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We are in the early innings of 2Q earnings reports, and the markets seem a bit on edge as they try to determine the impact of tariffs and newly announced trade deals on earnings growth. The Mag 7 stocks that represent more than 35% of the S&P 500 market capitalization, have been described as being priced for perfection after leading the broad markets to new highs on almost a daily basis. Can the trend continue higher or will stocks finally succumb to 'what goes up must come down.'

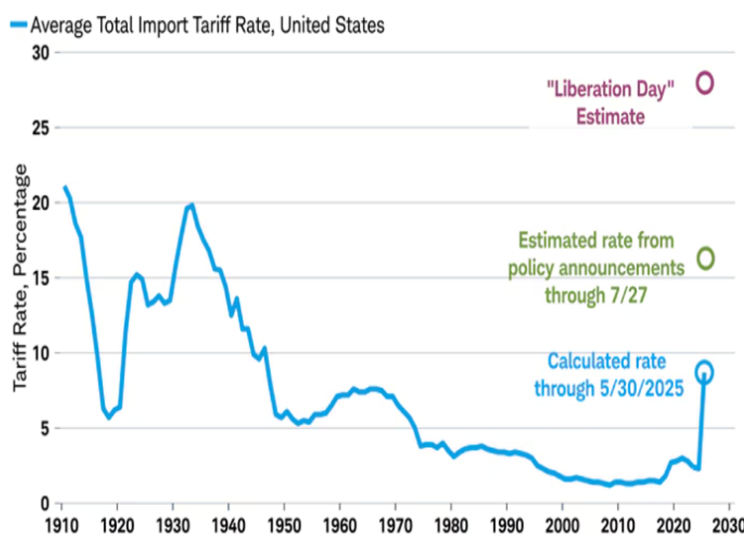
For the first time since it has been tracked, the Mag 7 stocks have experienced significant divergence in 2025. The best explanation for the divergence is the perceived tailwind from AI and impact of tariffs. Nvidia, Microsoft and Meta have charged ahead this year, gaining between 20%-30% as they are seen as the leaders in AI implementation and revenue growth from AI. The middle of the Mag 7 pack contains Amazon and Alphabet that are between +5% and -5% year to date. Concerns over the impact of tariffs on growth and anti-trust issues have dampened the outlook for these stocks. Lagging this year is Apple and Tesla, down 15% and 20% respectively, on disappointing AI adoption and flat earnings growth.

The S&P 500 is currently trading at 22 times forward earnings, among the top decile of valuations over the last 60 years. Some have described the equity markets as a balloon floating around Wall Street in search of a pin, but no one knows what that pin may be. Tariffs were rumored to be what ends the stock market streak of gains but as new trade deals get executed that risk appears to be diminishing. HSBC data does show that tariffs have increased 5-fold from 2024, increasing from an average of 2% last year to 13% in 2025. They estimate the current level of tariffs to cut 5% from corporate earnings.

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The potentially negative impact of tariffs has been offset by other factors that may be far more important for corporate earnings. First, we have seen a 9% drop in the US dollar against other major currencies. This helps exporters be more competitive in their pricing and increases multinational company revenues. Second, AI adoption

provides significant savings for early corporate adopters. Some examples include: ServiceNow has reported \$100 million in savings for hiring costs from AI tools. Microsoft is using AI to write 30% of their internal code with an estimated \$500 million in savings. IBM told investors their profit margin increased 200 basis points from AI utilization and JP Morgan reported internal AI coding increased developer efficiency by 20% and forecasted \$1 - \$1.5 billion in annual economic impact. Lastly, the Big Beautiful Bill's provisions on expensing Research and Development (R&D) is boosting capital expenditures in corporate America.



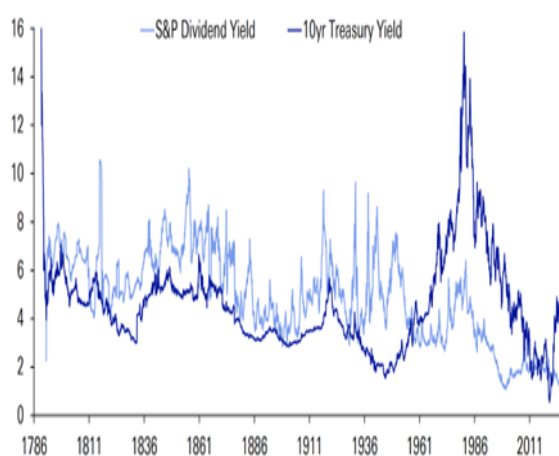
Source: Charles Schwab, U.S. International Trade Commission, Evercore ISI, Yale Budget Lab, retrieved 7/28/2025.

