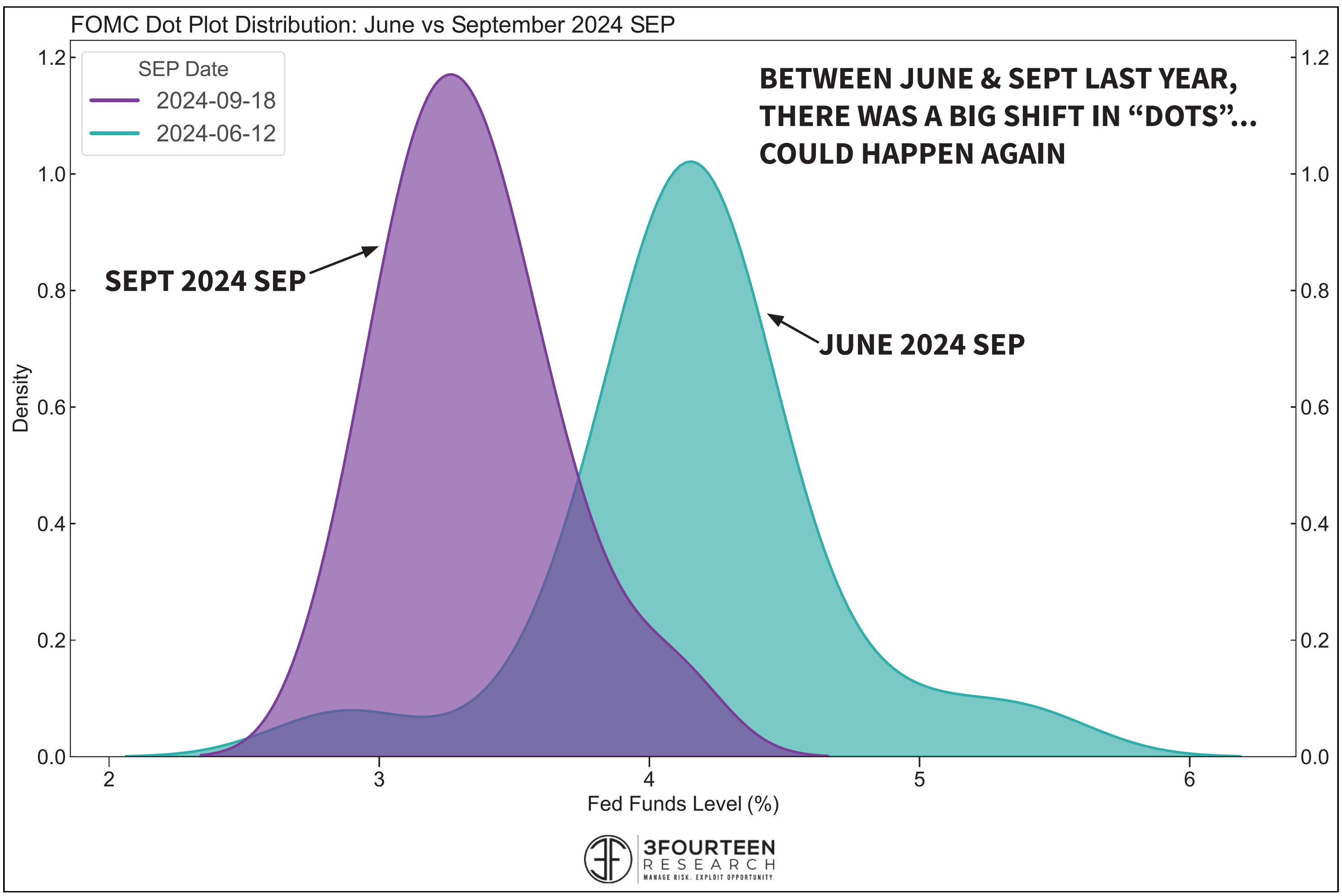


The blue histogram shades the distribution just three months ago (March SEP). Back then, before Liberation Day, there was a strong consensus that the Fed needed to cut multiple times this year (one blue hump). The purple histogram shows how this distribution has changed with the release of the June SEP. Notice there remains a sizable group at the 3.9-4% FFR level. These forecasters are still calling for multiple cuts. However, a second hump is emerging around the 4.4-4.5% level. The translation: More Fed members are signaling no cuts this year. Most likely, this comes down to a philosophical divide between those economists that believe the Fed should look through the "transitory" bump in prices due to tariffs and those who worry that the tariff bump could spiral into something more.

[Going back to February](), we worried that Trump's tariff policies could result in a more hawkish Fed. We called this the risk of a "recalcitrant Fed." In truth, Trump didn't do himself any favors with the outlandish Liberation Day proposal (and the subsequent layering of tariff delays/carve outs).

