

Coming Off the Boil?

“Uncertainty is an uncomfortable position, but certainty is an absurd one.”

– commonly attributed to Voltaire (1694-1778)

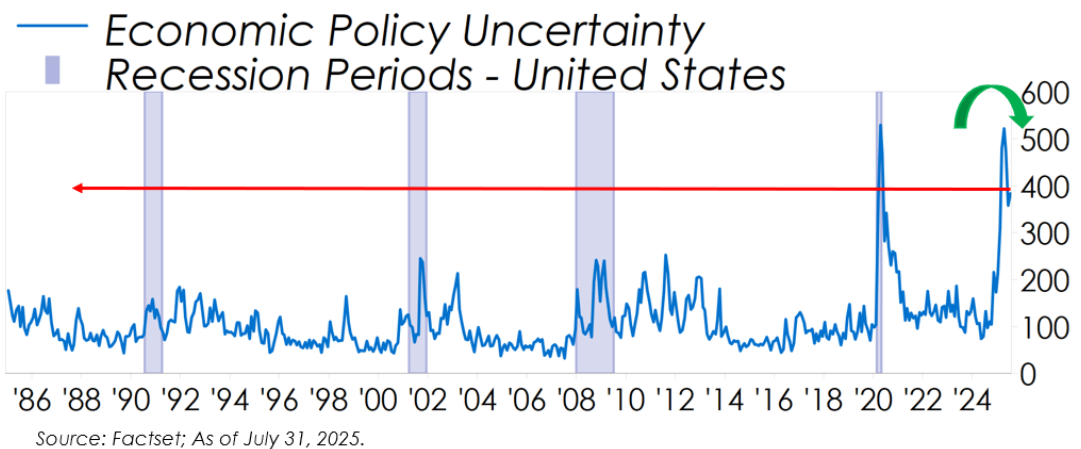
Uncertainty Reduction Theory (URT) was developed in 1975 by professors Charles Berger and Richard Calabrese to explain how communication is used to reduce uncertainty between people meeting for the first time. Receiving both verbal and nonverbal cues that tell us how a person thinks or acts helps to alleviate the uncertainty when meeting someone new. Perhaps a more simplistic (and old fashioned) way to explain this theory might be the “good ol handshake” which originated as a way to check for concealed weapons among visitors – dating as far back as ancient Greece. Of course, today, handshakes are a symbolic form of peace, friendship and trust.

As can be seen in the chart below, policy uncertainty had recently started to come off the boil – helped by several, of what

appear to be,
“handshake type”
trade deals.

Framework trade agreements this past month have included the likes of Japan, the EU, South Korea, Vietnam and Indonesia – all

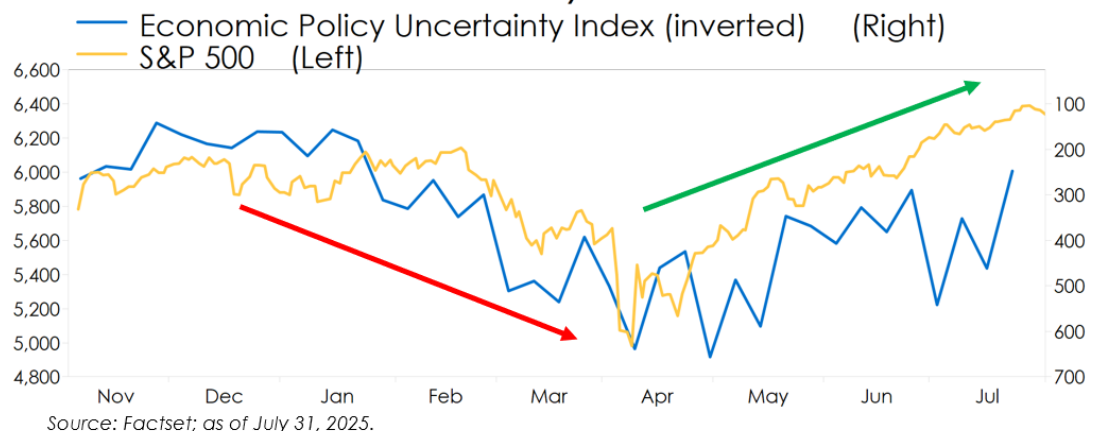
with tariff rates north of the existing 10% rate. Of course, successful passage of the budget bill along with Congressional approval of the debt ceiling hike (in June) helped alleviate some uncertainty as well. The above actions could be viewed negatively given that the budget bill is expected to add trillions to the federal debt and higher tariff rates might be seen as pressuring businesses, consumers or both. Yet markets took the news in stride in July with the S&P 500 continuing to make new record highs intramonth. This might beg the question as to why?



