Bitterroot
CAPITAL ADVISORS

CAPITAL MARKETS REVIEW

2025 Quarter 2

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Table of Contents

All public market data are as of April 15, 2025 unless indicated otherwise.

Executive Summary

- Equity Markets
- Government Bonds and Investment Grade Credit
- High-Yield Bonds & Leveraged Loans
- Hedge Funds
- Private Equity
- Private Credit
- Private Real Estate

Equity Markets

Global equities, as measured by the ACWI Index in USD, appreciated 11.5% in Q2 and are up 10.1% YTD. Equities (especially US markets) experienced significant volatility during the quarter. The ACWI Index swiftly declined by 10.1% from March-end through April 8th following the April 2nd Liberation Day tariff announcement (the S&P 500 declined by 15.0% during that same period). However, global equities rallied 17.4% (and the S&P 500 rallied by over 25% from intra-day lows) through June-end. The significant worldwide equity rally was a) driven by abating trade tensions following the Trump Administration's walking back of draconian tariff rates (and issuing a 90-day pause for trade negotiations with various countries), b) continued strong corporate earnings especially in the US, c) resumption of the AI trade in the US, and d) favorable currency movement associated with significant weakening of the USD. Following the sharp rally and YTD appreciation, global stock valuations have increased to 18.7x forward P/E from 15.5x at the April lows. The S&P 500's valuation has increased to 22.0x forward P/E from the 18.0x April lows. US valuations are near 15-year highs whereas international valuations are closer to historical averages. At current valuations, global and especially US equities are factoring in significant positive expectations with regards to a) trade tensions continuing to ease, b) geopolitical tensions not worsening, and c) favorable growth prospects arising from tax legislation passage in the US.

Government Bonds and Investment Grade Credit

During Q2, the Barclays AGG Index was up 1.2% with US government and investment-grade corporate bonds up 0.8% and 1.6% respectively. Treasury bonds benefitted from high coupon rates while bond yields remained stable at Q2 end vs. Q1 end (despite significant volatility during the quarter). Investment-grade bond performance was driven by high coupon rates and narrowing spreads. Spreads initially sharply widened from 95bps to 120bps following the early April Liberation Day announcement but then narrowed to 83bps by June end. YTD, the Barclays AGG Index is up 4.0% with gains driven by high coupon rates and price appreciation from bond yields that have declined by 35bps to 50bps across the curve. Bond yields have declined in response to mixed economic data and favorable inflation readings, which have increased expectations for rate cuts over the rest of the year. The AGG has also benefitted from investment grade corporate bond spread compression.

High-Yield Bonds & Leveraged Loans

US high-yield bonds were up 3.5% during Q2 with performance benefitting from high coupon yields, declining base rates, and tightening credit spreads. Spreads initially swiftly increased from 300bps to 450bps during the first week of April following the April 2nd Liberation Day tariff announcement before steadily retreating to end Q2 at 280bps as trade tensions abated and corporate earnings surpassed expectations. Leveraged loans were up 2.3% during the quarter, with performance benefitting from high coupon yields and tighter spreads.

Hedge Funds

Hedge funds (as measured by the HFRX Global Hedge Fund Index) were up 1.7% in Q2 and 2.4% YTD, with most strategies delivering positive performance. YTD, convertible arbitrage and long/short equity (+6.2% and +4.3%) performed best while global macro / trend following strategies performed worst (-3.1%).

Private Equity

Preliminary data indicates the private equity returns rose 1.8% in Q1 (latest data due to lagged reporting). US PE Deal activity declined to $234bln in Q2 from $279bln in Q1 as volatile tariff policy and overall macro uncertainty led to a pause in new deal activity. However, YTD, deal activity is still up 60% YTD. Exits also declined sharply, with Q2 exit value of $119bln well below Q1's $221bln figure. Still, exit value remained sharply higher than the quarterly levels of $50bln-$75bln seen through most of 2022 and 2023. Fundraising has slowed thus far in 2025, mirroring 2024's slowdown following three strong prior fundraising years.

The PE secondaries market represents a bright spot for deal activity with a 45% YOY increase in deal value during Q1 2025 relative to Q1 2024. This buoyant activity follows a record $160bln year in 2024 in terms of transaction volume. Both the LP-led and GP-led segments of the secondary market are experiencing healthy demand.

Private Credit

Private Credit (measured by the Cliffwater Direct Lending Index) increased by 2.1% during Q1 2025. This performance was softer than previous quarters' near 3.0% returns, with softer performance driven by slightly lower base rates and some negative mark-to-market impacts. Credit quality remains solid, and the percentage of loans in non-accrual status has remained stable. However, the percentage of income comprising paid-in-kind (PIK) rather than cash income has increased, which could portend future credit issues.

Within sponsor-backed direct lending, tight spreads continue to persist at the larger end of the market with unitranche deals pricing in the SOFR + 450-475bps range. However, spread compression has been less severe in the middle market with spreads at a 500-550bps range. Private credit borrower demand remains robust for bespoke capital solutions providers and for asset-backed lending.

Private Real Estate

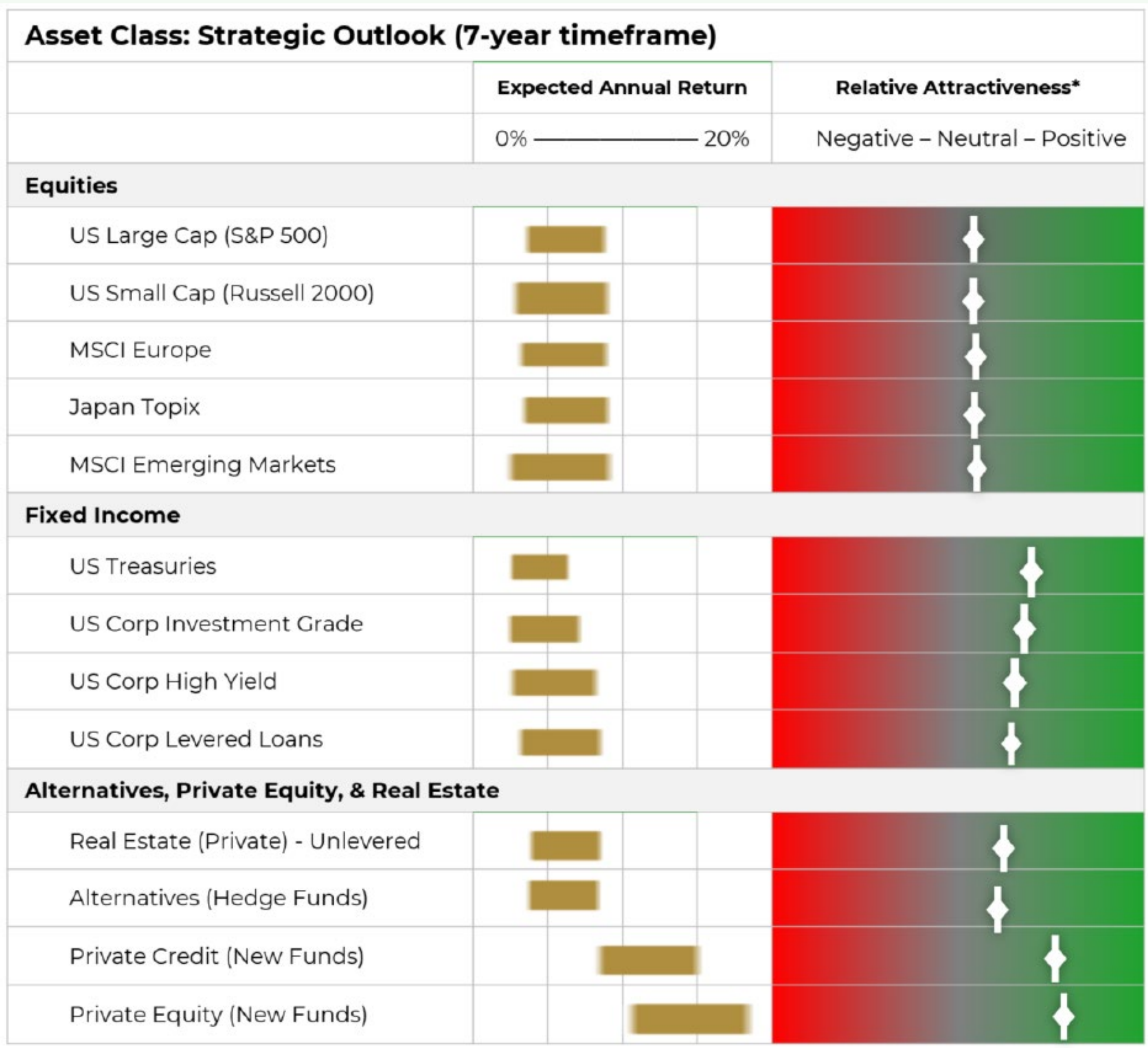
The private real estate market continued to experience a slight rebound in Q1, with the NCRIEF index up 1.3% in Q1 2025 (delayed reporting with a lag), marking the third consecutive quarter of positive performance. According to Green Street, prices for commercial real estate were relatively stable in Q1 and have appreciated by 5% over the past year. In recent months, however, pricing has remained relatively flat given the economic uncertainty. Operating fundamentals vary by property type with generally strong demand for apartment and industrial properties offset by surges in supply. Retail fundamentals appear strongest, and office fundamentals appear to have bottomed.

