Policy Uncertainty Blurs the Outlook

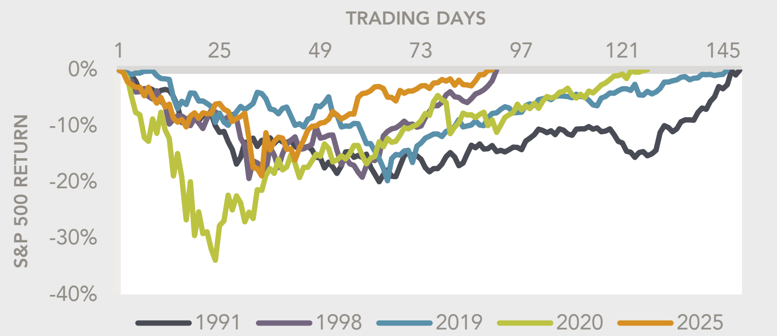
QUARTERLY LETTER FROM THE DIRECTOR OF RESEARCH

JULY 2025

As we enter the second half of the year, Liberation Day-induced market volatility seems like a distant memory with the S&P hitting another all-time high on July 10th and non-U.S. stocks outpacing their U.S. counterparts through June 30th. Meanwhile, the One Big Beautiful Bill was signed into law by President Trump on July 4th with varying expectations on its impact to growth but a consensus view that it will push the deficit higher.

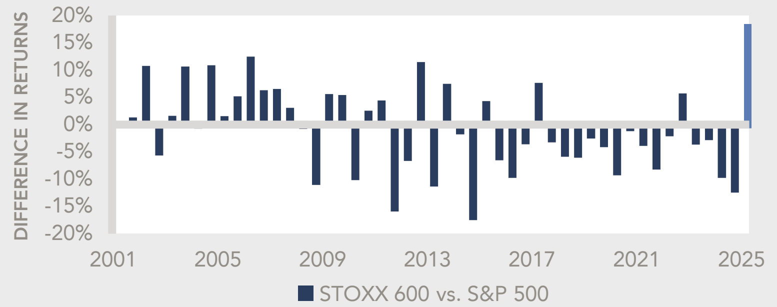
The Congressional Budget Office projects the bill to add almost $3 trillion to the federal deficit over the next decade which has pushed longer dated U.S. Treasury yields higher. While the growing deficit is a concern — and reflected via higher rates — investors are now offered more incentive to move further out on the yield curve. Current projections still suggest two rates cuts this year, but the Fed's ultimate decision will rest on the usual economic data around employment, inflation, and growth.