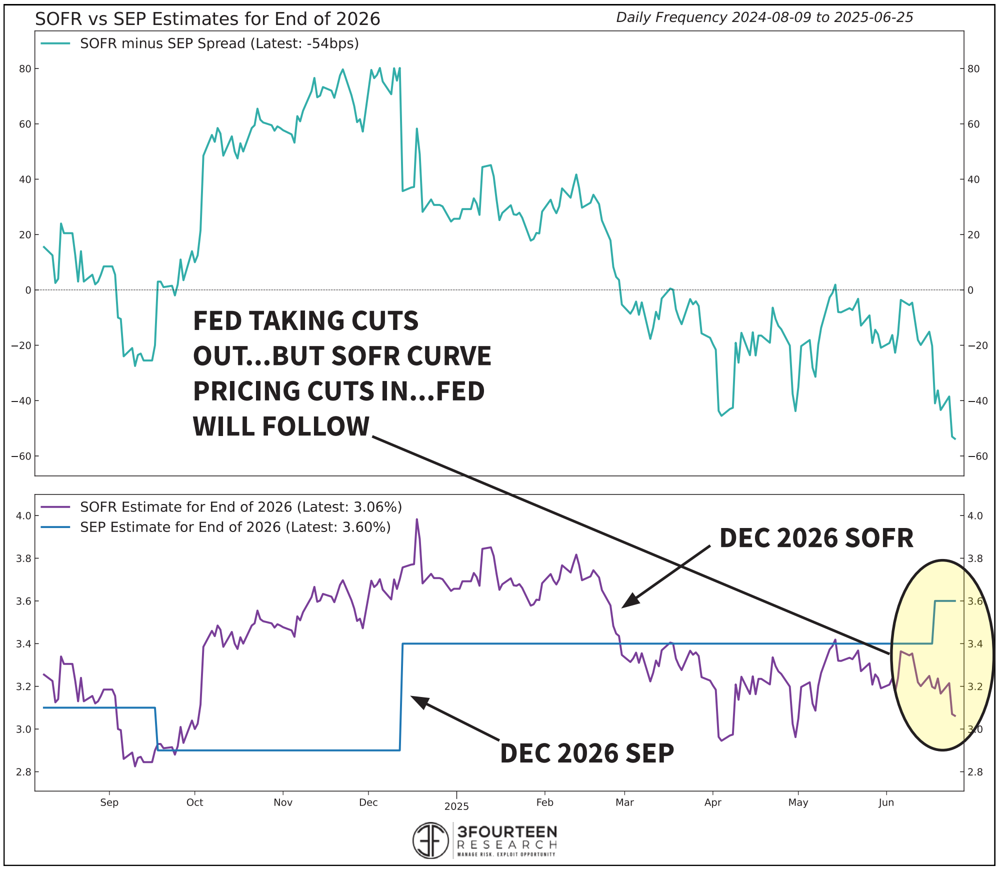
Whatever the next three months of CPI data says, our view is that tariffs are ultimately a tax. As all taxes, their net effect is deflationary. With this framing, it reveals what we view to be the most worrisome risk for the market in H2. If Trump persists with an aggressive tariff policy (few deals), inflation data may come in hot. Many on the Fed are set up to respond hawkishly. This is the recipe for a policy mistake that could derail the economy. Our base case, though, is that the doves win out. The Fed should be cutting by September at the latest—another 50-bp September cut (like last year) is not out of the question. Recall, last summer, the dots shifted in a dramatic fashion. The chart below plots the shift in dots from the June 2024 SEP (blue histogram) to September 2024 SEP (purple histogram). **We expect 3 rate cuts in H2.**

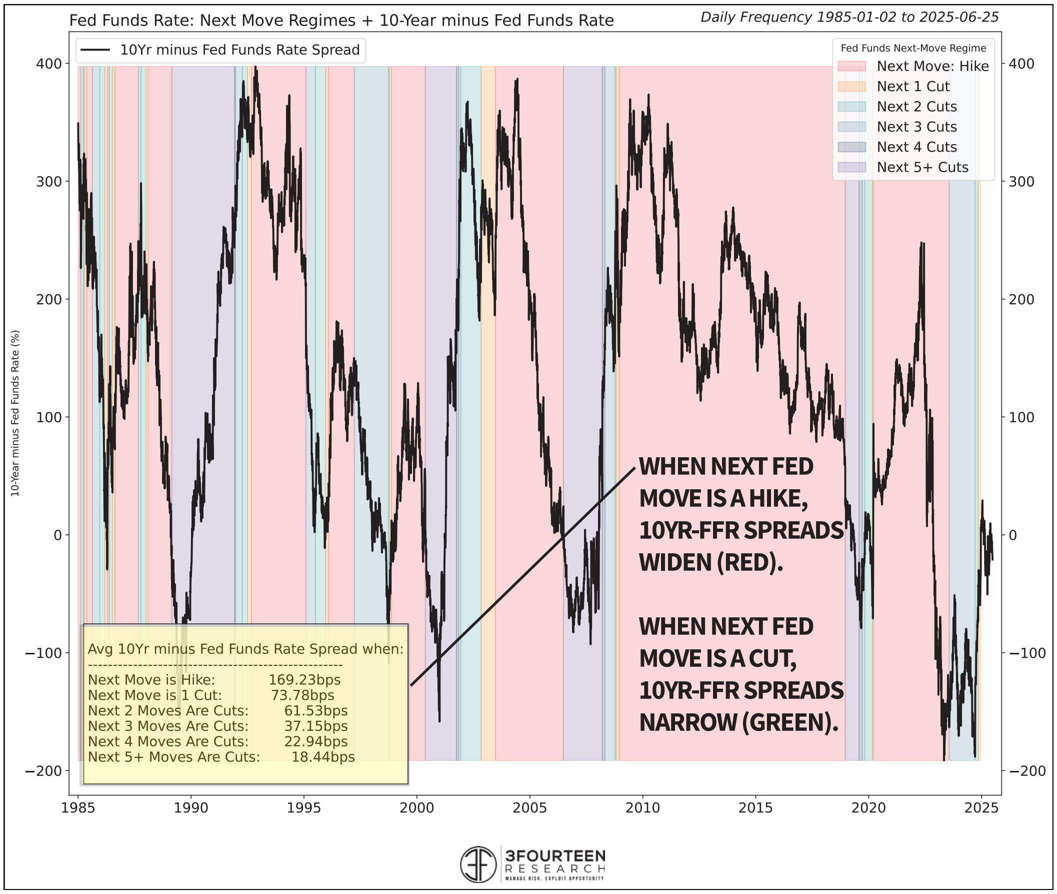
The market is already sniffing this out. While the June SEP removed cuts through 2026, the December 2026 SOFR contract continues to price in additional rate cuts (top chart next page). In general, the Fed gets in line with the SOFR market. However, this internal battle (and policy uncertainty) could provide a period of weakness in the August/September timeframe.



