

2025

Q3

INVESTMENT OUTLOOK

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Trust Company**

CAPITAL 
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Bank Anywhere, Anytime.



ALBANY

132 State St., Albany
65 Wolf Rd., Albany
581 Loudon Rd., Latham
1365 New Scotland Rd., Slingerlands

BRADFORD

5 W. Main St., Canton
159 Canton St., Troy

BROOME

127 Court St., Binghamton
100 Rano Blvd., Vestal

CAYUGA

110 Genesee St., Auburn
185 Grant Ave., Auburn

CHEMUNG

One Chemung Canal Plaza, Elmira
628 W. Church St., Elmira
100 W. McCann's Blvd., Elmira Heights
29 Arnot Rd., Horseheads
602 S. Main St., Horseheads
951 Pennsylvania Ave., Southport

CORTLAND

1094 Highway 222, Cortland

ERIE

5529 Main Street, Williamsville

SARATOGA

25 Park Ave., Clifton Park
3057 Route 50, Saratoga Springs

SCHENECTADY

2 Rush St., Schenectady

SCHUYLER

303 W. Main St., Montour Falls
318 N. Franklin St., Watkins Glen

SENECA

54 Fall St., Seneca Falls

STEUBEN

201 Bath Plaza, Bath
149 W. Market St., Corning

TIOGA

203 Main St., Owego
405 Chemung St., Waverly

TOMPKINS

909 Hanshaw Rd., Ithaca
304 Elmira Rd., Ithaca

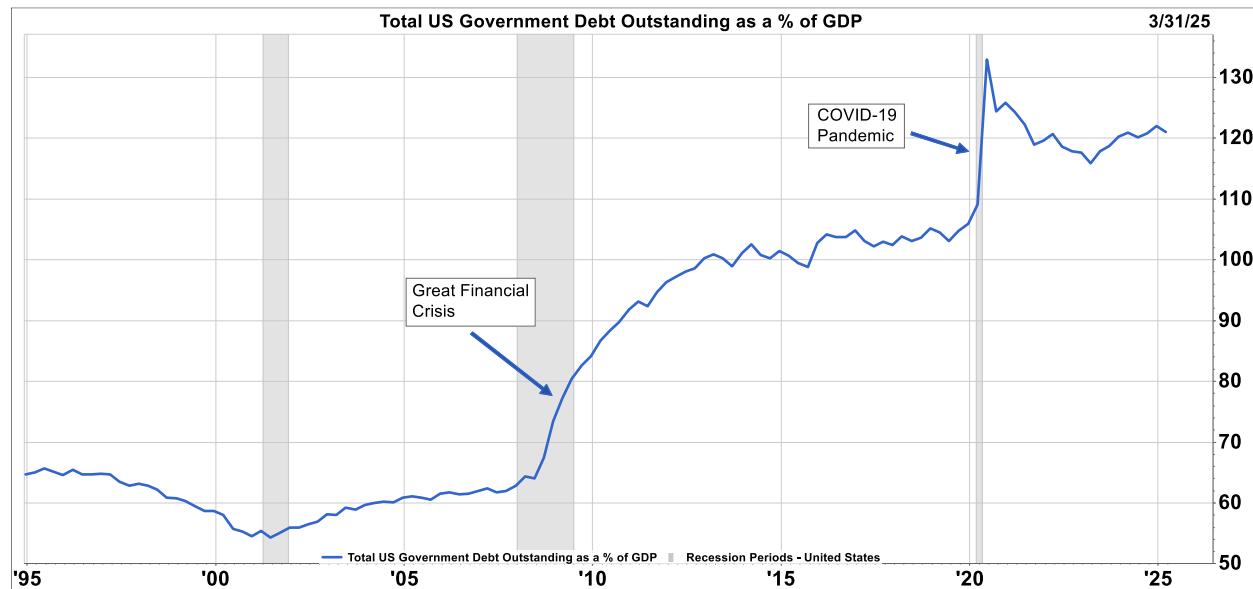
**2025 Third Quarter
Investment Outlook**

Government Debt and Spending, and the “One Big Beautiful Bill”

With much pomp and circumstance, President Trump’s One Big Beautiful Bill, hereinafter referred to as the OBBB, was signed into law on July 4th. Republican lawmakers have praised the bill as an immense achievement, one that will usher in a new era of growth and prosperity for the United States. Members of Congress on the other side of the aisle have issued scathing rebukes of the bill, citing increases in deficit spending and limits on access to social safety net programs. As with anything remotely political these days, the realities of the bill are murky at best.

The passage of the new legislation provides a timely opportunity to review the fiscal situation in the U.S., since most analysis of the impacts of the bill are focused on the levels of debt and spending above or below **current** levels. The interpretation of any change in the debt or deficit is meaningless without understanding the starting point.

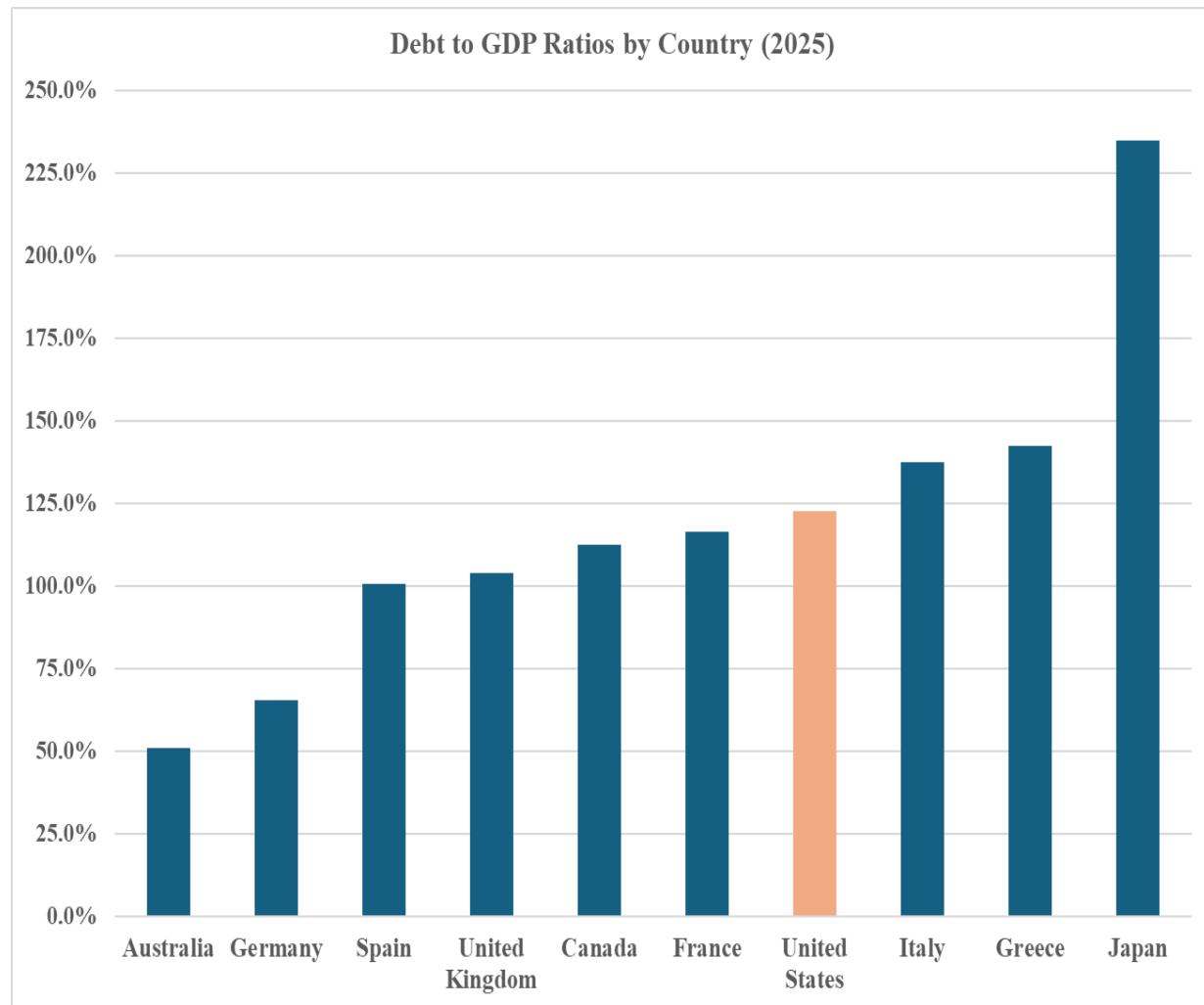
At the end of 2024, the U.S. debt to GDP ratio was at more than 120%. To put numbers to this, the government has issued about \$35.5 trillion in debt while the total economic activity in the country, as measured by gross domestic product (GDP), was about \$28.8 trillion.



