Q2 MARKET INSIGHTS

Summer 2025

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KEY TAKEAWAYS

Markets may react sharply to geopolitical events, but long-term performance is driven by fundamentals like monetary and fiscal policy and corporate earnings.

Monetary Policy: Tariff uncertainty is clouding the Federal Reserve's (the "Fed") inflation outlook, prompting a cautious stance that may keep interest rates higher for longer than markets anticipate.

Corporate Earnings: Earnings growth will likely be a key driver of equity market performance for the remainder of the year. Companies with pricing power and/or exposure to artificial intelligence appear better positioned to navigate the tariff environment.

Fiscal Policy: The recently passed tax bill is expected to support economic growth and boost investor sentiment in the short term; however, the longer-term fiscal implications may be significant.

A recently re-published study from The Quarterly Journal of Economics suggests that short-term thinking can lead to overly conservative decisions that can be misaligned with long-term financial goals.

Volatility this past quarter was amplified by a series of dramatic developments on the trade front, highlighted by President Trump's "Liberation Day" tariff announcement. Unveiling a baseline 10% tariff on all imported goods (with certain exceptions) and higher "reciprocal" tariffs on imports from countries with which the U.S. has the largest trade deficits, the declaration caught markets off guard and triggered an immediate wave of risk-off sentiment. Investors were rattled by the prospect of heightened trade tensions, fearing potential disruptions to global supply chains and a drag on economic growth. However, markets quickly reversed course less than one week later, when Trump announced a 90-day pause on implementing the new tariffs (excluding tariffs targeting China) to allow for negotiations and potential trade deals. Later in the quarter, the U.S. and China agreed to a 90-day pause on reciprocal tariffs between the two countries, prompting the equity markets to recover all losses that occurred since the original "Liberation Day" announcement.

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Despite geopolitical tensions in the Middle East, the rally continued through the remainder of the quarter as progress toward completing trade deals ahead of the July 9th deadline—and the possibility of further extensions—fueled investor optimism.

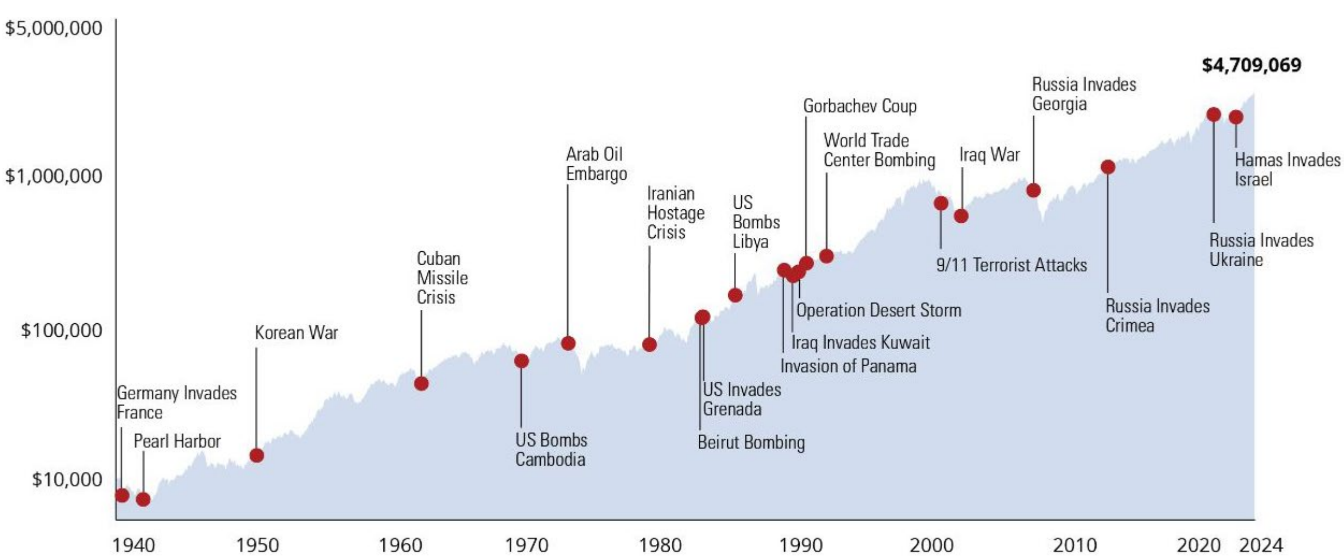
In sum, the stock market completed an impressive rebound from the steep declines of early April, finishing the quarter at an all-time high. The S&P 500 Index® posted a 10.78% return for the second quarter and finished June up 6.20% year-to-date. Internationally, foreign equities outperformed the S&P 500. In Europe, stocks saw continued momentum over policy reform efforts focused on increased defense spending. The MSCI EAFE Index, which represents developed foreign markets, returned 12.03% for the quarter (+19.94% YTD). Emerging markets performed slightly better, supported by a meaningful de-escalation in U.S.-China trade tensions and encouraging economic data out of China. The MSCI Emerging Markets Index rose 12.17% for the quarter (+15.52% YTD). Switching to fixed income markets, the leading benchmark for bonds, the Bloomberg U.S. Aggregate Bond Index, realized a modest positive return for the second quarter—rising 1.21% (+4.02% YTD) as stable inflation readings bolstered investor expectations for Fed rate cuts, increasing demand for bonds.

