

Cutting? Through The Noise

“Everything should be made as simple as possible, but not simpler.”

– Albert Einstein (1879-1955)

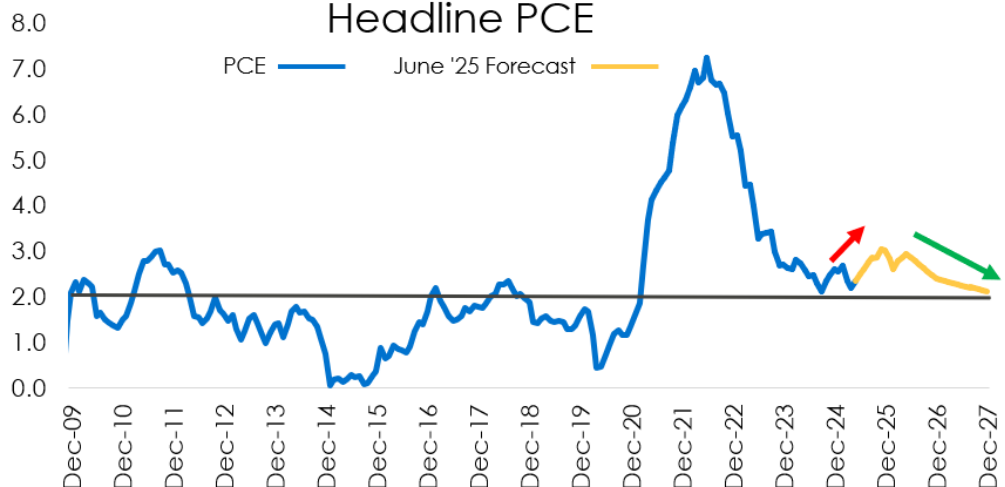
Good grief – that’s a whole lotta noise. Channeling my inner Charlie Brown, this author had a chance to reflect on this month’s news, and it didn’t disappoint on selling headlines.

Trade negotiations continued – culminating in an “agreement on an agreement” in Geneva – which led to a loosening of export controls between the US (on advanced Tech) and China (on rare earth metals) though tariff rates remained unchanged. Meanwhile, the One Big Beautiful Bill (OBBB) gained momentum (in fits and starts) with passage a couple days after month end. The budget bill extends the expiring tax cuts at a cost to the deficit though tariff revenue is expected to keep the deficit as percentage of GDP relatively unchanged between 6-7% (still elevated relative to history within the context of the unemployment rate). Incremental consumer and business aid helps to sterilize the tariff effects out to ’27 with fiscal austerity ensuing thereafter. If the above weren’t enough, geopolitics stole the show with Israel and Iran trading missile attacks before the US bombed three of Iran’s nuclear enrichment facilities. Thankfully a ceasefire was signed shortly thereafter in what has been called the 12-Day War.

Somewhat remarkably, the markets took all of this in stride with Stocks and Bonds posting positive returns in June. Meanwhile, the Fed remains in the unenviable position of having to determine what to do regarding interest rates. Perhaps not surprisingly so – and to the chagrin of the President – the Fed remains in “wait and see” mode. After cutting short-

Last Mile Is the Hardest

Headline PCE



Source: Factset; PCE forecasts are produced by the Federal Reserve as of June 2025 and are smoothed evenly over time.



term rates by 100 basis points (1.0%) in the third and fourth quarters of last year, the Fed has left rates unchanged in each of its last four meetings. The noisiness of the headlines has left policymakers anticipating a stagflationary-lite backdrop. As such, the Fed has taken their forecasts for growth down and inflation up. Consequently, as can be seen in the chart on the prior page, the Fed's preferred inflation gauge – the Personal Consumption Expenditure Price index (PCE) – is forecasted to re-accelerate toward 3% between now and year end. Inflation running north of the Fed's stated goal of 2% AND headed in the wrong direction has given them pause.

Having said that, the Fed is still anticipating two rate cuts by the end of this year (totaling 50 basis points or 0.5%) with one rate cut expected for next year (totaling 25 basis points or 0.25%) – see table at right. Comparatively, the Rate market (via the Fed Fund futures curve) is expecting a similar two cuts this year and two to three cuts for next year. This “Cutting Through The Noise” suggests a short lived inflation re-acceleration as Fed forecasts expect an eventual easing in 2026 and beyond.