As shown in the chart above, this ratio has been increasing since the early 2000's. Typically, this measure tends to increase most dramatically during recessionary periods, because the

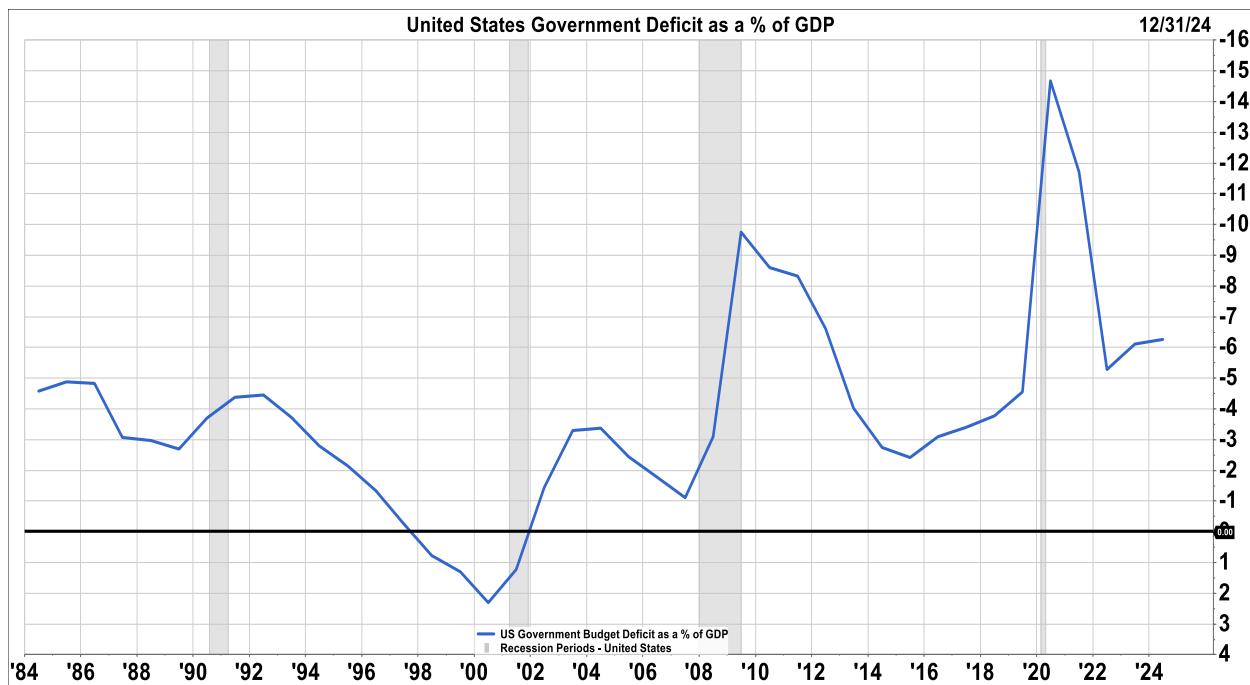
government engages in spending to stimulate the economy while GDP is contracting. This is best illustrated during the “Great Financial Crisis” and the COVID-19 pandemic recessions.

Globally, the United States still has one of the higher debt to GDP ratios among developed nations. Japan, by far, has the highest ratio at almost 250% of GDP! Greece and Italy follow next, both of which experienced a debt-related crisis in the last 10 years.



Many of the European Union (EU) countries cluster around the 100% of GDP mark. The U.S. is certainly not an outlier when it comes to its current debt ratio, but the concern here is the trend, not the ratio.

The U.S. continues to run persistent annual budget deficits, even in non-recessionary periods. In 2024, the U.S. deficit was roughly 6.3% of GDP. This means that the government spent about \$1.8 *trillion* more than it received in revenue! The last time the U.S. had a budget surplus was more than 20 years ago.



Prior to 2015, the budget deficit as a percentage of GDP generally rose during recessions (shaded areas, above), and declined during times when the economy was strong. This is both a normal and healthy occurrence. Increasing deficits during economic expansions was the anomaly and something that we have only seen during the last 10 years. The rationale is quite simple: the government should be cautious about deficit spending during periods of strength, so that it has the flexibility to increase spending when it is most critical, to support the economy during a recession.

Economists are still crunching and debating the numbers, since we are still only a few days removed from the passage of the bill, but most non-partisan estimates are pointing to an increase in the debt and deficit from the OBBB. The Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) estimate that the bill, as initially passed by the House on May 22nd, would increase the *primary* deficit (which excludes debt servicing payments) by about \$2.4 trillion over the 2025-2034 period. This is an increase over the existing deficit.

Because of the scope and size of the OBBB, the CBO and JCT are required to estimate the *economic* impact of the bill and incorporate those factors into their evaluation. They concluded that the OBBB would increase economic output slightly, giving some relief to the primary deficit. However, their modeling also suggests that the legislation is likely to increase interest rates and, in turn, increase interest payments on the federal debt by about \$440 billion over the next 10 years. Combined with the initial study, the CBO estimate of the impact of the OBBB on the national debt thus rises to \$2.8-trillion.

The President's Council of Economic Advisors (CEA), as you might expect, paints a more optimistic picture. But their analysis includes more aggressive growth estimates than the CBO, as well as the effects of other economic policies not contained within the OBBB, like tariff revenue and growth spurred by deregulation.

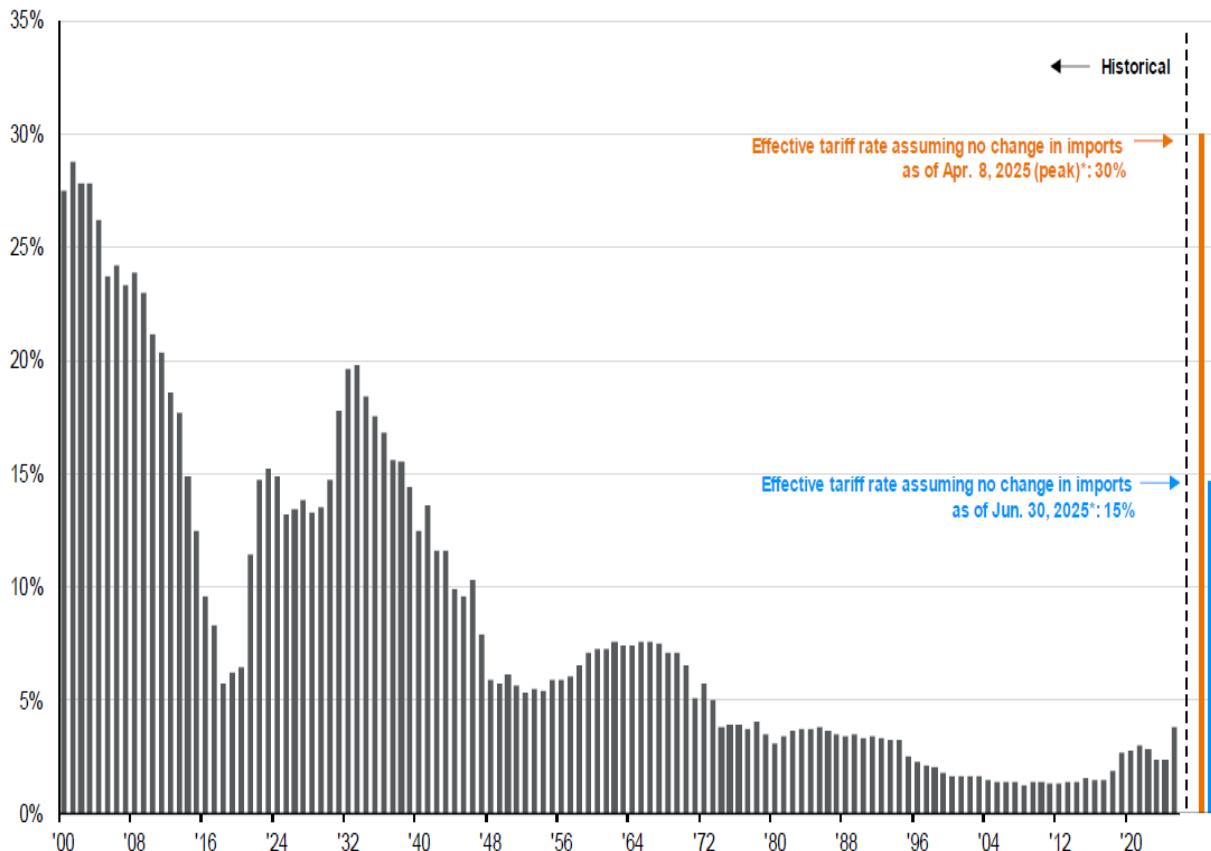
History tells us that none of these estimates will turn out to be even remotely accurate, and we probably won't remember to check back in ten years to see who was closer. But we will be watching the numbers in the meantime.

