Investment Commentary June 2025

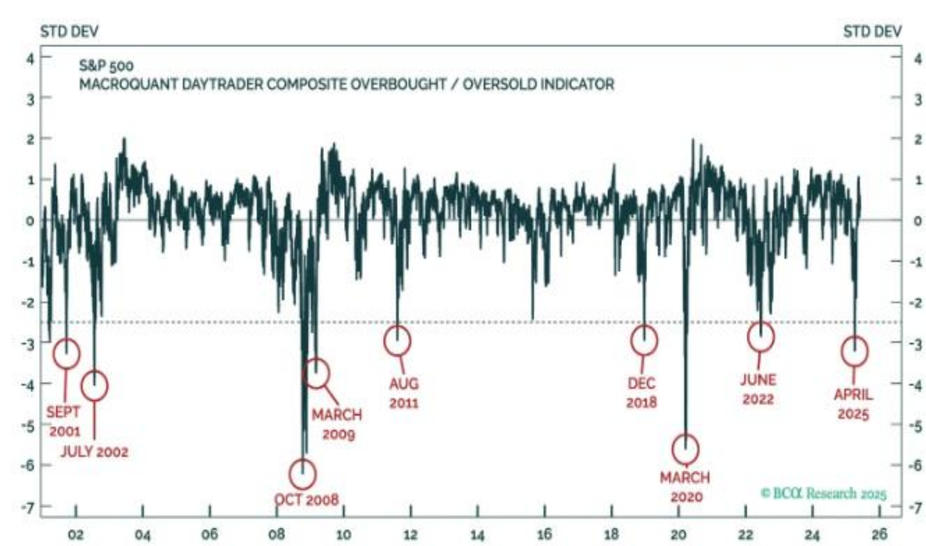
Markets extended their recovery in May, building on April's lows as consumer sentiment improved and trade tensions eased. Progress in U.S. trade negotiations with the European Union (EU) and a temporary delay to planned tariff hikes reduced fears of a global recession and led to broad-based gains for risk assets.

- The S&P 500 snapped back in May from oversold levels and returned 6.3%. Small-cap stocks reversed their downtrend and finished the month up 5.3%.
- The advance in the U.S. was led by technology stocks, which climbed 10.9% in May. Year to date, technology stocks have recovered most of their losses and are only down slightly. The top performing sectors year to date have been utilities, consumer staples, and industrials, all up in the high single digits.
- Foreign developed market stocks continued to perform well in May, with the MSCI EAFE up 4.7%. Year to date, foreign stocks are outperforming U.S. stocks by about 16%. Emerging market stocks also had a strong month, up 4.3%.
- Core U.S. bonds were down 0.7% for the month as interest rates rose on optimism that the trade wars would settle down.
- As we enter June, uncertainty regarding the economy, trade, and financial markets remain elevated. The next few months should give us a good read on the impact of the Trump administration's policies.

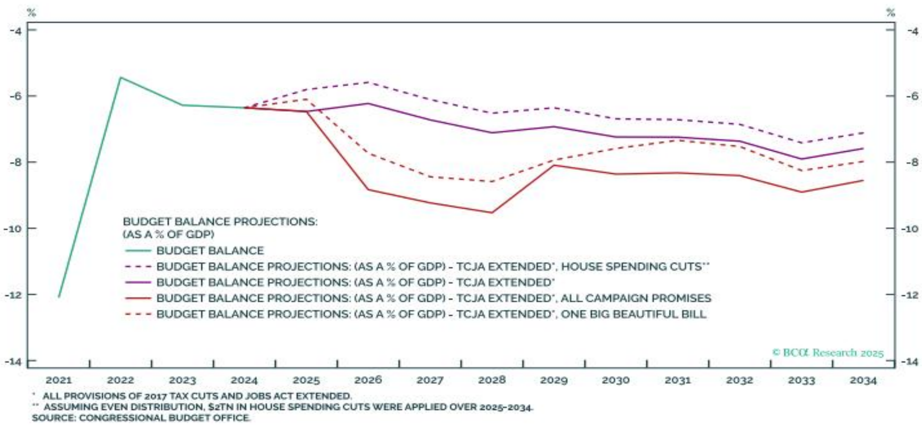
Below, we share some thoughts on the current market environment and things we are watching closely.

Thoughts on Recent Market Performance and the "BBB"

Stocks Were More Than Three Standard Deviations Oversold In Early April



Markets have staged a remarkable rally and recovered most of the losses from 'Liberation Day' back in March. The chart to the right indicates that the U.S. stock market became 3 standard deviations oversold in April, a level that does not occur often. In fact, it has only happened nine times in the past 25 years, and each time, the markets have snapped back relatively quickly. The oversold conditions have been unwound, and the snapback rebound appears mostly complete. Going forward, the main driver of market performance will be driven by economic and stock market fundamentals. We expect uncertainty to remain high regarding policy and fundamentals, suggesting that markets may get choppier from here.

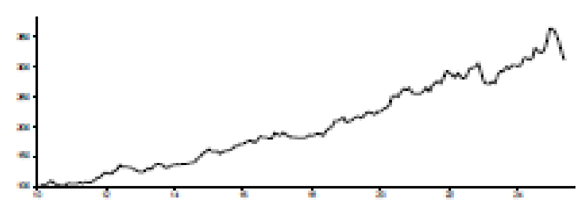


The republican controlled House of Representatives has passed a version of the Big Beautiful Bill (BBB), and it has moved to the republican controlled Senate to be ratified. In its current form, it is not likely that the BBB will be approved by the Senate. If you look at the chart to the left, it is easy to see why. All variations of the BBB are projected to add massively to the budget deficit and the national debt. The situation is likely to get messier before it gets resolved and may have significant impacts on the financial markets and mid-term elections next year.

