Q2 2025 Investment Letter

with Kevin Arenson, Akshay Krishnan & Tim Beck

Market Commentary

Equities	Q2	YTD
MSCI World (USD)	11.0%	8.6%
MSCI EM (USD)	11.0%	13.7%
S&P 500	10.6%	5.5%
STOXX Europe 600 (USD)	10.3%	21.2%

Fixed Income	Q2	YTD
FTSE Global Bonds	4.6%	7.3%
Investment Grade	2.0%	4.5%
High Yield	3.7%	4.9%
Bloomberg Global Agg Bond	4.5%	7.3%

Currencies	Q2	YTD
USD (DXY)	-7.0%	-10.7%
EUR (vs USD)	8.8%	13.7%
JPY (vs USD)	3.9%	9.1%
GBP (vs USD)	6.3%	9.5%

Commodities	Q2	YTD
Gold	5.8%	25.6%
Oil (WTI)	-8.9%	-9.2%
Natural Gas	-16.1%	-4.9%
Bloomberg Commodity	-4.1%	3.3%

Source: Bloomberg as of 30 Jun 2025

Q2 saw a number of events which impacted markets negatively, only to then recover as markets digested and saw moderation from potential scenarios. The quarter began with Liberation Day on 2 April and the announcement of a wide range of tariffs by the US, the levels of which far exceeded almost anyone's expectations, leading to a broad-based selloff in both equity and fixed income markets. The S&P 500 experienced its fifth worst cumulative 2-day decline in history (-10.8%). By mid May, the market began to rally as the US appeared to moderate with first a 90-day pause in tariff impositions and also reductions including, critically, de-escalation with China. The market effectively rediscovered the "Trump put" or "TACO" (Trump Always Chickens Out), though the essence is that trade tension has eased from the start of the quarter, with important agreements reached with major trading partners to the US.

The US also passed the One Big Beautiful Bill Act (OBBBA) in May, which made permanent the tax cuts from Trump's first term, as well as new funding and spending commitments of over $3.4tn. This led to further debate over the trajectory of the US fiscal situation and, at least in part, prompted Elon Musk to exit the administration. Fixed income yields also rose as a result, with the US 10-year hitting 4.5% before declining towards quarter end.

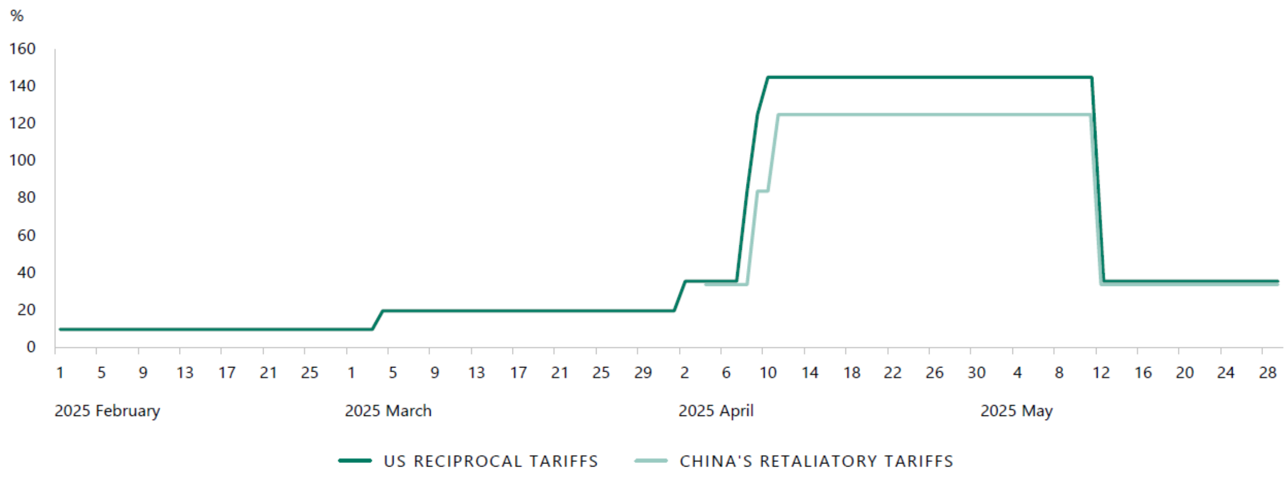
Geopolitical tensions again escalated with Israel, and then the US, launching a number of airstrikes on Iran. While Iran did retaliate, it was restrained from what this could have been, followed by a ceasefire between Israel, US and Iran. Market impacts, with a spike in energy markets in particular, have since largely reversed.