It's often been said that markets dislike uncertainty more than they dislike the bad news that alleviates it. As can be seen in the chart below, that seemed to be the case in the first half of this year. The S&P 500 initially struggled amid uncertainty of the things to come while subsequent trade and budget deals helped alleviate some of those unknowns.

But just as the French philosopher Voltaire opined that the belief of certainty might prove to be absurd – the first trading day of August brought with it some fireworks, right on cue.

Markets and Uncertainty



Investors woke up to new tariff rates announced on countries yet to secure a trade deal following the August 1st deadline. But markets were much more sensitive to a disappointing jobs report that had just followed a Fed decision to stand pat on interest rates two days prior. The weak jobs report and notable negative revisions to the prior two months drew the ire of the President leading to the replacement of the commissioner of the Bureau of Labor Statistics. The day ended with the resignation of Fed governor Adriana Kugler – whose term was set to expire in December. Her earlier than expected departure might accelerate the President's decision to appoint who might likely be the next Fed Chair (assuming Fed Chair Powell fulfills his term ending next May).

And with that – as quickly as certainty was coming back into view – there were plenty changes afoot. The Rates market is back to pricing in two rate cuts this year and three next year with the likelihood of a new dovish Fed chair. Additionally, 1H GDP growth averaging around 1.25-1.5% and the falloff in hiring both suggest a slowing growth backdrop. Still, we think it's important to note that 2Q earnings reports have been much better than anticipated and firing trends have remained incredibly benign.

What's one to think? As we've been communicating for much of this year, we think it pays to be diversified in order to mitigate this noisy environment with a particular emphasis in maintaining an adequate margin of safety on one's investments. Please see our outlook section for more details.



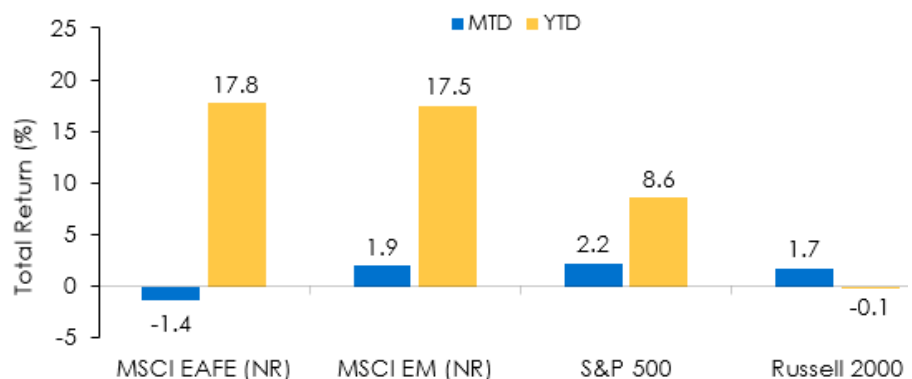
Stocks continued to rally in July as strong earnings propelled markets higher. Domestic equities posted solid returns while International markets were bifurcated with Emerging Markets up while Developed International markets were down after a very strong first half. While Bonds were down in July, they continue to deliver solid year-to-date returns, in part, from a re-tightening of credit spreads. REITs were down for the month and up marginally for the year. Finally, Commodities weakened in July as confusion around copper tariffs caused a sell off in industrial metals, though year to date returns remain solid.

Stocks

US Large Caps (S&P 500) led stocks higher for the month of July as strong earnings propelled stocks, particularly AI related companies. US Small Caps (Russell 2000) also performed well in the month despite still negative returns for the year.

