Second Quarter 2025

Portfolio Insights
Three Months of Fireworks

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In Brief

Fireworks came early this year. They started on "Liberation Day" and continued with the subsequent market selloff and speedy recovery as trade negotiations and tariff changes ensued. Artificial intelligence (AI), "One Big Beautiful Bill" and conflict between Israel and Iran all dominated markets and headlines at one time or another. Surprisingly though, equity markets finished the quarter higher. Going forward, key areas of focus include:

- Corporate Earnings: How will businesses be impacted by this environment? EPS growth is expected to be 7% for the second half of the year. Additionally, combining passive U.S. large cap exposure with active strategies that focus on less efficient areas of the market may be beneficial.

- The Fed: Rates have wide ranging impacts on economic growth, bond yields and the cost of capital. Treasuries provide yield for now, and dry powder to redeploy when better opportunities arise.

- Private Markets: Together, slower deal making activity, the "democratization of private markets," and increasing secondary activity create pockets of opportunity. Private capital programs can benefit from 1) manager selection as always, 2) secondary investments given current supply-demand dynamics, and 3) co-investments to dollar cost average down the all-in fee load.

Today, we believe a disciplined, long-term strategic approach with shorter-term risk management is essential to ensuring capital is appropriately positioned for both risk and opportunity. So stay the course, but be ready for more fireworks.

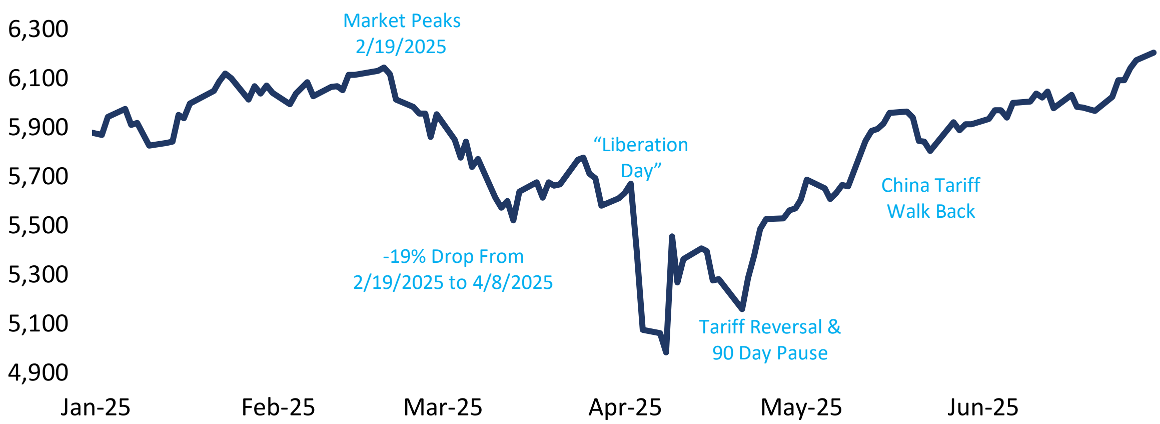
Public Markets
The Fireworks Continued, Here and Overseas

From the One Big Beautiful Bill and the loss of the United States' AAA-rated credit standing, to lingering trade war fears and bunker-busting bombs dropped on Iran, the second quarter of 2025 proved volatile. As is sometimes the case in investing, financial markets have an uncanny ability to climb a steep wall of worry and generate healthy returns for investors. This was certainly the case in the second quarter of 2025.

Just three months ago, the S&P 500 Index was on the verge of a 20% drawdown, credit risk premiums were closing in on historical averages, and uncertainty paired with significant market volatility took firm hold over investor sentiment. By the time the quarter closed, however, those outsized market moves felt like ancient history. Equities clawed back all of their earlier weakness (and then some), credit spreads tightened to near cycle lows, and volatility subsided.

