



All Time Highs...

3Q 2025 Economic and Market Outlook

It's hard to believe that just three short months ago, investors were in a full-blown panic driven by aggressive Trump Administration trade and tariff policy initiatives. Following up on campaign promises for trade fairness, "[Liberation Day](#)" marked the announced reciprocal tariffs on every nation on earth and already fragile markets swooned. As seen in the below chart, US stocks, which began the year on a strong note, fell 20% from a mid-

February high, including a 10% decline on the back of the announced tariffs. Like most investors, we were surprised by the severity of the decline but tried to look through the volatility to determine a likely outcome. As with all things Trump, it is sometimes difficult to separate the wheat from the chaff. So much bluster comes along with his policy prescriptions even when the policy proposals are constructive. Such is Trump, I guess.

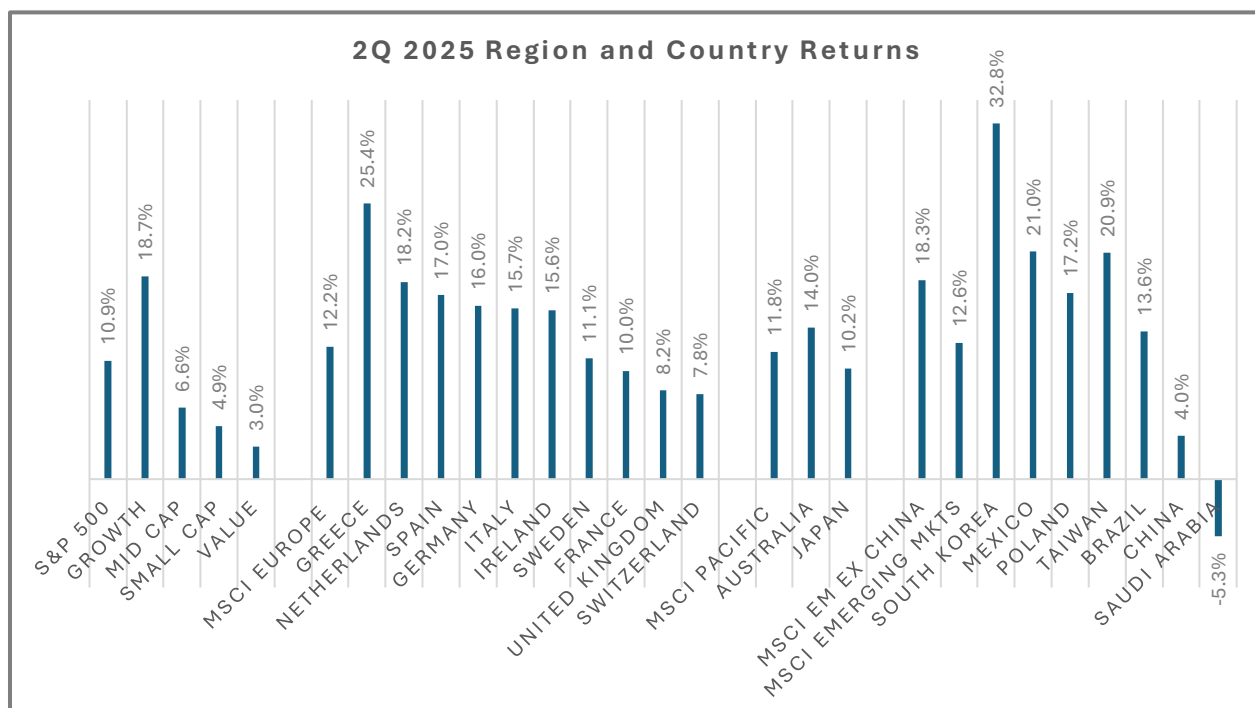
While conceding that risks and uncertainty were high and that Trump does not always take a nuanced approach, we took [a more constructive view relative to many others as we entered the second quarter](#). At his core, Trump is a mercantilist, and his economic policies are designed to fit that mercantilist standard. Like it or not, low interest rates, a weak dollar and protectionism are foundational to his economic view. But Trump is no ideologue. Despite these protectionist views he is also a pragmatist and is flexible. What he says today may very well be reversed tomorrow. And that flexibility was amongst the reasons why we remained constructive, while still understanding his mercantilist tendencies. A recession or stock market crash would not benefit Trump, so we believed a pivot from the Liberation Day announcement was likely. Additionally, we held that trade policy was just one element of Trump's early fiscal initiatives. Beyond tariffs, his tax reconciliation bill, now known as "[One Big Beautiful Bill](#)", is a net positive by making lower tax brackets permanent among other growth friendly initiatives. Additionally, the growing list of onshoring commitments by nations and corporations is another positive input to the economic mosaic.