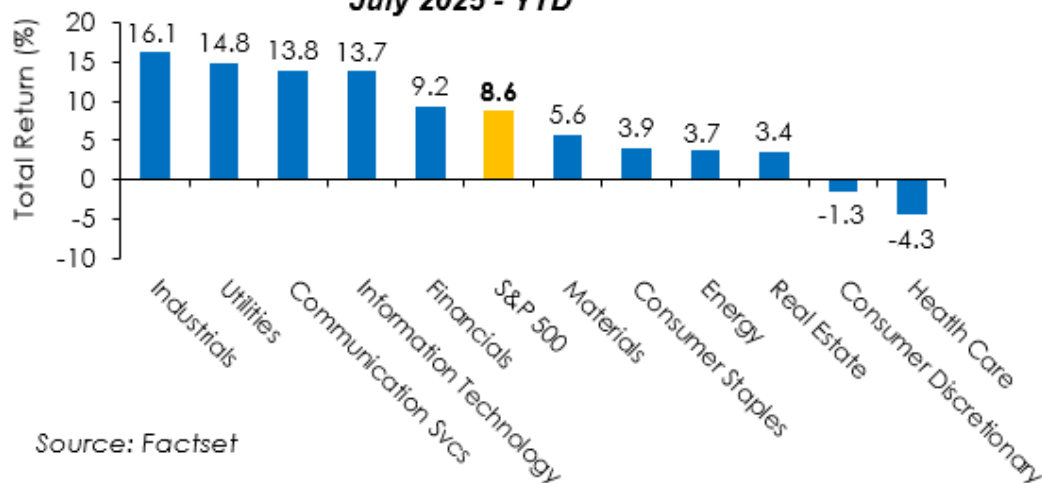
International Developed Markets (MSCI EAFE) retreated after a strong first half while Emerging Markets (MSCI EM) posted another strong month of returns. Year-to-date, foreign returns have benefited from dollar weakness and as investors look to increase portfolio diversification. From a sector perspective, outperforming areas include a combination of defensive (Utilities), cyclical value (Industrials, Financials) and growth (Communication Services, Tech) sectors.

Global Equity Returns
July 2025



Source: Factset

S&P 500 Sector Returns
July 2025 - YTD



Source: Factset



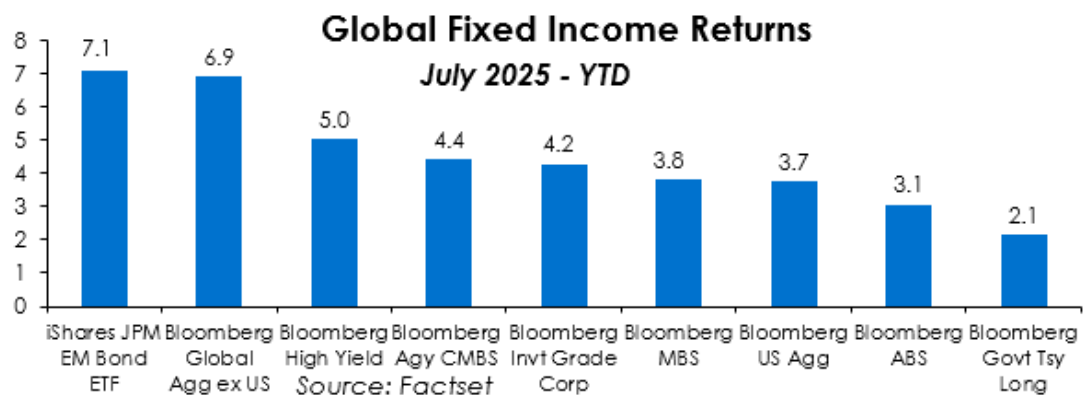
Bonds

After pivoting to an easing bias in the back half of last year, policymakers left rates unchanged at all of their 2025 meetings (January, March, May, June, and July). Consistent with that “wait and see” approach, since December, the Fed has reduced its number of expected 2025 rate cuts from four to two (25 basis points per) and indicated they expect slower growth and higher inflation by this year’s end. However, July’s weak jobs report now has the market pricing in accelerating rate cuts over the next eighteen months (two in ’25 and three in ’26). Despite the Fed’s forecasts for an implied stagflationary-lite backdrop, Bonds have performed

relatively well with returns generally up mid-single digits.

International (Bloomberg Global Agg ex US) and Emerging Markets (iShares JPM EM Bond ETF)

