

Key Insights

- **Remarkable Market Recovery:** The S&P 500's 27.72% surge from April lows to July highs completed 2025's most dramatic turnaround, with Technology (+46.43%) leading the growth-driven rally as the Russell 3000 Growth Index outpaced Value by 19.44 percentage points.
- **Strong Earnings, Stretched Valuations:** 80% of Q2 companies beat both earnings and revenue expectations (highest revenue beat rate since Q2 2021), but the forward P/E at 22.4 well above historical averages suggests limited upside despite five consecutive quarters of 12%+ profit margins.
- **Fed Policy Discord Emerges:** Governors Waller and Bowman's dissent for rate cuts marked the first dual governor opposition since 1993, highlighting tensions as unemployment rises to 4.2% while inflation persists at 2.8% annually against Powell's cautious stance.
- **Tariff Impact Accelerates:** Average U.S. tariff rates jumped from 2.3% to 15.2% under comprehensive trade policy overhaul, creating inflationary pressures while underlying economic momentum decelerates to 1.2% despite headline GDP strength of 3.0%.

Monthly Recap

The S&P 500 Index posted a solid 2.24% gain in July, capping off a remarkable recovery story that began in April. The tech-heavy Nasdaq Composite Index outperformed with a 3.73% advance, while the "Magnificent 7" tech giants demonstrated continued strength as part of the broader equity market turnaround. This performance represents the culmination of an extraordinary round-trip journey - from the market peak on February 19, 2025, through the trough on April 8, 2025 (a decline of nearly 19% on the S&P 500), and back to new recovery highs by month-end.

The July performance highlighted the dramatic reversal in market sentiment, with equities completing one of the most notable comeback stories of 2025. From the April 8 bottom through July's close, the S&P 500 Index surged an impressive 27.72%, the Nasdaq rocketed 38.62% higher, and the small cap Russell 2000 climbed 26.10%, effectively erasing the steep declines experienced during the February-April correction period.

Growth stocks substantially outperformed value counterparts across all capitalizations during July, continuing the momentum that began with April's recovery. The Russell 3000 Growth Index advanced 3.69% versus just 0.62% for the Russell 3000 Value Index, reflecting investors' renewed appetite for growth-oriented investments. This performance differential has been a defining characteristic of the post-April recovery, with growth stocks leading the charge back from the lows.

Large-cap stocks demonstrated superior performance compared to small-caps, though the latter showed respectable gains. The Russell Top 50 Index advanced 3.20% in July, while the Russell 2000 small-cap index gained 1.73%. This large-cap leadership has been consistent throughout the recovery period, with mega-cap technology stocks driving much of the market's resurgence.

Sector performance in July showed a utilities-led rally, with Utilities providing a surprising top performance with a robust 4.91% gain, followed by Technology advancing 3.76%. Industrials contributed 3.04% and Energy added 2.83%, while Healthcare continued its struggles with a -3.23% decline, extending its year-to-date underperformance to -4.37%.

The domestic versus international equity story remained compelling, though with mixed July results. While U.S. markets posted solid gains, international developed markets faced headwinds with the MSCI All-World Excluding U.S. declining -1.18% for the month. However, the year-to-date picture tells a different story entirely -

The James Investment Research Team



Brian Culpepper, CKA
President & CEO
Portfolio Manager



Fall Ainina, Ph.D., CFA
Director of Research
Vice President



Brian Shepardon, CFA, CIC
Vice President
Portfolio Manager



Trent D. Dysert, CFA
Associate Director of Research
Portfolio Manager

international markets have dramatically outperformed U.S. equities, with the MSCI All-World Excluding U.S. posting remarkable 18.07% returns versus the S&P 500's 8.58% year-to-date performance. Emerging markets have similarly outpaced domestic equities with 17.86% year-to-date gains.