It is said that Wall Street climbs a 'wall of worry' and there continues to be plenty to worry about. GDP could take a hit in the 2nd half of 2025 as a result of many companies frontrunning imports ahead of when tariffs were to take effect. There is also a surge in debt at all levels. Borrowing against portfolios is at a multi-year high and the Big Beautiful Bill is expected to raise deficits and debt by several trillion over 10 years. As noted earlier, valuations are extremely high, especially among the Mag 7 stocks, and any disappointment in earnings could leave the market vulnerable to a sharp correction.

Consensus estimates for 2Q earnings growth sits at just 5% on a year-over-year basis, the lowest growth rate in over 2 years, suggesting the bar to keep the punchbowl in place is reasonable. However, the US equity markets have benefitted from almost unprecedented foreign capital flows. The US equity total market capitalization in 2022 sat at \$40 trillion and exceeds \$60 trillion today. The \$20 trillion increase in market capitalization over 3 years is staggering when you consider the total market capitalization for China is just \$16 trillion, Japan is \$7 trillion and all of Europe only \$6 trillion. If the US is no longer viewed as the most attractive market to deploy capital, it seems unlikely they can maintain this level of market cap.

Good news still outweighs bad news on the equity front and AI is likely going to be as transformative as the personal computing revolution of the late 1990's. However, at current valuations, there is very little room for error or unexpected headwinds. Short-term capital needs, for 3 to 5 years, should remain well hedged while longer-term investments should be comfortable, taking on more risk.

Dividend Yields and Treasuries

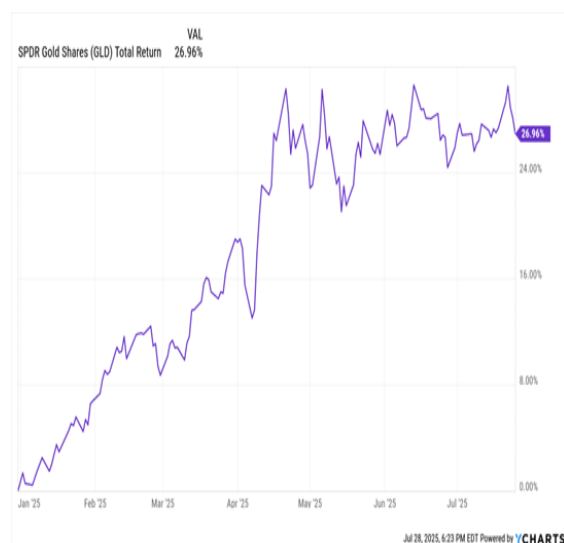


Source: Finaeon, Deutsche Bank

The stock market is booming, tech stocks are leading, most of our trading partners have come to the table and agreed on favorable trade policies, so what could go wrong? A recent chart from Deutsche Bank reveals that the dividend yield on the S&P 500 is within 0.20% of the lowest level in history, a figure set during the tech boom/bust of 2000. Prior to 1958, dividend yields were consistently higher than the 10-year Treasury as investors saw stocks as inherently riskier. That changed from 1960 forward as investors plowed capital into equities looking for more than just income from portfolios. In the mid-2000's, buybacks became the rage for financial engineering where companies could use cash to buy back their own stock and lift earnings per share without increasing earnings.

- Dividends serve as an effective buffer by providing income even when the price of stocks is falling. Low dividend yields equate to more market risk for investor portfolios.
- Dividend paying stocks take great pride in decades of history providing ever-increasing dividends to shareholders while buybacks tend to be discretionary when cash balances are high.
- Dividends may return to favor in the future if taxation remains favorable compared to taxes on interest from Treasuries. If investors buy strong dividend stocks, the message will be received.

Gold's Advance Stalls?



