June 2025

MARKET UPDATE

Equity markets demonstrated remarkable resilience in May, with the S&P 500 poised to record its best monthly performance since 2023, gaining over 6%. Key drivers of this rally included President Trump's decision to postpone a proposed 50% tariff on European Union imports, which helped alleviate investor concern – at least for the moment. Additionally, strong earnings from tech giants like Nvidia bolstered confidence, contributing to the market's upward trajectory. However, the reinstatement of certain tariffs and escalating U.S.-China trade tensions related to ongoing negotiations has renewed periods of volatility and underscores the market's sensitivity to geopolitical risk. Despite these challenges, major indexes like the S&P 500, Dow Jones Industrial Average, and the Nasdaq ended the month with solid gains, reflecting an overall investor optimism amid a complex economic landscape.

Like equities, the U.S. bond market experienced heightened volatility amid escalating fiscal concerns and shifting investor sentiment in May. The 10-year Treasury yield rapidly fluctuated between 4.43% and 4.63%, reflecting market reactions to President Trump's expansive tax legislation and the reinstatement of some tariffs, which raised apprehensions about increasing deficits and inflationary pressures. The Fed maintained its benchmark interest rate between 4.25% and 4.5%, adopting a cautious stance in response to the vast array of trade policy unknowns. Despite positive inflation data, the bond market remained sensitive with Moody's credit rating downgrade and concerns over the "One Big Beautiful Bill" contributing to a sell-off in long-term Treasuries. Consequently, investors reevaluated their strategies, with increased interest in shorter-duration bonds and credit-linked assets to mitigate risks associated with prolonged high rates and perceived fiscal instability.

The overall U.S. economy faced mounting challenges amid trade tensions and cautious consumer behavior throughout the month. Most notably, GDP contracted by 0.2% in the first quarter, marking its first decline since the pandemic, primarily due to weaker consumer spending and a significant drop in imports following the implementation of new tariffs. Inflation showed signs of cooling, with the Personal Consumption Expenditures (PCE) index registering at 2.1% in April; however, stubbornly high housing costs, which rose 4% year-over-year, continue to pose a threat to sustained inflation control. The labor market continues to provide positive data, as weekly jobless claims increased to 240,000. However, corporate profits experienced their largest drop since 2020, falling by $118.1 billion in the first quarter. Consumer confidence partially rebounded in May, with the Conference Board's index rising to 98.0 from 85.7 in April, indicating cautious optimism despite ongoing economic challenges. Finally, the Federal Reserve maintained interest rates (as expected) between 4.25% and 4.5%, emphasizing the need to control inflation amid concerns over potential stagflation and the economic impact of recent trade policies.

ADVISORS’ PERSPECTIVE

The market continues to navigate a complex environment shaped by a confluence of macroeconomic forces. At the forefront remains the Federal Reserve, which has held interest rates steady for the past several meetings but remains cautious in its outlook. Despite moderating inflation, the Fed continues to stress a data-dependent approach. While many market participants have priced in potential rate cuts in the second half of the year, recent economic data—particularly resilient labor market figures and sticky service-sector inflation—have tempered expectations. This has contributed to upward pressure on Treasury yields, with the 10-year yield climbing above 4.5% in recent weeks.

The rising yields reflect a market reassessment of the Fed’s timeline and signal growing confidence that the U.S. economy can withstand tighter monetary conditions without tipping into a recession. Consumer spending, while decelerating slightly, remains healthy, bolstered by real wage growth and a still-low unemployment rate. Corporate earnings for the first quarter came in largely above expectations, with strong showings in technology, healthcare, and industrials. However, the forward guidance from many firms continues to reflect cautious optimism, citing cost pressures and geopolitical uncertainty.

Trade tensions have resurfaced as a potential headwind, particularly between the U.S. and China. Tariff discussions have reemerged in response to concerns about unfair trade practices and supply chain dependence. Recent policy moves have targeted areas such as electric vehicles, batteries, and semiconductors, reigniting fears of retaliatory measures and broader economic implications. Markets are watching closely for signs of escalation, though the current measures appear measured and aimed more at strategic reshoring than full-scale trade conflict.

Meanwhile, the U.S. dollar has weakened modestly this year, reversing some of its 2022–2023 strength. This decline is partially attributable to shifting interest rate expectations and improved global growth prospects, particularly in Europe and parts of Asia. A weaker dollar can act as a tailwind for multinational corporations, boosting foreign revenue when repatriated, and may offer support to commodity prices and emerging markets. However, it also reflects a delicate balance in investor sentiment, with some questioning how long U.S. economic outperformance can persist.

In the fixed income space, rising yields earlier in the year initially pressured bond prices, but the market has since found firmer footing. With inflation stabilizing and a potential Fed pivot on the horizon, bond investors have started to position for recovery, particularly in longer-duration Treasuries and investment-grade corporate bonds. Credit spreads remain tight, signaling investor confidence in corporate fundamentals. Municipal bonds have also seen renewed demand amid favorable tax-equivalent yields.

Overall, the investment landscape is marked by careful optimism. Equities have shown resilience, supported by earnings strength and the prospect of eventual monetary easing. Fixed income markets are regaining their appeal as income-generating assets, while global diversification may become more attractive as currency dynamics shift. As always, risks remain—geopolitical instability, unexpected inflation spikes, or abrupt changes in Fed policy could shift the tone quickly. But for now, markets appear to be stabilizing after a period of volatility, with investors cautiously adjusting to a new phase of the economic cycle.

We continue to use a quantitative investing approach. In times of uncertainty, it is more important than ever to follow the data and not make decisions based on emotions. Hilltop’s partnership with Helios relies on facts and data which we use during our recalculations on a bi-weekly basis. Our models adjust appropriately to market conditions.

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