RISKS: RISING RATES

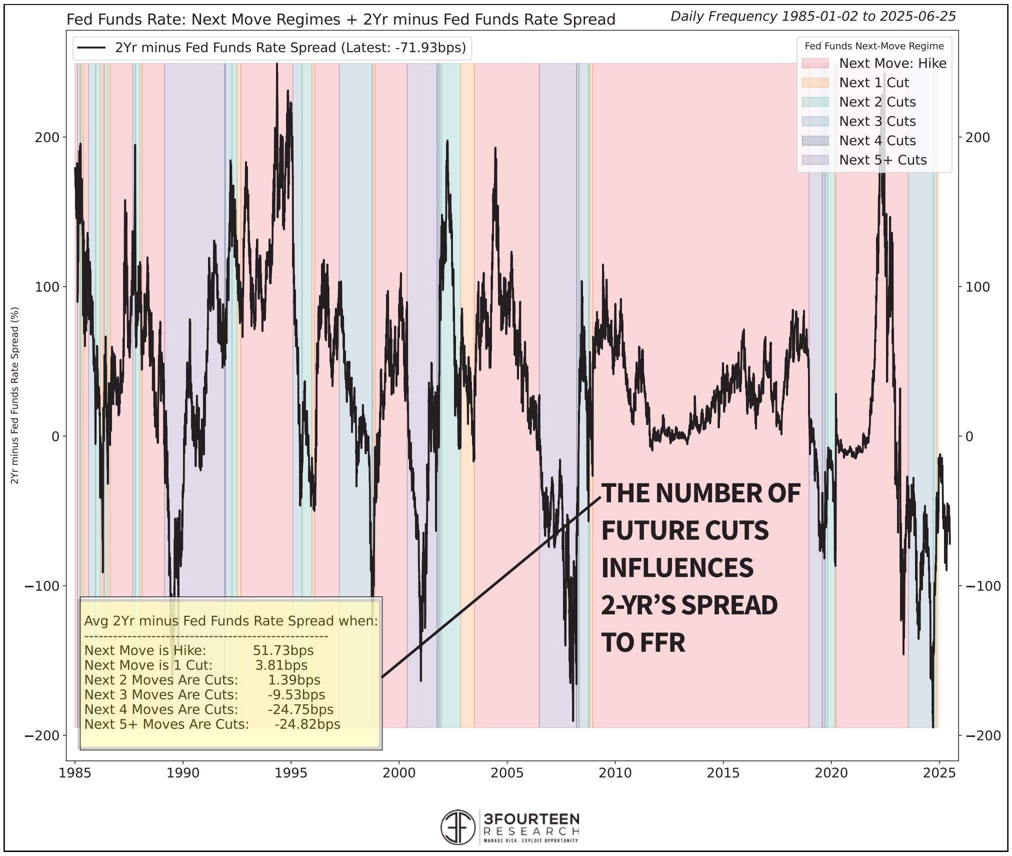
Coming into the year, it was consensus to call for higher 10-year yields. The most common explanation was that a rising term premium would force longer-term yields higher even as the Fed cut further. As evidence, bond bears pointed to the rise of the 10-year yield after the Fed began cutting last September. They read this as evidence of a Fed "mistake." We have written quite a bit trying to point out the flaws in that analysis (see here and here). For those still worrying about the bond market, we suggest going back and reading our framework. **Over the next six months (period covered by an H2 Outlook), we do not see a bond selloff disrupting equities.** The Fed remains on a cutting path. As stated, we see tariffs as deflationary. And, the economy is decelerating.