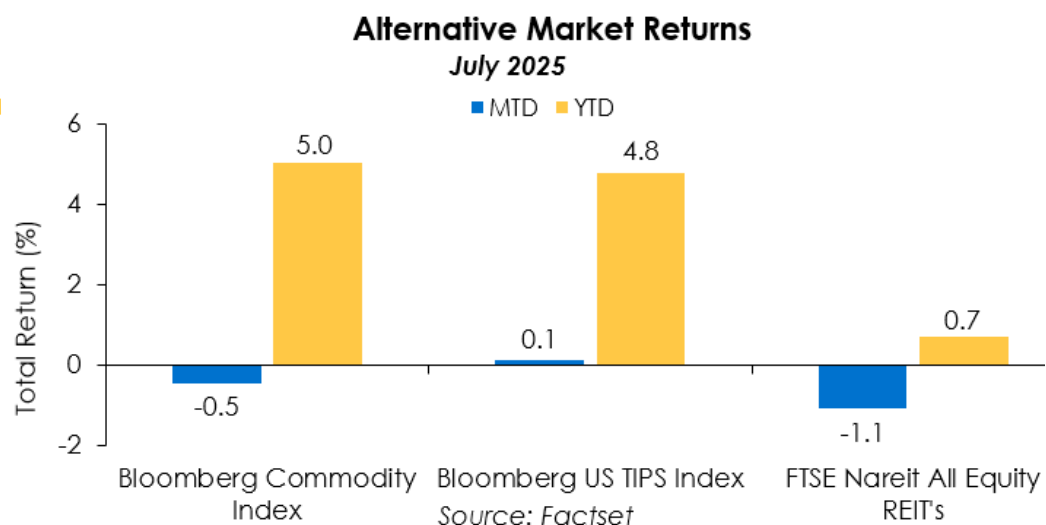
have been the standouts for the year due to dollar weakness while long duration Treasuries and Asset Backed Securities (Bloomberg ABS) have lagged.



Alternatives

Commodities lagged in July due to weakness in industrial metals, as copper prices sold off due to the 50% copper tariff being limited to only semi-finished products. Meanwhile, publicly traded Real Estate (REITs) posted

marginally positive returns for the year. Finally, year-to-date returns on Treasury inflation protected securities (TIPs) have performed slightly better than nominal Treasuries amid volatile inflation expectations.



Market Outlook

*"It's Tricky to rock a rhyme, to rock a rhyme that's right on time.
It's Tricky."*

– Run DMC, *It's Tricky* (1986)

As the page turns further into 2025, we remain focused on the ever evolving Tricky "Tri-Cycle" – the "three cycle" framework we're using to assess the landscape. A stagnating (and late) Economic Cycle, gradually

Tricky "Tri-Cycle"

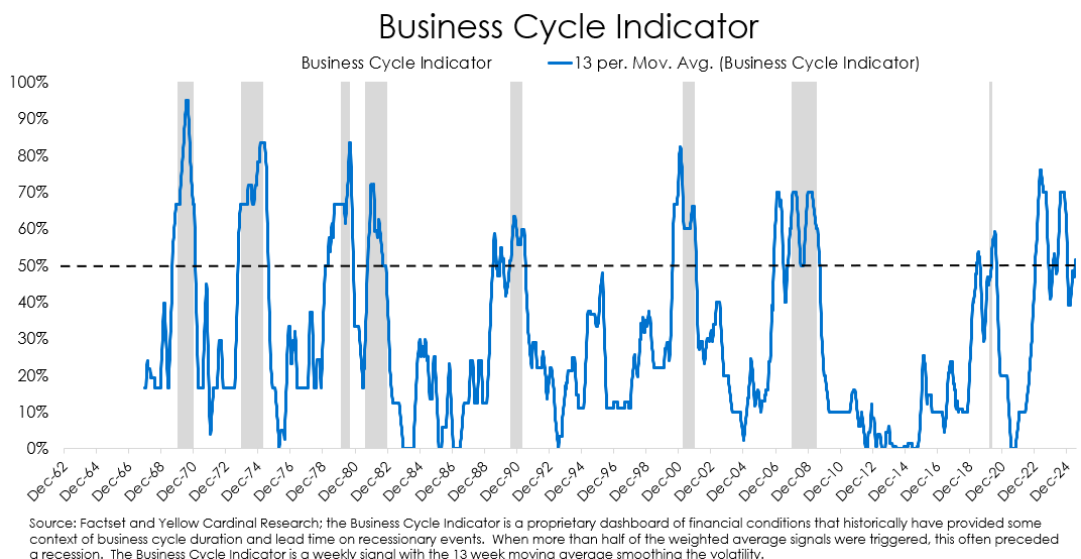
Cycle	Stage
Economic Cycle	Stagnating (and Late)
Profit Cycle	Maturing
Policy Cycle	Reversing

maturing Profit Cycle and wildly reversing Policy Cycle – makes for the continuation of a Tricky backdrop that requires investors to keep their proverbial eyes up and "Head on a Swivel". Let's explain.

