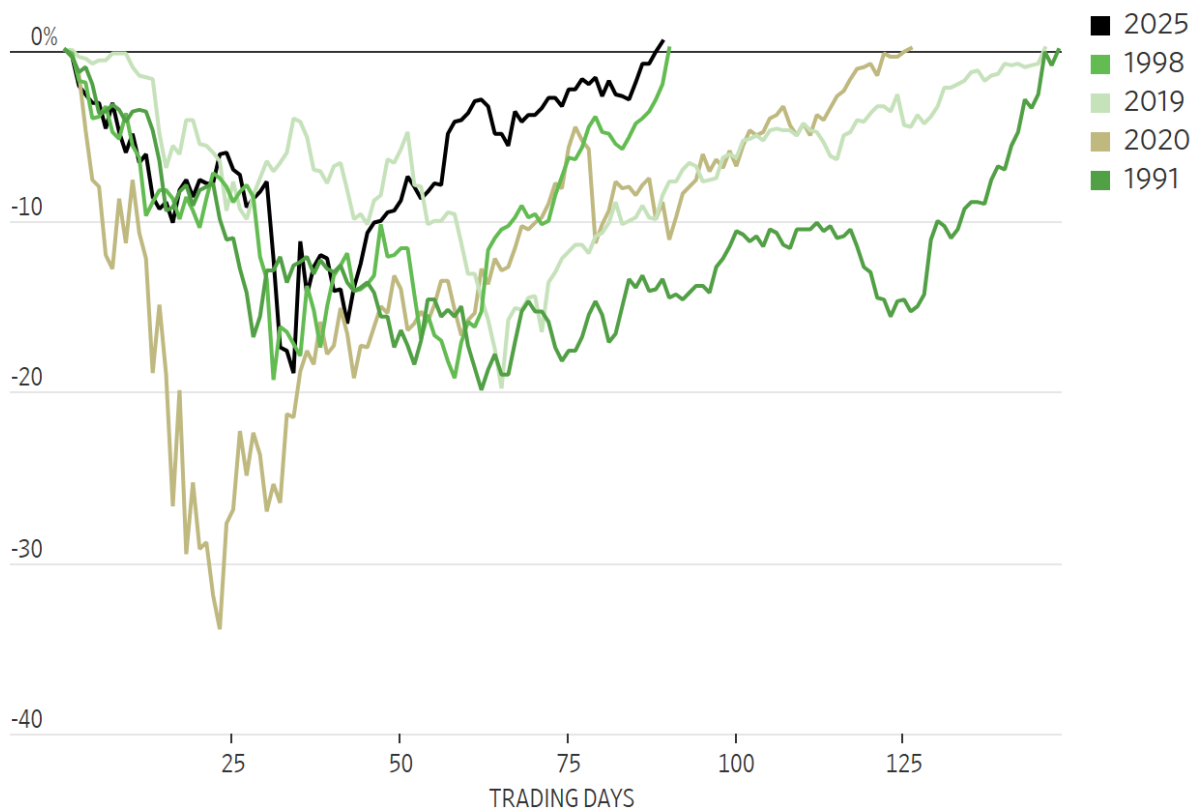


July 2025

Dear Clients and Friends,

Markets went on a rollercoaster ride in the second quarter with an extraordinary number of events and crosscurrents occurring. President Trump's "Liberation Day" tariff blitz sent stocks careening lower when the size and breadth of the tariffs was much more than expected. The 15-20% plunge in early April had forecasters calling for a new bear market and a certain economic recession. But a couple of days of near-crisis in select bond markets seemed to lead the President to backtrack on the tariffs. From there, tariff talk mostly cooled, uncertainty ebbed, and stocks launched the fastest rebound in their history (see chart below).

