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First Half Review and Investment Outlook

July 2025

As we enter the second half of the year and despite increased uncertainty, global economies remain surprisingly resilient, due to continued strength in government spending, labor markets and consumption, among other factors.[1] Capital markets have recovered significantly from their lows in April, when the U.S. administration announced much higher tariffs than had been expected.

Nevertheless, for several reasons we believe that the odds of a mild recession or a period of stagflation have increased. In the U.S., monthly inflation readings remain stubbornly above the Federal Reserve's 2% target, inflation expectations have moved higher, and the financial position of moderate-income households appears to be deteriorating. Furthermore, we are cognizant that the negative economic impact of trade shocks can take up to 12 months to materialize.

Major Asset Class Indices[2]	Total Return First Half 2025	Total Return Last 12 Months
S&P 500 (U.S. Large Cap Stocks)	+6.2%	+15.2%
MSCI EAFE (Foreign Developed Large Cap Stocks)	+19.9%	+18.3%
Bloomberg Aggregate Bond Index (U.S. Investment Grade Bonds)	+4.0%	+6.1%
US Short-Term Treasury Bills (Money Market Fund)	+2.1%	+4.5%

The first half of 2025 saw positive returns across most asset classes, albeit with considerable volatility in the case of U.S. stocks. Inflation has remained lower than feared and economic growth has come in higher than forecasted. Foreign assets were helped by a weakening U.S. Dollar, which has declined approximately 10% on a trade-weighted basis over the past six months. Foreign stocks also benefited from better growth in some overseas economies and lower starting valuations.

The point-to-point returns over the first six months of 2025 belie significant volatility. From its February peak the S&P 500 declined almost 20% in April, as tariffs announced on April 2nd fueled recession fears. Since then, investors have tried to analyze the impacts of a constantly changing set of tariff policies, which as we write are far from settled. We view the policy uncertainty emanating from Washington as a significant risk for both equity and bond investors. Despite this risk, as well as conflicts in the Middle East and the growing federal deficit, U.S. stocks have essentially returned to their all-time highs. Investors collectively appear to view these risks as manageable, transitory, or perhaps beyond the increasingly short time horizon of momentum-driven investors.

When any investment delivers exceptionally strong returns – especially over an extended period – it is easy to get caught up in the excitement. We believe, however, that over the long term successful investors keep an eye firmly on two things. The first is valuation, as studies have shown that the price one pays for a stock (as expressed as a multiple of earnings) is a good predictor of long-term returns. The second is risk. As share prices rise faster than earnings, they become increasingly vulnerable to a number of factors. High expectations may not be realized, rising interest rates (especially due to accelerating inflation) tend to hit stock prices harder, and any shock to the system, be it financial, political or due to some other factor, is more difficult for the stock market to tolerate.

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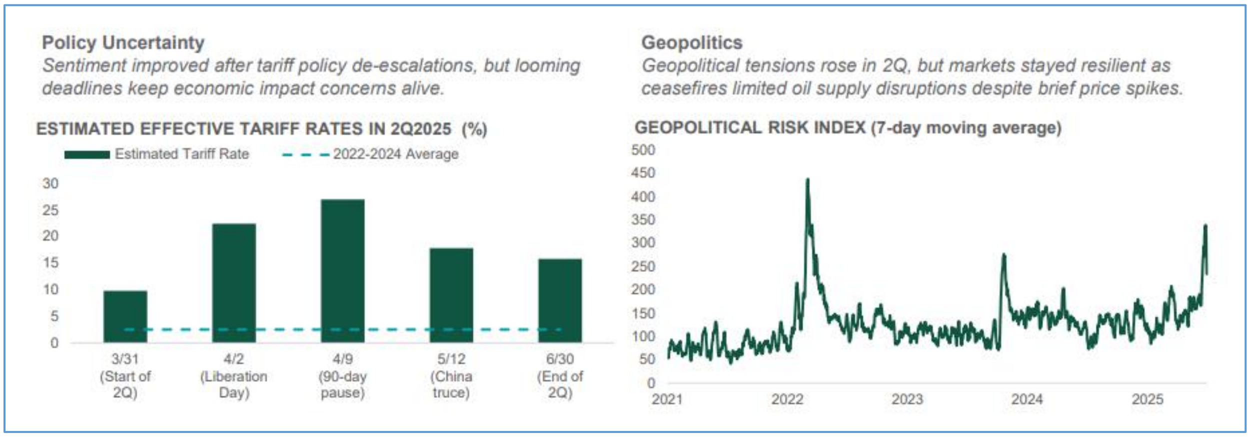
[1] We note, however, that in its April *World Economic Outlook* the International Monetary Fund reduced its estimate of 2025 global GDP growth from 3.3% to 2.8%. Additionally, Northern Trust note there are signs of "weakening around the edges" in labor market.

[2] The S&P 500 Index is a broad measure of U.S. large capitalization stocks; the MSCI EAFE Index (Net) is a broad measure of mid-large capitalization stocks in developed international markets; the Bloomberg U.S. Aggregate Bond Index is a broad index of U.S. investment grade bonds; the 90-Day U.S. Treasury Bill represents short-term government money market funds. Returns are provided by sources deemed to be reliable but are subject to change or revision.

Bullish market sentiment is based mainly on the fact that corporate earnings growth forecasts remain intact, although when compared to prior years the pace is expected to slow. Retail investors continue aggressively adding to stock exposure, and artificial intelligence is a key investment trend, with expenditures in this area increasing substantially.[3] Ultimately, optimists are counting on AI significantly increasing productivity and economic growth, but to date AI-enabled products have had a negligible impact on corporate profits.

We believe that investors are not giving sufficient weight to the risks outlined above. U.S. large cap stocks have performed extremely well, expectations are high, and the S&P 500's P/E ratio is well over 20 times the consensus earnings per share estimate. We have recently lowered recommended equity allocations, and we would be aggressive in rebalancing as stock exposures rise above strategic levels. Furthermore, we expect market volatility to remain elevated throughout the remainder of the year, due to heightened economic uncertainty and geopolitical turmoil. Longer term risks abound, including U.S. budgetary deficits.



While timing the impacts of policy changes on global trade, immigration enforcement and taxes is extremely difficult, negative effects often take several months to materialize. Commentators have noted that, with the massive federal tax and spending bill having passed and stocks essentially at an all-time high, there is greater risk that the administration will be emboldened to take a hard line on tariffs. In sum, although a host of potential negative market catalysts swirl around them, investors appear reluctant to discount the harm they could inflict.[4]

Looking at the intermediate to longer-term, we do not believe that the next decade is likely to see a repeat of the 13.5% annualized return produced by the S&P 500 over the last ten years, nor of the outsized gains by a handful of mega-cap technology stocks. Thus, investors with long time horizons should be mindful of how expensive the largest U.S. stocks have become – and that, relative to the recent past, attractive low-volatility alternatives such as U.S. Treasuries and money market funds are available. Our investment approach centered, upon risk-management, has in this market cycle led to more modest returns, but we believe this is prudent given that risks have increased materially. Above all, we remain focused on our long-term goal of participating in market rallies while limiting exposure to significant declines.

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[3] Including $75 billion in *higher* AI-related investments this year at only four companies (Alphabet, Amazon, Meta, and Microsoft).

[4] The June 20th piece by *Financial Times* columnist Gillian Tett was entitled "Markets are silent – that is worrying" and used the analogy that "markets are not grappling with a single 'heart attack' shock (as during the Covid-19 pandemic) but a spreading economic cancer, in the form of metastasizing uncertainty around future hurt. This is not 2020."