2Q 2025 – Quarterly Commentary

The second quarter of 2025 was marked by several potential negative catalysts. These included lingering tariff uncertainty, escalating geopolitical tensions, Moody's downgrade of the U.S. credit rating to below AAA and protracted budget negotiations aimed at averting a $400 billion tax increase. Despite these headwinds, risk assets nevertheless managed to post strong returns, retracing recent losses.

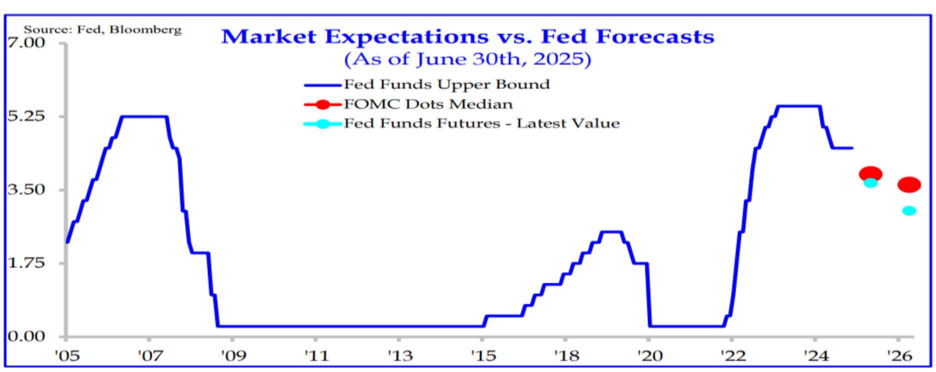
Concerns over the near-term economic outlook that were so pervasive late in the first quarter have given way to a more balanced view. Initially announced tariff rates have been negotiated lower and recent economic data indicate that the economy outperformed expectations. Despite the sharp decline in consumer confidence and some softening in both business and consumer spending, 2Q real GDP is still expected to advance 2.5% q/q annualized. Key support in this shift to a more positive outlook stems from the continued resilience of the labor market. The unemployment rate, despite a recent modest increase, still remains near historic lows at 4.2%. The prospect of supportive rate cuts from the Federal Reserve later this year also is an important factor supporting overall market valuations and sentiment.

BIG JUMP IN RECESSION ODDS AROUND TARIFF PROPOSALS ARE BACK DOWN TO PRE-APRIL LEVELS

Source: Strategas Macro Research

Despite the implementation of new tariffs, inflation remains contained. Although still modestly above the Fed's stated goal of 2.0% initial fears of a tariff induced sharp increase have not materialized. Core CPI was reported in May at 2.7%, in line with recent readings. The Federal Reserve has continued to pause the current rate cutting cycle that began in late 2024 pending more evidence on how the ever-evolving fiscal and tariff policies may impact inflation expectations. Market pricing for anticipated rate cuts later this year did moderate during the second quarter and now indicate two rate cuts by year end, slightly more then what is presently forecasted by members of the FOMC.

CONCERNS ABOUT TARIFF PRICE INCREASES KEEPING THE FED ON HOLD FOR NOW …

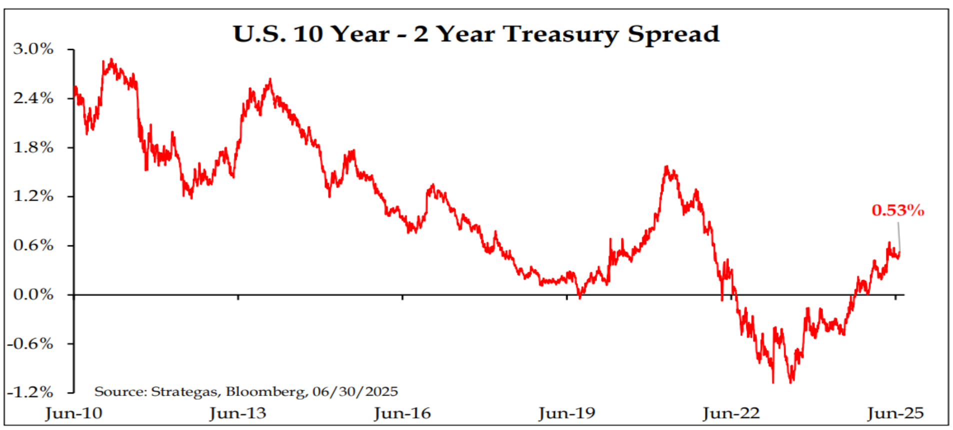


President Trump has been openly critical of Fed Chair Powell's decision to hold off on additional rate cuts which injects an unprecedented degree of uncertainty with respect to the future tenure of the Chairman of the Federal Reserve. While not zero, we believe the percentage likelihood that Chair Powell resigns or is relieved by the President prior to the end of his term in May 2026 is low. The next Fed Chair however will undoubtedly favor of a more accommodative monetary policy, which should add further support to the economy and markets.

As sentiment toward risk assets improved during the quarter, investment grade corporate bonds rebounded sharply, advancing 1.8% as measured by the Bloomberg Corporate Index. High Yield corporate bonds fared even better, advancing an impressive 3.5% as measured by the Bloomberg High Yield Corporate Index.

The trend towards a steeper yield curve that we have highlighted in previous commentaries was again evident during the second quarter. Short-Term U.S. Treasury yields declined for the period reflecting market expectation of rates cuts in the months ahead. A simple supply/demand function however continues to play out on longer dated bond yields. Intermediate and longer- term U.S. Treasury yields increased during the quarter reflecting investor unease over the amount of new U.S. Treasury bond issuance that will be necessary to finance the budget deficit. As the chart below highlights, while the curve has steepened materially from the inversion of 2022, the current spread between Two-Year and Ten-Year U.S. Treasury yields is still well below the historical average.

THE TREASURY CURVE CONTINUED TO STEEPEN AS DURATION SOLD OFF & SHORT RATES RALLIED



Corporate credit valuations traded in a wide range during the quarter which provided the opportunity to further increase portfolio exposure at attractive levels. Within this segment of the portfolio, given historically rich valuations, we continue to maintain a defensive stance with respect to interest rate risk by limiting exposure to longer term bonds.

As stated, our conviction remains high that the yield curve will continue to steepen from current levels. We were opportunistic during the quarter in further repositioning the portfolio to benefit from this trend by increasing portfolio exposure to bonds with two to five years to maturity.

We continue to believe the outlook for forward returns in the bond market is very favorable given both historically attractive overall yields and the likelihood of additional rate cuts later this year that should further amplify portfolio returns.

Birch Run Investments, LLC
June 2025