Strategic Asset Allocation (7-years)

- Macroeconomic and Market Factors
- Equity Market Outlook
- Fixed Income Outlook
- Credit Market Outlook
- Alternative Investment Outlook
- Portfolio Positioning

STRATEGIC ASSET ALLOCATION

Our 7-year forecasts consider several factors that will shape the mid-term investment landscape.



Note *: The attractiveness of each asset class (as depicted by the positioning of the sliders) is based upon riskadjusted returns when considering expected returns, volatility, and liquidity. Thus, US Treasuries with midsingle digit returns are shown as quite attractive given a low-risk profile whereas public equities are only rated modestly attractive despite their higher expected return as equities have much greater volatility.

Macroeconomic and Market Factors

Interest Rates Outlook

We anticipate that interest rates will decline from current levels over the forecast period, but they are unlikely to return to the ultra-low levels experienced from 2009 to 2021.

Corporate Profit Margins

Margins (especially in the US) will be affected by opposing forces. Increased onshoring, reduced labor flexibility from less immigration, and tariffs may exert downward pressure, while AI adoption could significantly boost productivity and expand profit margins, particularly in the U.S.

Geopolitical Risks

Heightened geopolitical uncertainty stemming from the U.S.-China relationship, conflicts in the Middle East, and the potential for other military tensions will likely influence market volatility and investment strategies. Traditional alliances may also fray as the Trump administration appears set on changing the global order both economically and with regards to defense.

Equity Market Outlook

Expected Returns

Following the furious market rally, global valuations have increased since early April. Notably, US equity valuations are trading well above historical levels. However, earnings uncertainty has also increased given heightened economic uncertainty. Weighing these factors, we now forecast 6.0%-7.5% nominal pre-tax annual returns over the next seven years. Given the potential for a prolonged seismic shift in global trade policies, along with shifts in geopolitical dynamics, we caution that the risk of lower-than-forecast returns is heightened.

U.S. vs. International Market

We have historically favored US stocks for several reasons including higher exposure to technological innovation, greater labor flexibility, a more shareholder-oriented corporate culture, and limited governmental involvement. While many of these factors still hold true, U.S. trade policy appears to be changing materially, with the “new world order” ramifications still unknown. We still anticipate US outperformance over the next several years but expect the magnitude of this outperformance to be lower, especially given elevated US equity market valuations.

Growth vs. Value Stocks

Quality and growth stocks are expected to continue outperforming value stocks, though at a slower pace compared to the past seven years, given elevated growth stock valuations. For U.S. equities, earnings growth and dividends are likely to be the primary drivers of returns, rather than multiple expansion.

Potential Wildcards

The adoption pace of generative AI could significantly impact U.S. tech sectors, potentially leading to above-trend revenue growth and margin expansion. Conversely, should AI capex spend decline from extremely robust current levels or revenue monetization from AI prove lower than expected, several US large-cap technology stocks may experience muted stock performance. Given their high concentration in the index, S&P 500 performance may be heavily influenced by the performance of a select number of stocks. Additionally, the ultimate level of US tariffs and any retaliatory actions or negotiated agreements remains to be seen.

Fixed Income Outlook

Modestly Attractive Base Yields

"Safe" fixed income remains appealing (especially in light of slowing economic growth and heightened uncertainty), although slightly less so than a few months ago. For US Treasuries, base yields across the curve range from 3.8% to 4.3% for maturities between 2 and 10 years. U.S. 10-Year Treasuries currently yield 4.3%, significantly higher than the 3.6% lows seen in September, but lower than the 4.7% levels observed in early February. We expect yields to stay within a 3.5% to 5.0% range in the near term, with a potential retrenchment from current levels appearing more likely than a sustained surge above 5.0%.

Expected Returns

We project close to mid-single digit returns for U.S. government debt and investment-grade bonds over the 7-year horizon.

Credit Market Outlook

Riskier Credit Assets

High-yield bonds have a yield-to-maturity (YTM) of 7.1%, while leveraged loans offer 8.0% YTM. Expected annual returns for these assets are near 6.0% factoring in default risks. The high base yields make these options appealing for generating current income.

Spread Considerations

High-yield spreads have contracted significantly over the past two months. At 283 bps, spreads are below historical averages and are also significantly below recessionary levels (600-800 bps). If a recession occurs, spreads may widen, negatively impacting near-term prices, but high starting yields should cushion total returns.

Comparative Attractiveness

With narrowing spreads and lower total yields, riskier credit is less attractive relative to Treasuries over the 7-year horizon today vs. a couple of months ago. Given increasing risks surrounding corporate earnings, spreads could easily widen further.

Alternative Investment Outlook

Private Market Strategies

We expect private equity and private credit to deliver higher returns compared to public markets over a multi-year period. Private equity secondaries, specialty finance, and asset-backed credit remain appealing areas for new investments given their potential for superior returns and diversification benefits.

Portfolio Positioning

We are incorporating these views into our portfolio positioning by:

Maintaining Duration

Even with recent declines in US Treasury bond yields (10-year bond yields at 4.3%, 40bps lower than February highs), we believe mid-term US Treasuries still offer reasonably attractive yields and capital appreciation potential should recessionary conditions emerge, and yields decline by 100bps.

Focusing on Private Investments

Continuing to allocate to new private investment strategies, with a particular emphasis on private equity secondaries and private credit, which offer compelling risk-adjusted return potential in the current environment.

Actionable Investment Opportunities

- US Government Bonds
- Private Equity
- Private Credit

US Government Bonds

US Treasury bond yields are still reasonably attractive with 2-year and 10-year Treasury bonds yielding between 3.8% and 4.3% respectively as of June 30, 2025.

At these levels, mid-term bonds (5-10 year maturities) provide relatively attractive coupons if held to maturity and provide potential for capital appreciation should bond yields decline due to recessionary conditions or faster than expected declines in inflation.

Private Equity

The secondary market for private equity remains robust, with strong activity in both LP-led transactions and GP-led deals. As buyer and seller expectations converge, the quality of LP portfolios and GP continuation vehicles offered via secondaries continue to improve, making this an appealing segment for discerning investors.

LP-Led Secondaries

Volume has surged as exit activity remains low and several PE fund vintages from 2007-2011 approach maturity walls. Despite the exit environment forecasted to improve in 2025, this trend is expected to continue as the overall secondary market transaction volume represents only 2% of private equity NAV.

GP-Led Continuation Vehicles

The market for GP-led transactions continues to expand, particularly for transactions involving high-quality assets. The supply-demand dynamic is also favorable with significantly greater demand from GPs to effect transactions vs. LP demand for investment (LP's can be choosier in terms of deals).

Private Credit

Private credit offers compelling potential returns, ranging from low double-digits to mid-teens, through a variety of specialty finance and structured credit solutions.

Specialty Finance

There is increasing interest in niche opportunities such as consumer credit card portfolio purchases, forward flow agreements (i.e., "lending to lenders"), and bank credit risk transfers. These transactions provide attractive yields as banks seek to reduce regulatory capital charges

Flexible Junior Capital

Demand is rising for flexible junior capital, which involves structuring payment terms with a mix of cash and PIK interest. These solutions offer mid-teens IRRs and can negotiate stronger financial and maintenance covenants, providing additional downside protection.

Asset-Backed Credit Solutions

There is a growing appetite for asset-backed lending, where companies pledge high-quality collateral such as receivables, inventory, and certain fixed assets to secure liquidity. This trend reflects a shift towards collateralized lending in a more cautious credit environment.

NAV Financing and Liquidity Solutions for PE Firms

There is increasing demand for NAV financing and other bespoke lending solutions tailored to private equity firms seeking to generate liquidity from their portfolios. These financing options can unlock capital without necessitating an asset sale.

Private Real Estate

We believe that real estate offers some interesting dynamics. The cycle has appeared to bottom, with significantly lower levels of supply expected over the next two to three years. Cap rates have likely peaked and may decline if interest rates are cut as expected. On the other hand, many properties are over-levered and in need of transitional financing. In addition, regional banks have pulled back significantly from real estate lending, especially to smaller borrowers.

