

Highlights

- Credit spreads widened on Liberation Day but narrowed back after the pause on optimism related to likely tariff outcomes and expected legislation. The yield curve steepened, and some of the portfolios outperformed.
- The economy likely grew reasonably in Q2 after declining in Q1. The growth rate has likely eased as the economy faces counteracting forces from policy and tariffs.
- Congress passed the OBBB in early July delivering at least one significant victory for the U.S. economy, the extension of lower corporate tax rates.

Markets

GIA	Average Quality	Returns (%)			
		2Q25 Gross	2Q25 Net	12 Months Gross	12 Months Net
Core Plus Composite	(A+)	1.63	1.54	6.48	6.11
Global Investment Grade Composite	(A-)	1.97	1.87	7.17	6.74
Global Credit Plus Composite	(BBB+)	2.42	2.30	7.95	7.41
Global High Yield Composite	(BB-)	3.92	3.77	10.15	9.49
Emerging Market Corporate Debt Composite	(BB+)	1.19	1.03	8.15	7.50
<i>Benchmark Bonds</i>					
Bloomberg U.S. Agg. Index	(AA)	1.21		6.08	
Treasury	(AA+)	0.85		5.30	
Corporate	(A-)	1.82		6.91	
Mortgage	(AA+)	1.14		6.52	
Government/Credit	(AA)	1.22		5.89	
ICE BofA U.S. Corporate & Yankees	(A-)	1.81		6.92	
ICE BofA U.S. Corporate	(A-)	1.79		7.04	
ICE BofA U.S. High Yield	(B+)	3.57		10.24	
ICE BofA Global High Yield Constrained Index (USD)	(B+)	4.76		11.81	
ICE BofA EM Corporate Plus	(BBB)	1.72		7.84	
ICE BofA Global Gov't ex-US	(AA-)	1.05		1.67	
JPM Emerging Markets EMBI GD	(BB+)	3.32		9.97	
JPM CEMBI Broad Diversified	(BBB-)	1.57		7.82	
JPM GBI-EM Global Diversified	(BBB+)	7.62		12.81	
<i>Benchmark Equities</i>					
S&P 500	NA	10.57		13.63	
Nasdaq Composite	NA	17.75		14.87	
Russell 2000	NA	8.11		6.22	
MSCI EAFE	NA	10.58		14.70	
MSCI Europe	NA	9.97		15.60	
MSCI Japan	NA	11.62		11.76	
MSCI Emerging Markets Equity	NA	11.02		12.57	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

What a quarter! “Liberation day” was April 2, 2025, and “obliteration day” June 22, 2025. In between those historically consequential dates, the quarter transpired as though neither even occurred. After the tariff uproar was paused, the Fed met twice and took no action anticipating likely price pressure from tariffs and a relatively stable labor market. The House of Representatives passed a version of the “One Big Beautiful Bill,” and the Senate narrowly passed a revised version on July 1. Economic data suggested the economy continued to moderate from its healthy Q4 2024 pace, and predictions of an imminent Liberation Day induced recession faded. Given the enormity of the book-end events during the quarter, it is not a surprise that financial markets experienced meaningful volatility. Equity markets collapsed after Liberation Day, only to recover after the President paused the tariffs and then hit new record highs. Between March 31 and April 8, the S&P 500 dropped -11.2% and then proceeded to rise 24.53% to close the quarter at a record. For the quarter, the S&P 500 was up a healthy 10.57% which brought the half year return to 5.50%. Meanwhile, bonds were much tamer, although long-term rates rose from 4.57% to 4.78% after touching a low of 4.40% on April 4 and a high of 5.09% on May 21. The Bloomberg U.S. Aggregate Index returned 1.21% reflecting solid performance from corporates and mortgages and a modestly steeper yield curve. Other highly volatile markets included oil which traded at \$72.79 to start the quarter, fell to \$59.70 in early May, spiked to \$77.08 on June 19 and then dove to close the quarter at \$66.74. The U.S dollar also reacted declining 8.5% against the Euro and, including other currencies, the Bloomberg U.S. dollar Spot Index fell 6.34%.