STAYING GROUNDED AMID MIDDLE EAST TENSIONS

Towards the end of the quarter, tensions between Israel and Iran erupted into a brief but intense military conflict, marking one of the most dangerous escalations in their long-standing feud. As hostilities intensified, global financial markets responded immediately. The S&P 500 fell over 1%, oil prices surged, and gold, U.S. Treasuries, and the U.S. Dollar rallied as investors rotated into traditional "safe haven" assets. However, once a ceasefire was announced, markets recovered quickly. This episode serves as a reminder not to overreact to geopolitical shocks. Investors often fear the worst in moments of uncertainty, but history shows that markets tend to recover quickly from such events. The market's behavior during military conflicts since World War II, including the Cuban Missile Crisis, the first Gulf War, and the Russian invasion of Ukraine, demonstrates a recurring pattern of sharp equity market declines followed by quick recoveries, sometimes within weeks (Illustrated in the chart below). Since 1939, the median drawdown in the S&P 500 from geopolitical events has been just -5.6%. In 60% of cases, those losses were fully recovered within a month, and in 80% of cases, within two months. While geopolitical events can create severe, short-term swings in markets, they rarely alter the long-term direction of equity prices. The initial reaction to events such as wars, terrorist attacks, or military escalations, like the recent Israel-Iran conflict, is typically driven by fear, uncertainty, and the repricing of risk. These reactions often reflect worst-case scenarios being rapidly priced in by investors. Yet, history shows that as the immediate uncertainty subsides and more information becomes available, markets tend to recover quickly. In our opinion, equity valuations are shaped not by geopolitics, but by monetary policy, fiscal conditions, and corporate earnings.

Geopolitical Conflicts Have Had Minimal Impact on Long-Term Equity Performance

Growth of $10,000 in the S&P 500 Price Index (1940–2024)



Source: Morningstar, Ned Davis Research

Unless a geopolitical shock materially changes the economic outlook or prompts a structural shift in policy, its impact tends to be fleeting. Ultimately, investors are best served by staying grounded in long-term fundamentals. While headlines may drive short-term moves, it is policy and profits that determine the market's long-run path.

