

Quarter-In-Review – The second quarter got off to a shaky start after the administration rolled out their new trade policy on April 2nd. The main equity indexes in the U.S. briefly dipped into bear market territory, but sentiment quickly changed when it became apparent that the announced tariffs were just an opening salvo in what was likely to be a long and protracted process of negotiation. The idea that policy isn't set in stone and that the administration was sensitive to weakness in the stock and bond market basically emboldened investors all quarter.

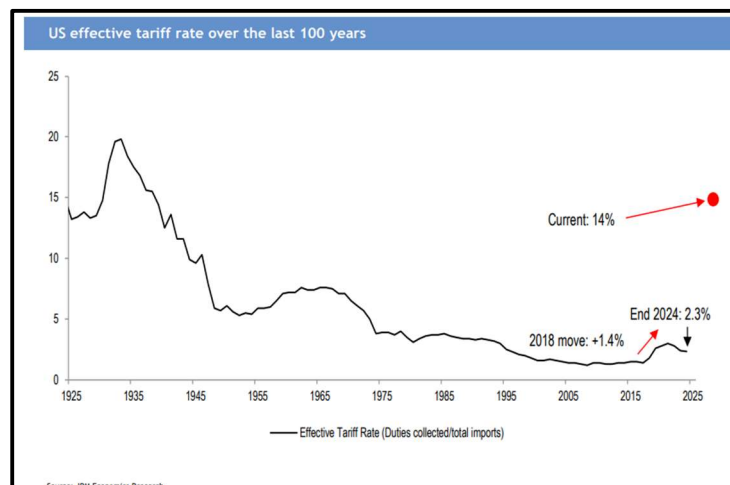
For the full period all the major equity indexes closed solidly in the black, with only REITS losing money over the three-months (-0.7%). Both international and domestic stocks performed well during the quarter, but international developed equities have materially outperformed their U.S. counterparts year-to-date. Tech stocks, and in particular AI related equities, bounced back solidly after struggling in the first quarter.

While some analysts contend that the delay in tariffs announced on April 9th was due to weakness in the stock market, the more likely catalyst for the change in policy was what was happening in the bond market. In early April you were starting to see real stress creep into the pricing of corporate bonds, and lower-quality issues in particular were hit hard. Just as importantly, liquidity in the so-called high-yield bond market was starting to dry up, potentially shutting off the credit spigot for many companies. This is the thing recessions are made of in the modern economy, and the Treasury Secretary, in particular, was apparently very sensitive to the turmoil that was unfolding. But as with the stock market, corporate bonds bounced back after the news on April 9th. High-yield bonds gained +3.7% in the second quarter, materially outpacing Treasuries. Intermediate-term government bonds added +1.4% during the quarter while short-term bonds picked up +1.1%. But as we will touch on below, there remains a tremendous amount of uncertainty regarding the direction of bond yields given the interplay between the evolving trade policy and trends in fiscal spending.

Market Benchmarks			
Market Indices	2Q25	YTD	3-Yr An
Global Equities	+11.4%	+10.3%	+17.0%
S&P 500 Index	+10.9%	+6.1%	+19.5%
Russell 2000	+8.5%	-1.9%	+9.9%
Int'l Index (EAFE)	+11.3%	+20.3%	+15.8%
Emerging Mkts	+9.5%	+11.7%	+9.2%
Other Indicators	6/30/25	3/31/25	12/31/24
Fed Funds Rate	4.25-4.50%	4.25%-4.50%	4.25%-4.50%
2-Year Treasury	3.72%	3.89%	4.24%
10-Year Treasury	4.23%	4.22%	4.57%
S&P 500 P/E Ratio*	22.0	20.2	21.5
Crude Oil	\$65.11	\$71.47	\$71.72
Core Inflation	2.7%	2.8%	2.8%
*Forward 12-month operating earnings per S&P			

Common Questions on Everyone's Mind – We talk to a lot of investors during a usual week, both large and small. They run the gamut from young families saving for college to large institutional investors managing multiple billions. What strikes us in these conversations is how everyone is grappling with the same uncertainty and asking very similar questions about what the future holds, especially as it concerns potential policy decisions. Allocating assets for the next three-to-five years depends not so much on assessing the state of the economy or the outlook for corporate profits given what we know now, but more building into our scenarios about the future and how different policy decisions might impact the fundamentals. Below we recap some of the most common questions we are receiving, and while we don't pretend to have all the answers, we offer our thoughts on each.

Does anyone know where trade policy in the United States will settle out at?



