Portfolio Themes for Q2 2025:

Introduction

In 2016, the NCAA officially changed it's branding for the end of year tournament to determine a national champion to "March Madness", reflecting the parity and how frequently higher seeds were upset in early rounds of the tournament. This year, not a single #1 seed was upset prior to the final 4, for the first time since 2008 (another "exciting" year for markets). Instead, the markets were the source of all the madness. The 1st quarter has reminded us that markets, like basketball tournaments, are unpredictable, but history shows that staying in the game leads to long-term wins. Survive and advance.

With that perspective, let's explore what the road ahead might look like for the markets.

Fed & the Economy

Navigating Economic Landscape:

At the last FOMC meeting in March, the Fed held on any changes, and consensus still called for 2 cuts this year. The Fed offered mixed signals, hawkishly increasing their inflation expectations from 2.50% to 2.80%, while dovishly reducing the monthly runoff of Treasury securities from $25 billion to $5 billion per month, starting in April. This adjustment suggests a shift toward a more accommodative monetary policy stance, aiming to maintain ample liquidity in the bond market, which could have an impact on pushing intermediate and longer-term interest rates lower.

The new favorite word for the Fed appears to be 'Uncertainty.' Market & economic forecasts are always uncertain, as there is some element of foretelling the future when putting together these types of predictions. 'Wait and see' are the terms I would use to describe the Fed, as they wait to see how fiscal policies from the other side of Washington ultimately impact inflation and employment trends. In fact, Powell spoke on April 4th, and said the following when asked if the Fed should consider rate cuts following the stock market selloff, "There's a lot of waiting and seeing going on, including by us, and that just seems like the right thing to do at a time of elevated uncertainty."[1]

[1] https://www.reuters.com/markets/us/no-fed-put-when-its-unclear-which-way-economy-may-pivot-2025-04-07/

US Politics

Tariffs & 'Liberation Day'

On April 2nd, which President Trump dubbed, 'Liberation Day,' the administration announced reciprocal tariffs on nearly all major US trading partners. While the actual tariff math is murky (Vietnam having 90% tariffs on U.S. goods, for example, is inaccurate), the point is now largely academic: the tariffs are in place, and in many cases, they go beyond simple reciprocity, which is part of why the market reaction was so swift and sharp.

Trump continues to frame tariffs as a tactical tool, not necessarily a permanent policy. He has long used them as leverage in negotiations, aiming to reshape trade relationships and reduce deficits. Tariffs are often deployed to:

- **Pressure countries** (e.g., China, Mexico, the EU) into trade, manufacturing, or currency concessions.
- **Align with broader goals**, such as reshoring manufacturing or punishing perceived adversaries.
- **Appeal to his political base**, particularly in manufacturing-heavy states.

Whether these tariffs stick will depend on how negotiations evolve. If talks are successful, some tariffs may be rolled back, much like we saw with the USMCA or Phase One China deal. If not, they could remain in place—or escalate—as a form of economic pressure or political posturing.

What's important to remember is that tariffs don't immediately change demand. But they *do* affect how and where goods are produced and how efficiently they move around the world. Take socks, for example: if Pakistan-made socks are now subject to a 30% tariff, that doesn't necessarily mean socks instantly get 30% more expensive. Supply chains adjust over time—other countries may fill the gap, or prices may be absorbed along the supply chain. Additionally, Trump has already said he's open to reducing tariffs if other nations come to the table. In that sense, tariffs could act more like a starting point for renegotiation than a permanent fixture.

Ultimately, the quicker the global economy adjusts—or the quicker some tariffs are rolled back—the faster uncertainty may decline. But if we enter a prolonged "wait and see" phase from both businesses and consumers, the result could be slower spending, weaker investment, and lower asset valuations in the months ahead.

Interest Rates and Federal Deficits

President Trump has once again turned his attention to interest rates, already calling on the Federal Reserve to lower its short-term policy rate. This isn't unfamiliar territory—during his first term, he frequently voiced frustration with the Fed's pace of rate hikes in 2018 and 2019, going so far as to publicly criticize Fed Chair Jerome Powell, whom he had appointed in 2017. These efforts reflected a broader desire to exert political influence over monetary policy, even as the Fed maintained its independence.