U.S. Equities Rebounded as Tariff Threats Ebbed

S&P 500 Index Price Level



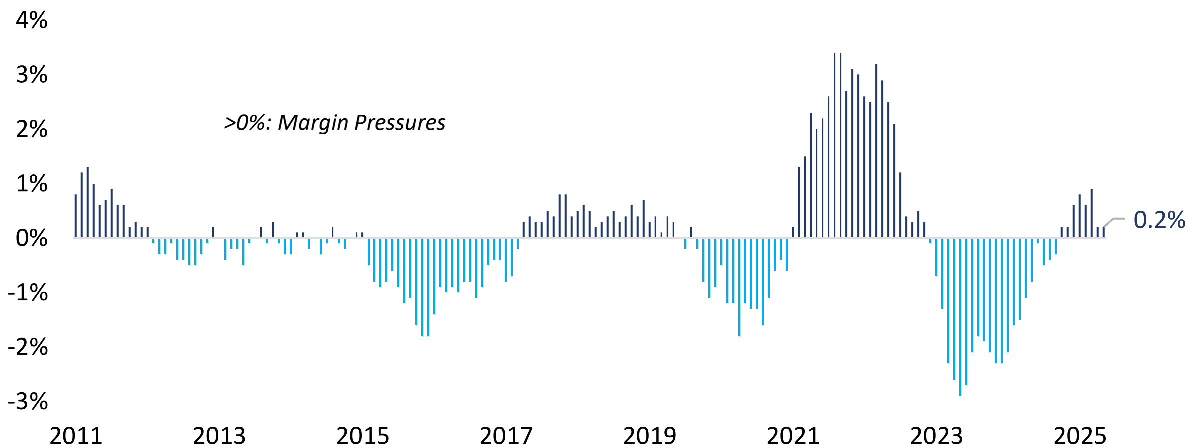
Source: Bloomberg, L.P.; Data as of 6/30/2025.

While today's list of "known unknowns" appears lengthy, one uncertainty in particular remains hotly debated: The economic impact on both growth and inflation that will result from the Trump Administration's attempt to level the global trade playing field. Specifically, will it be producers or consumers that absorb the lion's share of higher input costs? Producers' ability to pass along cost increases to the end consumer will have wide-ranging implications on profit margins, earnings growth, valuations, and of course inflation.

Although it is too early to have clear visibility on how this dynamic will progress, early producer and consumer price index data show producer price inflation running modestly higher versus consumer price inflation since late-2024. This suggests that, so far, producers are absorbing significantly more input cost increases than consumers. Should this dynamic persist, fundamental headwinds could grow for the U.S. production base.

U.S. Margins Under Pressure

Producer Price Inflation Minus Consumer Price Inflation



Sources: BLS, Bloomberg, L.P.; Data as of May 2025.

An additional theme on FEG's radar includes the declining value of the U.S. dollar (USD). The ICE U.S. Dollar Index (DXY) fell by 7% to 96.88 by the end of the second quarter, the worst quarterly decline since the fourth quarter of 2022. The drop bolstered the relative performance of international stocks in the second quarter. The largest beneficiaries were U.S.-based investors, as local currency returns were less robust, albeit still strong.

The weakening U.S. dollar continued to serve as a tailwind behind gold and gold mining stocks in the quarter. The spot price for gold rocketed to a record high as gold mining stocks (measured by the FTSE Gold Mines Index) posted a solid 14.9% gain.

A tumultuous first half of the year (certainly with the benefit of hindsight) presented a pleasantly surprising set of results. The second half of 2025 could similarly provide equally exciting outcomes, to the benefit of long-term, yet flexible, investors.

Global Equity
Volatility, Meet Resilience

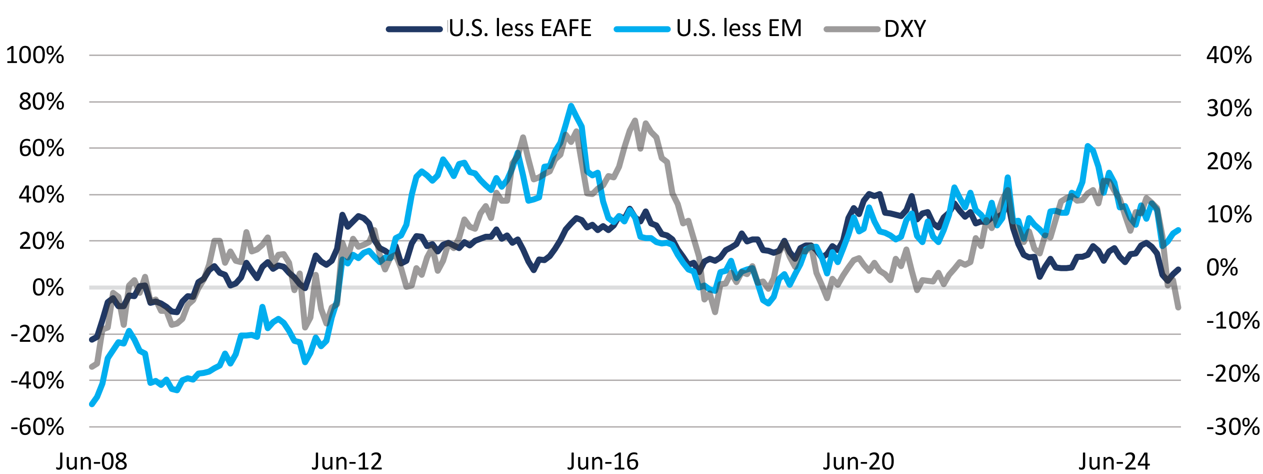
The fastest rebound from a 15% correction in market history was led by technology, communication services, and industrials, with the "Magnificent 7" stocks and renewed AI-driven optimism driving much of the advance. Earnings expectations moderated over the quarter, with consensus second quarter growth estimates revised down from 10% to 6%, reflecting cautious corporate guidance. Nevertheless, reported results proved resilient, particularly among mega-cap names.