Tariff War Update

In what seems like a distant memory, President Trump paused his Liberation Day tariffs on April 9th, after several days of mayhem in financial markets. This temporary pause was initially set to last for 90 days, allowing time for trade deals to be struck. Then just two days before the initial reprieve was set to expire on July 9th, the President extended the pause until August 1st.

Average tariff rate on U.S. goods imports for consumption

Duties collected / value of total goods imports for consumption



Source: Goldman Sachs Investment Research, United States International Trade Commission, J.P. Morgan Asset Management. For illustrative purposes only. The estimated weighted average U.S. tariff rate includes the latest tariff announcements. Estimates about which goods are USMCA compliant come from Goldman Sachs Investment Research. Imports for consumption: goods brought into a country for direct use or sale in the domestic market. The estimate does not consider non-tariff barriers, such as value-added taxes. *Figures are based on 2024 import levels and assume no change in demand due to tariff increases. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets - U.S. Data are as of June 30, 2025.

J.P.Morgan
ASSET MANAGEMENT

At the same time, it was announced that those of our trading partners who had yet to reach a preliminary trade agreement, would begin to receive letters stating the broad-based tariff rate that

would be levied on their imports into the U.S. Japan and South Korea were the first two countries to receive such letters, stating tariff rates of 25% that would be enforced starting August 1st. More recently, the European Union (EU) and Mexico were both threatened with a 30% tariff that would begin on that same August 1st date. However, it seems likely that a trade deal with the EU will be reached before that deadline. To date, the U.S. has announced initial trade agreements with three countries: China, Vietnam, and the United Kingdom.

Regardless of the exact tariff rate and number of agreements that trickle in over the coming days, U.S. consumers will likely be facing the highest average tariff rate in about 90 years. The last time tariffs approached this level was shortly after the Smoot-Hawley Tariff Act of 1930, which deepened the Great Depression and was essentially repealed in 1934.

The market's more recent, muted response to the uneven, stop-and-go nature of the rollout of the President's tariff policies have caused some financial pundits (not us) to dub this the "TACO" market. This acronym stands for "Trump always chickens out," in reference to the President's record of continually moving back the effective dates for his tariff agenda. But we think this is more a case of investors learning to live with chaos, and not over-reacting to every pronouncement, because it may or may not reflect actual policy a month from now, or a year from now. What matters are the numbers, not the headlines.

The War on Inflation – The Second Front

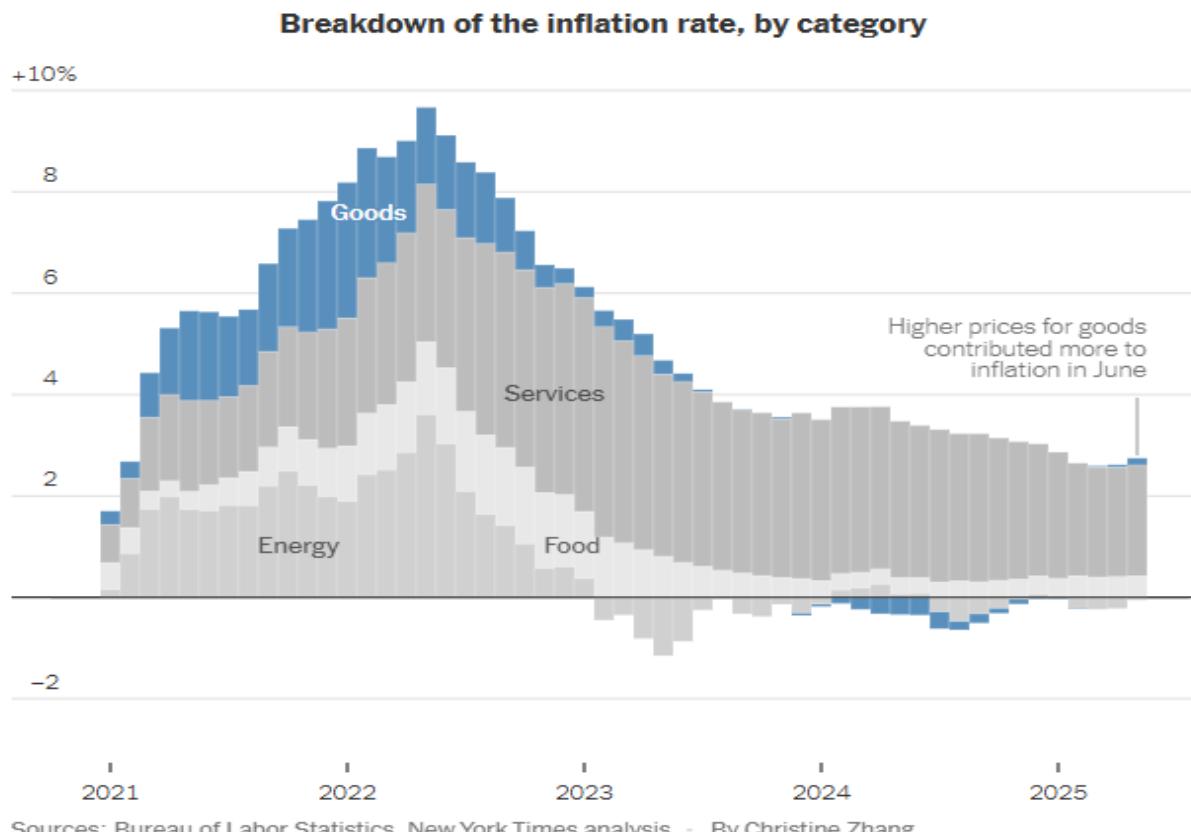
History and common sense suggest that you cannot successfully wage a war on inflation at the same time as you are initiating trade wars around the globe.

Private economists and analysts have warned from the outset of the Trade War that American consumers would ultimately bear the burden in the form of higher prices, as has historically been the case. It's taken just three months for initial signs of that reality to appear.

The Consumer Price Index (CPI) in June rose 2.7% from a year ago, the steepest rise since February and above May's reading of 2.4%. "Core" inflation, which excludes volatile food and energy prices, also moved higher, up 2.9% from the same time last year.

On a month-over-month basis, prices rose 0.3%, a significant increase from the 0.1% reported in May.

Products most exposed to tariffs rose even more. Household furnishings jumped 1%, and prices for appliances, specifically, rose 1.9%, up from their prior reading of 0.8%. The apparel index rose 0.4%, after many months of declining prices.



Gasoline prices rose 1% in June, after falling 2.6% in May. Increased Middle East tensions were clearly a factor in the June increase, and seasonal factors weighed in also as we move into the summer driving season.

The June numbers are not alarming on their face, but they indicate that the steps companies have taken to shield consumers from initial price shocks resulting from tariffs may be wearing thin. When the President says that China or Canada is paying a tariff of 30%, we have to say – again – that that is simply untrue. **Tariffs are a tax on imports, paid by U.S. companies that import the goods or materials.** These companies may have pre-ordered inventories in anticipation of higher tariffs. But as those stockpiles dwindle – and more tariffs are threatened on imports from the E.U. and other countries on August 1st – the consensus among economists is that prices will rise faster in the second half of the year as a result.

