Market Strategy
by STRATEGAS A BAIRD COMPANY

BAIRD
Private Wealth Management

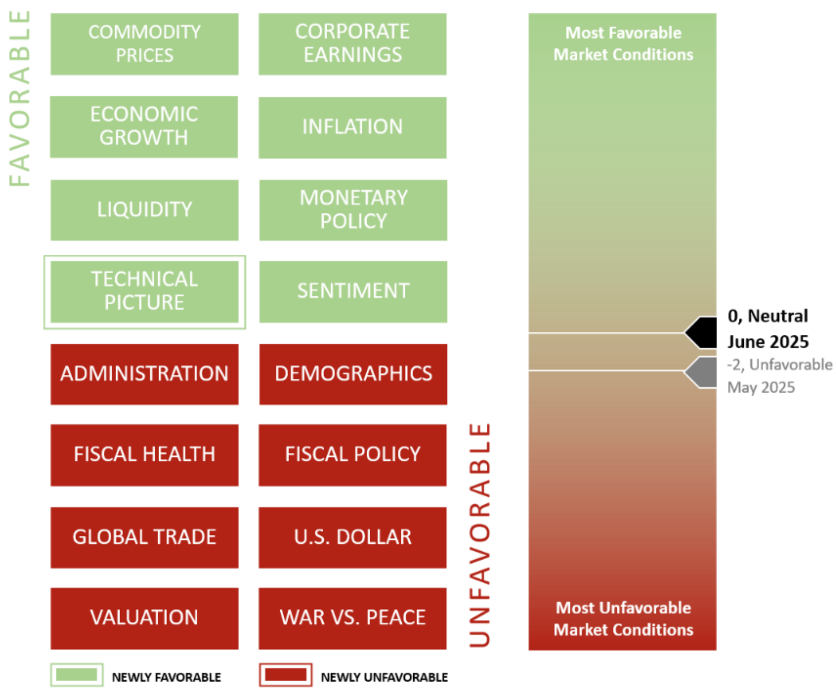
Market Gauge
June 2025

GAUGE TICKS HIGHER INTO A NEUTRAL READING

The Market Gauge is Neutral in its latest edition, with the **Technical Picture** having improved in recent weeks with the Administration partially walking back its tariff plans. Other Favorable signs include solid Corporate Earnings, largely bearish Sentiment (a contrarian positive), and a strong Liquidity backdrop.

After a one-month stint (May) in the Unfavorable column, the market's **Technical Picture** has returned to Favorable. Over the last several weeks, we've seen a textbook market rebound off correction lows, with the characteristics of a durable rally: strong breadth skews (lots of stocks rising), a surge in new high data (ditto), and outperformance by cyclical sectors (Technology, Consumer Discretionary, Industrials, and Communication Services). Although we're careful not to interpret history as scripture, current conditions resemble the 2018 correction and subsequent "Powell Pivot," when markets found their footing when policy pressures unexpectedly eased. Whether or not recent strength proves to be a "Trump Pivot," the market seems to be treating it that way for now as investors welcome strong Q1 corporate earnings, optimism on expected tax legislation, and softer trade rhetoric from the White House.

As was the case last month, we remain reluctant to draw sweeping conclusions from Q2 economic data—viewing Q2 as a "broken play" given the tariff distortions. Some activity will be pulled forward to get ahead of upcoming import levies, and some activity will be delayed because of operating uncertainty. In this environment, we remain focused on the three C's: the consumer (confidence and claims), credit spreads, and corporate profits. In May, Consumer Confidence was positive month over month for the first time since last November. Credit spreads are tight and sit below pre-Election levels. Corporate earnings for 1Q25 (pre-tariff) were strong (+13% year over year). The outlook for 2025 earnings continues to move lower at a pace slightly ahead of typical revision patterns, but we maintain most of our focus on the second half of the year.



FAVORABLE or UNFAVORABLE?

This table shows the 16 factors we monitor to understand the current environment for U.S. stocks. Eight factors in each group represents a neutral market environment. Our latest count puts the Gauge at **Neutral, or 0** (the sum of **+8** and **-8,** as seen in the table above). Positives include a solid economic growth backdrop and strong technical picture. Negative factors include high valuations and trade issues.

The Strategas Market Gauge is meant to be a snapshot of a moment in time, and not a predictive tool. See page two for more on our 16 building blocks, and what we look for to label each one "Favorable" or "Unfavorable." This assessment is as of May 30, 2025.

BREAKDOWN OF THE GAUGE'S FAVORABLE AND UNFAVORABLE ELEMENTS

COMMODITY PRICES ***(Do they reflect economic growth or contraction?)*** Energy commodities are underperforming in 2025, while Gold and Silver are up. Agriculture commodities remain mixed. There's concern that higher commodity prices will reignite inflation, but so far only pockets of commodities seem to agree.

