Market Insights June 3, 2025

Tom Lee Warns About Missing Out on a Melt-Up Rally on CNBC

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There's been no notable earnings, no political drama, and no important economic data this week. Despite those catalysts, stocks are on track to finish the week up, and that's a good thing, according to Fundstrat Head of Research Tom Lee.

Institutional investors are largely sitting on the sidelines of the recent monthlong rally, afraid to dip their toes until there is a broad tariffs resolution. Some are still net short the S&P 500. If the gains extend, that could leave investors caught off-guard to cover their short positioning, which could further boost the rally, Lee said.

"The risk is now of a substantial leg-up rally from here," Lee said on *CNBC's* Closing Bell with Scott Wapner. "We have to adjust to [tariffs], but it's not the thing that takes us to 4,000 for S&P 500 anymore."

Lee said that if 10% tariffs are enacted, then the hit to GDP would be a measly 1% because it would predominantly affect 15% of the GDP associated with imports. That would be the same level of impact as when oil prices rose to $80 a barrel from $40 in the pandemic years, but it didn't break the economy.

Stocks have jumped higher since May, as investors have grown more comfortable with the idea of ignoring most tariffs-related headlines to focus on earnings and economic data. The S&P 500 has added 7% over that period, while the Nasdaq Composite has climbed 11%.

However, one worry that investors are still contending with is a potentially unsustainable path for the U.S. budget deficit, amplified in recent days after the House passed the One Big Beautiful Bill, which includes provisions for the government to cut spending by little but boost tax breaks by far more.

Tesla chief executive and former DOGE leader Elon Musk joined those who oppose the bill on Tuesday, adding another layer of uncertainty over the bill's fate in the Senate. "This massive, outrageous, pork-filled congressional spending bill is a disgusting abomination," he said on X shortly before Lee's appearance on CNBC

Lee called this an event risk, but doesn't think it's a reason to justify turning structurally bearish. Such events might be tactical risks, but again they've been "buy the dip" opportunities, he added, which could lead to a melt-up rally.

He also defended his continued bullish stance on small-cap stocks, noting that they've had a rough go because of the Federal Reserve holding interest rates steady. "I know it's not been a great call, but small caps are still a second-half story," he said.

On Tuesday, small caps added 1.6%, outperforming the S&P 500's 0.6% advance.

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