

## HLM Capital Insight – June/July 2025

The U.S. economy has entered the second half of 2025 on a stable footing. Growth has moderated but remains positive, supported by consumer activity and healthy corporate balance sheets. Inflation has continued its downward trend, with core PCE (Personal Consumption Expenditures) now approaching the Fed target of 2 percent. Labor markets remain tight but are gradually cooling, contributing to the disinflation narrative without significantly weakening employment fundamentals. Against this backdrop, monetary policy is at an inflection point. The Federal Reserve has held the federal funds rate steady through the first half of the year, maintaining a data-dependent posture. Markets are now pricing in one to two rate cuts before year-end, contingent upon continued moderation in inflation and a stable labor market. While global economic growth remains uneven - particularly in Europe and China - the U.S. remains a relative bright spot, attracting capital flows and reinforcing dollar strength.

The current forward price-to-earnings ratio for the S&P 500 stands at roughly 21.5 times expected earnings, which is above its historical average. This premium reflects expectations for continued earnings growth, particularly in technology, industrial automation, and healthcare, but also underscores the narrow margin for disappointment. We are generally bullish on equities, however, with valuations already rich, the market's ability to generate further upside will depend heavily on actual earnings delivery, interest rates, and broader participation beyond the largest companies.

The bond market has also improved in 2025. The yield on the 10-year Treasury has declined to approximately 3.85 percent from last year's peak near 4.4 percent. Inflation-adjusted real yields are now positive across much of the curve, making high-quality bonds relevant again as both income generators and portfolio stabilizers. Investment-grade corporate bonds are offering yields between 4.5 and 5.5 percent\*, although spreads remain tight, indicating limited credit stress. While high-yield spreads have widened slightly in recent months, default rates remain below long-term averages.

From a portfolio strategy standpoint, we continue to emphasize balance and discipline. Our equity allocations prioritize high quality companies with strong balance sheets and free cash flow. While technology remains a key growth driver, we believe diversification across sectors and market capitalizations is increasingly important. Elevated valuations in the large-cap growth space may warrant some trimming or rebalancing into undervalued sectors, including healthcare and industrials and we are currently considering increasing allocation to both.

In summary, we continue to emphasize high-quality equities and some municipal bond exposure in taxable fixed income portfolios. We believe that staying invested with a long-term orientation, while adjusting tactically to changing conditions, remains the most effective strategy for preserving and growing wealth in this environment.

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### HLM Capital Management Group

1849 Green Bay Road  
Suite 200  
Highland Park, IL 60035  
847 563-3400 phone  
800 247-1541 toll-free  
847 563-3420 fax  
[www.hlmcapital.com](http://www.hlmcapital.com)



Partners: Ben Leshem, Charlie Margolis,  
Steve Hefter, and Micah Nathan