Investment grade credit recovered much of its first quarter underperformance as worries about a tariff-driven economic decline gave way to a steadier outlook with sustainable earnings. The sector’s longer duration and modest spread compression enabled the sector to generate positive excess returns for the quarter and year-to-date. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (COA0), was up 1.79%, which outperformed government bonds and delivered positive 104 b.p. of duration adjusted excess returns. Corporate option adjusted spreads (OAS) narrowed by 8 b.p. to 87 b.p., while the yield to worst of the index declined 11 b.p. from 5.12% to 5.01%. Borrowing remained healthy as issuers took advantage of tighter spreads and steady investor demand. New credit issuance totaled \$425.6 billion, which brought the year-to-date borrowing to a healthy \$1.07 trillion.

The high yield market also experienced a solid recovery as investors found the sector’s absolute yields appealing. With economic prospects improving after the tariff pause, strategists recommended the sector’s compelling spreads. The ICE BofA U.S. High Yield Index (HOA0) was up 3.57% for the quarter, meaningfully outperforming higher quality sectors. Year to date, the high yield market was up 4.55%. At quarter-end, the spread to worst was narrower by 49 b.p. from 371 b.p. to 322 b.p. The yield to worst declined to 7.02% compared to 7.65% in March. Fund flows turned slightly negative due to a large -\$10.9 billion outflow in April that was mostly offset in May and June. Specifically, investors withdrew \$0.01 billion during the quarter following inflows of \$7.2 billion during the first quarter. The default rate, including distressed exchanges increased to 1.41% from 1.20% at the end of March (0.43% not including distressed exchanges), well below the 3.4% historical average. While defaults remain well behaved for high yield bonds, the leveraged loan market experienced a still elevated default rate driven by distressed exchanges. The new issue market saw \$77.3 billion of gross issuance bringing year-to-date issuance to \$145.6 billion.

Emerging markets hard currency bonds continued to perform well driven by optimism that trade deals with the U.S. would be less onerous than initially envisioned. In addition, away from oil, commodity prices remained robust, and many countries experienced improved domestic performance. After lengthy periods of fund outflows, investors started adding funds to the asset class during the quarter. The Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 3.29% for the quarter and 5.64% over six months. Similarly, the JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) rose 1.58% over the last three months and 4.04% year-to-date. The quarter’s performance champion was the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, which returned an impressive 7.72% for the quarter and 12.26% for the half year on the back of robust currency appreciation.

Economy

The Trump Administration touted a growth agenda led by lower taxes, deregulation, and investment. Throwing a wrench into everyone's rosy forecasts, in April Trump initiated a tariff barrage that surprised everyone and caused an abrupt shift in expectations. Before the President backed off, a few economists revised their forecasts from growth to recession by the end of this year. Looking forward, we believe the tariff confrontations introduce a downside factor that counteracts the benefits of recently enacted legislation.

During the first quarter of 2025 the economy contracted -0.5%. This occurred due to a consumer pullback from healthy spending in Q4 2024, and a massive increase in imports to get ahead of tariffs. Net exports contributed a negative -4.6% to the first quarter's performance. The "pull forward" of purchases mostly by firms and intermediaries will likely become sales of goods during the ensuing months. In addition, the net exports drag should not be repeated, suggesting Q2 GDP will show a healthy recovery. Over the next six months, we believe the economy is more likely to react to tariffs than fiscal policy because tax driven stimulus takes time impact consumers. It is imperative to remember that the extension of lower tax rates does not bring new stimulus because low rates are already in place. New tax concessions on tips, social security, overtime, and auto loan interest will likely see some traction in 2026 and 2027, although the size of the benefit will likely be too small to have a large impact on GDP.

In the meantime, the Fed is watching. Fearful of the tariff impact on prices and taking comfort in labor market data, the central bank has deferred any policy actions. While the economy withstood the rate hikes in 2022 and 2023, current policy rates appear restrictive considering the levels of inflation. Data from credit monitoring entities suggests lower income consumers are struggling with their debt obligations and value conscious shoppers keep trading down. These actions are consistent with a moderating economy, yet they bear watching because we do not believe markets are pricing in any financial stress.