The bond market versus stock market dynamic continued to favor equities in July, though fixed income showed resilience. The Bloomberg US Aggregate Bond Index declined modestly by -0.26%, while the 20+ Year Treasury Bond ETF retreated -1.14% as longer-duration bonds faced pressure. High-yield corporate bonds bucked the trend with a 0.45% gain, reflecting improving credit sentiment. Gold also faced headwinds, declining -0.40% for the month despite maintaining strong year-to-date gains of 25.35%.

July's performance underscored the remarkable resilience of equity markets and the power of the recovery that began in April, setting the stage for continued market dynamics as investors navigate the evolving economic landscape.

Corporate Profitability & Valuation Considerations

According to FactSet, Q2 2025 delivered solid corporate performance amid continued market recovery. With 34% of S&P 500 companies having reported results by July 25, 80% posted positive earnings per share surprises - above both the 5-year (78%) and 10-year (75%) averages, while 80% exceeded revenue expectations, marking the largest percentage of positive revenue surprises since Q2 2021.

The blended year-over-year earnings growth rate reached 6.4%, representing the eighth consecutive quarter of year-over-year earnings growth despite marking the slowest gross domestic product ("GDP") growth since Q1 2024. This earnings performance occurred alongside a remarkable market recovery story that defined the first half of 2025.

A key highlight of the earnings season has been the sustained profitability, with the S&P 500 reporting its fifth consecutive quarter with net profit margins above 12%, reaching 12.3% in Q2.

This sustained profitability reflects management teams' ability to navigate cost pressures while maintaining pricing power, though margins declined modestly from Q1's 12.7%.

However, this strong fundamental performance comes alongside elevated valuations that warrant attention.

The forward 12-month price-to-earnings ("P/E") ratio stands at 22.4, significantly above both the 5-year average of 19.9

and the 10-year average of 18.4. This premium valuation reflects investor confidence in corporate earnings power but also suggests limited margin for disappointment. Since the end of Q2, the index price has increased 2.6% while forward earnings estimates have risen just 1.3%, indicating that multiple expansion rather than earnings growth has driven recent gains.

The trailing 12-month P/E ratio of 27.9 sits well above both 5-year (25.0) and 10-year (22.5) averages, suggesting that while corporate fundamentals remain strong, equity markets are pricing in considerable optimism about future growth prospects.

Despite the recent strong market recovery, stretched valuations and a slowdown in earnings growth to 6.4% - the weakest pace since Q1 2024 - suggest that investors may need to temper return expectations as markets navigate the tension between solid corporate results and elevated pricing multiples.

Navigating Today's Complex Economic Landscape

The current economic environment presents a paradoxical picture: robust GDP growth masking underlying weakness, persistent inflation concerns, and significant policy uncertainties surrounding trade and monetary policy. This complex backdrop creates both opportunities and challenges for investors and policymakers alike.

GDP Rebound Conceals Softening Fundamentals

The US economy delivered a stronger-than-expected performance in Q2, with real GDP expanding at an annualized 3.0% rate, surpassing consensus forecasts after contracting 0.5% in the prior quarter. However, this headline strength primarily reflected technical factors rather than broad-based economic vigor.

Net exports contributed a substantial 4.99 percentage points to GDP growth, driven largely by a steep decline in goods imports as businesses had previously front-loaded purchases to avoid anticipated tariffs. This inventory adjustment created a one-time boost that obscures more concerning underlying trends.

Beneath the surface, core economic momentum has decelerated markedly. Final sales to private domestic purchasers - a cleaner measure of underlying demand - slowed to just 1.2% in Q2, the weakest pace since late 2022.

The economy's average growth rate of 1.3% in the first half represents a sharp deceleration from 2024's 2.8% pace, signaling that fundamental economic activity was softening even before tariff costs fully filtered through to consumers.

Federal Reserve Faces Internal Discord on Policy Direction

The Federal Reserve ("Fed") maintained its cautious stance, leaving interest rates unchanged in the 4.25%-4.5% range for a fifth consecutive meeting despite mounting external pressure for cuts. Fed Chair Jerome Powell emphasized that "modestly restrictive policy" remains appropriate while maintaining a data-dependent approach to future decisions.