Cutting? Through The Noise

	Fed Forecast	Implied Cuts	Fed Fund Futures	Implied Cuts
Current	4.38%		4.38%	
12/31/2025	3.87%	-0.51%	3.88%	-0.50%
12/31/2026	3.63%	-0.24%	3.21%	-0.66%
12/31/2027	3.38%	-0.25%	3.35%	0.14%
Total		-1.00%		-1.03%

Source: Fed Forecasts are produced by the Federal Reserve as of June 2025. Fed Fund Futures are from Factset and smoothed to incorporate calendar year-end data. Data as of 7/3/25.

While another wave of inflation is not expected by either markets or the Fed, the question might be to what degree a cooling of inflation is connected with a cooling of growth. We think its worth noting that fundamental indicators are pointing to slowing growth ahead. As we pointed out last month, survey indicators have been weaker than actual hard data – which remained the case for this month as well. We see signs of softer survey data in manufacturing, CEO and consumer confidence, the labor markets, credit availability and with regards to earnings growth. To be clear, this doesn't mean that the fundamentals are a disaster – they aren't as 1Q earnings results were strong – but it does mean that one might not want to lose sight of the fundamental trends amidst all the noisy headlines. For now, investors seem to be content with an expected end to the extraneous risks presented in the first half of this year including; a better than feared tariff scenario, averting global war and successful passage of a budget complete with the extension of tax cuts, added consumer and business aid along with an increase in the debt ceiling. This, along with the expectation for a Fed that eventually joins the party by “Cutting Through The Noise” has propelled the S&P 500 to new record highs despite the significant drawdown in April. Still, keeping a balanced view, we think one should note that the recent rally in the equity market has been on the back of multiple expansion as opposed to anticipated earnings growth acceleration. As a result, we're staying steely-eyed to determine if the fundamentals can live up to what's been very strong price action to end this year's first half.



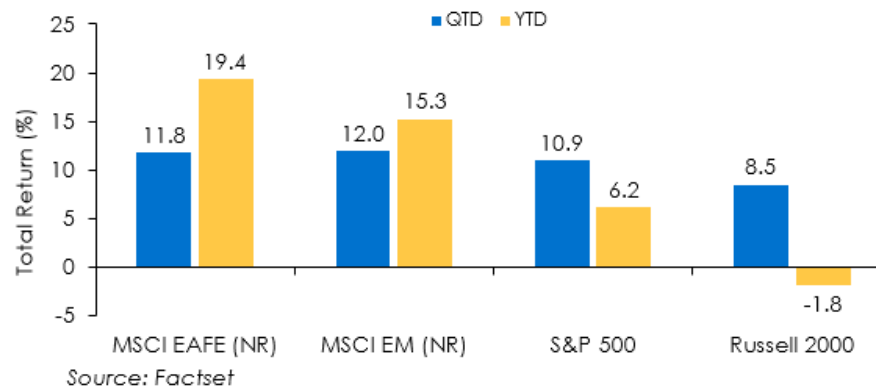
Stocks continued to rally in June putting the finishing touch on a very strong quarter. Equities were strong across the board with double digit returns in many cases as tariff and inflation fears subsided. Bonds posted strong returns for the quarter and year due, in part, from a re-tightening of credit spreads. REITs were down slightly for the quarter and up modestly for the year. Finally, Commodities weakened over the past couple of months after turning in very strong first quarter returns.

Stocks

International Markets (MSCI EAFE and MSCI EM) led for both the second quarter and the year. Foreign returns have benefited from dollar weakness and as investors look to increase portfolio diversification. Meanwhile, US Stocks (S&P 500 and Russell 2000) have underperformed amid trade and stagflation fears though concerns eased as the quarter progressed leading to a sharp rebound in May and June. US Small Caps (Russell 2000) have yet to fully recover their first quarter losses though did show some signs of life this past month. From a sector perspective, performance has broadened year-to-date with a combination of defensive (Utilities, Consumer Staples), cyclical value (Industrials, Financials) and growth (Communication Services, Tech) sectors outperforming though the month of June saw a return to incredibly narrow performance with just the latter two sectors outperforming the broader index.