Away from the U.S., the outlook appears brighter, although tainted by the impact of tariffs and mounting debt levels. The European Central Bank (ECB) continued to support the region's economies by lowering its policy rate. While the bank's moves seem appropriate given the behavior of inflation, necessary fiscal expenditures have elevated sovereign debt beyond the levels committed to at the inception of the Euro. For most European economies interest rates along the yield curve remain well below U.S. rates. However, with less liquid markets, governments may confront a conflict between public and private sector spending priorities.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the U.S. economy growing at a reduced pace of about 1.0% p.a. over the next six months. Growth moderated during the second quarter even though numerically the release will likely show solid performance. Macro data indicates the economy continues to grow, although few point to acceleration. The OBBBA will likely provide modest stimulus in 2026, although the next six months may be determined by the outcome of tariff negotiations. We believe the slowing economy should give the Fed cover to initiate a new cutting cycle in September 2025. While we expect foreign economies to perform better, we do not believe their improvement will have material effect on the U.S., especially because reciprocal tariffs may moderate U.S. exports. A silver lining is the U.S. dollar which has declined against most foreign currencies. While possibly inflationary, the weaker currency makes U.S. goods and services cheaper to foreigners. PROBABILITY 60%
2. A second scenario has the economy slowing to a rate of 0.0% to -0.5% at an annual rate during the next six months. In this scenario, tariff negotiations yield modest success and acrimony amongst the world's largest economies interrupts trade flows disrupting global commerce. Inflation moves higher in reaction to tariffs

preventing the Fed (and other central banks) from cutting rates aggressively. High interest rates and deteriorating economic activity discourage investment. Ultimately, the U.S. economy settles into a period of stagflation. PROBABILITY 20%

3. A third scenario has the economy expanding at a stronger pace of 2.0% to 2.5% at an annual rate during the next six months. In this scenario, the tariff negotiations result in reduced trade barriers amongst most nations including China and Europe. Anticipating freer trade, many countries experience new investment and a boost to confidence. In addition, passage of the OBBBA incentivizes capital investment leading to lower unemployment and higher wages. While it takes time to repair the damage from the original tariff shock, the economy sets up for a long period of healthy growth. PROBABILITY 20%

Market Outlook

The market faces significant crosscurrents as the second half of 2025 begins. Growth oriented policies like the “One Big Beautiful Bill Act,” deregulation, and government efficiency are being threatened by tariffs and the antagonistic treatment of segments of the labor market. The economy remained resilient during the first half of the year and likely has enough momentum to continue growing at a moderate pace. For fixed income, the tariff quandary likely keeps interest rates elevated for another quarter. Meanwhile, corporate America will likely deliver steady financial performance and stable creditworthiness. While credit spreads are tight by historical standards, we believe retaining exposure makes sense to earn a compelling yield while the competing forces get resolved.

Since the stimulative elements of the recently enacted legislation will likely take time to boost economic activity, we believe the economy will slow moderately over the next twelve months. The Fed will likely respond by cutting rates in September and longer-term rates will decline. While these rate moves may cause spreads to widen, we will keep the portfolios exposed to credit, albeit with a higher quality bias. In terms of sectors, we believe securitized instruments will begin to outperform as rates decline and emerging markets will benefit from increased flows as global investors diversify their significant U.S. exposure.

Commentary – One Big Beautiful Bill

On Tuesday July 1, the Senate passed President Trump 2.0’s signature legislation, the House ratified it quickly, and the President signed it into Law on July 4. Improperly named the One Big Beautiful Bill Act, the legislation delivers one essential policy victory for the U.S. economy, the extension of the corporate tax cuts enacted during Trump’s first administration, the Tax Cuts and Jobs Act (TCJA). Many adjectives may be used to describe the rest of the bill, although beautiful might not be one of them.

The bill was opposed by every democrat and 3 republicans. A legitimate criticism is that it does not do enough to reign in the deficits Washington willfully ignored over the last decade. However, that complaint should be leveled at the unwillingness to chip into entitlement spending, not the avoidance of a massive tax hike for the economy.

In our Q4 2017 letter after the passage of the TCJA, we wrote, “we believe this legislation will prove to be a seminal measure for the U.S. economy based entirely on the reduction in the corporate tax rate.” In addition, we cited the capital investment benefits countries like Ireland enjoyed because of their low tax rates. Despite the onset of Covid in 2020, the level of domestic non-residential fixed investment rose at a healthy clip as the economy exited the pandemic. The assurance of a competitive tax rate will likely continue to entice investment.