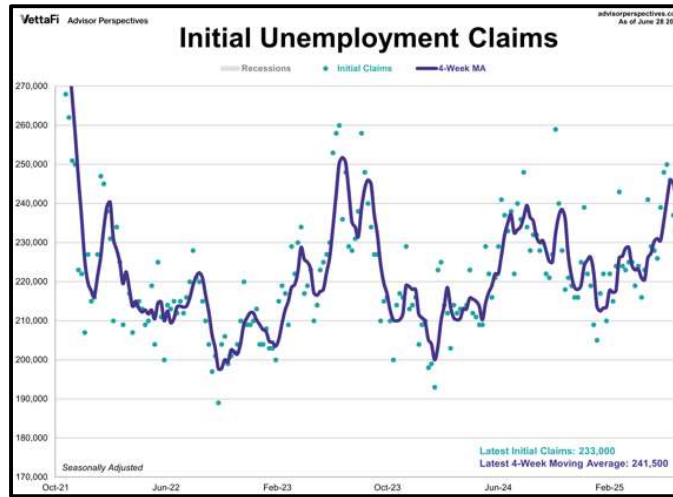
I think in this case, we have to admit we don't know. But then again, we suspect the policymakers themselves don't know either, so we aren't alone!!! The initial shock of 'Liberation Day' was in part the onerous nature of the new tariff regime, but contributing to the unease was the apparent rigidity of the proposal. Significant tariffs would be levied on friends and foes

alike immediately, with little apparent room for compromise. But this changed on April 9th when the administration signaled that everything was open to negotiation, the timeline was flexible, and policymakers were sensitive to jitters in the market. It's worth noting that the market rallied despite the fact that there's little prospect of the new tariff regime going away. As you can see from the chart at the bottom of page 1, today's effective tariff rate of roughly 14% far surpasses anything we've seen in modern history. Investors are coming around to the idea that the endpoint for this whole process is a blanket tariff rate combined with more onerous rates in certain sectors (think steel and aluminum) and on certain countries (China, ???). While much higher than historical levels, the markets (for now) are taking some comfort in the fact that the administration doesn't want to wreck the markets. Part of the fear in early April was the perception that the administration was in "damn the torpedo's" mode and didn't care what damage they caused to stocks and bonds. This is clearly not the case, and certain parts of the administration actually seem to care quite a bit, especially if the wrong policy choices lead to higher interest rates and greater difficulty financing the deficit.

Whatever the tariff regime proves to be, will we see a recession as a result?

We don't think this is the case, or at minimum, it's too soon to make that call. Granted, economic growth in the first quarter was marginally negative, but we shouldn't read too much into that. The contraction of -0.5% in the first quarter was largely due to a big increase in imports as businesses and consumers front-ran the change in trade policy. Consumer spending and employment held up just fine, and early data on second-quarter growth is pointing towards an expansion of 2% or more.

The U.S. economy really is a supertanker. Its natural state is one of expansion, and to move it off course takes an enormous shock to the system. So far, the change in trade policy is proving to be more of a headwind than a death knell. For example, as you can see from the chart at the top of the page, the jobs picture in the U.S. is softening modestly, but the U.S. economy isn't experiencing net job losses just yet.



Higher tariffs seem to be working their way through the system in a relatively predictable way. Once the initial surge of spending ahead of the levies abates, the economy finds a new lower equilibrium rate of growth based upon somewhat lower consumer spending, quite possibly significantly lower capital spending, and almost certainly lower hiring plans. Now, whether we see net job losses in the second half is unclear at this point, but it's far from a sure thing.

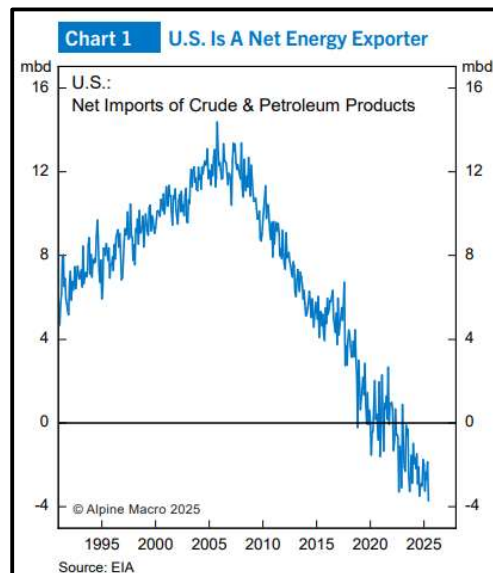
How can the markets be so calm after we just bombed Iran? I'm solely tempted to just sit in cash until things settle down in the Middle East.

