INVESTMENT PERSPECTIVES

JUNE 2025

Key Takeaways —

- What recession? Corporate America defies challenges.
- How trade balance might influence the "flow" theory of bond demand.
- When it comes to equity ideas, don't overlook the value of a picture.

WHAT IS CORPORATE AMERICA SAYING?

Mark Luschini, Chief Investment Strategist

Every three months, publicly traded companies publish their results, with a few announcing just days after the quarter's close and most all within two months. In these releases, management will speak to the company's preceding quarter's revenues, earnings, and other financial metrics and, most often, lend color on general levels of activity within their company and the industry at large. Many will also use the occasion to make forward-looking statements, often referred to as "guidance," about how they foresee the next few quarters or even year unfolding.

The analytical community tunes in to hear these quarterly earnings calls or read the transcripts posted, to help reinforce or establish new projections about a company's prospects. Some companies are viewed as bellwethers for domestic activity, like big-box retailers, while others serve as more of a read on global activity, such as large industrials. Banks are very important and of interest to everyone because they provide unique insights into the economy and consumers, since their credit facilities, deposits, and loan performance reflect the pulse of the economy. Consequently, discussions among bank executives about their outlook are often regarded as "must-see TV" for a broad audience of market participants. Collectively, these quarterly presentations help to frame a view of the macroeconomic conditions we see today and those we might expect going forward. Listening to the aforementioned categories of companies outline their business activity is almost always helpful, but it is particularly crucial now, given the elevated level of trade and economic uncertainty.

First, a quick review of the overall results from the first quarter's earnings season. In short, with most S&P 500 companies having reported, the earnings and sales numbers were very good and handily beat expectations. Importantly, and unlike last year, the 493 companies in the S&P 500, other than the Magnificent 7, saw much improved and strong revenue and earnings growth. This is a healthy sign for the economy. At the same time, since this information reflects "rear view mirror" conditions, all this shows is that neither economic nor trade policy uncertainty has yet weighed on Corporate America's profits. In fact, it probably helped boost them, given that some demand had been pulled forward in anticipation of tariffs being announced well before what is now known as Liberation Day on April 2.

Looking ahead, analysts have been lowering expectations about the results to be reported for the second quarter, as well as for all of 2025. The sectors that have seen the most deterioration in earnings forecasts include Materials, Consumer Discretionary, and Industrials, namely due to their potential tariff exposure. Lending itself to explain why the forecasts for corporate results have been marked down, the mention of a recession and generalized economic uncertainty was a frequent topic covered by company executives. So much so that some companies pulled their guidance on expected results over the coming quarters because the view from the C-suite is so unclear. To be sure, executives are preparing a range of mitigation strategies to protect margins from tariffs, so the overall hit to profitability may be less severe than some fear. A number of companies announced more investment in plants and facilities in the U.S., others explored ways to reorder their supply chains to reduce exposure to high-tariff countries, and more spoke of gaining operational efficiencies. Indeed, where companies have pricing power or lack the margin to absorb higher input costs, price increases were either implemented or under consideration.

Contradicting the soft data, where negative reports about the consumers' sentiment have been pervasive, commentary from large banks and credit card companies paints a different picture. One money center bank said, "The consumer keeps pushing money into the economy," and several major credit card companies noted positive spending patterns across all income cohorts, although there were signs of stress among less affluent households. Importantly, high-income earners (those in the top 10% of income), which represent better than 50% of domestic household consumption, are spending the fastest and distributing those purchases across goods and services alike.

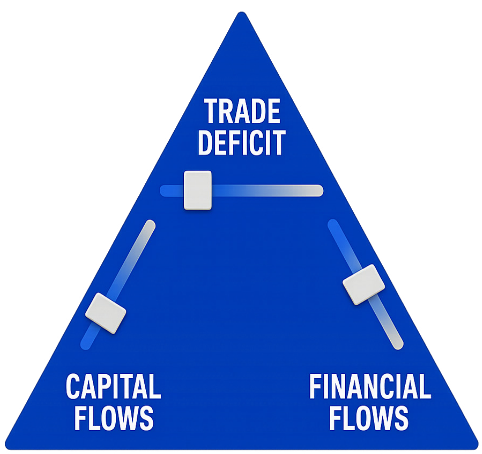
In sum, our interpretation is that consumers remain resilient. However, robust spending by wealthier Americans masks the pressure faced by less affluent households. We will be monitoring whether these strains are broadening, causing a shift by affluent consumers to value-seeking behavior, which could exert a negative impulse on economic growth. Until such time, the takeaway is Corporate America is in good health, and there is little evidence of a recession—even if uncertainty lingers for a while longer. That should help keep a bid in stock prices.

