**QUARTERLY REVIEW & OUTLOOK** **Q2-2025**

*"In investing, what is comfortable is rarely profitable."*

*Robert Arnott, Founder of Research Affiliates*

As we round out the second quarter of 2025, it's clear the market has managed to climb a wall of worry—and then some. The rally over the last three months has been helped by a key development: tariff threats that had loomed heavily over investors were delayed, easing pressure and giving both the markets and participants room to breathe. Another important tailwind has been the weakening of the U.S. dollar. While not great news for your European summer vacation budget, it's a boon for large-cap companies, especially those in the S&P 500, where approximately 40% of revenues come from overseas. A weaker dollar makes U.S. goods more competitive abroad and boosts reported earnings when foreign sales are converted back to dollars.

We've also seen a "pull forward" effect in demand, with both companies and consumers racing to make purchases ahead of potential future tariffs. One notable example includes logistics-driven decisions by major firms to expedite inventory movement, a reflection of economic agility in response to trade policy uncertainty. While the tariff issues are far from being resolved, we're seeing signals that additional trade deals may be negotiated. However, if additional tariffs are imposed, this could contribute to inflationary pressures. The cooling housing market and a recent decline in job openings could help offset these worries.

On the policy front, expectations are building around potential interest rate cuts by the Federal Reserve. While an immediate shift isn't anticipated, the broader direction seems clear. Markets are beginning to price in rate reductions later this year or into early 2026. That would offer supportive conditions for both equity and fixed-income assets. Meanwhile, a record $7 trillion remains parked in money market funds—capital that could reenter risk assets rapidly if rate cuts are confirmed or market volatility creates attractive entry points.

Naturally, some headwinds remain. U.S. federal debt now exceeds $36 trillion and continues to grow. The cost of servicing this debt, previously around 2% in 2022, is expected to more than double, potentially consuming 15% of government spending. This would place it just behind major entitlements like Social Security and healthcare programs. Policymakers are targeting higher GDP growth to counterbalance this challenge.

While recent developments have created a more favorable market backdrop, uncertainty remains a constant companion. Trade negotiations could still falter, leading to abrupt policy reversals or renewed tariff escalations, which would weigh on corporate margins and consumer sentiment. The trajectory of inflation also poses a risk, especially if it proves stickier than anticipated and delays the Federal Reserve's policy pivot. Geopolitical tensions and elections, both domestic and abroad, add another layer of unpredictability, potentially impacting investor confidence. And while the rapid deployment of capital from money markets could provide fuel for further improvement, it also heightens the risk of

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overextension if earnings growth fails to meet elevated expectations. Prudent positioning and flexibility will be key in navigating these crosscurrents.

With this said, we remain cautiously optimistic. Corporate earnings for the second half of 2025 should benefit from the early demand pull-in we've witnessed this quarter. If rate cuts materialize later this year or in early 2026, they could offer meaningful support to financial markets. The recent rally may take a breather, but with steady earnings, improving trade policy signals, and easing monetary conditions, there's room for continued progress in the months ahead.

Please reach out any time with questions or to discuss your portfolio further.

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