However, the decision revealed unprecedented internal tensions, with Governors Christopher Waller and Michelle Bowman dissenting in favor of a 25 basis point cut - marking the first time two governors have dissented since 1993. Their opposition centered on concerns that prolonged policy restraint risks unnecessary labor market deterioration.

Waller characterized the Fed's "wait-and-see" approach as "overly cautious" given emerging downside risks to employment, while Bowman warned that delaying action could precipitate further economic deceleration.

Inflation Persistence Complicates Monetary Policy

Inflation remains stubbornly elevated, with the Fed's preferred core personal consumption expenditures ("PCE") measure advancing 0.3% monthly in June and 2.8% annually - indicating limited progress toward the 2% target. While Powell acknowledged inflation has returned "most of the way" to target levels, tariff-related price pressures are increasingly visible across consumer goods categories.

Products subject to trade levies - including household furnishings, sporting goods, apparel, toys, and appliances - have experienced notable price increases. Bloomberg Economics estimates that tariff escalation since the current administration took office could lift core prices by 1.1% over the next two to three years, creating additional complexity for monetary policymakers.

The delayed impact of tariffs on consumer prices puzzles economists, who attribute the lag to factors including pre-emptive inventory building and supply chain cost-sharing arrangements that may prove temporary as businesses exhaust these buffers.

Labor Market Deterioration Accelerates

Employment conditions have weakened considerably, with job growth averaging just 35,000 over the past three

months - the worst performance since the pandemic. July's payroll gain of 73,000 fell well short of expectations, while significant downward revisions to prior months amplified concerns about labor market momentum.

The unemployment rate edged higher to 4.2% in July, contrasting sharply with Powell's earlier characterization of labor conditions as "solid." Manufacturing employment declined for a third consecutive month, representing the longest contraction in two years as producers grappled with elevated input costs from tariffs and weakening demand.

Dissenting governors Waller and Bowman argue the labor market has become "less dynamic" with "increasing signs of fragility," supporting their case for more aggressive policy accommodation to prevent further deterioration.

Comprehensive Trade Policy Overhaul Reshapes Commerce

The administration has implemented sweeping tariff measures fundamentally altering global trade dynamics and corporate cost structures. The tariff architecture now features minimum 10% baseline levies across all trading partners, with enhanced rates of 15% or higher for countries maintaining trade surpluses with the US.

Bloomberg Economics projects these measures will elevate average US tariff rates to 15.2% from 13.3% - a dramatic increase from the pre-administration baseline of 2.3%. The suspension of the de minimis exemption for imports under \$800, effective August 29, closes what officials termed a "catastrophic loophole" and subjects previously duty-free e-commerce shipments to tariff treatment.

Despite recent clarifications, "plenty of tariff uncertainty remains" according to trade analysts, with sector-specific levies on pharmaceuticals, semiconductors, and critical minerals anticipated in coming weeks. This phased implementation approach, combined with ongoing legal challenges to "reciprocal" tariff mechanisms, complicates long-term business planning and supply chain optimization.

Consumer Resilience Shows Signs of Strain

Consumer spending - the economy's primary growth engine - has exhibited notable weaknesses. Inflation-adjusted consumer expenditures edged up merely 0.1% in June following May's decline, marking the softest consecutive quarters since the pandemic. Durable goods purchases fell for a third consecutive month while services spending remained subdued.

A cooling labor market, combined with flat real disposable income and minimal wage growth, underpins this

consumption weakness. While consumer confidence reached a five-month high in July amid stock market gains, the fundamental spending backdrop remains concerning for sustained economic expansion.

Critical Juncture Ahead

The US economy stands at an inflection point, balancing technical GDP strength against clear evidence of weakening underlying fundamentals. The Federal Reserve must navigate these crosscurrents while managing internal dissent and external political pressure, all as evolving trade policies continue reshaping domestic price dynamics and global commerce patterns. The path forward will depend critically on incoming economic data and the ultimate scope of trade policy implementation.

