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Q3 2025 Outlook

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Economy: The first half of the year saw the US economy display great resilience in overcoming numerous hurdles with the hope that fewer hurdles the remainder of the year will allow more normal growth trends to resume.

- The recent final revision to Q1 GDP growth showed a decline of 0.5%. While negative readings are not generally viewed as indicative of a strong economy, the figures were skewed meaningfully by a surge in imports ahead of the President's tariff policies, which were announced on April 2nd's "Liberation Day" at the start of Q2 but were largely anticipated to disrupt import availability and pricing. As companies and consumers purchased overseas goods ahead of the implementation of tariffs, a negative trade imbalance was created that had an outsized impact on US GDP. We are likely to see a bounce back in Q2 data as those same companies and consumers have less need to buy internationally, causing the opposite effect. Sure enough, the Atlanta Fed currently projects 2.5% GDP growth in Q2. A meaningful slowdown indicative of recession would generally spread over multiple quarters, which we aren't yet forecasting. While we are not in a recession, economic activity over the first half of the year was modest in total and came with great volatility, which was a disappointment relative to expectations at the start of the year.

- The labor market has provided some mixed signals but appears generally strong. Unemployment has crept higher and has done so at a magnitude that often precedes recessions. However, the starting point was an extremely tight labor market that wasn't sustainable. Generally, current data has shown normalization and resilience, with companies still coming to the market with a healthy amount of job openings, discretionary quits amongst employees pretty high and unemployment stable. Policy makers are watching closely for any further creep in unemployment as a signal that policy should be eased. Despite the overall stability in the labor market, bifurcation has emerged as younger workers seeking jobs that are more "entry-level" have found it challenging to land a job. That segment's high rate of unemployment is a clear deviation from the rest of the market, and one explanation could be the emergence of AI and its ability to eliminate the need for those roles. This is a trend that could have serious implications and we think it will be a topic that grows in coverage over time.

- Inflation has gotten stuck a bit above the Fed's longer-term targets. Fiscal and trade policy have provided a major headwind and are not allowing inflation to fall further. The combination of tariffs and unnecessarily stimulative fiscal policy provide for structurally higher inflation and interest rates, and it is hard to see inflation falling meaningfully from where it is unless we enter a recession.

- Although the economy seems to be weathering the tariff storm for now, April's market environment showed similarities to crisis scenarios of the past and we are monitoring for longer term damage that may have resulted. The environment was unique in that normal reaction functions and correlations broke down and it appears that demand for US assets has come under question. We did not see a traditional "flight to safety" trade where stocks were sold to buy Treasuries and the US Dollar. Instead, when panic was unfolding those assets were sold along with stocks. Gold was a clear beneficiary, and it appears that the world's central banks continue to view gold as their preferred store of value over US assets, which could cause interest rates to remain high and make it harder to finance the government's sizable debt load. Our view is that running high deficits and growing the level of debt outstanding is sustainable until the rest of the world (and the bond market) decide it's not. Some of the unique market behavior in Q2 signaled that this sustainability is no longer a certainty.

- Although public markets bottomed in April and have surged to new highs as described below, it has been curious that private market activity has still been muted. Buyers in the private markets, namely private equity and real estate, have been extremely cautious. Contracts have been cancelled with buyers blaming macro uncertainty. One positive offsetting this muted activity has been the pickup in IPO activity. A number of notable companies have gone public this year and been received well, which should hopefully allow other private companies to mature to the public stage and find liquidity for their investors.

Stocks: The S&P 500 closed Q2 at 6,205, an all-time high. This represents a gain of about 5.5% from the start of the year.

- After some concerns early in the quarter about a more protracted bear market caused by tariff-inflicted economic deceleration resulting in a decline in earnings growth and margins, Hollencrest now sees potential for modest gains the remainder of the year so long as policy holds as the market expects. The S&P saw a peak to trough decline from February to early April of about 19% followed by a rally of over 24% off that low to the end of the quarter. We expect the S&P could continue its rally and reach 6,600 later this year.

- Valuation, breadth, and sentiment are all market characteristics we monitor closely, along with economic data, and when added all together our indicators are neutral and most recently have pointed towards reducing exposure. The primary culprit has been breadth, where the participation in the surge off of April's lows has been fairly concentrated amongst a limited number of stocks. If and when breadth returns via rotation, the market should find fuel for another leg higher.

- Hollencrest's exposure, driven by the aforementioned indicators, is slightly less aggressive than at the start of the year. We continue to utilize innovative products and structures to mitigate downside risk and protect against catastrophic loss while also participating in the market's rally. Should valuation and sentiment improve with a widening in breadth, we will turn to a more aggressive allocation. In the meantime, we have built a position in gold that has performed well. This position is a hedge against capital flight from the US and we see its uptrend having significant room to run.

Bonds and Rates: Treasury yields were volatile during Q2, driven by the capital market dynamics and US assets falling out of favor during the market correction. Rates stabilized as the quarter came to a close with the 10-year's yield ending up at 4.23%, only about 2 bps higher than where it ended Q1.

- The Fed has been in a curious position this year. Their messaging has been that they wish to cut rates as they feel current Fed Funds of about 4.3% is higher than where they would like it over the long run. However, economic data does not appear to support a cut. Growth has been resilient, and inflation has frustratingly been stuck higher than they would like. With fiscal and trade policy also creating further risks, it doesn't seem they will be able to cut anytime soon. We would venture that market projections for rate cuts are overly optimistic.

- The 10-Year Treasury's yield is likely toward the lower end of its trading range. With inflation unlikely to fall meaningfully anytime soon and a Big Beautiful Bill set to pass that will amplify some already big and not-so-beautiful government deficits, we see rates as structurally higher for longer.

- Credit spreads remain historically tight and continue to provide evidence that the financial system is functioning well and credit is readily obtainable. As we have mentioned in the past, this is one of our most important indicators and a significant widening would usually precede a truly challenging economic environment and a recessionary bear market in stocks. Right now, spreads are still giving the all-clear signal.