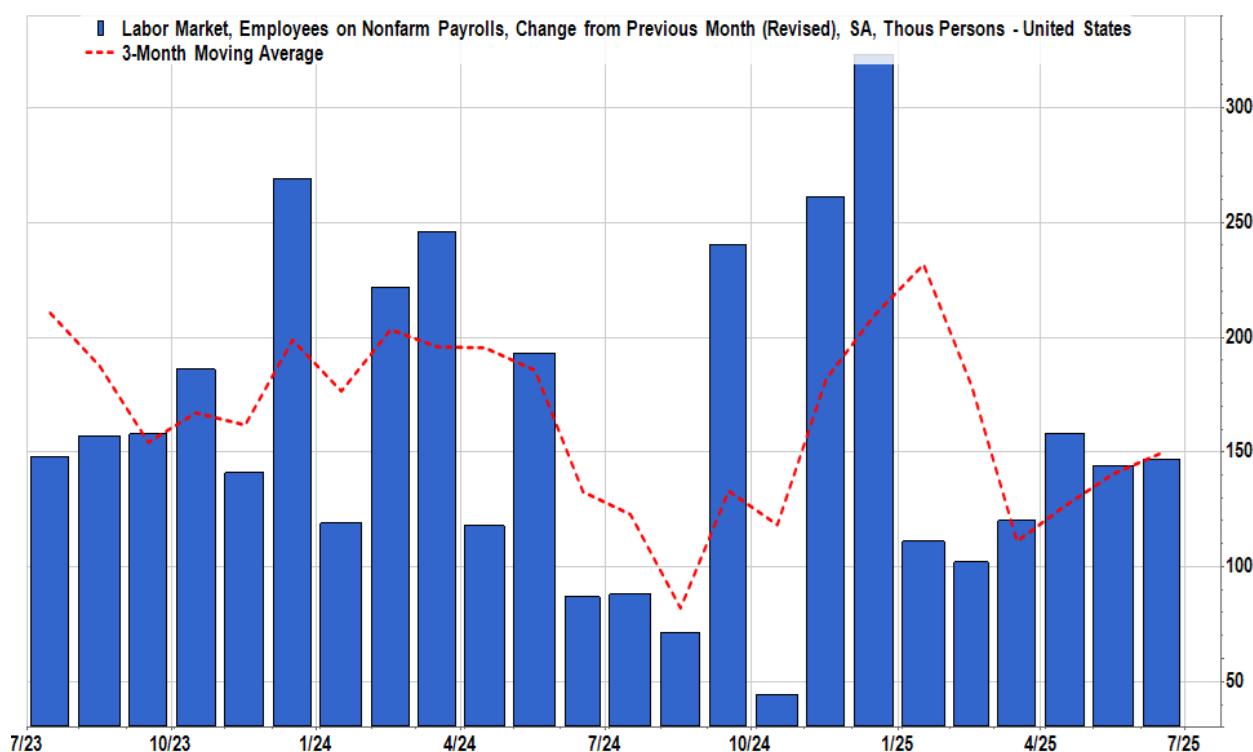
Inflation – The Cruelest Tax of All

Inflation has often been called the cruelest of all taxes that governments can impose on people. It is insidiously destructive, it affects everyone, and there is no avoiding it. For the holder of a CD paying 5% interest, it makes no difference whether there is zero tax on the interest while inflation is 5%, or whether inflation is zero but the government tax on the interest is a confiscatory 100%.

The OBBB is being touted by its proponents for its “historic” tax cutting measures. There are wildly varying assessments of who is benefiting and by how much. But whatever economic benefits may ensue from tax cutting, on one hand, are likely being negated to some degree, so long as the other hand is advancing trade policies that nearly all economists fear will drive up prices for everyone.

The Jobs Market

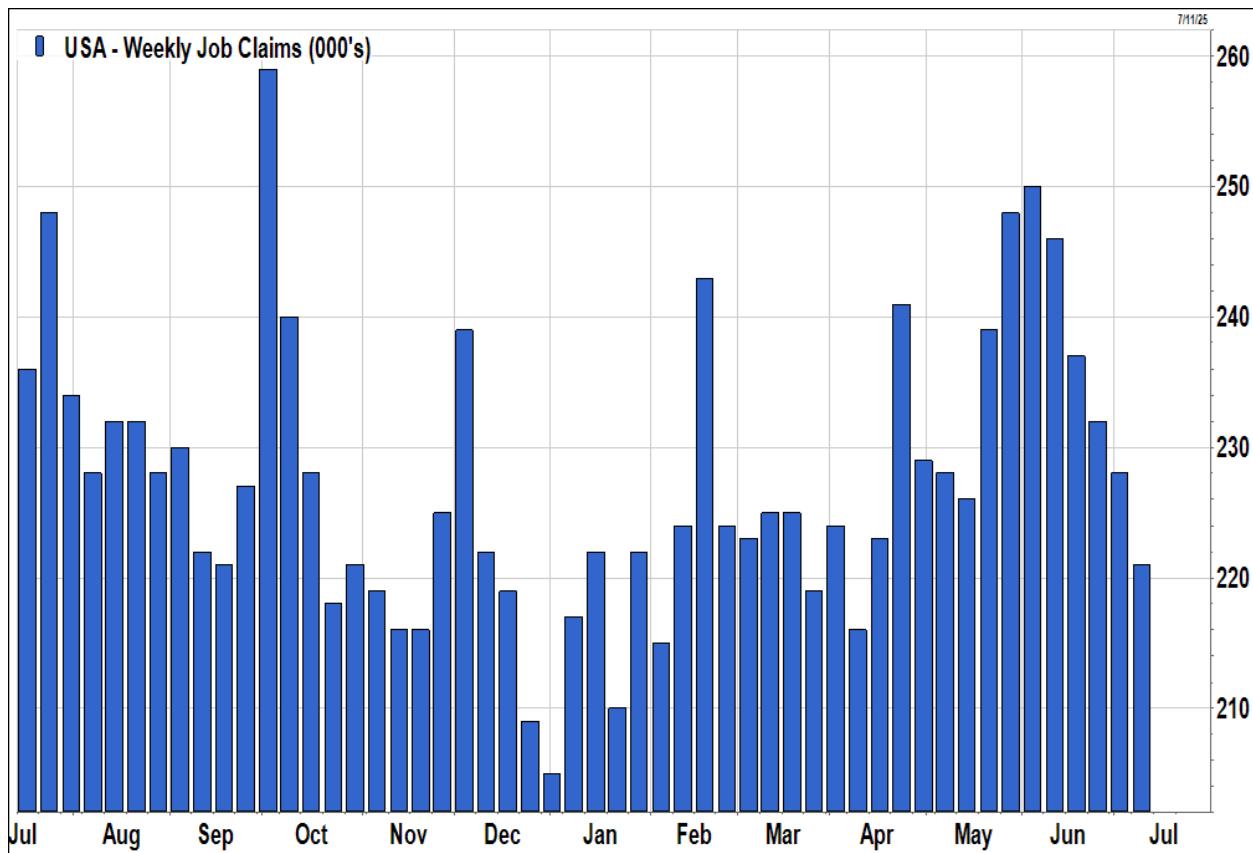
Job growth was better than expected in June. Nonfarm payrolls increased by 147,000 for the month, well above the 110,000 expected, and marginally ahead of the upwardly revised total of 144,000 in May. April’s results were also revised upward by 11,000 to 158,000.



The unemployment rate fell to 4.1%, the lowest since February and lower than the forecast rate of 4.3%. It should be noted, though, that the lower rate was due to a decrease in the number of people looking for jobs, rather than a major pick-up in hiring.

The strong headline numbers on new jobs and the unemployment rate are evidence of a strong and stable labor market. But as one analyst put it, “It may be a tent being increasingly held up by fewer poles.” Government hiring accounted for 73,000 new jobs, or more than half the total June number. Health care and social assistance accounted for almost all of the private sector gains. For job seekers outside of those sectors, June’s results are likely to ring hollow.

The best forward-looking indicator of labor market strength is the weekly report of initial unemployment claims, and that number has dropped in each of the last 4 weeks up to June 28.



The Federal Reserve

The question now is how the June reports on jobs and inflation will impact Federal Reserve policy when they meet in late July and mid-September. The consensus is that further rate cuts are likely “off-the-table” for July. The strong jobs report gives the Fed time to consider more data as it comes in over the next two months. Chairman Powell has said that he expects higher inflation in June, July and August, so a September rate cut, which most analysts expect, is very much up in the air.

Prior to the President’s inauguration in January, the Fed had set out on a course of easing with three rate cuts in the second half of 2024 totaling 100 basis points, or a full 1%. Chairman Powell has indicated that there might have been additional cuts in 2025 were it not for the expected inflationary consequences of the new President’s higher tariffs that were threatened from the outset of his term and announced in April.