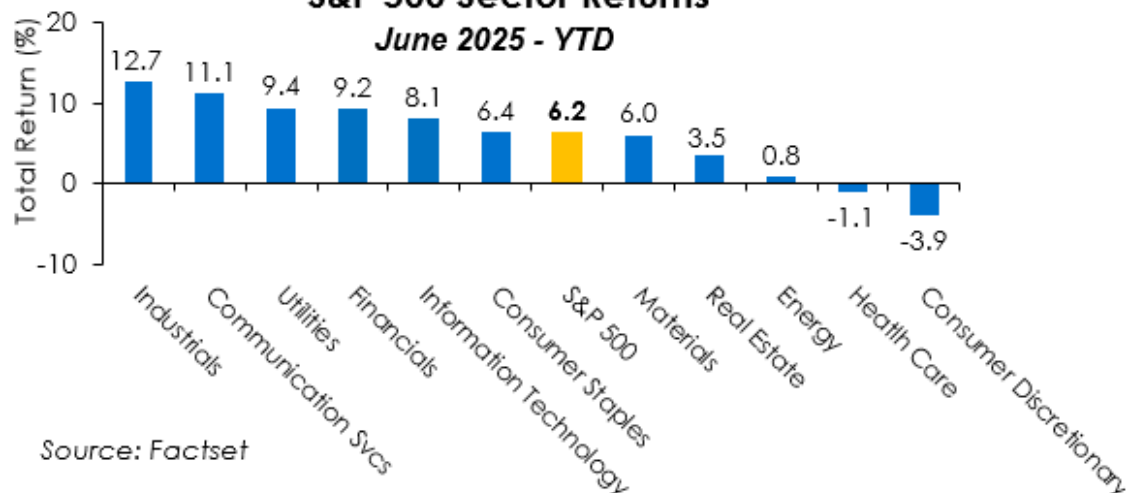
Global Equity Returns

June 2025



S&P 500 Sector Returns

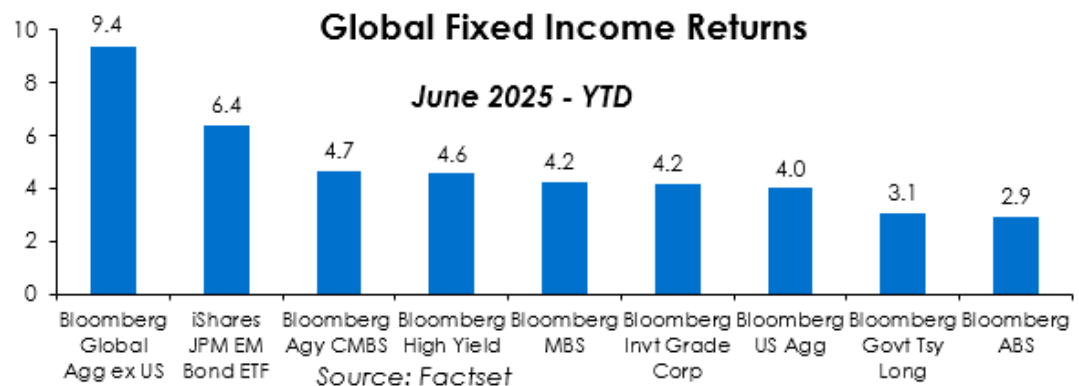
June 2025 - YTD



Bonds

Policymakers pivoted to an easing bias by reducing the Fed Funds rate by 50 basis points at their September meeting and another 25 basis points each at their November and December meetings (Fed Funds at 4.25-4.50%). While this easing bias is the first in over four years, policymakers left rates unchanged at the January, March, May and June meetings. Since December, the Fed has reduced the number of expected 2025 rate cuts from four to two (25 basis points per) and indicated they expect slower growth and higher inflation by this year's end. Despite