Most importantly, however, Trump did pivot. Temporary pauses in the implementation of the tariffs allowed room for calmer voices to take the scene and for negotiations to take place. Trade warriors, Howard Lutnick and Peter Navarro were sidelined in favor of Treasury Secretary Scott Bessent. And from extremely oversold levels, the equity market began its dramatic resurgence resulting in one of the [best quarterly performances](#) on record, with the S&P 500 finishing the quarter at an all-time high. It is important to note, that throughout the volatile period of tariff announcements and negotiations, [first quarter earnings results](#) were being announced and they were broadly strong across a majority of sectors, industries and companies. Yet, another validation of the resilience of the US economy and the ability of corporations to grow despite policy uncertainty.



Source: YCharts

Beyond the US, international markets continued to outperform. Non-US equity investors, however, have recently encountered a shifting landscape. With U.S. equities comprising 64% of the MSCI All-Country World Index as of May, their dominance has long buoyed global returns thanks to both a strong market and a rising dollar. However, the recent tariff shock—along with growing concerns over U.S. fiscal sustainability has disrupted this favorable dynamic. Rather than acting as a haven, the dollar has weakened as investors reassess its role in the current environment. Notably, the US Dollar Index (DXY) is down 11.5% from its January peak and nearly 15% from its cyclical high in 2022. Additionally, stimulus measures sparked a pickup in economic activity, particularly in Europe. While part of this reflects a normalization from overvalued levels, some fund managers were caught offside—expecting the dollar to rise in tandem with falling U.S. equities, only to see the opposite happen.



Source: S&P/MSCI/YCharts

In the U.S., first-quarter growth appeared soft due to a rush of imports ahead of scheduled tariffs, but that was likely a temporary distortion. A rebound in the second quarter seems likely, and while some slowing concerns remain due to high rates and lingering trade uncertainty, we don't see an imminent recession. Europe is enjoying a modest rebound in demand, supported by increased public investment, while China's growth is holding up thanks to domestic demand, even as exports take a hit. Other export-driven economies in Asia have also seen short-term boosts as they tried to beat tariff deadlines. These quirks in the data should start to normalize as the year progresses. On the growth front, our models point to a healthy economic expansion. US Real GDP is expected to grow at a 2.5% annual rate in 2025, accelerating to 3% in 2026. The likelihood of a recession over the next couple of years appears low. This encouraging view aligns with a broad sense that the worst of the monetary and trade shocks are likely behind us.

Interest rate dynamics are also shaping the outlook. We believe that inflation will continue to grind lower and that tariffs will ultimately prove not to be inflationary. This opens the door for more accommodative monetary policy, on behalf of the Fed and suggests a steepening of the yield curve ahead. While the long end holds steady, the short end will move lower, implying a more normal yield curve slope—historically a good sign. Still, it raises the question: Is the short end decline a signal of easing inflation, slower growth, or both?

We anticipate continued but measured downward pressure on the dollar. This reflects a confluence of factors: narrowing interest rate differentials as the Fed signals potential rate cuts, evolving global capital flows driven by shifting growth prospects, and increased scrutiny over US fiscal policy. While we don't foresee a full-blown crisis or a threat to the dollar's reserve currency status, these dynamics reinforce the importance of valuation and global diversification. The dollar remains the world's dominant funding currency, and neither the euro nor renminbi are positioned to supplant it.