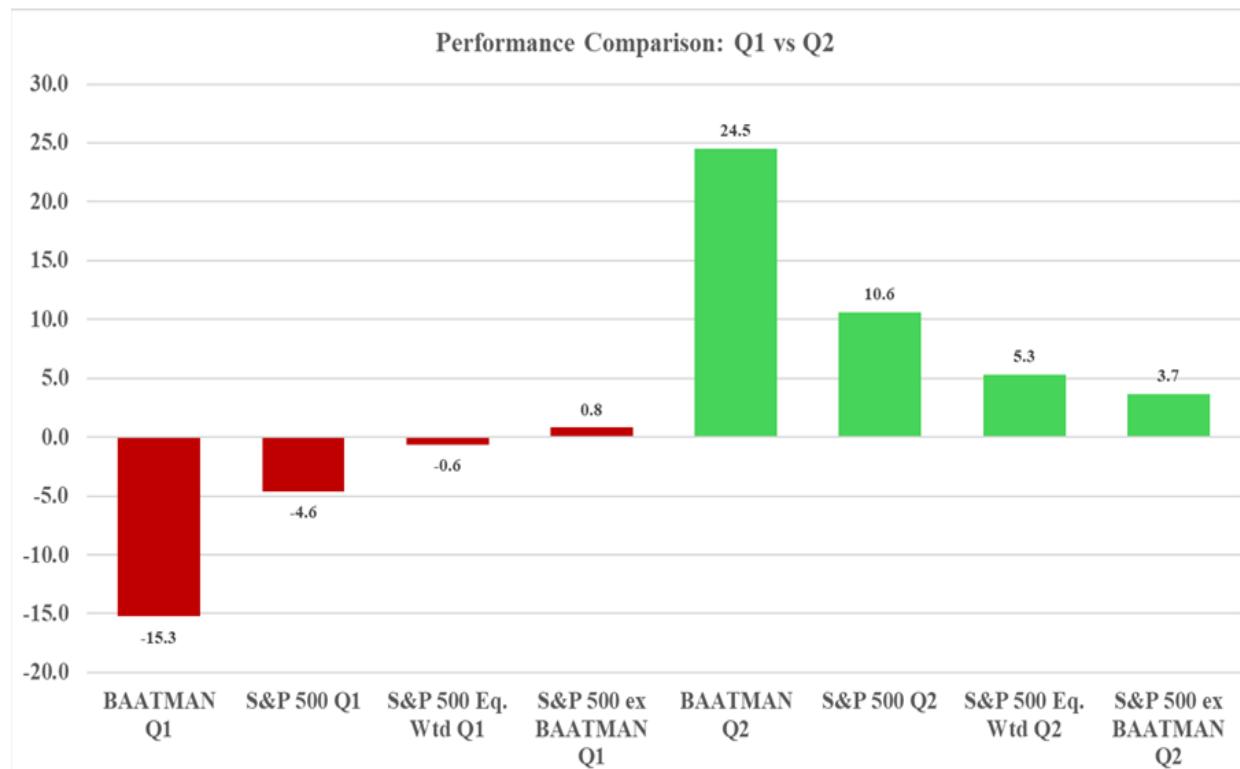
The President has been fiercely and visibly critical of the Fed Chairman, calling for a rate cut of as much as 300 basis points because our borrowing costs are too high. But the Fed is an independent agency, and it is critically important that its independence be maintained so that its decisions are data-driven and not politically motivated. Its responsibilities are to maintain price stability and maximum employment, which it has done deftly during some very challenging

times. Lowering borrowing costs is within the purview of the Congress, not the Fed. The Congress has ample tools to accomplish that task, if only its members could summon the will.

The Stock Market

The major stock market indexes had a wild ride during the second quarter. The Standard & Poor's 500 index fell just over 12% in the days following the President's Liberation Day announcement on April 2nd and then gained back 9.5% when the "pause" was announced a week later. For the quarter, the S&P was up 10.6% on a price only basis, more than offsetting its first quarter decline and almost 25% above the post-Liberation Day low.

As has been the case for most of the last four years, the BAATMMAN stocks – Broadcom-Alphabet-Amazon-Tesla-Meta-Microsoft-Apple-Nvidia – have accounted for the lion's share of the market's gains, or losses as was the case in the first quarter. As a group, they were up 24.5%



during the quarter, more than twice the return of the index as a whole. Given the fact that these stocks now account for almost 35% of the total index, their 2nd quarter performance contributed 8.1% of the index's rise of 10.6%. The equal-weighted S&P 500 rose just 5.3% in the quarter, and the S&P ex. the BAATMMAN stocks rose just 3.7%.

It's fair to point out that what BAATMMAN giveth, it can also taketh away. The same 8 stocks accounted for **all** of the index's decline – and then some – in the first quarter, falling 15.3% as a group versus the S&P's minus 4.6%. The rest of the S&P stocks were **up** by an average of just under 1%.

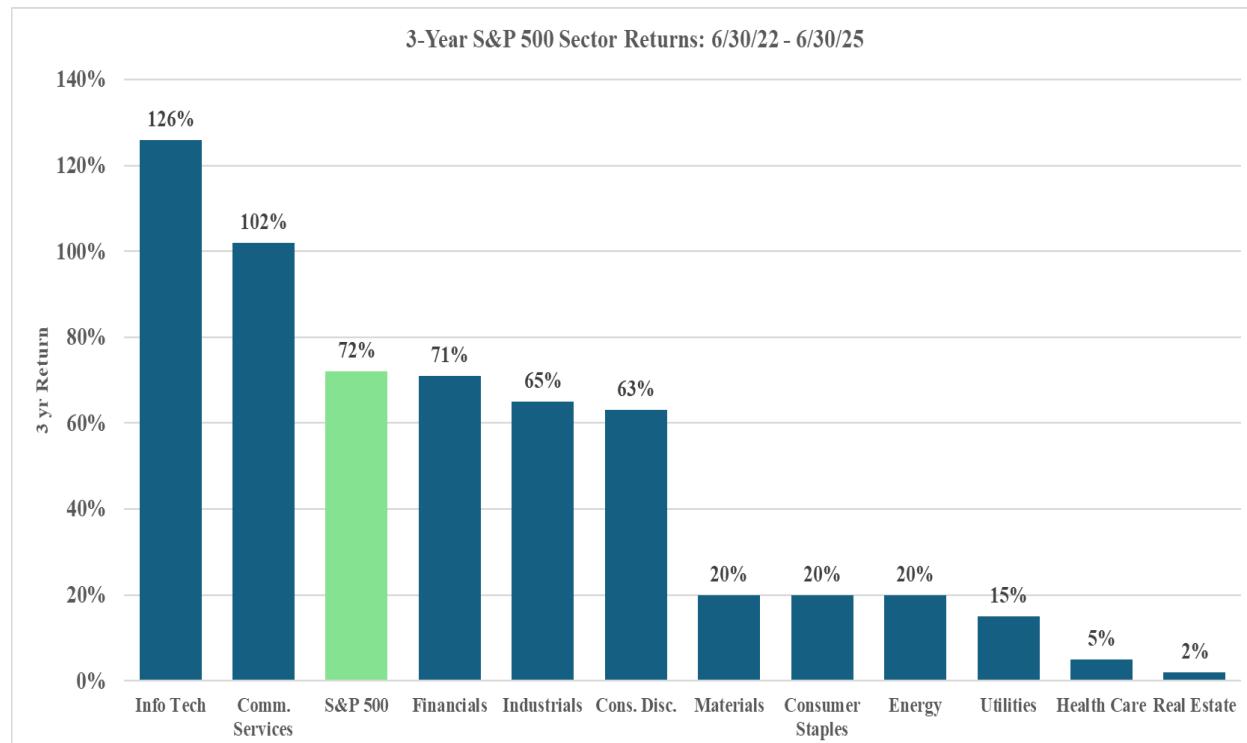
The first two quarters of this year are a practical illustration of Warren Buffett's Two Rules of Investing, which are, Rule #1: Don't lose money. Rule #2: Don't forget Rule #1.

As impressive as a return of 24.5% for the BAATMANN stocks in a single quarter might seem, it was earned on a principal base that had declined more than 15% in the prior quarter. The two quarters, combined, for those stocks generated growth of just 5.5%. The S&P 500, on the other hand, generated the same 5.5% return, but with much less volatility.

This is admittedly a very short-term example, but it does reinforce an important point that is at the core of our investment approach. And that is that a portfolio that loses 10% and then gains back 10% is not even; it is still down 1%.