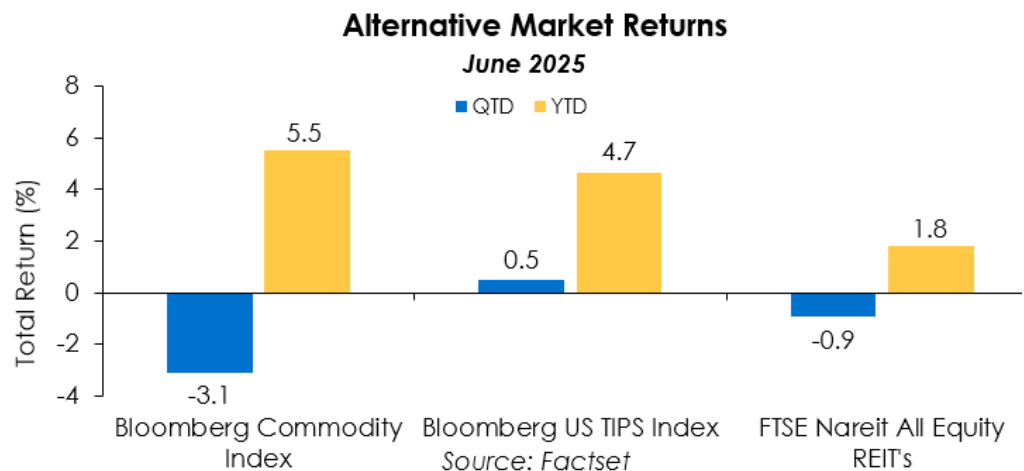
the implied stagflationary-lite backdrop, Bonds have performed well with returns generally up mid-single digits. International (Bloomberg Global Agg ex US) and Emerging Markets (iShares JPM EM Bond ETF)



(iShares JPM EM Bond ETF) have been the standouts for the year due to dollar weakness while long duration Treasuries and Asset Backed Securities (Bloomberg ABS) have lagged.

Alternatives

Commodities lagged in the second quarter on cooler inflation data and as OPEC increased oil production amid a short-lived geopolitical conflict. Meanwhile, publicly traded Real Estate (REITs) posted marginally positive



returns for the year. Finally, year-to-date returns on Treasury inflation protected securities (TIPs) have performed slightly better than nominal Treasuries amid volatile (first rising, then falling) inflation expectations.



Market Outlook

***"It's Tricky to rock a rhyme, to rock a rhyme that's right on time.
It's Tricky."***

– Run DMC, *It's Tricky* (1986)

As the page turns further into 2025, we remain focused on the ever evolving Tricky "Tri-Cycle" – the "three cycle" framework we're using to assess the landscape. A stagnating (and late) Economic Cycle, gradually maturing Profit Cycle and wildly reversing Policy Cycle – makes for the continuation of a Tricky backdrop that requires investors to keep their proverbial eyes up and "Head on a Swivel". Let's explain.

Tricky "Tri-Cycle"

Cycle	Stage
Economic Cycle	Stagnating
Profit Cycle	Maturing
Policy Cycle	Reversing

Economic growth remains choppy with a stagnating impulse, in part, due to trade and fiscal policy. In isolation, the sizeable increase in the deficit would have made the budget bill virtually impassable. However, when viewed within the

context of tariff revenue as an offset, the GOP was able to successfully pass the fiscal measure. Still, tariffs raise the question of stagflation for the Fed which means they may be reluctant to act in the short term in the absence of material weakness in the labor market. Stepping back a bit further, we believe there's fundamental evidence – including the yield curve, leading economic indicator composites, certain survey relationships and especially labor