Earlier this year we wrote about gold's remarkable run year-to-date, with the precious metal having gained approximately 30% in 2025 against a backdrop of reckless fiscal policy and the prospect of elevated inflation from tariff policy. Compared to other investments like equities and fixed income, the risk-to-reward ratio for gold seemed more attractive. The chart to the left shows the price of the SPDR Gold Trust ETF (GLD) from the beginning of the year. However, as the graph illustrates, the price for gold has more-or-less flatlined since the end of April when the tariffs were announced, perhaps reflecting changes in investor expectations.

- Some of gold's recent stall might simply be due to profit taking after earlier gains and a rotation into other assets. The initial fear around tariffs, which was one of rampant inflation and Trump's Big Beautiful Bill, has subsided somewhat. The market better discounts the trade rhetoric today than a few months ago and so far, inflation has remained contained.
- If the Fed signals a rate cut, that will likely be good news for stocks and bonds, particularly if the Fed is more aggressive than anticipated. Under this scenario the rotation out of gold could continue in the near term.

U.S. Dollar Rebound



The U.S. dollar strengthened against the euro, yen, and other major currencies after the U.S. and EU reached a trade agreement that eased global trade tensions. President Trump and EU Commission President von der Leyen agreed to a 15% tariff—half the initially proposed rate—averting a potential trade war. The dollar's gains were also supported by resumed U.S.-China trade talks and last week's U.S.-Japan deal. Investor confidence returned as fears over severe tariffs faded, shifting focus toward corporate earnings and upcoming central bank meetings. The Fed and Bank of Japan are expected to hold rates steady, though markets are closely watching Fed commentary and Trump's response.

- With trade tensions easing and safe-haven demand for the dollar returning, analysts believe the currency could maintain upward momentum. Continued investor focus on U.S. interest rate policy and macroeconomic resilience may also underpin the dollar's performance.
- Earlier in the year, concerns over aggressive tariffs and potential economic fallout pressured the dollar lower, especially against the euro, which was up as much as 13.8% for the year up until recently.

Quinn VandeKoppel

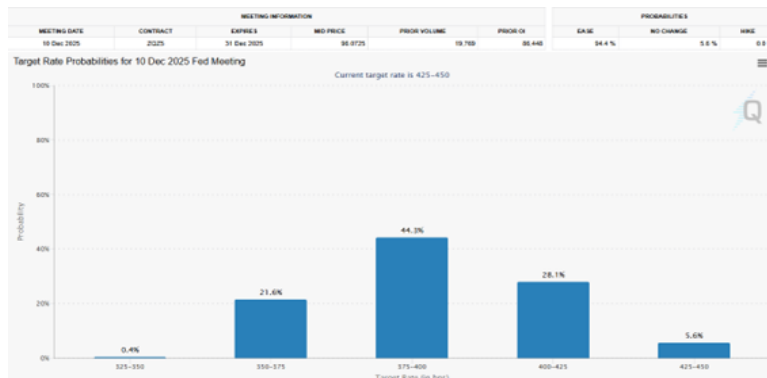
Macro View – EU – U.S. Trade Deal

The newly agreed EU-U.S. trade deal, which imposes a 15% tariff on EU goods versus a 10% rate on U.K. exports to the U.S., may give the U.K. a competitive trade advantage. With U.K. goods now relatively cheaper, U.S. firms may favor British imports over European alternatives, potentially boosting British exports. Experts suggest EU manufacturers could relocate to the U.K. to benefit from the lower tariff environment and available post-Brexit capacity. However, while the U.K. may be a "big indirect winner," the overall benefit could be limited by the modest 5% tariff differential and existing trade contracts. Both the EU and U.K. still face higher barriers than before, and the long-term impact will depend on how global firms respond as trade policies evolve.



Fixed Income – Incoming Rate Cuts

President Trump signaled confidence that the Federal Reserve will soon cut interest rates after a positive meeting with Fed Chair Jerome Powell. Trump took Powell's economic comments as an indication that rate cuts are likely. While the Fed has remained cautious due to strong data and inflation risks, the White House continues pressing for easing, particularly to boost the housing market. Budget Director Russell Vought supported cuts and called for more oversight of the Fed's \$80 billion operational shortfall. Though past tensions have cooled, markets aren't expecting a cut at the upcoming meeting. However, CME's FedWatch Tool shows a 61.6% chance of a 25bp cut in September and a 44.3% chance of at least 50bps in total by year-end, as economic uncertainty and political pressure mount.