Topic of the Month: Back-to-School 2025: Economic Implications and Consumer Behavior Shifts

The back-to-school season represents America's second-largest retail spending event, generating approximately \$128.2 billion in total spending across K-12 and college segments in 2025. This massive consumer expenditure creates significant economic ripple effects throughout the retail ecosystem, labor markets, and broader GDP calculations. However, the 2025 season presents unique challenges as families navigate persistent inflation, new tariff pressures, and evolving shopping behaviors driven by economic uncertainty.

Unlike traditional seasonal retail events, back-to-school spending serves as both an economic barometer and a structural necessity that directly impacts workforce participation and long-term human capital development. The confluence of tariff-induced price pressures, value-seeking consumer behavior, and generational shifts in shopping preferences creates a complex economic landscape that extends far beyond simple retail metrics.

Economic Foundation Under Tariff Pressure

The back-to-school shopping season serves as a major economic driver, with the National Retail Federation forecasting \$39.4 billion in K-12 purchases and \$88.8 billion in college expenses for 2025 - amounts that have held steady year-over-year despite inflationary pressures. This spending stability masks significant underlying behavioral shifts as families adapt to economic pressures through strategic shopping modifications rather than absolute spending reductions.

President Trump's comprehensive tariff structure - including a 10% universal tariff, 15% on Japan, and 30%

on China - creates unprecedented cost pressure when combined with peak back-to-school demand. The tariff impact demonstrates the "sticky" nature of remaining imports from targeted countries. Unlike previous trade challenges where companies could shift supply chains to Vietnam and Mexico, remaining imports represent products with specialized manufacturing requirements, making price increases more likely to be passed directly to consumers.

Consumer Behavioral Revolution

The 2025 back-to-school season reveals a fundamental shift toward more sophisticated value-seeking behavior. Families are shopping more strategically, with only 61% of expected spending completed by the end of July (down from 66% in 2024), 75% expressing willingness to switch brands for better prices (up from 67%), and a pronounced move toward mass merchants over specialty retailers as the preferred channel for maximizing value.

Income-based spending patterns reveal stark inequality effects. Lower-income families plan to increase spending by 10% year-over-year due to higher prices, contrasting sharply with middle-income families (declining 7%) and higher-income families (declining 9%) who possess flexibility to reduce discretionary spending.

State Tax Holidays: Critical Relief Mechanisms

State back-to-school tax holidays have evolved from simple consumer relief measures into critical economic policy tools, particularly as tariff-induced price increases compound existing inflationary pressures. These temporary sales tax exemptions create concentrated economic activity with significant behavioral and fiscal implications.

The economic mechanics of the 2025 back-to-school season demonstrate sophisticated consumer price sensitivity, most clearly illustrated by "purchase bunching" - deliberately timing purchases to maximize tax holiday and promotional savings. This tactical behavior has intensified in 2025 as families confront both persistent inflation and new tariff-driven cost increases. Households earning \$10,000-\$40,000 annually are particularly inclined to adjust their shopping schedules and tactics to maximize tax savings, positioning them as a key demographic for retailers during major promotional periods.

The strategic timing between state tax holidays and federal tariff implementation creates unprecedented dynamics. States scheduling tax holidays in late July gained competitive advantages as consumers seek to complete purchases before August 1 tariff increases.

The combination of tax exemptions and retailer promotions creates “stacking” opportunities where consumers achieve cumulative savings of 15-25% on eligible items.

Cross-border shopping dynamics intensify during tax holiday periods, creating temporary economic shifts as consumers travel to maximize savings opportunities. This geographic arbitrage benefits states with generous tax holiday provisions while potentially disadvantaging neighboring states, creating regional competitive dynamics that influence longer-term business location decisions.

The “One Big Beautiful Bill”: Transforming Educational Finance

The “One Big Beautiful Bill” (OB BB) represents the most significant overhaul of educational financing mechanisms in decades, creating new market dynamics that extend far beyond traditional back-to-school spending patterns.