Looking ahead, the expiration of the 90-day tariff moratoriums on July 9 and/or August 1 introduces the potential for renewed volatility, contingent on trade negotiations with China and other trading partners. At the same time, the S&P 500 is trading at approximately 23x forward earnings, an elevated multiple by historical standards. This suggests limited upside unless supported by stronger macro data or monetary easing.

International developed equities delivered solid performance in the second quarter, particularly in U.S. dollar terms. The MSCI EAFE Index gained meaningfully, supported by a 7% decline in the DXY, which enhanced translated returns for U.S.-based investors. While local currency returns were more subdued, European equities stood out. Industrials and real estate led gains amid increased defense spending and two rate cuts from the European Central Bank (ECB), which brought the policy rate to 2%. ECB commentary suggests, however, that the easing cycle is nearing completion.

Currency is Driving Global Equity Market Performance

Rolling 3-Year Returns of U.S. Dollar Versus International and Emerging Markets



Sources: Factset, FEG; Data as of 6/30/25.

Japanese equities also posted strong gains, buoyed by investor enthusiasm around AI adoption, ongoing corporate governance reforms, and a favorable currency backdrop. Looking forward, continued dollar weakness could act as a tailwind for developed ex-U.S. equities, particularly in Europe and Japan. With European valuations still trading at a discount to U.S. counterparts, the region could benefit from earnings normalization should global trade conditions stabilize.

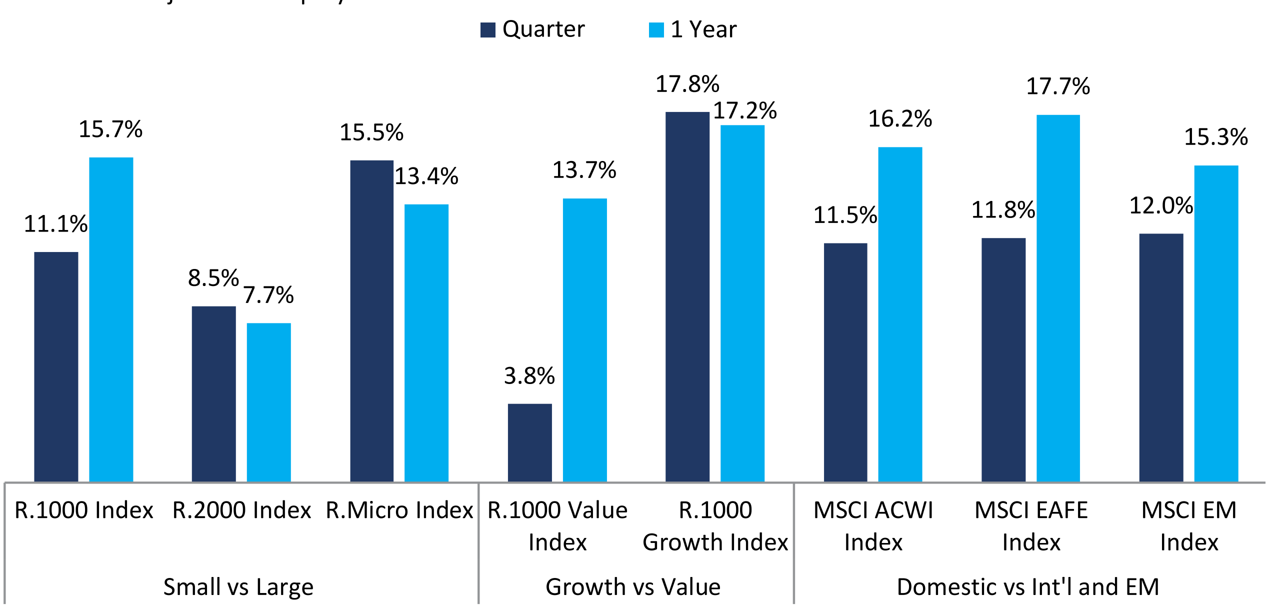
A constructive resolution to U.S.–China trade negotiations would reduce uncertainty

Emerging market equities outpaced developed peers, with gains supported by U.S. dollar weakness, the temporary suspension of U.S. tariffs, and robust performance from key markets such as Korea, Taiwan and Brazil. Taiwan and Korea, in particular, saw a resurgence driven by strong demand for AI-related technologies and significant local currency appreciation, which amplified U.S. dollar-based returns.