Given this backdrop, earnings should continue to benefit, as well. With growth picking up and inflation cooling off, corporate earnings are expected to rise steadily.

In short, while the road ahead still has plenty of potholes—tariff risks, geopolitical flare-ups, and interest rate volatility—the macro backdrop appears to be stabilizing, and momentum is slowly shifting in a more constructive direction.

2025 3Q Key Economic and Investment Drivers

Real Economic Growth	Rising Stable Falling	After an early 2025 growth scare, the economic growth trajectory in the US has improved markedly with the Atlanta Fed now posting strong projections into 3Q and beyond.
Inflation	Rising Stable Falling	Inflation has improved throughout most of the last 12 months, allowing for a modest pivot in monetary policy. Continued improvements may occur but will be more difficult going forward.
Real Interest Rates	Rising Stable Falling	Real interest rates remain near 10-year highs. A slowing economy and more accommodative monetary policy would result in further lower real rates.
US Dollar F/X Value	Rising Stable Falling	For many years the dollar has been the king currency among global competitors but fiscal uncertainty coupled with falling interest rates and a slowing economy may result in a weakening of the greenback.
Taxes and Regulations	Rising Stable Falling	The likely enactment of the "A Big Beautiful Bill Act" will make permanent the personal income tax cuts of 2017 which should be encouraging to markets. Other elements of the bill increase spending and increase fiscal strain.
P/E Ratios	Rising Stable Falling	S&P 500 earnings growth is expected to further increase in 2025. US large cap growth stocks re-rated lower in the first half of 2025 and are no longer at excessive valuations. International equities re-rated higher and are no longer cheap.
Fixed Income Risk Premiums	Rising Stable Falling	High yield spreads tightened over the past quarter, as broad economic risks fell. With stronger economic conditions and ample liquidity, we expect spreads to remain narrow.
Volatility	Rising Stable Falling	On the back of Trump's tariff announcement, volatility spiked but quickly diminished as trade and other economic risks diminished. Periodic increases are always a risk.

Source: TPCM

Bullish Neutral Bearish

Understanding the above economic backdrop, our outlook for investment markets going into 3Q remains constructive and we believe that investors should overweight risk assets such as global equities and credit over defensive assets such as government backed bonds.

