On The Mark

HP | HARMONY POINT WEALTH ADVISORS

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Halfway There: 2025 Mid-Year Outlook

Key Takeaways

- Markets held up **better than expected** in the first half of 2025, despite a brief but stunning drawdown in April.
- Growth and inflation have been **relatively stable** so far, but risks may be building.
- The first half of the year was a great example of why investors should avoid **reacting to the headlines** and stay focused on the long term.

Alive and Kicking

The first half of 2025 is in the books. While it may not have unfolded exactly as envisioned, we're on pace for a pretty good year in the equity markets. In fact, the S&P 500 returned 6.2% over the first six months, slightly above the historical average for the first half of the year.

The market's resilience is notable, especially given how much uncertainty investors were forced to absorb. After all, equity markets briefly dipped into bear market territory during the post "Liberation Day" sell-off. Since then, markets have powered through wave after wave of unsettling headline, from erratic new tariff policies and DOGE-related government spending cuts, to rising debt levels, mass deportations, and escalating geopolitical tensions. Through it all, markets have shown a surprising ability to "climb the wall of worry."

Against All Odds

The U.S. economy grew at about a 1% annual rate during the first half of the year. This is markedly slower than historical averages, but not surprising given the extremely high policy uncertainty. Because of this uncertainty, many companies and consumers have delayed big spending decisions until gaining more clarity on trade policies.

Adding to the uncertainty is the distortion in headline growth numbers like GDP. Many companies rushed to import goods in March ahead of increased tariffs. Since imports count as a negative in GDP growth calculations, that made growth look weaker in the first quarter than it really was. We expect those effects to even out over the next couple of quarters.

Under the surface, the core parts of the economy – consumer spending and business investment – held up well. Consumers continued to spend thanks to steady real wage growth. Wage growth has outpaced inflation since mid-2023. That's helped households strengthen their balance sheets and continue to spend. On the business side, much of the investment came from large technology companies that continue to expand their AI capabilities.

But there are signs of slowing ahead. Employers have delayed hiring, causing the number of unemployed to rise to levels that typically signal a softening labor market. If delayed economic activity turns into canceled activity, we could see growth decline more meaningfully.

Running Up That Hill

Inflation has continued to cool in 2025, despite worries that tariffs would push prices higher. Much of the improvement came from lower energy prices. Even when excluding food and energy, we've seen encouraging signs, especially in services inflation.

Shelter costs, which are a big part of service inflation, have started to decline, following the decline in the broader housing market. This trend could continue

through the rest of the year and may help offset some of the expected increases in goods prices from new tariffs.

Businesses have already sold much of the non-tariffed inventory built up in the pre-tariff import binge. This implies higher prices are in store for the future.

Under Pressure

The Federal Reserve has kept interest rates steady since December 2024. They believe current rates are modestly restrictive to economic growth. This is helping inflation, currently at 2.7%, to slowly decline to its 2.0% inflation target.

Because economic growth and inflation have both remained relatively stable, the Fed hasn't felt the need to lower interest rates yet. In their view, inflation is still elevated, and employment remains sound. However, they do expect a slowdown later this year and have forecasted two rate cuts by year-end. Their ability to cut rates if they need to is important – and reassuring – for the financial markets.

Don't Stop Believing

The key lesson from the first half of 2025 is that staying invested through uncertainty is often the best course. This can be a very challenging thing to do, especially in a highly divisive political environment. During the early phase of the Trump administration, several policies have taken shape: higher tariffs and tighter immigration rules. These policies tend to be stagflationary (they tend to increase inflation and decrease growth).

However, other policies such as tax cuts and increased government spending (from the recently passed spending bill), as well as potential deregulation later this year, could support future economic growth.

While risks remain – from continued policy volatility to slowing growth and rising inflation – we also see long-term investment opportunities. Areas like international markets, high-quality growth companies (especially large technology firms), and tax-advantaged municipal bonds may offer attractive potential going forward.

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