TARIFF PING-PONG AND ITS IMPACT ON POLICY AND PROFITS

Geopolitics aside, the unpredictable cycle of tariff announcements, delays, and retaliatory measures has complicated the Fed's task of setting appropriate monetary policy. President Trump's shifting stance on tariffs has clouded the economic outlook, and made it more difficult for the Fed to anticipate inflationary pressures or assess the strength of the labor market. (As a reminder, the Fed is guided by its dual mandate: to promote maximum employment and maintain price stability.) For instance, abrupt tariff hikes may temporarily push up prices for imported goods––creating inflationary headwinds, while also weighing on business confidence and investment––which could slow corporate hiring and economic growth. Despite these challenging issues, recent reports have shown that inflation has continued to moderate, with the Consumer Price Index ("CPI") falling to an annual rate of 2.4% in May—down significantly from its 9.1% peak in June 2022 and moving closer to the Fed's 2.0% target. However, the potential inflationary impact of new tariffs remains a concern. Without clarity on trade policy or formal agreements in place, the Fed has indicated that it lacks sufficient data to confidently move forward with rate cuts. At the same time, the labor market remains resilient. According to the June 2025 jobs report, the U.S. economy added 147,000 jobs, marking the 54th consecutive month of employment gains. This streak represents the second-longest stretch of uninterrupted job growth on record, highlighting the durability of the post-pandemic recovery. In addition, the unemployment rate fell to 4.1% (after holding steady at 4.2% for several months)

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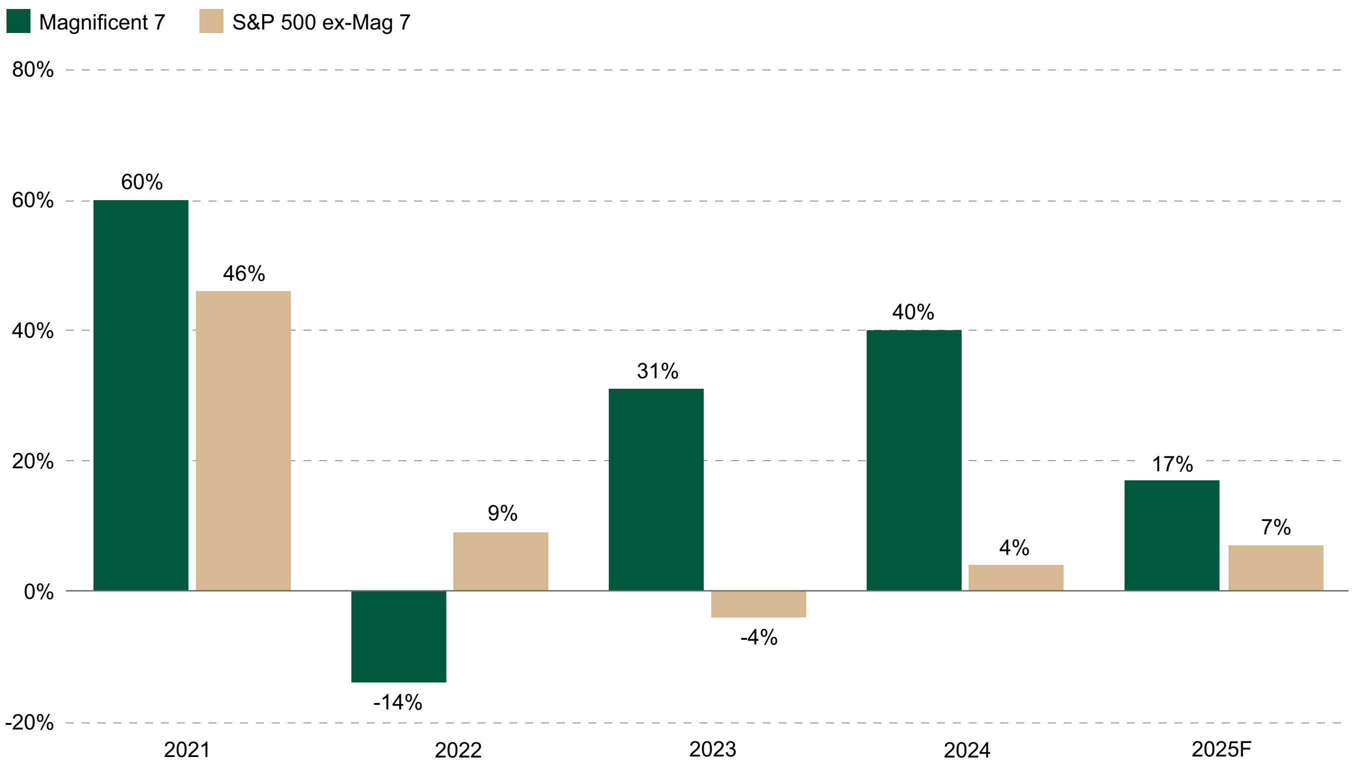
and remains near multi-year lows. While the pace of hiring has cooled from the breakneck levels seen in 2021–2022, the labor market has proven remarkably steady in the face of tighter financial conditions, allowing the Fed flexibility when determining its next steps. While the Fed Funds futures market is currently pricing in more than two 0.25% rate cuts by year-end, Fed officials have been clear: they want to better understand the economic impact of tariffs before taking action. As a result, interest rates may remain higher for longer than the market anticipates.