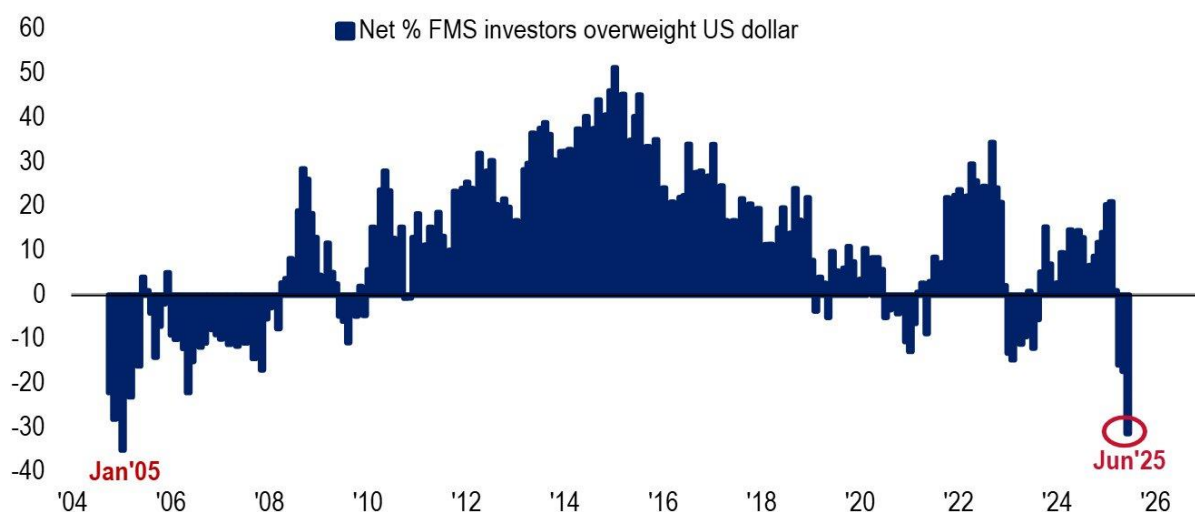
2025 3Q Asset Class and Sector Probabilities	
Major Market Asset Class	Likelihood of Outperformance
Bonds outperform Cash	56.0
Equities outperform Bonds	57.5
Non-Traditional outperforms Equities	57.5
Non-Traditional outperforms Bonds	54.0
Europe outperforms the US	48.5
Asia outperforms the US	45.0
EM outperforms the US	54.5
Small Cap outperforms Large Cap	47.0
Mid Cap outperforms Large cap	52.0
Value outperforms Growth	32.5
Credit outperforms Government bonds	51.5
Sectors v Market	Likelihood of Outperformance
Discretionary	55.5
Energy	42.7
Financials	64.1
Health Care	53.4
Industrials	53.4
Info Tech	60.9
Materials	42.7
Real Estate	53.4
Staples	47.0
Communications	60.9
Utilities	53.4
Source: TPCM	
Bullish Neutral Bearish	

Among equities, the question of going global or staying domestic is a critical issue. Thus far in 2025, international markets have strongly outpaced the US with [MSCI EAFE rising over 20% for the first six months of 2025, whereas the S&P 500 has only risen by 6%](#) marking the largest outperformance over the last 15 years. But will it continue? We started 2025 with a very fully valued US equity market, particularly large cap growth stocks, and very undervalued international markets. European equities, in particular, were very

much an unloved and under owned class. [In January, European equities traded at roughly 25% forward p/e discount to the S&P 500. But no longer as valuation gaps have narrowed.](#) Additionally, international equities are no longer unloved. In fact, global investors have pivoted sharply over the past several months and now are underweight the dollar and US investments in favor of international.