Within emerging markets, India underperformed, held back by elevated valuations and persistent growth concerns. China, while modestly positive, remained weighed down by soft domestic data. Looking ahead, a constructive resolution to U.S.–China trade negotiations would reduce uncertainty and serve as a catalyst for further upside across Asian markets. Broadly, emerging markets continue to trade at a relative valuation discount to developed markets and stand to benefit from potential Chinese fiscal stimulus and a continued rotation of global capital—provided risk appetites remain intact.

Global Equities Returns Resisted U.S. Turmoil

Returns for Major Global Equity Markets



Sources: Lipper, MSCI, and FEG; Data as of 6/30/25.

Fixed Income

Volatile Rates, Steady Fed

The yield curve remained upward sloping throughout the second quarter of 2025, with the 10-year/2-year treasury spread widening modestly. The spread fluctuated within a range of 44 bps and 65 bps, ending the quarter at 52 bps, a notable increase from early 2025 but still below the historical average of 85 bps. This steepening reflects shifting market sentiment amid growing expectations of multiple Fed rate cuts by year-end, driven by signs of slowing economic growth and moderating inflation during the quarter.

The Fed held its benchmark interest rate steady at 4.25%–4.50% during both policy meetings in the second quarter, maintaining the level set in December 2024. In its June Summary of Economic Projections, the Fed reaffirmed its expectation of two rate cuts in 2025, consistent with its March dot plot.[1]

Fixed income markets outside the U.S. continued to navigate a disinflationary environment, with central banks in Europe and parts of Asia accelerating their easing cycles. The Bank of England (BoE) cut rates by 25 basis points in May, bringing its policy rate to 4.25% and marking its fourth cut since August 2024. Meanwhile, the ECB lowered its deposit facility rate to 2.25% in June, its seventh cut since mid-2024, as it responded to weakening growth and persistent disinflationary pressures.[2]

> New issuance remained resilient, particularly in the investment-grade segment

On the credit side, high-yield corporate spreads experienced significant volatility during the second quarter. After peaking above 4.6% in early April amid heightened trade and growth concerns, spreads tightened to 3% by the end of June, supported by strong inflows and improving earnings. While still below its historical average of 5.3%, the sector remains sensitive to macro shocks and policy uncertainty.

New issuance remained resilient, particularly in the investment-grade segment, which recorded a record $585 billion in supply during the first quarter.[3] That momentum extended early into the second quarter before tapering off amid rising market volatility. High-yield issuance also increased, though at a more measured pace, reflecting a selective and cautious investor base. Meanwhile, demand in the structured credit space, especially CLOs, held steady, supported by attractive liability spreads and the continued expansion of investment-grade CLO ETFs.

Reflecting ongoing macroeconomic headwinds, corporate default rates in the U.S. edged higher during the second quarter. The trailing 12-month default rate for high-yield bonds rose to 2.3%, while defaults in the leveraged loan market climbed to 4.5%. Moody's projected that speculative-grade bond defaults would reach 3.4% by quarter-end, roughly in line with historical norms. In contrast, defaults among speculative-grade loan issuers could rise to 8.6%, significantly above the long-term average. Despite these increases, major institutions such as Barclays and Morgan Stanley expect high-yield bond defaults to remain relatively contained for the year, between 2% and 3%, suggesting that credit markets are not yet signaling systemic stress.[4]

[1] Source: CME FedWatch - CME Group.

[2] Source: BoE Leaves Rates Unchanged, ECB Cuts as Expected, Chatham Financial; ECB Cuts Interest Rates Amid Below-Target Inflation, Morningstar; Monthly Fed Funds, ECB, BoE interest rates 2003-2025, Statista.

[3] Source: SIFMA U.S. Corporate Bonds Statistics.

[4] Source: Moodys.com, "U.S. firms' default risk hits 9.2%, a post-financial crisis high"; March 4, 2025.

Real Assets
High Rates and Volatile Energy

Persistently higher Treasury yields remain a headwind for real estate and led to modest declines for U.S. Real Estate Investment Trusts (REITs) in the second quarter. Real estate securities declined sharply in early April, reflecting concerns about the impact of tariffs on the broader economy but recovered in May as concerns abated. U.S. REIT property sectors posted mixed returns, with data centers and cell tower companies showing gains, while industrials fell on concerns about decreased global trade.

