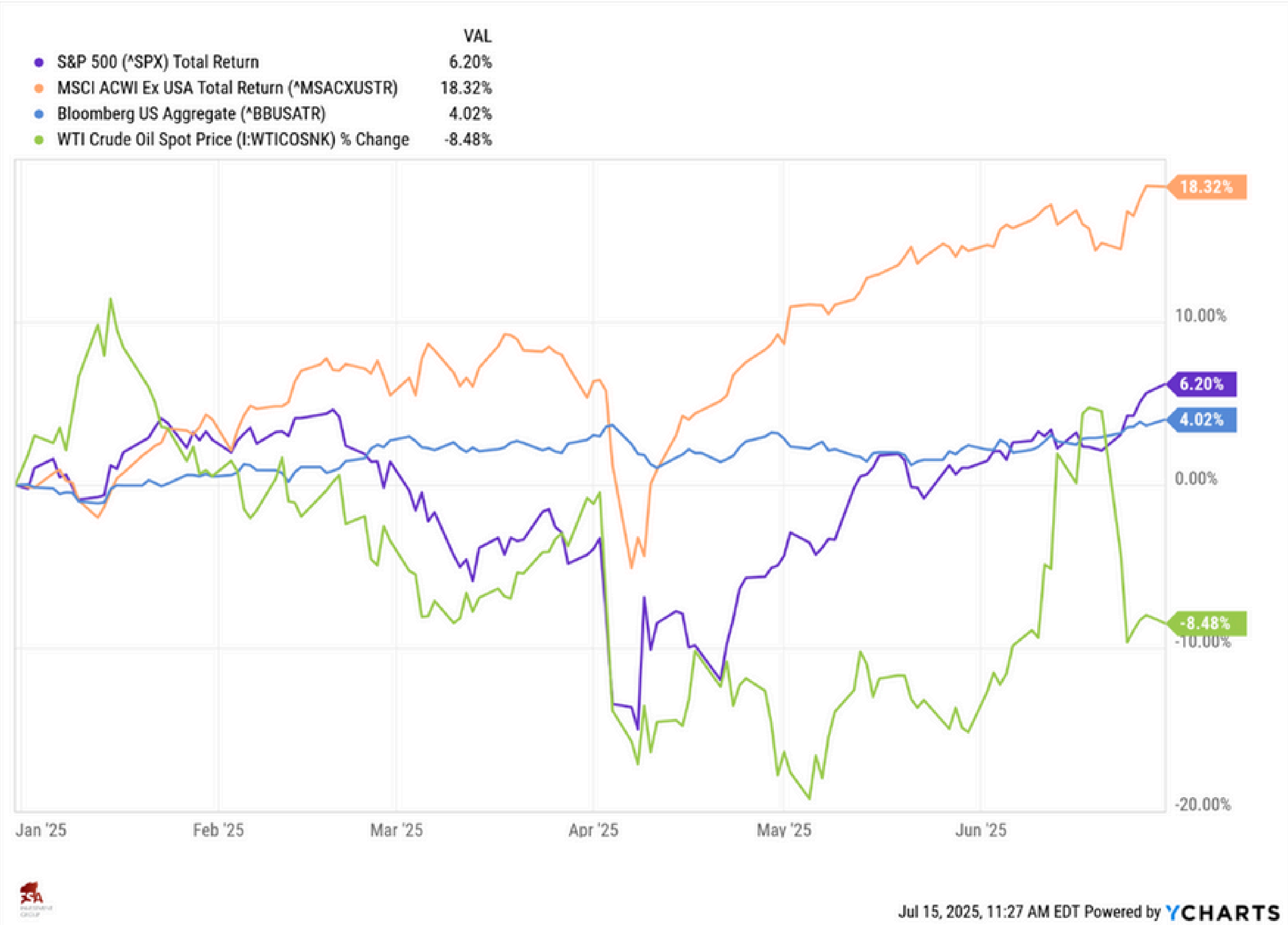
FSA INSIGHTS

QUARTERLY MARKET UPDATE: Q2 2025

Imagine being told that in just three months:

1. Fears of a global trade war would erupt;
2. Budget negotiations would stall, risking a $400 billion cost to taxpayers;
3. The last AAA credit rating on U.S. debt would be downgraded;
4. A hot war would breakout between Israel and Iran; and
5. The U.S. would strike three of Iran's nuclear enrichment sites.

Who would have guessed that, despite all this, the S&P 500 and NASDAQ would hit new all-time highs, Treasury yields would fall, the dollar would drop 10%, and oil prices would decline year-to-date?



Source: Ycharts, Jan 1 – June 30 2025: 1: S&P 500 Index Total Return; 2: MSCI ACWI Ex-US Index Total Return; 3: Bloomberg US Aggregate Bond Index Total Return; 4. WTI Crude Oil spot price

At the onset of the quarter, the market experienced new lows, falling 19% from its February high. As the market was bottoming, we sent out a letter called "Should I Stay or Should I Go" and discussed why investors should rebalance portfolios and remain invested. This was a good call as the market had its fastest recovery following a 15% correction in history. While we never know if any pullback will be short-lived or the beginning of a bigger downturn, history shows that the stock market recovers from downturns, and most sound investment strategies are built to withstand volatility, even sharp pullbacks.

Investors seem to have come to the conclusion that with Trump, everything is a negotiation and there are no loyalties to previous conventions. While there remain a lot of questions on trade deals with individual countries, it does seem that the worst tariff-related fears have subsided, and markets have rebounded. As we look to other potential policy risks, the Big Beautiful Bill, while subject to much debate and scrutiny, should provide a boost to the U.S. economy in the form of fiscal stimulus, especially as it relates to capital spending. From a monetary policy perspective, it has been over 8 months since the Federal Reserve has cut interest rates, and many expect the next cut is just around the corner. While we have seen the rate of inflation subside with gas prices hovering lower, we are not so sure the Fed is in a hurry to cut rates. In fact, we think it's important to note that 7 of the 19 members of the FOMC see no need for a cut in the Funds rate in 2025, although this expectation is tempered by the futures market, which is implying more than an 80% probability of two and a half cuts by the end of the year. With the market continuing to rise, investors are betting on an easing of monetary, fiscal, and regulatory conditions that justifies the S&P's nearly 23x forward multiple. It can be easy to forget that stock prices are a function of both interest rates and earnings. In this regard, expectations are somewhat lackluster in the short-term. Currently, the consensus sees earnings growth for the second quarter at only 6%, down from the 10% expectation at the start of the quarter. With animal spirits growing, further multiple expansion cannot be ruled out, especially as it looks that economic data will be soft.

At the halfway point of 2025, we believe that now is a time to focus on diversification in portfolios. It's important to stay invested, stay active, and diversify portfolio exposures across regions, sectors, and asset classes. During the quarter, we paired back some of our US exposure in favor of cheaper international equities and global infrastructure. These asset classes also have much higher dividend yields which provides an extra layer of support for client portfolios. Furthermore, we are monitoring other asset classes that have not performed as well, including real estate. If Trump gets his way and rates decline substantially in 2026, then this asset class should perform well. We believe proper asset allocation and diversification in line with investors' time horizon and risk tolerance are essential considerations when constructing a portfolio. Diversification remains important both across and within asset classes. Investors can help increase their chances of achieving their goals by focusing on time in the market rather than timing the market and ignoring outside noise such as politics and news headlines.

We appreciate your continued trust and partnership. Should you have any questions or wish to discuss your portfolio in greater detail, please do not hesitate to contact us.

Respectfully,

Andy Webb
Chief Investment Officer

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