



From the Market Desk

Earnings drive stock prices

Consolidation needed



August 1, 2025

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Macro

- The US economy is resilient, but it is also slowing. GDP for the first half of the year grew at a 1.25% annualized rate. That is well below last year's 2.50% pace and also below long-term trend growth of about 2%.
- Consumer spending is also slowing. What caught my attention in the July 30 FOMC press conference was Federal Reserve (Fed) Chair Jerome Powell stating, "Economic growth is not part of our mandate." That's true, but I question whether that implies the Fed is focused on full employment and stable prices and not at all worried about an economy that is slowing.
- Either way, the Fed seems to be content to sit tight and watch the data come in before making a judgment on whether to cut rates or not. Two-year note yields generally lead Fed policy. As of this writing, the two-year yield is 3.95%, roughly 25 basis points (bps) below the 4.25% lower federal funds (FF) rate boundary. The bond market is suggesting the Fed is too tight and risks being late to cut rates. The July nonfarm payrolls (NFP) number (+73,000) should ring some alarm bells. (Source: US Bureau of Labor Statistics.)
- FF futures made big moves during Powell's post-meeting press conference. At the beginning of his presser, the market was indicating a 66% chance of a cut in September and a 69% chance of a cut in December. By the time he finished speaking, those odds had moved down to 41% for September and 61% for December. On the heels of the NFP data, the odds for September jumped to 72% and to 69% for December.

Equities

- Interesting action on Thursday: On the heels of phenomenal earnings reports from both Meta (META) and Microsoft (MSFT) Wednesday night, the tape opened Thursday at the high tick for the day. The market bled steadily after that, and the S&P 500 Index essentially closed on the lows. When a stock or an index trades through the prior day's highs and closes below the prior day's lows, technical analysts, who study price/chart patterns, call it an "Outside Reversal." An analyst using a type of chart called a candlestick chart would describe it as a "Bearish Engulfing Candle." In either case, that type of price action usually signals exhaustion and a trend change. This could be the start of the consolidation I think we need after a 30% rip from the April lows. I would think of it as a pause that refreshes.
- Let's talk earnings. The Q2 earnings season has been positive in general, but we are also seeing the first signs of tariff-related misses. I continue to be of the mindset that the biggest risk to the market comes from earnings misses. And with valuations at 24x 2025 EPS and 24x next-12-month EPS, there is not a lot of room for mistakes. META and MSFT blew it out in spectacular fashion and helped pull the Magnificent Seven (Mag 7) into the leadership spot for the year-to-date (YTD), but there were a handful of disappointments as well.
- Sherwin Williams, Whirlpool, Conagra, Texas Instruments, Stanley Black and Decker, Hershey, Adidas, Puma, General Motors, Shake Shack, Budweiser, and Ford all suffered from tariff-related cost pressures and/or weakening in consumer spending. Most of those

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Equities (continued)

stocks did not react well to those misses. Most companies are eating the increased costs of goods sold (COGS) so far.

- Mixed earnings results offer a timely reminder that this is a stock-pickers' market. It has been all year (actually, for the last 16 months) and will continue to be, in my view. Active management should be able to deliver relative alpha in this environment. In fact, through Q2, 51% of active managers are beating the S&P 500, versus just 10% of active managers beating the S&P 500 over the last decade. (Source: Morningstar.)
- The death of the US dollar is greatly exaggerated. The dollar index (DXY) has rallied about 4% from its recent lows, putting the dollar back to the levels of early April, when the storm hit. This seems to be putting a tad bit of pressure on foreign equity markets. Should this continue, we would favor adding to European/emerging markets (EMs) equities. Forward earnings power for 2025 and 2026 is stronger in Europe and EMs than in the United States. We have the data and would be more than happy to share it with you.

Fixed income

- The 10-year US Treasury yield remains stuck between 4% and 4.5%. We think rates will likely stay in this range through year-end, so we do not expect rates to help or hurt total returns going forward.
- Credit spreads remain near the tightest levels of the past 10 years in both investment-grade (IG) and high-yield (HY) space, with minimal bps movement last week. Much like rates, we think spreads are unlikely to aid total returns from here.
- We remain bullish on shorter-duration mandates that have half-of-a-year to a year of duration risk and carry a mid-4 handle (about 4.50%) yield.
- Similarly, we remain bullish on HY bonds, believing that credit quality remains firm and the all-in carry here is a mid-7 handle (about 7.50%). Fixed income seems like a "keep duration exposure short and clip coupons" exercise.
- We find municipal bonds compelling based on strong fundamentals, attractive taxable equivalent yields, and properties of diversification within a fixed income sleeve. Our recent white paper summarizes our view: ["Municipal bonds are back."](#)

Sentiment

- Investors remain cautious. The AAII Sentiment Survey data continues to suggest the Wall of Worry remains in place.
- The percentage of investors that are bullish is at 40%. Readings over 55% suggest complacency. Similarly, the percentage of investors that are bearish is at 37%. Not much movement week-on-week. We see no signal to act on here.

We'll continue to study the markets and will share new insights next week.

Source of data (except where noted) is Bloomberg as of August 1, 2025. **There is no assurance that any forecast, projection or estimate will be realized.** Important data provider notices and terms available at www.franklintempletondatasources.com.

Glossary of terms

AAII: The AAII (American Association of Individual Investors) Sentiment Survey offers insight into the opinions of individual investors by asking them their thoughts on where the market is heading in the next six months.

Bearish engulfing candle (or pattern): In technical analysis, a chart pattern comprising two consecutive candles, featuring a smaller bullish candle followed by a larger bearish candle that engulfs the first. It can signal a reversal in an upward price trend.

Cost of goods sold (COGS): The cost companies pay to produce goods excluding indirect expenses such as for distribution.

Duration: A measure of how much a bond's price changes relative to changes in interest rates.

Glossary of terms (continued)

Dollar Index (DXY): The US Dollar Index tracks the value of the dollar against a basket of major foreign currencies.

Earnings per share (EPS): A company's earnings divided by its outstanding shares of stock.

FOMC: The Federal Open Market Committee of the US Federal Reserve, which sets the federal funds rate target range.

Handle: The whole number in a quoted price; the number to the left of a decimal point.

Magnificent Seven (Mag 7): The stocks of Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA and Tesla.

Nonfarm payroll (NFP): A measure of US employment reported monthly, accounting for approximately 80% of workers.

Outside reversal: In technical analysis, a two-day pattern when a security's high and low prices for the day exceed the high and low of the previous day's trading session. It can signal a reversal if runs counter to an existing trend.

Spreads/tights: Spreads are the difference between yields on differing debt instruments of varying maturities, credit ratings, issuers or risk levels. "Tight" in reference to spreads indicates small differences in yields.

Tape: Reference to the ticker tape that transmitted stock prices during the 19th and 20th centuries.

Taxable equivalent yield: The yield of a municipal bond investment calculated to reflect the benefits of income tax exemption and to be comparable to the yield of a taxable bond.

Indexes

Commentary about performance of equity categories or investment styles are based on indexes. Large-capitalization stocks are represented by the S&P 500 Index.

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