

## July 2025

### Market Update

Markets have been active in 2025, but returns are not too far off what you might expect at the halfway point of the year. Many asset classes (US large, US mid/small, low-quality bonds, real estate, and commodities) turned negative after tariff discussions started. But prices reversed over just the course of just a few weeks, and now all primary asset classes except for US small caps are positive.

Bonds are up 4.0% with TIPS (Treasury Inflation-Protected Securities) bonds and lower quality bonds up 4.5%. The S&P 500 is up 6.2% with value and growth stocks up the same amount. US small caps are slightly negative at -1.8%. However international stocks are up between 16% and 20% YTD. Real estate and commodities are both up about 2.0%. Gold is the best performing asset class at +24.4%.

One of the biggest movers so far this year has been the US dollar. The dollar had been moving higher since 2011 largely because US interest rates have been above those of most of the world's developed market rates. But over the last 50 years the dollar is lower, and in 2025 is about -10% YTD. This has helped the returns of assets that are priced in foreign currencies such as foreign bonds, stocks, and real estate. For a US based investor, the returns of these assets are roughly 10% higher than the US equivalent assets. For foreign based investors though, returns in their local currencies are roughly the same what US investors have received investing in US assets.

The Federal Reserve has kept rates steady, which is probably the better course of action in hopes that inflation will continue to fade. It is encouraging to see inflation falling but still remains above the 2% target. Inflation protected bonds have performed better than nominal bonds, and gold has outperformed every other broad asset class, indicating the market still sees inflation as a risk.

But growth also appears to be slowing. New jobs, while positive, have continued to slow over the last several quarters. Consumer defaults have been rising, and consumer confidence has remained low for some time. This is likely a result of interest rates remaining high and slowing growth and inflation. However, since inflation is approaching target, the Fed may decide to begin lowering rates if economic numbers, while positive, continue to grind lower.

Our base case for 2025 is that GDP will slow from current levels. Higher interest rates and higher debt pressure on US households will have a slowing effect on spending and growth. Household net worth is likely to remain bolstered by home values and investment accounts which have remained high. Inflation may have become entrenched above the Fed's 2% target. Markets and interest rates generally appear to be at appropriate levels with the exception of the largest and growthiest US companies which are trading 2-3 standard deviations above their typical valuations.

## Fixed Income Strategy

The fixed income markets delivered somewhat more muted performance in the second quarter than the first but broadly posted solid returns for the quarter. Market performance was driven by a resumed steepening of the yield curve, as shorter maturity yields fell, while longer maturity yields rose. The 10 year benchmark Treasury was the fulcrum of the yield curve; little changed from beginning to end at 4.23%. However, this masked the intra-quarter volatility of yields, particularly in the wake of the Liberation Day tariff announcements, where the 10 year yield traded in its widest weekly range since 2001, trading as high as 4.59% after bottoming at 3.86% in that short time span.

Following the Trump administration's decision to ease off some tariff rate increases and allow time for negotiations with trading partners, fixed income volatility eased and has settled into more of a range-bound trading environment. While tariff rates have moved significantly higher and may move higher still, it seems likely that they will remain at levels shy of a de facto trade embargo with other countries, particularly China. We believe the impact of this policy in the near term will be to reduce economic growth, while adding to inflationary pressures. Part of the economic drag is the uncertainty of final tariff and trade details, causing businesses to hold off on larger expenditures and hiring. Somewhat counteracting this is the impending passage of the One Big Beautiful Bill budget, which looks to be modestly stimulative in the coming several quarters.

Despite pressure from the administration to cut rates, the Federal Reserve held its policy rate steady this quarter and it has been unchanged this year. Since final tariff rates are still unknown, the committee is unsure of the degree to gauge them and are concerned that anticipated inflation from tariffs could become persistent. Although the economy looks to have softened somewhat from last year, underlying growth continues at a reasonable pace. While labor market growth has also cooled, unemployment remains at what is thought to be full-employment levels. As the Fed projects two rate cuts in 2025, it will take a continued absence of tariff pass-through to inflation, or a cracking in the labor market, to justify the action to cut.