This time, however, the environment has shifted. The Federal Reserve has already begun a rate-cutting cycle, and the political incentive to support lower rates may be even stronger. With interest payments on U.S. federal debt climbing, lower rates offer a path to reducing the federal deficit—something the President has signaled as a priority. His push for fiscal restraint, exemplified by the creation of the Department of Government Efficiency (DOGE) and the strategic use of tariffs, underscores a broader agenda aimed at reining in government spending. It's clear that President Trump remains fixated on yields and may be open to unconventional measures to bring borrowing costs down.

Looking Ahead

Corporate earnings season in the US is around the corner with many of the big banks set to report their earnings on Friday, April 11th. Future expectations will be the key areas of interest:. Are firms exposed to this trade policy? And if so, in a negative or positive way? Do these changes impact their customer base, suppliers, or other stakeholders?

Institute for Supply Management (ISM) data. These various reports provide insights into supply chain pressures and overall industrial activity, which could be highly sensitive to changing tariff regimes and a sign of changing corporate decision-making.

Business Inventories Firms may have started stockpiling inventory ahead of potential tariffs going into effect, creating distortions that could ripple through logistics and demand forecasts. The next release of this data will be the middle of April.

Consumer Confidence. The monthly University of Michigan survey remains a key driver of US economic activity, particularly retail spending and housing. However, it's often viewed as a *contrarian indicator*—tending to peak when economic conditions already feel strong and to decline when the worst may have already passed. As such, sharp moves in sentiment are worth watching, but should be interpreted in the broader economic context.

Equities

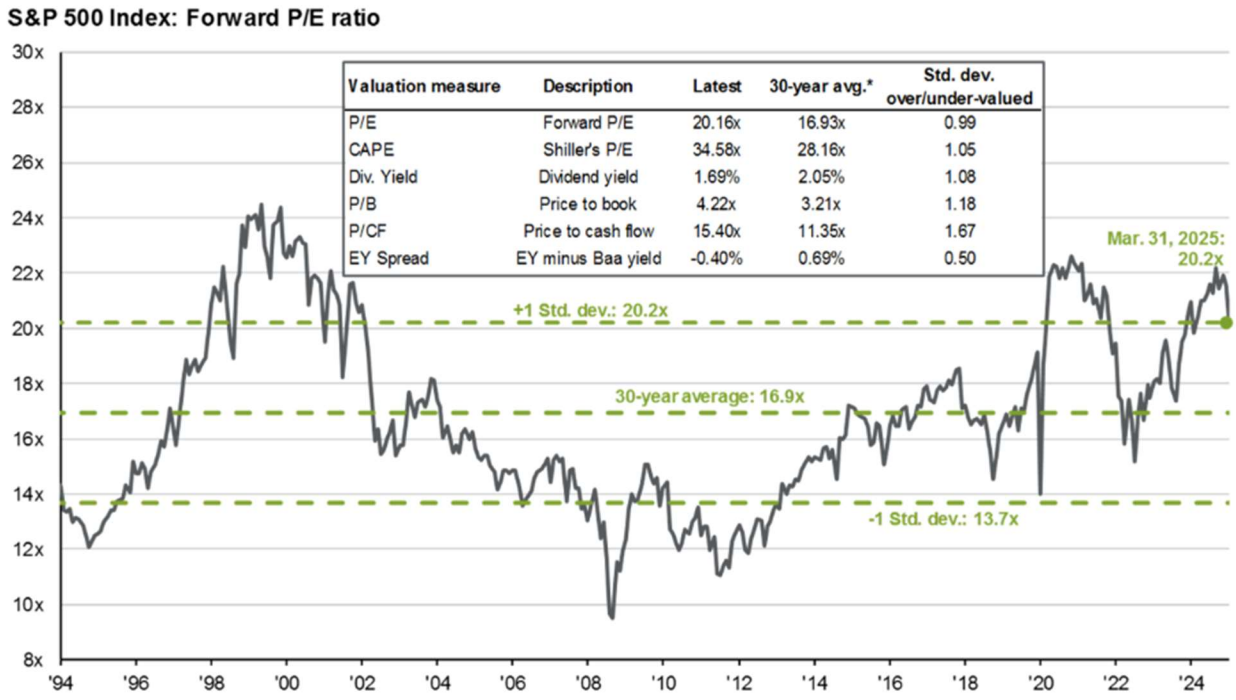
After two consecutive years of ~25% gains in the S&P 500, investors entered 2025 with high expectations. Through mid-February, it looked like the market was on track for an elusive "three-peat" of double-digit returns, with the index hitting a new all-time closing high of 6,144.15 on February 19. But things shifted quickly. The S&P 500 ended the first quarter down 4.27%—its first negative quarter since Q3 2023—and losses accelerated into early April, as investors digested the announcement of President Trump's reciprocal tariff policy. The selloff pushed the index back into correction territory, erasing much of the early optimism.

