

MARKET REPORT SECOND QUARTER 2025

Key Points

- The S&P 500 declined 11.2% in the first six trading days, then rebounded.
- Markets are pricey by many yardsticks.
- Small- and mid-cap value companies are least expensive, on average.
- The bond market carries a big stick.
- We discuss forecasting follies.

Total Return as of June 30, 2025						
			Annualized			
	QTD	YTD	1 Yr	3 Yr	5 Yr	10 Yr
S&P 500	10.9%	6.2%	15.1%	19.7%	16.6%	13.6%
NASDAQ	18.0%	5.9%	15.7%	23.7%	16.1%	16.2%
Russell 3000						
Index	11.0%	5.8%	15.3%	19.1%	16.0%	13.0%
Value	3.8%	5.6%	13.3%	12.5%	13.9%	9.0%
Growth	17.6%	5.8%	16.9%	25.1%	17.6%	16.4%
Russell Mid Cap						
Index	8.5%	4.8%	15.2%	14.3%	13.1%	9.9%
Value	5.4%	3.1%	11.5%	11.3%	13.7%	8.4%
Growth	18.2%	9.8%	26.5%	21.5%	12.7%	12.1%
Russell 2000 (Small Cap)						
Index	8.5%	-1.8%	7.7%	10.0%	10.0%	7.1%
Value	5.0%	-3.2%	5.5%	7.5%	12.5%	6.7%
Growth	12.0%	-0.5%	9.7%	12.4%	7.4%	7.1%

A Review of the Quarter

An enthralling quarter! The S&P 500 declined 11.2% in the **first six** trading days as “reciprocal” tariffs became effective at midnight on April 8, but on April 9 those tariffs were paused for 90 days. The market regained its composure with the S&P 500 posting a **single-day** gain of 9.5%. In those early days, market volatility spiked to levels not seen since COVID and we worked to capitalize on opportunities. Trade policy “evolved” thereafter, and markets began discounting the most severe outcomes. Equities generally posted a strong quarter with pricier issues rising the most – rising further into expensive territory.

The Federal Reserve (the “Fed”) left the Fed Funds target range unchanged at 4.25% - 4.50% at its May and June meetings, despite being frequently rebuked by the White House. As Chairman Powell stated after the May meeting, “If the large increases in tariffs that have been announced are sustained, they are likely to generate a rise in inflation, a

slowdown in economic growth, and an increase in unemployment.” The global rate cycle is not in sync, as some central banks are cutting rates while others, like the Fed, are on pause.

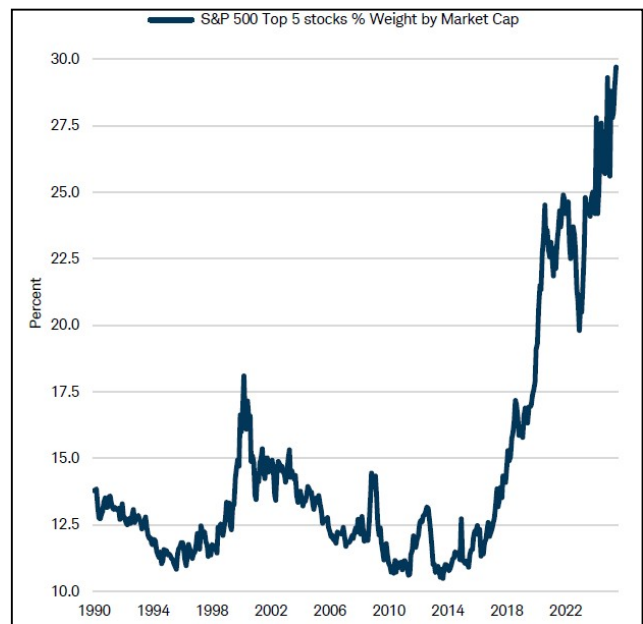
To date, the U.S. economy has proven resilient; however, significant sales were likely pulled forward in anticipation of the tariffs—lessening the economic impact during the quarter. In addition to buying goods before tariffs hit, companies also used Customs Bonded Warehouses (“CBW”) and Foreign Trade Zones (“FTZ”) to delay the impact. In the case of a CBW, “dutiable merchandise may be stored, manipulated, or undergo manufacturing operations without payment of duty for up to 5 years from the date of importation.” Tariffs are not owed until goods are released into the domestic supply. An FTZ operates in a similar fashion except there is not a five-year limitation.