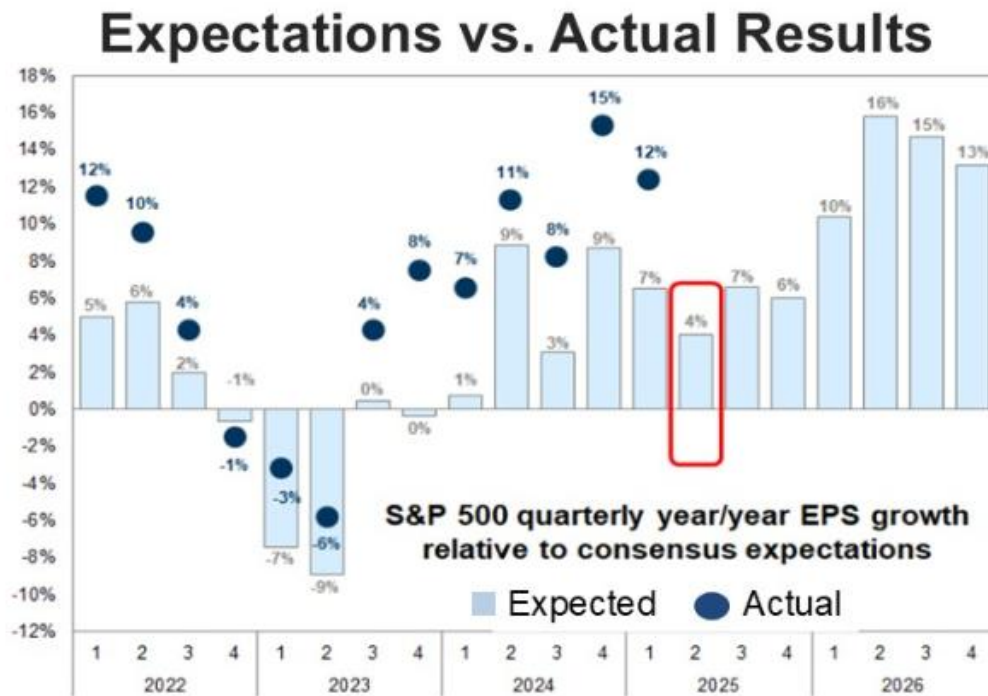
S&P 500's quickest recoveries to records following a decline of at least 15%



Source: Dow Jones Market Data

Throughout May and June, tariffs had moved clearly to the backburner. Market participants came to believe that the U.S. and China would avoid significant trade disruption. Investors turned their focus back to when the Federal Reserve will cut interest rates. Trump continues to pressure the Central Bank to ease rates while the Fed points to the unknown impact of tariffs and a possible resumption of growing inflation as a justification for waiting. The market seems to have settled on the first cut in September as of now.

Supporting the rapid market recovery was a strong earnings quarter from the market's largest companies. The increasingly broad-based strength in earnings also helped investors set aside tariff concerns. While it's widely believed tariff impacts are yet to come, projections of the overall magnitude have shrunk markedly. This chart shows the substantial earnings growth expected once interest rates begin falling.



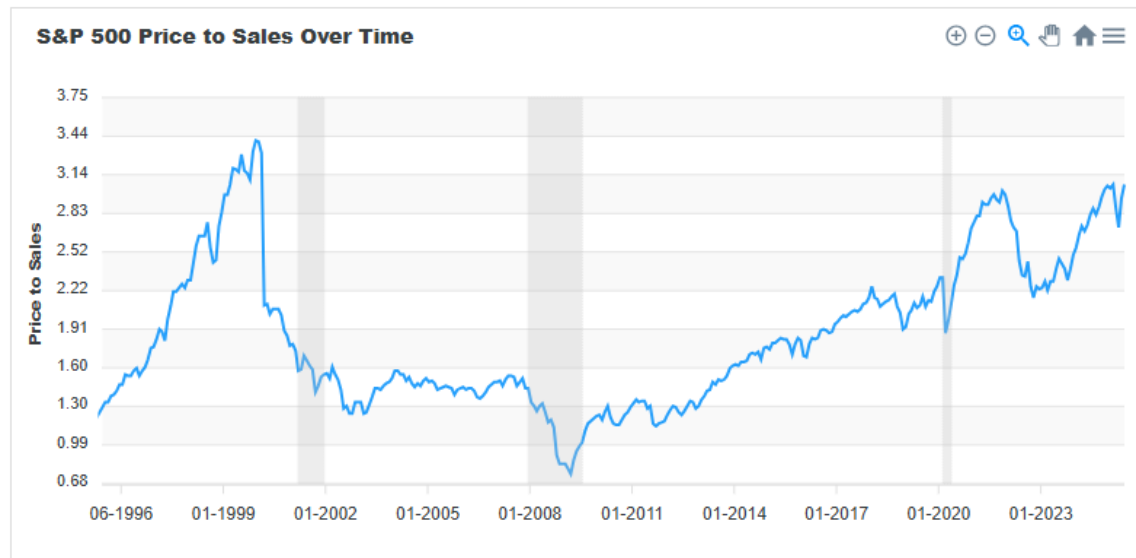
Source: FactSet, Goldman Sachs Global Investment Research

While the above topics were the most influential in the second quarter, there was much more for investors to consider. President Trump's first budget and the preceding work of Elon Musk's DOGE initiative kept longer-term interest rates higher than they might have been while also pressuring the U.S. dollar to its worst quarter in decades. The budget process also reignited the long-simmering debate about how much debt is too much for the U.S., another factor possibly keeping interest rates higher. Finally, there was the Israeli and U.S. airstrikes on Iran and the Iranian response. That event sent oil prices spiking higher for about a week before they dropped back quickly as the potential for an escalating conflict failed to materialize.