Markets delivered strong performance overall. The MSCI World rose 11.0%, with gains across regions. Notably, the narrative of US underperformance paused, as AI-related equities led the charge though the USD weakened against most currencies. Credit spreads tightened, with high yield and investment grade spreads reaching historically narrow levels (high yield now sits in the 8th percentile since 1997). However, yields remain relatively attractive given elevated risk-free rates. Fixed income rallied alongside falling interest rates, with the US 10-year yield dropping 35bps to end the quarter at 4.23%. Commodities were broadly negative, though precious metals outperformed amid rising concerns over fiscal sustainability

Despite political pressure from the US administration, the US Federal Reserve kept interest rates constant at 4.25-4.50%, as well as the median end-2025 forecast of two 25bps rate cuts for the remainder of the year. The Fed did highlight the increased economic uncertainty and the increased risks of higher unemployment and inflation, increasing the forecast of inflation by 0.3% to 3.1% for 2025 and revising down the estimate for economic growth by 0.3% to 1.4%. There is a general trend towards easing of monetary policy, but with some divergence with the ECB following their two cuts in Q1 with a further one in June.

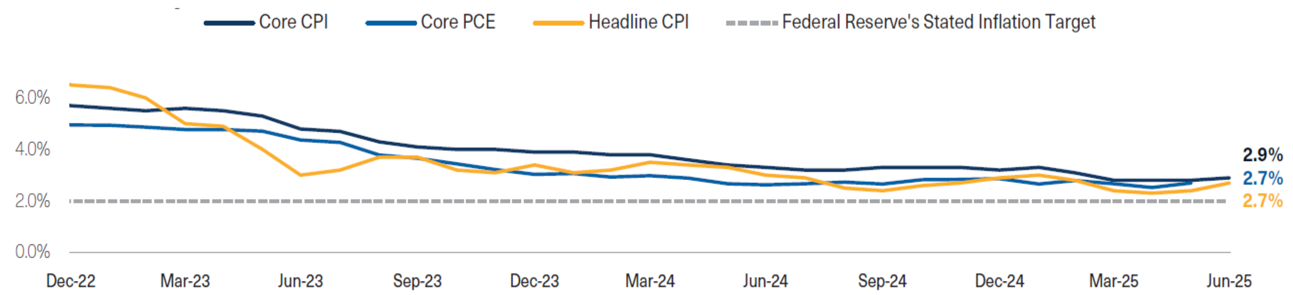
Trade policy has seemingly stabilised, but this is still a major change to the world economy; according to the Yale Budget Lab, the average effective tariff rate is 15.8% per current US policy, the highest level since 1936. While there may be some stability now, it is unclear how persistent this will be. Below are the stated tariffs between the US and China, just to illustrate how extreme announcements have been.

US-China tariffs have been on a roller-coaster ride[1]



These tariffs, even at more moderate levels, have yet to work through the system as retailers stockpiled inventory ahead of the levies, but it would seem likely to have an impact on inflation; Deutsche Bank estimates the first-round impacts to be 0.9% additional inflation. The rate of inflation picked up in June (CPI rose 0.3%) after a steady decline in 2024 and 2025, remains higher than the Fed target but far from alarming levels, though we would expect this to increase.

