

# HALFTIME

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PRIVATE WEALTH MANAGEMENT

*Welcome to July and the second half of the year! Each month, we aim to provide fresh insights into the financial markets and break down current headlines to help you cut through the noise and become a more informed investor. Your feedback and suggestions are always welcome, and if you know someone who might benefit from this piece, we encourage you to share it!*

The investment climate has shifted rather dramatically since the beginning of the year. As the calendar turned to 2025, the financial markets reflected an embrace of November's presidential election outcome, but sentiment quickly turned. From February 19 to April 8, the S&P 500 fell 18.9%<sup>1</sup>, driven by heightened investor anxiety over President Trump's tariff proposals and concerns surrounding China's DeepSeek and its implications for U.S. technology firms. However, markets regained their footing after April 8, once Trump moderated his stance on tariffs and major AI companies reaffirmed their capital investment plans. Adding to the rebound, S&P 500 forward earnings estimates reached record highs, further supporting market performance.

Despite considerable uncertainty, the financial markets delivered surprisingly strong results over the first half of the year. The S&P 500 gained +6.2% while the Dow Jones Industrial Average and NASDAQ Composite returned +4.5%, and +5.9% respectively<sup>1</sup> – solid performances by historical standards, but especially so given the volatile policy and geopolitical environment. The fixed income markets also participated in the rally, with the Bloomberg U.S. Aggregate Bond Index returning +4.0%<sup>1</sup>, supported by falling inflation expectations and greater clarity from the Federal Reserve on the future path of interest rates.

The question now is, where do we go from here and what do we anticipate for the second half of the year?

Those familiar with our investment approach know we don't place too much weight on year-end targets. Markets don't follow a calendar, and arbitrary analyst predictions often distract from the more important work of evaluating the underlying forces that influence returns. Instead, we focus more on assessing the environment itself – looking for signs of structural tailwinds or headwinds that may shape the path of the markets in the coming months.

## Tailwinds: Reasons for Optimism

- **Trade Policy** – Financial markets appear to be treating President Trump's renewed tariff proposals as a negotiating position rather than a fixed policy. This interpretation has helped ease fears of a full-scale trade war, particularly with China.
- **Economic Resilience** – While trade tensions remain a concern, they have not materially impacted economic growth or triggered the inflationary pressures that were widely feared. In fact, recession probabilities have dropped sharply – from 65.5% on May 2 to just 22% today<sup>2</sup>. June's jobs report further affirmed the strength of the labor market.
- **Corporate Earnings** – After several quarters of downward revisions, analysts have stabilized their forecasts for 2025 and 2026 S&P 500 operating earnings. Current expectations now point to a healthy +14% earnings growth through 2026<sup>3</sup> – an encouraging sign for equity markets.
- **Geopolitical Tensions** – While the Middle East remains fragile, the situation has become more stable. Concerns over a potential disruption to global oil flows via the Strait of Hormuz – especially fears of an Iranian blockade – have eased meaningfully.
- **Tax Policy: The "Big Beautiful Bill"** – We'll have more on this in another week or so, but the recently passed legislation to extend the 2017

tax cuts beyond their scheduled expiration at year-end provides an important tailwind. Without it, individuals and businesses would have faced a significant tax increase beginning in 2026.

## Headwinds: Reasons for Caution

- **Interest Rates and Fed Policy** – While inflation remains moderate, it remains above the Federal Reserve's 2% target, and the timing and pace of future rate cuts remain uncertain. The Fed's cautious approach suggests they may remain restrictive longer than markets would like.
- **Valuation Risk** – Equity markets are no longer cheap. With the S&P 500 trading at elevated forward multiples, especially in technology and AI-related sectors, expectations are high. Any disappointment in earnings or economic data could trigger volatility or a broader re-pricing.
- **Global Political Uncertainty** – Although geopolitical concerns have eased, the global landscape remains fragile. Tensions with China, Russia's ongoing war in Ukraine, and instability in the Middle East all pose risks that could quickly regain prominence.
- **U.S. Political Risk** – With the midterm elections drawing closer, political uncertainty is likely to increase. The potential for policy shifts – whether in trade, regulation, or taxation – could add volatility to both equity and bond markets as 2026 approaches.
- **Federal Debt and Fiscal Risk** – While the extension of the 2017 tax cuts through the "Big Beautiful Bill" removes near-term uncertainty for taxpayers and markets, it also has the potential to add meaningfully to the nation's debt. Thus far, bond markets have taken this in stride – Treasury yields remain relatively well-anchored, and demand for U.S. debt has been stable. But this complacency may not last indefinitely.

Admittedly, a meaningful degree of uncertainty still exists. From policy shifts and geopolitical tensions to evolving trends in technology and inflation, there have been – and still are – plenty of reasons to question the sustainability of this year's rally. However, our philosophy has always emphasized facts over what-if scenarios, and reality over speculation. The fact is, despite these challenges, markets have moved higher. Investor sentiment has shifted from glass-half-empty in April to glass-half-full today, and many of the issues that previously weighed on markets have largely been discounted.

Our takeaway – we believe that tailwinds presently rule the day and may continue to do so for the foreseeable future. While challenges remain, we believe the underlying trend that began with the October 2022 lows remains intact, and if current conditions hold – or improve – we believe this bull market has the potential to join the ranks of the best cycles since the 1960s. And as surprising as it may seem, the greater risk at this stage may be not a correction, but rather a "melt-up" that pushes stocks into speculative territory, perhaps as we saw in 1999.

Of course, we can't promise where the markets will take us in the months ahead. But we can promise that we'll be right here with you, every step of the way. We'll continue to monitor conditions, help you make sense of whatever comes next, and we'll remain steadfastly focused on the strategies that support your goals. Our role – now and always – is to help you feel confident in your plan, whether tailwinds or headwinds prevail.

Onward.

<sup>1</sup>Wells Fargo Investment Institute <sup>2</sup>Polymarket.com <sup>3</sup>Yardeni Research

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