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# Marco Investment Management

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Investment Newsletter

August 2025

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## Market Review

### *Introduction*

So far in 2025 the stock market has been on a roller coaster ride that presently leaves us near all-time highs. Fixed-income securities are in a trading range as the market awaits the next Federal Reserve move. How are things looking for both markets as we move into the last few months of the year? We will discuss these and other topics in this edition of our Investment Newsletter.

### *Equity Markets*

The tariff scare that sent the market into a tailspin in March and April was replaced by renewed optimism that led the S&P 500 Index to a new all-time high on July 28<sup>th</sup>. This change in sentiment reflected the fact that, at least for now, the impact of tariffs seems manageable for the economy and lots of tariff revenue is being collected. In addition, the “Big Beautiful Bill” was narrowly passed in early July, making the 2017 tax cuts permanent and adding further incentives for business investment. We have yet to see any negative inflationary impact from the tariffs, although there could be a delayed reaction.

Even though there has been a lot of price volatility in stocks this year, a “stay-the-course” philosophy has worked well. Through July, the capitalization-weighted S&P 500 Index was up 8.6%, with the equal-weighted S&P 500 up 5.8%. The capitalization-weighted S&P continues to benefit from enthusiasm for mega-cap technology stocks, especially those viewed as leaders in artificial intelligence. This enthusiasm, however, has driven valuations for these stocks into uncharted territory and has made the index very dependent on a handful of stocks.

Perhaps somewhat surprisingly, Technology is not the number-one-performing sector in 2025. That title goes to the Utilities sector. Utilities are not generally known for market-leading performance; rather, they are viewed as income plays. However, because of the tremendous need for new electric capacity fueled by data centers, increasing population, etc., utilities are now viewed as potential growth stocks.

Year-to-date through July, the Utilities sector is up 14.8%. Because of the weighting scheme of the capitalization-weighted index, the overall impact of these stocks, at 2.5%, isn't nearly as great as Technology, at 34%.

Performance among the sectors has been very uneven in 2025. Healthcare has lagged a good bit and is the worst performer, down 4.3% through July. Confusion over tariff rates on drugs manufactured overseas, Medicare reimbursement rates, and an attempt to bring drug prices more in line with the rest of the world have all been overhangs for the sector. Longer term, the aging population and potential treatment breakthroughs for difficult-to-treat diseases could bring the sector back into favor.

Looking ahead, the next few months could remain volatile. Seasonally, we are entering a historically weak period (August-September), and valuations are not cheap. The cap-weighted S&P 500 trades at almost 23X forward estimates (equal-weighted 17.6X) and there isn't much dividend support, with the average stock yielding only 1.2%. On the positive side, the mega-cap tech stocks are delivering particularly strong earnings growth, with huge capital spending budgets that could sustain that growth for a long time. Dividends, while low on a nominal basis, are growing 7-8% per year. Non-tech sectors sport fairly reasonable valuations and could play catch-up. This year the gap between the cap-weighted and equal-weighted indexes has narrowed, meaning the market has broadened out a bit.

There is still a lot of cash on the sidelines, and if the Federal Reserve cuts rates later this year, as expected, the move could prompt investors who are currently parking money in money market funds to reallocate capital to stocks. Technically, the market remains in an uptrend, with the index above both the 50- and 200-day moving averages. We remain optimistic towards stocks despite the potential for some near-term profit taking. Historically the best three-month span for the stock market is November through January, and we think 2025 could repeat that pattern.

## Fixed Income Markets

Despite a lot of pressure for the Federal Reserve to lower short-term interest rates, so far they have taken a wait-and-see attitude on the economy. Chairman Powell has cited uncertainty about the impact of tariffs on inflation, but inflation has yet to pick up and the consensus of market participants is that we will see at least two rate cuts this year.

Currently the upper boundary of the Fed Funds target rate is 4.5%, which is about 70 basis points above the yield of the 2-year Treasury note. Normally the Fed Funds rate is below the 2-year, so the market is telegraphing to the Fed that short-term rates need to come down. The rest of the yield curve is positively sloped (from two years to thirty years) so the outlier is the short end, which is controlled by the Fed.

Based on the futures market, we could see at least three rate cuts by next March, resulting in a Fed Funds rate around 3.5%.

Corporate bond yield spreads to Treasuries are fairly tight at the moment, implying little risk of near-term recession. For relative value, we see some opportunity in well-structured mortgage-backed securities, and we continue to favor intermediate-term maturities. We believe Treasury rates will likely remain in a 3.5-4.5% range for the next several months.

## Economic Outlook

The U.S. economy continues to grow, but there are some signs of potential weakness.

The most recent headline number for Gross Domestic product (GDP) looked strong at 3%, but GDP in the first half of the year was significantly affected by a surge in imports in advance of new tariffs. This surge depressed Q1 GDP and was offset by a large decline in imports in Q2. Averaging the two quarters gives us a first-half annualized growth rate of 1.3%. The consensus expects growth to average 1.5% in 2025, picking up to 1.7% in 2026. There could, however, be potential upside if growth initiatives out of Washington and investment from the private sector pan out.

Recent economic data has been mixed. Personal income continues to grow and was up 0.3% in June. Hourly earnings outpaced inflation at 3.9% year-over-year. However, the unemployment rate ticked up to 4.2% in June, from 4.1%.

There is also a lot of confusion over the non-farm payroll numbers. While this monthly measure has always been subject to significant revisions, the most recent downward revision of negative 258,000 jobs in April and May left many scratching their heads, as it meant the three-month average is only 35,000 new non-farm jobs, which is well below trend. Looking at the glass as half full, the revised report still shows growth and not contraction in the jobs market, but it certainly bears watching in the coming months to determine the overall trend.

Two surveys by the Institute for Supply Management (ISM) also paint a mixed picture. The most recent Manufacturing survey came in at 48, which indicates a mild contraction. The Services survey was 50.1, which is just barely in the expansion category. Consumer Confidence is well off the highs from last fall but still in a range that indicates optimism.

Many agree that deficit reduction is a worthy goal, given the level of debt outstanding (please see chart) and the high cost of servicing that debt. There is disagreement whether the recently passed tax bill will worsen the deficit or spur growth that leads to increased tax receipts and deficit reduction. The impact of tariffs will also be a meaningful factor in the debt-reduction discussion. So far, tariff receipts are significant, but their long-term impact on our economy is unknown.

## Summary

While stocks haven't had a smooth ride this year, we remain optimistic that the long-term uptrend will continue and the U.S. economy will continue to grow at a modest pace. Inflation should remain relatively subdued at around 3%, allowing bonds to provide modestly positive real rates of return.

*Disclosures: The S&P 500 Index is a capitalization-weighted index designed to measure changes in the aggregate value of 500 stocks representing all major industries. An investor cannot invest directly in any index. Index performance does not reflect the deduction of advisory fees, transaction charges and other expenses. Potential for profit is accompanied by possibility for loss, including loss of principal.*