TRADE BALANCE, FEDERAL DEFICIT, AND INTEREST RATES

Guy LeBas, Chief Fixed Income Strategist

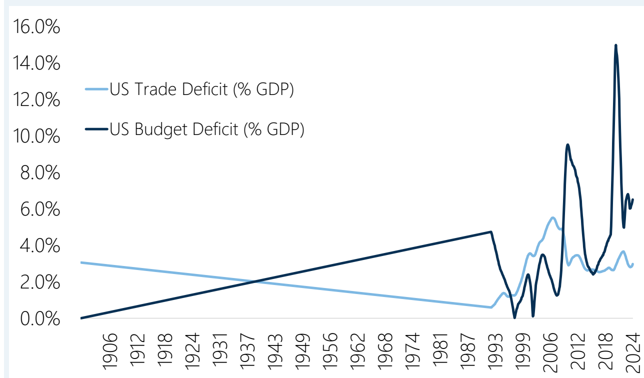
The trade balance—the net of United States imports from and exports to the rest of the world—launched onto the stage in 2025 as a matter of public and political debate. Government statistics agencies have been collecting monthly data on the topic since 1992. For each month in that entire history, through boom and recession and pandemic, the trade balance has been negative. The U.S. has imported more than it has exported for all of contemporary history. While new policies might marginally change the size of the trade deficit, they will not turn it positive in the foreseeable future.

"Balance of payments" is an immutable accounting identity with three components: the trade balance, capital flows, and financial flows. These three things measure all the dollars coming in and leaving the U.S., and they definitionally add up to zero. If one is negative, the others must be positive to add up to zero. For our purposes, that means if the trade balance remains negative and dollars flow away from the U.S., there are equal and opposite dollar flows back into the U.S. in terms of physical or financial investment. Another way to think about it is that when the U.S. net imports goods and services, we net export U.S. dollars, and those dollars get recycled back into the U.S. economy and financial markets.



Our monthly Investment Perspectives column is a bond market one, not a description of trade accounting. However, this trade accounting introduction has important implications for foreigners' demand for U.S. fixed income. When the U.S. exports dollars, foreign private companies and governments hold dollars. No one wants to hold stagnant assets, so those foreign entities, among other things, buy U.S. dollar-denominated bonds. To complete the loop, when the U.S. runs a trade balance, foreigners buy U.S. Treasuries.

Chart 1: Trade Deficit Essential for Funding Government Budget Deficit



Source: Janney ISG; US Commerce Dept; US Treasury Dept.

When viewed through that lens, some of the flows into and out of U.S. bonds over the last two months of trade policy swings makes more sense. On April 2, the Trump Administration proposed sizeable tariffs on substantially all of the U.S. trading partners (the Administration and court decisions have since limited those tariffs). Equity markets felt the impact most acutely, but one of the stranger aspects of the financial markets' response was the lack of safe haven bids in bonds. Typically, when there are increased economic risks and falling equity prices, bonds perform relatively well. In this case, short-term bonds remained stable, but long-term bonds, instead of rallying, fared poorly. A source of this weakness was concern that a shrinking trade deficit could reduce the amount of foreign dollars available to buy U.S. bonds in the coming years. Weakness in the U.S. dollar, relative outperformance of non-USD bond markets, and weaker foreign bidding at government bond auctions all support this flow theory of bond demand.

One implication—not a new one—of this flow theory is that the size of the trade deficit is directly correlated with the U.S.'s ability to run a budget deficit. Lower trade deficits mean reduced demand for bonds, which means higher financing rates, and a tougher time for the federal government to borrow. If the government continues to borrow aggressively in the face of a shrinking trade deficit, that will likely impair the dollar and lead to inflation, causing the trade deficit to widen again. There is no clear endgame for this feedback, but the point is that the relationship between trade, federal borrowing, and bond markets is effectively a closed loop. If markets genuinely believe that a set of policies will reduce the trade deficit and the federal deficit is not changing, then higher interest rates over the long term are a must.

HOW MUCH IS A PICTURE WORTH?

Gregory M. Drahuschak, Market Strategist

It is said that a picture is worth a thousand words. However, in a stock reference, a picture can be worth millions.