Although corporate spreads widened sharply after Liberation Day announcements, investment grade spreads ended the quarter modestly tighter at +83bps. High yield credit spread volatility and subsequent tightening was stronger, narrowing to +290bps as equities powered to all-time highs. An overall solid fundamental backdrop, coupled with strong demand from investors, has supported the corporate markets, leading to historically tight spread levels.

Due to what we feel is a wide range of policy and economic outcomes, along with tighter corporate spreads, we have a balanced approach across our strategy. As a result, our maturity distribution is relatively balanced with an overall duration being overweight. We have incrementally increased our government sector allocation, including adding exposure to TIPS, as corporate spreads have become less attractive, although our strategy has maintained a corporate sector focus to augment portfolio yields.

## Equity Income Strategy

The Equity Income strategy's primary goal is to provide reasonable income while also offering the potential for capital appreciation.

Capital preservation strategies in the second quarter underperformed the broader market. The "risk-on" sentiment favored more speculative, low-profitability companies instead of equities with steady, reliable cash flows. These strategies, which focus on minimizing volatility and prioritizing stable assets, couldn't capture outsized returns as the overall US market and growth stocks outperformed, particularly the Information Technology and Industrials sectors. Relative to the benchmark, the Equity Income strategy delivered a return of about 2.3% in the second quarter, outperforming the underlying benchmark which fell about -1.6%.

In the quarter we had no trades to report.

As always, we continue to look for opportunities to upgrade the quality of the portfolio while staying true to our disciplined valuation process.

## **Defensive Equity Strategy**

The Defensive Equity strategy remains focused on identifying companies with stable operating results and reduced stock price volatility in the broader market.

Despite the market's strong preference for growth stocks in the second quarter, low volatility and defensive strategies managed to produce competitive returns alongside the broader rally. These approaches, often focused on stable, dividend-paying companies, attracted investors seeking reduced risk amid ongoing uncertainty. Their performance underscores the continued appeal of risk-managed exposure during periods of market volatility.

From a portfolio perspective, we added Salesforce, FTI Consulting, and LVMH. We exited Fortrea and International Flavors and Fragrances.

## **Core Equity Strategy**

The second quarter of 2025 was marked by elevated market volatility. After a tariff-driven sell-off in early April with the S&P 500 touching bear market territory (-20%) the market staged a robust recovery, ending the quarter with a total return of approximately 11%—its best quarterly performance since 2023. The rebound was supported by a 90-day pause on newly announced tariffs, a corporate earnings season that exceeded muted expectations, and continued outperformance by mega-cap technology stocks.

Despite this broad market strength, a notable divergence in performance was observed across various sectors. Specifically, the Healthcare, Energy, and Consumer Staples sectors underperformed the broader market, returning around -7%, -8%, and 1%, respectively. The challenges faced by the Healthcare sector were largely driven by company-specific issues, particularly with major players like UnitedHealth Group, which contended with increased utilization costs and heightened regulatory scrutiny related to Medicare Advantage. Concurrently, the Consumer Staples sector grappled with

persistent inflationary pressures on input costs and a diminished capacity to pass these costs onto the consumer. Lastly, the Energy sector struggled as oil and gas supply is expected to outpace demand through 2025, leading to lower prices. Geopolitics, trade policy impacts, and financial pressures also contributed to the underperformance.

The "Magnificent 7" group of technology giants, which experienced underperformance in the first quarter of 2025, rebounded, delivering a return of 23.7% over Q2. This performance outpaced the remainder of the S&P 500 by about 14%. The Industrials sector did well as the aerospace industry continues to benefit from increasing air traffic and higher aftermarket sales, which has contributed to above average sales growth and margin expansion.

The Federal Reserve maintained its target interest rate at 4.25%-4.50%, lower than the peak of 5.50% the year prior. The Fed's decision to keep rates at current levels reflects a cautious stance, given persistent inflationary pressures and a healthy labor market. Economic indicators during the quarter presented a mixed picture as job growth remained steady, and wage growth continued to outpace inflation. The housing market continued to face an affordability crisis, characterized by a widening gap between property prices and incomes.

