Quarterly Investment Newsletter - Issue 14

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Never too Late for Spring Cleaning

Here we are in July 2025 and I'm still talking about spring cleaning. Despite both the weather and calendar clearly turning the page to summer, I firmly believe that spring cleaning never stops. Maybe (or **most likely** as people close to me would say) I'm just overly neurotic and a clean freak.

I still think back to July 2018 when I first moved into my current home. We had settled on the house on my sister's (and now ironically also my daughter's) birthday in May and we were still getting ourselves situated. Sure enough, a heat wave arrives and we find out that the outdoor central A/C unit wasn't working properly. Those were some brutally hot days and while we were able to get everything fixed after a few weeks, I always remind myself that the issue was preventable. Had we done a proper annual servicing of the unit we could have identified the potential issue and avoided scrambling in the (literal) heat of the moment.

My point in telling that story is that I fear many investors are forgetting to do spring cleaning on their portfolios, financial plans, and candidly their expectations. Maybe its recency bias but I've noticed some complacency in markets that had led investors to forget that stock markets can be quite volatile. For investors born after 1978, its unlikely that they have seen a recession that brought along a prolonged period of low return stock markets. This isn't to say that my expectation is for poor markets moving forward, but rather that we need to mentally prepare ourselves for the ebbs and flows of investing. Nothing like a bear market, trade wars, and actual war to remind us that markets can quickly change and, if not prepared, have us questioning our portfolios and financial plans. Grab a rag and a broom and let's dig in...

Politics, Politics, and More Politics

If you went to sleep on January 1st and woke up on June 30th, you would've seen both global equity and fixed income markets up and trending for a solid calendar year. Given that most asset classes are positive on the year, that individual probably also thought it was a relatively calm year from a volatility standpoint. That individual would obviously be wrong.

As we sit here today in July, we've run the gamut so far in 2025 in terms of potential market risks. We've gone from new political administration taking hold in D.C., new protectionist trade policies, and escalation in Middle East tensions. From peak to trough, we also saw the S&P 500 Index (which measures the 500 larges U.S. public companies) drop nearly 20%. We've fielded a lot of questions on markets, economics, and outlooks so far this year and can certainly sense a great deal of uneasiness in investors. With all of that said, you can see in this graphic that the market rebound was quite fast and largely across the board.

Market and Economic Chartbook | July 2, 2025

Diversified
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Global Market Summary

Global stocks, U.S. sectors and interest rates

Global Stock Market Summary

Index	Level	WTD	MTD	QTD	YTD
S&P 500	6198	0.4%	-0.1%	-0.1%	5.4%
Dow Jones Industrials Average	44494	1.5%	0.9%	0.9%	4.6%
NASDAQ Composite	20202	-0.3%	-0.8%	-0.8%	4.6%
MSCI Emerging Markets Index	1229	0.1%	0.5%	0.5%	14.3%
MSCI EAFE Index	2655	0.0%	0.0%	0.0%	17.4%
MSCI All Country World Index	917	0.3%	-0.1%	-0.1%	9.0%
MSCI Europe Index	2419	-0.2%	0.1%	0.1%	20.8%

Sector Performance

Index	WTD	MTD	QTD	YTD
Materials	2.4%	2.3%	2.3%	7.4%
Healthcare	2.0%	1.4%	1.4%	-0.6%
Financials	1.4%	0.5%	0.5%	9.0%
Real Estate	1.2%	0.6%	0.6%	2.3%
Cons. Stap.	1.2%	0.8%	0.8%	5.9%
Industrials	0.8%	0.3%	0.3%	12.3%
Utilities	0.7%	0.3%	0.3%	8.1%
S&P 500	0.4%	-0.1%	-0.1%	5.4%
Energy	0.1%	0.8%	0.8%	-0.1%
Technology	-0.2%	-1.1%	-1.1%	6.5%
Cons. Disc.	-0.7%	0.2%	0.2%	-4.1%
Comm.	-0.8%	-1.2%	-1.2%	9.3%

Global Rates Summary

	Jul 1, 2025	Jun 30, 2025	Dec 31, 2024
3-Month Treasury Yield	4.40%	4.41%	4.37%
2-Year Treasury Yield	3.78%	3.72%	4.25%
10-Year Treasury Yield	4.26%	4.24%	4.58%
30-Year Treasury Yield	4.78%	4.78%	4.78%
30-Year Fixed Mortgage	6.77%	6.77%	6.85%
German 10-Year Bund Yield	2.57%	2.61%	2.37%

Currencies and Commodities

Index	Level	MTD	QTD	YTD
US Dollar Index	96.82	-0.1%	-0.1%	-10.8%
Euro	1.18	0.3%	0.3%	13.7%
Chinese RMB	7.16	0.1%	0.1%	1.9%
Japanese Yen	143.49	0.7%	0.7%	8.7%
British Pound	1.37	0.1%	0.1%	9.5%
WTI Oil	66.64	0.5%	0.5%	-8.0%
Brent Oil	67.65	0.0%	0.0%	-9.5%