While pullbacks are a natural part of long-term investing, this one came just as valuations were running historically rich. As we noted last quarter, the market's strong performance in 2023 and 2024 was driven more by price-to-earnings (P/E) multiple expansion than earnings growth alone. This left equities particularly vulnerable to policy shocks or shifting sentiment. High expectations

around AI, U.S. exceptionalism, and the start of a Fed cutting cycle helped justify elevated valuations—but in markets, narratives alone can only carry prices so far and can also be a double-edged sword, just as tariffs can be.

Valuations & Earnings

Market dynamics and earnings have continued to be favorable, but valuations have fallen sharply from the beginning of the year. The below from JPMorgan shows US equity markets have certainly compressed their multiple further and are now within 1 standard deviation of 30-year averages, which should provide some reprieve to those who thought markets were overvalued. Multiple expansion or compression can create significant short-run volatility, as we are seeing. What drives long-run valuations, however, is fundamental data around earnings expectations, future cash flows, and profits. If corporations start cutting forecasts, we could see further short-term volatility in equity markets.



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[2] Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

AI Capital Spending & Deep Seek

In late January 2025, headlines about DeepSeek—a small Chinese startup—sent shockwaves through the AI ecosystem. Unlike many ChatGPT competitors that have failed to scale or prove cost-effective, DeepSeek reportedly developed a highly capable model for under $6 million in just two months, using older Nvidia H800 chips. Even more notably, it released the model as open source under the MIT license, allowing for easier integration and replication. This revelation sparked a selloff across key AI infrastructure names, with Nvidia leading losses, as investors questioned whether the multi-billion-dollar arms race for top-tier chips and energy-intensive data centers is already facing disruption.

Despite the selloff in chips and infrastructure-linked sectors like energy, utilities, and industrials, the S&P 500 heatmap from January 27th[3] reveals a more nuanced market response. Major tech platforms—Apple, Amazon, and Meta—closed in the green, perhaps signaling that reduced AI buildout costs could benefit firms developing their own models. Software names like Salesforce (CRM), Adobe (ADBE), ServiceNow (NOW), and Intuit (INTU) also saw strong performance, as a more open, cost-efficient AI environment makes integrating language models into enterprise tools more accessible. In that light, DeepSeek's emergence might not undercut the AI narrative, but rather shift the balance from capital-intensive infrastructure to leaner, software-driven innovation.

[3] https://finviz.com/map.ashx

International and Currencies

International Outperformance

Over the past several quarters we have discussed how international equities have much lower valuations and expectations, paired with much higher dividend yields than US Stocks. This finally materialized as return in the 1st quarter, as the MSCI EAFA index was up over 6% through March 31.

The performance data quoted presents past performance; past performance does not guarantee future results; the investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost; current performance may be lower or higher than the performance data quoted. The most recent month end performance data can be accessed at https://go.ycharts.com/fund_contact_info. (See the Standardized Returns section of this report for standardized returns information).

A significant structural change is occurring in Europe, driven by expansionary fiscal policies (Increased Government Spending) in infrastructure and defense. Europe's economy is believed to have more ties to government spending than here in the US. Effectively, this can be seen as a re-industrialization of the continent that will support energy and energy security to reliably power local industry. Importantly, the political narrative is also shifting toward pro-industrialization policies from leaders in Europe's two largest economies, Germany and France. While it is true that European equity markets have rallied significantly, we must remember that Europe has had sluggish valuations for a long time. As a result, many investors are underweight Europe and may need to rebalance by closing that underweight. This could lead to longer-term technical support for European assets.

The other two tailwinds for european equities has been softer interest rates and a strengthening Euro. The European Central bank, and others on the continent, have undergone more rates cuts than here in the US. This provides lower borrowing and cost of capital for consumers and businesses. The stronger Euro provides a tailwind for international investors investing in Europe, before converting back to their home currency.

