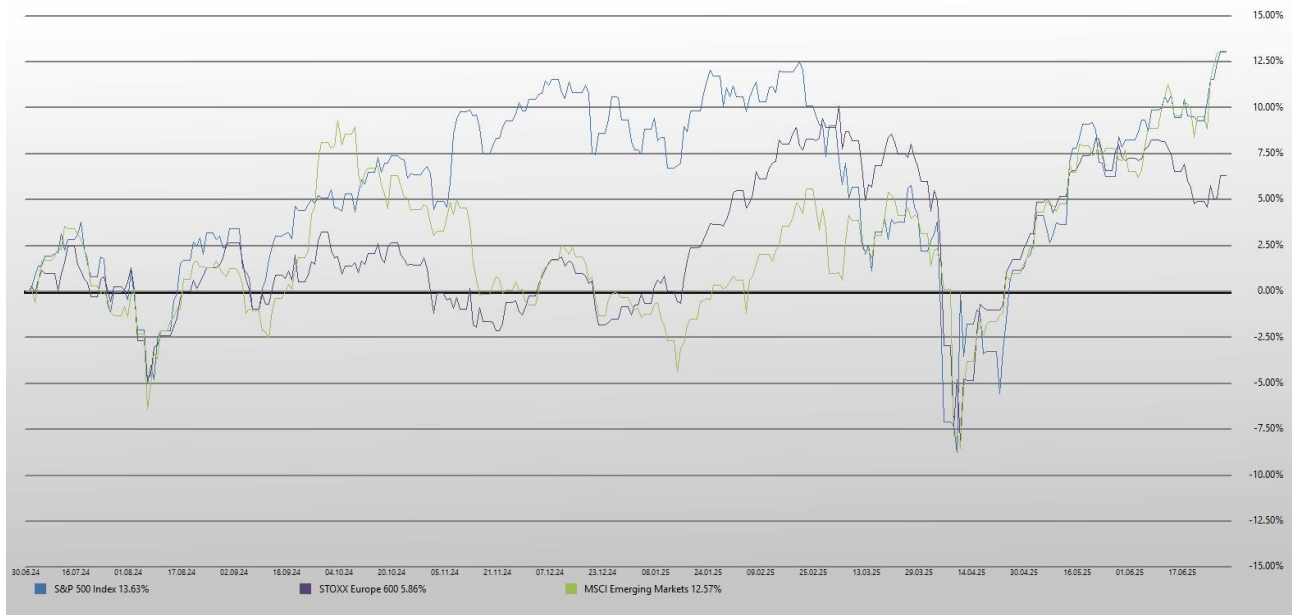


Quarterly Financial Market Update, June 2025

During the second quarter of the year, the financial markets fared well, buoyed by favourable developments in reciprocal tariffs. The escalation in geopolitical tensions in the Middle East added to an already high level of volatility, but did not derail the recovery in asset prices following a dreadful March and early April. Looking ahead, investors' nervousness will probably persist, as further news regarding tariffs will arise over the weeks to come. As equity valuation has increased following the strong rebound, we believe a more neutral stance towards risky assets is now adequate.

In 2Q, the overall financial markets were well oriented. Global stocks posted a return of 11.7%. Emerging Markets led the way, up 12.2%, followed by the USA (10.9%). On the bond side, prices increased 4.5% on a global basis.

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

As in the previous quarter, President Trump continued to monopolies the world's attention (and it is not likely to change in the foreseeable future). His policy on tariffs created significant market movements, in particular on the equity side. Indeed, on 2nd April, i.e. Mr. Trump's so-called "Liberation Day", he presented reciprocal tariffs for all US' trading partners. This led the markets to decline significantly (down 12% for the S&P 500 Index during the week that followed the announcement). However, as President Trump paused these tariffs and started negotiations, equity prices recovered over the months that followed.