Sources: Clearnomics, LSEG

As we think about all that has happened so far this year, below is how I would summarize the major events:

- **New Administration, New Rules:** Naturally, a major focus of markets, businesses, and individuals in 2025 has been the expectation around the new administration in Washington. Early on, it was clear that trade was in the crosshairs given the push to implement reciprocal tariffs and renegotiate trade deals. While tariffs shouldn't be forgotten as we need more clarity to understand the potential impact, the new focus is on the "Big Beautiful Bill" before Congress. This reconciliation bill is a major piece of legislation that the new administration wants to get implemented. The debates around its context are still ongoing, but expectations are for an extension of the 2017 Tax Cuts and Jobs Act, an increase of the debt ceiling, and spending cuts in areas like Medicaid and green-energy tax incentives. This is an area we're focused on as we expect continued policy implementation over the rest of 2025 and into 2026.
- **International Stocks Rally:** Ever since the financial crisis of 2008/2009, U.S. equities have largely led global public stocks returns. For the first six months of 2025, that theme reversed itself as international stocks rallied for a few reasons. First, U.S. trade policy shifted capital out of the U.S. in favor of international markets. Over the course of the last 15 years, many foreign investors have increased their U.S. equity allocation and it appears that policy uncertainty here in the U.S. offered them a chance to take some gains and rotate some of the portfolio to Europe, Japan, and emerging markets. The other two key components have been the weakening of the U.S. dollar and starting valuations for foreign equities. Specifically on that last point, international markets have been cheaper for some time and offered a fair landing spot for investors looking to built out diversification. For perspective, the All Country World Index ex-US outperformed the S&P 500 by over 11% for the first six month of the year.
- **U.S. Stocks on a Roller Coaster:** Through 6/30/2025, the S&P 500 was up 6.2%. Nice first half of the year, right? What's even more surprising is that number when kept into context that the same index was down -18.9% from its peak on 2/19/2025 through the trough on 4/8/2025. U.S. equity markets have gone full circle this year as investors grapple with extrapolating the impact of tariffs, legislation, and a gradually slowing economy.
- **Economic & Fiscal Uncertainty:** As you'll see in the next section, current economic conditions still look rather strong. That said, markets are a forward-looking mechanism and what is happening today matters less than the expectation in the future. Our focus is on what consumer spending, labor markets, and GDP growth look like moving forward and whether we'll see weakening in the economic data. In addition, we have fiscal conditions in the U.S. where our sovereign debt and interest payments are becoming increasingly concerning.

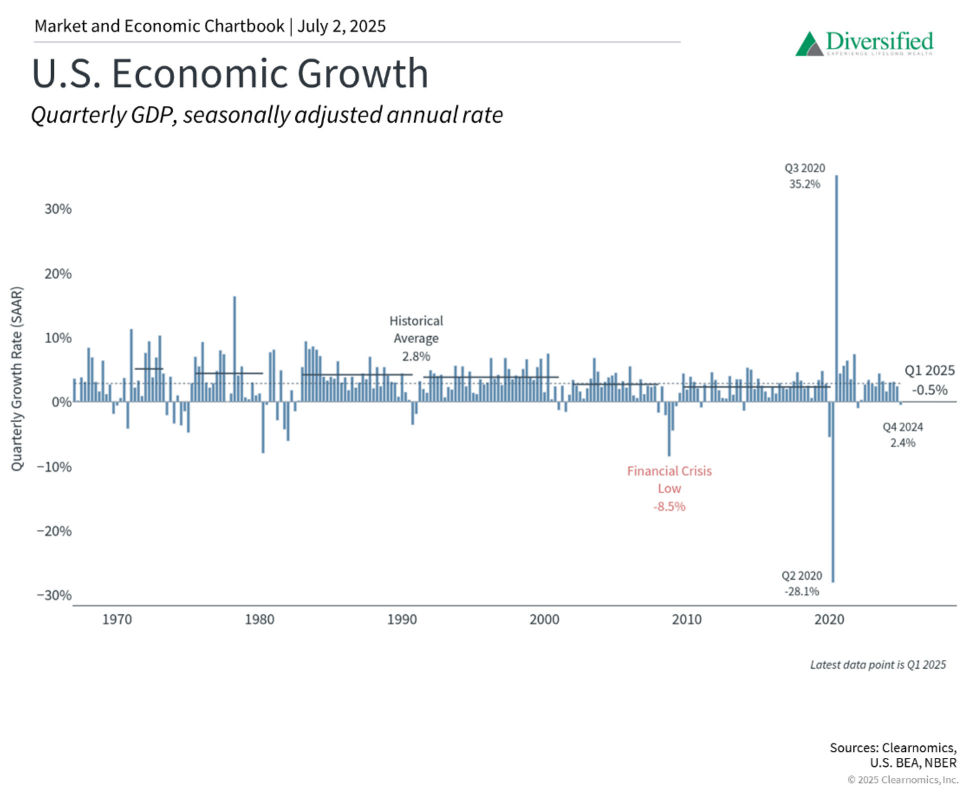
Despite risk assets (mostly stocks) recovering quickly from their swift fall, we see a highly uncertain path as we look forward. A lot of that uncertainty is centered in major economic conditions, where we don't quite know the underlying impact of these new trade and legislative policies. It's worth spending some time digging into those areas, such as GDP, labor, and the consumer, to give an idea as to our focus moving forward.

