

The Legacy Group, Inc.

Dear Legacy Clients,

Thank you for your continued partnership and trust, and welcome to our quarterly economic and investment update. In this letter, we will be detailing our thoughts on the current investment landscape, reflecting on the first half of 2025, and providing our general economic/investment outlook going forward.

After enduring extreme volatility and downside during the first quarter of the year, global equity markets rebounded and rallied for the entirety of the second quarter, with the S&P 500 index now reaching new all-time highs once again. This came after President Donald Trump announced a 90-day pause of the extremely high tariff rates (20-50%) that were set in place on April 2nd of this year. These high tariffs were initially announced in order to incentivize other countries to strike more favorable trade deals with the U.S., but they came at the expense of inciting fear of global economic slowdown. The much lower (10%) tariffs have remained in place though, and have so far generated around \$98 billion in federal revenue without meaningfully affecting economic activity or inflation. This revenue is unfortunately not nearly enough to offset the government's budget deficit, but it is still already more than double the amount of tariff revenue collected all last year, according to the Bipartisan Policy Center. Regarding trade deals, ongoing talks have been taking place between the administration and various trading partner countries, as many foreign governments remain hopeful for further negotiations in order to strike deals. The initial deadline of the 90-day pause was July 9th, and this has since been pushed back even further to August 1st. In addition to sending warning letters to various other countries, President Trump has also stated that there will be no more delays past this August 1st deadline. The exact number of the tariff rates will not be known for certain until this date, and only time will tell whether or not President Trump follows through on his threats. Right now, the stock market seems to be looking through this August 1st deadline, as President Trump has shown in the past that he does not always do exactly what he says he'll do.

The relationship between the administration and the Federal Reserve (the "Fed") also remains tenuous, as President Trump has been publicly calling for Fed Chair Jerome Powell to dramatically lower interest rates, hoping that it will reduce the interest expense that the U.S. will have to pay on its future debt. This rationale however has not influenced Powell's stance on interest rate policy, as it has nothing to do with Fed's mandate from Congress: stable prices and maximum employment. As a reminder, the Fed hikes rates higher when they want to slow inflation (aka stabilize prices), and they cut rates lower when they want to support the labor market and economy. This matters for the stock market as well since lower rates are generally supportive of stock prices. The Fed is still looking to moderately reduce interest rates later this year, although these rate cuts expected to happen this year are more about "recalibration" than economic support. They hiked rates up to 5% two years ago to combat inflation levels that were much higher than they are today, and if they leave rates high for too long, it could unnecessarily hurt economic growth. Although tariffs could potentially cause some inflation in the short term, the Fed sees this as likely to be a one-time price increase rather than a long-term inflationary pressure, in which case they would not need to address it. During Powell's June press conference however, he reiterated that he still wants to be patient with the speed at which they cut interest rates to ensure that this is the case, much to the President's dislike.

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With respect to current inflation, the annual PCE inflation rate (“PCE” inflation is the Fed’s preferred measurement of inflation) is 2.3% as of May. This is lower than the 2.8% number we reported last quarter, and close to the Fed’s 2% target. Despite potential tariff-related goods inflation that could come soon, we still believe that inflation will continue to cool over time, as a large portion of current inflation is being driven by higher auto insurance and shelter prices, which we do not think is sustainable. We have already seen significant progress in shelter inflation especially, which has been on a downward trajectory since March of 2023. Nick Colas of Datatrek Research points out that if this trajectory continues, it should return to its 2016-2019 run rate by the end of this year, helping to buffer against any potential near term tariff-related price increases in goods. Finally, we still continue to see additional progress in declining wage inflation via the most recent measurement of average hourly earnings as well as the Federal Reserve Bank of Atlanta’s wage growth tracker.