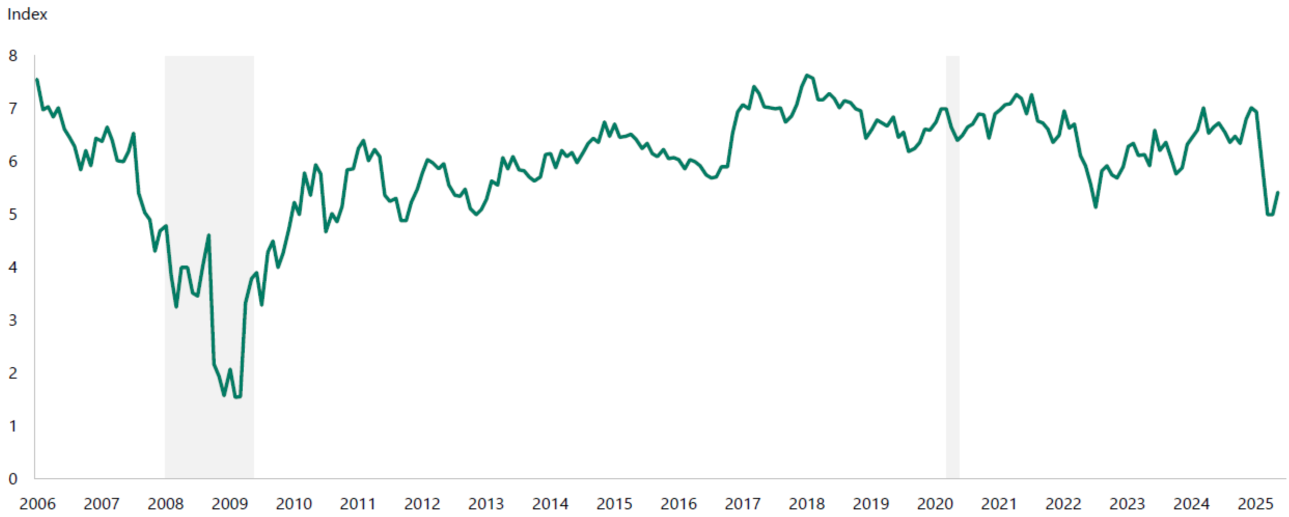
US Inflation (% year over year change)[2]



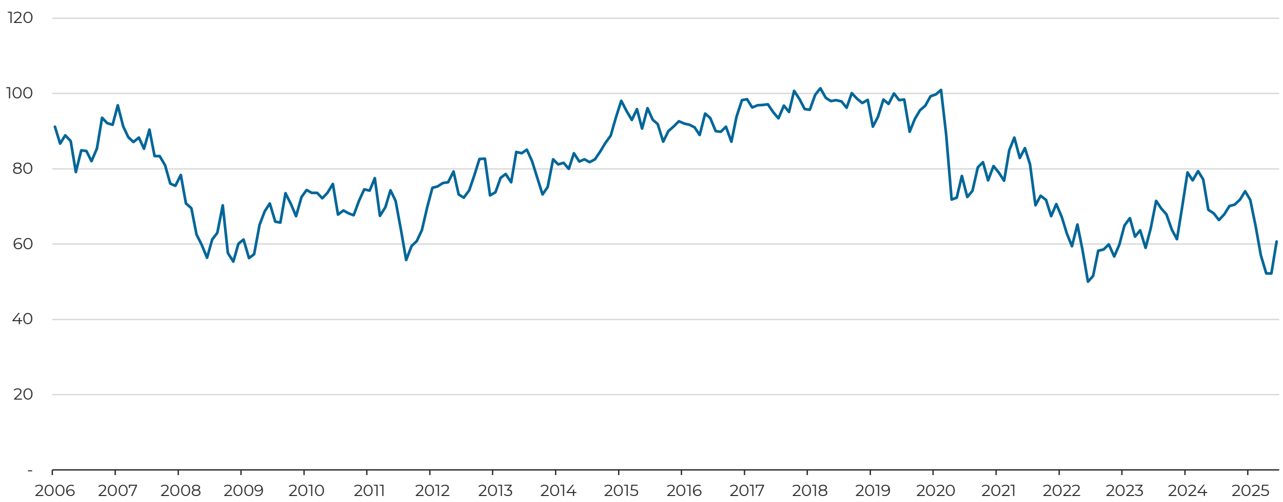
[1] *Data as of 29 May 2025. Source: White House, China Ministry of Finance, Macrobond, Apollo Chief Economist.*
[2] *Source: Bloomberg. Core CPI and Headline CPI shown as of 30 Jun 2025. Core PCE shown as of 31 May 2025.*

Demand and consumer sentiment have moved in line with policy announcements, and overall, tend to be at perhaps unexpectedly depressed levels. Consumer sentiment rebounded towards the end of the quarter but remains at levels similar to those seen during Covid. Similar surveys indicate the same concerns, such as consumers worried about losing jobs, all the more surprising given the low level of unemployment as well as a record share of consumers pessimistic about the economy and a sustained fall in CEO confidence.