The Current Economic State

With financial media having a field day with the frenzy of economic, policy, and geopolitical news coming out this year, I find that the real data is slipping through the cracks. Let's fill those gaps with a summary of current economic conditions, including the story around GDP growth, labor, and the all-too-important consumer.

GDP Growth:

After robust expansion in late 2024, the U.S. economy dipped in Q1 2025 mainly due to tariff-driven import spikes. The concensus belief is that many consumers and businesses looked to front run tariffs (or the uncertainty of tariffs) and those net imports negatively affected growth early this year. While domestic demand shows signs of stability, core growth has moderated. Most forecasts we see point to low-to-mid single-digit growth (1–2%) through 2025, with inflation and trade policy the principal headwinds.

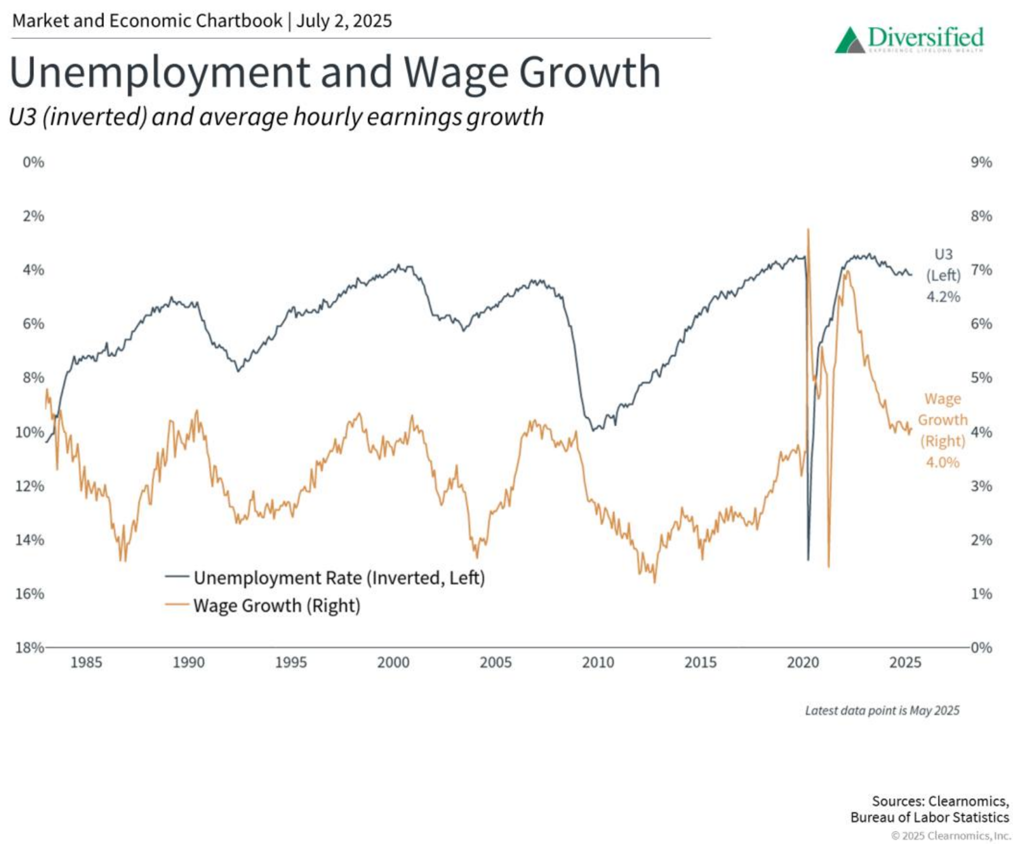


The Labor Market:

Over the past few months, the labor market has shown signs of controlled cooling after the extremely tight conditions seen during the pandemic recovery period. In May 2025, U.S. employers added 139,000 payroll jobs, beating expectations but significantly below 2024 averages of roughly 168,000 per month . While that pace helps preserve job growth, it's a noticeable slowdown from the highs of recent years. This slowing was once again evident in the June numbers.