U.S. Equities

Regardless of your yardstick – price-to-trailing earnings, price-to-forward earnings, price-to-5-year normalized earnings, price-to-cash flow, dividend yield, Shiller’s CAPE (cyclically adjusted P/E) or Market Cap / GDP, **market averages** are pricey relative to history. Some future performance has seemingly been pulled forward, at the market level, as enthusiasm for anything AI remains elevated.

Valuations typically have little relevance as it relates to near-term performance but are more important when looking 5-7 years or more into the future. Expensive can always become more expensive.

Fortunately, we only need 25-40 of what we believe to be reasonably priced, quality companies in our strategies which call for individual stocks. In spite of the general priciness of stocks, we continue finding a few bargains. Small- and mid-cap opportunities have outnumbered their large-cap brethren in recent quarters.



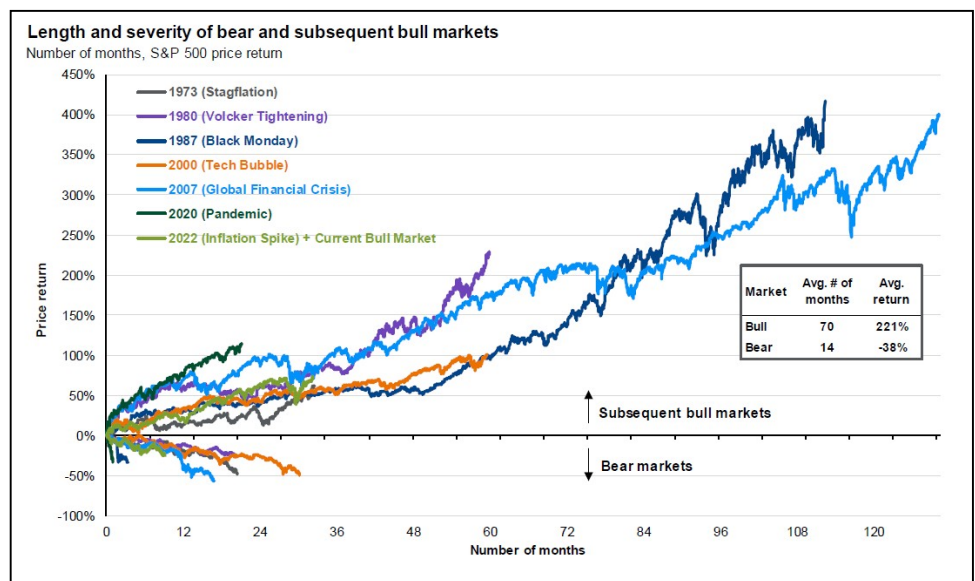
Market concentration remains elevated, as indicated in the **accompanying chart** (above, right!), showing just **five** companies in the S&P 500 account for **nearly 30%** of the total market cap.

The **table** (top rightⁱⁱ) illustrates forward P/E's as a percentage of 20-year average P/E's. You will note that all categories, except small-cap value, are **priced above** their 20-year averages and that the value category is the **least** expensive. Within the value category, large is the most expensive followed by mid- and small-cap. This **dovetails** with our own experience in recent quarters.