CEO Confidence Index: confidence in the economy 1 year from now[1]



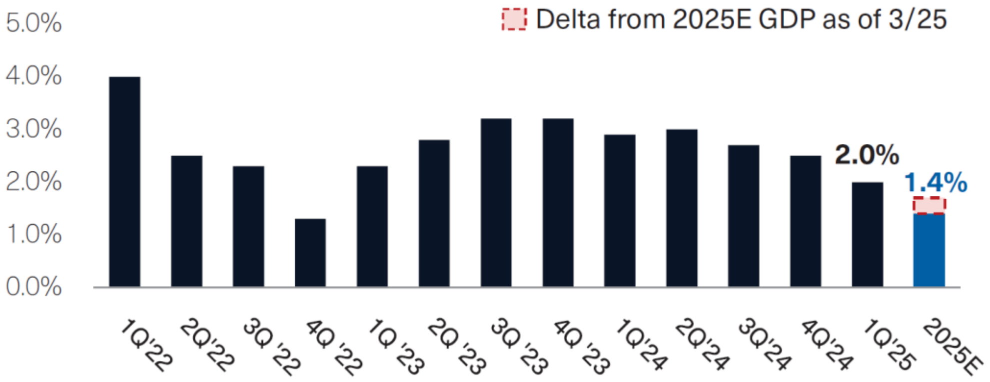
US consumer sentiment[2]



[1] *Data as of 1 May 2025. Source: Chief Executive Magazine, Bloomberg, Macrobond, Apollo Chief Economist.*
[2] *Source: University of Michigan via FRED.*

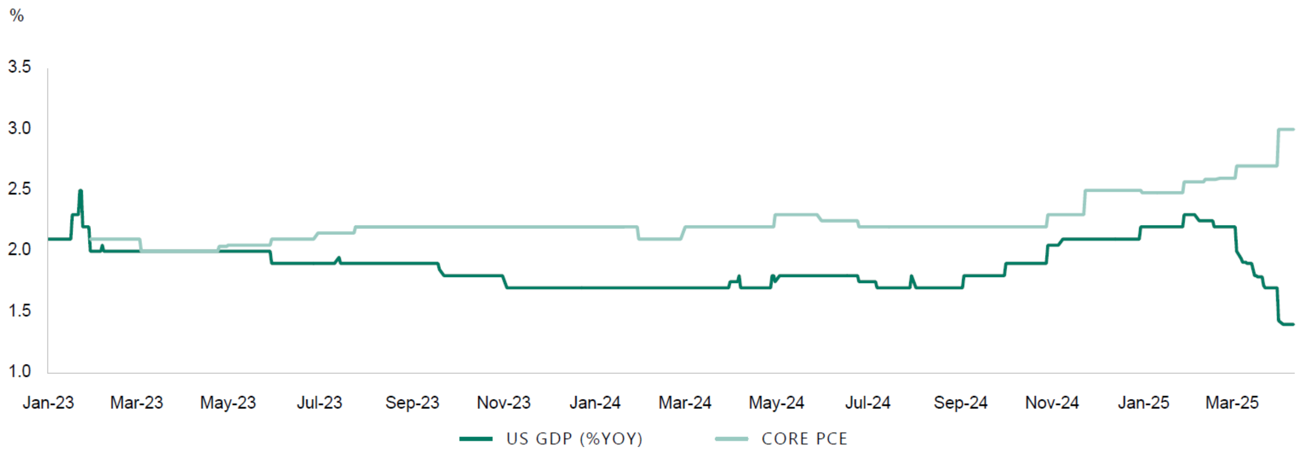
Economic growth has trended down, albeit remaining positive, and expectations for economic growth has also fallen moderately.

US Real GDP: % change from the preceding year[1]



A potential US recession in the near term seems less likely with the passing of the stimulus in the Trump tax and spending bill, which should drive near-term consumer spending. However, tariffs are typically stagflationary, and there does seem to be evidence of growing pressure of higher inflation and lower economic growth, evidenced by the Bloomberg consensus forecast.