Our Emerging Market Approach

We changed our emerging market approach following the election of President Trump. We have continued with an actively managed strategy, which employs a top down, country by country based approach, that includes exposure to frontier countries, such as those in Africa, which are often excluded from traditional MSCI Emerging Market indices. We believe their top-down approach will provide greater flexibility within this space, as compared to traditional stock picking. The strategy selects countries based on the trajectory of economic freedom and then takes a broad, passive equity stake within those countries. Countries with high economic freedom would be believed to low appetite for trade barriers. This nimbleness is particularly valuable as adjustments to U.S. & foreign trade policy could create disparities between winning and losing countries. Specifically, potential tariffs may drive increased dispersion in asset performance across countries.

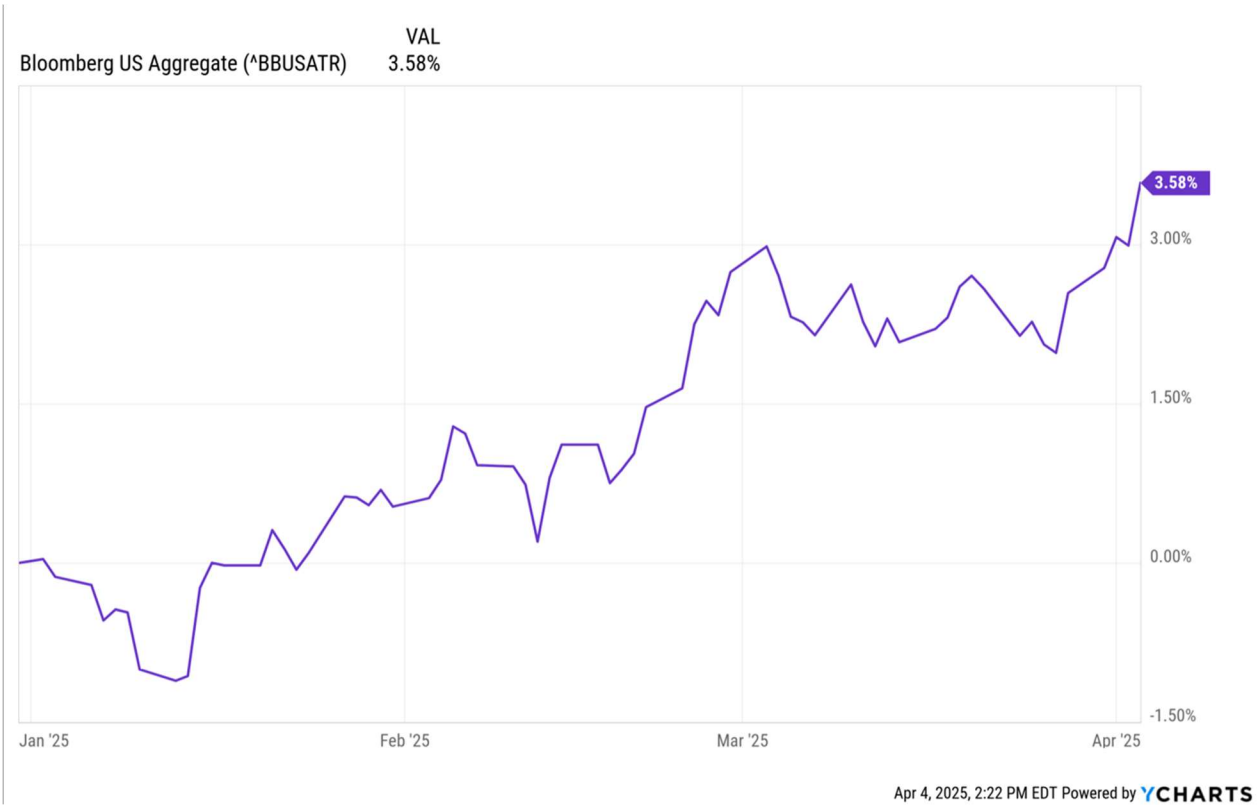
Fixed Income

Fixed Income Recap

Bond markets had a strong 1st quarter, returning just over 2% as measured by the total return of the US AGG Bond Index, providing some negative correlation to equities and some relief for more diversified investors. Entering the year, the annual yield on the AGG was about 4%, thus the 'coupon clipping' would be about 1% per quarter. The additional return came from interest rates falling throughout the quarter.