ECONOMIC RESILIENCE FUELS A QUICK MARKET RECOVERY



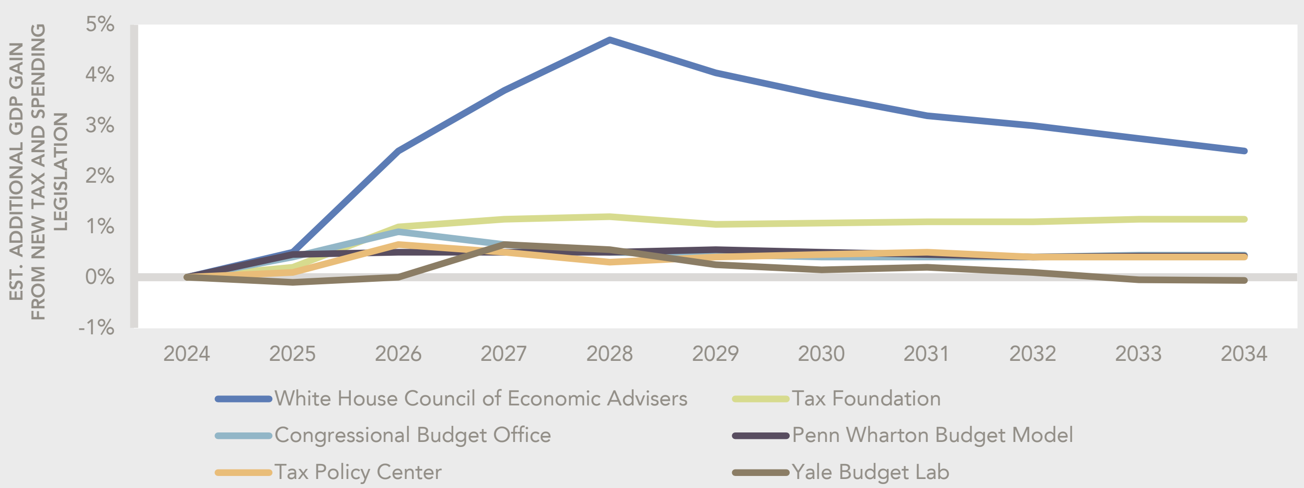
Source: Bloomberg as of July 8, 2025

EUROPE CONTINUES TO OUTPERFORM U.S. PEERS



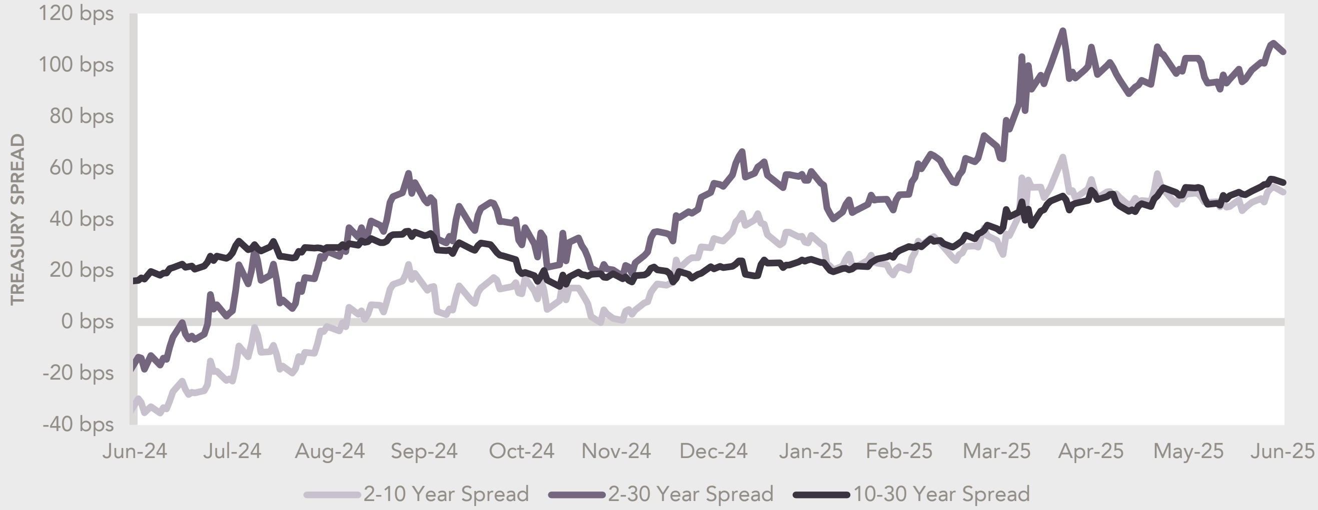
Source: Bloomberg as of June 30, 2025

FORECASTS FOR GDP GAINS DUE TO "OBBB" ARE MIXED



Source: Various as of July 5, 2025

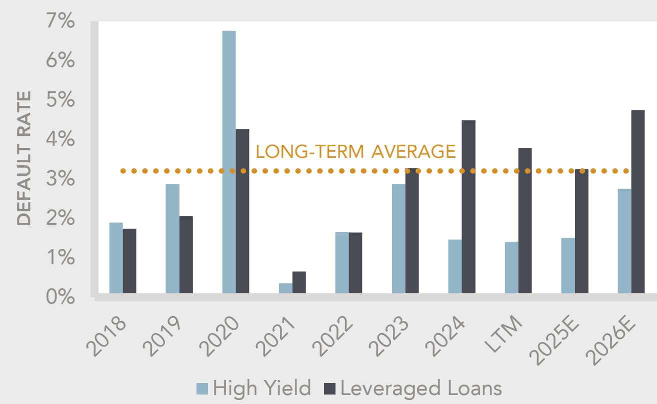
AN EXPANDING TERM PREMIUM



Source: Bloomberg as of June 30, 2025

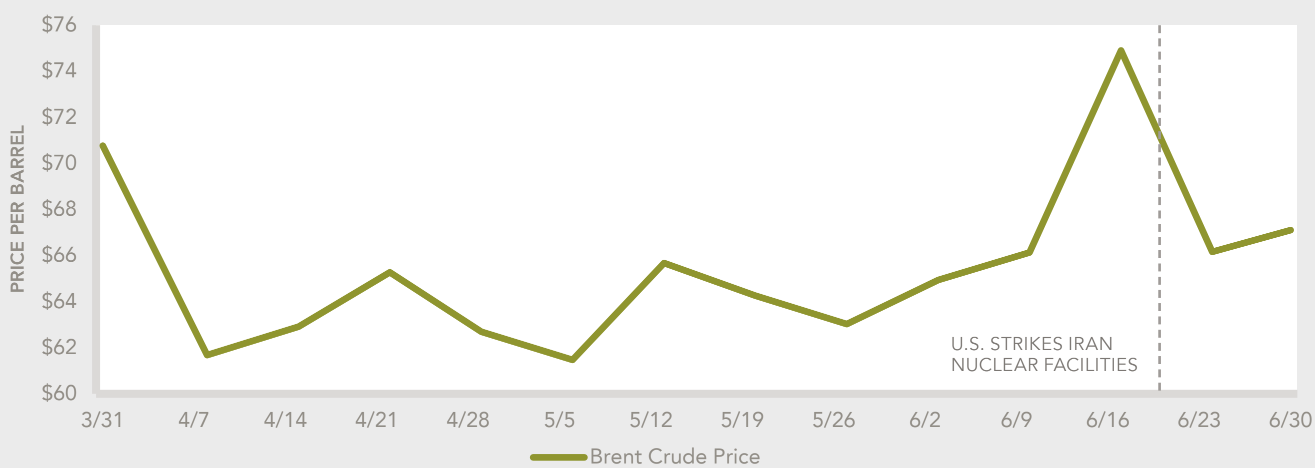
Tariff and policy uncertainty continue to weigh on market forecasts, but general risk parameters suggest a relatively benign environment. From a fixed income perspective, default projections have been revised slightly higher but remain around long-term averages. From an equity perspective, the commonly cited "fear gauge" — the