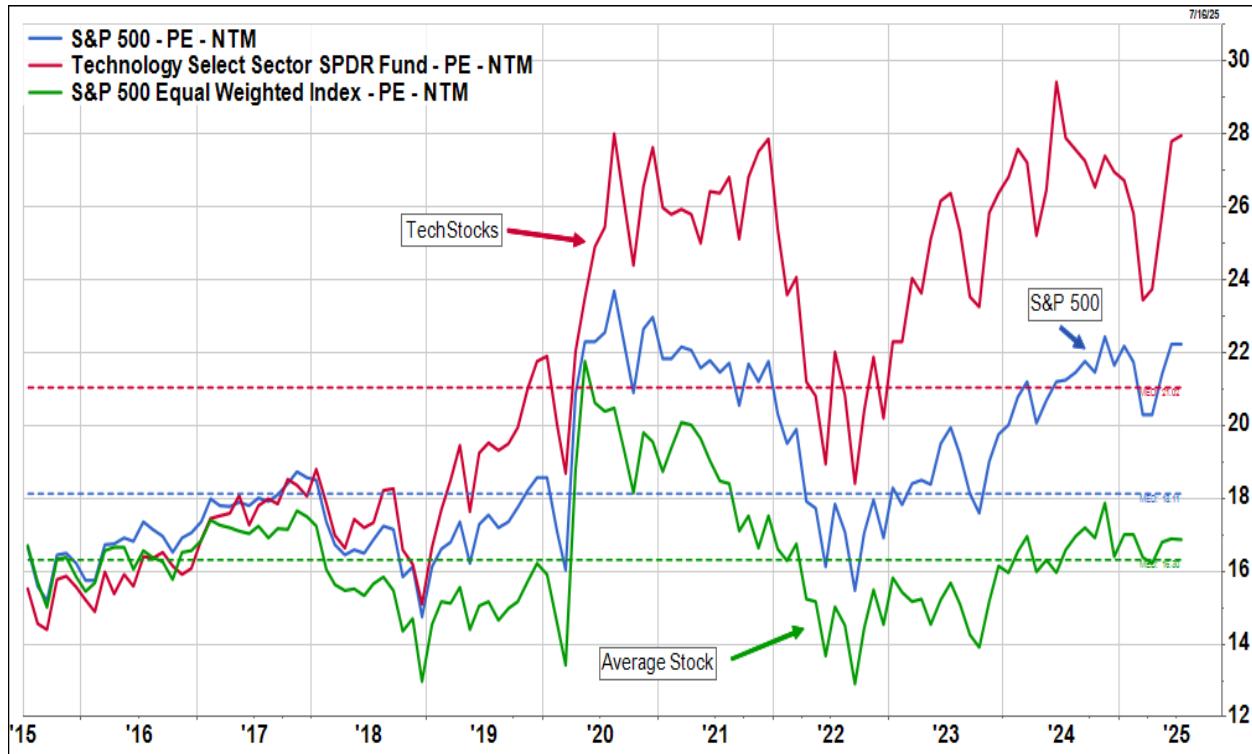
Valuations Remain a Concern, But Should They?

The S&P has risen 72% from its low in 2022, but 9 of the 11 S&P sectors have trailed the index. More than half of the sectors have underperformed the index by 50% or more. Health care, which accounts for 18% of our GDP, has generated almost no return over the last 3 years. Meanwhile, Information Technology and Communication Services are up 126% and 102%, respectively. The BAATMMAN stocks, as a group, have risen 265%. Not coincidentally, all



of those stocks, except Amazon and Tesla, are in the technology and communications sectors. The historic disparity in performance over the last three years is such that most of the market's fortunes – and risk - is now concentrated in this very narrow segment of the market.

The market's continued rise has driven valuations even further above historical norms. The S&P 500 now trades at more than 22 times forward earnings estimates, more than 20% above its long-term average multiple of 18. But that measure is skewed by the inflated P/E's of the BAATMMAN and technology stocks. The stocks in the tech sector are trading at a weighted



average P/E multiple of 28 times earnings, well above its long-term average of 21. The BAATMMAN group (not shown) is now priced at a multiple of 35 times earnings. Meanwhile, an equal-weighted average P/E multiple of the 500 stocks in the S&P index is under 17, and pretty much in line with its long-term average. The index is overvalued relative to its long-term average, but the market is not.

Expensive, But Worth the Risk?

Another of Warren Buffett's nuggets to investors is that, "Price is what you pay, but value is what you get."

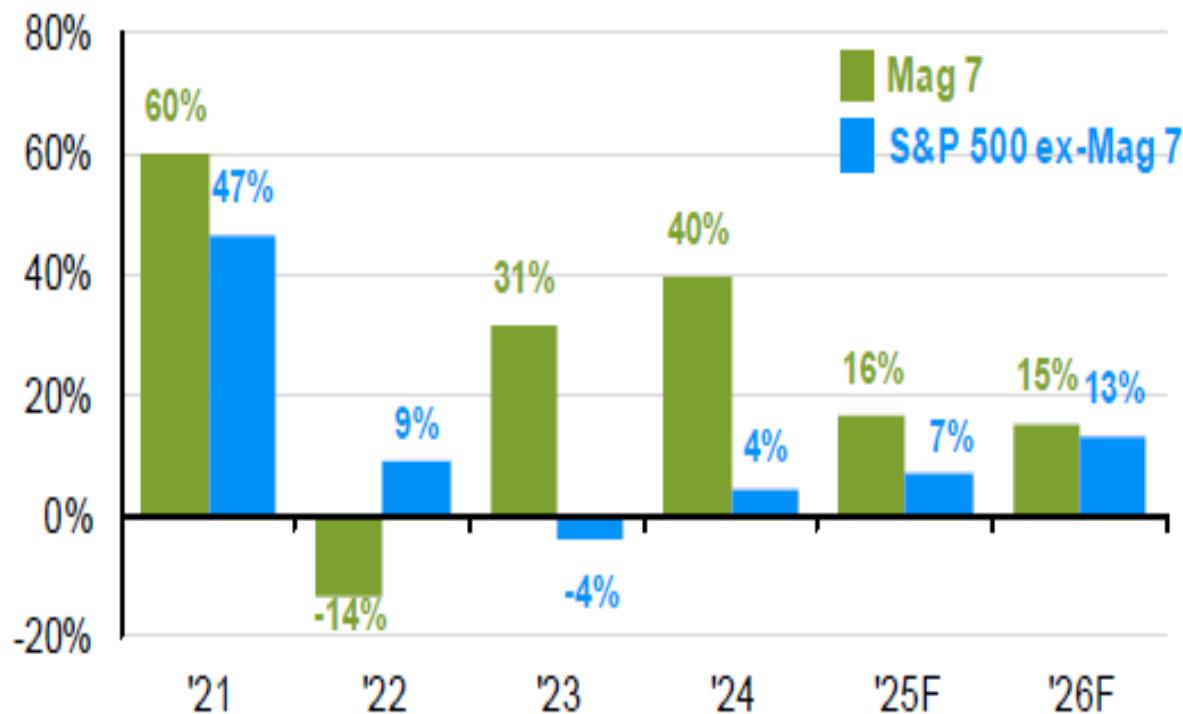
The stocks we have been writing about are priced at historic premiums to the rest of the market, implying a significant level of risk if earnings disappoint or expectations are not met. In fact, just meeting expectations may not be enough to drive some of these stocks higher. And their price volatility may be more than most of our clients could endure. Tesla, for example, has traded as high as \$489 and as low as \$182 in just the last year. At its current price, it is 77% above its low, but 34% below its high. If you bought it at its high, you're down 63% in just a few months. Even Microsoft, perhaps the most established name in the group, fell 26% between December and April, before soaring 49% in the last 2 months!

But just as these companies have accounted for most of the market's gains and have inflated the market's valuations, they have also accounted for most of the market's earnings growth over the same period.