As long-term, fundamental investors, we continue to believe that interest rates and corporate earnings are the primary drivers of equity prices. With the Fed making it clear that any decision to lower rates will be data-dependent, and given current inflation and labor market trends, we believe that earnings growth is likely to be the most important determinant of equity performance in the second half of the year. One of the most pressing variables in the months ahead will be the evolving landscape around trade policy. Despite ongoing uncertainty, the first quarter's earnings season (which took place during the second quarter) provided investors with some insight into how U.S. companies are navigating a complex policy environment. Notably, there was a clear divergence in commentary from management teams. Some firms, particularly those serving price-sensitive customers, are choosing to hold prices steady and instead focus on cost reductions, supply chain efficiencies, and operational discipline to maintain volumes. While this strategy may help maintain revenue growth, it also risks compressing profit margins. Others, especially companies with pricing power or inelastic demand, have passed cost

Earnings Growth (Pro forma EPS, Year-over-year)



Source: J.P. Morgan

increases through to consumers, helping defend margins more effectively. Looking ahead, the lack of clarity on tariffs continues to cloud the outlook for earnings. In fact, it may take another quarter or two before the full impact of these policies on corporate profitability becomes clear.

One area that appears immune to tariffs is artificial intelligence (AI). Adoption of AI technologies was a key factor in driving earnings growth in the first quarter and continues to accelerate, fueling substantial investment and robust demand across a wide range of industries. According to FactSet, S&P 500 earnings grew 13.3% year-over-year during the first quarter, marking the second consecutive quarter of double-digit earnings growth. Companies exceeded analyst estimates by 8.2%, well above the previous four-quarter average of 4.9% and the 10-year average of 6.9%. Much of that strength came from the technology sector, particularly companies exposed to AI. This dynamic was especially evident among the so-called "Magnificent 7" companies—Apple, Alphabet, Microsoft, Amazon, Meta, Tesla, and NVIDIA—which achieved 28% year-over-year earnings growth in the first quarter, compared to just 5% for the remaining 493 companies in the S&P 500. This translated into strong equity performance, with the Magnificent 7 gaining 23.6% over the remainder of the quarter, compared to a 13.9% increase for the other 493 stocks in the S&P 500 since the start of first-quarter earnings season (which began on April 11th). Despite the potential headwinds posed by tariffs and broader trade tensions, demand for AI solutions is expected to remain strong. Businesses across industries continue to prioritize digital transformation and automation, viewing AI as a strategic imperative to enhance efficiency, reduce costs, and maintain competitiveness. Additionally, government and enterprise investment in AI infrastructure and capabilities remain resilient, driven by the long-term benefits of AI adoption. As a result, even in the face of rising input costs or disrupted supply chains, the secular growth trend in AI is likely to persist. This trend is reflected in the chart above, courtesy of J.P. Morgan, which shows that the earnings growth of the Magnificent 7 is expected to continue to outpace the broader market, underscoring AI's role as a powerful engine of profit growth.

