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# The Aurora Project

## Market Research

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# Market Outlook – Q2

***From The Aurora Project***

The first half of 2025 delivered immense turbulence amid sweeping shifts in domestic and foreign policy. Liberation Day marked the dramatic unveiling of a new U.S. trade doctrine—an assertive pivot toward a reimagined era of globalization and multilateral relationships. Initial panic around the announcement triggered aggressive de-leveraging and a quick 20% drawdown in the Nasdaq 100(NDX). Yet markets rebounded with equal intensity, bottoming intraday on April 7th before surging to new all-time highs in both NDX and SPX by quarter's end.

In the weeks that followed, markets began to digest these policy shifts with surprising composure. Fears of a trade-war-induced depression gave way to a more restrained reality as tariffs were narrower than expected and targeted toward sectors framed as strategically vital. The international community, while initially rattled, has demonstrated a remarkable ability to recalibrate—showing both resilience and a growing tolerance for the U.S. administration's erratic policy theater.

The administration's One Big Beautiful Bill Act (OBBBA) has progressed through Congress, combining large-scale government investment with targeted tax incentives for U.S. manufacturing and infrastructure. This shift—from Q1's uncertainty to a clearer fiscal roadmap—fueled renewed optimism, even against a backdrop of elevated valuations and revised earnings estimates.

As we stated in our Q1 report:

*"If tariffs ultimately become more targeted and strategic—applied at the industry level rather than broadly across trading partners—there is a path for this policy shift to evolve into a reorientation of global trade, rather than an outright reversal... A measured recalibration, rather than a wholesale rejection, could yield a more balanced outcome over the long term."*

That possible path has largely played out.

Risks remain—escalation in the Middle East, Ukraine, or another Liberation Day 2.0—but peak uncertainty seems to have passed. The VIX spike to 60 on April 7th was a rare five-sigma event. From here, additional shocks are likely to be incremental.

Markets now appear to understand the policy mix: reduced immigration, lower long-term taxation, high fiscal spending, moderate inflation, and a dovish Fed on the horizon. Separating practice from rhetoric, the administration's strategy looks more like a reorientation of global trade than a retreat—and risk assets have responded positively.

## Fundamental

Equity valuations remain elevated across nearly all metrics. While valuations rarely provide timing signals, they serve as useful context for market positioning. As of quarter-end, the S&P 500 trades at approximately 23.3x 2025 consensus earnings of $265, and 20.6x 2026 estimates of $300. That implies a 13% earnings growth base case for next year, with current multiples approaching 95% of the July 1999 peak forward P/E ratio of 24.4. [1] This is far from a cheap market. Still, valuations alone are unlikely to constrain momentum—particularly with markets anticipating a renewed Fed cutting cycle and continued fiscal stimulus.

A key point of divergence this quarter was productivity. Q1 2025 saw a 1.5% annualized decline in U.S. nonfarm productivity—surprising given the backdrop of rapid AI adoption.[2] We believe recent productivity data reflects either the lagging impacts of AI productivity gains or outdated measurement methodologies. Much of AI's impact—workflow acceleration, coding efficiency, process automation—doesn't show up cleanly in output-per-hour statistics.

Yet corporate disclosures tell a different story, suggesting the real impact is already material. Salesforce CEO Marc Benioff noted AI now performs 30–50% of the work in engineering, coding, and support functions.[3] Microsoft's Satya Nadella reported AI generates around 30% of the company's codebase. PwC's 2025 Global AI Jobs Barometer found that productivity in AI-exposed industries (e.g., finance, legal, software & healthcare) rose from 7% (2018–2022) to 27% (2018–2024), while less-exposed sectors experienced outright declines.[4] While official data may lag, we believe the underlying productivity trend remains robust—and will become increasingly measurable as adoption matures and tracking methods improve.

In the near term, financial conditions have continued to ease in certain areas, despite mixed signals from rate markets. The U.S. dollar (DXY) declined 7.10% for the quarter, while crude oil (CL) fell 8.91%, contributing to softer input costs and improved earnings visibility. Credit markets remained supportive, with high-yield debt (JNK) rising 2.07%, reflecting investor confidence in corporate balance sheets and forward earnings. The 10-year Treasury yield (US10Y) stayed muted at around 4.32%. This mix of currency weakness, mild inflation data, and steady credit markets provides a favorable tailwind for risk assets heading into the second half of the year.

[1] *Datatrek Morning Briefing. June 24, 2025.*
[2] BLS
[3] AI is doing up to 50% of the work at Salesforce
[4] AI linked to a fourfold increase in productivity growth

## Technical:

On the technical front, major U.S. indices have broken decisively above their prior all-time highs from February, signaling renewed strength and momentum. As anticipated in our Q1 report, the S&P 500 retested the critical support zone around 4954, briefly breaking lower to an intraday low of 4835 in early April. That washout cleared excess leverage and reset sentiment to an extremely bearish level, setting the stage for the powerful V-shaped recovery that followed. By quarter-end, the S&P had surged to new highs, closing near 6187—a level unthinkable just two months prior.

Volatility followed a similarly dramatic arc. The VIX spiked to a closing high of 52 on April 8th, a level that historically reflects heightened fear and broad-based deleveraging. As we noted in Q1, volatility events of this magnitude often mark tactical re-entry points for disciplined investors. This case proved no different. The weeks that followed saw a sharp collapse in volatility; catalyzing a relief rally that later found footing in improving fundamentals and greater policy clarity.

With SPX and NDX now in uncharted territory, attention turns to breadth. We're watching for the Equal Weight S&P 500 (RSP) to return to its all-time highs from November 2024, and for the Russell 2000 to reclaim the 2,242 level. A breakout in these broader indices would confirm that participation is expanding and the cyclical bull market is still healthy.

 

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