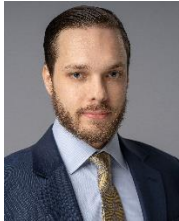
As stocks rallied this quarter off the April lows, leadership once again returned to U.S. large cap growth and technology stocks, though this was likely due to the fact that these stocks were also down the most during the sell-off, and stood to benefit the most from a “rebound” trade. Data coming from both Franklin Templeton’s and JPMorgan’s economic research projects earnings growth to broaden out from the “magnificent 7” companies (Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, Tesla), to the rest of the S&P 500, with broad S&P earnings growth hitting mid-to-high single digits in 2025. International equities also rallied significantly this quarter, building off momentum that was set in place during the first quarter, and continuing to outperform U.S. equities this year. The biggest driver of these returns has been the decline in value of the dollar relative to foreign currencies, due mainly to the administration’s perceived attempt at decoupling from the world economically. We believe the dollar has room to fall further from here. Currency exchange rates are driven by a number of complicated factors, but historically speaking, the dollar tends to decline during periods of global economic strength combined with easing domestic monetary policy, both of which are in play now. Additionally, despite this recent foreign stock rally, international valuations remain well discounted relative to U.S. stocks, meaning that even a small amount of positive news can have a strong positive impact. Bonds declined modestly this quarter as rates rose slightly once markets became less worried about recession, and gold has been trading near its all-time high since late April.

Turning now to our own economic and recessionary outlook, much still depends on the future of tariffs, which is fundamentally impossible to predict. Assuming the administration remains open-minded in its approach to trade policy though, it’s difficult to imagine a recessionary scenario plying out in the near term. The Federal Reserve Bank of Atlanta has now returned to forecasting trend-like economic growth of 2.6% (annualized) for the second quarter. Going forward, we continue to stress that consumer spending makes up 68% of GDP, and the consumer still appears to be in very good shape given higher aggregate household net-worth since 2020, as well as high-net worth individuals making up half of total consumption in the U.S. Additionally, significant tax cuts proposed in the “One Big Beautiful Bill” should fuel consumption even further in 2026. The longer-term deficit increases from this bill will have to be addressed at some point in the future via higher taxes and/or reduced spending, but in our view, this is a much longer-term issue that is also fundamentally impossible to predict. Increased bond issuance needed to fund the bill may send longer-term interest rates (mortgages, 10-year rates, etc.) higher though, even if the Fed lowers short-term interest rates. Finally, we continue to emphasize the resilience of our labor market which continues to employ more people, continues to maintain low unemployment (4.1%), and continues to provide elevated job openings (7.7 million as of May).

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Regarding our own portfolios, we maintain that our current allocations are working as intended. We mentioned last quarter that we still believe this administration is willing to focus on pro-growth policies like tax cuts and deregulation, and this bill (albeit expensive) is a first step towards that. As it pertains to tariffs, we cannot ever really know for sure what the final destination is, as they can be removed just as quickly as they can be added. We may see a flurry of both positive and negative trade-related headlines in the coming months, and a return to volatility wouldn't surprise us either. Despite these known unknowns, the fact remains that our economy stands on strong fundamental footing, insulated by the strength of our consumer and labor market, and the Federal Reserve still has the ability to cut interest rates and support it if necessary. Ultimately though, uncertain environments like this are why we stay diversified, and the fact that diversified portfolios have greatly helped buffer against trade-related volatility this year should be the primary focus of stock market investors. We hope that you find these updates helpful, and please do not hesitate to reach out if you have any questions.

Sincerely,



Austin Smith, Analyst for The Legacy Group, Inc.

Craig Lestner

The Legacy Group, Inc.

Resources used:

<https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20250618.pdf>

<https://www.atlantafed.org/chcs/wage-growth-tracker>

<https://www.atlantafed.org/cqer/research/gdpnow#:~:text=Latest%20estimate%3A%202.7%20percent%20%E2%80%94%20January,from%20January%207%20after%20rounding>

<https://finance.yahoo.com/news/live/trump-tariffs-live-updates-trump-says-he-wont-extend-august-1-deadline-after-letters-to-japan-south-korea-others-200619781.html>

<https://finance.yahoo.com/news/trumps-previous-tariffs-terrified-world-200746692.html>

<https://www.cnbc.com/2025/06/27/pce-inflation-report-may-2025-.html>

<https://www.cnbc.com/2025/07/03/jobs-report-june-2025.html>

<https://www.bls.gov/jlt/latest-numbers.htm>

<https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/>

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<https://www.franklintempleton.com/insights/anatomy-of-a-recession>

DataTrek Research: DataTrek Morning Briefing

- June 11, 2025: “US/ROW Correlations, Longer Run US Returns, Altman AI”
- June 18, 2025: “Powell Comments, New SEP, Big Tech Price Targets”
- July 1, 2025: “Dollar Weakness, JOLTS, NAS Bubble Indicator”