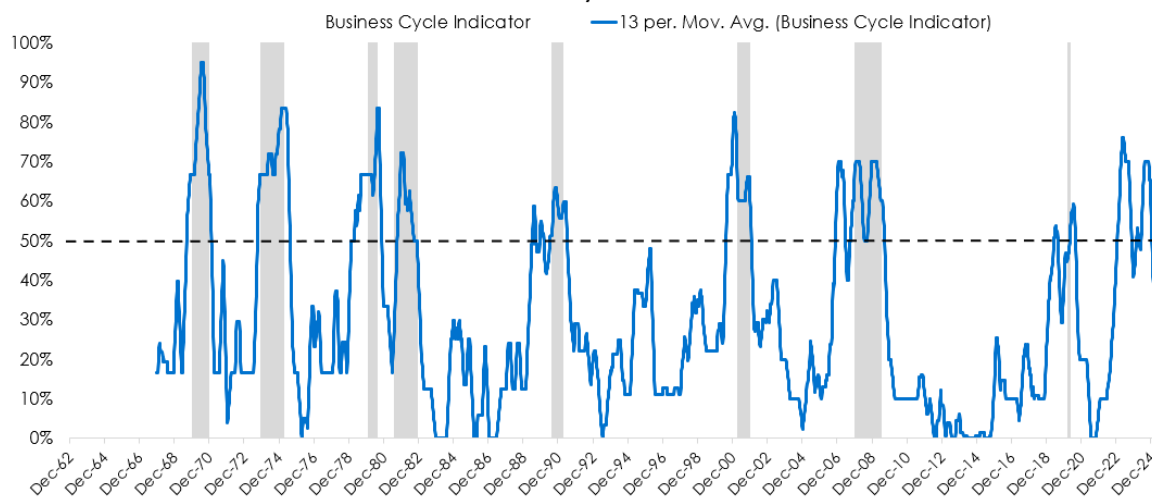
market measures

– that point to being on the later side of the economic cycle.

As can be seen in our business cycle indicator at right, an increased percentage of measures being triggered is a good illustration

that we remain at comparable late cycle levels in the economy (with recessions designated by shaded regions).

Business Cycle Indicator



At this point, the profit cycle doesn't look as late as the economic cycle but the fundamental trends suggest a gradually

maturing

backdrop. As can

be seen in the

chart at right, our

proprietary top-

down earnings

regression model

suggests healthy

but slowing

earnings growth

ahead. This is

corroborated by

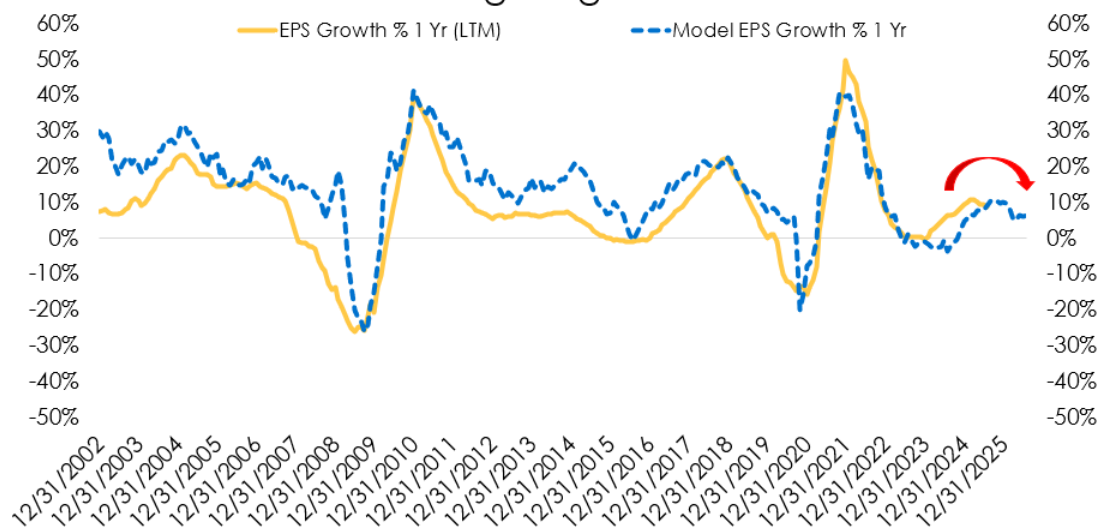
bottom-up

earnings growth

expectations that

peaked back in January. We think positive but slowing earnings growth denotes a gradually maturing profit

S&P 500 Earnings Regression Model



Source: Factset; S&P Dow Jones; Yellow Cardinal Research. EPS Growth Model uses multiple proprietary regression models based on economic inputs that are found to be good predictors of the S&P 500 profit cycle with a 6-12 month lead time. EPS Growth LTM actual earnings is based on iShares S&P 500 ETF (IVV) from Factset.