On the fiscal front, Congress recently passed President Trump's tax bill, dubbed the "One Big Beautiful Bill". The "One Big Beautiful Bill" represents a sweeping package of tax reforms designed to provide substantial relief for both corporations and individuals. The legislation aims to make permanent many of the tax cuts first enacted in 2017, including lower rates for businesses and high-income

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households, expanded deductions for small businesses, and increased estate tax exemptions. For individuals, the bill temporarily boosts the child tax credit from $2,000 to $2,200 through 2028 and raises the standard deduction for seniors by $6,000 for four years. High earners will see continued benefits from an expanded estate tax exemption, a permanent 37% top income tax rate, and enhanced deductions for certain business income. The bill also includes a higher cap on state and local tax (SALT) deductions for most filers, while phasing it down for higher incomes. It also includes provisions designed to boost take-home pay for service workers by reducing taxes on tips and provides targeted relief for consumers purchasing American-made vehicles, allowing taxpayers to deduct interest paid on loans for new vehicles assembled in the U.S. For corporations, the bill extends and expands deductions for domestic investment, research, and manufacturing, aiming to bolster U.S. competitiveness and incentivize business activity at home. These measures are expected to support economic growth and boost investor sentiment in the short term, however, the longer-term fiscal implications may be significant.

While the “One Big Beautiful Bill” may provide meaningful tax relief and near-term economic support, it also raises important questions about fiscal sustainability and the long-term impact of serially running large deficits. Unfortunately, this legislation appears certain to worsen the trajectory of the U.S. fiscal deficit. Indeed, we’ve argued since before the 2024 Presidential election that the U.S. deficit was unlikely to significantly improve, no matter which political party was in office. The core issue is that meaningfully addressing the ongoing deficit situation requires politically difficult decisions, such as cutting mandatory spending (Social Security, Medicare, Medicaid, and other entitlement programs) or raising taxes. Both options are deeply unpopular, and few policymakers appear willing to take them on. As a result, the fiscal gap is expected to continue to widen, with little indication that a serious course correction is forthcoming. The longer this dynamic persists, the greater the potential implications for inflation and interest rates.

At its core, a deficit occurs when the U.S. Government spends more money than it collects during the fiscal year. This happens when expenditures on programs like Social Security, defense, healthcare, and interest on existing debt exceeds what is generated from taxes (including tariffs). This shortfall is covered by borrowing, typically through the issuance of Treasury bonds. Borrowing money isn’t necessarily bad. In fact, many countries borrow to invest in infrastructure and education, and to manage short-term crises like wars or recessions. However, persistent and growing annual deficits mean the government must continually borrow more, causing the overall debt burden to expand. Over time, if deficits remain large and unaddressed, investors may demand higher interest rates to compensate for the increased risk and to entice them to continue purchasing U.S. debt. Alternatively, demand for Treasuries, especially from foreigners, could decline altogether, also putting upward pressure on yields. Rising interest costs, in turn, could crowd out other areas of government spending, leaving less room in the budget for essential programs. To keep borrowing costs contained, the Fed may be compelled to step in and absorb more Treasury issuance. While this might help cap yields in the near term, it risks morphing into a form of monetary financing—where the central bank effectively funds government spending by expanding its balance sheet. This can lead to an increase in the money supply, fueling inflationary pressures. In such an environment, where the Fed is suppressing bond yields while inflation is being stoked by monetary expansion, investors may find it increasingly difficult to earn a real return on longer-term government bonds.

Collectively, the evolving dynamics of monetary and fiscal policy, alongside corporate earnings trends, warrant close attention. While conditions continue to evolve, we see no immediate signs of a recession. As long as job growth remains positive—a key indicator of economic resilience—the likelihood of a recession in the U.S. appears relatively low.

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In our view, a recessionary environment would be the primary risk to corporate earnings and equity valuations. Short of that, if earnings for this fiscal year come in as expected, markets should remain stable; if earnings exceed expectations, that would be an added positive. Conversely, if earnings disappoint, we would expect some valuation adjustment, but not a severe market repricing unless accompanied by clear signs of an economic contraction. Ultimately, labor market strength remains the critical buffer supporting both the economy and the market outlook.