VIX index — has dropped precipitously from where it was in early April, suggesting the market's anxiety around tariff policy has at least partially subsided. Even fears of oil supply shortages after the U.S. bombed Iran were short-lived with crude oil trading below $70 at the end of June.

DEFAULT FORECASTS HAVE BEEN REVISED SLIGHTLY HIGHER



Source: J.P. Morgan as of June 30, 2025

OIL PRICES MUTED DESPITE IRAN BOMBING

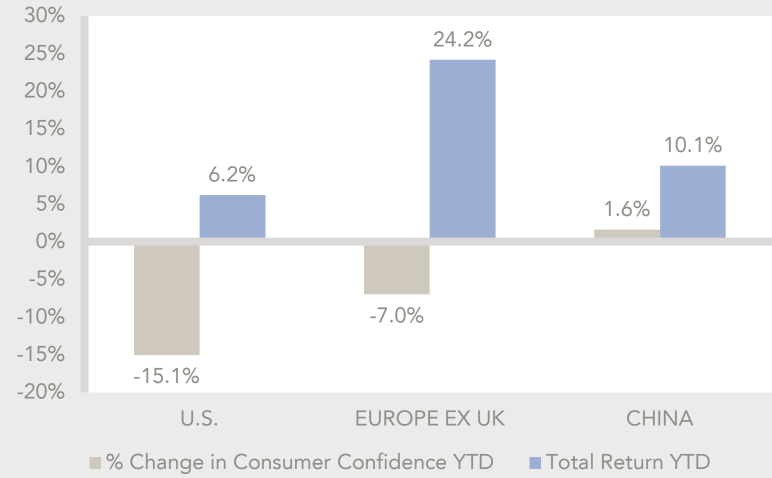


Source: Bloomberg as of June 30, 2025

Nonetheless, market returns through June are surprising when assessed against falling consumer confidence. While earnings growth has been the main driver of U.S. equity returns — largely on the shoulders of the Magnificent Seven — non-U.S. stocks have mostly soared on a weaker dollar and multiple expansion.

