



“Big Beautiful Quarter”

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Dear Clients and Friends:

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Just ninety or so days ago, the Trump administration instigated a global trade war. The “Liberation Day” reciprocal tariffs would raise the effective tax rate on U.S. imports from below 5% to more than 25%, marking the largest tariff increase in over a century. It was a seismic event, threatening economic growth and corporate earnings. The market response was swift and severe, losing trillions of dollars in value in one of the worst three-day stretches since World War II. The S&P 500 declined almost 20% from the all-time high reached in February.

Policy reversals emerged with similar speed. By mid-April, the fallout and outcry forced the administration to announce a pause on most of the new tariffs. The White House claimed that the tumult was all part of the plan to get countries to the negotiating table. They prepped the world for “90 deals in 90 days.” In early May a truce with China further reduced the odds of a trade war induced recession. With these de-escalations, stocks ripped higher. By quarter-end, the S&P had fully retraced its April drawdown, ending at yet another record high.

The S&P 500 gained 11% during the quarter, with the technology sector – the first quarter’s biggest laggard – leading the market higher once again. Growth stocks posted gains of almost 17% while the value cohort was up only 5%. Erasing first quarter losses, the benchmark index is now up about 6% for the year. International stocks, with the help of the continued falling dollar, were up another 12% for the quarter and now up 19% for the year. Small caps, while rallying 8% during the quarter, were still down -2% for the year. The bond market experienced its own volatility but eked out a 1% gain to finish the first half up almost 4%.

The U.S. dollar has been this year’s loser. The currency’s largest first-half decline since the era of free-floating currencies began in the early 1970s has left it more than 10% weaker against its major peers. It now sits at a three-year low. This decline has both helped U.S. investors’ holdings in international stocks and aided the rise in alternative assets like gold and Bitcoin. Dollar strength had been a result of the U.S.’s perceived economic stability and investment opportunity. Some economists now fear this reversal could illustrate mounting concern over American Exceptionalism and our burgeoning budget deficit.

As mentioned, a large part of the market’s rebound during the quarter hinged on easing geopolitical tensions and tariff related de-escalations, including the emergence of the TACO trade. This is an acronym for “Trump Always Chickens Out.” While admittedly derogatory, the phrase captures Wall Street’s belief that the President often talks tough on tariffs but hasn’t yet followed through. The numerous pauses, changes, and extensions have led to increasing bets that there will always be last-minute policy pivots. These pivots will create and preserve a “Goldilocks” scenario to protect overall economic and corporate earnings growth, the current trend in declining inflation, and expectations for rate cuts from the Federal Reserve.

One Big Beautiful Bill

Another reason for the market's recovery can be attributed to the President and Congress's delivery on their promised signature tax and spending "One Big Beautiful Bill Act." After weeks of dramatic negotiations and narrow votes, on July 4th President Trump signed the megabill that is sure to be the centerpiece of his domestic agenda. The legislation extends and expands many provisions in Trump's original 2017 Tax Cut and Jobs Act, changes rules for federal income taxes and estate planning, and focuses on the administration's priorities. These priorities increase appropriations for defense and border security while cutting funding and mandating stricter work requirements for Medicaid beneficiaries.

From the bill's 870 pages, here are the areas we think most affect our clients:

