



Q2 INVESTMENT OUTLOOK UPDATE

# What's Changed, and What Remains



## Executive Summary



Much has transpired since we published our 2025 outlook in December. What appeared like the setup for a robust economic and earnings environment has given way to tariff-driven uncertainty. As such, we've examined which of our forecasts may hold up under the new regime and which we are rethinking.



For one, animal spirits in the U.S. equity market have been caged, largely due to tariff threats and other policy changes.



Similarly, with escalating trade tensions and tariffs likely to weigh on growth and inflation, the supportive backdrop we'd envisioned for small caps may be eroded.



The ultimate impact of tariffs could range from modest to highly disruptive, depending on how trade negotiations unfold. We've outlined our bear, base and bull cases below, with outlooks for S&P 500 performance and the broader economy.



While much of the broader economic context remains intact, the sharp rise in tariff-driven risk has created new challenges for both sentiment and valuations. Investors should remain adaptable in the face of a wide range of possible outcomes.



Since the release of our 2025 Outlook and Investment Playbook, the global landscape has shifted meaningfully. What once looked like a robust economic and earnings environment—strong enough to support elevated valuations and even push them higher—has been clouded by a surge in tariff-driven uncertainty.

In response, we’re providing this Q2 update to clarify where our outlook remains intact, what has materially changed, and how investors can recalibrate in the face of evolving risks and opportunities.

## Animal Spirits Have Been Caged

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*Equities are poised for continued growth in the new year, riding a wave of investor optimism and the anticipation of pro-growth policies.*

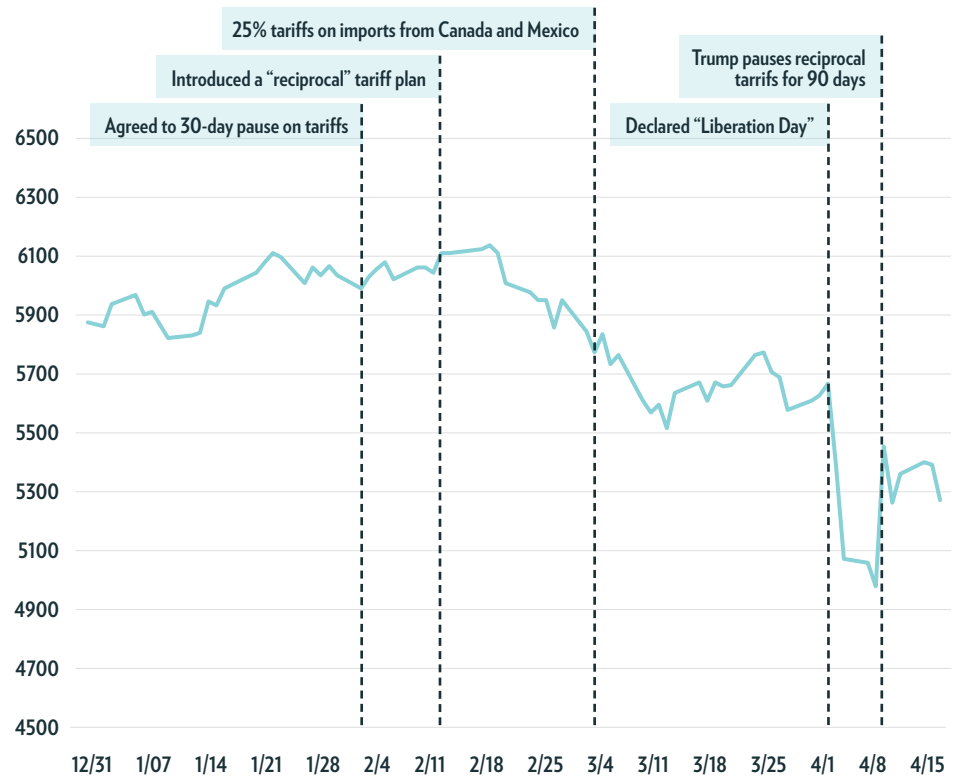
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That was the tone as we entered 2025. Investor sentiment was running high, propelling equity valuations into the 93rd percentile relative to historical norms. While we cautioned that even a modest negative catalyst could disrupt that momentum, our base case assumed sentiment would stay resilient and valuations would remain elevated—or even climb further.

However, the landscape has shifted. A flurry of tariff threats, policy proposals, implementations, and retaliatory measures, outlined in the chart below, has sharply dampened sentiment. As a result, valuations have pulled back. In effect, tariffs have caged the very “animal spirits” that were fueling the rally.