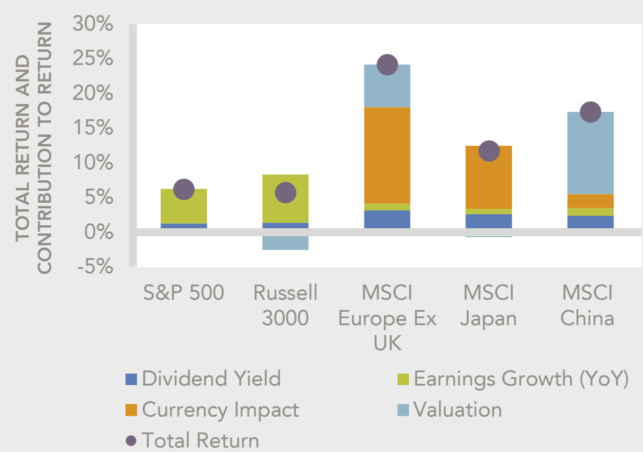
For non-U.S. stocks, the weaker dollar has been a stark reversal from 2024. However, counting on sustained currency weakening is not a foundation for further positive returns and is notoriously difficult to predict. Going forward, the market's reconciliation of earnings expectations vs. reality will dictate returns during the second half of the year.

MARKET RETURNS DEFY LOWER CONSUMER CONFIDENCE



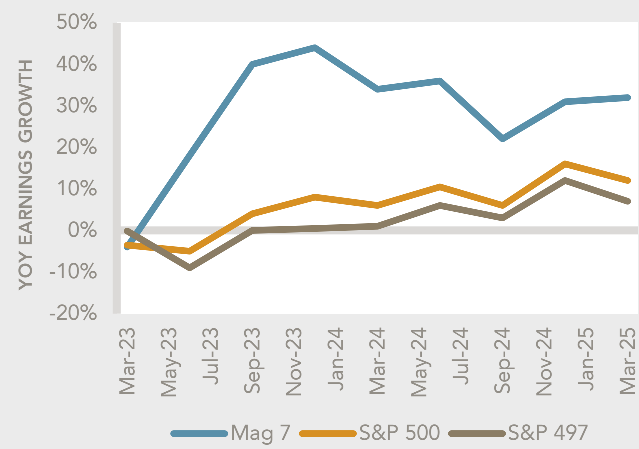
Source: Bloomberg as of June 30, 2025. U.S. equity returns represented by the S&P 500, Europe ex UK returns represented by the MSCI Europe ex UK Index, and China returns represented by the MSCI China Index. Data for China as of April 30, 2025.

