Yardeni Research

August 11, 2025

Morning Briefing

Why Are Stock Prices Still Rising?

Check out the accompanying chart collection.

Executive Summary: With recent economic releases on the weak side, why have stock investors been taking the bad news in stride and pushing the S&P 500 ever higher? Dr Ed examines this question, offering four possible explanations: Investors expect the Fed to ease in September, although we're not totally convinced the Fed will—or should. Recession fears have receded, helping to justify higher valuations. Productivity rebounded during Q2, and subdued unit labor cost increases helped to contain inflation. Finally, the Digital Revolution will continue to drive economic growth—supporting our Roaring 2020s scenario.

Notice. Dr Ed is on vacation. So his next Monday morning webinar will be on August 18.

Strategy: Another Good Week for Stocks. The economic news has been weaker than expected since Friday, August 1, when July payrolls rose by only 73,000. Even more disturbing was that May's gain was revised down from 144,000 to 19,000, and June's increase was revised down from 147,000 to 14,000 (*Fig. 1*).

Also on Friday, August 1, July's M-PMI release was disappointing. The regional business surveys conducted by five of the 12 Federal Reserve district banks had suggested that it might have bounced back above 50.0, but it remained below 50.0 instead (*Fig. 2*). Then, last Tuesday, July's NM-PMI disappointed too. It fell and remained barely above 50.0 (*Fig. 3*). July's employment subindexes of both the M-PMI and NM-PMI were well below 50.0, at 43.4 and 46.4, lending support to the concerns about the labor market (*Fig. 4* and *Fig. 5*).

The S&P 500 tumbled on Friday, August 1, but was almost back at its July 28 record high one week later on Friday, August 8. If the economy is getting weaker, why would the S&P 500 resume its climb so quickly to match its recent record high? The Nasdaq rose to a new record high on Friday. Several expectations that might be helping to bolster the stock market come to mind:

(1) *The Fed will ease*. Following the latest batch of weak economic indicators, the odds of a Fed rate cut during September rose sharply to end the week at 89% according to the CME FedWatch tool. Over the next six and 12 months, the federal funds rate (FFR) futures

market is signaling that two and four rate cuts are likely to occur (*Fig. 6*).

We've been in the none-and-done camp in 2025, but we have to concede that a rate cut in September has become more likely. However, we note that several inflation and employment indicators will be released before the September 16-17 FOMC meeting. They might show that tariffs heated up July and August CPI and PCED inflation rates and that the rebound in payrolls during July continued in August.

On the inflation front, we know that tariffs heated up durable goods inflation during June (*Fig. 7* and *Fig. 8*). They might have done so in July and August too. The Cleveland Fed's *Inflation Nowcasting* model shows the core CPI rising 3.04% and 3.02% y/y in July and August. Those numbers would be consistent with our view that tariffs stalled the descent in inflation to the Fed's 2.0% target. On the other hand, the CPI components for used cars and rent might still be moderating (*Fig. 9* and *Fig. 10*).

On the employment front, our thesis is that Trump's Tariff Turmoil (TTT) caused many employers to postpone their hiring plans. TTT may not be abating as rapidly as we expected, but business managers should be learning to live with it. If so, they may decide to move ahead with their plans to expand their payrolls and capacity in coming months.

Now, suppose we are wrong about hotter inflation and employment numbers being released before the September FOMC meeting. In that case, the committee probably would lower the FFR, as widely expected, an expectation reflected in this week's rebound in stock prices.

(2) *The economy remains resilient.* If we are right about the economic indicators ahead, then the FOMC members would vote to pass on a rate cut until the inflationary impact of tariffs turns out to be transitory, as widely believed. They might also state that the actual condition of the labor market remains hard to assess as a result of tariffs and immigration policies.

The economy has been growing in recent years despite the pandemic, global supply-chain disruptions, rapidly rising inflation, monetary tightening, and now tariffs. It has proven its resilience and should continue to do so in our base-case scenario.

If this scenario is on the mark, then high valuation multiples can be justified by the widening perception that a recession is unlikely in the foreseeable future. Furthermore, earnings would be the main driver of the bull market rather than even higher valuation multiples. That would be a most welcome development.