As a result, we expect sentiment to remain a headwind for equities in the near term—at least until reciprocal tariffs are meaningfully reduced, legally challenged, or fully rolled back.

S&P 500 RESPONSE TO TRUMP TARIFFS



Source: Bloomberg, Innovator. S&P 500 Index Level data from 12/31/2024 - 04/15/2025. A selection of Tariff news dates has been indicated via the gray horizontal lines. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.



# Small Cap Potential: Delayed, Not Derailed

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*A second Trump term could be a boon to small caps and those who invest in them, with deregulation giving smaller businesses some breathing room.*

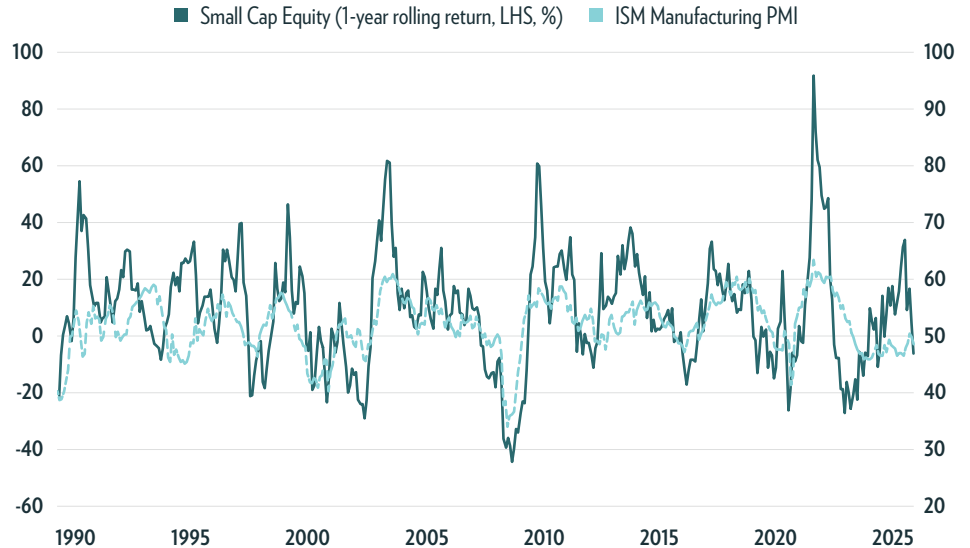
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While our medium-term outlook for small caps remains constructive, we now expect 2025 to continue to hold challenges for the asset class. Our initial optimism was based on the prospect of strong economic growth and well-anchored inflation, factors that typically favor smaller companies.

However, escalating trade tensions and the introduction of new tariffs are likely to weigh on both growth and inflation. The longer these policies remain in place—or escalate further—the more they threaten to erode the seemingly supportive backdrop small caps had been poised to benefit from.

As such, small caps may continue to face headwinds throughout 2025, with rising growth risks and persistent inflation concerns pushing out the timeline for a sustained rebound. While the structural case remains intact, the cyclical environment has become less favorable—delaying, but not derailing, the opportunity ahead.

## ISM MANUFACTURING PMI OFTEN LEADS SMALL CAP EQUITIES



Source: Bloomberg, Innovator. Small Cap Equity performance represented by the Russell 2000 Index. The ISM Manufacturing Purchasing Managers Index (ISM PMI) is constructed via monthly survey responses by purchasing and supply executives across an array of companies. An ISM PMI above 50 is intended to be indicative of an expanding manufacturing economy while an ISM PMI below 50 is intended to be indicative of a contracting manufacturing economy. Data from 12/29/1989 – 3/31/2025. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.

## INFLATION EXPECTATIONS



Source: Bloomberg, Innovator. Inflation expectations represented by the 2-, 3-, and 5-year U.S. Treasury Inflation-Protected Securities (TIPS) Breakeven Inflation Rates (represented by the USGGBE02, USGGBE03, and USGGBE05 Indices, respectively). A TIPS Breakeven Inflation Rate is the difference between the yields of a Treasury and TIPS with similar maturities. Data from 1/1/2024 – 4/21/2025.



## The Administration Goes Overboard on Tariffs

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*Bulls beware. Any disruptions to the current narrative could quickly unravel recent momentum...Proposed tariffs, coupled with harsher immigration policy, could be counterproductive to the growth agenda, with consumers' wallets and the labor market shouldering the burden.*

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Coming into the year, we flagged aggressive trade policy as a key downside risk, one that could undermine the otherwise favorable setup for equities. Still, the tariff measures announced to date have far exceeded even our bear case expectations.