Bloomberg consensus forecast 2025[2]



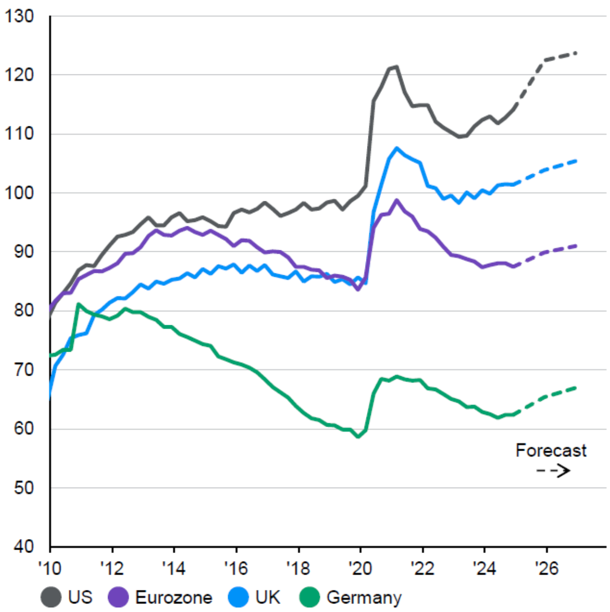
The impact of tariffs will not be confined to the US – the US is a net contributor to global aggregate demand. In contrast to the 1930/40s when tariffs were at similar levels, the US now runs a trade deficit rather than surplus. Any deterioration in the health of the US consumer will have wider implications on the global economy.

There is the ongoing concern and threat of deteriorating fiscal positions in developed economies. The new budget bill in the US looks set to increase spending, the deficit and debt still further. Government debt is forecast to increase in the coming years from already historic high levels. Developed economies have shown an inability to reduce budget deficits (let alone debt) and it is difficult to see the motivation for a political party to do so given electoral cycles outside of a fiscal crisis. The US is not alone, and probably the least vulnerable

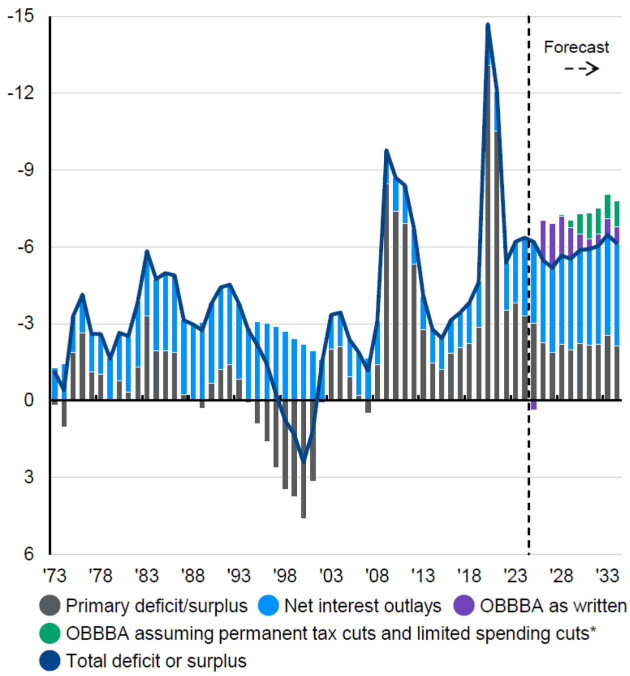
[1] *Data as of 30 Jun 2025. Source: Bloomberg. Projected 2025 GDP reflects FOMC Projection materials published on 18 Jun 2025.*
[2] *Data as of 5 May 2025. Source: Bloomberg, Apollo Chief Economist.*

given the USD's reserve currency status, with other developed markets, including the UK, seeing similar pressures, made all the more acute with the increase in interest rates and so interest payments representing a large portion of government deficits.

Government debt[1]
% of nominal GDP



Composition of the US federal deficit[2]
% GDP



The AI-driven rally in Q2 shows how secular themes can outweigh other factors and indeed drive the performance of entire sectors. How ultimately disruptive AI is to existing companies is still unknown, but its impact is and will be huge. We are beginning to see AI-driven revenue and growth come through; this is not just from the existing large companies but also newer startups, which are scaling more rapidly than many of the SaaS predecessors. The future growth and need for capital expenditure is massive with Goldman Sachs estimating capex from the major US hyperscalers at over $400bn per year from 2027. The need to provide this financing will become a key theme in fixed income markets in the coming years and the developments resulting from it likely to be a major driver of all markets.