Bridge and Value-Added Real Estate Debt

These short-term loans (usually 12 to 36 months) are used as transitional capital for a) refinancing expensive construction loans and finishing remaining construction expenses but prior to lease-up and stabilization or b) executing a value-added capital expenditure program to an existing income producing property. These loans are senior in the capital structure and are often yielding 10%+ unlevered returns.

Net Lease Strategies

These are equity strategies consisting of sales and leasebacks of mission critical industrial or retail real estate sites to borrowers. Tenants enter into long-term leases and are responsible for all property operating and capital expenditures. Usually, the leases have very tight covenants that can only be broken through bankruptcy proceedings. Several evergreen net lease funds are offering annual distribution yields of 6%-7% and high-single digit total annual returns. For US investors, these funds also provide attractive tax attributes.

Macroeconomic Conditions

- United States
- Canada
- Europe
- China

United States

US economic growth rebounded in Q2 following a GDP contraction in Q1. However, the outlook remains uncertain with both potential tailwinds (pro-growth tax legislation) and headwinds (higher tariffs and continued uncertainty).

Following a contraction of 0.5% annualized in Q1 GDP growth (largely driven by high levels of front-loaded imports ahead of anticipated tariff activity), the US economy is anticipated to have rebounded in Q2 with most economists projecting 1.5% to 2.5% annualized growth.

Consumer spending has shown signs of fatigue after early-year tariff driven buying. Retail sales fell 0.9% in May (dragged down by declines in auto and building-supply sectors), following a 0.1% increase in April and a 1.7% gain in March. Core retail sales were also modestly negative MOM in both April and May.

While manufacturing PMI's remain subdued, they have stabilized during Q2, with business surveys showing optimism about modest revenue growth ahead. Services activity also held steady, contributing to the Q2 GDP rebound.

The labor market has cooled but remains healthy with the recent June employment report of 147,000 net job additions easily surpassing consensus forecasts of 110,000. The unemployment rate fell to 4.1%. However, lower levels of immigration (and thus job seekers) contributed to this fall. YTD, employers have not hired aggressively. At the same time, layoffs remain low, and employers are retaining workers for longer.

Inflation has continued to trend downward with the Federal Reserve's preferred inflation indicator (Core PCE) averaging 0.1% MOM increases over the past three months. Interestingly, there has not been any pickup in consumer inflation yet from tariff pass-throughs. Most economists believe that tariff-induced price increases will manifest themselves through higher inflation data over the next several months. Given the strong employment data to date, the Fed remains on pause with regards to interest rate cuts. However, the Fed is forecasting two cuts (totaling 50bps) over the remainder of 2025, followed by additional 25bps cuts in 2026 and 2027. Some Fed governors have recently advocated for faster rate cuts over the past month.

Canada

The Canadian economy has experienced slower growth in recent months, primarily due to concerns about trade policy and the impact of tariffs.

Canada's economy has reported two consecutive monthly contractions in GDP of 0.1% in April and May. Consumer spending remains subdued with retail sales flagging and consumer sentiment sharply lower. The labor market has softened as well with the unemployment rate climbing to 6.9% in April and May, up from the sub-6% levels seen last year. Business investment has stalled or even declined in Q2 with firms delaying machinery and equipment outlay amid tariff uncertainty.

Canada's annual inflation rate remained at 1.7% in May 2025 while core inflation eased to 3.0%, the top range of the Bank of Canada's target band of 1%-3%. The Bank of Canada has already cut its policy rate by 50bps this year to 2.75% (and 225bps of rate cuts since the easing cycle begun). Market consensus expects further rate cuts throughout the year with the policy rate ending the year around 2.25%.

Looking forward, Canada's economic trajectory will depend heavily on external trade tensions (and any resolution of escalation thereof) and the effectiveness of policy measures aimed at supporting domestic demand.

Europe

Europe's economy closed Q1 on a positive note but enters Q2 facing heightened uncertainty.

Europe's recovery has gained some traction in 2025, though momentum remains uneven. GDP grew at 1.5% annualized in Q1 with economists forecasting 1.0% annual growth in 2025 followed by a moderate rebound to 1.2%-1.5% in 2026.

Consumer spending has remained steady, supported by resilient labor markets (unemployment is relatively low at 6.0%). Retail spending has shown cautious strength as real incomes stabilize, and business investment is expected to rebound later in the year underpinned by easing credit and EU fiscal measures (especially Germany's pledge to increase defense and infrastructure investments).

Eurozone headline inflation eased to 1.9% YOY in May (the first time it has dipped below the ECB's target in eight months). Core inflation has also cooled, dropping to 2.3% YOY in May from 2.7% previously. Since mid-2024, the ECB has cut rates by 200bps, bringing its deposit rate to 2.0%. Most economists project another rate cut later this year which would likely conclude its easing cycle.

While increased fiscal spending is a major positive, trade-related uncertainties remain high as tariff negotiations are ongoing.

China

China's economic growth surpassed expectations through April. However, recent data has indicated slowness.

China's economy grew 5.4% YOY in Q1, maintaining strong momentum from Q4 2024 and surpassing expectations, supported by a surge in exports ahead of US tariffs. Beijing has also deployed targeted stimulus in the form of consumer vouchers, trade-in-schemes, a 2 trillion Yuan sovereign bond issuance, and targeted infrastructure and mortgage support to lift consumption and stabilize housing.

However, the economic recovery continued to display unevenness. Consumer spending decelerated in June from a relatively strong May that benefited from trade-in programs that allowed households to upgrade appliances. Home builders and real estate agents reported sharp monthly declines in sales and price growth.

However, US-China trade tensions have improved as both countries have sharply scaled back elevated tariff rates that had essentially frozen trade for a couple of months. As such, China's government is likely to continue enacted measured stimulus efforts rather than launching a massive stimulus package.

Short-Term View: Key Issues & Scenarios

- US Trade Policy & Tariffs
- Inflation Trajectory and Fed Policy
- Economic Growth
- Corporate Earnings
- AI Adoption
- China Stimulus and Trade Policy
- Geopolitical Risks

- Scenario A: Base Case
- Scenario B: Optimistic Case
- Scenario C: Pessimistic Case

Short-Term View: Key Issues

Below, we visit vital issues affecting markets over the next 12-18 months.

Issue #1: US Trade Policy and Tariffs

While draconian tariff levels seem unlikely to be enacted, substantial uncertainty still exists as the administration has signed few agreements to date.

Tarriff uncertainty has subsided significantly since the Trump administration's Liberation Day April 2nd announcement (up to 45% rates on some countries and a rapid escalation to 145% on Chinese imports). However, these were rapidly walked back within one week to a 10% base tariff rate in effect for most countries for the next 90 days giving countries time to negotiate trade agreements with the US. Additionally, the US and China have scaled back tariffs against each other with the effective tariff rate on Chinese goods now 32% (down from a brief high of 145%)! Overall, the US ETR is now roughly 13%, which is much higher than the 2% US ETR entering 2025.

While the Trump administration has claimed considerable progress made in negotiating trade agreements, thus far, a trade deal has been announced with the UK and a truce has been entered into with China (essentially reverting tariff rates back to pre-Liberation Day levels). While countries originally had till July 9th to reach trade deals (before Liberation Day tariff rates would be imposed), the Trump administration has extended this deadline till August 1st. Market participants believe that Trump will likely continue to extend the period for negotiation while maintaining the current rates in effect.

Most economists believe that these tariffs will reduce global economic growth and serve as a consumption tax in the US. Economists are forecasting a 0.5%-1.0% hit to global GDP resulting from the tariffs. At the same time, they are predicting rising inflation, especially in the US. Interestingly, this rise in inflation has yet to manifest itself in inflation reports.

Equity markets are pricing in that a) tariffs will settle near a 10% universal rate with some product and sector specific tariffs applied on top of that and b) that the additional costs of these tariffs will be split along the value chain, with a limited impact on end consumers. Equity analysts have sharply reduced S&P 500 earnings forecasts to $258-$263 per share vs. $272-$275 earlier in the year and have also reduced earnings for 2026 as well.

While our base case is inline with most economist forecasts for ultimate tariff rates, we caution that uncertainty may increase as the 90-day post Liberation Day pause for trade deal negotiations is scheduled to end in early July. In the short-term, clarity around ultimate tariff rates will certainly be positively received by businesses and by equity markets. It remains far too early to predict longer-term consequences and potential ramifications on global appetite for US assets.

Issue #2: Inflation Trajectory and Fed Policy

Most economists anticipate that Trump's tariffs will result in increased inflation. However, thus far, tariff-related inflation has not materialized in the data.