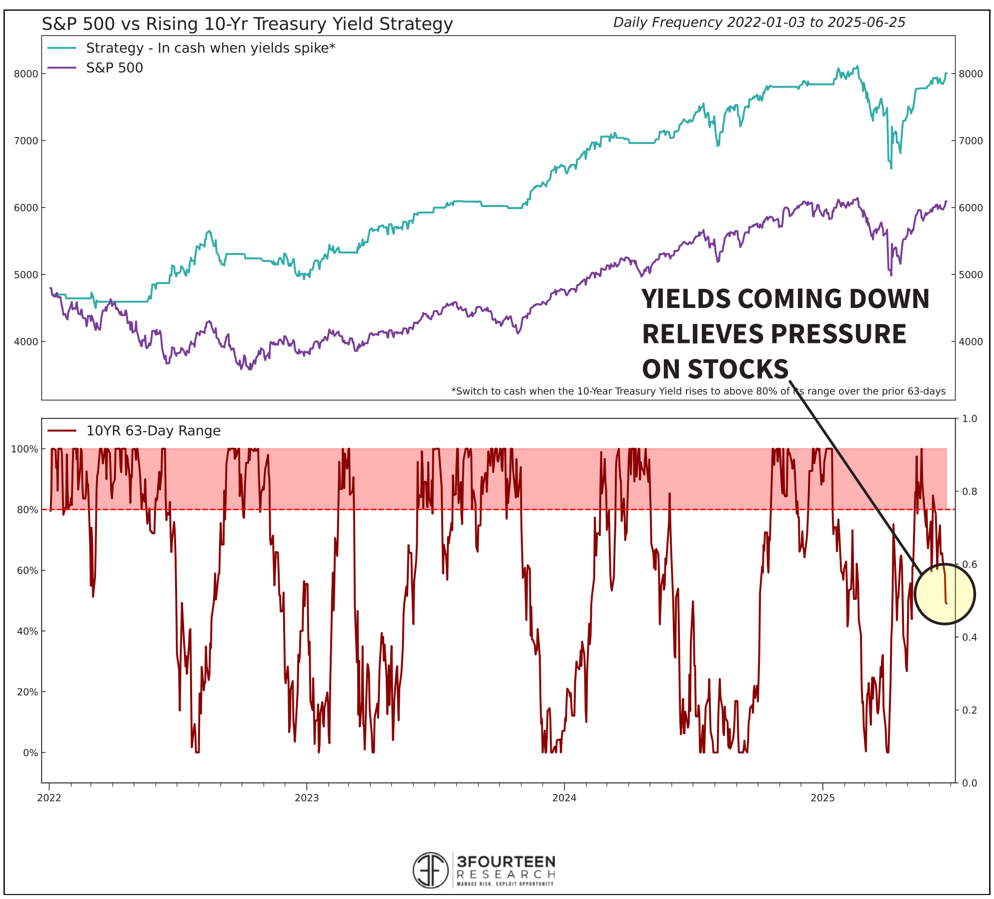


Despite the recent geopolitical spike, oil is unlikely to be a source of inflation (see section below). For now, the Fed is recalcitrant. But, the internal debate highlighted on page 14 is likely to break in favor of the doves. Finally, Trump will undoubtedly nominate a chair who is amenable to further cuts. This partially explains the cuts coming into December 2026 SOFR futures (chart above). In our view, so long as the market believes the current cutting cycle has legs, current yields are around fair value. The chart to the left is one we have shown many times before. Here, we compare the 10-year's average spread to the FFR based on how many cuts are left in the cycle. The more cuts left in the cycle, the closer the 10-year trades to FFR. The top chart on the next page does the same analysis for the 2-year yield.

To be clear, in each of these charts, we purposefully build in lookahead bias. It gives us a rough framework to spot check current yields. The SOFR curve is now baking in close to six cuts by December 2026. Given our framework, this puts the 2-year fair value at ~3.95% and the 10-year at ~4.4%. In other words, the bond market may be *slightly* overvalued, but it is not a current source of risk.



Given the ongoing fiscal profligacy, we are not blind to the risks that the bond market will eventually present. [In May, we laid out our theory that investor mindsets are undergoing a shift from debt deflation to currency debasement.] To quote: "*The transition from a deflation to debasement mindset is the high-level story operating in the background of markets. It manifests in a number of consumer behaviors and market dynamics.*