(3) *Productivity will more than offset the shortage of labor.* We weren't all that troubled by the downward revisions in May and June payroll employment. That's because we reckon that uncertainty about the economy was especially high for a few months following the "Liberation Day" reciprocal tariffs that Trump announced on April 2. That probably resulted in temporary hiring freezes that should start to thaw over the rest of this year.

Besides, we know that real GDP rose 3.0% (saar) during Q2, so the downward employment revisions implied a stronger rebound in productivity. Sure enough, nonfarm business productivity rebounded to 2.4% (saar) during Q2, up from -1.8% during Q1, the biggest upward swing from one quarter to the next since 2021 (*Fig. 11*).

That increase might explain why inflation wasn't boosted much by tariffs, at least during Q2. During the quarter, unit labor costs rose only 2.6% y/y, as the 3.9% increase in hourly compensation was offset by the 1.3% y/y increase in productivity (*Fig. 12*). Unit labor costs is the main driver of the headline and core CPI inflation rates, which rose 2.7% and 2.9% y/y through June.

(4) *The Digital Revolution will continue to drive the Roaring 2020s.* In our Roaring 2020s scenario, average annual productivity growth increases to somewhere between 3.0% and 4.0% over the remainder of the decade. We've been telling this story since 2020, and we are sticking to it. Little did we know that artificial intelligence (AI) would start taking off after November 30, 2022, when OpenAI introduced ChatGPT. We've described AI as an evolutionary development in the Digital Revolution, which started in the mid-1960s with IBM mainframe computers.

The Digital Revolution is all about processing more and more data, faster and faster, at lower and lower costs. As that has been happening, more data are being created to process. AI is the latest stage of this revolution, with the potential to boost productivity dramatically.

Faster productivity growth would mean faster real GDP growth with subdued inflation. It would increase the standard of living by boosting real hourly compensation. In addition, profit margins would expand.

In this Roaring 2020s scenario, the S&P 500 is likely to rise to 10,000 by the end of the decade.

Calendars

US: Mon: None. **Tues:** NFIB Small Business Optimism Index 98.6; Headline & Core CPI 0.2%m/m, 2.8%y/y & 0.3%m/m, 3.1%y.y; Federal Budget Balance; OPEC Monthly Report; Barkin; Schmid. (Source: FX Street)

Global: Mon: Italy CPI 0.4%m/m,1.7%y/y; UK Retail Sales Monitor 2.1%y/y. **Tues:** Eurozone ZEW Economic Sentiment 28.1; Germany ZEW Economic Sentiment 39.7; UK Average Earnings ex Bonus 4.7%; UK Unemployment Rate 4.7%; Japan GDP 5.6%q/q, 4.3%y/y; Japan PPI 0.2%m/m, 2.5%y/y; RBA Interest Rate Decision 3.60%. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 2.4% during the August 8 week and closed at a record high for the first time since July 28. That was behind the 2.7% gain, which is just 1.1% below its July 24 record high. The AC World ex-US had been hitting new record highs since May 14 for the first time since June 15, 2021. Despite its recent strength, the US MSCI only outperformed the AC World ex-US in 10 of the past 28 weeks. EM Latin America was the best performing region last week, with a gain of 4.5%, followed by EMU (4.1%), Europe (3.0), EMEA (2.9), and EAFE (2.8). EM Asia was the worst regional performer, albeit with a gain of 2.0%, followed by EM (2.3). The Spain MSCI index, with a drop of 6.5%, performed the best among country indexes, ahead of South Africa (6.3), Sweden (5.2), Brazil (4.3), and Mexico (4.2). The India MSCI index was the worst performer w/w, with a decline of 1.1%, followed by Switzerland (0.2), the UK (1.6), China (2.0), and Australia (2.2). In terms of ytd performance rankings, the US MSCI index is up 8.8% ytd, but ranks as the second worst country performer and trails the 17.8% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EMU leads with a gain of 26.5%, followed by EM Latin America (25.5), Europe (20.9), EMEA (18.9), EAFE (18.5), and the AC World ex-US. EM Asia is the worst ytd performer, albeit with a gain of 15.5%, followed by EM (16.6). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 49.9%, followed by Korea (41.4), South Africa (35.9), Germany (32.4), and Mexico (31.1). The worst performing countries ytd: India (-1.7), the US (8.8), Australia (11.8), Japan (13.8), and Switzerland (15.6).