The following chart from JPMorgan breaks out the year-over-year earnings growth of these companies versus the rest of the market over the last four years. (They use what is commonly known as the Magnificent 7 stocks, which excludes Broadcom.) Clearly, most of the market's

Earnings growth

Year-over-year



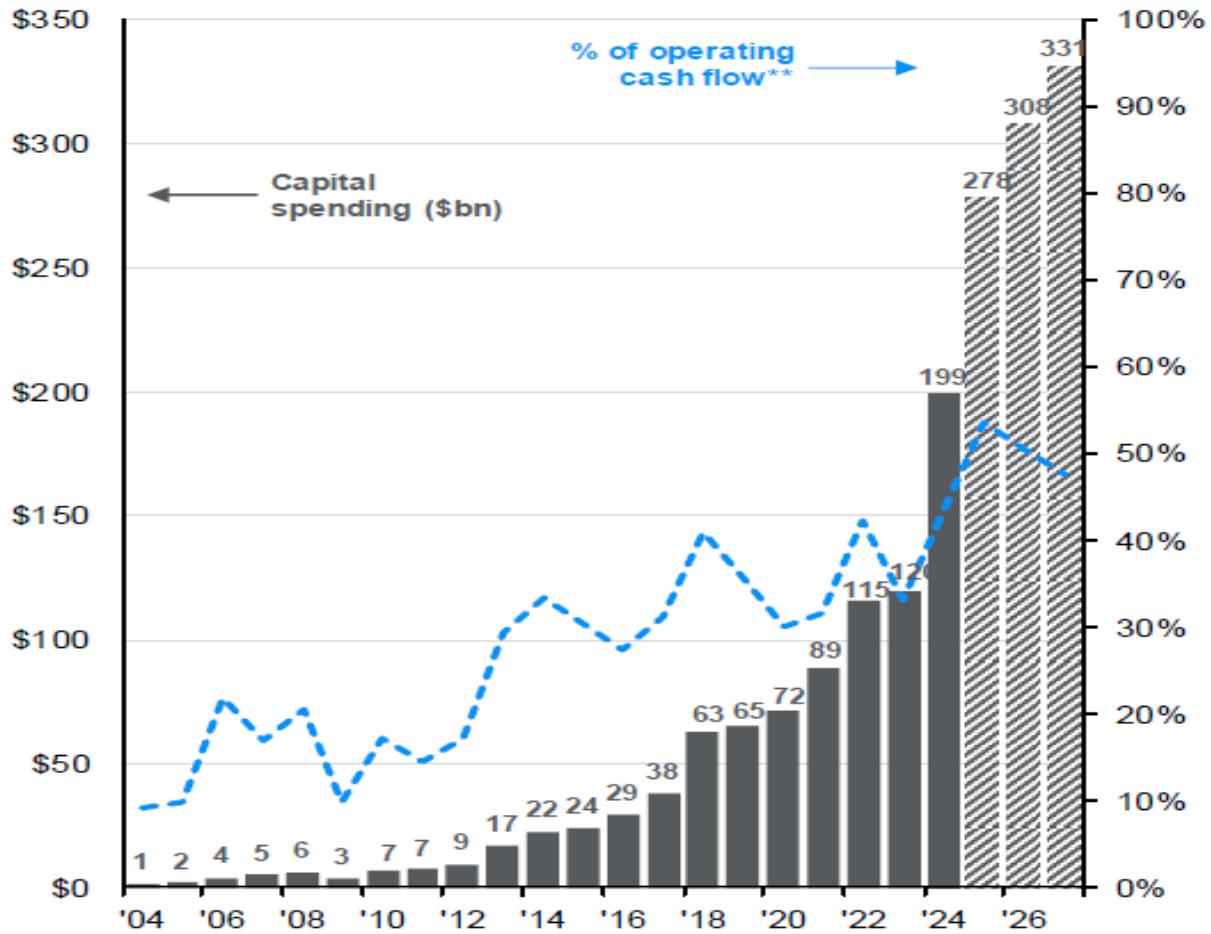
earnings growth during this period was attributable to this small group of tech stocks. Over the last 2 years, the Mag 7 earnings grew 83% while the rest of the market was essentially flat.

Whether you use the Magnificent 7 or the BAATMMAN acronym, this group of stocks has been identified as being the biggest early beneficiaries of the Artificial Intelligence (AI) revolution. It remains to be seen whether AI will have the same revolutionary effect as the computer or the internet, but the commitment that these companies are making to AI suggests that its impact will be significant and long lasting.

The major hyperscalers (cloud service providers that provide computing and storage on a global scale) committed \$200 billion in capital expenditures to AI in 2024, which amounted to more than 40% of their operating cash flow (chart, below.) That's 73% more than it was just two years

Capex from the major AI hyperscalers*

Alphabet, Amazon (AWS), Meta, Microsoft



ago, and it's projected to increase another 40% to \$278 billion this year, or more than 50% of their operating cash flow.

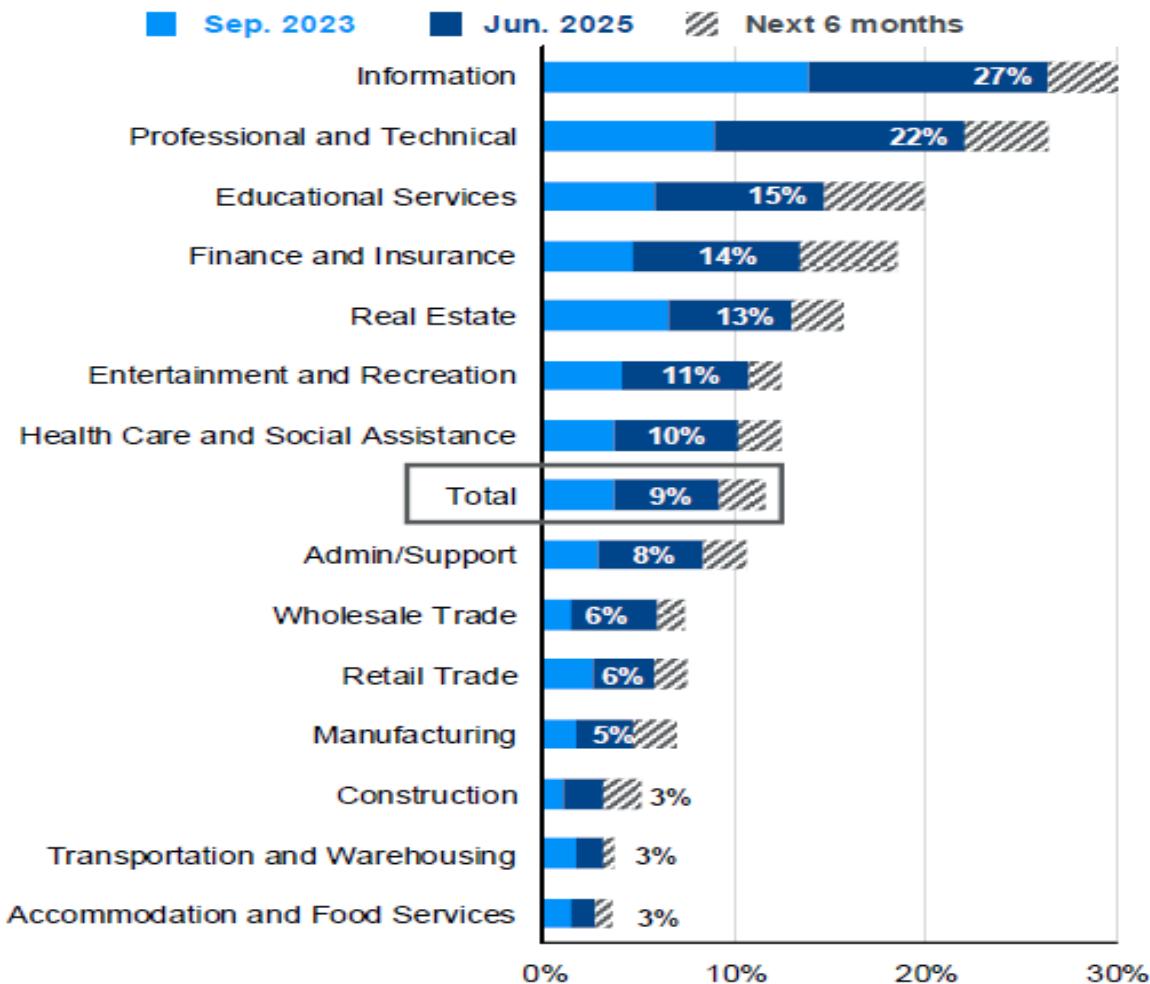
To appreciate what this means to a company like Nvidia, for example, it's estimated that they command a 70-95% share of the AI microchip market, and 60% of **all** capital spending on AI goes into Nvidia's chips. With net profit margins exceeding 50%, more than half of this revenue growth goes straight to the bottom line. **Nvidia's earnings for the 12 months ending in January 2025 were higher than their revenues had been just 4 quarters earlier**, and its Return on Equity (ROE) for the most recent 4 quarters was 114%!

So, this company, like most of the others in this group, is unarguably expensive. But who can say for certain that it is overvalued.

If we, like many others, were slow to appreciate the full extent of AI's potential, the chart, below, is evidence that its adoption by businesses throughout the economy is no longer a possibility that is far into the future, but rather a near-term reality. And the fact that the actual numbers are still small suggests that the long term outlook for this technology is enough to reward even those who may have come late to the party.