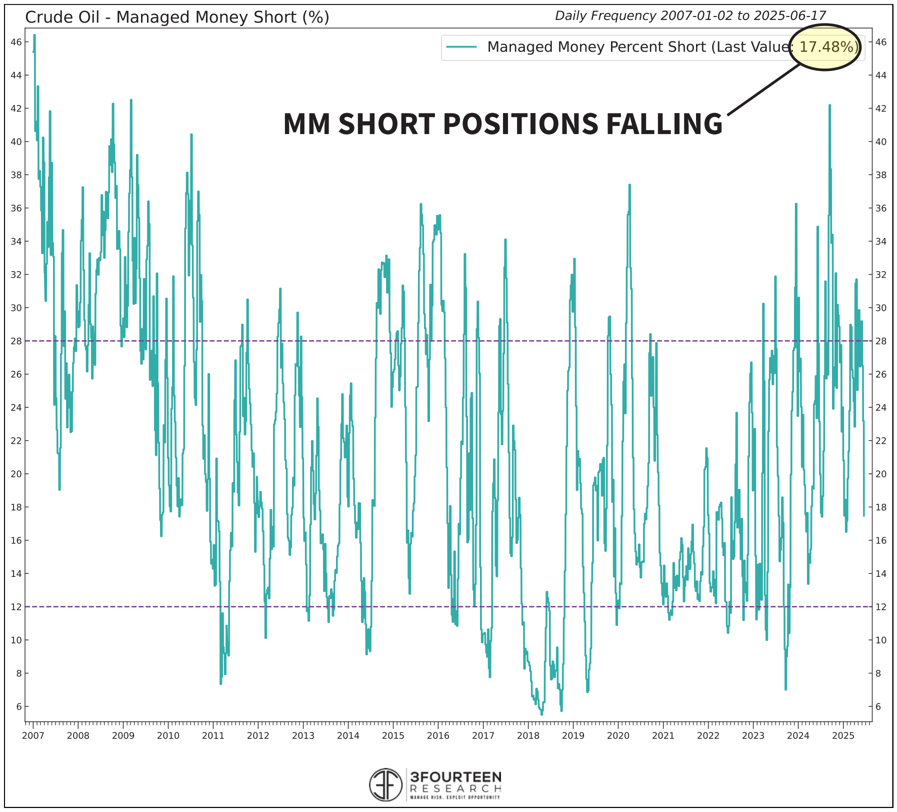


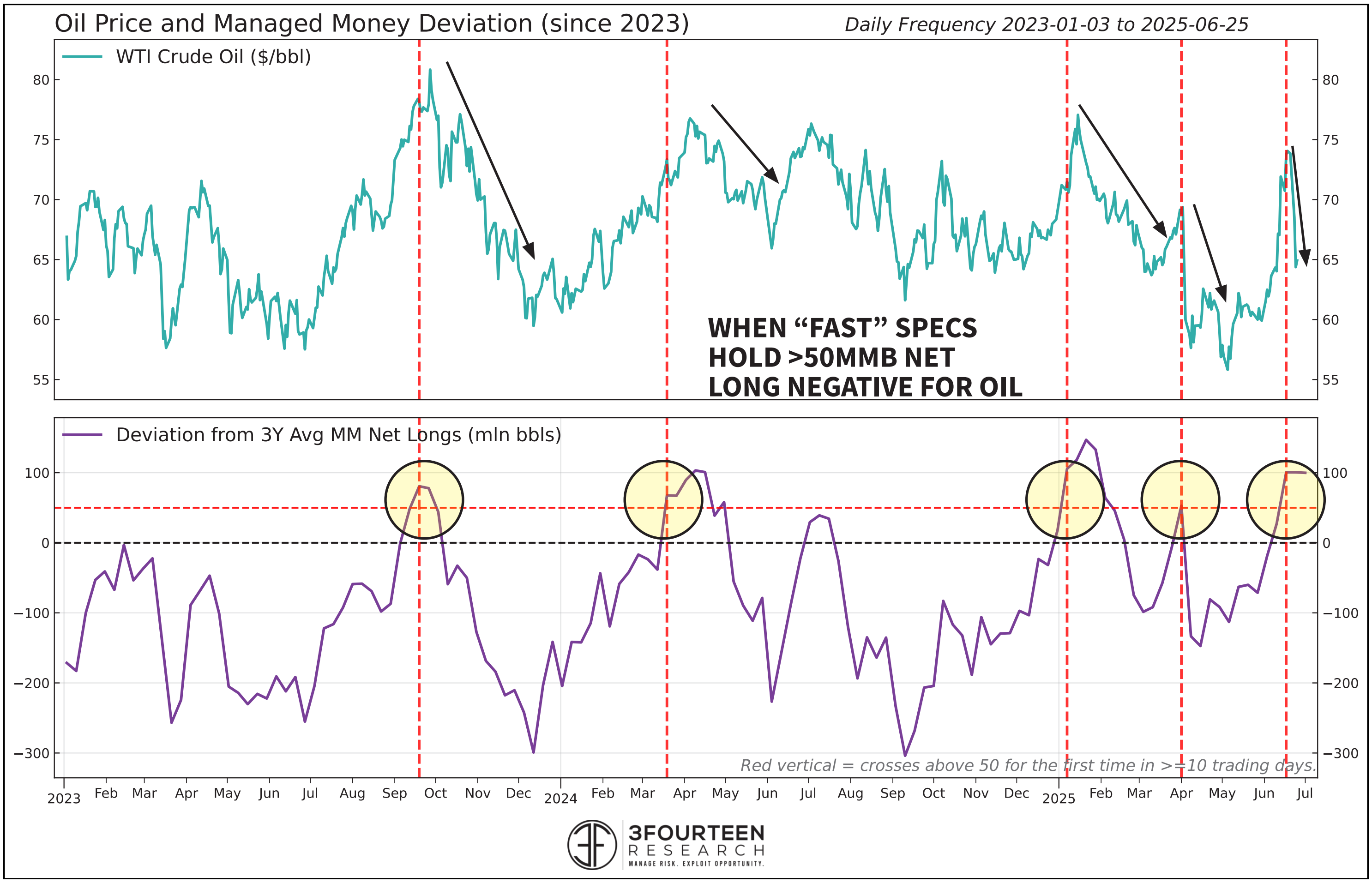
A lower savings rate, increased speculation, and faster stock rebounds are all symptoms. In a 6-8% deficit world, recessions are harder to summon. There's an automatic bid beneath equities, gold, Bitcoin and real estate. On the other hand, bonds are relative losers. The demand for longer-term developed market debt is declining while supply is rising. Consequently, it's more likely that the bond market will cause an equity selloff."

Over the long-term, bonds pose a serious market risk. However, over the next six months, we are not concerned.

RISKS: OIL

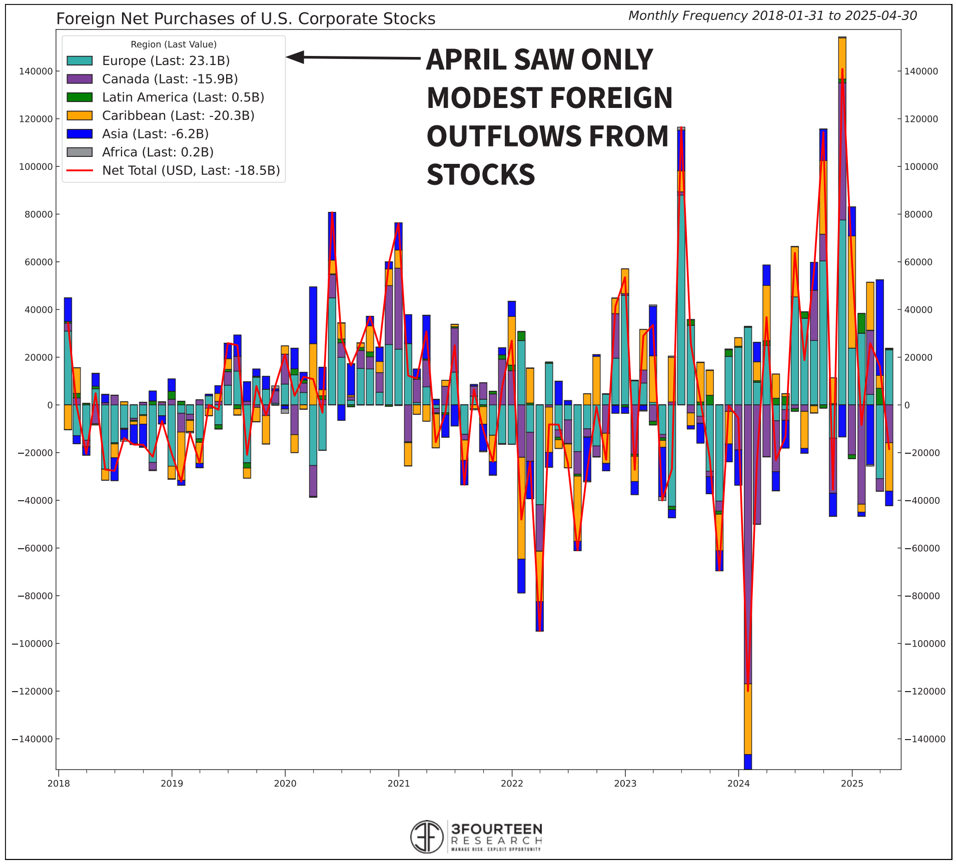
Only a week ago, the Israel-Iran War threatened to drive the price of oil to triple-digits. Last week, we discussed our view that it was an unlikely outcome. Our thesis was that the most lasting impact of the conflict would be a positioning reset, which would set oil up for a dramatic selloff. With geopolitical tensions easing, this is now in full swing. The charts on this page show Managed Money positioning through the early part of last week. Shorts are now down to 17% (chart right). And, specs are now net long over 100 MM barrels. This is bearish for oil price in the near term (chart below). We continue to see oil drifting lower over the back half of 2025. New OPEC supply is coming (along with production increases from non-shale/ non-OPEC sources). **Bottom line: Oil is not a risk to equities in H2.**