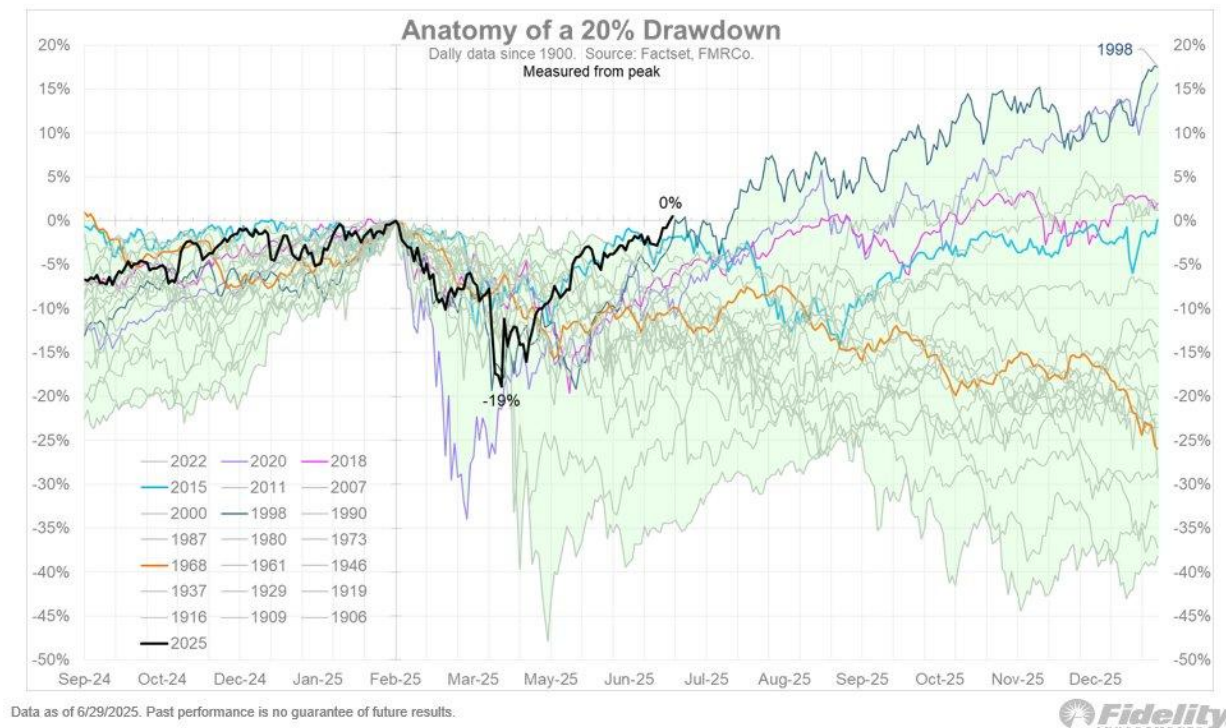
All in all, it was a remarkable quarter for markets with stocks so quickly recovering from near-disaster to achieve fresh record highs. The resilience of investors has been impressive. As the quarter came to an end and the calendar turned to July, the stock market was in full-on bull mode with the rally expanding to include lagging small caps and other higher-risk areas of the market.

Of course, with such a dramatic rebound, stocks have once again become expensive while the impact of tariffs begins to flow through the economy. It's certainly possible that investors have become too complacent once again and that they are mispricing the risks ahead.

To that end, PIMCO, one of the world's largest asset managers, in a note to clients, stated that stock valuations are hovering at levels that have "historically preceded major corrections." To their point, looking at the chart below, sales multiples for the S&P500 have now reached a level that has previous augured downturns greater than 20%.



Bespoke Investments noted last week that the 3-month period starting 7/15 is the weakest 3-month period in the year. Their note was bolstered by Fidelity Investment mapping of this year's returns versus historical returns which indicates that stock indexes are more likely to fall than rise given the recent bounce.



Going into the second half of the year, the bullish case says that the Fed will begin cutting interest rates, inflation will remain tame as tariffs will have a minimal impact, earnings will hold up better than expected and economic growth will remain a solid 2-3%. In short, there will be no notable disruptions to force investors to back off.

The bearish case posits that foundational cracks are beginning to appear in the economy. A weakening labor market will keep consumer spending flat, as it has been for almost a year. The lagged effects of the tariffs will keep inflation stubbornly high, leading the Fed to continue being reluctant to lower interest rates. With bulls relying on lower interest rates as fuel for a second half 2025 rally, markets will fall back.

Regardless of which scenario plays out, we will continue focusing primarily on managing risk in pursuit of returns, especially in such an uncertain environment.

To future profits,


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