Natural gas remains well-positioned

Oil prices were extremely volatile during the quarter, impacted by continued tariff uncertainty and the war between Israel and Iran. In early April, prices declined to levels not seen since 2001 on fears that the impact of tariffs could dampen future oil demand. In June, prices rebounded on increased expectations of Middle East supply interruptions. Natural gas prices fell, driven by warmer winter weather, increased production, and higher storage levels. Although natural gas prices declined during the quarter, year-to-date, prices rose by double digits on expectations for continued growth in demand from liquefied natural gas (LNG) exports.

Looking ahead, publicly listed real estate performance may remain closely tied to changes in interest rates. Any further decline in U.S. Treasury yields could positively impact the asset class, particularly rate-sensitive sectors. Concerns about a potential slowdown in the domestic economy, however, may lead to a divergence in performance across property types, with more economically sensitive sectors potentially facing increased headwinds.

Natural gas remains well-positioned. It stands to benefit from increased demand driven by growth in liquid natural gas exports and growing power demand in the U.S.

Diversifying Strategies

Broad Strength Amid Tailwinds and Volatility

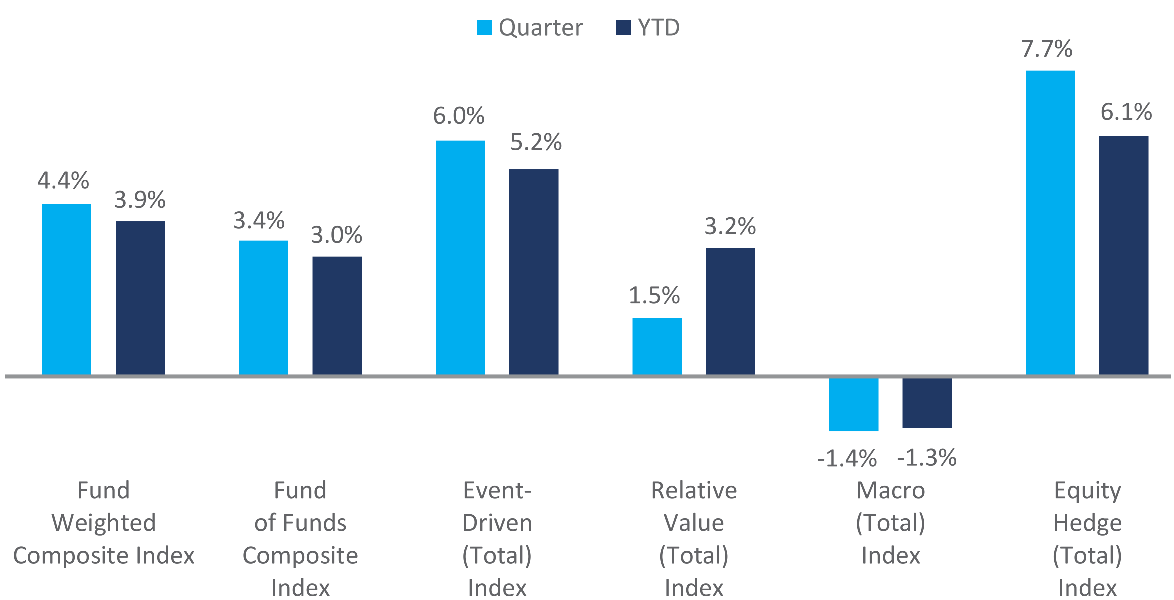
With the exception of global macro, hedge funds posted strong performance in the second quarter. Equity hedge and event-driven strategies led the way with gains north of 5%. Equity hedge performance was propelled by technology and healthcare sectors, which benefited from a strong tailwind from public equity markets. Similarly, event-driven strategies saw gains across special situations, distressed, and merger arbitrage.

Within macro, discretionary strategies outperformed their systematic counterparts. Trend-following was the biggest laggard as markets continued to present choppy price movements. Early in the quarter, those strategies faced the most pain, only to slightly recover by quarter-end. Discretionary strategies were able to be nimbler and react to volatile prices.

Given the heightened level of uncertainty in public markets and the risk of continued rate volatility, FEG believes diversifying strategies have the potential to be a valuable source of relative stability and diversified returns.

A Quarter of Broad Strength

HFRI Indices Performance Returns (U.S. Dollars)



Source: Hedge Fund Research; Data as of 6/30/25.

Private Markets

Current Fireworks Obscure Business Fundamentals

While some of this year's fireworks started in April, private capital markets have been dealing with fireworks of some kind for the last five years. The COVID shutdown, the related bump in technology valuations and subsequent correction, the war in Ukraine, the rise of artificial intelligence, and this year's tariffs and the Middle East conflict are just a few of the pyrotechnics we have witnessed.