- **2017 Tax Cuts made permanent.** The lower individual income tax rates that were passed in the 2017 bill were set to expire at the end of 2025. While the headlines associated with this new bill tout "tax cuts," the reality is that this bill makes the old provisions permanent. Without the legislation, taxes would have increased for most taxpayers in 2026.
- **Estate Tax.** Beginning in 2026, the estate tax exemption will rise to \$15 million for individuals and \$30 million for couples. Most importantly, these levels will be permanent and indexed for inflation.
- **No tax on tips. No tax on overtime. No tax on Social Security.** These were all central pledges from President Trump's 2024 campaign; however, a simple plan proved to be more difficult than the slogans suggested. The new bill addresses each of these income sources with special provisions for tax years 2025 through 2028. The first \$25,000 of tip income and \$12,500 (\$25,000 for couples) of overtime pay will be exempt from taxes; however, those amounts get phased out at certain income levels. Likewise, social security recipients will receive a special \$6,000 deduction, meant to offset some of that income. This deduction also gets phased out with incomes above \$75,000 (\$150,000 for couples).
- **Accounts for newborns.** One of the more interesting aspects of this bill was the creation of new investing accounts, dubbed Trump Accounts. The idea has been around for quite some time. The intent of the accounts is to provide a financial stake in the capital markets for all children, starting at birth, so they will learn about investing, benefit from compound growth, and share a common interest in the broad success of American industries. This is accomplished with an investment account initially seeded with \$1,000 by the government. Parents can continue to make non-tax-deductible contributions up to \$5,000 annually until age 18. Earnings grow tax deferred, and withdrawals are not allowed until after age 18. Upon withdrawal, gains will be taxed as ordinary income. Many other nuances are still to be finalized. We believe the intent of these accounts is admirable, but existing savings accounts (ESAs, 529s, IRAs, Roth IRAs, etc.) will likely continue to be better options when matched with more specific goals.
- **Tax credits for green energy.** The bill winds down most of the tax credits that were approved under the 2022 Inflation Reduction Act. The \$7,500 electric vehicle credit now goes away on September 30th. Rules also state that any wind, solar, or other renewable fuel projects must be in operation by 2027 to qualify for any incentives.

Like most everything else coming out of Congress, there are many other changes that we, and our congresspeople, will learn about over time. The one thing that we do know is that this legislation will continue to add to the national debt at a time when it is becoming increasingly worrisome to investors. The Congressional Budget Office says this bill will add about \$3.4 trillion in debt over the next 10 years. This is the number that everyone is focused on but is only about 16% of the story. \$3.4 trillion is the amount that will be added **in addition** to the already planned debt that will be created over the next 10 years.

Currently, the government is spending about \$1.8 trillion a year more than it is collecting. So, as planned, we were already adding \$18 trillion in additional debt over the measured period. This bill bumps up the addition to about \$21 trillion. The nation's total debt presently stands at about \$36 trillion, or about 120% of our GDP. 10-years from now, the debt will be closer to \$57 trillion. Even with the expected growth in the economy, the debt-to-GDP ratio will be near 150%. This is not sustainable. Arguably, financial markets have not punished the U.S. for this misconduct... yet.

Outlook

Though the speed of the most recent market selloff and recovery was intense, it followed a familiar pattern. Since 2020, investors have weathered significant shocks – from the COVID pandemic to Russia's invasion of Ukraine – and now tariff turmoil. Each of those episodes prompted steep double digit market declines followed by swift recoveries. Those fast-moving market rotations echoed a longer-term pattern. History shows that over the last 150 years, bear markets triggered by exogenous shocks have generally resolved faster than those caused by financial crises or restrictive monetary policy. We, and our clients, are to be commended for maintaining discipline through the latest market turbulence.

That being said, this bounce back in equity prices assumes a lot of good news amid high expectations moving forward. Additionally, complacency seems to have set back in with the belief in TACO. The volatility may not be over. The economy is entering the second half on wobbly footing. There are mixed economic signals, including a downward revision to an already negative first quarter GDP, a slight uptick in inflation, and sustained elevated monthly jobless claims. The July 9th deadline associated with Trump's tariff pause came and went with no meaningful "deals" having been signed, only a couple of broad trade frameworks being pencilled in. The deadline was again extended to August 1st.

Markets have mostly shrugged off these worries in favor of more optimistic indicators. The JOLTS job opening survey unexpectedly rose in May to the highest level in eight months, and economists see easing inflation in areas like housing and energy helping offset tariff-related price increases. Continually moderating inflation data is expected to give the Fed cover to resume some of its interest rate cuts.

To be sure, the first half of the year has been a geopolitical mess. The interplay of politics, economics and markets will make assessing the paths of stocks, bonds, commodities, and currencies this year harder than usual. The capriciousness of the world's most important person compounds the difficulty. We started off last quarter's commentary stating that when you read this letter, if everything has changed, know we did our best. Ditto this quarter. As we write, President Trump has just changed the tariff rates on Canada... and Mexico... and Japan... and the European Union...

Thank you again for your continued confidence and trust as we work through these extraordinary times. We welcome your comments, questions, and referrals. Please don't hesitate to contact us. Stay safe and well.

Summit Asset Management LLC