While we contemplated the possibility of a 60% levy on Chinese imports (with a 20% base case) and a 10–20% range on other nations, the reciprocal tariffs unveiled on Liberation Day shattered those assumptions—surpassing even the infamous Smoot-Hawley Tariff Act of 1930 in scale and impact.

In hindsight, while we correctly identified the risk, our downside projections weren't bearish enough.

## Quantifying the Range of Outcomes

### What Investors Should Be Thinking About Now

So where do we go from here, and how should investors prepare?

The ultimate impact of tariffs could range from modest to highly disruptive, depending on how trade negotiations unfold. The trajectory remains highly uncertain: retaliation could escalate or taper off, legal challenges may gain traction or stall, and President Trump could double down or pivot entirely.

Given this uncertainty, we believe it's essential for investors to position portfolios with flexibility—prepared for a wide range of potential outcomes. In the sections that follow, we outline the possible scenarios we see for both U.S. equities and interest rates, and the implications of each.

	CURRENT	BEAR	BASE	BULL
Price	5,288	3,933	5,469	6,303
P/E Ratio	19x	15.8x	20.9x	23.8x
EPS	245	249	261	265

*Note: Innovator S&P 500 Index forecast and current scenario as of 4/22/2025. 1-Year Forward P/E Ratio shown for current scenario. The forecast scenarios are for 2025 year end. Price-to-earnings (P/E) is a ratio of a company's share price to its earnings per share (EPS) over a year. For illustrative purposes only and not intended to be relied upon for investment or other purposes*



## THE RANGE OF POTENTIAL OUTCOMES

### Bear



In this scenario, the U.S. economy slips into recession while inflation remains firm—handcuffing the Fed’s ability to respond with meaningful easing. The S&P 500 retreats to 3,900 as corporate earnings weaken and risk appetite fades.

Tariff negotiations yield only minor agreements with lower-impact trading partners, offering little relief to global supply chains or domestic inflation. The resulting growth scare prompts a broad exodus from U.S. assets, driving interest rates higher and sending the U.S. dollar sharply lower.

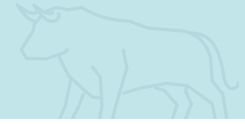
### Base



U.S. growth decelerates but stays in positive territory, avoiding a full recession. The S&P 500 rises modestly to 5,550 as earnings growth slows but remains supportive, and investor sentiment stabilizes.

Trade negotiations result in deals with most major trading partners, reducing the effective tariff burden to more manageable levels—around 10%. While tariffs on China are only slightly reduced and remain elevated, the broader easing of trade tensions helps calm markets and anchor expectations.

### Bull



In this scenario, legal challenges to the administration’s use of the IEEPA prove successful—or President Trump reverses course and meaningfully reduces tariffs on key trading partners, bringing effective rates below 10%. Tariffs on Chinese imports are scaled back to 20%, easing pressure on global supply chains and inflation.

With trade tensions de-escalating, growth reaccelerates and business confidence improves. Investor optimism returns in force, driving strong multiple expansion and lifting the S&P 500 to 6,300.

## INTEREST RATES

Tariff-induced inflation accelerates meaningfully, eroding real incomes and investor confidence. Foreign and domestic investors retreat from U.S. assets, driving yields higher and the dollar lower. Bond vigilantes re-emerge, demanding greater compensation for fiscal and inflation risks, pushing the 10-Year Treasury yield above 5%.

Despite the slowdown in growth, the Fed remains on hold—trapped between the risk of recession and persistently high inflation. With monetary policy constrained and market pressures mounting, financial conditions tighten sharply.

Tariff-driven inflation remains sticky throughout the year, complicating the Fed’s policy stance. In response, the central bank cuts rates by 0.25% to 0.50% by year-end, but its ability to ease significantly is limited by persistent inflationary pressures.

Foreign demand for U.S. Treasuries wanes, reflecting broader concerns about trade risks and global growth. As a result, the 10-Year Treasury yield remains range-bound between 4% and 4.75%, constrained by mixed domestic economic signals and reduced overseas appetite.

In this scenario, the Fed cuts rates by 0.5% to 1% by the end of the year in response to slowing growth and the fading impact of tariff-induced inflation. The inflationary pressures from tariffs prove to be transitory, gradually subsiding as supply chains adjust and cost pressures ease.