Economic growth remains choppy with a stagnating impulse, in part, due to trade and fiscal policy. In isolation, the sizeable increase in the deficit would have made the budget bill virtually impassable. However, when viewed within the context of tariff revenue as an offset, the GOP was able to successfully pass the fiscal measure. Still, tariffs raise the question of stagflation for the Fed which has meant they've been reluctant to act in the short term. However, with the recent weakness in

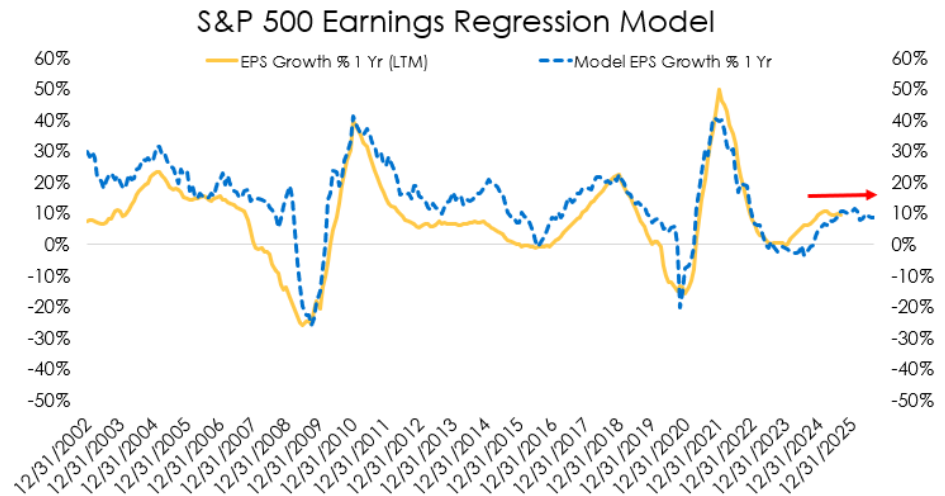
the jobs report along with the President's ability to nominate a new Fed governor (due to a recent departure), the market is anticipating that is likely to change. Stepping back a bit further, we believe there's

fundamental evidence – including the yield curve, leading economic indicator composites, certain survey relationships and especially labor market measures – that point to being on the later side of the economic cycle. As can be seen in our business cycle indicator above, an increased percentage of measures being



triggered is a good illustration that we remain at comparable late cycle levels in the economy (with recessions designated by shaded regions).

At this point, the profit cycle doesn't look as late as the economic cycle but the fundamental trends suggest a gradually maturing backdrop. As can be seen in the chart at right, our proprietary top-down earnings regression model suggests healthy but slowing earnings growth ahead. This is corroborated by bottom-up earnings growth expectations that peaked back in January. We think positive but slowing earnings growth denotes a



THIRD YEAR OF A BULL MARKET

S&P 500 Index, Since 1950

Major Low - S&P 500	First 12 Months Year 1	Next 12 Months Year 2	Next 12 Months Year 3
1953	45.8%	40.9%	8.0%
1957	43.1%	12.0%	0.5%
1962	31.1%	21.5%	6.2%
1966	30.5%	9.5%	-6.4%
1970	41.7%	10.7%	0.2%
1974	38.1%	30.4%	-4.1%
1987	16.6%	31.7%	-3.1%
1990	33.6%	8.8%	17.8%
2002	36.2%	9.9%	8.5%
2009	72.3%	18.1%	6.1%
2020	77.8%	15.6%	-9.9%
2022	23.7%	35.6%	8.4% *
Average	40.9%	20.4%	2.7%
Median	37.1%	16.8%	3.3%

Source: Factset. S&P 500 data series uses quarter end pricing to determine major low periods from 1949-1987 and daily pricing to determine major low periods from 1988-current. *Year 3 from latest October 2022 low is as of 8/1/25.

gradually maturing profit cycle – an important observation within the context of the general strengthening equity market price action. As can be seen in the table at left, analyzing the evolution of bull markets over the last 75 years suggests we're in rare air in this third-year leg. Not only are we well above the average and median historical results but there's only been one instance that's offered a noticeably better third-year return – less than a 10% observation. Cumulatively, there's only been three other episodes that have delivered better performance – only 25% of all observations. While the equity market quickly shook off the uncertain backdrop earlier this year, renewed changes indicate certainty is anything but a given. We still think its important to monitor the late economic cycle and downshifting of earnings growth and not lose sight of both fundamentals and context.