There is always some level of speculation when interest rates move, but we view the primary reasons as investors buying into safe-haven assets (bonds), expectations for lower economic growth in the US, and the potential impact from US federal policies that could lower the deficit.

Although interest rates continue to be volatile, the cash flow from coupons and 'insurance' you are receiving from investing in fixed income remains appealing. Furthermore, fixed annuity rates appear relatively attractive to similar term investment grade corporate bonds.

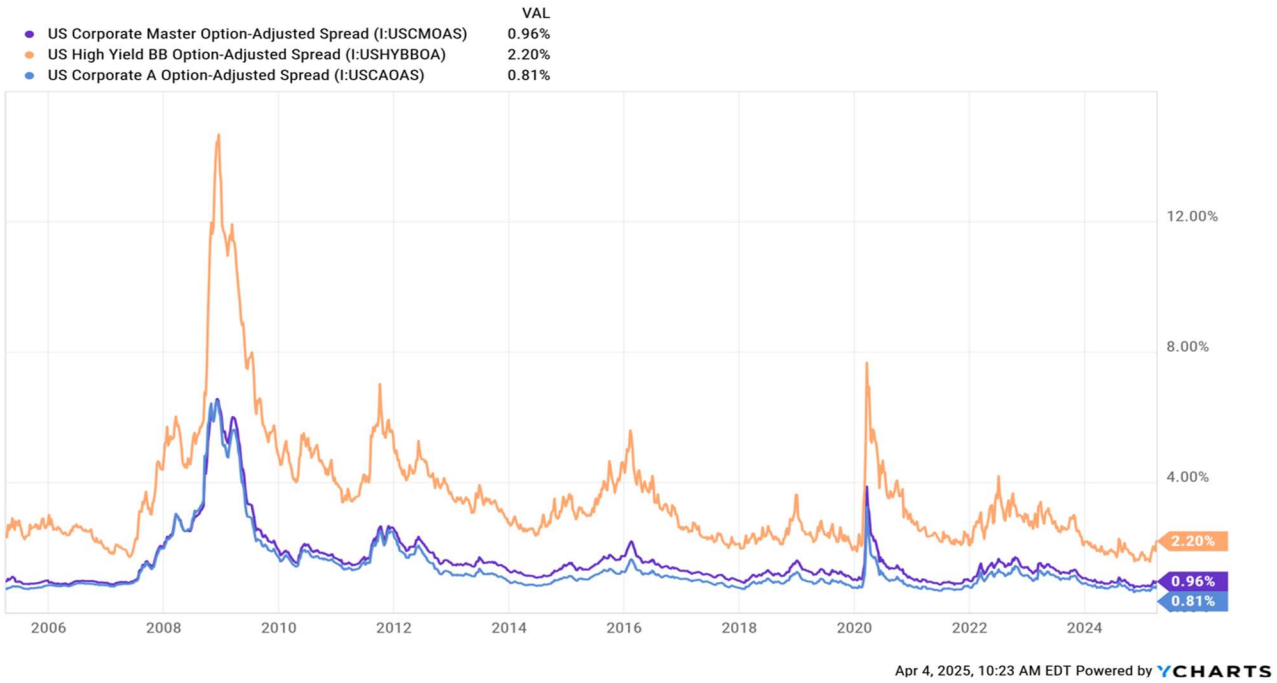


Fixed Income Spreads

Despite the recent equity market correction, bond market behavior has remained relatively steady. Fixed income spreads— the 'extra yield' one gets over a risk-free treasury instrument, for taking on a higher level of credit risk —have widened, but only marginally. This is notable, as we've long held a conservative stance on high yield bonds, given how historically tight spreads have remained. The resilience in fixed income spreads suggests that bond markets are not yet flashing the same level of concern seen in equity markets.

Traditionally, credit markets are viewed as more reliable indicators of future economic conditions than equity markets, though neither is perfect in isolation. That said, if recent volatility leads to softer growth or a rising risk of recession, we believe spreads have considerably more room to widen. Many areas of the credit market—both investment grade and high yield—entered this period near historically tight levels. An equity selloff of this magnitude would typically warrant a larger repricing of credit risk, which hasn't materialized as of the time of this writing. In our view, this leaves credit markets offering poor convexity: limited upside and significant downside if fundamentals deteriorate.