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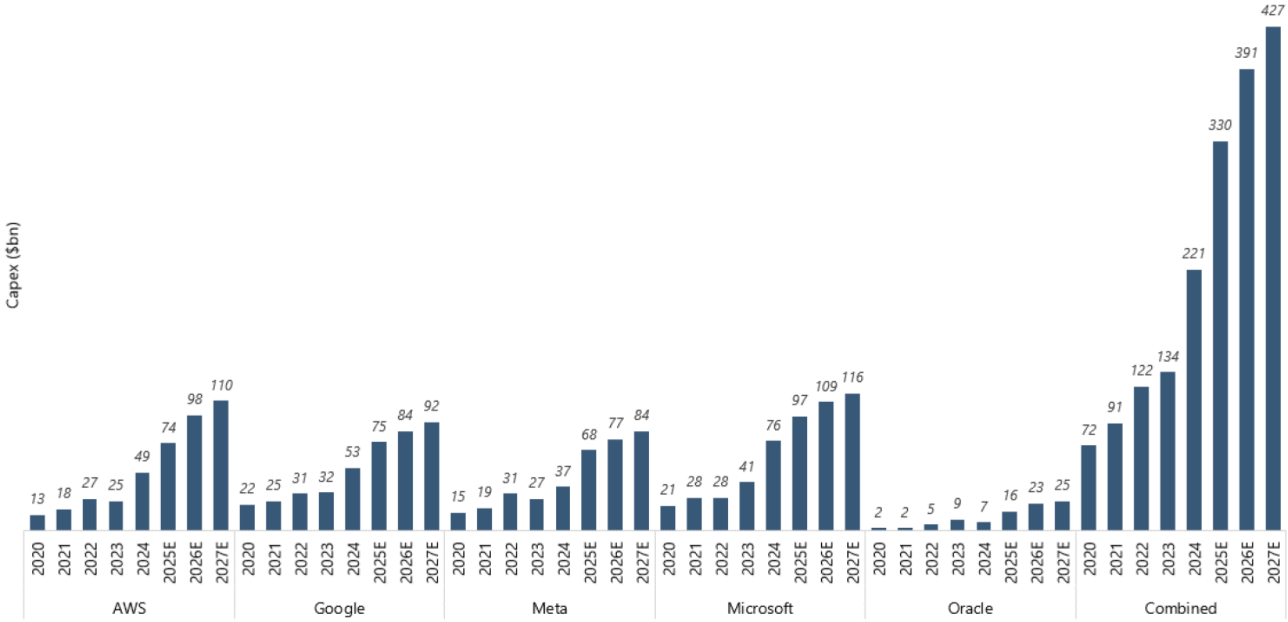
[1] *Debt refers to gross debt at face value. Dotted lines represent IMF forecasts. Source: Bank for International Settlements, Eurostat, IMF, LSEG Datastream, JP Morgan Asset Management.*

[2] *Data as of 30 Jun 2025. Source: BEA, CBO, CFRB, US Treasury, JP Morgan Asset Management. *Assumes tax cuts and incentive provisions are made permanent, and backdated spending cuts are not implemented. Forecasts are based on the CBO's latest budget and economic outlooks, CFRB projections and internal JP Morgan Asset Management estimates. Years shown are fiscal years. Guide to the Markets -UK. Data as of 30 June 2025.*

US hyperscaler capex by company ($bn)[1]



We have seen huge volatility in economic policy/announcements as well as geopolitics. While each individual event did not transpire into the worst case (and markets made back any losses they suffered), it does show the levels of uncertainty. While a global recession is not by any means a base case, there are risks and significant uncertainty. At the very minimum, we expect more pressure on economic growth and a likely pick up in inflation, which will keep interest rates higher for longer. We are also conscious of market complacency – there seems to be a general belief that policies will be backtracked if they start having an impact on markets. To some extent that has proven true, but we would caution on assuming that at all times, or indeed, that such a solution is always possible.

Strategy Allocations

Our portfolios performed well in Q2 and have generated solid gains for the year, typically up 4-6% YTD, with some higher. We continue to run with limited (if any) beta to markets. We see no reason to change this stance, given the significant uncertainty which exists, and continue to believe that a target return of high single digits with no beta to markets is highly attractive. We maintain a continual focus on accessing both high-quality new launches (often only available to a small number of select investors) and existing funds, which have been closed but may open for new capital raises.

Discretionary and Systematic Global Macro

Uncorrelated strategies had another strong quarter with discretionary macro managers leading gains. Quantitative equity market neutral strategies were also positive, while some relative value managers and commodity funds struggled.