Forward P/E as % of 20-year avg. PE			
	Value	Blend	Growth
Large	122.0%	137.5%	147.0%
Mid	109.2%	110.6%	142.5%
Small	99.3%	107.0%	123.8%

Planning nearly always leads to better outcomes, based on our observations. Market drawdowns of at least 20% (bear market) happen periodically. It is part of equity investing. When they do, investors can be rattled. Thinking about how you will react **in advance** can help make better long-term investment decisions. For the avoidance of doubt, this is not a forecast. It is simply a good idea to plan for turbulence while cruising in clear skies rather than waiting until you are in a storm to make a plan.

When a meaningful drawdown does occur, if you believe, as we do, that American ingenuity and capitalism will prevail in the long run, staying the course, potentially increasing equity exposure and/or adding to your investment can be logical choices. If possible, investors should avoid exiting



equity markets during significant drawdowns as long-term compounding **can be** permanently interrupted. As you will note in the **chart** (above ⁱⁱ), the length and magnitude of historical recoveries, relative to drawdowns, supports the notion of staying invested.

Fixed Income & Commodities

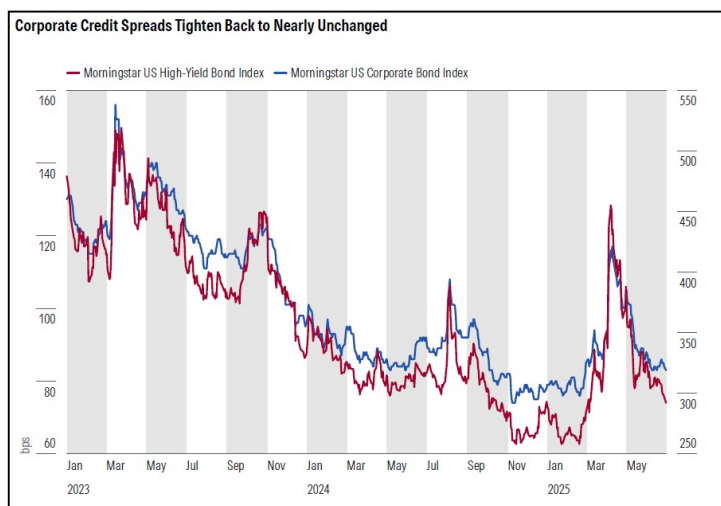
BBB yields along the two-to-four-year segment of the curve ended the quarter in the mid-four percent range after declining slightly during the period. Corporate

credit spreads (i.e., the difference in yield between a corporate bond and a U.S. Treasury of equal maturity) widened in March and April (see chart **below** ⁱⁱⁱ) on tariff concerns but contracted thereafter as volatility subsided. For the quarter, credit spreads along the two-to-four-year segment of the curve were little changed.

Corporate investment-grade and high-yield credit spreads remain tight.

“Since 2000, **less than 10%** of the time have both credit spreads ever traded at tighter spreads than today,” according to Morningstar. In this environment, we selectively take credit risk, work to capitalize on bouts of volatility and purchase Treasuries, where appropriate, when compelling corporate opportunities are not available.

Total Return as of June 30, 2025						
<i>Fixed Income</i>	QTD	YTD	1 Yr	Annualized		
				3 Yr	5 Yr	10 Yr
ML U.S. Corp. 1-10 Yrs	2.1%	4.4%	7.9%	5.3%	1.7%	3.0%
ML U.S. Tr./Age. 1-10 Yrs	1.4%	3.9%	6.3%	2.8%	0.2%	1.6%
<i>Commodities</i>						
Bloomberg Comm. Index	-4.1%	3.3%	1.0%	-4.5%	9.4%	-0.7%
Oil (WTI)	-8.9%	-9.2%	-20.1%	-14.9%	10.6%	N/A



The bond market is the epitome of “walk softly and carry a big stick.” In the U.S., Treasuries, which are considered risk-free, serve as the foundation for all fixed-income instrument yields. Non-Treasury fixed-income instruments typically yield more than Treasuries, thus creating the spread referenced above and compensating investors for corporate default risk.