We've been doing this for a long time, and for as long as we've been involved in the financial markets, the 'Iran Question' has always made the list of existential market threats. In years past, whenever someone published their year-ahead outlook or list of possible surprises, nine times out of ten Iran would fall into the negative column. But it's striking how this latest round of hostilities was almost over before it began. President Trump ordered the bombing of Iranian nuclear sites on June 22nd (after Israel had essentially eliminated Iran's air defense) and declared a "ceasefire" between Iran and Israel just 24 hours later. And while it is still hard to know the exact extent to which the American bombing campaign has degraded Iran's nuclear capacity, the term 'paper tiger' is being used more frequently when referencing Iran.

Almost certainly, the long-term obsession with Iran goes back to the oil embargo in the 1970s. The fact that Iran was always mentioned as a major risk was just another way of saying that higher oil prices were a threat to the global economy. But times have changed. As you can see from the chart below, the U.S. became a net oil exporter around 2020. For all the worry about Iran closing the Straits of Hormuz, this isn't the existential threat it might have been in 1978, at least for the U.S. China, on the other hand, has a bigger problem. Approximately 80% of their imported oil comes through this part of the world.

Bottom line: historically, taking a bearish position based solely on geopolitical risks has been a losing trade. We think that is still the case.

At the end of 2024 international stocks were despised. Now they are trouncing their U.S. counterparts. I feel like I



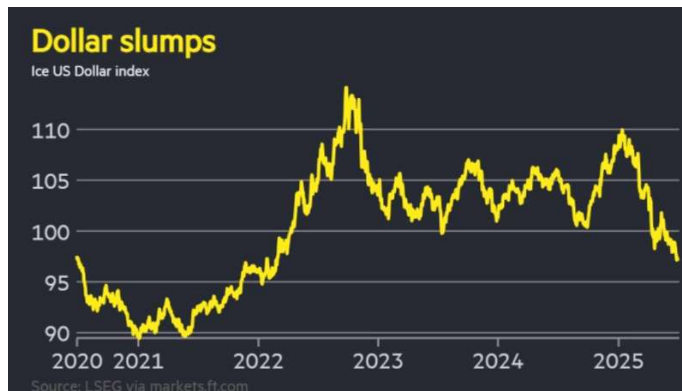
want more international exposure, but I acknowledge that I'm just chasing performance. What should I do?

It's always clear in retrospect, but rarely at the moment. We distinctly remember having conversations at the end of 2024 and the beginning of 2025 about why we even own international stocks. They had underperformed for so long and were 'clearly' going to lag forevermore. Of course, looking back, this was a sign that the performance league table was going to flip!!

But it is only fair to acknowledge up front that much of the reason international stocks have outperformed in 2025 is because the dollar has been so weak. In the first half of this year, the dollar index has lost -10.8% (see chart above). The euro is up +13.8%, the Swiss franc +14.4%, and the British pound +9.7%. This relative performance goes a long way towards explaining the performance differential of the EAFE index versus the S&P 500. What we haven't seen is twofold: 1) a meaningful outperformance of overseas earnings growth relative to the U.S., or 2) a major re-rating in valuations.

Skeptics will argue that little has fundamentally changed in the 'U.S. exceptionalism' theme, and that as soon as the dollar bounces back, domestic stocks will go back to their winning ways vis-à-vis their international counterparts. And this could very well be true - if the dollar bounces. But looking at the chart below, it is possible that we are only in the early innings of the dollar bear market. Triggers for more dollar weakness range from international investors choosing to diversify out of their concentrated U.S. holdings, Fed rate cuts sometime later this year, or renewed political dysfunction. But predicting currencies is awfully hard. For long-term investors, our recommendation is pretty boring and predictable - simply hold a diversified portfolio that includes some international stocks. There is a compelling valuation case to be made to hold them and they are a natural hedge against a continued bear market in the dollar. From our perspective, though, we may add to our international allocation at some point in the third quarter.

What does the U.S. budget mean for the markets? Surely, the markets are going



to riot at some point because deficits are too high.

This is the question people want to talk the most about, and seems to be a topic that transcends today's partisan divide. Rarely does any topic unite both sides of the aisle like angst over the deficit (at least when the opposing party is in power)!!

We won't delve into the details of the One Big Beautiful Bill Act (OBBA) that President Trump just signed into law. Needless to say, by making the 2017 temporary tax cuts permanent, this act normalizes 6% or higher budget deficits relative to GDP (see the chart at the top of the next page). The OBBA also virtually guarantees that public debt will rise relative to GDP for the foreseeable future, with most analysts thinking this number will increase to 125% by 2035 (today it sits at roughly 100%).

