Sunpointe Investments

ILLUMINATIONS

Economic Review

August 2025

Fault Lines

Beneath the surface of seemingly robust economic performance, subtle but significant fault lines are beginning to emerge across global markets. While U.S. GDP surged an impressive 3% in Q2—well above expectations—the July employment report revealed troubling cracks, with job creation plummeting to just 73,000 new positions and massive downward revisions erasing 258,000 previously reported jobs. These divergent signals reflect deeper structural tensions: manufacturing remains mired in its fifth consecutive month of contraction, inflation pressures are building as tariff-related costs flow through to consumers, and speculative trading activity has reached concerning levels with heavily shorted stocks surging 58% since April lows.

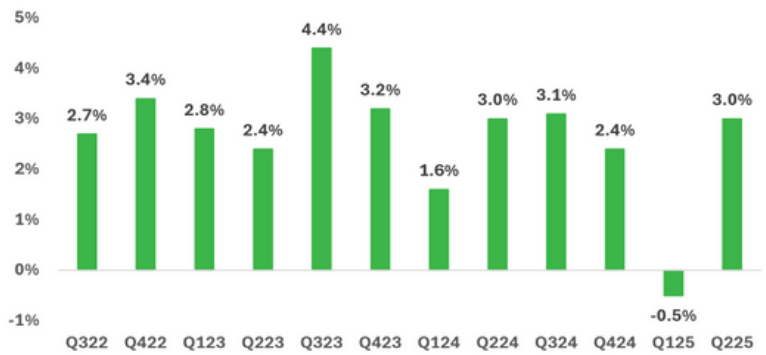
Yet despite these emerging fissures, U.S. corporate earnings continue to shine, with 81% of S&P 500 companies beating expectations and aggregate Q2 earnings growth reaching 11.8%—well above the initial 4.9% estimate and marking the third consecutive quarter of double-digit growth. From the Eurozone's persistent economic malaise to China's resilient GDP masking weakening retail demand, the global landscape reveals a complex web of stress fractures that will continue to impact investment performance in the months ahead.

Are Cracks Starting to Show in U.S. Labor Markets? GDP Outperforms Expectations

The July employment report was much weaker than anticipated with significant downward revisions to the May and June reports. U.S. employers added just 73,000 new jobs to the economy last month, below the 100,000 estimate. June and May totals were revised sharply lower, down by a combined 258,000 from previously announced levels. The unemployment rate ticked up by 0.1% to 4.2% and the broader U6 unemployment rate rose to 7.9%. Average hourly earnings increased 0.3% month-over-month (M/M) or 3.9% year-over-year (Y/Y). Health care and social assistance combined for 94% of the job growth.

Q2 GDP increased 3% Y/Y, well ahead of the 2.3% estimate from economists and the 0.5% contraction reported in Q1. Consumer spending rose 1.4% in the second quarter, better than the 0.5% in the prior period. While exports declined 1.8% during the period, imports fell 30.3%, reversing a 37.9% surge in Q1. GDP posted its strong rise without help from government spending. Federal spending declined 3.7% while state and local government spending rose 3%. Business spending was solid but slowed from its Q1 pace.

US GDP GROWTH



Source: U.S. Bureau of Economic Analysis

Will Tariffs Cause Inflation to Tick Higher?

The Personal Consumption Expenditures Price Index (PCE), the inflation gauge the Federal Reserve uses for its 2% target rate, rose 0.3% M/M or 2.6% Y/Y. This was the PCE index's highest level since February. Core PCE increased 0.3% M/M or 2.8% Y/Y. The PCE price index was expected to increase slightly in part because of rising gas prices, as well as pricier goods from businesses passing along tariff-related costs to consumers. Energy prices rose 0.9% while goods prices increased 0.4%.

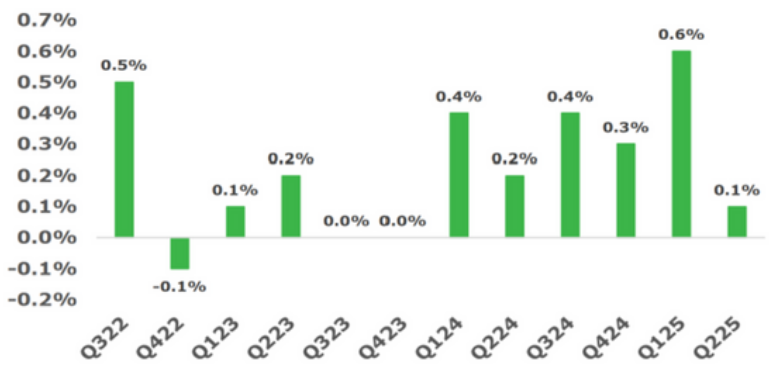
Manufacturing and Services Both Weaken in July

July's ISM Manufacturing PMI remained in contraction territory for the fifth consecutive month. The headline reading of 48.0 was down from 49.0 in the prior month. While new orders and production strengthened in July, the gauges for employment and prices both fell. Most components are in contraction territory with the exception of prices, which reflect the higher inflation environment. The ISM Services PMI fell from 50.8 in June to 50.1 in July. Prices firmed while production, new orders, and employment softened.

Eurozone GDP Flatlines Again; Inflation Remains Near ECB's Target

The Eurozone's GDP grew by a modest 0.1% in the second quarter of 2025, a slowdown from 0.6% growth in the first quarter. This growth is attributed to a combination of factors, including stronger-than-expected growth in Spain (+0.7% growth) and France (+0.3%), while others, such as Germany (-0.1%) and Italy (-0.1%) contracted. Core inflation, which strips out more volatile food, energy, alcohol, and tobacco prices, came in at 2.3% in July. Services inflation eased last month after a hotter-than-expected reading in June. The European Central Bank (ECB) is expected to hold rates steady at its next meeting after eight rate cuts over the past year.

