

Equity Markets Q2 2025 Commentary



Dan Kim CFA®
Director of Research & Portfolio Manager

From tax cuts and deregulation to the concept of market backstops if stocks became too volatile, investors began the year cheering the Trump Administration’s economic agenda. This framework collapsed spectacularly when investors realized the Trump “put” had not only expired out of the money,¹ but was replaced by an expensive, long-dated “call” option² that resembled wartime economic measures. The administration’s message was that the expensive premiums paid for the call options (trade wars, domestic restructuring) would eventually lead to American prosperity in the form of long-term investments and fair trade.

Meanwhile, Federal Reserve Chair Jerome Powell declined to provide monetary accommodation – not surprising given his history with the president. Although frustrating to many, Powell’s justification has merit. No one has any idea how the tariffs will impact sustained inflation expectations, so a reasonable decision could be to wait and see.

The convergence of geopolitical uncertainty and monetary inflexibility created the perfect storm that culminated on April 2, with reciprocal tariffs being

¹A put option expires worthless if the underlying stock price does not reach the strike price. In this analogy, investors expected the administration would back off on policy if markets sold off aggressively. This did not happen.

²A call option rises in value if the underlying asset price increases. In this analogy, investors must pay a premium upfront, but it is unknown if economic conditions will improve to justify the policy moves.

Key Market Takeaways

- 1 **The U.S. economy is experiencing a sharp split between struggling consumers and thriving enterprises, a divergence intensified by rapid artificial intelligence (AI) adoption and post-pandemic distortions.** While consumer confidence and spending are showing signs of weakness, corporations are reporting significant productivity gains and margin expansion from new technologies.
- 2 **The rise of AI is creating a paradox where businesses become more efficient and profitable even as some segments of the labor force face redundancy or obsolescence.** This structural shift means corporate profits can rise even as consumer purchasing power potentially declines, not from traditional cycles but from technological displacement.
- 3 **Persistent geopolitical uncertainty, tariffs, and monetary policy rigidity are fueling market volatility, but a major, sustained equity decline appears unlikely.** Investors are advised to focus on high-quality, low-debt companies that are resilient through cycles and benefit from productivity-enhancing technologies, while avoiding those heavily reliant on discretionary consumer spending.

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imposed by the US to virtually every other nation on the planet. This moment of maximum pessimism marked the bottom in investor sentiment and subsequent recovery in global equities.

Amid the daily headline chaos, fundamental economic trends have remained surprisingly constructive. Core inflation has generally trended lower, tariffs have not yet triggered major global supply chain disruptions, and corporate earnings momentum has been resilient. However, beneath the surface, we are witnessing an economic bifurcation that will likely reshape the equity investment opportunity set, perhaps meaningfully.

The Great Bifurcation

What makes the current cycle unique is the divergence between consumer and enterprise economies — a phenomenon amplified by both the post-COVID economic distortions and the rapid adoption of artificial intelligence across corporate America. This bifurcation represents a fundamental shift from traditional economic cycles where consumer and business health typically moved in relative synchrony.

One may recall the concept of “rolling recessions” during and following the pandemic, where specific industries experienced independent cycles of contraction and recovery rather than moving together as in traditional economic downturns. This fragmented pattern is precisely why many economists incorrectly predicted a broad recession that ultimately did not materialize. Sectors such as semiconductors, housing, and industrials each followed their own distinct trajectories, creating a patchwork economic landscape that defied conventional forecasting models.

The consumer sector, however, never really went through its post-pandemic rolling recession. It has held up reasonably well due to various factors including excess savings, stimulus effects, and a robust labor market. However, recent data is beginning to show increasing signs of distress. The Conference Board's Consumer Confidence Index declined 5.4 points to 93 in June, with the Expectations Index falling to 69, with anything below 80 historically signaling a recession. Real personal consumption expenditures and retail sales declined 0.3%, and 0.9% in May, respectively.



Enterprise AI Revolution

Meanwhile, the corporate sector is beginning to see an acceleration of AI-driven productivity gains and margin expansion. Our conversations with enterprise software vendors reveal productivity improvements in the 20–50% range across various business functions. The negative byproduct of this technological revolution is becoming increasingly apparent: over the next few years, certain areas of the labor force will likely face redundancy or even obsolescence.

This creates a paradoxical economic environment where corporate profitability marches higher while consumer purchasing power faces increasing pressures — not from traditional cyclical factors, but from structural technological displacement. The implications are clear: businesses are becoming more efficient and profitable as the broader consumer base potentially weakens.

Market Outlook

The convergence of geopolitical uncertainty, tariff-induced supply chain adjustments, and the underlying economic bifurcation continues to shape a complex investment landscape. The Federal Reserve will likely remain resistant to material policy changes, especially as the inflationary effects of tariffs begin to filter through to official statistics. While the administration will likely continue to secure new trade agreements, the pace may be slow and incremental. We expect continued volatility driven by the president's forceful negotiating

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tactics, but markets appear to have developed a numbness to this type of rhetoric, suggesting a major, sustained decline in equities is unlikely.

Navigating this environment demands a steadfast focus on our core investment principles – identifying high-quality companies with low debt and recession-resilient business models that compound value through economic cycles. Such businesses often displace or acquire weaker competition during downturns while reinvesting to widen their moats during expansions.

Given the unique nature of this bifurcated economy, we are particularly focused on companies that are enablers of productivity enhancement, disciplined adopters of these same technologies, and practitioners who are both leading vendors and internal users of their own solutions. Conversely, we believe businesses overly dependent on discretionary consumer spending may face sustained headwinds as the delayed consumer recession finally materializes.

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1-800-728-8762

1300 N. State Street
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