From a portfolio standpoint, we exited Estee Lauder in the quarter.

## International Equity Strategy

International markets strength continued into the end of the second quarter of 2025 with gains of around 12%. The Communication Services, Information Technology, and Industrials sector led the way, rising approximately, 20.6%, 19.1%, and 17.9%, respectively. International equities continued to outperform US stocks, supported in part by investor caution toward increasing US exposure amid ongoing tariff uncertainty.

The Industrials sector's strong performance was partly supported by fiscal developments in Europe, where countries like Germany announced major spending plans focused on infrastructure and defense. This wave of government investment is expected to benefit companies involved in construction, manufacturing, and defense. Additionally, a North Atlantic Treaty Organization (NATO) summit agreement committing member nations to increase defense budgets further boosted demand for defense-related stocks, contributing to the sector's outperformance.

Our goal is to have a portfolio of high-quality businesses with competitive advantages that can withstand changes in economic conditions and thrive through a business cycle. Companies with established moats often expand market share and strengthen their business during a downturn. These are the types of companies that we continue to look for in the International Equity strategy.

While we cannot predict near-term risk factors, we can control the companies we invest in. Our disciplined approach of owning high quality, financially viable and intrinsically cheap companies form the International Equity portfolio.

From a portfolio standpoint, we added ING Bank. We exited positions in International Flavors and Fragrances, FMC Corp, and STMicroelectronics in the quarter.

## **Value Strategy**

In the second quarter, the Russell 1000 Value benchmark rose about 3.8% while the Value strategy rose about 5.2%.

At the sector level, Information Technology led the benchmark with a gain of approximately 15.7%, driven by resilient fundamentals and investor enthusiasm for AI-related innovation. Industrials followed closely, advancing around 13.5% as infrastructure demand and capital investment trends remained supportive. In contrast, Health Care and Energy were the weakest performers, each lagging the broader market amid sector-specific headwinds and shifting investor sentiment.

The second quarter saw a sharp shift in market leadership, with growth stocks strongly outperforming value stocks—a notable reversal from the prior quarter. This renewed preference for growth was driven by strength in the Technology, Communication Services, and Industrials sectors, which led the broader market higher. In contrast, the Health Care sector declined approximately 8.7%, pressured by lower-than-expected Medicare Advantage reimbursement rates that weighed on managed-care insurers. Rising medical costs, fueled by greater use of GLP-1s and other specialty drugs, further added to the sector's challenges. The Energy sector also underperformed, falling around 7.6%, as increased Organization of the Petroleum Exporting Countries (OPEC) production placed downward pressure on oil prices.

As always, valuation continues to guide sector positioning. At present, we see compelling opportunities in healthcare and consumer staples, where relative value remains attractive.

From a portfolio standpoint, we added a few new names: Danaher, Vulcan Materials, Lowe's, and Ross Stores. We exited positions in InMode, Centene, Okta, On Semi, Anheuser Busch InBev, Helmerich and Payne, International Flavors and Fragrances, FMC Corp, Mercedes-Benz, and Capri in the quarter.

## **Thematic Equity Strategy**

Thematic is by far our most aggressive growth strategy with over 40% in Technology and 10% in Biotech –to this extent Thematic outperformed this quarter due to its exposure to Technology and investors increasing their risk spectrum.

As ever, we remain vigilant in our efforts to identify new themes of secular growth that would benefit the strategy.

## **Covered Call Strategy**

The primary goal of The Covered Call strategy is to obtain exposure to equities, with greater income potential at the cost of reduced upside participation.

This quarter we maintained our strategy and allocated roughly 15% of capital invested in the Russell 2000 via the IWM ETF. While small caps may be more vulnerable in the event of an economic downturn, the relative valuation of the Russell 2000 compared to the S&P 500 remains attractive. Additionally, allocating a portion of assets to the Russell 2000 helps to lower the concentration risk in megacap tech that remains a concern in the S&P. Finally, option prices in IWM are higher, offering greater return potential.