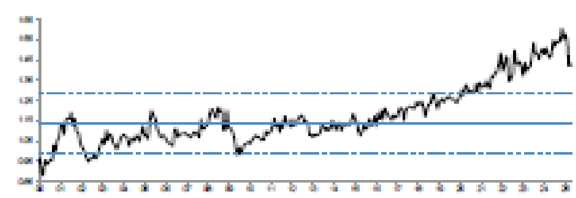
Secular Change?

Since the Great Financial Crisis (2007-2008), the global trend in financial markets has been one of U.S. Exceptionalism. Post the GFC, the U.S. had the strongest economic growth, spent more on fiscal policy, and ran bigger trade deficits by a wide margin relative to other countries. Creating a cycle of excess liquidity and consumption in the U.S., which led to both huge trade and budget deficits. To fund the deficits, we had to export a vast amount of U.S. dollars to other countries that then recycled the dollars back into our financial markets. Thus, U.S. Exceptionalism (USE) became a virtuous cycle that increased the size of our stock market from 50% of the global market capitalization in 2010 to over 70% at year-end. It also took the valuation of U.S. stocks from on par with foreign stocks in 2010 to an over 40% premium at year-end. A key debate in the financial markets is whether the secular trend of USE is coming to an end or not. To the right are a few charts that illustrate what USE looks like and a summary of why it may be reversing.

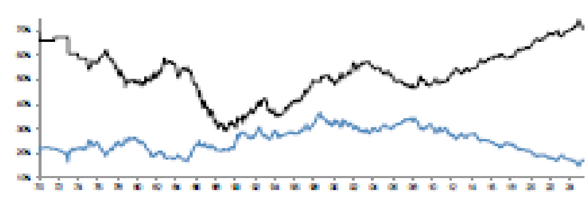
Over the past 15 years, US had a largely uninterrupted period of outperformance...



...US exceptionalism was reflectd in P/E rerating... the drivers could be changing...



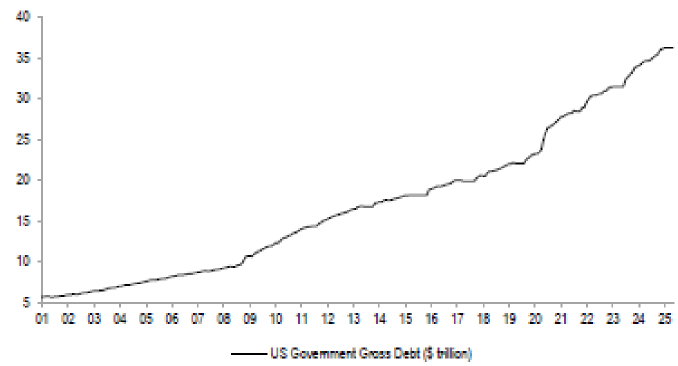
...this may result in some reduction in US relative weight



Source: Datastream, J.P. Morgan, Bloomberg Finance L.P.

1. The U.S. has reached a point where we are no longer able to pump excessive fiscal stimulus into the economy and markets without the markets pushing back. Our budget deficits have been extremely high since the GFC, and our gross debt has reached over 100% of our GDP (see the chart to the right). This is not sustainable. Either deficits will need to be cut (not likely in the current political environment) or the financial markets may start to rebel in the form of higher bond yields and lower stock prices.

Figure 17: US Government Gross Debt ($ trillion)



Source: Bloomberg Finance L.P.

2. The current U.S. trade and tariff policies have escalated trade tensions and will likely lead to less global trade. Higher tariffs will have a potentially significant impact on domestic inflation and economic growth, and less global trade will reduce the amount of U.S. dollars that are exported and recycled back into the U.S. stock market. If foreign investors start to pull back from investing in the U.S. due to lower trade or other reasons, this will likely reduce future returns on U.S. assets.

3. We are seeing a dramatic shift in global economic policy. That includes a paradigm shift from globalization to a framework where countries are becoming more nationalistic and using government policy to orchestrate their own economies, become less reliant on other countries, and have to be responsible for their own self-defense. Countries have recognized that they may no longer be able to count on the U.S. to play the same role in the global economy as it has for many decades. The research team at Bridgewater has labeled the new paradigm 'Modern Mercantilism."

Bridgewater believes the shift to Modern Mercantilism will be a radically different economic and market environment than the past 15 years, in which the U.S. has experienced extraordinary returns. They believe it will also reverse the trend of the past 40 years of laissez-faire economic policy, globalization, and disinflation. The U.S. has led the global economic and security order, and the world is recognizing that this has changed, and there is no going back to the old order.

If this truly is a secular shift to a new paradigm, it will have a significant impact on the global economy and financial markets for years to come. The obvious impacts are higher inflation (at least in the near term); slower economic growth as trade and supply chains sacrifice efficiency for security; a shift in capital flows away from U.S. financial assets; pressure on an overvalued U.S. dollar; a desire for real assets and real returns; a rotation into foreign financial assets. Less obvious impacts will be an increase in market volatility and increasing global competition and conflict. Being on the right side of secular change will have a significant impact on portfolio returns in the years ahead.

In general, our portfolios are well-positioned for the current environment and the potential impacts of secular changes to the global markets. If you have any questions regarding this commentary or your investment strategy, please give us a call.

Best regards,

Steve Giacobbe, CFA, CFP®