Recent inflation data has been encouraging. Core PCE (the Fed's preferred inflation gauge) increased by 0.1% MOM in both April and May. Thus far, tariffs do not appear to have been passed on to consumers. However, economists caution that consumer price increases may occur with a lag as retailers are likely working through inventories purchased before tariffs went into effect.

The Fed is currently forecasting two 25bps interest rates cuts in 2025, followed by one 25bps cut in both 2026 and 2027. However, there is a wide range of forecasts across individual Fed officials. In recent days, two prominent Fed governors have joined President Trump in calling for rate cuts.

Outside of the US, inflation continues to recede in Europe, Canada, and many other developed markets. Growth remains slower in those economies than in the US. As such, it is likely that rates in Europe and Canada decline at a faster pace and to lower ultimate levels than in the US. However, tariff policy remains a wildcard with regards to future impacts on interest rate policy.

Issue #3: Economic Growth

Economic growth is expected to slow as the effects from tariffs and policy uncertainty work through the system.

Economic growth has been uneven thus far in 2025. In Q1, US real GDP contracted by 0.5% on an annualized basis. However, the data was nuanced with much of the contraction driven by a surge in imports as businesses stockpiled inventories ahead of expected tariff increases. Business investment and consumer spending grew, although at slower rates than in prior quarters. Consumer spending grew at 1.2% annually, its weakest pace since Q2 2023. In May, core retail sales (ex autos, gasoline, building materials, and restaurants) were down 0.1% MOM but up 3.9% YOY. The Atlanta Fed GDPNow forecast model is projected to be 2.5% annualized Q2 GDP growth but that is likely distorted by a sharp decline in imports following the Q1 stockpiling mentioned earlier. Looking through the noise, H1 2025 is likely to reflect a healthy but slowing economy. The Fed and other economists are forecasting a slowdown in growth with US Real GDP growth projected at 1.4% in 2025 and 1.6% in 2026 vs. 2.8% in 2024.

Just as with inflation, there are varying views regarding US economic growth prospects. Bears argue that the effects from tariffs, reduced business investment, and federal government downsizing have yet to be fully felt. Bulls contend that ultimate tariff rates are in-line with what was originally anticipated and will be managed without causing a jump in inflation. Bulls also contend that the US economy will reaccelerate in H2 2025 and into 2026 driven by less regulation and pro-business policies included in the recently passed tax legislation.

US employment has also remained relatively stable and strong but has shown signs of cooling. The unemployment rate remains low at 4.1% (although this is partly explained by fewer immigrants) with low levels of both new hiring and job losses.

Globally, growth prospects are uncertain as well. European GDP is forecast to increase by 1.0% in 2025 vs. 0.8% in 2024. While the European Union has promised significant fiscal spending increases for defense and infrastructure needs, implementation will take time. Additionally, China is likely to further increase consumption driven stimulus measures as export growth becomes challenged. While these measures may offset some weakness, most international economies are dependent on exporting to the US (the largest consumer market). If US demand weakens, these countries may face economic challenges.

Issue #4: Corporate Earnings

Forecasting near-term corporate earnings remains challenging given the uncertainty regarding tariffs. However, analysts have been adjusting earnings growth projections down and Q1 earnings materially surprised to the upside.

Entering Q1 earnings season in mid-to-late April, analysts had steadily ratcheted down S&P 500 earnings growth estimates from 14% YOY in Q1 to 6.5%. Actual Q1 earnings surprised to the upside with 13.0% YOY growth, with strong earnings growth driven by a) continued stellar Magnificent Seven earnings growth at 28% and b) broadening growth of 9% YOY across non-Mag 7 companies.

However, analysts have taken down their 2025 FY earnings forecasts to reflect weakening consumer and business spend given tariff uncertainty and are currently estimating full-year 2025 earnings growth of $260 per share vs. $273 entering 2025. These estimates look realistic if not perhaps conservative. However, the real question is what earnings are going to be in 2026 and what a sustainable growth rate is in 2027 and beyond.

At this stage, it is difficult to have confidence behind earnings estimates until there is more clarity with regards to ultimate tariff policy, both in terms of the ultimate level of tariffs and the timing associated with implementation. If tariff clarity emerges and actual tariffs settle at current levels, we expect S&P earnings growth to accelerate in 2026 and 2027 following a H2 2025 slowdown, as pro-growth tax and regulatory policies coupled with continued robust AI demand offset negative tariff-driven effects.

Issue #5: AI Adoption

AI drove the strong S&P 500 performance in 2023 and 2024. Thus far, in 2025, AI demand has continued to be extremely strong and actually accelerated in Q2. We anticipate that the market will continue to have tug-of-war reactions in terms of assessing AI demand with respect to likely continued increases in AI-related capital expenditures on the part of hyperscalers.

It has been a tale of two quarters for AI-related stocks in H1. In Q1, the Mag 7 were down 14.7% (and bottomed at down 25.1% YTD on April 8th) and significantly underperformed the S&P 500 (-4.3% in Q1) and the MSCI ACWI Index (-1.3% in Q1). Investors sentiment soured as several hyperscalers such as Amazon, Alphabet, Meta and Microsoft increased planned data center capex by 60%-80% over 2024 levels while revenue growth had not shown acceleration (companies stated this was due to lack of capacity rather than a plateauing of AI demand).

However, AI-related stocks have rallied furiously since Q1 earnings were released (+17.6% in Q2 and +33.5% since April 8th lows) and have once again outperformed broader market indexes (S&P 500 up 8.8% and 22.2% respectively over those time frames). Mag 7 and AI-related stocks smashed Q1 earnings expectations with a reacceleration in AI demand both in the US and globally as well.

For now, AI fundamentals continue to be red-hot. However, this view is reflected in stock prices, which have rallied substantially (in some cases 40%-70% from April lows).

Issue #6: China Stimulus and Trade Policy

China has enacted significant fiscal stimulus aimed at stimulating domestic consumption and has also adopted a pro-business sentiment after several years of ramping up regulatory actions. Softening trade tensions with the US should enable China to deliver GDP growth of near 5%.

China's Q1 GDP growth of 5.4% surpassed expectations. Importantly, the government has intensified consumption-driven fiscal stimulus and adopted a more pro-business tone. Property declines are showing signs of bottoming while exports and industrial output beat expectations in April and May. Furthermore, retail sales grew 6.4% YOY in May, the fastest level of growth since December 2023.

However, recent economic data has shown worrisome signs with weakening retail sales growth, continued home price declines, and sharply declining exports. The government will likely need to increase fiscal stimulus if they are to meet official growth targets.

Issue #7: Geopolitical Risks

Conflict in the Middle East has surged following the war between Israel and Iran, although the worst-case scenario seems to have been averted.

The Middle East was thrown into turmoil when Israel pre-emptively attacked targets within Iran and Iran responded in kind. Oil prices sharply increased to $75-80 from the low 60s level prior to the conflict. After the US bombed three nuclear sites in Iran, analysts feared that Iran may pursue extreme measures which could include effectively shutting the Strait of Hormuz through which 20% of global oil is transported. Such a measure would likely have led to surges in oil prices well north of $100mm and depending on the length and severity of such prices, could push the global economy into recession. Fortunately, Iran's response to the US bombings has been relatively benign and they have indicated a desire to de-escalate the conflict. Oil prices declined sharply as the worst-case scenario seems to have been avoided.

Over the past few years, we have seen a significant increase in geopolitical conflicts (Ukraine / Russia, Israel / Gaza and Israel / Iran). The risks of a China / Taiwan conflict, while highly unlikely, have also risen. Over the next several years, it is likely that the world will live in an era of greater geopolitical and trade policy volatility than during the relatively benign period following the GFC through 2022.

Short-Term View: Scenarios

Given the considerable macro uncertainty surrounding tariffs, we discuss a range of scenarios below, with return percentages relative to the S&P 500's $6,205 June 30th closing price.

Scenario A: Base Case

This scenario assumes tariff clarity emerges inline with current consensus over the next few months and / or additional longer extensions to reach deals are granted. Furthermore, this scenario also assumes positive growth effects emerging from the stimulative and pro-business aspects of the recent US tax legislation.

We assume that while effective tariff rates increase to the low double-digit range, more tariff clarity emerges over the next few months as deal frameworks are struck with multiple countries or extensions are granted. While economic growth slows in H2 2025, the US avoids a recession. Inflation increases modestly, but the Fed leans towards supporting the economy and cuts rates two to three times – a total of 50bps-75bps over the remainder of 2025. We forecast S&P 500 earnings of $280-$300 in 2026 and $310-$330 for 2027, relative to $260 in 2025. As tariff uncertainty abates and positive growth signs emerge following the tax bill's passage, the market focuses on 2027 earnings potential and the S&P climbs to $6,250-$6,750 by mid-to-late 2026 (+2%-10% total return from current levels), assuming a 20x-21x forward EPS multiple (down from 22x currently).