We have no great insights on this topic, but a few things jump out at us. First, despite the hyperventilating about this latest budget, there is very little interest on the part of voters about deficits and debt. Maybe this changes during the mid-term elections next year, but the average person cares little about abstract notions of fiscal sustainability, especially if addressing it means higher taxes or lower benefits. Thus, little of substance is likely to change unless a crisis forces it. Secondly, there is nothing about today's situation that indicates it isn't sustainable, at least over the intermediate term. The bond market has had plenty of time to digest the details of the OBBA, and interest rates have barely budged. The yield on the 10-year Treasury has traded in a tight range around 4.2% to 4.5% during the entire budget debate. If investors were really fretting about fiscal sustainability, it would show up in rising yields.

Third, we think the common view is that the fiscal situation in the U.S. ends with a bang – some 'out of the blue' shock similar to COVID or the financial crisis. But we suspect the ultimate path could be very different. For example, it's not unreasonable to think that annual interest costs could easily surpass \$1.5tn soon. To put this in perspective, the U.S. government takes in roughly \$5tn of revenues a year. We'd wager that there's some level of interest expense that triggers a policy response, and we might already be there. With Fed Chairman Powell due to step down mid-next year, there's a scenario where



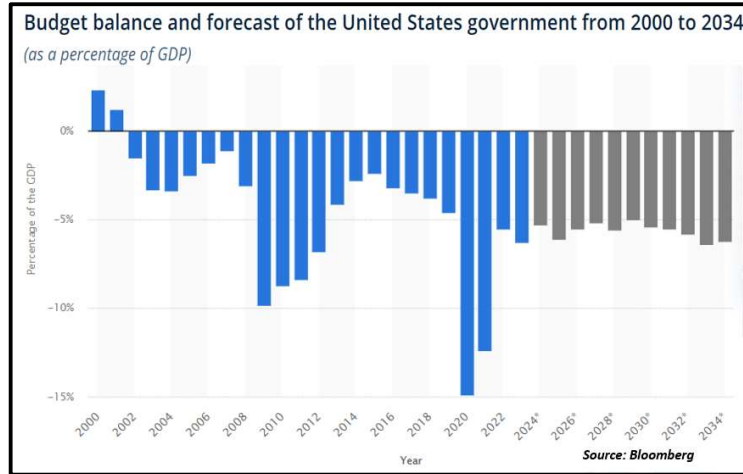
the President nominates a new Chairperson whose marching orders are to lower short-term rates to ease the interest burden. But such a move isn't without consequences, of course, and it would have both growth and inflationary implications. But if we had to guess, the next chapter in the eternal debt/deficit debate isn't some crisis of foreigners dumping their Treasury holdings, but an attempt to tinker with the system (maybe Fed independence?) to bring down financing rates.

Could the Fed really cut interest rates this year with inflation as high as it is?

Actually, yes. Even if the President doesn't do anything to put his thumb on the scales, it's quite possible the Fed cuts at least once this year, particularly if we see a month or two of net job losses. Inflation has been surprisingly well behaved (chart at the bottom of the page), and if it wasn't for 'Liberation Day,' it's likely the Fed would have cut in the second quarter. If inflation remains subdued, it's quite possible we will see a rate cut in October or December.

Then we have the issue of replacing Powell. His term ends in May 2026, but it's quite possible President Trump could nominate a favored candidate to the board before the year is out. If he tags this person as Powell's successor, this so-called 'shadow chair' could start directing market pricing, pushing expectations for future rates much lower than what is priced in today. What would this mean for markets? Time will tell, but stocks might initially view this positively, and the dollar could renew its decline and encourage investors to seek opportunities outside the U.S.

The fixed-income markets are trickier. Historically, lower



policy rates have been a tailwind for all sectors of the bond market. But if investors perceive that rates are being lowered for political reasons, they may start to embed a higher inflation premium in longer maturity bond prices. Again, time will tell.

Looking Ahead

Allocating assets today means making an educated assessment about many

things, but high on the list are 1) what ultimately happens with trade tariffs, and 2) how legislators around the world choose to deal with the rapid accumulation of government IOUs. Of course, no one can know with certainty, but we'd hazard a guess at three things. First, tariffs are going to be a fact of life for the foreseeable future. Populist governments around the world view them as a source of revenue and an extension of foreign policy goals, and this isn't likely to change over the next few years. Higher prices and less spending are the likely result. Second, policymakers seem to realize they can only push this theme so far before the markets riot. This means the markets don't have to price in the 'worst case scenario' the way they were in early April – think more volatility in the stock market rather than a renewed bear market. Finally, there is little political or voter desire to address fiscal deficits anytime soon. But this doesn't imply an immediate crisis. If anything, what has been a slow-burning issue continues to

simmer, and policymakers will almost certainly try tinkering with the system before making any hard decisions. We can't rule out interest rates being adjusted as much for political reasons as economic ones, and while the equity markets might initially greet the move favorably, we continue to think fixed income investors need to be cautious.

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