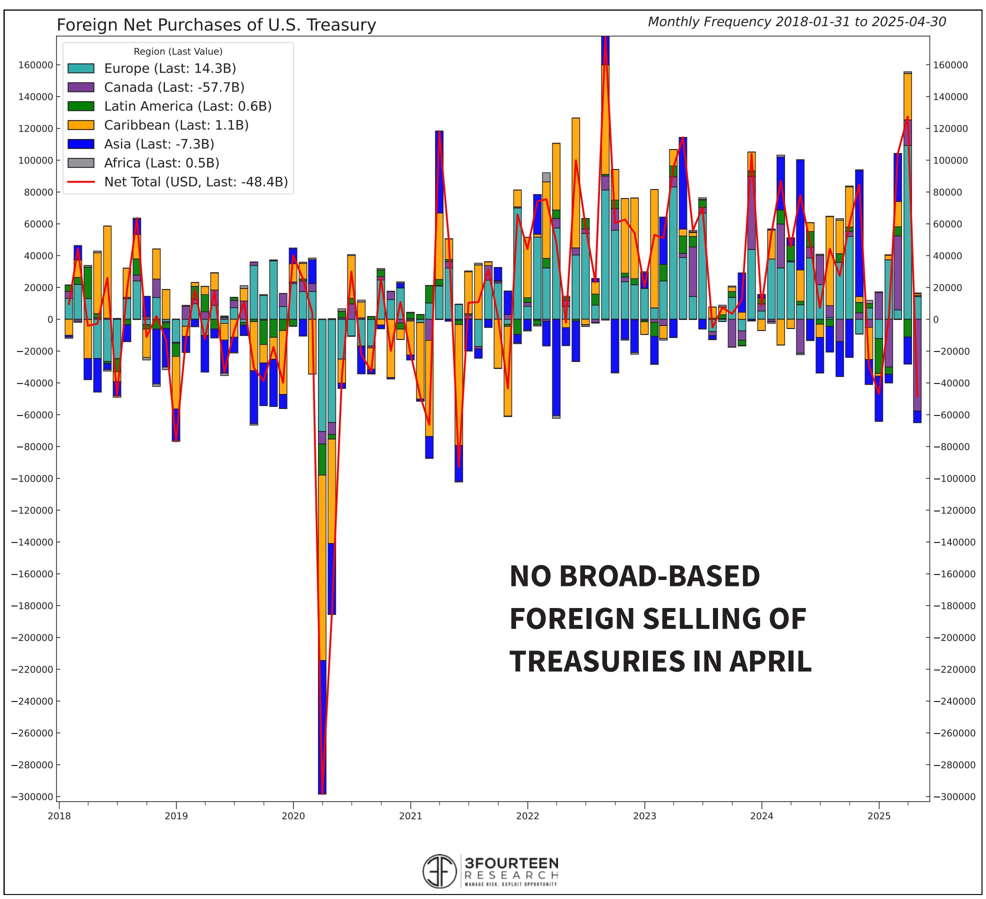




RISKS: FOREIGN OUTFLOWS/TARIFFS

Earlier this year, we confronted what we called the "doomsday scenario" for investors. What is this scenario? To quote from our April 17 report: "*For American investors, the doomsday scenario is a true de-dollarization regime and the loss of the Dollar's status as the global reserve currency. For the record, we do not believe this will be the outcome of the current crisis.*" While we dismissed the most bearish narrative at the time, it had our attention. The reason: Everyone is overweight U.S. stocks. American household equity holdings as a percent of financial assets is at an ATH. U.S. pension funds are historically overweight equities vs debt. And, foreigners hold a larger percentage of the market than ever (U.S. net international investment position). A true redirection of global flows is a big risk to U.S. assets.