Scenario B: Optimistic Case

This scenario assumes that through exemptions and other deals, tariff rates are slightly lower than currently anticipated. Furthermore, this scenario assumes greater impact from the Republican tax bill.

While we anticipate transitory economic weakness, businesses and consumers adjust, and the economy and businesses display pent-up growth in 2026 and beyond. We assume that inflation does not materially accelerate and the Fed cuts rates by 100bps over 2025 and 2026. Continued slow dollar weakness also adds to S&P 500 earnings growth. We anticipate that analysts' 2026 earnings accelerating to $290-$305 and 2027 earnings potential $320-$340. If multiples remain at 22x-23x EPS, we forecast the S&P climbs to $6,800-$7,400 by mid-to-late 2026 (+11%-21% total return from current levels)

Scenario C: Pessimistic Case

This scenario assumes that trade deals take longer to complete, and the effects of tariffs manifest themselves in a recession beginning in H2 2025 or H1 2026.

In this case, we assume that tariff negotiations stall or take longer to reach agreement frameworks (with sharpened rhetoric and heightened uncertainty). We also assume that certain sector specific levies are introduced and that ultimate effective tariff levels are higher than in the base case. Furthermore, we assume that the incremental effect from the Republican tax bill is relatively muted. Economic activity will likely weaken substantially in H2 2025, and unemployment will begin to rise over the next six months. We also assume that inflation begins to moderately rise again, and the Fed remains cautious (ultimately cutting rates aggressively but from a position of weakness and behind the curve). Analysts begin to slash EPS expectations for 2026 and 2027. Investors price in S&P 500 earnings declines of 7%-10% (associated with a mild recession) vs. peak levels, which results in a range of $235 to $245 per share) and the S&P 500 troughs in the mid-to-high 4,000 range later this year or early next year.

Given the still elevated level of policy and geopolitical uncertainty today, it is difficult to place probabilities with regards to any of the scenarios unfolding. The potential for a global recession increases the longer tariff uncertainty persists.

However, for investors with a long-term horizon, we would begin adding US equities if the S&P 500 declines to the low-to-mid $5,000 level, with more aggressive additions upon further weakness below $5,000.

Asset Class Reviews

- Equity Markets
- Fixed Income
- Hedge Funds
- Commercial Real Estate
- Private Equity
- Private Credit
- Venture Capital

Equity Markets

Performance

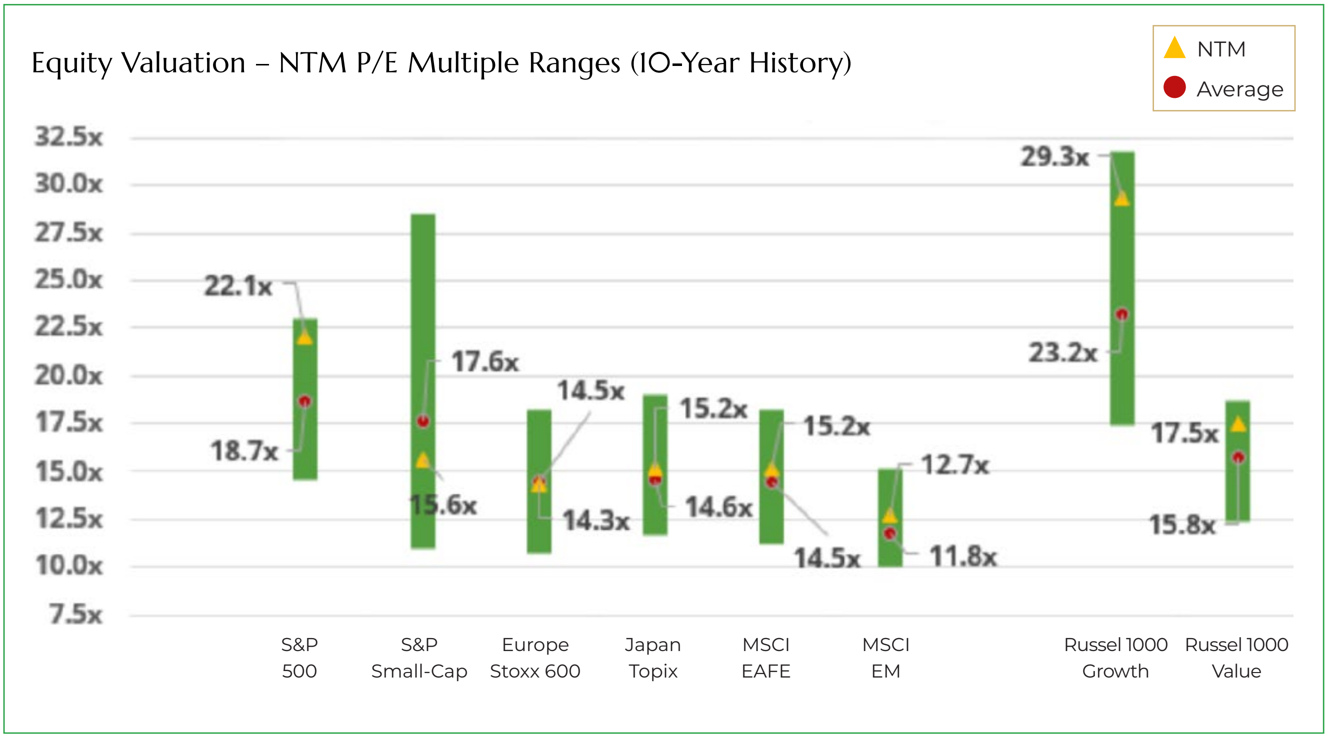
Equity Indicies – Performance	YTD 6/30/25	Qtr 6/30/25	Annualized Returns 6/30/25 1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	6.0%	11.5%	14.7%	19.1%	16.1%	13.8%
US Small Cap (Russell 2000)	-1.9%	7.8%	7.5%	9.9%	10.0%	5.5%
MSCI EAFE	19.4%	9.5%	17.7%	16.0%	11.2%	7.2%
MSCI Emerging Markets	15.3%	10.1%	15.3%	9.7%	6.8%	4.5%
MSCI ACWI	10.0%	11.2%	16.2%	17.3%	13.6%	10.8%
S&P 500 - Equal Weight	4.5%	6.1%	12.1%	12.1%	13.7%	10.1%
MSCI ACWI - Equal Weight	12.4%	9.1%	17.4%	8.9%	8.0%	5.3%
US Style Factors						
MSCI US Quality	5.0%	9.0%	9.2%	21.1%	15.7%	15.4%
Russell 1000 Growth	6.0%	17.9%	17.0%	25.4%	17.9%	17.6%
Russell 1000 Value	5.3%	4.2%	12.6%	11.9%	13.1%	8.8%

Performance Observations

- In Q2, all regional equity markets performed well, with furious rallies from early April lows (following brief sharp corrections post the US Liberation Day tariff announcements).

- In Q2, US growth stocks (+17.9%) substantially outperformed US value stocks (+4.2%), reversing the relative performance in Q1. The Mag 7 appreciated by 20.5% during Q2 (and up 37.0% from their April 8th lows!), with strong performance driven by better than expected earnings and significant positive news flow confirming buoyant AI demand.
- YTD, international stocks have significantly outperformed US stocks in USD terms, with outperformance driven by a) investor perception that international equities will be less impacted by US tariff policy relative to US stocks, b) less demanding valuations for international stocks entering the year relative to US stocks, and c) favorable currency translation for international stocks as the US dollar index has declined by 10.9% YTD.

Valuation



Key Observations

- Following the swift global equity market rallies after early April lows, valuations across regions are higher and, in some cases, near recent high points. However, earnings uncertainty given tariff uncertainty and resultant effects on demand is higher.
- The S&P 500 is now trading at 22.1x forward EPS (well higher than its 10-year average and more expensive than its historical 18.7x) and is near its recent 22.6x peak in February. Growth stocks (Russell 1000 Growth Index) valuations have expanded considerably to 29.3x forward EPS relative to 24.2x in early April.
- While earnings growth far surpassed expectations in Q1 and AI demand remains exceptionally strong, investor expectations are elevated with regards to favorable policy developments such as abating trade tensions and faster than expected Fed interest rate cuts.
- International developed equities are now trading modestly above historical averages.

- Historically, given a greater exposure to cyclical companies with higher levels of exports, international developed company earnings have been more influenced by global macroeconomic developments than S&P 500 earnings.

- YTD, international developed markets earnings growth has been sluggish and analyst forecasts for double-digit earnings growth in 2026 may prove optimistic.

- Additionally, YTD weakness in the USD is a further headwind for international company earnings.