The expansion of 529 plan eligible expenses to include K-12 curriculum, digital learning platforms, tutoring services, and educational therapies, combined with doubled annual withdrawal caps (\$20,000 from \$10,000), dramatically broadens the addressable market for tax-advantaged educational spending. This expansion effectively subsidizes educational technology companies, tutoring services, and specialized learning programs through tax advantages.

Federal Reserve and Monetary Policy Implications

The back-to-school spending surge occurs within a complex monetary policy environment where Federal Reserve officials maintain heightened vigilance regarding inflation expectations. Atlanta Fed President Raphael Bostic’s statement that monetary policy intervention would be warranted if tariffs begin influencing inflation expectations, takes on particular relevance during back-to-school season.

The concentrated nature of family spending during this period, combined with limited substitution options for many school-required items, creates conditions where price increases may be more readily accepted by consumers and potentially embedded in expectations. The Federal Reserve’s data-dependent approach becomes complicated because spending patterns are inherently seasonal and driven by non-discretionary needs.

Technology Adoption and Market Evolution

The 2025 season demonstrates accelerated technology adoption with significant retail channel implications. The preference for mass merchants (83% versus 77% in 2024) and online retailers (68% versus 65% in 2024) reflects continued value-seeking behavior, while the decline of

overseas value retailers (only 9% plan back-to-school usage despite 35% recent usage) suggests these platforms are losing competitive advantage as cost benefits diminish.

Channel preferences vary significantly by product category, with furniture (70%) and clothing (58%) preferred for in-store purchase, while electronics (71%) and computer hardware (69%) are preferred online, creating distinct operational requirements for retailers across categories.

Forward Implications and Transformation

The 2025 back-to-school season represents a transformative moment in American retail and consumer behavior. Families demonstrate remarkable sophistication in adjusting shopping behaviors to maintain educational priorities while managing budget constraints through early shopping, brand flexibility, and channel optimization.

The regressive impact on lower-income families and the potential for embedded inflation expectations require careful monitoring by policymakers. For retailers, the season offers critical lessons in value communication, promotional timing, and technology integration that extend beyond traditional back-to-school categories.

The convergence of tariff policies, state tax holidays, federal educational finance reforms, and generational technology adoption creates a complex economic environment where traditional retail strategies must evolve. The strategies developed during this period will likely influence spending patterns across categories and seasons, making 2025 back-to-school a potentially transformative moment in American consumer behavior.

Conclusion

July 2025 represents a pivotal moment where remarkable market resilience intersects with mounting economic headwinds, creating a complex landscape that demands careful navigation. The extraordinary 27.69% recovery from April lows to July highs demonstrates equity markets’ adaptability, yet this impressive rebound occurs against stretched valuations - with forward P/E ratios at 22.4 well above historical norms - and decelerating earnings growth of 6.4%. While corporate profitability remains robust with five consecutive quarters of 12%+ net margins, the sustainability of premium multiples depends increasingly on continued earnings execution rather than multiple expansion.

The paradox of 3.0% headline GDP growth masking underlying weakness of just 1.2% in final domestic sales captures the current economic moment perfectly. The Federal Reserve’s unprecedented internal discord, with

two governors dissenting for the first time since 1993, reflects the complexity of navigating persistent 2.8% inflation, rising unemployment to 4.2%, and comprehensive tariff policies that have elevated average tariff rates from 2.3% to 15.2%. Meanwhile, the back-to-school season reveals sophisticated consumer adaptation strategies, with stark inequality effects as lower-income families increase spending 10% while higher-income households reduce purchases, highlighting the regressive nature of inflationary pressures.

As markets navigate this environment, success will require balancing optimism about corporate resilience and market recovery with realism about stretched valuations, policy uncertainties, and weakening economic fundamentals. The convergence of tariff implementation, Federal Reserve policy evolution, and consumer behavioral shifts creates both risks and opportunities that will likely define investment outcomes through the remainder of 2025, establishing precedents that influence American economic dynamics well beyond the current cycle.

Reality and adapt their approaches accordingly will be better positioned for success in what promises to be a challenging but potentially rewarding environment.



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