Unless Donald Trump prolongs the pause in reciprocal tariffs, they will soon come to an end (9th July) for most countries (except for China, 12th August). According to some readings, it is likely that some sort of general agreements will be found by then. However, market swings are likely in the foreseeable future, as the majority of the details continue to be discussed.

Tariffs are expected to drive inflation higher. The consensus foresees the US inflation rate to be at 3.3% at the end of the year, up from 2.4% currently. This threat has prevented the US Federal Reserve (Fed) to reduce its benchmark interest rate in order to support the economy. Indeed, the latter is still running in a low gear, with areas of weakness. For example, both ISM Manufacturing (at 49.0) and Services (at 49.9) indices show a contracting economic activity.

From a geopolitical standpoint, things have unfortunately not improved. As Mr. Trump signed a deal with Ukraine to obtain access to its minerals, his attention moved toward the situation in the Middle East. The US have indeed bombed Iranian nuclear sites, thus helping Israel. As a consequence, the oil price skyrocketed to about USD 79/brl from as low as USD 60/brl, before losing most of this rise as Iran retaliated in a measured manner and without impacting something important for the world's economy, such as the Strait of Ormuz. Despite many countries, including the US, calling for Iran to find a truce with Israel, the situation there remains very tense, being another source of concern for the financial markets overall.

The gold price also benefited from this climate of anxiety, gaining 5.8% over the quarter. For some weeks now however, the price of the precious metal has been fluctuating between USD 3'200/oz and USD 3'400/oz. Gold can be a hedge against geopolitical risk, but after the fantastic rise in recent years, the potential gains are limited. For example, analysts see the price of gold at USD 3'247/oz at the end of the year. Investors wishing to buy gold at these levels should also be aware that the asset is not defensive. So if geopolitics improve, as Mr. Trump sees himself as a peacemaker in the Middle East and Ukraine, the price could fall sharply.

President Trump's unpredictability and his plans for tariff legislation, amongst other things, have weighed on investor confidence in the US dollar. The dollar depreciated by 7.0% against other currencies. In the short-term, the greenback is unlikely to strengthen. Indeed, over the next twelve months, the consensus calls for an exchange rate of 1.18 against the euro and 1.38 against British pound, more or less at today's levels.

Tariffs aside, Mr. Trump's tax and spending bill, i.e. the so-called "Big Beautiful Bill", could be another area of uncertainty in the short-term, in particular on interest rates. At the time of writing, the bill is now at the House of Representatives for review and vote, having just passed the Senate on Vice President Vance's tie-breaking vote. If adopted as is, the US deficit could be increased significantly, fueling questions about the debt burden for Uncle Sam. During the quarter, we have seen Moody's downgrading the USA by one notch to Aa1, as well as early concerns over this bill. As a consequence, the yield on the US 10-year rose to 4.60%, before coming back to 4.23% at the end of the second quarter.

Our positioning on fixed income has not changed. Investors can lock in attractive yields in USD and in GBP, without taking high risks, by focusing on Investment Grade bonds. We would not invest in the High Yield segment in an anemic growth environment, though. Looking at consensus' forecast, the US GDP should increase between 1%-1.5% in 2025. The picture is about similar for the UK (1.1%) and for the European Union (1.2%).

As far as equities are concerned, we became more neutral compared to our previous overweight positioning. We have been positive on stocks for the past few years, but given the high level of uncertainties on many fronts and the solid performance seen during the quarter, we believe taking a "wait-and-see" mode is more adequate for the time being. For example, the S&P 500 Index trades at an estimated forward P/E ratio of 23x for a meager 6% expected corporates' earnings growth. In this environment, we fail to see significant upside revisions of earnings. We have thus taken some partial profit on stocks recently, in particular on US ones.

As mentioned in the past, we expect volatility to remain elevated, with potentially periods of intense weakness. The proceeds of the sales would thus be re-invested in equities, should the environment improve or if valuations become more attractive, all else being equal.

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