Businesses using AI to produce goods and services

% of all firms reporting use of AI applications



The Rest of the Market

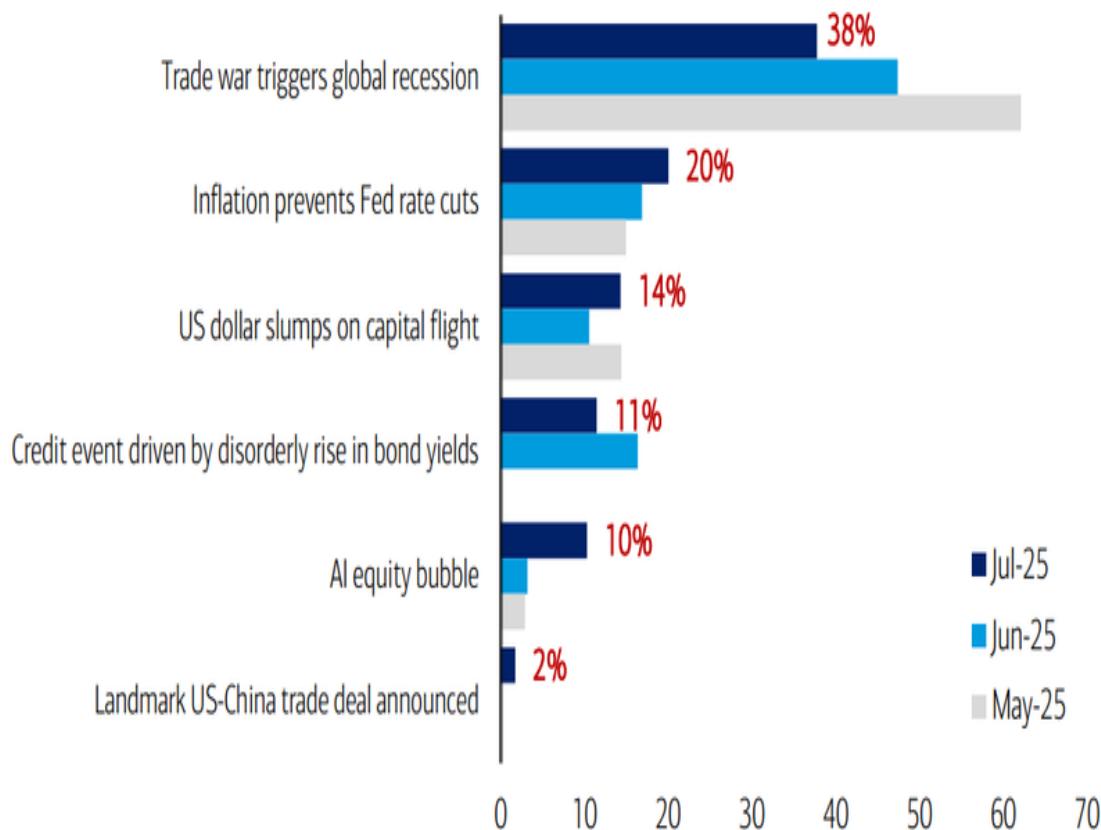
It's often said that when the market falls, all stocks fall together; but when the market rises, they don't all rise. That actually makes sense when you think about what causes investors to buy or sell. So, a disappointment by any of the large tech companies who now occupy such concentrated positions in the market poses a risk to all stocks.

Having acknowledged that, market fundamentals remain generally positive. The economic backdrop has just enough concerns to form the "Wall of Worry" that all markets must climb, but no single event on the horizon that might cause us to trim our equity positions.

Fund managers nationwide cite trade wars as their biggest concern, but the percentage of managers citing this has gone down in the last 2 months. Inflation fears, however, have risen in that time, which seems contradictory since the major risk to inflation is trade.

Chart 13: Trade war triggering global recession still seen as biggest 'tail risk'

What do you consider the biggest 'tail risk'?



Source: BofA Global Fund Manager Survey.

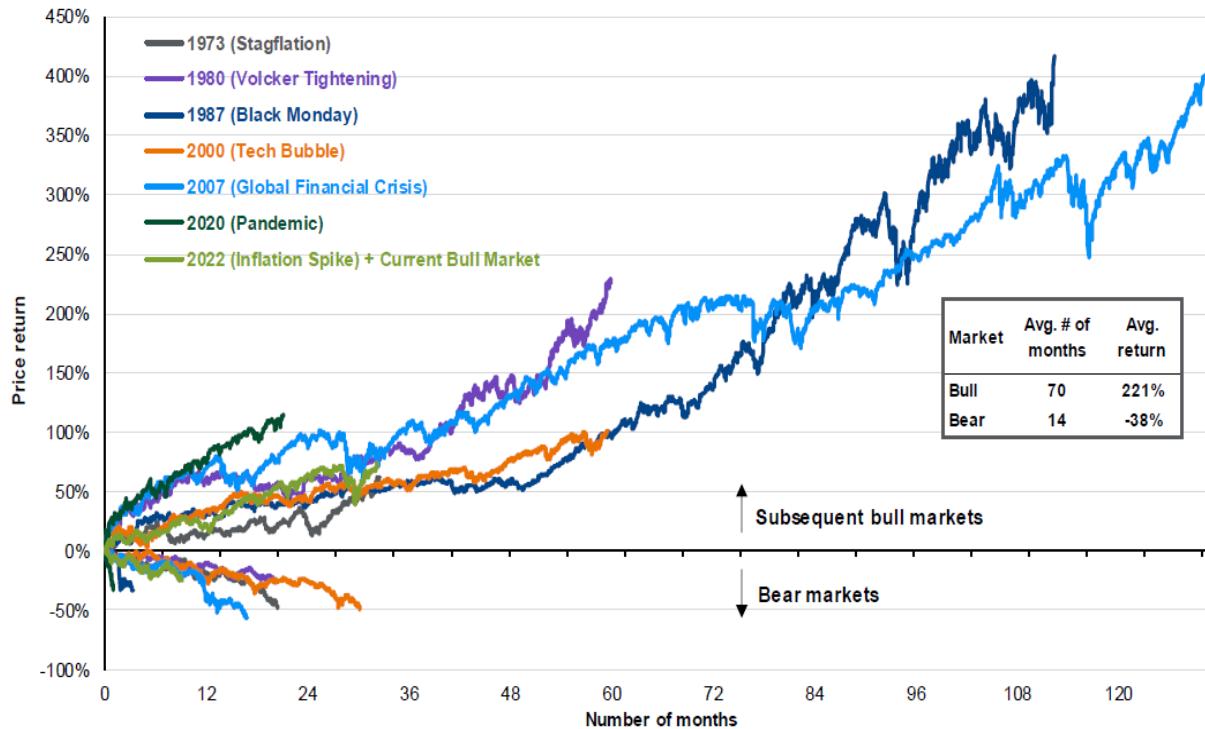
BofA GLOBAL RESEARCH

Beyond the macro environment, earnings estimates for the rest of 2025 and into 2026 are holding steady, or even rising slightly. The most recent estimate changes for 2025 show 1.4 upward revisions for every downward revision, while the same ratio for 2026 is 1.6 to 1. We are early in the 2nd quarter earnings reporting season, but 1st quarter results for both earnings and revenues were overwhelmingly ahead of expectations.

The chart, below, shows that the last 6 bull markets drove stock prices up by an average of 221%, and lasted for an average of nearly 6 years. The chart also shows that in each case, there were many bumps along the way which surely seemed concerning to those who experienced them. But those who persevered were amply rewarded.

Length and severity of bear and subsequent bull markets

Number of months, S&P 500 price return



We don't deal in making predictions, and we can't be certain that the current rise will follow the path of any of those that have preceded it. But the context is helpful in showing us where we are now compared to where we have been before. And it's telling us that this is a bull market, so be bullish – but not piggish.

Joseph J. Tascone
Senior Vice President &
Chief Investment Officer
jtascone@chemungcanal.com

Shelby M. Fay, CFA, CFP®
Vice President &
Senior Investment Officer
sfay@chemungcanal.com

Michael D. Blatt, CFA, CMT
Vice President &
Senior Investment Officer
mblatt@chemungcanal.com

Kevin W. Brimmer
Assistant Vice President &
Investment Officer
kbrimmer@chemungcanal.com

Peter M. Capozzola, CFA
Vice President &
Senior Investment Officer
pcapozzola@capitalbank.com

Ryan E. Weinhoffer
Portfolio Manager
rweinhoffer@chemungcanal.com