US Stock Indexes (*link*): Forty-five of the 48 major US stock indexes that we follow rose during the week ended August 8, a big turnround from 47 indexes falling in the prior week. The Nasdaq Composite index was the best performer for the week, rising 3.9%, ahead of S&P 600 SmallCap Pure Value (3.8%), Nasdaq 100 (3.7), Russell 1000 Growth (3.2), and Russell 3000 Growth (3.2). The S&P 400 MidCap Pure Growth index was the worst performer, with a decline of 0.6%, followed by S&P 500 LargeCap Pure Growth (-0.3), Russell MidCap Growth (-0.3), and S&P 400 MidCap Pure Value (0.3). Thirty-seven of the 48 indexes are now higher so far in 2025, down from a ytd peak of 47 in mid-February. With a gain of 13.3%, the Dow Jones 15 Utilities index is in the top spot as the best performer so far in 2025, ahead of S&P 500 LargeCap Growth (13.0), Nasdaq 100 (12.4), S&P 500 LargeCap Pure Growth (11.1), and Nasdaq Composite (11.1). The worst performing major US stock indexes ytd: S&P 600 SmallCap Value (-6.4), S&P 600 SmallCap Equal Weighted (-5.2), S&P 600 SmallCap (-4.0), Dow Jones 20 Transports (-3.5), and S&P 600 SmallCap Pure Value (-3.4).

S&P 500 Sectors Performance (*link*): Nine of the 11 S&P 500 sectors rose during the week ended August 8, but just three were ahead of the S&P 500's 2.4% gain. That compares to just one S&P 500 sector rising a week earlier, when five were ahead of the S&P 500's 2.4% decline. The outperformers last week: Consumer Discretionary (3.6%), Information Technology (3.0), and Consumer Staples (2.7). The underperformers last week:

Health Care (-1.7), Energy (-1.0), Industrials (0.6), Real Estate (0.7), Financials (0.7), Utilities (0.8), Materials (1.8), and Communication Services (2.1). The S&P 500 is now up 8.6% ytd, with eight of the 11 sectors positive ytd and four ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Industrials now shares the crown as the best ytd performer with Information Technology, with gains of 14.3%, ahead of Utilities (14.1), and Communication Services (13.6). These seven sectors are lagging the S&P 500 so far in 2025: Health Care (-6.4), Consumer Discretionary (-1.8), Energy (-0.9), Real Estate (2.0), Materials (5.5), Consumer Staples (5.8), and Financials (7.1).

Global Economic Indicators

Germany Industrial Production (*link*): German industrial production in June recorded its largest contraction in nearly a year, sinking to its lowest level since May 2020, during the pandemic, as the positive impact from companies rushing to beat US tariffs subsided. *Industrial production* dropped 1.9% in June, more than triple the consensus estimate of a 0.5% shortfall. Meanwhile, May data showed a sharp downward revision, falling 0.1%, down from the preliminary estimate of a 1.2% increase. The report notes that May's revision was attributed to corrections from establishments in the automotive sector. *Exports* rose 0.8% in June, slightly higher than the consensus estimate of 0.5%. Exports to *EU countries* advanced 2.4%, while they fell 1.2% to *non-EU* nations, reflecting a 2.1% drop in exports to the *US*—the third successive monthly drop, falling to its lowest level since February 2022. *By industry*, the decline in June industrial production was led by shortfalls in the pharmaceutical (-11.0%), food (-5.3), and machinery & equipment (-5.3) industries. Meanwhile, energy output rose 3.1%, partially offsetting some of the decline. *Excluding energy and construction*, production fell 2.8% during June and was 4.7% below a year ago. *By sector*, consumer (-5.6%), capital (-3.2), and intermediate (-0.6) goods production all fell in June. The decline in German industrial production came on the heels of a weak *factory orders report*, with orders unexpectedly falling 1.0% in June—the second straight monthly decline, reflecting weak foreign demand.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102