Given the current conditions outlined above, we believe investors are best served by maintaining equity exposure to companies that are market share leaders with durable, sustainable competitive advantages. These businesses are often well-positioned to deliver consistent earnings growth and typically exhibit pricing power, which helps mitigate the impact of tariffs and inflation. Many also operate with low leverage and generate strong free cash flow, providing the flexibility to reinvest in growth, pursue strategic acquisitions, or return capital to shareholders through buybacks and dividends. In an environment where the tailwinds from falling interest rates may be limited, these attributes become even more compelling. Within fixed income, we believe it is prudent to maintain exposure to short-term bonds, which are generally less sensitive to inflation and interest rate risk. Additionally, we view investments in gold, bitcoin, or a combination of both as a reasonable hedge against the potential for elevated inflation and valuable tools to protect purchasing power. Finally, an allocation to alternative investments, such as private credit, private real estate, or private equity may offer valuable portfolio diversification due to their typically low correlation with public equities and fixed income. Together, allocations to alternatives, gold, and bitcoin—which may not be suitable for all investors and should be assessed in light of individual financial goals and risk tolerance—can help reduce overall portfolio volatility and enhance risk-adjusted returns.

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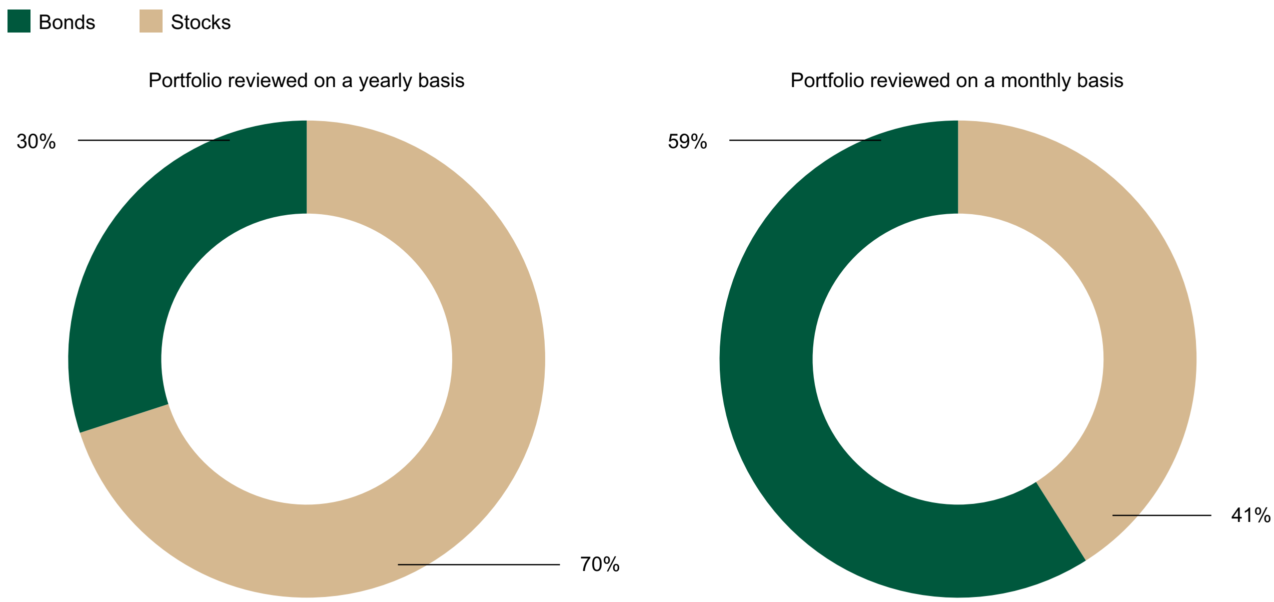
RIP VAN WINKLE

"Rip Van Winkle," a short story written by Washington Irving, tells the tale about a man who falls asleep in the mountains and wakes up 20 year later. Imagine if you fell asleep on March 31st and woke up on June 30th to find that the S&P 500 finished up over 10% for the quarter. At first glance, you might assume something very positive must have happened. But for those who remained awake and tuned in during the past three months, the story was anything but calm. For investors watching daily headlines, the whiplash effect of this back-and-forth can be disorienting. In today's hyper-connected world, resisting the urge to check your investment account every day is harder than ever. The average American now spends five hours and twenty-four minutes on their mobile device each day, checking their phone an astonishing 96 times—roughly once every ten minutes[1]. With financial news, real-time portfolio updates, and market punditry constantly at our fingertips, it's easy to get pulled into a cycle of short-term thinking.