> It is easy to overlook the fact that there is little fundamentally wrong with the private markets other than the lack of realizations

Despite sometimes significant external factors, private capital investing remains a relatively straightforward proposition. Fund managers must source and close new investments, add value to the asset, and then sell the asset for a profit. The difficulty of executing this strategy can be significant, but certainly doable and repeatable for talented managers.

Amid the current fireworks, it is easy to overlook the fact that there is little fundamentally wrong with the private markets other than the lack of realizations. Buyers and sellers still have ample capital to transact. (Bain & Company estimates there is $1.2 trillion of dry powder in buyout funds waiting to be deployed.) Despite this, deal-making activity has been muted while limited partner demand for distributions has increased.

We expect to see more innovative solutions on the secondary market as general partners weigh the trade-off between generating liquidity today and the risk of holding for a higher return in the future. Manager selection is even more critical now due to market uncertainty and the somewhat increased difficulty of executing private capital strategies.

Private Equity

Declining Activity Despite Resilient Fundamentals

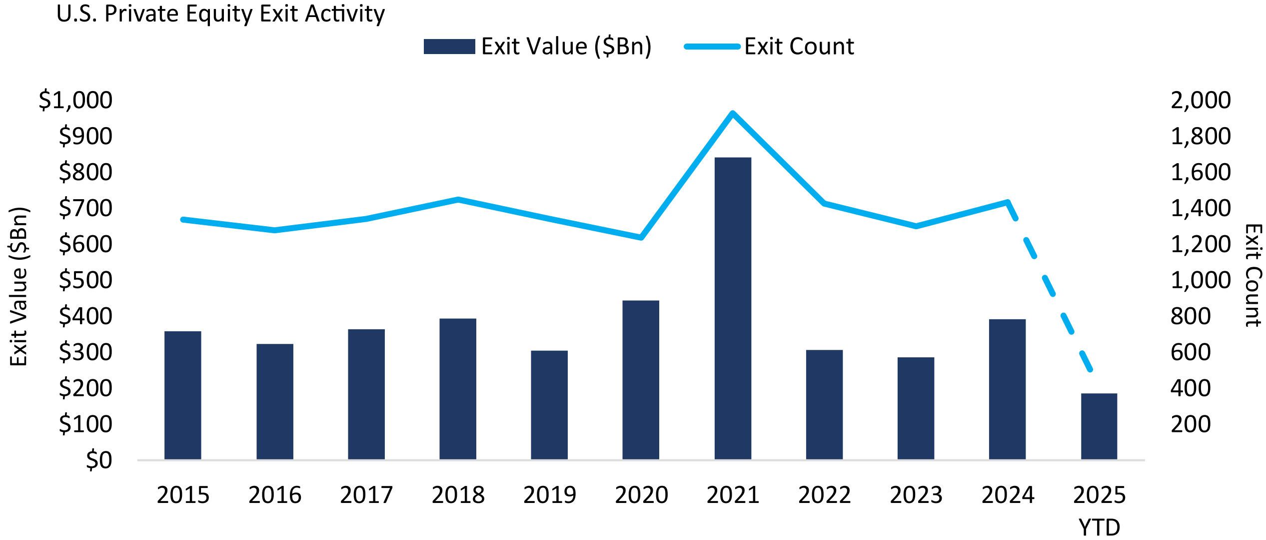
Private equity fundraising in 2025 has extended the deceleration observed in 2024. In Q1, $56.7 billion was raised across 79 funds reaching final close, with capital increasingly concentrated among a smaller cohort of large, established managers. Despite persistent macroeconomic headwinds and rates and tariff uncertainty, deal activity remained resilient. An estimated 2,263 transactions were recorded in the first quarter (the latest data available), reflecting a 5.5% decline quarter-over-quarter but an 11.8% increase year-over-year.

Valuations remained relatively strong. Trailing 12-month buyout multiples declined to 12.2x EBITDA in the first quarter, yet remained above both pre-pandemic levels and the five-year average. EV/revenue multiples held steady at approximately 2.0x, which is in line with 2024. U.S. valuation multiples edged higher, supported by robust exit activity. An estimated 402 exits generated $186.6 billion in aggregate value—up 44.9% from the fourth quarter of 2024. Notably, the median exit size continued its upward trajectory through 2023 and 2024, with a further increase in Q1 of this year, despite an ongoing slowdown in exits.

In this environment, we advise investors to adopt a selective approach to new commitments, favoring managers who emphasize operational value creation over financial engineering or excessive leverage.