Chart 1: FMS most underweight the US dollar in 20 years

Net % FMS say they are overweight the US dollar

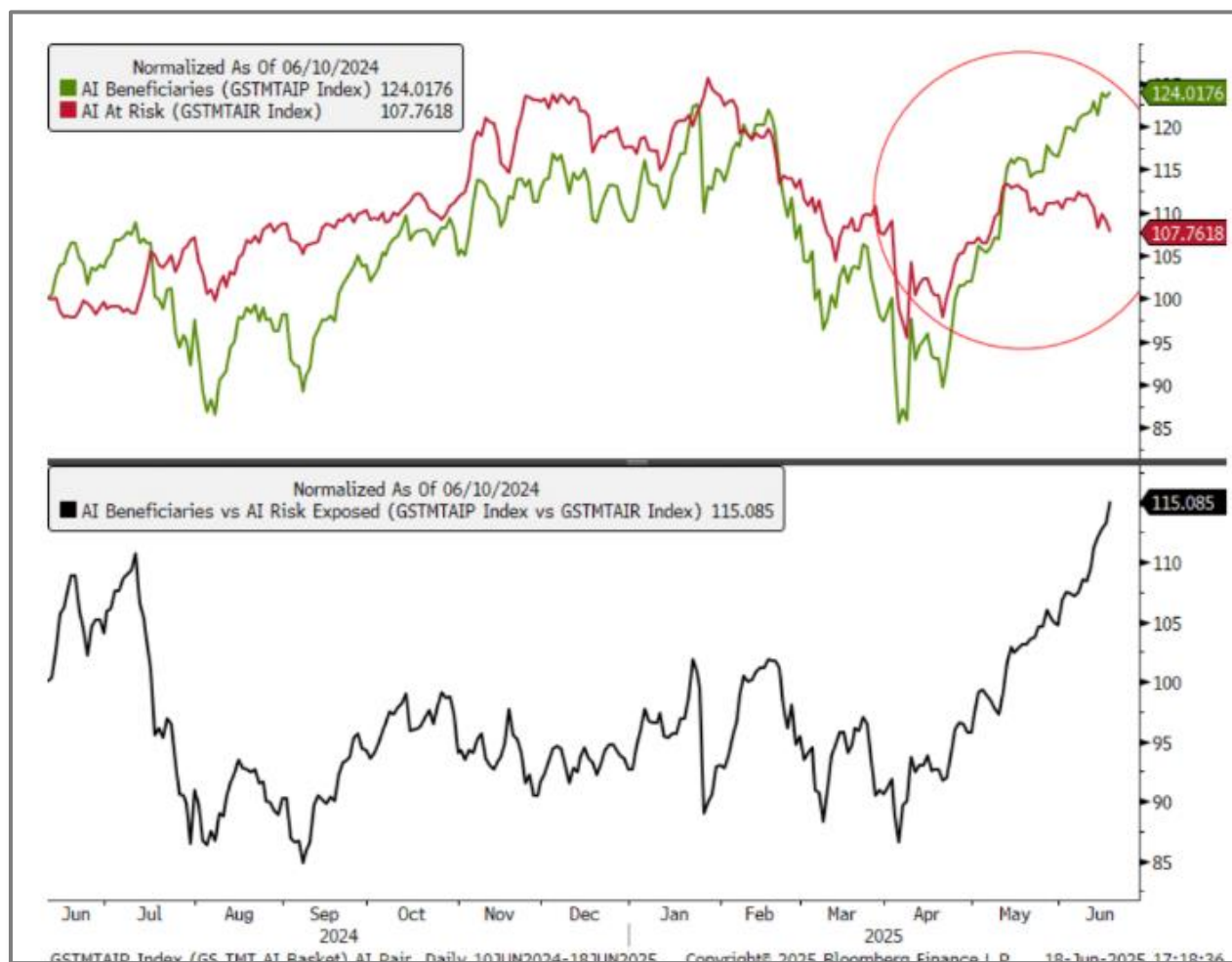


Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

So, international equity enthusiasts must now rely on economic growth and a continued weak dollar to bolster returns. Another valuation pop is no longer likely. Given that, our viewpoints on international investments have diminished. We will remain invested but at levels lower than where we have been over the past several months.