To put it in perspective, option-adjusted spreads (OAS) across corporate bonds remain well below levels seen in past periods of equity stress. That's an important point of distinction for nervous investors, but also a word of caution for those chasing yield in lower-quality bonds. There's still significant room for spreads to widen if conditions worsen, which reinforces our preference to take risk in equities rather than credit at this stage.



Yield Curve
As mentioned, rates moved down over the quarter. Most of the moves came from the 2-10 year range, and in nearly equal increments, as the 10-2 spread remains similar to the beginning of the year, reflecting no major changes to the shape of the curve. As of this writing, the 10 year is right around 4%, reflecting a sizable shift to where it began the year.

US Treasury Yield Curve Data

			Date	4/3/2025	3/27/2025	3/3/2025	1/3/2025	10/3/2024	4/3/2024
	Label	Ticker	Name	Current	1W Ago	1M Ago	3M Ago	6 M Ago	1Y Ago
Years to Maturity	0.083	I:1MTCMR	1 Month Treasury Rate	4.36%	4.37%	4.38%	4.44%	4.99%	5.47%
	0.25	I:3MTCMR	3 Month Treasury Rate	4.31%	4.33%	4.35%	4.34%	4.68%	5.42%
	0.5	I:6MTCMR	6 Month Treasury Rate	4.20%	4.27%	4.31%	4.25%	4.37%	5.33%
	1	I:1YTCMR	1 Year Treasury Rate	3.92%	4.10%	4.06%	4.18%	4.02%	5.03%
	2	I:2YTCMR	2 Year Treasury Rate	3.71%	3.97%	3.96%	4.28%	3.70%	4.68%
	5	I:5YTCMR	5 Year Treasury Rate	3.75%	4.09%	3.97%	4.41%	3.62%	4.34%
	10	I:10YTCMR	10 Year Treasury Rate	4.06%	4.38%	4.16%	4.60%	3.85%	4.36%
	30	I:30YTCMR	30 Year Treasury Rate	4.49%	4.73%	4.45%	4.82%	4.18%	4.51%
10-2 Spread				0.35%	0.41%	0.20%	0.32%	0.15%	-0.32%

Source:yCharts

Portfolio Context

Rebalancing
Policy uncertainty is creating a challenge for capital allocation. Most economic figures, which are backward looking, still look strong. Forecasts in this constantly changing policy environment, have proved extremely inconsistent. Capital has made some shifts, to defensive sectors, bonds, real estate, and overseas. When these big rotations occur, market participants generally reduce their winners, and take some profits. That is ultimately a form of normal rebalancing, which we do in blended portfolios with a target of twice per year.