While bond markets are generally viewed as unexciting, they have a significant impact on every Americans’ daily life. For example, as Treasury yields increase or decrease it costs more or less to finance America’s debt. Higher or lower Treasury yields also generally translate into higher or lower mortgage rates, which can impact the affordability of home ownership. Yields or the cost of money, also impacts the viability of corporate projects. So, while the bond market typically sits in the background quietly doing its thing, and

equities and private equity are in the limelight – it carries a big stick. In our view, the bond market serves as a counterbalance to many of the Administration’s plans regarding tariffs, firing Chairman Powell, etc. Although many ideas are “tested,” the bond market gets to cast its vote. The Administration certainly does not want higher yields.

Commodities, as measured by the Bloomberg Commodity Index, decreased 4.1% for the quarter and are up 3.3% year-to-date. Oil (WTI) declined 8.9% during the quarter, bringing the year-to-date return to -9.2%. U.S. oil production remained near record levels, buffering the impact of turmoil in the middle east.

The oil and gas industry’s **actual** experience under the current Administration is **different** than **expected**. The Administration has called for oil prices (WTI) in the \$40-\$50 range, which is a tall order. Producers will be challenged to deliver higher volumes without price support. The industry has become fiscally disciplined post-COVID, living within its means rather than borrowing to grow rapidly as it did in the early days of the shale revolution.

In the March 2025 Dallas Fed Energy Survey, companies estimated they needed \$65 WTI to profitably drill new wells. Foreign demand (China is a wildcard) and production (think OPEC+) are just a couple of the many variables that impact pricing. Just over a decade ago, then Saudi energy minister Ali al-Naimi abandoned price stability in favor of protecting market share. U.S. producers have scars from that period. Those memories coupled with Wall Street’s demand for fiscal discipline may cause companies to reduce capital expenditures, defer activity and search for greater efficiencies. As the old saw goes, “the cure for lower prices is lower prices.” **In reality**, Administrations have limited control over oil production volumes.

Forecasting Follies

Every day we see prognosticators trying to predict the future. Turn on the TV and someone will be giving their “expert opinion” on anything from interest rates, S&P targets, and earnings expectations to predicting the next Super Bowl winner. The question we ask is, how valuable are these “expert opinions?” **In this piece**, we discuss the track record of forecasting, forecasters’ potential biases, the value of perfect information and the role forecasting has in our investment decision-making process.

In a 2017 study (*Evaluation and Ranking of Market Forecasters*) covering more than 6,000 market forecasts by 68 forecasters, researchers found that accuracy in forecasting was **less than 50%**. Those professionals **would have been** more successful, on average, by flipping a coin. Other studies have had nearly identical findings. The fact is, there are **too many** unknowns and variables, that cannot be foreseen – to make reliable predictions.

It is human nature to rationalize events. Humans can often suffer from hindsight bias – the tendency to see past events as predictable or obvious in retrospect. Forecasters are not exempt. They tend to suffer from this and other biases that allow them to rationalize their forecasts and continue making such predictions even when the history of being correct is **so low**. Some other biases forecasters can suffer from include, but are not limited to:

- **Confirmation Bias** – Forecasters may seek information that supports their point of view while ignoring or discounting contradictory evidence.
- **Overconfidence Bias** – The overestimation of their abilities and prediction accuracy.
- **Anchoring Bias** – This happens when the first piece of information presents a baseline for someone's view.
- **Recency Bias** – Giving more weight to recent data points or events.

Forecasters tend to blend these biases into excuses for why things did not go their way. All too often you will hear comments such as, “If this one thing would have happened, I would have been right,” or “It did not happen, but I was close” or “I am not wrong, just early.” All this ties together **to illustrate**: the future is unknown and unknowable. So, in our view, using forecasts to make investment decisions is unhelpful given their low batting average.