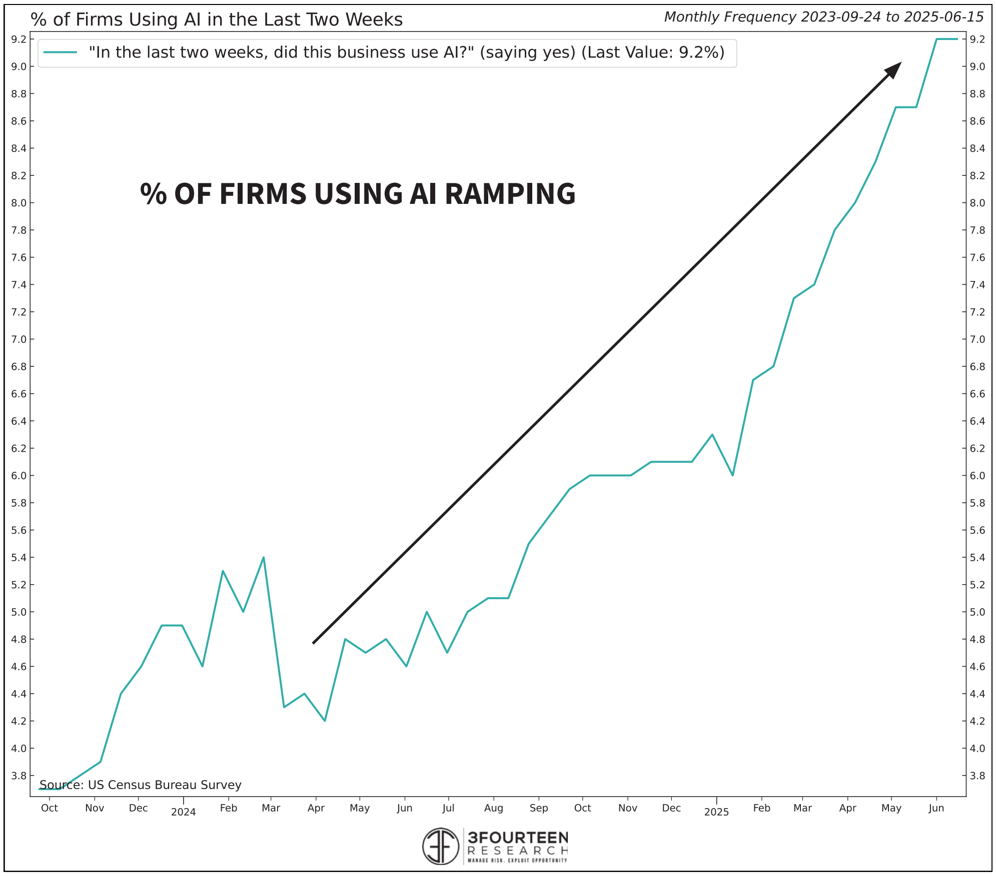


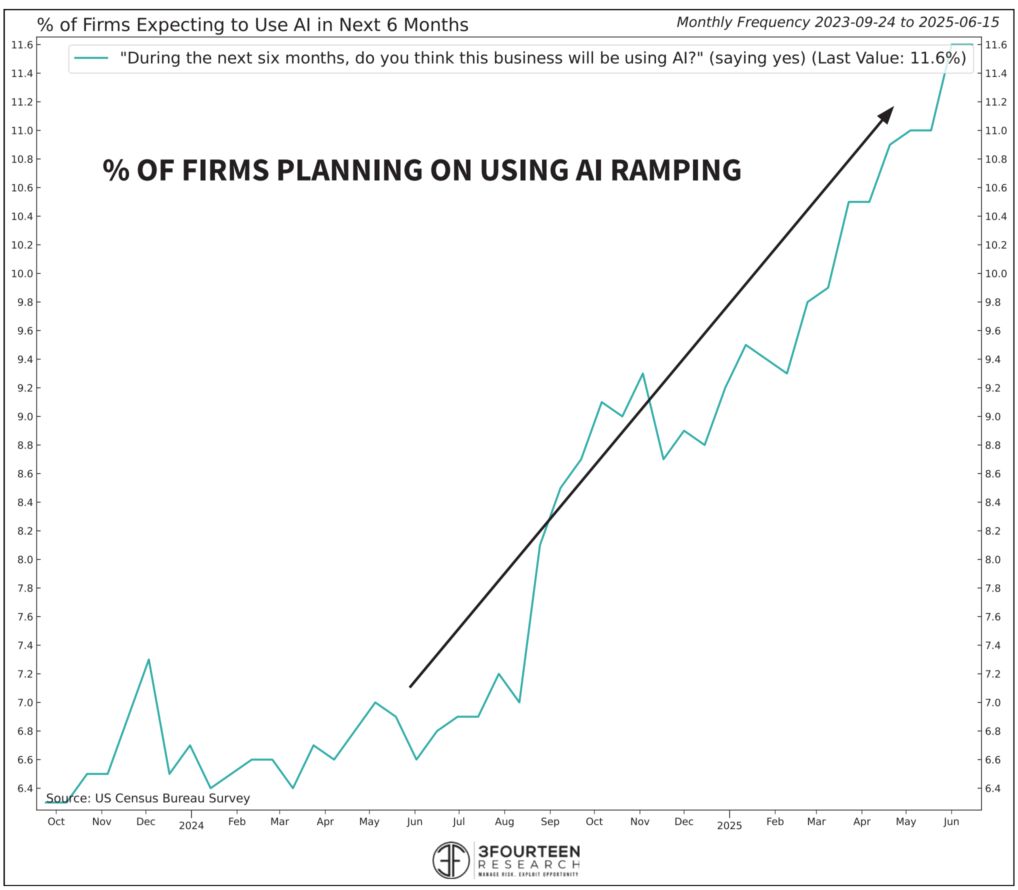


The good news is that the TIC data for April is now in. And, it shows relatively benign foreign outflows from U.S. stocks. The chart above shows there were modest foreign outflows from U.S. stocks. Notably, Europeans and Asians were—in combination—net buyers. The chart to the left looks at flows into (and out of) the U.S. Treasury market. Again, the data is less scary than many feared at the height of the April panic. There were Canadian selling of treasuries, but the two key regions in question—Europe and Asia—were combined buyers of U.S. debt. **As we suspected, it will take more than Trump's bluster to change the global flows into U.S. assets**.

THE UPSIDE: AI PRODUCTIVITY BOOM AHEAD?

So far, this outlook has described strong price action and improving earnings. We then considered—and largely dismissed—the most concerning market risks: a weakening economy, recalcitrant Fed, rising oil price, and foreign outflows. Sometimes, strong price action and the absence of a negative shock is all a bull market needs. Yet, in the current case, there is a powerful positive catalyst lurking on the horizon: AI productivity boom. The chart to the right shows how the AI future may be here soon. In this chart, we plot the percentage of respondents to the biweekly census survey who answered that they are using AI tools in the past two weeks. In recent months, this number has taken off. Over the next six months, businesses plan to accelerate their AI usage (chart below).