A Continued Decline in PE Exits

U.S. Private Equity Exit Activity



Sources: FEG; Pitchbook "Q1 2025 U.S. PE Breakdown Summary"; Most recent data available.

Venture capital investors remain selective, with limited partners cautious after years of muted returns. First quarter fundraising reflected this sentiment, with just $10 billion raised across 87 funds—putting the year on pace for the weakest fundraising in a decade. The ongoing liquidity crunch has slowed capital deployment, as managers preserve dry powder. According to PitchBook, 77% of managers who raised capital in 2021 or 2022 have yet to close a successor fund.

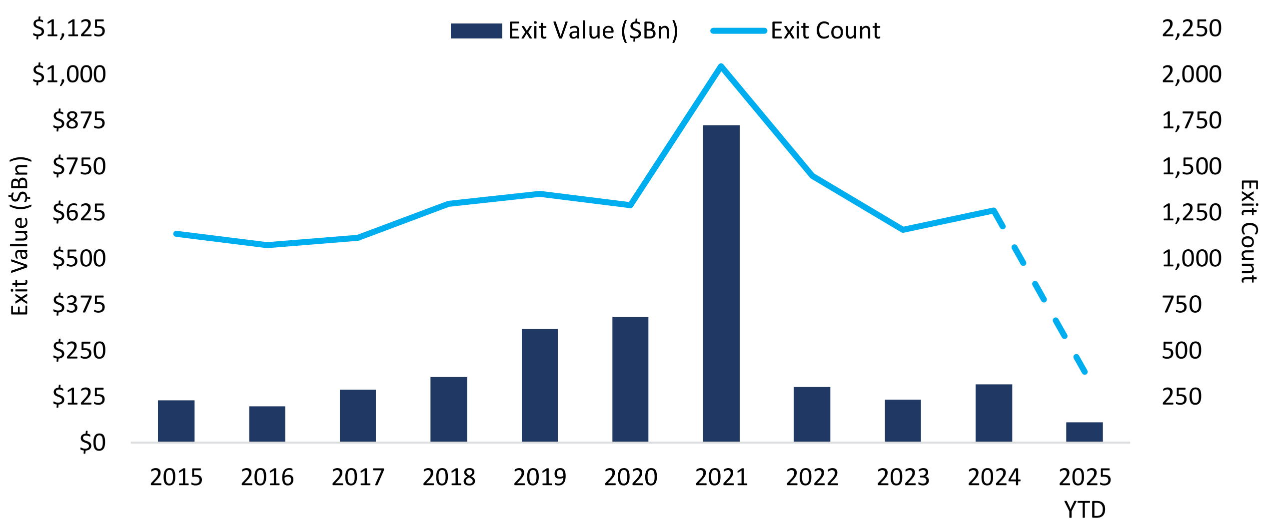
Despite headwinds, deal activity held steady. An estimated 3,990 deals closed in the first quarter, up 10.9% QoQ and in line with first quarter 2024. Deal value rose 18.5% to $91.5 billion—the highest since first quarter 2022. High-quality companies, particularly capital-intensive AI startups, continued to attract capital.

Exit activity also rebounded in the first quarter, reaching $56.2 billion across 385 exits—the strongest quarter since the end of 2021. However, it is worth noting that nearly 40% of value came from a single IPO: CoreWeave. Distributions show early signs of recovery, but remain well below historical norms. Until distribution yields improve, fundraising and new deal activity are unlikely to rebound meaningfully.

FEG continues to advise caution with venture capital exposure. However, clients are encouraged to consider selectively allocating capital to high-conviction managers. For patient investors, current market conditions may offer attractive entry points at more favorable valuations.

VC Exit Activity Continues to Drop

U.S. Private Equity Capital Activity



Sources: FEG; Pitchbook “Q1 2025 Pitchbook NVCA Venture Monitor Summary”; Most recent data available.