CORPORATE EARNINGS ***(Are they growing or falling? Are profit margins expanding or contracting?)*** S&P 500 EPS estimates for 2025 are being revised lower (now at +7% growth) but are still strong. Most of the downward revisions are for Q2, when tariff-related cost increases and demand pressures are expected to matter most. Strong Q1 results suggest to us that U.S. firms are holding up well for now.

ECONOMIC GROWTH ***(What is the recent trend in GDP growth? Are leading indicators rising or falling?)*** With the tariff shock in April, the odds of a U.S. recession rose. For now, economic data still benefit from a "pull-forward" of activity ahead of impending duties. Tariff delays may indicate that the worst won't come to pass and that the Administration will listen to CEOs and the markets on this issue.

INFLATION ***(Is it near the Fed's target? What's driving it? How are consumer expectations?)*** The first U.S. inflation wave appears over. A second wave could happen, but we're still in the lull (which historically can last for years). Tariff shock will affect pricing if nothing changes.

LIQUIDITY ***(What do money stock growth, real rates, credit spreads, and financial conditions look like?)*** Credit spreads have tightened. The economy has absorbed higher real interest rates so far. Govt. policy (including emergency help for banks) has helped avoid a crisis and so far, 2025 has not seen a systemic credit event.

MONETARY POLICY ***(Are interest rates accommodative or restrictive? Are other central bank programs market-friendly?)*** U.S. monetary policy is pivoting from restrictive toward neutral. More rate cuts are likely, though the pace of easing has slowed.

What impacts market health the most?

Important
Administration
Demographics
Fiscal Health
Global Trade

More Important
Commodity Prices
Fiscal Policy
Inflation
Monetary Policy
Technical Picture
US Dollar

Most Important
Corporate Earnings
Economic Growth
Liquidity
Sentiment
Valuation
War vs. Peace

(ranking of categories is based on Strategas analysis and opinion)

SENTIMENT ***(Are investors optimistic or pessimistic? Pessimism is a positive.)*** Since the April market low, ETF in-flows have been led by bond funds and crypto; out-flows have been led by cyclical sectors and small-caps. Equity in-flows have cooled and futures positioning is also tilted toward expectations for volatility. One risk to be mindful of is that options data are starting to reflect more bullishness.

TECHNICAL PICTURE ***(What does price action tell us? What do market breadth, trend, and momentum look like?)*** We're seeing stronger breadth and Industrials are maintaining a procyclical leadership posture. Over half of S&P 500 stocks made a new 20-day high recently and our Discretionary vs. Staples ratio has firmed after a brief downtrend.

ADMINISTRATION ***(Is the White House "market-friendly" on taxes, regulation, and trade?)*** Tariffs are increasing the odds of a recession, a slowdown in business activity, and financial market stress, though they have been somewhat walked back. Congress is moving forward on a bill that may provide tax relief for consumers in 2026 and tax cuts for businesses that would encourage investment.

DEMOGRAPHICS ***(Are trends in population, age, and the worker-to-retiree ratio positive or negative?)*** An aging population is a headwind for U.S. labor supply, creating pressure on the Fed via higher wages. Aging demographics also hastens investor preference for income over capital gains.

FISCAL HEALTH ***(Is the deficit growing or shrinking? Is federal spending in line with economic growth?)*** Entitlement spending continues to climb and the cost of servicing the national debt is elevated at 18% of tax revenues. Federal spending is still above its pre-pandemic average.

FISCAL POLICY ***(Is the government pro-growth and market-friendly?)*** Policymakers are focused on addressing the deficit while also extending tax cuts. To offset the cost of the tariffs, Congress included pro-growth tax provisions in the tax bill but we are still in a net austerity environment with more spinach (spending cuts, tariffs) than candy (tax cuts).

GLOBAL TRADE ***(Are attitudes more "free trade" or more "protectionist"?)*** Higher tariffs on China are likely to remain in place. A recent court ruling against the use of emergency powers to impose tariffs will likely not prevent the Administration from pursuing other avenues.

U.S. DOLLAR ***(Is it strengthening or weakening vs. other currencies?)*** Global investors appear to have lost appetite for the currency. Even if that reverses, any flight to quality is likely to be a headwind for U.S. exporters and emerging market economies.

VALUATION ***(Are stocks expensive or cheap vs. historical averages?)*** Equity valuations have cooled slightly but the market is trading at 23x trailing 12-month earnings, vs. the l average of 16x (going back to 1950). On a forward basis, the S&P is also heightened at 21x.

WAR vs. PEACE ***(Are tensions inhibiting global economic growth?)*** Ceasefires remain elusive in Ukraine and Gaza. The U.S. push for other countries to increase defense spending raises doubts about traditional alliances. Trump's trade war is leading to tensions with allies and with China. The U.S. will increase defense spending by $150 billion as part of the tax bill, indicating it does not see geopolitical threats diminishing.

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