The unemployment rate remains historically low, around 4.2%, with weekly jobless claims in the typical 200–250k range. However, there's growing evidence of softness: labor force participation has edged down to about 62.4%, wage growth remains solid but has decelerated slightly.

In general, the labor market has been a bright spot in the U.S. and has given consumers confidence to spend (the lifeblood of the U.S. economy). If cooling continues, the Fed will have to consider lowering rates to boost economic activity.



The Consumer:

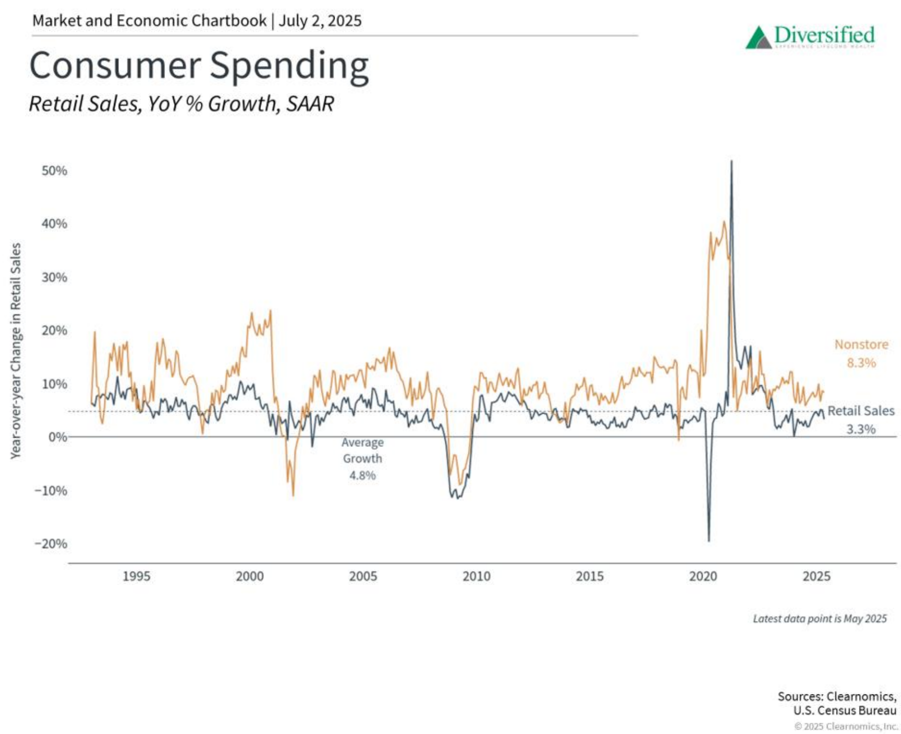
We've said it before and we'll say it again, consumer spending is so important as it makes up 70% of U.S. GDP. From a historical perspective, the average consumer and household has never been wealthier, which is a good starting point.

That said, retail and food services sales dropped 0.9% in May 2025, the sharpest decline in the year, reversing earlier "panic-buying" ahead of anticipated tariff hikes. The National Retail Federation expects slower core retail growth in 2025—just 2.7% to 3.7%, down from 3.6% in 2024. While we see slowing in this area, we aren't at a concerning level at this point.

The interesting conversation we have internally is the discrepancy between "hard" data and "soft data." The hard data shows consumer spending, saving, and real wages all at reasonable levels. The soft data surveys show that individuals don't "feel" great right now. These two discrepancies will converge, and the question becomes in which direction.

You can see some of the soft data coming through into areas of the hard data. As an example, the personal saving rate rose to 4.9% in April 2025, up from around 3.9% in March, suggesting consumers are choosing to save rather than spend.

In general consumer spending has remained positive, driven by stable income, employment, and modest inflation. But the tariff-driven splurge earlier in the year has faded. Now, caution is setting in—retail outlays are softening, and consumers are saving more and spending selectively. Sentiment remains fragile as trade uncertainty and inflation continue to weigh. Overall, households are shifting priorities toward essential purchases and value-oriented retail.



