ICR® 2nd Quarter Newsletter – July 2025

The second quarter began with a four-day, mini-crash in which the S&P 500 lost over 12%, but as tariff plans were delayed, markets rallied back and ended up more than 10%. Technology stocks rebounded from their difficult start to the year and led the way with a 23.7% gain, while three sectors suffered losses: energy (-8.6%), health care (-7.2%), and real estate (-0.4%). Despite gaining over 8% in the second quarter, small cap stocks are still negative for the year due to their almost 10% drop in the first quarter.

Foreign stocks continued their strong showing, adding 10.6% as measured by the MSCI EAFE Index for developed foreign markets. Despite the potential issues associated with tariffs, emerging markets stocks gained 11%, partially due to improving fundamentals, but also riding the tailwind of a weakening U.S. dollar. The dollar has lost over 10% of its value versus a basket of other currencies since the beginning of the year, likely due to some combination of the potential for tariff-induced inflation, ever-increasing debt burdens, and possibly an erosion of confidence in the independence of the U.S. Federal Reserve.

Fed Independence

That last point has been the source of some unease in the markets as President Trump has floated the idea of firing Fed Chairman Jerome Powell. The ability of the Federal Reserve to make monetary decisions that are independent of Congress or the president has long been a source of confidence for investors – both domestic and foreign. The idea that the Fed could become an extension of whichever political party is in power is concerning. Fortunately, it sounds as though Trump is leaning against that option and will simply wait until Powell's term as chair ends in May of 2026. It seems clear that the number one qualification for the next chairman, from Trump's perspective, is a desire to lower interest rates immediately and substantially. While the chair's opinion is the most influential, there are eleven other voting members, and the majority viewpoint will dictate the direction of interest rates, so even a Trump-appointed loyalist may struggle to fulfill the president's desire for very low interest rates.

Whether rates should be lower is a legitimate debate. Many central banks around the world have continued reducing their key policy rates while the U.S. Federal Reserve has put those cuts on pause since December despite inflation remaining below 3%. In a speech on July 1st, Powell confirmed that Trump's tariff plans are a big reason for that pause: "…we went on hold when we saw the size of the tariffs and essentially all inflation forecasts for the United States went up materially…" With the biggest tariffs mostly having been delayed, the inflation impact has been modest so far, but there have been upticks that may justify the Fed's anxiety over lowering rates too quickly.

The Spending Bill and Its Impact

The so-called "One Big Beautiful Bill" (OBBB) was signed into law just after the quarter ended, and while it created many changes, we are just going to focus on some of the aspects that might most affect your financial situation. One significant change for taxpayers in high-tax states like California is the state and local tax (SALT) deduction cap being raised from $10,000 to $40,000 for the next five years, beginning this year. This will lead to many more people being able to itemize their deductions, so be sure to check with your tax professional to see if you fall into that category. In addition, the gift and estate tax exemption increased a little over $1 million to $15 million per person, indexed for inflation.

On the charitable front, there were some meaningful changes. The good news is that if you do not itemize your deductions, beginning in 2026, you will be able to deduct up to $1,000 ($2,000 for a married couple) of cash contributions to qualified charities. The bad news is that contributions to donor-advised funds don't count towards that; it must be cash contributions. More bad news: beginning next year, if you itemize your deductions, there will be a hurdle of 0.5% of adjusted gross income (AGI) that you will have to clear before you can deduct charitable contributions. For example, if your AGI is $100,000 and you contribute $5,000 to charities, you will only be able to deduct $4,500 of that (because $500 represents 0.5% of your $100,000 AGI). What that means is that 2025 may be the year to front-load your charitable giving to a donor-advised fund so you can enjoy the full deduction before the 0.5% hurdle is implemented. Please get in touch with us if you think this is a strategy you would like to pursue.

As with any legislation, the long-term effects won't be known for a long time. For example, there has been plenty of debate about the deficit implications of such a large spending bill. That's a big, messy topic, but as long as the U.S. still enjoys the advantage of printing its own currency, it should never go "bankrupt." But, if the U.S. public – and foreign entities – ever lose faith in that currency and the demand for American debt dries up, we could be in for a reckoning. As we mentioned earlier, the U.S. dollar has fallen this year, suffering its worst first-half since 1973, so perhaps there are cracks in the dollar's role as the dominant reserve currency. Indeed, there is evidence that foreign central banks have been attempting to diversify away from the dollar, with gold as the most obvious alternative. A wholesale shift away from the dollar isn't the type of thing that happens overnight; but rather, would be a years-long, gradual process. Whether this proves to be a blip or a more serious problem will largely depend on whether future policy decisions regain or further erode the world's confidence in the U.S.

As always, thank you for trusting us with the privilege of helping you achieve your financial goals. If you have thoughts or questions about how any of the topics we've discussed here might impact your financial future, please don't hesitate to reach out to us.

Sincerely,

James A. Heine

James L. Cobb

Market Report (as of 6/30/25)

Index	2025 (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	5.5	17.9	14.9
Dow Jones Industrial Average	3.6	12.7	11.3
U.S. Aggregate Bond Index	4.0	2.6	-0.7
MSCI EAFE (Foreign Index)	17.4	12.9	8.3