Outlook

With the recent sharp rise in global equities (especially US large cap stocks), valuations no longer appear compelling. While certain catalysts appear positive (potential for trade agreements, passage of pro-business US tax legislation and further de-regulation and expected ramp-up in European fiscal spending), several uncertainties still exist.

As long-term investors, we advocate the following:

- Selectively adding to US quality and growth stocks (especially in the technology and communication services sectors) if presented with material stock pullbacks as valuations are now highly elevated.

- Adding opportunistically to international developed stocks upon further weakness.

Fixed Income Markets

Performance

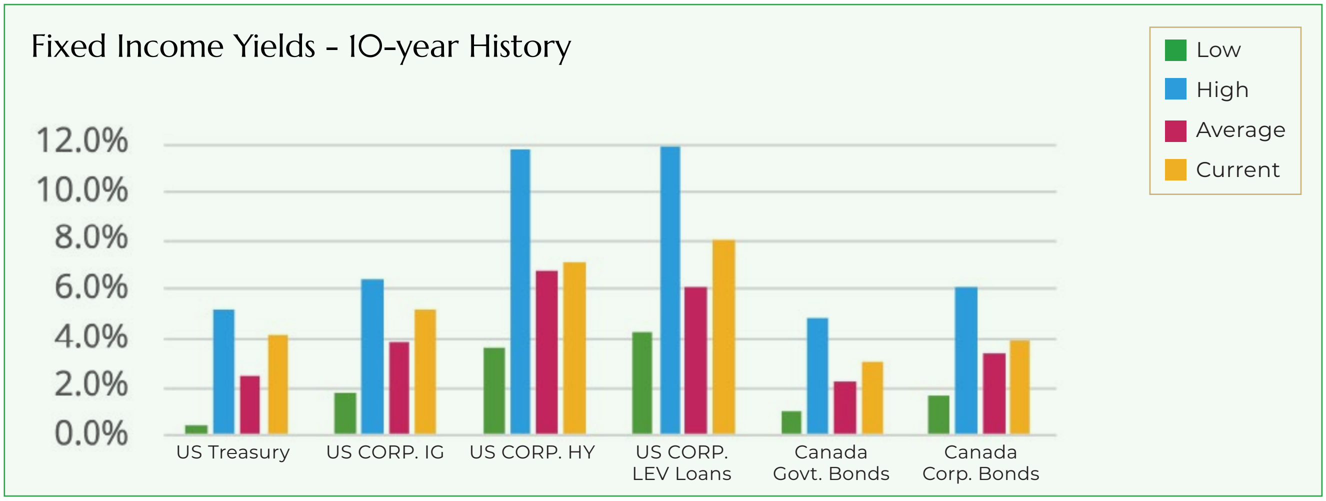
Fixed Income Indicies – Characteristics and Performance in USD	% Ret YTD 6/30/25	% Ret Qtr 6/30/25	Annualized % Returns 6/30/25 1Y	3Y	5Y	7Y	Duration (yrs)
US Treasury	3.5%	0.8%	5.0%	1.4%	-1.7%	1.2%	5.9
US Corp. IG	3.7%	1.6%	6.4%	4.2%	0.0%	2.8%	6.9
US Corp HY	4.3%	3.2%	10.0%	9.8%	5.9%	5.3%	3.2
US Corp Lev. Loans	2.8%	2.1%	7.3%	9.7%	7.4%	5.5%	NA
Barclays US Aggregate	3.7%	1.1%	5.7%	2.4%	-0.8%	1.7%	6.1
Barclays Canada Agg. *	0.9%	-0.6%	5.4%	4.0%	-0.5%	1.7%	7.4

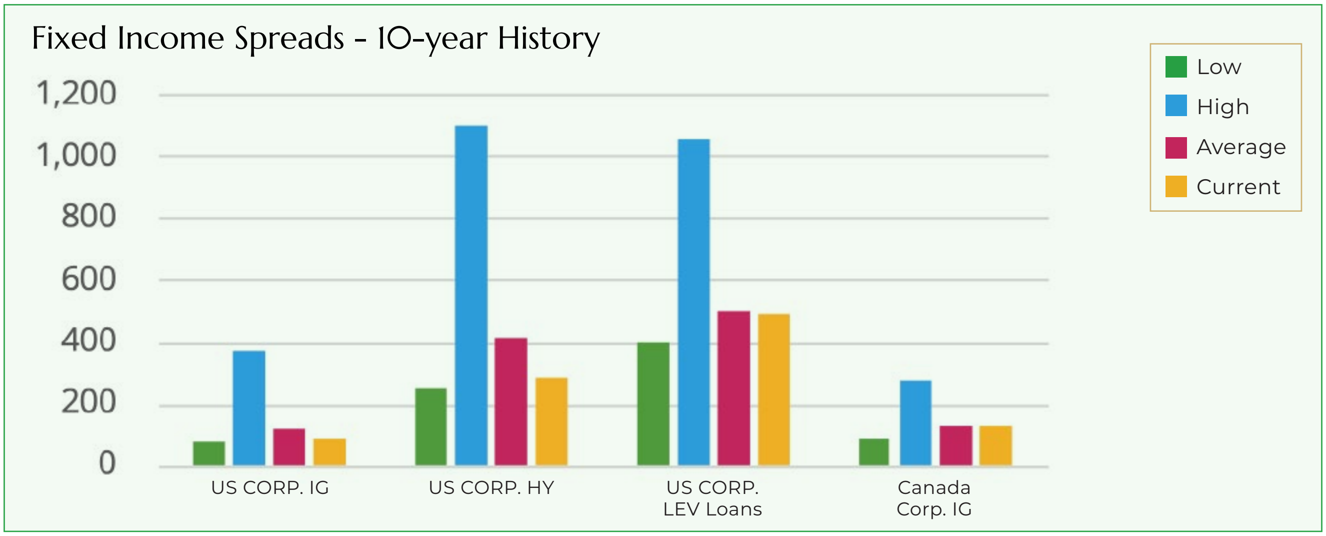
** Barclays Canada Aggregate Index returns in CAD*

Key Observations

- During Q2, government bonds appreciated modestly, with gains driven by coupon income as bond yields were relatively stable at the beginning and end of the quarter (although volatile during the period). Corporate investment grade bonds performed well and benefitted from high coupon income coupled with narrowing spreads.
- In Q2, high yield bonds benefitted from high coupon income coupled with narrowing spreads as well. Leveraged loan performance was driven predominantly by high coupon income.
- YTD, bonds have performed well and have benefitted via high coupon income and tightening spreads for corporate credit. Performance for both lower-quality (CCC-rated) high-yield bonds and higher-quality (BB or B rated) has been similar thus far.

Valuation





Key Observations

- Absolute yields are still reasonably attractive for safe fixed income with Treasuries generally yielding between 3.8% and 4.3% across most maturities up to 10 years, and investment grade bonds yielding 5.1%. Yields are also attractive for high-yield bonds and leveraged loans at 7.1% and 8.0%, respectively (although less attractive than a couple of months ago). However, leveraged loan yields will likely come down as we project 100bps+ of Fed base rate cuts over the next 18 months.

- Credit spreads have narrowed sharply over the last two months. HY Spreads are now at 280bps after reaching 450bps in early April. While corporate earnings have been better than feared, these spreads could certainly widen to 600bps or more should recessionary conditions emerge.

Alternatives & Private Investments

Hedge Funds

Hedge funds (as measured by the HFRX Global Hedge Fund Index) were up 1.7% in Q2 and 2.4% YTD, with most strategies delivering positive performance. YTD, convertible arbitrage and long/short equity (+6.2% and +4.3%) performed best while global macro / trend following strategies performed worst (-3.1%).

Commercial Real Estate

The NCREIF Index for commercial real estate increased by 1.3% in Q1 2025, marking the third consecutive quarter of positive performance. According to Green Street, prices for a weighted index of commercial real estate was relatively stable in Q1 and have appreciated by 5% over the past year. While commercial real estate seems to have stabilized broadly, it is unclear how potential economic slowdowns might impact certain sectors. On the one hand, operating fundamentals are likely to weaken for some sub-sectors. On the other hand, if interest rates decline, cap rates may decrease as well.

Data from the RCA Commercial Property Index highlights variation across different property sectors:

Office and retail properties appreciated by 1.2-1.5%% YTD through May 31, 2025, while apartments and office properties declined roughly 1% YTD. On a YTD basis, most property types exhibited relatively flat price performance with the retail sector performing best at +4.3%.

Operating fundamentals across property types show divergence:

Office: Office fundamentals seem to have bottomed with signs of improvement. Nationally, net absorption was negative in Q1 but was actually positive for a third of US markets. Additionally, the amount of vacancy coming from occupiers putting space on the sublease market has declined for four straight quarters. Asking rents have remained relatively flat for several quarters and the new supply pipeline has dwindled considerably. However, the office sector is highly sensitive to economic conditions and many uncertainties remain.

