Economic and Market Outlook

| 2Q25

KEY TAKEAWAYS:

1. **In a reversal of the post-election euphoria, policy uncertainty, particularly around the implementation and impact of broad-based tariffs, weighed heavily on market sentiment.**
2. **Investors are also considering the costs and benefits of building out AI infrastructure, a driving force behind stock growth in recent years.**
3. **Despite growing concern, we believe the economy is on solid footing, as consumer financial health and the employment picture remain strong.**
4. **The market's tendency to sell off in times of uncertainty overlooks the underlying strength of the economy. Sentiment should stabilize or improve as we get more direction on tariff policy and we welcome the potential of broadening index leadership.**

Economic uncertainty is usually bad for stock investors because they rely on existing laws and regulations to predict earnings, inflation, interest rates, and economic growth. While not always perfect, the U.S. economy is generally predictable. However, three of President Trump's initiatives—a new tariff system, the Department of Government Efficiency (DOGE), and deregulation—have made the future less certain, leaving investors uneasy.

The stock market's reaction makes sense. A boat caught in sudden fog slows down, hesitates to change course, and its captain becomes more cautious. In fog, standard navigation rules no longer apply—every vessel must take action to avoid a collision. Similarly, in uncertain economic times, investors proceed carefully and remain on high alert.

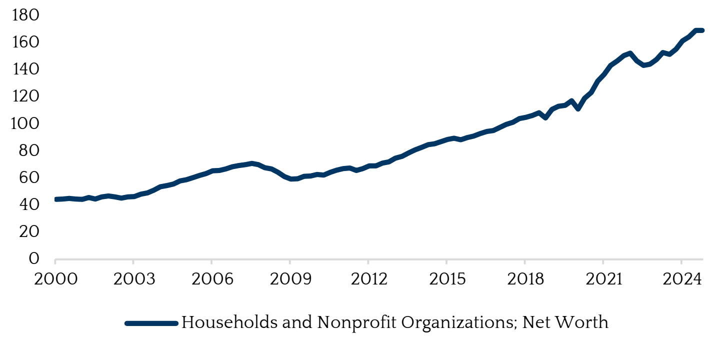
We attribute most of the economic "fog" to the tariffs. DOGE will likely have a muted impact on the broader economy. Deregulation, on the other hand, should largely be seen as a positive for potential future growth.

The widespread expansion of tariffs makes it difficult to forecast key metrics like inflation and economic growth. For example, the recently announced automobile tariffs will likely lead to higher car prices and fewer choices for consumers. Automakers may see a hit to earnings, either through reduced sales or an inability to pass through tariff costs, and any slowdown could impact the over 3 million people that work in either motor vehicle and parts manufacturing or dealers.

This uncertainty has unsettled investors, as reflected in the S&P 500's -4.3% first quarter return. In response, investors sought refuge in fixed-income securities, including both Treasuries and corporate bonds. The yield on the U.S. 10-year Treasury Note fell to 4.21%, a positive sign for mortgage rates and other loans.

Historically, except during extreme financial crises like the Great Financial Crisis or the COVID-19 pandemic, economic trends closely follow the financial health and job prospects of American consumers. By those measures, the economy is on solid footing. Even after recent stock market volatility, consumer financial health remains strong, with key indicators—such as Household Wealth—still near record highs.

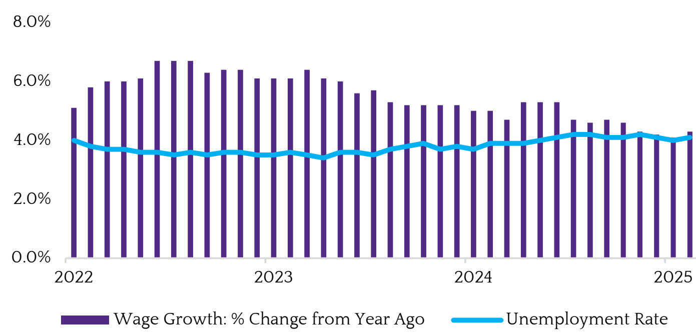
Household Wealth (in trillions) 2000 - 2024



Source: Board of Governors of the Federal Reserve System (US)