Many discretionary macro managers entered April with reduced risk ahead of the tariff announcements on Liberation Day. They were able to use the market volatility and dislocations to build positions which worked subsequently throughout the quarter. Most managers added to their short exposure in the USD against

[1] *Source: Goldman Sachs as of 30 Jun 2025.*

developed market and emerging market currencies. Within interest rates, managers continued to hold a view that yield curves globally would steepen. The short USD risk and steepening views in yield curves drove gains for much of the quarter. Some managers struggled from flatteners in the long-end of the Japanese bond market, as well as positions in US swap-spreads. Overall, we were pleased with how our managers navigated the volatility in April and generated gains.

Quantitative strategies had a good quarter with performance once again led by equity statistical arbitrage strategies. These managers generated strong returns in April and May, and have had a phenomenal start to the year. However, they struggled towards the end of the quarter amid a rally in “junk” stocks, including heavily shorted names, which has continued into July.

Relative value returns were flat. Our fixed income-focused relative value managers were profitable, while our manager focused more on equity relative value, including volatility arbitrage, struggled. In general, relative value managers struggled amid the market volatility in early April and de-risked portfolios, which meant they could not fully participate in the market recovery.

Our long volatility hedges were positive, with our managers focused on long volatility strategies in equities, currencies and rates outperforming our short credit managers.

Commodity strategies were mixed amid the choppiness in commodity markets. Both discretionary and systematic commodity managers struggled. Quantitative strategies had a good quarter with gains led by equity statistical arbitrage strategies. These managers started the year strongly as the momentum factor rebounded in January following a poor December. More elevated market volatility and volume created liquidity provision opportunities. Mean reversion signals also did well.

Equity Long/Short

Equity markets delivered strong gains in Q2 despite a volatile start to the quarter. As mentioned, the MSCI World rose 11.0%, reaching a new all-time high, while the HFRI Equity Hedge advanced 7.6%.

The highly-anticipated Liberation Day, during which President Trump unveiled a series of proposed trade tariffs, proved more severe than markets had expected. This triggered a sharp selloff, with the S&P 500 falling nearly 20% from its February highs. Sentiment reversed a week later on 9 April following the announcement of a 90-day tariff pause, sparking a rapid recovery in equity markets. US technology stocks, including the ‘Magnificent Seven’ and other AI-related names, led the market recovery.

Stenham’s allocation to equity managers contributed positively to performance. Key drivers included a global multi-manager platform fund and a fundamentally-focused global long/short fund with moderate net exposure. However, our tilt toward less correlated equity managers meant that we did not fully participate in the sharp rebound. Our allocation to specialist managers across healthcare and utilities also proved a headwind, with both sectors underperforming. Healthcare has been particularly challenging; the S&P Healthcare sector had its worst quarter of relative performance vs. the S&P 500 since the early 1990s. We have decided to reduce some of our directional exposure to this sector but retain an allocation to select managers we think can generate returns independent of market direction.

Event Driven

Deal activity in Q2 was similar to Q1 with $1.16tn of deals announced per Bloomberg. This is up from 2023, but significantly down from 2021 and the start of 2022, and indeed from the expectations at the start of the Trump presidency. With some stability in tariff negotiations we are optimistic deal levels may increase.

That said, our event driven allocation had a very strong quarter and one of the strongest we have seen. Our managers were able to capitalise and benefit from positive events in older transactions. These included US Steel, which concluded its takeover by Nippon Steel, as well as some soft catalyst positions in preferred securities of the GSEs, and a soft catalyst equity position driven by both fundamentals and technicals with the stock having a heavy short interest. Overall, there were also very few significant detractors from performance.

Credit

Our credit allocation performed well, though with performance down from Q1. Long/short managers were able to protect capital in the selloff in April, with one then able to lightly lean into the market and benefit from the recovery in spreads. More short-biased managers gave back some performance. Our convertible bond manager was positive, though convertible bonds generally saw some price weakness with strong issuance towards the end of the month. With spreads tight, managers are generally conservatively positioned and have reduced both gross and net exposure.

Summary

We are encouraged by both the performance of our portfolios and our growing access to high-quality funds, which are often capacity constrained. The outlook remains strong with a target to generate high single-digit returns with minimal beta to markets.

Thank you for your ongoing confidence. Please get in touch if you would like to hear more about our strategies or funds. Further information can also be found on our website.

The Executive Advisory Committee

Kevin Arenson

Akshay Krishnan

Tim Beck

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