Finally, the chart on the last page of this report provides another way to envision the AI adoption curve. Here, we estimate the number of tokens generated by the various LLMs now in operation (see chart for all assumptions). For the uninitiated, a "token" roughly translates to a word generated. We then forecast how token generation should evolve based on analyst estimates of NVDA future revenue. A few big picture thoughts to leave you with: First, our estimate is that AI Models are currently generating ~50 trillion tokens daily. This equates to roughly half of all words spoken by all human beings on the planet! Second, in one year, daily token generation should surpass 100 trillion. **For those searching to explain the market's aggressive ramp, the acceleration of AI adoption and the commensurate productivity boost is a research area to linger on.**

H2 2025 PREDICTIONS + CONCLUSIONS

It is time to revisit and "mark to market" the forecasts we made in our 2025 Outlook. Below, we list our predictions from six months ago and how we would change them (if at all) for the next six months:

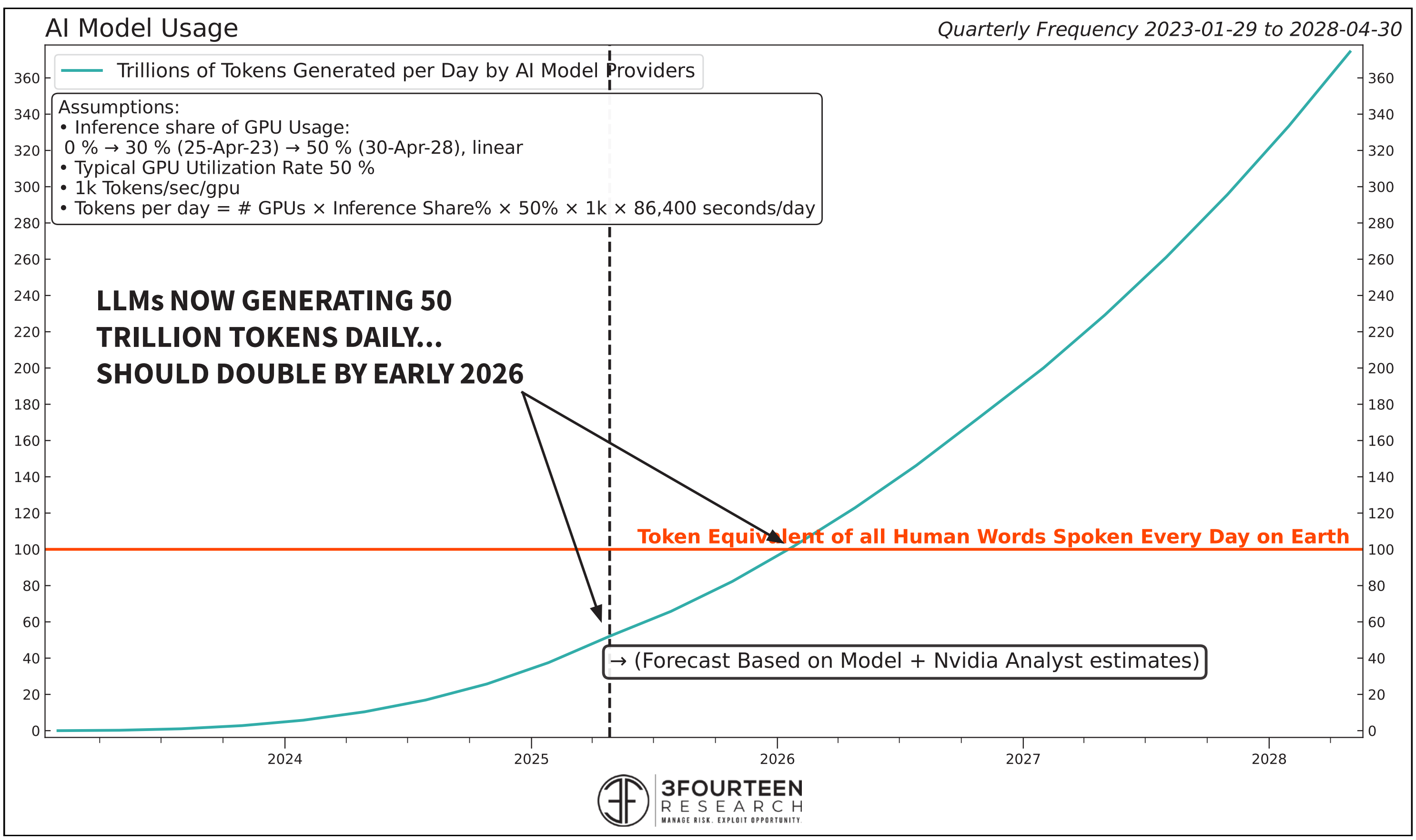
- "*The economy avoids recession, but suffers a growth scare in late-Q1/early-Q2.*" We continue to see a deceleration and downside to econ data. **However, we maintain our no recession call for H2.**
- "*The Fed attempts a 'hawkish pause' early next year.*" This pause is ongoing. But, the doves are winning the war. **We expect the Fed to start cutting in September.**
- "*The Fed cuts 100 bps.*" **We expect 75 bps of cuts now**.
- "*The S&P 500 finishes the year at 6,800, but suffers an H1 drawdown of 10%.*" We maintain our bullish outlook. **Our end of year S&P 500 target stays at 6,800**…Sentiment has been reset as we had hoped.
- "*Mid-caps outperform small caps.*" This has worked and **we expect small-cap underperformance to persist into H2.**

3FR STRATEGIC AA RECOMMENDATIONS

ASSET	RECOMMENDATIONS	BENCHMARK %	MAX	MIN
US Stocks	60% (OW)	55%	70%	40%
US Bonds	30% (BMW)	30%	45%	15%
Commods	5% (UW)	10%	25%	0%
Cash/Bills	5% (BMW)	5%	20%	0%
MAY 13, 2025	UW = Underweight; BMW = Benchmark Weight; OW = Overweight			

- "*Oil breaks below $60.*" This also has happened. **Despite the geopolitical noise, we expect oil to again break below $60 in H2.**
- "*The 10-year averages less than 4% and breaks below 3.5%.*" While we have been directionally correct on yields this was too aggressive. **10-year will break below 4% in H2 and will average close to 4.1% as data deteriorates**.
- "*Gold hits $3,000.*" Check. **Still bullish gold…raising year-end target to $3,500.**

As always, we prefer frameworks to predictions and will pivot from any of these "calls." Flexibility is paramount in these markets.



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