Taking Stock – Future of Learning

OpenAI has launched a new "study mode" within ChatGPT to support student learning by promoting critical thinking rather than simply giving answers. Aimed at the one-third of college-age users already engaging with ChatGPT, study mode guides students through problems step-by-step using prompts and reflective questions. The feature was co-developed with input from educators, scientists, and student users from ChatGPT Lab. A demo showed how students are asked to explain concepts in their own words after working through multi-step processes. OpenAI's goal is to shift the tool from an "answer machine" to an educational assistant that enhances academic performance. Study mode is now available to all users, including Free, Plus, Pro, and Team tiers, and will be integrated into ChatGPT Edu soon. The launch follows CEO Sam Altman's recent comments about AI's potential to transform education.



Technical – Apple Eyes Breakout as Q3 Earnings Near

Apple is set to report fiscal Q3 earnings on July 31, with consensus estimates calling for \$95B in revenue and EPS near \$1.60–\$1.62. The stock is trading just above its 20-day moving average (\$211), consolidating between \$210 and \$215. This tight range and declining volume form a coiling pattern that often precedes a breakout. A move above \$235 on strong earnings could drive the stock toward its all-time high of \$245. On the downside, a break below \$210 may lead to a retest of the 50-day MA, with stronger support around \$195–\$200. Momentum indicators like RSI and MACD are neutral, suggesting investor indecision, but the current setup points to a potential inflection point for the company's stock price.



Factor Performance

To say that 2025 has been an unusual year for stocks would be an understatement. Consider what investors have had to endure so far this year: a new administration that was dedicated to unraveling much of what team Biden implemented over the prior four years, a trade war the likes of which we have not experienced in over a generation and a massive spending bill that pushes our fiscal condition to the limit.

Despite all the turmoil and a roughly 20% drawdown earlier in the year, the S&P 500 Index, including dividends, has managed a gain of roughly 9% year-to-date. Not surprisingly returns have been somewhat bifurcated based on factors such as momentum, value and quality. The charts below illustrate the returns of various factors in 2025, including dividends.

The Relative Winners



Depending on which index you use for comparison purposes, the momentum factor has led the way so far in 2025. The factor is highly path dependent based on when positions are rebalanced based on trends, such as short-term and long-term moving averages. In hindsight, the drawdown in April around the tariff announcement proved to be very short lived.

As the initial tariff levels were paired back, investors quickly rotated back into equities and pushed stock prices to new highs. Consequently, the momentum factor did not suffer the whipsaw effects that it was prone to back in 2022, for example. The S&P 500 Momentum Index is higher for the year by roughly 22% for the year compared to the 9% gains for the broader S&P 500 capitalization-weighted index.

Matching the S&P 500 returns is the quality factor, which is not surprising given the composition of the index. The S&P 500 Quality Index is higher by 9% for the year, led by names such as Visa (V) and Coca-Cola (KO).

Clint Pekrul, CFA

Middle of the Pack



By design, the low volatility factor owns stocks that exhibit relatively low variability of returns and typically holds more defensive names than the broader index. The S&P 500 Low Volatility Index held up relative well in April by declining by only a fraction of the S&P 500 but has largely missed the subsequent rally. Consequently, the index is higher by roughly 5% for the year.

Likewise, the value factor has delivered a similar return of 5% for the year, as measured by the S&P 500 Value Index. The rally off the April lows has been considerable, but the factor bore much of drawdown when the tariffs were initially announced.

Relative Laggard



Not surprisingly, small cap stocks, or the size factor, have disappointed year-to-date relative to the other factors. Smaller cap companies face stiffer headwinds than their larger counterparts, and the prospect of even a mild recession has repelled investors as the risk-to-return ratio for the factor does not seem compelling. The S&P 600 Index is lower for the year by roughly -1.4%, having yet to fully recover from the April drawdown.

Q: Is the labor market showing signs of weakness?