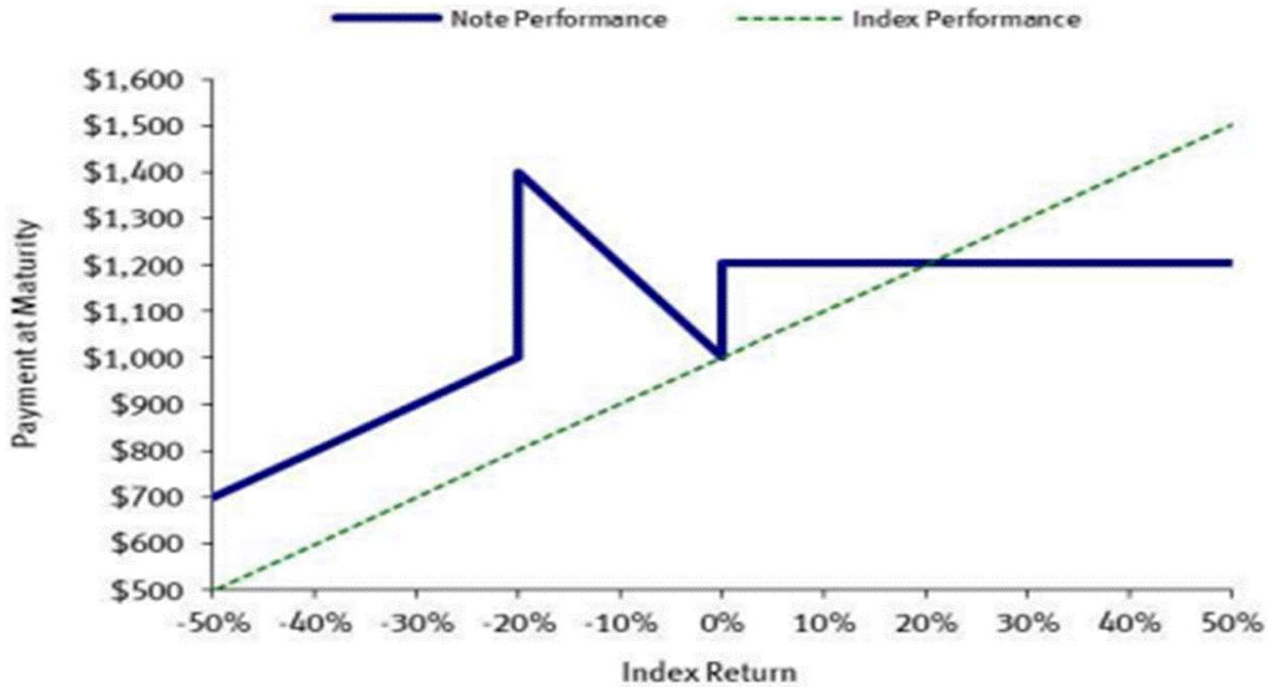
Unlike the broad-based declines seen in 2022, the current market correction has been more nuanced. The **S&P 500 briefly entered correction territory on March 11th**, while **Fixed Income, International Equities, and Real Estate** remained resilient, with positive returns, through the end of the 1st quarter. Given these conditions, we rebalanced most portfolios and added a structured note hedge during the second half of March. This goal is to help mitigate risk in blended portfolios and take advantage of the opportunity to sell high, and buy low, which is ultimately what a disciplined rebalancing approach is designed to do.

Structured Notes

Dating back to the summer of 2024, and as recently as late March, we've started to introduce some custom dual directional structured notes, which are designed to provide low or even inverse correlation to equity markets, specifically the S&P 500.

The impetus of this creation was to have something that works as a direct hedge to equity markets, while still providing a solid, consistent return profile if equity markets do just fine. These can be thought of as replacements for certain bonds, which can have correaltion to equity market downsides or act as a true alternative within portfolios. We favor structured notes as alternatives, because our terms are known upfront, it often reduces the expesne rato, and compared to other alternative investments the transparency is far higher.

The below chart shows, at a high level, how one of these $1,000 par value notes may work. This type of note may use the S&P 500 as the underlying index, over a stated time period, say 3 years. The note would have a buffer to the downside, buffering against S&P 500 drawdowns. The note would also have a dual directional feature, where the note value increases, as the S&P 500 draws down, as long as it doesn't end through the buffer zone. If the S&P 500 goes up, the note will provide a digital coupon, and pull up in value, as it nears maturity.



Structured products do have some with tradeoffs and risk, such as illiquidity and credit risk of the underlying issuer. If you want to learn more about structured notes, please contact your financial advisor.

Always a Reason to Sell[4]

This chart is a great reminder in the event you are considering a move out of equities. Over the past 15 years, we've seen countless headlines and events that, in the moment, felt like compelling reasons to abandon a long-term investment plan. Whether it was the debt ceiling, inflation spikes, elections, or global conflict, these moments often tempt investors to sell during periods of uncertainty—usually at prices that reflect short-term fear rather than long-term fundamentals. As the chart title suggests, there are always "reasons to sell," which brings to mind a quote from the late John Bogle: “The stock market is a giant distraction from the business of investing.”

It’s also worth remembering that this isn’t the first time the U.S. has faced heightened trade tensions. While today's tariff announcement may feel disruptive, the 2018–2019 trade war between the U.S. and China also sparked volatility. Markets pulled back, headlines were intense, and uncertainty was high. But companies adapted, countries negotiated, and people kept going to work, improving their lives. Markets eventually found their footing and recovered, as they tend to do when given time to adjust. While no two scenarios are the same, history reminds us that panic-selling during times of policy change rarely leads to better outcomes—and that staying invested through volatility has consistently rewarded patient investors.

