Information through 6/30/2025

ASB Investment Management

Institutional Portfolio Management Quarterly Review

EQUITY OVERVIEW

After a difficult first quarter of 2025, when the S&P 500 retreated 4.28% (on a total return basis), the index rebounded in the second quarter with a gain of 10.94%. The total return for the first half of the year was 6.2%. This was a healthy gain on a historical basis (if not a spectacular one) for US equity investors.

However, market movements don't neatly follow calendar quarters. The S&P 500 had its lowest close for the year on April 8th. This occurred (not coincidentally) soon after the announcement of "Liberation Day" tariffs on April 2nd. At that point the S&P 500 had declined 14.99% for the year.

From the April 8th market close to the end of the first half of the year (June 30th), the S&P 500 rebounded (rather spectacularly) for a gain of 24.92%.

While it is difficult to dissect the myriad factors that contribute to market movements, the announced delay of tariff implementation was certainly a catalyst as was a seemingly benign macroeconomic backdrop.

As welcome as a rebound in equity values is, we do have concerns about the durability of this rally based on the nature of the market leadership since the year-to-date nadir of the S&P 500 on April 8th. The impressive 24.92% gain of the S&P 500 was dwarfed by gains in some of the most speculative segments of the equity market.

For the same period (April 8 to June 30) the UBS US Low Quality Basket had a total return of 41.92%, the Goldman Sachs Non-Profitable Technology Basket had a return of 47.18%, the Morgan Stanley US Momentum Long Basket had a return of 49.07%, and, finally, the Goldman Sachs Bitcoin Sensitive Equity Basket had a return of 99.07%.

EQUITY OUTLOOK

The market conditions described above, on a relative basis, do not favor high quality stocks trading at reasonable valuations. However, we do, and always will favor investments in financially sound, profitable companies that do not trade at exorbitantly optimistic valuations.

We think it is a question of when and not if many of today's speculative and stratospherically expensive equity investments fall back to earth. We don't know when that will happen, but we believe patience and avoiding the pitfalls of the fear of missing out is as important now as it has ever been.

At this moment in market history, we think investors would be wise to pay heed to Warren Buffett's famous aphorism: "In the short run, the market is a voting machine but in the long run it is a weighing machine."

ASB INVESTMENT MANAGEMENT

FIXED INCOME OVERVIEW

By the end of the second quarter the world's most important reference price, the yield of the United States Treasury ten-year note, increased only two basis points, to 4.23%, from the beginning of the period. The more dramatic move was the steepening of the curve. The yield of Treasurys shorter than ten years fell, while the yield of Treasurys ten years and longer rose. The slope of the two-to-thirty-year curve increased from 68 basis points to 106.

During the quarter, the Aggregate Bond Index returned 1.21%, bringing year-to-date results to 4.02%. Intermediate indexes that do not hold maturities longer than ten years earned returns thirty to fifty basis points higher for the quarter, and ten to fifteen basis points more year-to-date.

On February 19th, the same day the stock market traded to an all-time high, investment grade credit spreads traded at 77 basis points over Treasurys, their tightest level of the year. On April 8th, the same day that equities bottomed in a risk-off move at the peak of tariff consternation, credit spreads widened out to 119 basis points. The 55 days from the stock market's April 8th low to a new all-time high on June 27 marked the fastest roundtrip recovery for equities following at least a 15% decline in history, and investment grade credit spreads experienced a similar dramatic turnaround. Soon after the quarter's end credit spreads retraced their sell-off and recovered all the way back to the year-to-date tight level of 77 basis points, a credit spread move that corresponds to a 3.25% change in price for a ten-year corporate bond.

An environment of stable short rates, a steeper curve, and quickly recovering credit spreads seem incongruous with the quarter's events. April 2nd's Liberation Day tariff expectations set off fears of a global trade war. Negotiations for the Big Beautiful Bill risked an increase of $400 billion in taxes. Moody's, the last rating agency holdout clinging to a AAA rating, downgraded U.S. Government obligations to AA1. The United States joined a hot Israel-Iran war with an aerial bombardment of Tehran's nuclear facilities. Amidst the turmoil, stable rates, tight credit spreads, lower oil prices, and equity markets trading to all-time highs remind us of an eternally optimistic strategist referred to as a "jack-in-the-box" who always replied with a positive outlook regardless of the dour nature of the current situation.

FIXED INCOME OUTLOOK

Interest eats while you sleep, and the interest expense of the record federal debt increasingly consumes a larger percentage of GDP. Federal debt as a percentage of GDP is higher than nominal growth, which means that the deficit will continue to grow and become an increasingly larger problem. Over the past twelve months we have

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spent more servicing our debt than on defense. The Treasury must roll $7.3 trillion of debt over the next twelve months. Depending on whether T-Bills or longer bonds are used, the Treasury will need to refinance at least another $3 trillion of debt the following year. We believe this is the biggest risk to an optimistic outlook for U.S. fixed income investors. We have been living with burgeoning deficits for so long, we do not know when the situation might spark a calamity for investors.

We expect the Treasury curve to continue to steepen. As a result, we try to favor portfolio maturity structures concentrated in the five-to-seven-year part of the Treasury curve. Consider two portfolios with the same six year weighted average maturity. The first portfolio holds only six-year bonds, the second portfolio holds only two- and ten-year maturities. The former portfolio holding only six-year bonds will outperform the latter portfolio in a steepening yield curve environment. When portfolio considerations allow for it, such maturity restructuring represents one way that our actively managed portfolios can add value by outperforming more passive or buy-and-hold oriented bond portfolios.

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