While the headline June jobs report suggested a pickup in hiring for the economy, if you look “behind” the numbers, it tells a very different story. The Labor Department reported an increase of 147,000 new jobs in June, slightly above the 6 months average of 130,000 new jobs per month. However, the June figures include an increase of 80,000 new State and Local government jobs that every analyst sees as a one-time increase in that sector. Private sector hiring was extremely weak adding only 67,000 jobs, almost half of the monthly average in 2025. Private Education, Healthcare, and Leisure and Hospitality were the only sectors to add meaningful private sector jobs.

The unemployment rate in June fell from 4.2% to 4.1% leading many to believe the labor market is healthy. However, June saw a reduction of 130,000 in the force, if the labor force has remained steady, the unemployment rate would have climbed. A key statistic is the Labor Force Participation Rate that shows how many working age adults either have employment or are actively seeking employment. The participation rate was 63.5% prior to the pandemic and sits at just 62.3% today.

Driving weak private sector hiring has been a reduction in spending growth for 2025. We finished 2024 with 4% annualized growth in spending that has fallen to just 1.6% through the first 6 months of 2025. Lower spending suggest GDP growth is slowing and private sector hiring seems to be a leading indicator of what is to come.



It largely depends on who you ask. Despite an overall unemployment rate below 5%, which is considered full employment, there are signs that the labor market is weakening somewhat. In particular, a slowdown in consumer demand could be a potential headwind. New unemployment insurance claims have been creeping higher and continuing claims are more elevated today compared to a year ago and the highest since 2021. The slowdown in wage growth is also noteworthy. Between 2023 and 2024, wages grew at an annualized rate of approximately 4%. However, this rate of growth has decelerated somewhat in recent months.

Noteworthy is the decline in hiring in the tech sector, which has seen recent layoffs, and difficult prospects for younger college graduates and older workers looking to reenter the workforce. However, certain sectors have proven more resilient, such as financial services, energy and manufacturing, all of which exhibit unemployment rates below the national average. To be sure, stagnate wage growth is more impactful to middle to lower income earners, who feel the pinch of overall higher prices more so than higher wage earners. Any meaningful slowdown in consumer demand could have reverberating effects on the labor outlook, but for now, unemployment remains fairly stable.

Q: Has the Fed backed themselves into a corner on rates?

I think it all depends on how thick-skinned Jerome Powell and the other Fed members are. My short answer would be no, the Fed remains willing to carry out their agenda regardless of political pressure or even the data. This was clear in the period after the COVID pandemic when the Fed left rates too low even when the data clearly pointed to rising inflation. The Fed allowed itself to get behind the curve on interest rate hikes and consequently needed to hike rates at the fastest pace in Fed history. To suggest they ‘learned a lesson’ would be overly optimistic in my opinion.

You might notice that I did not suggest the Fed would act independently but rather according to their agenda. I may be in a minority with this opinion, but I do think the Fed is agenda driven and sets policy accordingly. I believe the Fed acts in a defensible manner based on current data but there are clear signs the outcomes they try to engineer can be politically motivated. I think Powell relished the current battle with the Administration and wants to be seen as being data-driven and not influenced by outside pressure. Their problem, in my opinion, is that sufficient data has existed for some time that rates may be too high and a cut of 50-75 basis points would be warranted to keep the economy moving forward.



The Federal Reserve’s balancing act, as always, is to weigh inflation while supporting full employment. For now, the labor market is fairly stable, with the unemployment rate below 5%, despite some pockets of weakness (e.g., slower wage growth in recent months). Meanwhile, the inflation picture has remained remarkably tame in the face of tariffs, although due to timing effects, price increases could ultimately push their way through to the consumer in the back half of the year. While not dominating the headlines to quite the extent of prior months, the prospect of stagflation is still not off the table, which makes the central bank’s balancing act more difficult.

Consider a scenario where wage growth stagnates below the true rate of inflation, which would likely curtail spending habits particularly across middle- and lower-income wage earners. This would in turn lead to an uptick in the overall unemployment rate as businesses would cut back on hiring and implement layoffs to offset lower revenues. In response, the Fed would loosen monetary policy through a rate cut. However, the Fed could be boxed in if ultimately tariffs eventually lead to higher prices overall (remember, someone has to pay the tariff tax). While there are differing opinions as to the inflationary effects of tariffs, the Fed might not be so willing to pull the trigger on a rate cut if they see prices creeping higher.



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