[4] Source: YCharts

Portfolio Changes:

Foundational Equity Changes

1. Sell ABEMX (Abrdn Emerging Markets Fund Inst), buy EICOX (Eaton Vance Emerging and Frontier Countries Eq I)
2. Portfolio Re-Weighting

Rational #1: We are maintaining our investment in emerging markets but shifting to a new fund manager for this allocation. Eaton Vance's strategy employs a different benchmark that includes exposure to frontier countries, such as those in Africa, which are often excluded from traditional MSCI Emerging Market indices. We believe their top-down approach will provide greater flexibility within this space, as compared to traditional stock picking. The strategy selects countries based on the trajectory of economic freedom and then takes a broad, passive equity stake within those countries. This nimbleness is particularly valuable as adjustments to U.S. trade policy under the incoming administration could create disparities between winning and losing countries. Specifically, potential tariffs may drive increased dispersion in asset performance across countries. Additionally, the strategy currently excludes direct investments in Chinese equities, aligning with our decision to remain underweight Chinese equities, relative to traditional EM benchmarks, while giving the fund manager the ability to pivot into China, if they have conviction in their stock market in the future.

Rational #2: Re-weighting our portfolio's constituent investments is an exercise we undertake periodically to ensure alignment with evolving benchmarks and market dynamics. Benchmarks can change over time due to market movements and adjustments in index classifications, making it necessary to review and update portfolio allocations as needed.

In recent years, there have been significant differences in returns between U.S. large-cap and small-cap stocks, as well as between U.S. growth and value styles. Reflecting these trends, index providers may reclassify stocks and adjust their weightings within indices.

For example, in the S&P indices, stocks like Apple and Microsoft, which were previously categorized as pure growth, are now classified as blended stocks. As a result, their weights are now partially allocated to both the S&P Growth and Value indices. Such changes influence the underlying holdings of both index funds and actively managed funds that we incorporate into our portfolios.

When these shifts in index classifications and weightings are significant, as they are this year, it is prudent to review and adjust portfolio weights accordingly. This ensures that we remain properly allocated and avoid any unintended overweight or underweight without a clear rationale.

Discovery Individual Stock Changes

1. Eliminated Corning (GLW)
2. Added Salesforce (CRM)
3. Added Marvell (MRVL)
4. Some additional adjustments to weights within the portfolio

Asset Class Positioning

	Short View	Long View	Trend	Fund
Domestic Equity				
Large Blend			Neutral	FXAIX
Large Value			Neutral	VTV
Mid Blend			Neutral	FSMDX
Small Blend			Neutral	JDSCX FSSNX
Real Estate			Neutral	CSRIX
International Equity				
Foreign Large Blend			Neutral	FSPSX
Foreign Small/Mid Growth			Neutral	FIXIX
Diversified Emerging Mkts			Neutral	ABEMX
Short Term Bonds				
Short Government			Neutral	EILDX
Short-Term Corp			Neutral	LUBYX
Core Bonds				
Intermediate Government			Down	SCHR
Inflation-Protected Bond			Up	STIP
Long Government			Neutral	VLGSX
Investment Grade Corp			Neutral	FGBPX AGG
Securitized			Neutral	MTGDX
High Yield Bond				
Bank Loan			Down	EIBLX
High Yield Bond			Down	BGHIX
Preferred Stock			Down	CPXIX

Disclosures

We believe the sources to be reliable, however, the accuracy and completeness of the information is not guaranteed.

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Indices mentioned are unmanaged and cannot be invested into directly. The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. The Bloomberg U.S. Aggregate Bond Index is an unmanaged index comprised of U.S. Investment grade, fixed rate bond market securities, including government agency, corporate and mortgage-backed securities. The Russell 1000® Value Index measures the performance of those Russell 1000 Companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000® Growth Index measures the performance of those Russell 1000 Companies with higher price-to-book ratios and higher forecasted growth values. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The Nasdaq 100 Index is a basket of the 100 largest, most actively traded U.S. companies listed on the Nasdaq stock exchange. The index includes companies from various industries except for the financial industry, like commercial and investment banks. Structured products are complex. Protections on structured notes may be full, partial, or contingent on a specific event occurring, such as a specific loss range. Gains may also be capped as a tradeoff for protections. Notes carry a call risk or the ability for the issuer to call or redeem the note before maturity. This can result in gains or losses. Protections are subject to the creditworthiness of the issuer. Protections may only apply if held to maturity and there may be no secondary market for structured notes.