

QUARTERLY MARKET REVIEW

SECOND QUARTER 2025



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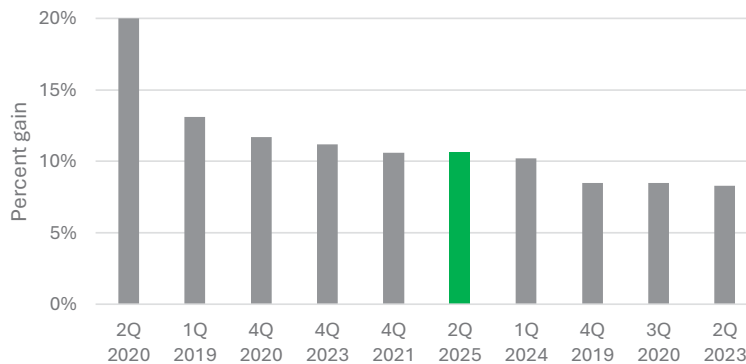
JULY 16, 2025

Separating the Signal from the Noise: Navigating Trade, Growth, and Earnings

The second quarter of 2025 was an uncomfortable ride for investors, but for all the chop and churn, markets have actually been resilient. In a departure from the last 15 years, and a welcome reward for diversified investors, the key contributor has been non-U.S. stocks. Year-to-date, the EAFE International Developed Index has risen +19%, the MSCI Emerging Markets Index +15%, and the S&P 500 a solid +6%.¹

The quarter began with a sharp drop in early April that pushed the Nasdaq Index into bear market territory - a decline of 20% or more from its high. However, by quarter-end, the Nasdaq and the S&P 500 closed at new highs, the latter posting its sixth-best quarterly return in the past decade rising 10.6%.

S&P 500 Index Quarterly Performance 2015-2025



Multiple factors contributed to the early-quarter decline. The White House stoked economic growth and inflation concerns with the rollout of its tariff plans, geopolitical turmoil intensified as tensions rose in the Middle East, and analysts worried that corporate earnings would suffer. Although U.S. equity markets have looked past initial concerns, economic growth and corporate profitability continue to be at risk amid persistent policy uncertainty.

Trade Policy

The details of the Administration's tariff plans released on April 2 caught both Wall Street and Main Street by surprise. Leading up to the event, many strategists expected a uniform tariff (or 'levy') of around 15% to 20%. Instead, the levies presented varied drastically from country to country and were overall much higher than anticipated. Strategists began to incorporate both upside and downside scenarios of the initial tariffs into their market outlooks, while momentum investors—like hedge fund managers—focused on the vast uncertainty ahead and began raising cash.

Soon after the initial announcement, the White House appeared to shift gears as policymakers began to dial back their previously harsh rhetoric. Just one week later, Trump administration officials said they would delay the implementation of new levies, giving trading partners time to negotiate deals, and instead move to a 10% universal tariff—excluding China.

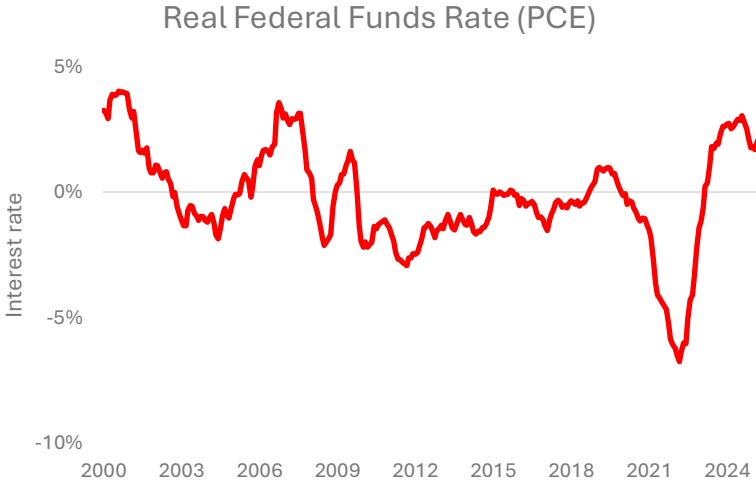
Policy tensions have continued to ease over the last few months. The U.S. recently signed framework trade deals with the U.K., China, and Vietnam with lower tariff levels than initially suggested. As these conversations progress, investors are focused on a continuation of lower-than-expected tariff levels across key trading partners – including Canada, the European Union, India, Japan, and Mexico, among others.

Central Bank Policy Support

During the first half of the year, central banks outside the U.S.—including the Bank of England, European Central Bank, Reserve Bank of Australia, and Swiss National Bank—cut interest rates. They cited concerns about economic growth related to trade tariffs. These policymakers want to ensure continued support for household and business spending.

While the Federal Reserve has not lowered borrowing costs so far this year, it has reiterated it is prepared to do so. While testifying before Congress in mid-June, Chair Jerome Powell said the Fed would be easing rates if not for the uncertainty of tariffs. He stated policymakers would like to wait until there is more certainty around policy decisions to assess potential effects on both economic growth and inflation.

Based on the current real rate of interest (effective federal funds rate minus inflation) the Fed has plenty of cushion to make such changes.