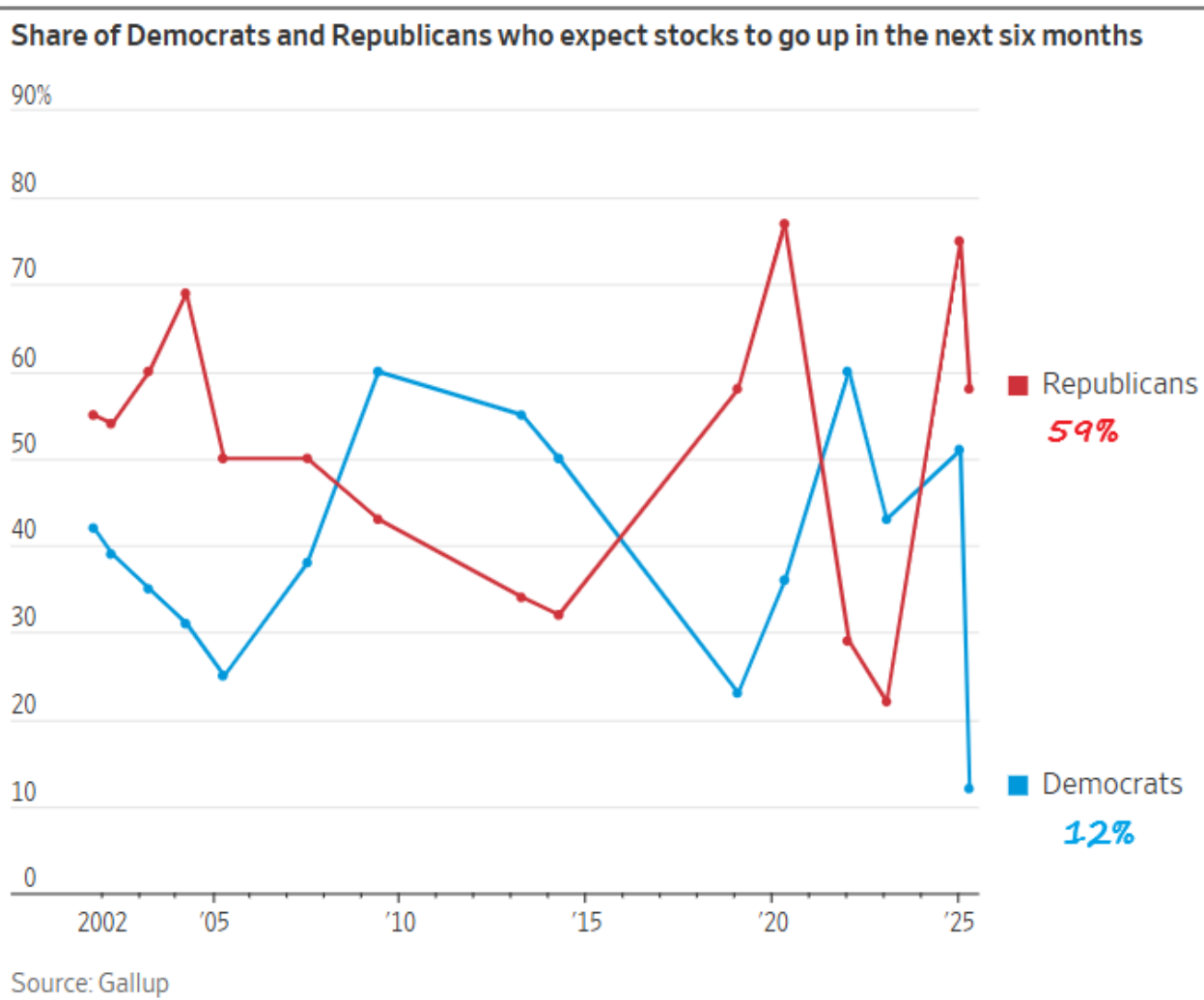
Among US equities, small and mid-caps have remained underperforming sectors relative to large cap. In fact, the underperformance of large cap growth proved to be a temporary, first quarter phenomena as [large cap growth and technology companies came roaring back in 2Q, rising over 18% over the period.](#) The AI boom is real and US tech companies stand to continue to benefit from this long term secular trend. Down capitalization companies trade at a significant discount to large cap but the earnings growth trajectory is just not there. As such, we have increased our weightings in large cap growth companies in lieu of other equity types.



Source: Bloomberg

At the risk of being political, we're going to be political for a moment. It goes without saying that we live in a very divided era and that Donald Trump is the most polarizing politician we've ever seen. Very few people have lukewarm opinions of him or his policies. It tends to be love or hate. Recently, this polarization has translated to market analysis as it is increasingly difficult to find a "just the facts" viewpoint on economic statistics or market trends. We believe, however, letting partisan bias drive investment decisions is a costly mistake. This trend is troubling but also creates arbitrage for those of us who try (very hard) to take an objective view on the market opportunities at hand.

Markets don't care about red or blue. They care about green. Invest accordingly.



We continue to believe the long-term, secular trend of technology-driven productivity growth—which has fueled U.S. economic expansion and rising stock prices—remains firmly intact. Investors who stay the course through short-term policy-driven volatility are likely to be rewarded with strong returns, over time.

IMPORTANT DISCLOSURES

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