What if we had perfect information regarding earnings, dividends and interest rates? Robert Shiller won the Nobel Prize for finding that market volatility **cannot** be explained by the volatility of these variables. He took historical earnings, interest rates and stock prices and calculated the value one should have paid with perfect hindsight (i.e., you were 100% accurate in forecasting the input variables). He found those variables only explain **20%** of the variance in five-year stock prices. This percentage goes down as the time horizon is shortened. This brings us back to the reality of markets....so much is unknown and uncertain that even actual financial results do not fully explain future stock prices.

One of our core values is **humility**. We realize the future is uncertain and that there are many variables in play that are beyond our control. As such, we believe our efforts are best spent executing a sound investment process rooted in business fundamentals. Assessing a company's balance sheet, competitive advantages (moats), earnings quality, etc. is a much better use of time, in our opinion, than trying to guess what earnings will be next quarter or year, or what interest rates will do. As discussed above, those factors only

explain a **small amount** of short-term stock price movements. We think long-term and do our best to ignore the day-to-day noise in markets.

Margin of safety is another core value we have spoken about frequently. This means investing when a security is trading at a discount to our estimate of its intrinsic value. Investing with a margin of safety can help reduce the risk of a permanent loss of capital. This process coupled with a long time horizon reduces the impact forecasting has on long-term investment performance. Sometimes when a security is purchased, the market quickly recognizes the discount and the gap between price and value closes. We, of course, are happy when that happens; however, it often takes years for the market to adjust. During stretches of time when there is seemingly a disconnect between share price performance and underlying business fundamentals, we typically remain patient monitoring the company's progress. Staying objective and minimizing the impact of biases on an investment thesis is important and we do so through the use of checklists and thoughtful questioning by fellow team members. If fundamentals are sound and the company's moats are intact, we typically stay the course.

The late economist John Kenneth Galbraith said, "The only function of economic forecasting is to make astrology look respectable." This may seem harsh, but the track record of forecasting is well documented and speaks for itself.

Case in point, on **May 16, 2025**, the Federal Reserve Bank of Philadelphia released the results from its then recent *Survey of Professional Forecasters*: "According to 36 forecasters surveyed," they predicted the economy would grow at **1.5%** (real GDP) for 2Q 2025. As recently as **July 25, 2025**, the Federal Reserve Bank of Atlanta GDPNow model was estimating 2Q 2025 real GDP of **2.4%**. On **July 30, 2025**, the U.S. Bureau of Economic Analysis released its "advance estimate" of 2Q 2025 real GDP of **3.0%**. Significant misses!

To summarize, the future is unknown and unpredictable. Rather than making bold predictions about the future, we follow an investment decision-making process grounded by business fundamentals and a long-term focus. While nearly everyone suffers from biases, we work diligently to minimize our own and to remain objective in our investment decision making. A margin of safety can help reduce the risk of a permanent loss of capital. We will remain patient and objective until the right pitches come along.

Looking Ahead

Based on what we have heard from the field, the impact of tariffs should start to roll through more financials during the third quarter, and of course, there could be some

impact from incentives created in *The One Big Beautiful Bill*. This can lead to disparity between current expectations and actual results. When reality is different than expectations, volatility can ensue and to varying degrees. Should volatility surface, we will strive to use it to our advantage - as always.

During frothy markets, many market participants become infatuated with get-rich-quick schemes and forget about risk. We believe this is a mistake. Our value-oriented investment process serves as a filter, reducing the risk of us pursuing unproven businesses and/or those trading at lofty valuations.

Enjoy the balance of your summer.

Past performance is not indicative of future results and all investments involve some degree of risk. Market and economic data have been provided by third party sources. This data, while believed to be reliable, has not been independently verified by EBS.

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ⁱ **Source:** Q3 2025 Quarterly Chartbook

ⁱⁱ **Source:** 3Q 2025 Guide to the Markets

ⁱⁱⁱ **Source:** Q3 2025 North America Market Outlook