The effective federal funds rate has remained at 4.4% since our central bank last eased in December. Based on the personal consumption expenditures (PCE) measurement, headline inflation growth is 2.3%, which puts the current real rate of interest at 2.1% (4.4% minus 2.3%). In theory, we could see 210 basis points of rate cuts before borrowing costs become neutral to economic growth, whereas today they are relatively impeditive.

The Economy

Domestic growth has weathered the storm thus far. In the first quarter, gross domestic product (GDP) contracted by 0.5% on a seasonal adjusted annual rate basis due to companies rushing to buy overseas goods ahead of the tariff onset. However, the trend is expected to reverse itself with the release of second quarter growth. According to the Atlanta Fed's GDPNow estimate, the U.S. economy should experience an increase of 2.6%. Additionally, the latest Summary of Economic Projections from the Federal Reserve states that policymakers expect full year economic growth of 1.4% for 2025, 1.6% for 2026, and 1.7% for 2027.

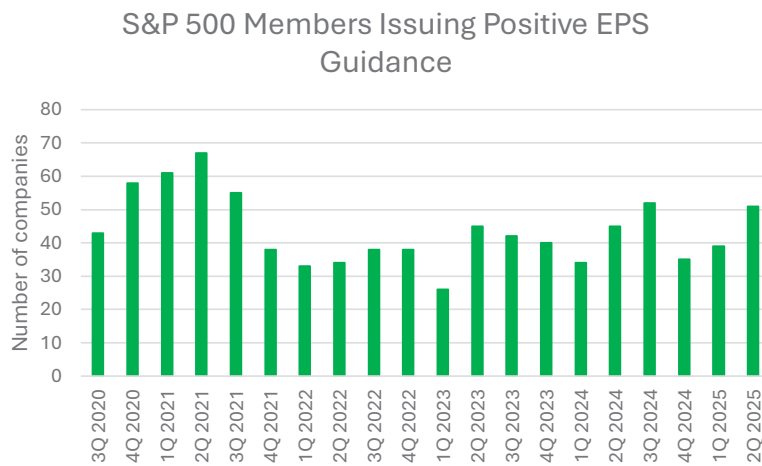
Evidence of this can be seen in the labor market. In 2025, monthly average job gains have been just over 130,000, even with weakness in the first few months. During the second quarter, the average monthly gain increased to 150,000, compared to 111,000 in the first quarter. The shift is notable considering that hiring trends over the last decade show employment tends to decelerate during this time frame.

Despite initial calls for a surge in inflation, price growth is still showing a downward trend. The latest PCE growth rate of 2.3% for May is below the 2.6% growth rate at the end of last year. In addition, the 2.4% increase in May for the consumer price index (CPI) has eased from the 2.9% increase in December 2024. Declines in the cost of energy and slowing rent growth have been major contributors to this trend.

Corporate Earnings

Lastly, the corporate earnings collapse that had been predicted has yet to materialize. Leading into first quarter reports, analysts lowered their estimates by 4.2%. The major concerns were potential damage from tariffs and speculation that infrastructure buildout expectations related to artificial intelligence were sensationalized. However, across the earnings season, 78% of companies reported better-than-expected earnings while 64% beat revenue expectations. In addition, overall net profit margins were 12.7% compared to the five-year average of 11.8%.

Forward-looking guidance from management teams further support this trend. During the first quarter, 51 companies issued positive EPS guidance compared to 39 the quarter prior and the five-year average of 44. The shift is noteworthy considering companies typically wait until after the first quarter to raise or lower guidance because they have a better sense of how their business is operating in that given year.



One of the key drivers of the increase to forward-looking guidance was artificial intelligence demand. Major cloud and data storage companies like Oracle, Microsoft, and Amazon said they are still having trouble keeping up with customer demand. Speaking to how strong their pipeline is for AI, Oracle Chair Larry Ellison stated one of their customers said it will buy all of the data center capacity Oracle can produce. Larry said he had never seen anything like it in his 48-year tenure at the company. The statement speaks to the earnings power and multiple expansion potential for technology companies moving forward, which could act as a tailwind for both the S&P 500 and Nasdaq Composite.

In Summary

Despite a volatile start, the second quarter of 2025 reinforced a core investing philosophy: resilience often follows uncertainty. While tariffs, inflation, and geopolitical tensions stirred headline risk, the underlying economic and corporate fundamentals proved sturdier than expected. Global central banks responded with supportive policy, trade negotiations evolved constructively, and earnings outperformed expectations.

With equity indices notching fresh highs and economic indicators pointing to continued growth, albeit moderate, we believe this environment offers a compelling backdrop for long-term investors. Risks remain, but by keeping a steady hand and focusing on fundamentals, investors can take advantage of volatility rather than fall victim to it.

As we head into the second half of the year, we remain cautiously optimistic. Opportunities lie ahead—not only in cyclical recoveries but in structural themes like technological transformation and international collaboration. In short, patience and perspective remain valuable assets.

As always, we appreciate the trust and confidence that you place in us.

Sincerely,
Your Sargent Investment Team

¹ Orion Advisor Solutions. *Blended Benchmark Performance*. 30 June 2025.

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