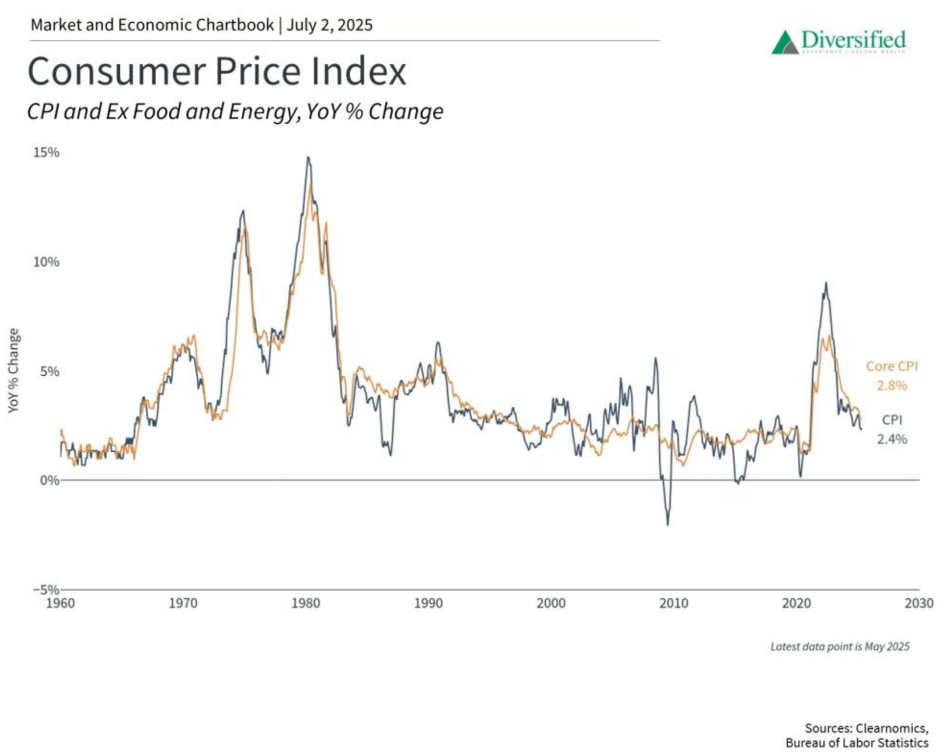
When you look at the overall economic conditions here domestically, it sort of makes sense why many investors have become complacent. I know the theme of the newsletter is to do some spring cleaning, but you could say economic data has been in a sort of heatwave the past few years. Whether it be growth, spending, debt levels, or labor related, we see a general trend of healthy conditions. Some of these are being put to the test here in 2025 and are a core focus of the Diversified Investment Committee as it relates to positioning. Are conditions going to trend into a crisp autumn cooling or will a heat dome form over the economy. Maybe it was the 100 degree days in June but I don't think I've ever used so many weather analogies.

In Focus - The Fed & Fiscal Conditions

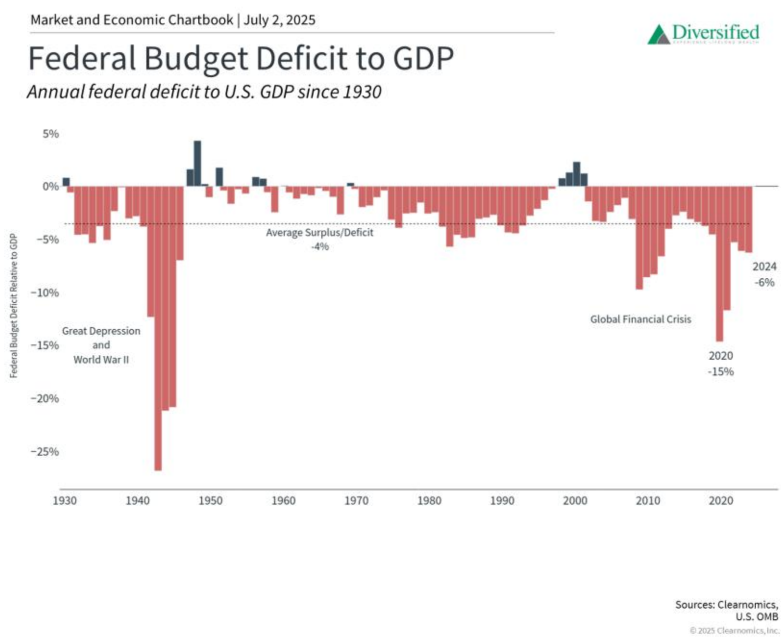
Everyone's favorite topic, the Federal Reserve (the Fed). While we've been speaking about this committee ad nauseum since 2020, their decisions and rhetoric give us good insight into the path of key economic conditions (unemployment and inflation) and the cost to borrow (or said another way, the yield of cash).