The stock market grinds out billions of statistics every day, all of which can be useful in divining potential movement. Research analysts wade through mountains of data from income and balance sheets in their effort to find ideas worthy of committing potentially substantial sums of money.

There are others, however, whose view of an investment approach centers on a simple snapshot of a market index or an individual stock.

This last group, of course, is typically referred to as technicians, whose methods often are viewed with disdain by traditional research analysts. What some people might call a narrow-minded and overly simplistic approach, in fact, recognizes a most basic instinct that what we see provides the basis for rationally determining what we should do.

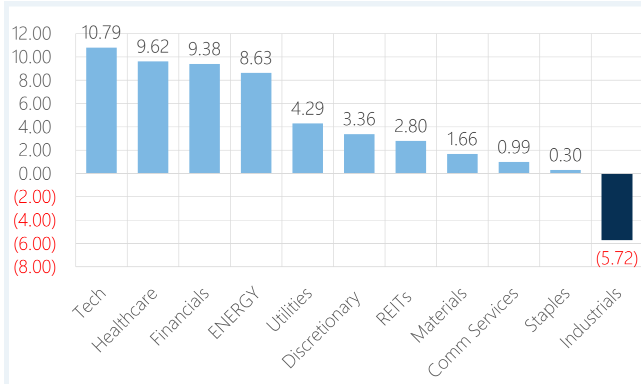
The next time you consider buying a stock, before looking at any recommendations or fundamental data, find a quality charting service and look at a detailed chart of the stock. Instinctively, the chart is a simple snapshot that tells you whether the market overall thinks your idea has been worthwhile. This process should only be part of the due diligence needed to find equity ideas, but as you hone your chart-viewing skills, you can develop significantly better insight into whether taking a position in a stock makes sense.

The pages available in Investment Perspectives do not allow sufficient space to expand this admittedly simple entrée into technical analysis, but in this reference, ignoring the time-honored premise about the value of a picture can be a costly oversight.

Our contribution to Investment Perspectives last month ended by saying, "Above all else, clarity on tariffs is essential for stocks to challenge the February 19, 2025, S&P 500 high." Investors did not get total clarity, but some of the roadblocks to higher market levels, at least temporarily, were set aside. By the end of May, the S&P 500 was only 3.83% below its all-time intraday high. Nonetheless, tariffs will likely continue to be an issue that stymies the market.

At the end of April, many market watchers had a downbeat view of technology, largely based on valuation and the fact that the group sector already had an enormous gain. The Technology sector had the best gain in May, which was a key reason why the capitalization-weighted S&P 500 had its second-best result in the last 76 Mays. However, the May result for technology was not enough for the cap-weighted S&P 500 to regain its performance lead over an equally weighted version of the S&P. We suspect that as the market advances further, high-profile technology and related stocks will regain a performance edge over the equally weighted S&P 500.

Chart 2: May Sector Results

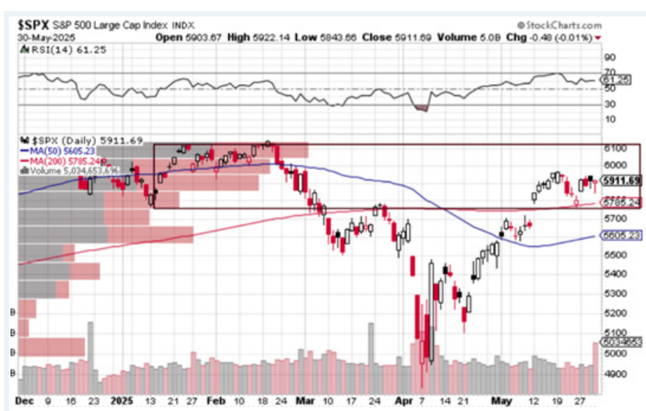


Source: LSEG T1; Janney investment Group Strategy Group

Chart 3: Standard & Poors 500 vs. Invesco 500

Source: Stockcharts.com; Janney Investment Strategy Group

Chart 4: S&P 500 Large Cap Index



Source: Stockcharts.com; Janney Investment Strategy Group

The market picture we see entering June has a pleasing appearance but one that might need time to adjust to the aggressive move up from the April low. The S&P 500 faces a range of volume and price congestion from the prior high close on May 31, 2025, which could provide stocks with temporary resistance to an additional rapid advance, especially considering the typically lackluster seasonal factors in June.