A DECOMPOSITION OF EQUITY INDEX RETURNS



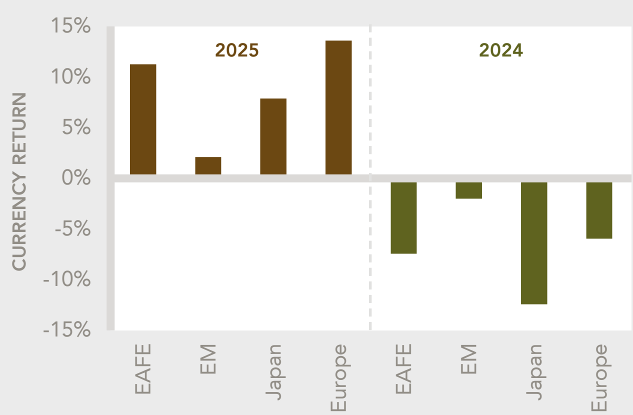
Source: Bloomberg as of June 30, 2025

MAGNIFICENT 7 CONTINUES TO DRIVE EARNINGS GROWTH



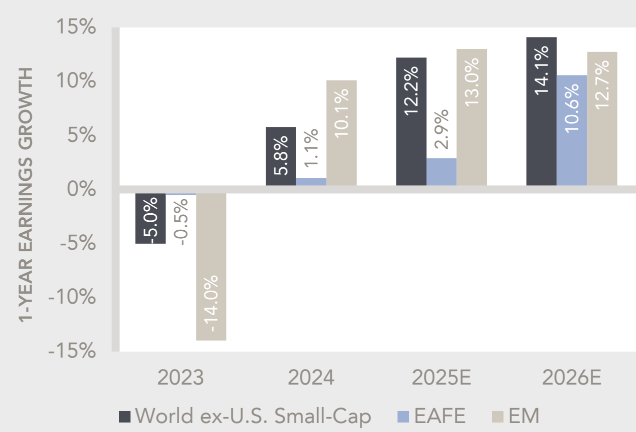
Source: FactSet as of 1Q25 earnings season

U.S. DOLLAR DOWN, NON-U.S. EQUITIES UP



Source: Bloomberg as of July 7, 2025; countries representative of MSCI Country Indices

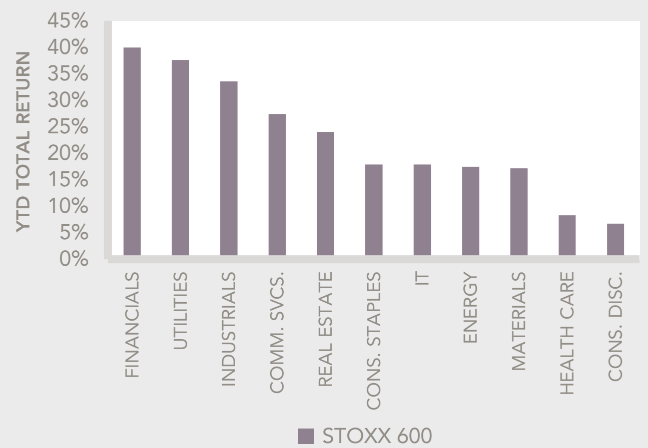
POSITIVE EARNINGS OUTLOOK FOR NON-U.S. STOCKS



Source: FactSet, Morgan Stanley as of June 30, 2025. Estimates in USD.

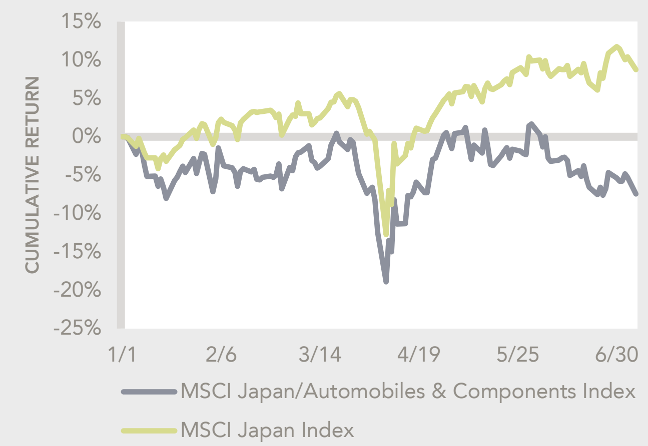
In particular, the Eurozone's broad-based rally bears watching to see if the positive momentum continues. Finally, it goes without saying that while the worst of the tariff-induced selling is behind us, tariffs loom over the market, with Japan one of the prime examples.

EUROPEAN SECTOR PERFORMANCE



Source: FactSet as of June 30, 2025

TARIFFS CONTINUE TO IMPACT POCKETS OF THE MARKET



Source: Bloomberg as of July 7, 2025

There is much to watch the second half of the year, from tariff revisions to Fed policy to earnings reports. The overhang of unpredictable and constantly changing economic policy makes it even more difficult to forecast markets. Although overall risk indicators do not suggest a correction is imminent, valuations are high and markets led by multiple expansion can be quick to correct. While it is likely too early to suggest a "new normal" powered by fluid policies, we are carefully monitoring the economic and geopolitical landscapes to see what they deliver to markets.

Until next time,

Greg Leonberger, FSA, EA, MAAA, FCA
Partner, Director of Research
gleonberger@marquetteassociates.com

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS

PHONE 312-527-5500
WEB marquetteassociates.com

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