Efforts to reduce government spending and headcount—particularly under DOGE initiatives—hit their targets, helping to rein in fiscal imbalances. As a result, the 10-Year Treasury yield retreats to a more balanced range of 3.25% to 3.75%, reflecting a more stable macroeconomic environment and renewed investor confidence.

*For illustrative purposes only and not to be relied upon for investment or other purposes. This scenario analysis displays the author’s evaluation of market conditions that may potentially yield the corresponding scenario noted.*



## THE BEAR CASE

### ELEVATED RISKS AND SIGNIFICANT DOWNSIDE

While the outcome remains uncertain, we believe there is a high probability that key elements from the bear case scenario will unfold. The Trump Administration has set ambitious demands, and it's already clear that zero tariffs will not be sufficient to secure a deal. Negotiations with China, the EU, and Canada face considerable hurdles.

Should reciprocal tariffs go into effect as outlined, even for a brief period (3-6 months), we believe this could trigger a U.S. recession, with shattered investor sentiment as the catalyst. We would expect the severity of the market drawdown to be largely influenced by the inflationary environment and the Fed's ability to intervene. However, current equity valuations are misaligned with recessionary conditions, suggesting the potential significant drawdowns on major indices to reflect a deteriorating macro outlook.

## THE BASE CASE

### TARIFFS SET TO STAY ELEVATED

In his 1987 book *The Art of the Deal*, President Trump outlines a key negotiation strategy: starting with an aggressive anchor. He states:

“

*I aim very high, and then I just keep pushing and pushing and pushing to get what I'm after.*

”

While we believe the extreme nature of the Liberation Day tariffs reflects this approach, investors should understand that the final outcome may result in the highest level of tariffs seen this century. President Trump has been unequivocal about his support for tariffs, calling them “the most beautiful word in the entire dictionary of words,” and proclaiming, “I love tariffs. I think they're beautiful. It's gonna make us rich.”

While we believe negotiations and deals will unfold, hopefully reducing tariffs to more manageable levels, the post-negotiation landscape seem likely to leave tariffs well above where they were at the start of the year—particularly on China.

In this environment, we expect earnings growth to slow, while valuations edge up and stabilize. A relief rally through improving sentiment and business confidence could occur on any significant deals with major trading partners. However, the persistence of stick inflation and slower growth would limit equity upside, even if we see appreciation from the current levels.

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*The most beautiful word in the entire dictionary of words is the word tariff... I love tariffs. I think they are beautiful. It's gonna make us rich.*

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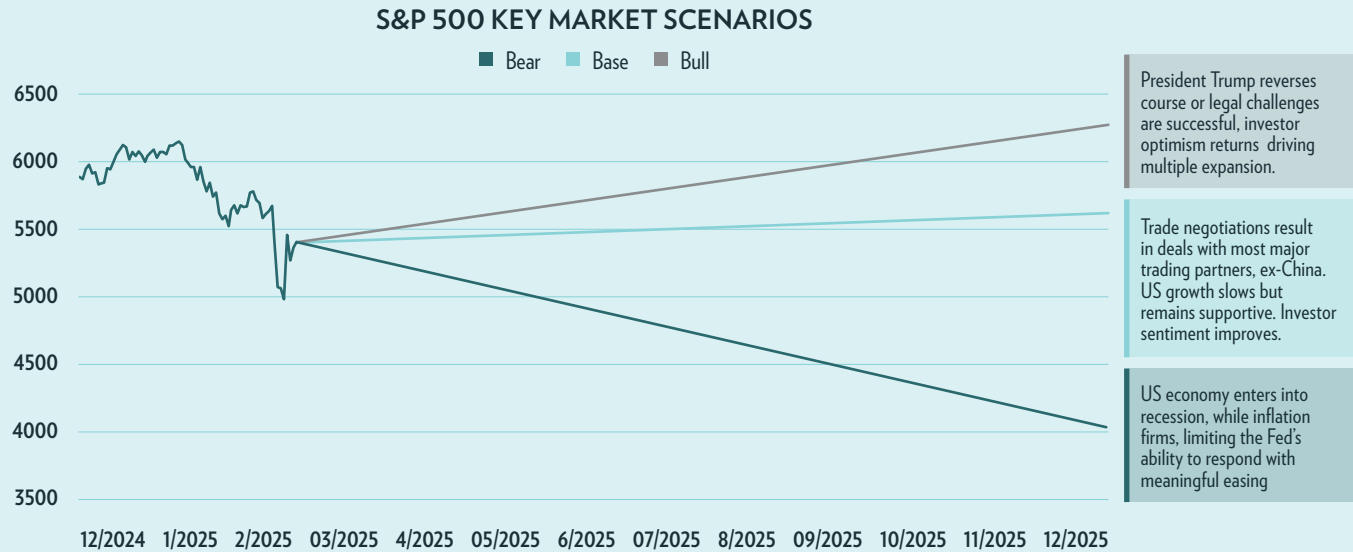
*The United States of America is going to take back a lot of what was stolen from it by other countries and, frankly, by incompetent U.S. leadership. We're going to take back our wealth, and we're going to take back a lot of the companies that left.*

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## THE BASE CASE CONT.

