

Aptus Market Outlook: Q2 2025 Highlights

Strong Earnings and Market Resilience

Following a challenging Q1 marked by a 10% drawdown and continued selling pressure to start the quarter, Q2 delivered a sharp reversal as equity markets bounced off the April lows. The S&P 500 ended the quarter solidly higher, validating our view that volatility does not always signal deterioration in fundamentals. Corporate earnings proved the key driver, with Q1 earnings for the S&P 500 growing 14% year over year, well above the 8% forecast at the end of Q1. This followed 16% growth in Q4 2024, confirming the strength and adaptability of U.S. businesses. In our last outlook, we stressed that volatility is not only normal but often offers opportunity. That view was rewarded as disciplined investors benefited from the market's rebound.

Reassessing Fixed Income: Real Yields, Real Risk

Unlike Q1, where long-duration bonds outperformed amid falling rates, Q2 was less kind to some areas within traditional fixed income. Despite stable credit spreads and continued strength in high yield, long-term bonds struggled due to rising nominal growth expectations and fiscal concerns. Treasury Secretary Scott Bessent's comments about needing 6.5% nominal GDP growth to stabilize debt to GDP highlighted the growing risks to duration-heavy portfolios. While the bond market continues to offer a modest buffer, we believe allocations should favor shorter-duration instruments and diversifying strategies, particularly those positioned to benefit from elevated volatility or persistent inflation.

Equity Market Themes: Growth, Quality, and Concentration

Mega-cap tech companies once again led the charge, with six of the "Mag 7" names beating earnings expectations on both the top and bottom lines. Capital expenditures in AI infrastructure drove much of the upside, reinforcing the narrative of durable growth from the top of the market. While this concentration has raised concerns, we've long noted that U.S. large caps retain superior fundamentals. That conviction remains. Importantly, margins expanded and earnings-per-share growth was supported by healthy buyback activity, reminding investors that companies have levers. Bonds do not.

Small caps continued to lag despite an improved macro backdrop and solid earnings growth. International equities extended their outperformance from Q1, buoyed by currency tailwinds and multiple expansion. However, the fundamental case remains mixed, and we continue to favor U.S. equities from a risk-reward standpoint.

Policy Environment and Fiscal Realities

The quarter saw renewed attention on tariffs and fiscal sustainability. While we have downplayed the broader impact of tariffs on GDP, the policy noise continues to influence investor sentiment. Legal efforts to reintroduce tariffs added to uncertainty, but the market appeared to discount long-term implications. The more pressing concern remains the federal deficit and the trajectory of interest expense. As nominal growth becomes a policy imperative, markets may need to digest the tradeoff between inflation, rates, and fiscal discipline. We believe the fiscal setup continues to support real asset ownership over nominal fixed income.

Market Structure and Behavioral Tails

A key theme we highlight is the importance of focusing on tails rather than averages. That dynamic played out again this quarter. The market rebounded rapidly off its April lows, demonstrating once more that selloffs can reverse with little notice. In fact, history shows that markets rarely deliver average returns. Since 1950, only four calendar years have delivered gains between 7% and 9%. The path is rarely smooth, and investors need to be prepared for both left-tail risks and right-tail opportunities.

Outlook and Positioning

As we enter the back half of 2025, the setup is more constructive than headlines suggest. Inflation appears under control, the consumer remains resilient, and earnings strength continues to surprise to the upside. While political dynamics may create short-term dislocations, we believe the fundamentals support continued equity ownership with a preference for quality and flexibility. Fixed income remains a necessary portfolio component, but exposure should be intentional and focused on real return potential.

We continue to advocate for diversified, risk-managed portfolios with exposure to both upside participation and downside mitigation. Strategies that are responsive rather than reliant on the calendar remain critical as the market navigates through an environment shaped by macro policy, earnings leadership, and structurally higher volatility.



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