EUROZONE GDP (Q/Q % GROWTH)



Source: Eurostat

China's Economy Remains Resilient on the Surface, but Slow Retail Sales Show Pressure on Consumers

China's economy grew at a faster-than-expected rate in Q2 2025, keeping the country on track to meet its full-year target of 5% and easing some pressure on policymakers. GDP increased 5.2% in Q2, ahead of the 5.1% expectation but below the 5.4% rate in Q1. Domestic consumption contributed 52% of GDP in the first half of 2025. The share of consumption rose in Q2 while the contribution of trade fell. This is important, albeit for a short period of time, for rebalancing the Chinese economy away from investments and trade towards consumption.

Chinese exports remained largely resilient in Q2 as businesses diverted trade to alternative markets. U.S.-bound shipments have shrunk 10.9% YTD through June 30th, while exports to Southeast Asia nations and European Union countries (the groupings China counts as its two largest trading partners) jumped 13% and 6.6%, respectively. It is important to note that much of the resilience has come on the back of significant price discounts. In June, Chinese retail sales growth slowed to 4.8% Y/Y, compared with the 6.4% Y/Y increase in May. Industrial output expanded by 6.8% Y/Y, ahead of estimates.

India's Economy Slows; Tariffs Expected to Weigh Heavy

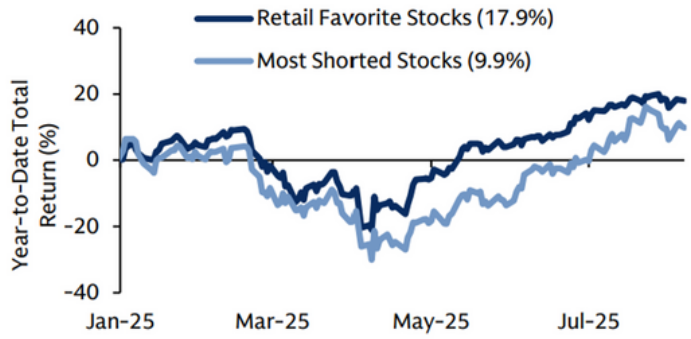
India's economy expanded 6.5% in the fiscal year ended March 31st — the slowest pace since the pandemic. Most economists expect growth in the 6.0–6.5% range in the coming years, with U.S. tariffs likely trimming 20–30 basis points from activity. Some estimates suggest the drag could be closer to 1% of GDP.

Speculation Returns! Q2 EPS Crush Estimates

U.S. equities have fully recovered from their mid-April lows. One could classify the current market environment as risk-on and driven by speculation. Large-cap growth/tech stocks have rebounded sharply, likely driven by strong earnings growth expectations, but many low-quality, loss-making, or heavily shorted stocks have also surged higher over the past few months.

Stocks popular with retail investors have risen by 50% from early April lows, while highly shorted stocks have gained 58% since their 2025 lows. There has been a surge in call option activity, which is bullish for stocks, along with strong first day performance from IPOs. While increased speculative trading may signal above-average near-term returns, they can also indicate risk to the medium-term outlook. Ultimately, we believe fundamentals and earnings should drive stock prices higher over time.

...THOUGH PART OF THE RISE REFLECTS SPECULATIVE ACTIVITY



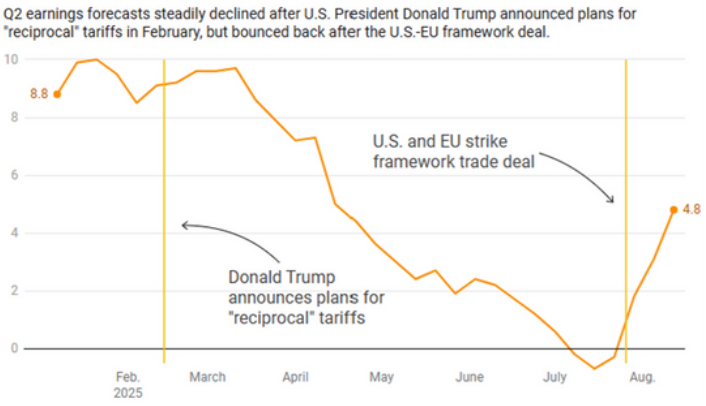
[2] Source: GS GIR, Bloomberg. As of August 6, 2025. Bloomberg tickers for retail favourites: GSXURFAV. Bloomberg ticker for most shorted: GSCBMSAL.

GOLDMAN SACHS ASSET MANAGEMENT

Through 90% of the Q2 earnings season for the S&P 500, 81% of companies have outperformed consensus earnings expectations, and 81% have reported better-than-expected revenues. The aggregate growth rate for Q2 EPS was 11.8%, well ahead of the 4.9% estimate at the start of the quarter. If current growth figures hold, this will mark the third consecutive quarter of double-digit growth. Communication services, technology, and financials have reported the highest earnings growth this quarter, while energy and materials have seen earnings contract in Q2.

Analysts have been revising their earnings growth forecasts for this year, with current 2025 expectations sitting at 10.3%. Analysts expect earnings growth of 13.3% in 2026. Earnings in the eurozone routinely come in below expectations, with growth that far lags U.S. equities. Current 2025 estimates for the Stoxx 600 (eurozone) sit at 3.1%.

EXPECTATIONS OF Q2 2025 STOXX 600 EARNINGS' YEAR-ON-YEAR GROWTH RATE



Sources: Javi West Larranaga, LSEG I/B/E/S, Reuters

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