Corporate tax rates are a critical policy tool globally. In an article titled *Corporate Taxes Around the World, 2022* by Cristina Enache of the Tax Foundation, she notes that corporate taxes have been declining. The global GDP weighted average statutory tax rate was 46.52% in 1980 and only 25.43% in 2022. Not surprisingly, the weighted average dropped significantly after 2017 when the TCJA reduced the U.S. federal rate from 35% to 21%. Even after that huge drop, the U.S.'s effective rate is only near the global average and still higher than most of Europe and Asia. The author writes, "Prior to the U.S. tax reform in 2017, the United States was largely responsible for keeping the weighted average rate higher given its relatively high tax rate, as well as its significant contribution to GDP."¹ More striking, had the statutory rate increased above 25% upon expiration of the TCJA, the U.S. tax rate would have been higher than 203 of the 224 countries analyzed for the report.

Despite the temptation to tax large, profitable, and amorphous organizations, we believe lower corporate taxes make for better policy. In a simplistic manner corporations can be seen as "pass-through" vehicles between consumers and corporate stakeholders – employees, shareholders, creditors, suppliers, and tax authorities. The more the government takes, the less that is available for the others. Governments have many sources of revenue, and the contribution of each source varies. In the U.S., personal income taxes constitute the largest source of revenues. It should be intuitive that with high employment and robust wages, the government's take increases. Similarly, incentivizing investment increases employment which boosts consumption and GDP.

Critics argue low corporate taxes are a gift to the rich because they own or manage the companies and pay themselves handsomely. Also, lower taxes boost net income and returns to shareholders, who are often associated with wealthier people. According to the Bureau of Labor Statistics, wages and salaries for private industry workers grew steadily from 2017 through 2024. In addition to the pandemic disruptions, part of that period included a spike in inflation. Nevertheless, workers experienced low levels of unemployment and growth in real wages that helped power consumption and a robust economy over the last few years.

The stock market also benefited from the tax cuts, as would be expected. From the end of 2016 through the end of 2024, the S&P 500 returned an impressive 12.77% per annum. This occurred despite a 34% collapse during the first month of the pandemic in 2020. Given the stimulus thrust at the economy by both the Federal government and the Fed, it is hard to attribute the performance to tax policy. However, from the end of 2017 through the end of 2019 the stock market rose nearly 10% per annum. Healthy equity and bond markets become a key source of stimulus for the economy by boosting consumer confidence and lowering the cost of capital.

A defining feature of the U.S. economy is the vibrancy of the private sector. History has shown that the most reliable paths to development, growth, and wealth accumulation come from investment, innovation, and entrepreneurship. According to the Census Bureau new business applications surged over the last five years. Again, the pandemic likely influenced behavior, and the rapid evolution of technology likely propelled new business formation. Still, policies that promote private sector growth by containing regulation and limiting taxation should contribute to the economy's dynamism and continued growth.

July 15, 2025

¹ Corporate Tax Rates Around the World, 2022, Cristina Enache, The Tax Foundation, December 13, 2022.

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Index Definitions

Bloomberg U.S. Aggregate Index

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate Index

This index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. (Future Ticker: I02765US)

Bloomberg U.S. Mortgage-Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index

The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index

The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody’s, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody’s, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index

The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA Global High Yield Constrained Index

ICE BofA Global High Yield Index tracks the performance of USD, CAD, GBP and EUR denominated below investment grade corporate debt publicly issued in the major domestic or eurobond markets and issuer exposure is capped at 2%..

ICE BofA US Emerging Markets Corporate Plus Index (EMUB)

The ICE BofA US Emerging Markets Corporate Plus Index is a subset of The ICE BofA Emerging Markets Corporate Plus Index including all securities denominated in US dollars.

ICE BofA Global Government Excluding the U.S. Index (N0G1)

The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

Emerging Markets Bond Index Global Diversified (EMBI® Global Diversified):

The EMBI Global Diversified is a uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)

The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)

The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index

An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index

An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index

An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index

The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index

The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index

The index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.