But this constant monitoring can come at a cost. Fidelity Investments recently highlighted a 1997 study that was published in *The Quarterly Journal of Economics*, "The Effect of Myopia and Loss Aversion on Risk Taking" by Richard Thaler, Amos Tversky, Daniel Kahneman, and Alan Schwartz, which explores how frequent exposure to market information can influence investor behavior. Their research found that investors who received more frequent feedback about short-term returns were more likely to exhibit loss aversion and adopt overly conservative investment strategies—despite having long-term goals. The study found that investors who reviewed their portfolios more frequently, such as on a monthly basis, tended to allocate significantly more to bonds and less to equities compared to those who only reviewed their portfolios once per year (see chart on the next page). This behavior was driven by what the authors called "myopic loss aversion": a combination of short-term focus (myopia) and sensitivity to losses (loss aversion).

[1] Source: Zippia, 20 Vital Smartphone Usage Statistics [2023]: Facts, Data, and Trends on Mobile Use in the U.S., April 2023.

Frequent Portfolio Evaluation can Lead to Risk-adverse Behavior



Source: "The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test." The Quarterly Journal of Economics 112.2 (1997)

Frequent monitoring increased the likelihood that investors would see negative returns, which in turn made them more risk-averse, even though the historical long-term probabilities favored equities. In contrast, participants who saw their portfolio performance less often perceived fewer short-term losses and were thus more comfortable maintaining higher equity allocations, leading to better long-term risk-adjusted returns. The study provided early and compelling evidence that too much information can lead to overly conservative decisions that may be misaligned with long-term financial goals. In essence, when we constantly check our portfolios and are reminded of every uptick or downtick, we risk losing sight of the bigger picture. Emotional reactions to short-term losses, even when temporary, can push us to make decisions that are misaligned with our financial objectives and time horizon.

The volatility we saw this past quarter is a powerful reminder of the importance of maintaining a long-term perspective. Markets will always fluctuate, often violently in the short run. But having a thoughtfully constructed asset allocation—one tailored to your specific goals, risk tolerance, and investment horizon—is what enables investors to weather these storms and stay on course.

We thank you for your ongoing confidence and trust. Please reach out to your relationship manager with any questions, or if you wish to discuss your portfolio allocation.

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The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are not managed and do not incur fees or expenses. Performance numbers for the index are total return with dividends reinvested in the index.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Performance numbers for the index are total return with dividends reinvested in the index.

The Bloomberg Barclays US Aggregate Bond Index provides a measure of the total return performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corporate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the United States.

The Consumer Price Index (CPI) is issued by the U.S. Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

Artificial intelligence (AI) is a wide-ranging branch of computer science concerned with building smart machines capable of performing tasks that typically require human intelligence. While AI is an interdisciplinary science with multiple approaches, advancements in machine learning and deep learning, in particular, are creating a paradigm shift in virtually every sector of the tech industry. Artificial intelligence allows machines to model, or even improve upon, the capabilities of the human mind. And from the development of self-driving cars to the proliferation of generative AI tools like ChatGPT and Google's Bard, AI is increasingly becoming part of everyday life—and an area companies across every industry are investing in.

Please contact us for more information on how we can assist you with your financial needs.

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Additional note on chart labeled Frequent Portfolio Evaluation can Lead to Risk-adverse Behavior: In the study, subjects were assigned simulated conditions that were similar to making portfolio decisions on a monthly or yearly basis.

Beaumont Financial Partners | (781) 400-2800 | www.bfpartners.com | 250 1st Ave, Suite 101 Needham, MA 02494