PENOBSCOT
FINANCIAL ADVISORS

MARKET COMMENTARY

Q2 2025

MARKET REVIEW

Following a volatile first quarter, the second quarter of 2025 was defined by a broad recovery in risk assets despite persistent geopolitical and policy uncertainty. U.S. equity markets staged a strong rebound, with the S&P 500 gaining 6.2%, driven by resilient corporate earnings, particularly in technology and AI-linked sectors. The Nasdaq surged over 9%, reflecting renewed investor confidence after the steep selloff in the first quarter.

Much of the quarter's optimism was underpinned by better-than-feared economic data and a temporary easing in trade tensions. While the Trump administration’s tariff threats loomed large early in the quarter, the announced delay in implementation allowed markets to regain footing. Investors interpreted the pause as a signal that cooler heads may prevail in ongoing trade negotiations.

Economic data releases generally pointed to a resilient, though moderating, global economy. In the U.S., consumer spending remained stable, and the labor market showed signs of cooling without significant deterioration, supporting the soft-landing narrative. Inflation data continued to trend lower, albeit at a slower pace than desired by policymakers. Abroad, European manufacturing activity improved modestly on the back of targeted fiscal support, while China saw early signs of recovery amid ongoing stimulus and regulatory easing efforts. Emerging market economies displayed mixed performance, largely influenced by currency fluctuations and export demand. These diverging economic trends led to varied responses by central banks, with some easing rates while others remained cautious.

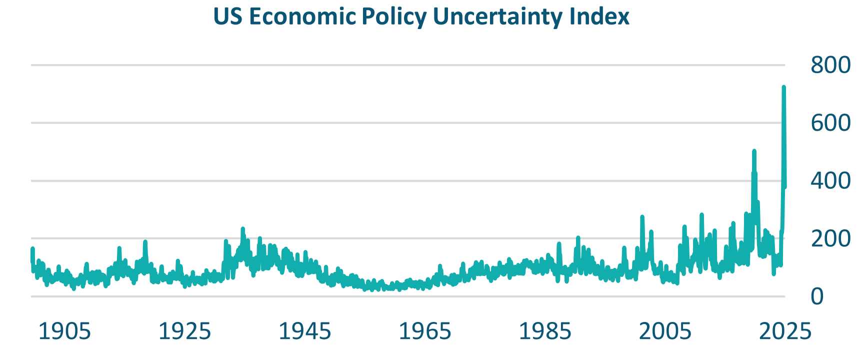
Beneath the headline gains, sector performance remained uneven. Technology, communication services, and consumer discretionary sectors led the way, while more defensive areas like utilities and consumer staples lagged. International equities also delivered strong returns, buoyed by Europe’s fiscal stimulus announcements and signs of economic stabilization in China. Fixed income markets were mixed, with intermediate U.S. Treasuries gaining modestly, while longer-dated bonds faced pressure from rising deficit concerns. Credit spreads remained tight, supported by resilient earnings and a decline in default expectations.

Commodities also showed divergent trends. Gold extended its rally to new highs as central banks and investors sought protection against inflation and geopolitical shocks. Meanwhile, crude oil struggled to sustain gains amid softening demand expectations and an uncertain global growth outlook.

LOOKING FORWARD

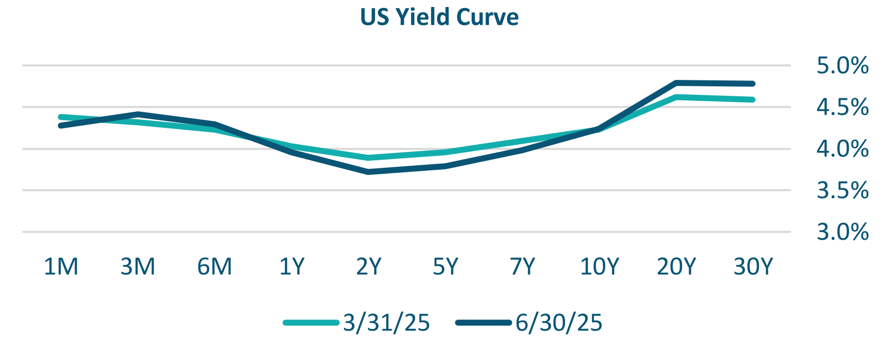
POLICY UNCERTAINTY

Policy remains a dominant driver of market volatility. The Trump administration's evolving stance on tariffs, fiscal stimulus, and tax policy continues to inject risk into economic forecasts. Although the 90-day tariff delay bought time for negotiations, it also highlighted the fragility of the global trade framework. With midterm elections approaching in 2026, political incentives may shift toward market-friendly positioning, but unpredictability remains a feature, not a bug, of the current policy regime.