We also maintained a high cash level (generally above 10% on average). This benefitted the strategy earlier in the year during market declines, but was a drag during the second quarter as equities rallied and the S&P 500 hit all-time highs. This cash position was helpful to fund call sales as we rolled strike prices higher given the rise in equity markets. If equity valuations become more stretched, we may adjust positioning accordingly to better calibrate the risk/reward of the strategy.

Investors in the growth and accumulation phase of their investing life cycle or those with a strong bullish outlook may wish to look at other appreciation-focused strategies, while those in the distribution phase or with a more neutral market outlook may find Covered Call an attractive complement to their traditional portfolios.

## Sources & Disclosures

### **For Internal Fidelity Use Only - Not for Client Distribution**

All earnings data comes from Standard and Poors' S&P 500 Earnings and Estimates Report as of 6/30/2025

All economic data comes from Federal Reserve Economic Data (FRED) as of 6/30/2025

Asset class performance numbers come from Morningstar as of 6/30/2025

The S&P 500® is widely regarded as the best single gauge of large-cap US equities. There is over USD 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately USD 3.4 trillion of this total. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

Treasury yields are yields on debt obligations issued by the US Government. US Treasuries can be purchased individually.

The Russell 2000 Index® measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The iShares Russell 2000 ETF (the IWM ETF) seeks to track the investment results of an index composed of small-capitalization US equities.

The Russell 1000 Value Index measures the performance of the large-cap value segment of the US equity securities. It includes the Russell 1000 index companies with lower price-to-book ratios and lower expected growth values. It is market-capitalization weighted.



Standard deviation is a statistical measurement that shows how spread out a set of data is. It is used to assess risks of investments.

A "Moat" is a term that refers to a business's ability to maintain a competitive edge over its competitors.

The Magnificent Seven is a group of high-performing US stocks and includes Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla.

Treasury Inflation-Protected Securities (TIPS) are US Treasury bonds indexed to inflation to protect investors from decline in the purchasing power of their money. The principal value of TIPS increases with inflation and decreases with deflation.

Investors should be aware that there are risks associated with options. Additionally, options transactions produce tax consequences when closed. Market related actions, political issues, and economic issues can adversely affect the option market. These factors could restrict, halt, suspend, or terminate option positions written (sold) or purchased, which would prevent us from an ability to act or react to any of these conditions. Note: Options involve risk and are not suitable for everyone. Prior to buying or selling options, you should read the option disclosure document, Characteristics and Risks of Standardized Options, which can be obtained on the Options Clearing Corporation website at <https://www.theocc.com/about/publications/character-risks.jsp>, or by contacting your custodian.

**PAST PERFORMANCE IS NOT AN INDICATION OF FUTURE RETURNS.** Information and opinions provided herein reflect the views of the author as of the publication date of this article. Such views and opinions are subject to change at any point and without notice. Some of the information provided herein was obtained from third-party sources believed to be reliable but such information is not guaranteed to be accurate. We do not guarantee the content or its accuracy and completeness. The content is being provided for informational purposes only, and nothing within is, or is intended to constitute, investment, tax, or legal advice or a recommendation to buy or sell any types of securities or investments. The author has not taken into account the investment objectives, financial situation, or particular needs of any individual investor. Any forward-looking statements or forecasts are based on assumptions only, and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. Any assumptions and projections displayed are estimates, hypothetical in nature, and meant to serve solely as a guideline. No investment decision should be made based solely on any information provided herein and the author is not responsible for the consequences of any decisions or actions taken as a result of information provided in this article. There is a risk of loss from an investment in securities, including the risk of total loss of principal, which an investor will need to be prepared to bear. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable or suitable for a particular investor's financial situation or risk tolerance. Exencial Wealth Advisors, LLC ("EWA") is an investment adviser registered with the Securities & Exchange Commission (SEC). However, such registration does not imply a certain level of skill or training and no inference to the contrary should be made. EWA may only transact business in those states in which it is registered, notice filed, or qualifies for an exemption or exclusion from registration or notice filing requirements. Complete information about our services and fees is contained in our Form ADV Part 2A (Disclosure Brochure), a copy of which can be obtained at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov) or by calling us at 888-478-1971.