Apartments: Demand remains strong, with high absorption, but an increase in new supply is still limiting rent growth. Multi-family rents are forecast to increase 1.5% nationally in 2025 following flattish growth in 2024, with strength in the Northeast and Midwest offsetting weakness in the Sunbelt and Mountain West. With peak deliveries forecast in 2025 and a significant slowdown in 2026 and beyond, annual rent growth is expected to return to the 3%+ level over the next few years.

Industrial: Industrial demand remains strong with high leasing activity and absorption. However, supply has rapidly increased and the vacancy rate increased to 7.3% in Q1 2025, up from a post-pandemic low of 3.7%. Industrial market rents have declined nationally for three consecutive quarters. However, in-place rents are still substantially below market rents given the longer effective lease terms in many industrial leases. This tug of war is setting up an interesting dynamic between tenants and landlords in terms of concessions for new vacant rental space but large upward repricing for existing renewals.

Private Credit

Private Credit (measured by the Cliffwater Direct Lending Index) increased by 2.1% during Q1 2025.

This performance was softer than previous quarters near 3.0% returns with softer performance driven by slightly lower base rates and some negative mark-to-market impacts. However, private credit did outperform the US Leveraged Loan market (+0.5%) during the quarter. Unlevered yields approximate 10% at base rates of 4.3%. Current credit quality remains solid, and the percentage of loans in non-accrual status has remained stable. However, the percentage of income comprising paid-in-kind (PIK) rather than cash income has increased, which could portend future credit issues. In the sponsor-backed lending space, competition is intensifying among private credit lenders. At the larger end of the market, spreads have compressed by 150bps compared to mid-2023 levels. Spread compression has been less severe among lower-middle-market and middle-market borrowers (75bps-125bps).

Private Equity

Preliminary data indicates the private equity returns rose 1.8% in Q1 (latest data due to lagged reporting).

US PE Deal activity declined to $234bln in Q2 from $279bln in Q1 as volatile tariff policy and overall macro uncertainty led to a pause in new deal activity. However, YTD, deal activity is still up 60% YTD. Exits also declined sharply, with Q2 exit value of $119bln well below Q1's $221bln figure. However, exit value remained sharply higher than the quarterly levels of $50bln-$75bln seen through most of 2022 and 2023. Fundraising has slowed thus far in 2025, mirroring 2024's slowdown following three strong prior fundraising years.

The PE secondaries market represents a bright spot for deal activity with 45% YOY $ volume increases relative during Q1 2025 relative to Q1 2024. This buoyant activity follows a record $160bln year in 2024 in terms of transaction volume. Both the LP-led and GP-led segments of the secondary market are experiencing healthy demand. Pricing has recovered across LP-led deals, with younger, higher-quality portfolio interests trading in the low-to-mid-90s (discounts of 5%-10%). This recovery in pricing has led to a significant increase in secondaries brought to market, which enables smaller funds to hive off select LP fund interests where they see significant opportunities for continued value appreciation.

Venture Capital

Venture capital delivered 2.0% returns in Q1 according to the State Street PE Index.

Q2 US VC deal activity at $70bln declined by 25% sequentially from Q1 2025's $93bln levels. However, deal count only declined by 2%. AI remains a dominant theme within VC with 2025 YTD deal value of $104bln equaling the full-year level for 2024. YTD, AI deals represent 64% of deal value, up from 49% for full-year 2024.

At $68bln, Q2 exit activity improved by 31% vs. Q1's $52bln levels and has significantly improved from the $20bln to $40bln quarterly levels seen from 2022 through 20254.

VC-backed IPOs have performed extremely well thus far in 2025 with the average stock up 137% and the median up 33%. Coreweave and Circle have been the notable star performers YTD.

Signs of valuation froth are emerging with regards to AI venture deals. Outside of the AI sector, investor terms for new deals have become more favorable compared to the 2020-2021 period.

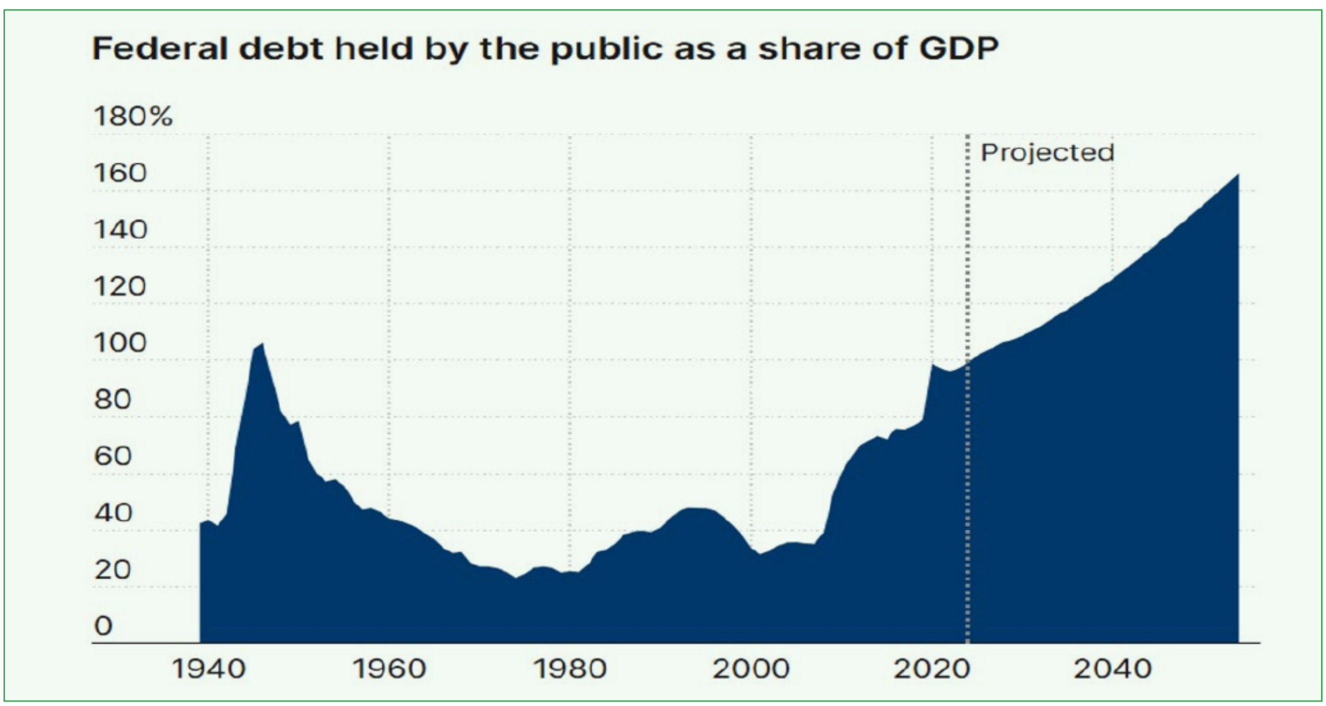
Special Topic: US Fiscal Position and Portfolio Strategies

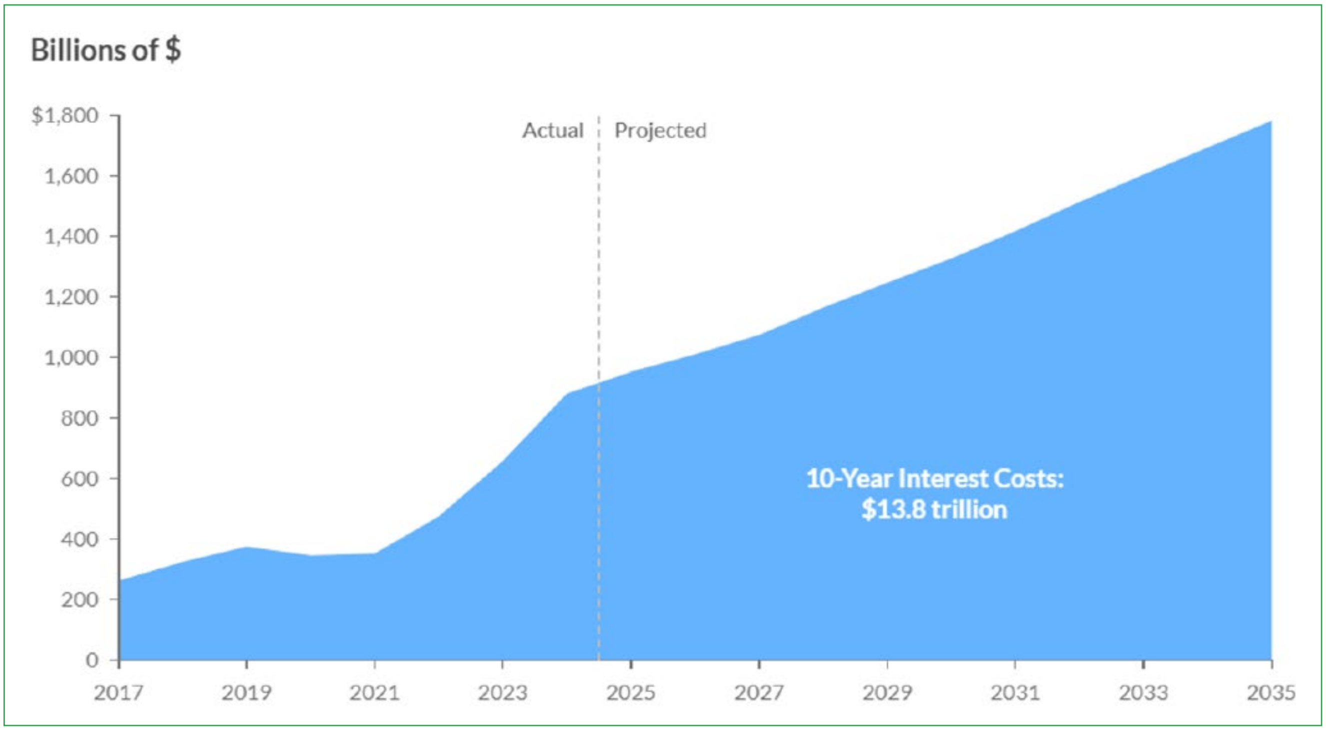
- US Federal Debt and Deficits
- Strategy Pros & Cons