### TARIFFS SET TO STAY ELEVATED



Source: Bloomberg, Innovator. S&P 500 Index Level shown from 12/31/2024 - 4/14/2025. Innovator "Bear", "Base", and "Bull" cases have been added for illustrative purposes only and are not intended to be relied upon for investment or other purposes. Past performance is not necessarily indicative of future results. One cannot invest directly in an index. Index performance does not account for fees and expenses.

## THE BULL CASE

### PATHS TO A MARKET RESURGENCE

There are multiple routes to our bull case scenario. The simplest path is for President Trump to reverse course and change his stance on tariffs. While this is technically possible, given his historical position, the odds of this happening are low in our view.

Other potential paths include Congressional Republicans pressuring the President to lower or remove tariffs in exchange for support on a budget reconciliation package in the summer, or successful legal challenges to the President's use of the International Emergency Economic Powers Act (IEEPA) to impose tariffs. While alternative routes to implementing tariffs could be pursued, legal challenges—questioning whether longstanding trade deficits qualify as an "emergency"—may prove successful. Challenges are already emerging, and we will be watching to see how they unfold.

In any case, a resolution to the tariff issue would likely shift investor focus back to the administration's pro-growth initiatives, such as tax cuts and deregulation. This would likely restore investor sentiment and could push valuations back to levels seen before the tariff escalation at the start of the year.





## The Investment Playbook

In a climate where uncertainty reigns and outcomes are nearly binary, it's critical for investors to prepare for a wide range of scenarios. The playbook below details strategies aiming to help position portfolios effectively, regardless of which path the year ultimately takes.

### Protect Equity Gains

## ZAPR

*Innovator Equity Defined Protection ETF® - 1 Yr April*

Investors looking to protect gains can use ZAPR, designed to provide a 100% buffer against losses, subject to fees and expenses, while tracking the S&P 500 ETF (SPY) up to a cap of 7.52%.

### Diversify Bond Volatility

## BALT

*Innovator Defined Wealth Shield ETF*

With longer term bond yields expected to remain elevated, reduce the reliance on rates for risk management with a built-in quarterly 20% buffer, while tying dollars to the equity market for upside potential.

### Hedge Downside Risks

## SFLR

*Innovator U.S. Equity Managed Floor ETF®*

SFLR seeks to smooth out market corrections with a built-in 10% laddered floor, while maintaining uncapped upside potential by aiming to participate in 70-80% of U.S. large cap equity returns.

## Staying Adaptable for the Uncertain Road Ahead

Since the release of our original 2025 Outlook and Investment Playbook, the landscape has shifted significantly, primarily driven by escalating tariff uncertainty. While much of the broader economic context remains intact, the sharp rise in tariff-driven risk has created new challenges for both sentiment and valuations. As a result, our updated outlook reflects a more cautious near-term view, with a focus on potential market volatility and the need for flexibility in portfolio positioning. Given the evolving dynamics, it's crucial for investors to be prepared for a wide range of outcomes, whether that's through tariff de-escalation or prolonged trade tensions. As we move forward, adaptability and an eye on key developments will be essential to navigating 2025's unpredictable market terrain.

**The Funds have characteristics unlike many other traditional investment products and may not be suitable for all investors. For more information regarding whether an investment in a Fund is right for you, please see "Investor Suitability" in the prospectus.**

The Funds face numerous market trading risks, including active markets risk, authorized participation concentration risk, buffered loss risk, cap change risk, capped upside return risk, correlation risk, liquidity risk, management risk, market maker risk, market risk, non-diversification risk, operation risk, options risk, trading issues risk, upside participation

risk and valuation risk. For a detailed list of Fund risks see the prospectus.

**Buffer ETFs™ Risk.** There is no guarantee the Funds will be successful in providing the sought-after protection. If the Outcome Period has begun and the Underlying ETF has increased in value, any appreciation of the Fund by virtue of increases in the Underlying ETF since the commencement of the Outcome Period will not be protected by the Buffer, and an investor could experience losses until the Underlying ETF returns to the original price at the commencement of the Outcome Period.