THIRD YEAR OF A BULL MARKET

S&P 500 Index, Since 1950

Major Low - S&P 500	First 12 Months Year 1	Next 12 Months Year 2	Next 12 Months Year 3
1953	45.8%	40.9%	8.0%
1957	43.1%	12.0%	0.5%
1962	31.1%	21.5%	6.2%
1966	30.5%	9.5%	-6.4%
1970	41.7%	10.7%	0.2%
1974	38.1%	30.4%	-4.1%
1987	16.6%	31.7%	-3.1%
1990	33.6%	8.8%	17.8%
2002	36.2%	9.9%	8.5%
2009	72.3%	18.1%	6.1%
2020	77.8%	15.6%	-9.9%
2022	23.7%	35.6%	9.0% *
Average	40.9%	20.4%	2.7%
Median	37.1%	16.8%	3.3%

Source: Factset. S&P 500 data series uses quarter end pricing to determine major low periods from 1949-1987 and daily pricing to determine major low periods from 1988-current. *Year 3 from latest October 2022 low is as of 7/4/25.

cycle – an important observation within the context of

the strengthening equity market price action. As can be

seen in the table at left, analyzing the evolution of bull

markets over the last 75 years suggest we're in rare air

in this third-year leg. Not only are we well above the

average and median historical results but there's only

been one instance that's offered a better third-year

return – less than a 10% observation. Cumulatively,

there's only been three other episodes that have

delivered better performance – only 25% of all

observations – and we still have three months left to go!

The bottom line is that the equity market seems unphased

by the late economic cycle and downshifting of earnings

growth. Perhaps the removal of tail risk worries has

breathed new life into this bull market though we still

think its important not to lose sight of both fundamentals

and context.



Add to that, the third leg of the stool – a policy cycle that’s abruptly reversing from looser fiscal and tighter monetary to one that suggests the opposite – (relatively) tighter fiscal and (relatively) looser monetary. We say relatively because, while the deficit remains unchanged in aggregate, the recognition of its unhealthy status is leading to some reductions in government spending and the need to find more government revenue (tighter fiscal). As a result, higher

tariff rates are likely to cause the Fed to react in lowering rates (looser monetary) – though this might be delayed due to

The Certainty of Uncertainty

Past Policy	Future Policy
Looser Fiscal	(Relatively) Tighter Fiscal
Tighter Monetary	(Relatively) Looser Monetary

the inflationary nature they initially cause. This reversal in policy is causing investors, consumers and companies to re-think the backdrop as denoted by high uncertainty and weak survey results. The good news is that the rally in risk assets since the second half of April (from backing off of the worst case tariff rates) was a constructive move that flipped the technical script from bearish to bullish. This suggests that the market hasn't deemed anything a foregone conclusion and, as we noted in the opening, the hard data thus far has held up. With what seems like an increasingly large number of potential scenarios still on the table, it's no wonder that the only certainty might be a high degree of uncertainty.

So what are the implications and key takeaways for portfolios?

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance as a way to mitigate the high uncertainty as referenced above. While diversification has previously been an uncontroversial concept, the concentration present in passive indices today – by virtue of the price action over the last couple of years – suggests this notion remains a relic of the past. We respectfully disagree and earlier this year took the opportunity to rebalance portfolios to maintain that degree of balance. In so doing, we took some profits in US Large Caps and added to our overweight (OW) in US Core Fixed Income. As a result, we’ve remained UW the most expensive and concentrated areas where we’ve viewed the long-term risk reward less favorably.

Within equities, our positioning incorporates balance geographically (tilt toward International) and within our US Large Cap exposure especially (away from the top of the market). Our bias has generally been to have more exposure to less expensive areas (down market cap). As such, we’ve maintained a larger OW in Cyclical Value and Defensive sectors combined with a smaller sized cap bias. We remain UW the most concentrated and expensive Cyclical Growth areas and think that if AI is as transformative as advertised it’s benefits will need to accrue to more than just the select few.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – where we’re slightly longer in duration for diversification purposes. We’ve also added to International Fixed Income



(EW), where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market (High Yield) where extremely tight spreads have made this unattractive in our view.

Within alternatives, we remain fairly balanced across the board with neutral positions in Diversified Alternatives, Real Estate and Commodities. Most recently, we adjusted our mix of Diversified Alternative managers in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions, thus, enhancing diversification.

Above all else, we find investors should keep in mind the following:

- Stay focused on the things you can control like ensuring you have adequate 6-12 month liquidity needs which should allow your long-term investment monies to stay invested.
- Has the structural integrity of your plan changed (purpose of money, time horizon, liquidity needs, risk tolerance)? If the answer is no, then recognize that the economy and the market run in cycles that diversified portfolios are there to help mitigate.
- Short term volatility is often the price one pays for the benefit of higher long-term returns.

Thanks for giving this a read.

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