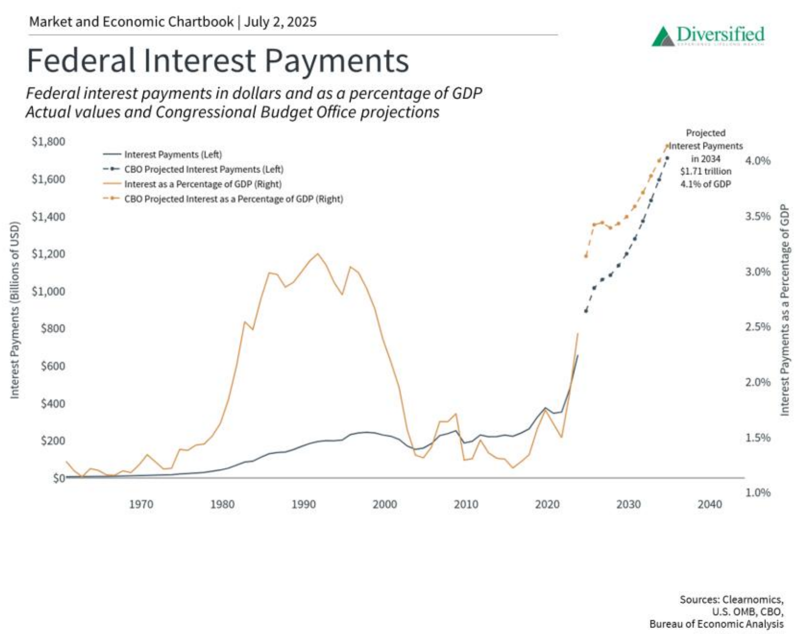
In the June 2025 decision meeting, the federal funds rate was held steady at 4.25%–4.50%, marking the fourth consecutive meeting without a change. As Chair Powell has said multiple times this year, the Fed still anticipates two quarter-point rate cuts in 2025, but with mounting internal caution as the survey shows some disagreement on the future path. To be specific, seven of the 19 members now see no cuts this year (up from 4 in March), while two favor one cut, and about 10 support two cuts.

Despite the pressure to cut rates, the Fed has remained steadfast in its interest rate policy as they highlight a few key risks. They see tariffs as a potential inflationary pressure, and don't want to be forced to increase rates if they prematurely cut. Second, their focus is on unemployment and growth, both of which they see easing. While we haven't seen inflation tick up yet, we're still early in the trade process and year-over-year comparisons are going to get more difficult as we look forward.



A big part of the pressure on the Fed to cut rates is tied to the cost for the U.S. to keep running fiscal deficits. It should surprise no one that the U.S. continues to spend more than it brings in, and it has certainly reached a point where sustainability should be questioned. For perspective, the annual deficit was approximately $1.8trillion (6.4% of GDP) in FY2024 and projected at $1.9trillion (6.2%) for FY2025. In addition, net interest payments have already exceeded $882billion in FY2024, surpassing defense and Medicare spending, and expected to exceed $1trillion in FY2025. The U.S. will need to focus on growing the economy and cutting its deficit to reach a more sustainable point. After Moody downgraded U.S. debt in May, now all three major rating agencies have moved the sovereign debt rating below the highest level.