Special Topic: US Fiscal Position and Portfolio Strategies

US Federal Debt and Deficits

The US federal debt as a percentage of GDP, is currently at levels not seen since World War II and is projected to grow considerably in the future given that the US continues to run structural deficits, where federal spending far exceeds federal revenues. The annual deficit at $1.4 trillion or 6% of GDP is unprecedented considering that the US economy is neither in a recession nor in a wartime environment. While stronger economic growth driven by productivity gains can help increase government revenues, federal deficits likely cannot be reduced without raising taxes, reducing fiscal spending, or some combination of both. Politically, neither party has exhibited the will or desire to meaningfully address tax or spending policy. In fact, the recently passed tax bill is projected to add another $3 to $4 trillion to national debt over the next decade using current law as a policy baseline.





For many years, the interest burden associated with the federal debt was low (in a period of near-zero interest rates). However, with interest rates near-or-above 4% across the curve today, federal interest expense has grown to $950 billion in 2025 vs. $250 billion in 2017 and is projected to grow to $1.8 trillion by 2035 if current interest rates hold. This interest burden alone has now grown to 3.0% of GDP, surpassing the previous high in 1991.

Most economists agree that over the long-term, growing deficit and debt levels may negatively impact the economy as interest rates rise and crowd out private investment. Lower private investment could lead to lower productivity which would likely lead to slower economic growth.

What is a fiscal crisis and could the US end up in one?

Economists define a fiscal crisis as a sudden, large and sustained decline in the demand for a countries bonds, US Treasuries in this case, relative to supply. This decline would trigger a sharp and persistent spike in interest rates, likely accompanied by steep falls in the value of the US dollar and global equity markets. A fiscal crisis could impact the economy for a prolonged period through higher borrowing costs. However, the more worrisome risk is that a breakdown in Treasury markets could cause a global financial crisis that sharply erodes asset values and pushes economies into deep recessions.

The Eurozone fiscal debt crisis, which peaked in the early 2010s, involved a period of economic uncertainty and financial instability in several Eurozone countries, primarily triggered by excessive government debt levels. The bursting of housing bubbles in some countries and the lack of unified fiscal policy also contributed to the crisis. Greece, Portugal, and Ireland were the most severely affected, requiring bailouts from other Eurozone countries, the ECB and the International Monetary Fund. The crisis led to austerity measures such as spending cuts and tax increases implemented by several countries which resulted in a multi-year period of very slow growth across the Eurozone.

High public debt levels are not the sole determinant of whether nations experience fiscal crises. Japan's gross and net public debt steadily rose to 235% and 162% by 2020, and yet the country did not suffer a fiscal crisis. Rather, Japan was still able to issue 30-year debt at 0.1%. In recent years, however, Japanese bond yields have increased with 10-year Japanese bonds yielding 1.4%. This rise in bond yields has largely been driven by inflation, which has helped reduce the net debt to GDP ratio to 135%. Additionally, only 12% of Japanese debt is held by foreigners, which makes a run on government bonds less likely. However, Japan's increased fiscal spending, especially with regards to entitlement programs, and suspension of certain consumption taxes bears watching over the next few years.

In terms of the US, we view the risks of a fiscal crisis as relatively low for several reasons including:

- The USD is still the dominant reserve currency of the world with limited alternatives.

- The market for US Treasuries is by far the most liquid and deep in the world. As such, it is highly unlikely that institutions will dump Treasury holdings.

- Most Treasuries are owned by US individuals and institutions. Foreign ownership has modestly declined in recent years (as a % of total ownership) and now represents roughly 30% of total Treasuries held.

- The US has never defaulted on its debt, and the punitive cost of doing so would outweigh any potential benefits from a debt restructuring.

- Since the GFC, the Fed has consistently demonstrated the willingness and ability to swiftly step in and head off crises before they develop. If signs of a fiscal crisis emerge, the Fed is likely to step in aggressively to buy US government bonds and dampen yield increases, though this would have inflationary and other consequences.

Over time, nevertheless, we may see a continued gradual trend towards increased ex-US asset ownership with perhaps gradual pressure on the USD. And in the hyper-polarized political environment and given the current administration's stance towards upending long-standing US geo-political relationships, we acknowledge that the risks (although very small) of a US fiscal crisis have increased. If such a crisis develops, we would expect sharp declines in global equity markets without potential appreciation from longer-duration bonds. As such, we are exploring further portfolio diversification and tail-risk hedging strategies including:

Further Diversification

STRATEGY	PROS	CONS
Gold	• Given US and other central banks increasing fiscal deficits, gold's appeal as an alternative to fiat currency should continue to increase. • US trade policy may remain volatile, which could increase gold's appeal. • Non-US central banks may continue to increase gold holdings as part of a gradual diversification from US Treasuries. • Geopolitical volatility is likely to remain high, increasing gold's appeal as a safe-haven.	• Gold has appreciated by almost 80% over the past two years after being essentially flat for the prior three. Gold has become a momentum trade which could easily reverse. • Gold's price as a store of value is largely based on investor sentiment. There are limited fundamental underpinnings to gold's value. • Gold's role as a portfolio diversifier during periods of market upheaval has been mixed. While gold appreciated in the days following the Liberation Day equity market meltdown in April 2025, it declined in-line with equity markets during 2022 and during March 2020.

Further Diversification (CONTINUED)

STRATEGY	PROS	CONS
Bitcoin	• Gaining popularity as a digital "store of value" and an alternative to fiat currency. The US government is pro crypto, and institutions are increasing crypto allocations as well. • Bitcoin has a scarcity premium as it has a finite supply. • Bitcoin's market value as percentage of gold's market capitalization has steadily increased from 1%-2% in the 2014-2020 range to 8.5% today. If this ratio was to increase to 20% and assuming gold remained flat, bitcoin's value could appreciate to $250,000 from roughly $100,000 today.	• Like gold, Bitcoin lacks fundamental valuation underpinnings. It is a store of value only because of investor sentiment. • Bitcoin has exhibited extremely high volatility relative to other asset classes. • Thus far, Bitcoin has not provided effective portfolio hedging during sharp equity market downturns.

Tail-risk Strategies

STRATEGY	PROS	CONS
Out-of-the-money-put-options	• Less initial capital outlay required. • Option prices are likely to increase significantly with big market declines coupled with increased volatility.	• High upfront cost ranging from 4%-6% for strike prices 10%-15% out-of-the-money for options dated 2.0-2.5 years out. • Options can expire worthless if the market does not decline before the expiration date.
Tail-risk hedge funds	• Certain strategies are designed to produce flat to slightly negative returns during normal / bull markets but deliver asymmetric large positive returns during equity market drawdowns. • Potentially high upside during market drawdowns with relatively low volatility during other periods.	• Given the limited frequency of large equity and credit market shocks (small sample size), it is unclear that particular tail-risk strategies will deliver a strong upside in the next market downturn. • The black box nature of many tail-risk strategies makes it difficult to fully understand the nature of the hedges.

As we continue to refine our thoughts on these potential hedging and diversifying strategies, we will circle back with potential recommendations for incorporating a mix of these strategies or others, if conditions warrant, into investment portfolios.

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