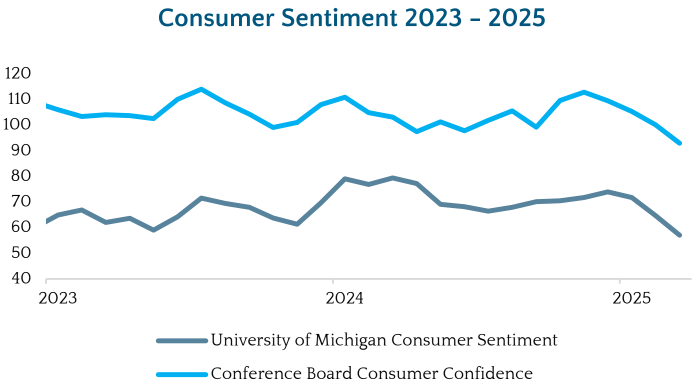
The employment picture is also robust, with wages up over 4% and unemployment holding at historically low levels.

U.S. Unemployment Rate and Wage Growth 2022 - 2025



Sources: Federal Reserve Bank of Atlanta; U.S. Bureau of Labor Statistics

While these statistics reflect a growing economy, we are increasingly concerned about growth slowing. Consumer surveys indicate a more cautious outlook on inflation and the economy's future path. Improvements have appeared in the housing market which, if sustained, will bolster the economy in 2026, but not this year. In addition, many companies have contemplated a pause in their investment spending until there is clarity on global trade rules.

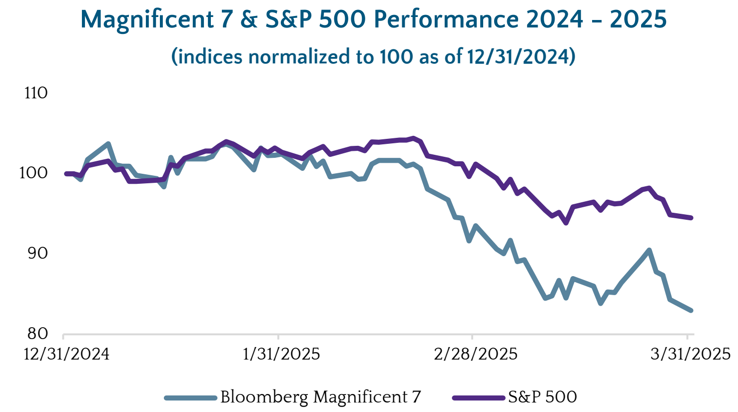


Source: Bloomberg

The early euphoria of what was perceived to be a pro-growth Trump administration has given way to caution. Now that we have returned to a traditional interest rate structure, stock prices, over time, should respond to earnings growth and the level of interest rates. Should the tariff-induced risks to growth prove modest, the current stock market malaise may be an opportunity.

In addition to grappling with uncertain trade policies, the stock market is adjusting to the diminished clout of the Magnificent 7 stocks: Apple, Microsoft, Alphabet, Meta, Nvidia, Tesla, and Amazon. These stocks dominated the market for the last two years as only about 25% of stocks outperformed the S&P 500.

Investors are also weighing the costs and benefits of building out artificial intelligence (AI) infrastructure, the driving force behind stock growth in recent years. AI is a disruptive technology that will take time to fully integrate, much like past technological breakthroughs. Investors often pause to assess the direction and magnitude of such changes, and any pause can feel unsettling.



Source: Bloomberg

Large technology companies are in a capital investment phase, a battle amongst giants to build the most powerful and useful AI set of tools. Combined they are spending over $330 billion this year. This largesse should filter down to all sorts of providers, boosting a broader set of companies and related stocks.

The uncertainty caused by the lack of clear direction on tariff policy will weigh on investors until more clarity emerges, possibly as soon as President Trump's announcement on April 2. However, the economy's key players, consumers, businesses, and organizations, have consistently shown an ability to adapt to changing conditions. This situation is no different. Once the rules are clear, the players will adjust accordingly.

The stock market's tendency to sell off in times of uncertainty overlooks the underlying strength of the economy. Despite the current "tariff fog," the economy remains resilient, even if growth expectations have softened. Like any tax, the impact of tariffs won't be immediate.

Market sentiment should stabilize or improve as we get more direction on tariff policy, allowing investors to focus on economic growth, earnings, inflation, and interest rates. The economy is strong enough to withstand this short-term uncertainty. We welcome the potential of a broadening stock market in a relatively stable interest rate environment. Stock returns are likely to be muted compared with the last two years but still supportive of capital appreciation over time.

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