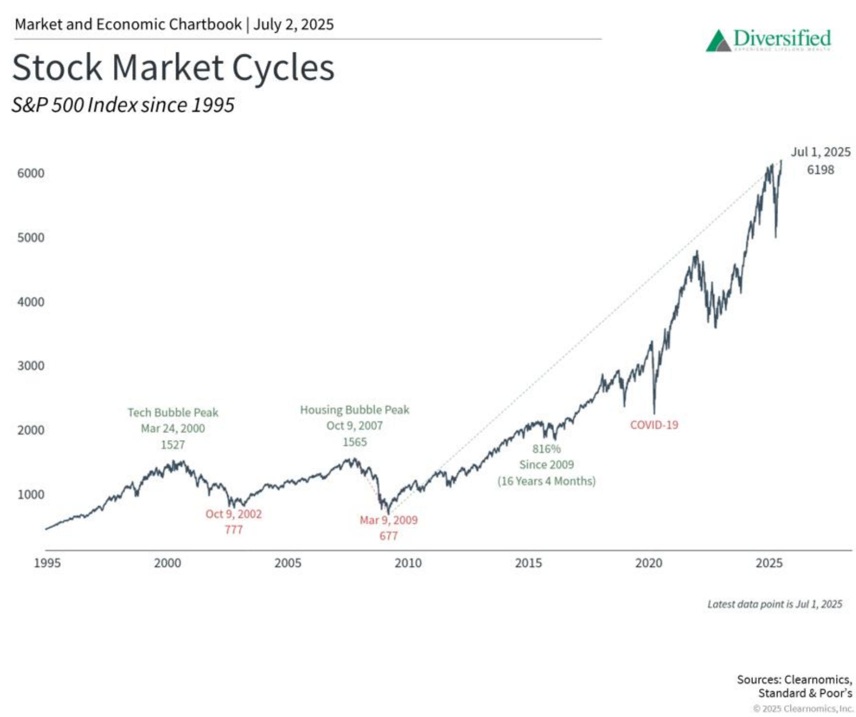


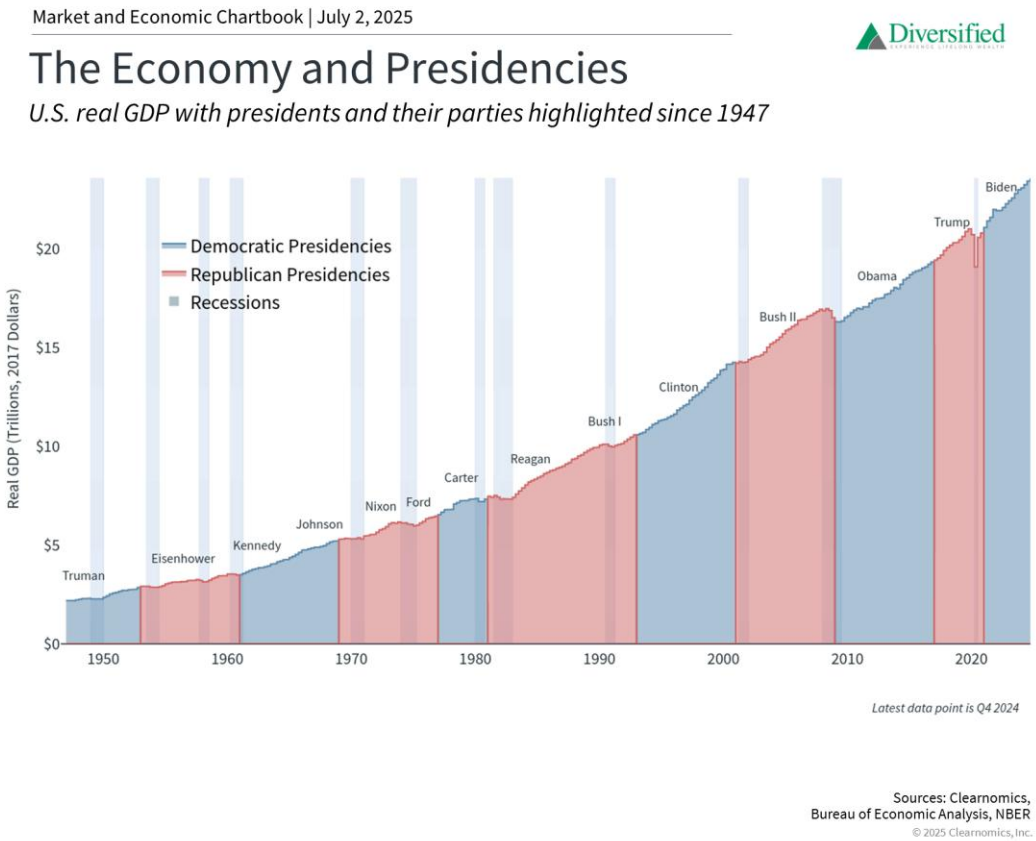
Spring Cleaning

What in the world does any of this have to do with spring cleaning? For me, spring cleaning is always about doing a thorough cleaning of areas that don't get done regularly. In the portfolio context, I believe it should involve a thorough review of an investors financial plan, risk tolerance, and underlying portfolio positioning. The good news is that you work with some of the best individuals for the job (no bias of course).

It's no secret that equity markets have performed well in the aftermath of the financial crisis of 2008/2009. That's a great thing, as equities are one of the primary allocations we use for the objective of long-term growth in a portfolio. Here's the catch...I'm sensing that many investors have become complacent with their perception of portfolios. With complacency comes some bad habits, such as the inclination to want to sell out of markets when they fall or the questioning of portfolio diversification.

This year has been no different. When markets fell nearly 20% over the course of 6 weeks, we naturally received requests to abandon the long-term strategy because "this time was different." Here is something I always remind myself during times of market stress...we've been here before. In the last five years we've seen both a global pandemic and the worst calendar year for bonds in modern history. The reason why we can so easily forget those not-so-distant memories is that we know how the story ends. The time to prepare ourselves for the next market volatility is BEFORE it happens, not reacting to it as it happens.





The good news is that spring cleaning is built into our DNA here at Diversified. Its our core process to consistently reforecast financial plans, discuss risk tolerance, and proactively manage portfolios so that we're preparing for whatever may come next. In our opinion, this would be our checklist for consistent "cleaning" of our finances:

Spring Cleaning Checking – Diversified Edition

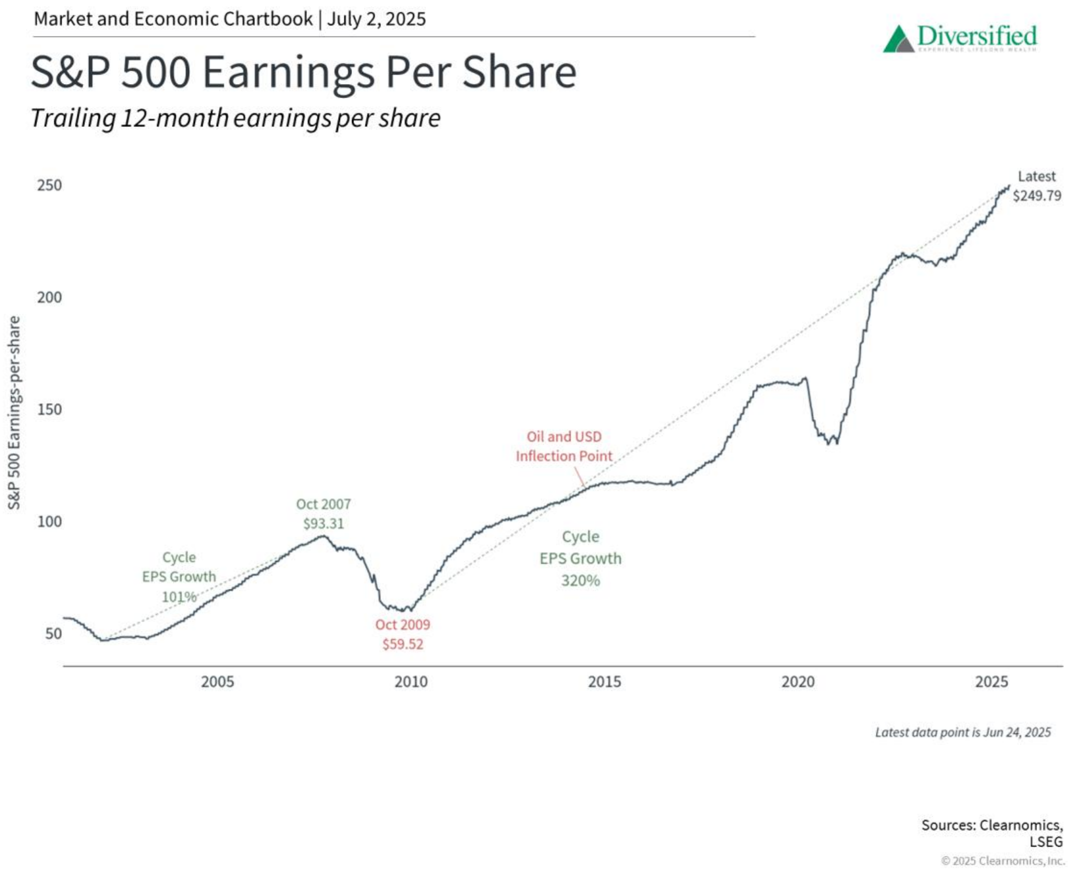
- **Reforecast Financial Plan | Discuss Assumptions | Run Alternative Scenarios**
- **Discuss Portfolio Risk & Return Needs**
- **Review Portfolio Positioning & Expected Asset Class Returns**
- **Revisit Additional Planning Needs (estate, insurance, tax, etc.)**

We've used the same final line in our weekly market update since we started it back in 2020, which is that we build these financial plans not for the easy times, but rather to prepare for the tough ones. Get out your broom and let's do some spring cleaning.

Final Recap & Positioning Thoughts

Investors have a lot to consider as we enter the second half of the year. Do economic conditions hold up to what we've seen so far, or do we see some weakening across the major data points. Does the Fed hold steady or do they cave to the pressure of lowering rates? Overall, there is a lot to like but plenty to consider as it relates to portfolios. What are the major themes in our portfolios and what are we considering?

- We continue to be overweight U.S. stocks, especially large cap. Despite the international rally this year, we still believe earnings will drive markets and domestic businesses continue to drive profits.
- Within that large cap allocation, we do have a tilt towards a combination of quality, dividend-paying companies and the semiconductor industry.
- We do maintain a preference for roughly 15-20% international within the stock allocation, which is healthy but underweight global markets. That allocation favors developed countries but will also own some emerging markets. We've had lengthy discussions around whether to increase this allocation, however, the consensus was that we still are convicted in the domestic overweight.
- Within the bond allocation, we prefer shorter duration corporate bonds. With the flat yield curve and uncertainty around rates, we prefer a slightly shorter duration profile. We also see default rates remaining benign and prefer the extra yield from corporate credit than owning too heavy an allocation to government debt.
- One consideration we're reviewing is the addition of TIPS (inflation-protected government bonds) to our bond allocations. With more protectionist trade policies globally, inflation is likely to remain sticky. While we want to use government bonds for their historically low correlation to stocks during drawdowns, inflation can be a pest to those returns. We would look for TIPS to offer that same diversification benefit with some protection if inflation exceeds expectations. This is a current consideration with our investment committee.



In many ways, we're always doing spring cleaning here at Diversified. From my perspective, portfolio management and proactive adjustments will never stop so its something that has to be built into our culture. If you ever find yourself feeling anxious about the financial plan or your portfolio, just know we're always here to go through the checklist together.

As always, thank you for the trust you put into the Diversified team.

Disclosures:

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