Private Debt

Declining Exits and Alterations Also Impacting Debt

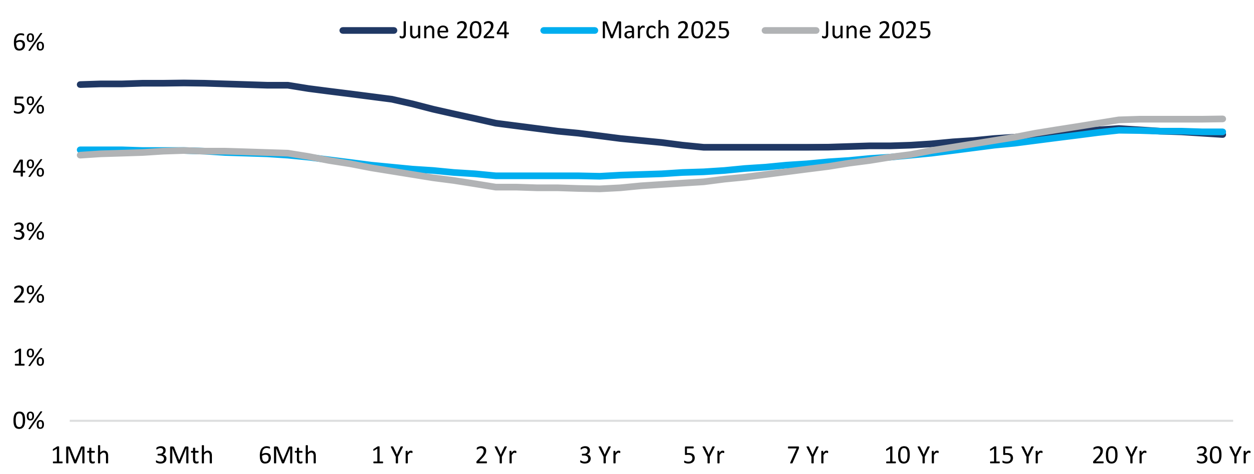
Spreads remained tight in the second quarter of 2025, most notably in the upper middle market (UMM), which remains highly competitive. The UMM continued to converge with the broadly syndicated loan market throughout the year, as loans are often covenant-lite and deals are syndicated to multiple lenders. Despite Fed rate cut projections moving lower, unlevered yields remain compelling across private credit strategies. As floating rates reset lower over time, mezzanine debt spreads/yields will become relatively more attractive.

Mezzanine debt pricing remained steady in the second quarter. As in the first quarter, lenders dealt with the same issue as private equity managers: Extended exits and alterations in cash versus payment-in-kind interest as companies looked to reduce their cost of capital. We continue to see lenders looking at options to provide liquidity for LPs in older funds, including continuation vehicles and secondary sales.

FEG favors strategically allocating to private lending strategies to exploit the persistent illiquidity premium. In the event of a recession, a new wave of distressed investment opportunities could be ushered in, making a case to favor both private lenders and distressed managers.

Continued Move to Normalization?

U.S. Treasury Yield Curve



Source: Factset; Data as of 6/30/2025.

Private Real Assets

Private Real Estate Finally Stabilizes

Following a three-year downturn, private market real estate values saw little change in the first quarter of 2025 (the latest available data). According to the NCREIF Property Index, real estate values rose slightly, led by the industrial and retail sectors. Following the downturn that began in 2022 when the Fed raised interest rates, real estate values have stabilized but continue to face headwinds in a higher-for-longer interest rate environment.

Demand for oil and natural gas is expected to grow through the end of the decade, in part driven by AI's position as a key driver of increasing demand for electricity. While the supply and demand outlook for oil is uncertain, natural gas stands to benefit from abundant domestic supplies, which can be exported to meet global demand.

Looking ahead, private real estate market values have reset from their record highs in 2021. A gradual recovery should continue, with property owners poised to benefit from eventual lower rates and increased transaction volume. Continued growth in demand for power should broadly benefit the energy infrastructure sector, with natural gas positioned as the most readily available source of power.

Looking Ahead
Beyond Today's Fireworks

Despite the perhaps unique nature of current headwinds and their seemingly hourly changes in strength and direction, equity and fixed income volatility has, thus far, been of levels that we have seen before and will no doubt see again. A long-term perspective is especially valuable.

It is prudent to be concerned about tariff-driven price increases and their potential broader impact. The risks are real and potentially significant. But it is also prudent to acknowledge the underlying long-term strength of the U.S. economy and, as FEG has said before, Warren Buffett's often cited belief in never betting against it.

In private capital markets it is an opportune time for managers to earn their fees and carry. Talented and experienced managers need to take advantage of the near-term uncertainty through creative deal-making and value creation activity to deliver returns to their investors.

Across public and private markets, FEG believes new opportunities will arise, along with new fireworks, as the year progresses – sometimes in rapid succession. Portfolios should be positioned appropriately for both.

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All data is as of June 30, 2025 unless otherwise noted.

Indices

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The FTSE Gold Mines Index Series is designed to reflect the performance of the worldwide market in the shares of companies, the revenues of which are primarily derived from the mining of gold. A company's eligibility is based on it being able to consistently produce a minimum quantity of gold per annum, and on a minimum percentage of its revenues being derived from mined gold.

The S&P 500 Index is a capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Information on any indices mentioned can be obtained either through your advisor or by written request to information@feg.com.