These Funds are designed to provide point-to-point exposure to the price return of the Reference Asset via a basket of Flex Options. As a result, the Funds are not expected to move directly in line with the Reference Asset during the interim period.

Investors purchasing shares after an Outcome Period has begun may experience very different results than Funds' investment objective. Initial Outcome Periods are approximately 3-months, 6-months, 1-year, or 2-years beginning on the Funds' inception date. Following the initial Outcome Period, each subsequent Outcome Period will begin on the first day of the month the fund was inceptioned. After the conclusion of an Outcome Period, another will begin.

**Fund shareholders are subject to an upside return cap (the "Cap") that represents the maximum percentage return an investor can achieve from an investment in the Funds for the Outcome Period, before fees and expenses. If the Outcome Period has begun and the Fund has increased in value to a level near to the Cap, an investor purchasing at that price has little or no ability to achieve gains but remains vulnerable to downside risks. Additionally, the Cap may rise or fall from one Outcome Period to the next. The Cap, and the Fund's position relative to it, should be considered before investing in the Fund. The Funds' website, [www.innovatoretfs.com](http://www.innovatoretfs.com), provides important Fund information as well information relating to the potential outcomes of an investment in a Fund on a daily basis.**

**The Funds only seek to provide shareholders that hold shares for the entire Outcome Period with their respective buffer level against reference asset losses during the Outcome Period. You will bear all reference asset losses exceeding the buffer. Depending upon market conditions at the time of purchase, a shareholder that purchases shares after the Outcome Period has begun may also lose their entire investment. For instance, if the Outcome Period has begun and the Fund has decreased in value beyond the pre-determined buffer, an investor purchasing shares at that price may not benefit from the buffer. Similarly, if the Outcome Period has begun and the Fund has increased in value, an investor purchasing shares at that price may not benefit from the buffer until the Fund's value has decreased to its value at the commencement of the Outcome Period.**

**SFLR Risk.** The Fund seeks to provide risk-managed investment exposure to the U.S. Large Capitalization Companies represented by the Solactive GBS United States 500 Index through its hedging strategy. There is no guarantee that the Fund will be successful in implementing its strategy to provide a hedge against overall market exposure. The Fund seeks to achieve its investment objective by purchasing a series of four, one-year Flex Options packages with "laddered" expiration dates that are 3 months apart. The Fund will also systemically sell short-dated call option contracts, which have an expiration date of approximately two weeks, with an objective of generating incremental returns above and beyond the premium outlay of the protective put option contracts. The Fund does not provide principal protection or non-principal protection, and an investor may experience significant losses on its investment. In a market environment where the Solactive GBS United States 500 Index is generally appreciating, the Fund may underperform the Solactive GBS United States 500 Index and/or similarly situated funds.

The Sub-Adviser will seek to "ladder" the Fund's option contracts by entering into new purchased put option contracts packages every three-months. After such put option contracts expire, the Fund will enter into new put option contracts with one-year expiration dates that are staggered every three months. As a result of the Fund's laddered investment approach, on an ongoing basis the Fund will experience investment floors that are expected to be greater or less than the 10% Floor provided by an individual Options Portfolio. The Fund seeks to provide capital appreciation while seeking to limit the amount of losses experienced by investors.

Because the Fund ladders its option contracts and due to the Fund's put option contracts having different terms (including expiration dates), different tranches of put option contracts may produce different returns, the effect of which may be to reduce the Fund's sought-after protection. Therefore, at any given moment the Fund may

not receive the benefit of the sought-after protection on losses that could have been available from an Options Portfolio with a single expiration date.

**BALT Risk.** Although the ETF targets a 20% buffer, it may fall into a range of 15-20%; there is no guarantee that the buffer will be within this range or that the Fund will provide the buffer.

**FLEX Options Risk.** The Funds will utilize FLEX Options issued and guaranteed for settlement by the Options Clearing Corporation ("OCC"). In the unlikely event that the OCC becomes insolvent or is otherwise unable to meet its settlement obligations, the Funds could suffer significant losses. Additionally, FLEX Options may be less liquid than standard options. In a less liquid market for the FLEX Options, the Funds may have difficulty closing out certain FLEX Options positions at desired times and prices. The values of FLEX Options do not increase or decrease at the same rate as the reference asset and may vary due to factors other than the price of reference asset.

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