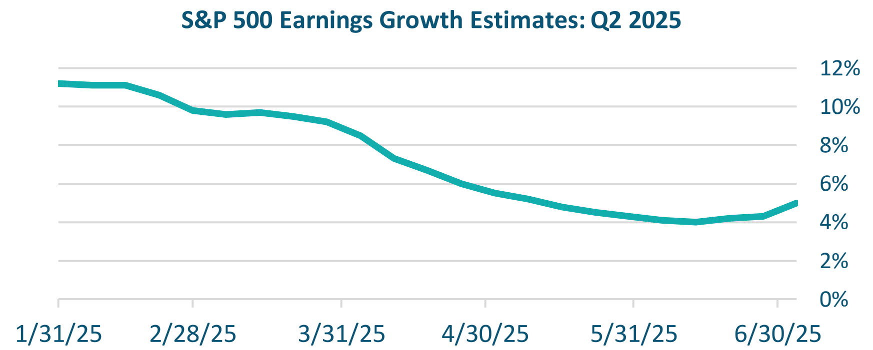
A NARROWING PATH TO RATE CUTS

The Federal Reserve held interest rates steady through the second quarter, and markets have repriced to expect fewer rate cuts in 2025. Inflation—particularly in services—has not fallen as quickly as hoped, and the risk of tariffs pushing prices higher adds to uncertainty. The yield curve has steepened somewhat, reflecting both lower recession concerns and rising worries about government debt.



EARNINGS UNDER PRESSURE

Earnings estimates for the second quarter have been revised downward primarily due to concerns that tariffs will shrink corporate margins and weigh on profits. Companies with limited pricing power are expected to absorb more of the tariff burden, while those in cyclical sectors—particularly consumer discretionary, basic materials, and energy—face the steepest earnings declines. Analysts anticipate these pressures to be gradual but persistent, with some companies already stockpiling inventory or adjusting supply chains to manage the impact.



OUR TAKE

So far in 2025, diversification has proven its value, both within and across market segments. Bonds are once again doing their job of offering stable income and low correlations to equities—thereby reducing portfolio volatility. Within equities, market leadership has broadened meaningfully following last year's narrow rally dominated by a handful of U.S. tech stocks. International equities have outperformed U.S. counterparts in many regions, reflecting improving fundamentals and shifting investor sentiment. Looking ahead, continued divergence in monetary policy and trade dynamics reinforces the case for global diversification—not only as a return driver, but also as a hedge against any policy missteps.

Barring any significant policy mistakes, U.S. economic growth is expected to slow at a manageable pace in the second half of 2025. We anticipate one or two rate cuts by the Federal Reserve over the remainder of the year to support growth. While downside risks remain, we do not believe a recession is imminent, and our base case remains a soft-landing scenario.

While U.S. economic conditions remain a focal point, the international outlook is becoming increasingly important. Europe is showing early signs of economic improvement, supported by targeted fiscal stimulus, increased defense spending, and a push for structural reform. Japan's economic normalization continues gradually, underpinned by improving wage growth and corporate investment. In emerging markets, prospects are mixed but improving in regions with stable currencies and strong trading partners. China's incremental stimulus and easing regulatory tone have helped stabilize conditions, though long-term structural challenges remain.

Within stocks, we are favoring defensive sectors while modestly increasing exposure to big tech companies. Defensive areas like consumer staples and utilities offer pricing power, which can defend against higher costs associated with interest rates and tariffs. Meanwhile, big tech stocks have become more appealing as valuations have moderated. These companies are well positioned to benefit from the fiscal policy initiatives which support innovation and domestic production. Continued investment in artificial intelligence should act as a tailwind for these firms, regardless of how the broader economy develops.

In bond markets, we continue to focus on short to medium-term maturities, where yields are attractive and risk is more manageable. Longer-term bonds face more challenges due to concerns about the sustainability of government debt. We have also increased exposure to inflation-protected securities to guard against the possibility that tariffs could reignite price pressures.

Beyond traditional stocks and bonds, we are seeking further diversification through alternative assets. Our allocation to private equity remains in place, supported by historically attractive valuations and a recent uptick in deal activity. Additionally, we maintain exposure to gold, which is intended to hedge against geopolitical risk, inflation, and economic shocks.

Each client's exposure to these investments varies based on their individual goals and risk tolerance, but all are built with diversification in mind. Allocating investments across various asset classes and geographic regions helps reduce the impact of any single event. This diversified approach supports long-term discipline, helping clients stay focused on their goals rather than the noise of ever-changing news headlines.