Add to that, the third leg of the stool – a policy cycle that’s abruptly reversing from looser fiscal and tighter monetary to one that suggests the opposite – (relatively) tighter fiscal and (relatively) looser monetary. We say relatively because, while the deficit remains unchanged in aggregate, the recognition of its unhealthy status is leading to some reductions in government spending and the need to find more government revenue (tighter fiscal). As a result, higher tariff rates and slowing growth are likely

The Certainty of Uncertainty

Past Policy	Future Policy
Looser Fiscal	(Relatively) Tighter Fiscal - Less government spending / More government revenue
Tighter Monetary	(Relatively) Looser Monetary - Higher tariff rates likely lead to lower interest rates though not initially.

to cause the Fed to react in eventually lowering rates. This reversal in policy is causing investors, consumers and companies to re-think the backdrop as denoted by high uncertainty and weak survey results. The good news is that the sharp rally in risk assets since the second half of April (from backing off of the worst case tariff rates) was a constructive move that flipped the technical script from bearish to bullish. This suggests that the market hasn't deemed anything a foregone conclusion and, as we noted in the opening, the hard data thus far has held up with solid 2Q earnings results. We'd also be remiss if we didn't mention that consumer and business aid are likely to kick in next year with targeted pro-growth stimulus (like 100% expensing, increased SALT deductions and child tax credit measures) that sterilizes the tariff effect in the near term. The bottom line is that we continue to live in an environment that suggests an increasingly large number of potential scenarios still on the table. It's no wonder that the only certainty might be a high degree of uncertainty.

So what are the implications and key takeaways for portfolios?

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance as a way to mitigate the high uncertainty as referenced above. While diversification has previously been an uncontroversial concept, the concentration present in passive indices today – by virtue of the price action over the last couple of years – suggests this notion remains a relic of the past. We respectfully disagree and continue to look for opportunities to rebalance portfolios to maintain that degree of balance. As a result, we've remained UW the most expensive and concentrated areas where we've viewed the long-term risk reward less favorably.

Within equities, our positioning incorporates balance geographically (tilt toward International) and within our US Large Cap exposure especially (away from the top of the market). Our bias has generally been to



have more exposure to less expensive areas (down market cap). As such, we've maintained a larger OW in Cyclical Value and Defensive sectors combined with a smaller sized cap bias. We remain UW the most concentrated and expensive Cyclical Growth areas and think that if AI is as transformative as advertised it's benefits will need to accrue to more than just the select few.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – where we're slightly longer in duration for diversification purposes. We've also previously added to International Fixed Income (EW), where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market (High Yield) where extremely tight spreads have made this unattractive in our view.

Within alternatives, we remain fairly balanced across the board with neutral positions in Diversified Alternatives, Real Estate and Commodities. Earlier this year, we adjusted our mix of Diversified Alternative managers in order to provide greater insurance against market volatility by emphasizing income and short exposure – areas that can benefit from choppy market conditions, thus, enhancing diversification.

Above all else, we find investors should keep in mind the following:

- Stay focused on the things you can control like ensuring you have adequate 6-12 month liquidity needs which should allow your long-term investment monies to stay invested.
- Has the structural integrity of your plan changed (purpose of money, time horizon, liquidity needs, risk tolerance)? If the answer is no, then recognize that the economy and the market run in cycles that diversified portfolios are there to help mitigate.
- Short term volatility is often the price one pays for the benefit of higher long-term returns.

Thanks for giving this a read.

The information presented in the material is general in nature and should not be considered investment advice, is not designed to address your investment objectives, financial situation or particular needs. Information is gathered from sources deemed reliable but its accuracy or completeness is not guaranteed. The opinions expressed herein may not come to pass, are as of the date of publication and are subject to change based on market, economic or other conditions.

You cannot invest directly in an index. Indexes are unmanaged and measure the changes in market conditions based on the average performance of the securities that make up the index. Investing in small and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Asset allocation and diversification does not ensure a profit or protect against a loss.

Yellow Cardinal Advisory Group, a division of First Financial Bank, provides investment advisory, wealth management and fiduciary services. Yellow Cardinal Advisory Group does not provide legal, tax, or accounting advice. The products and services made available by Yellow Cardinal Advisory Group:

Not Deposits | Not FDIC Insured | Have No Bank or Federal Government Guarantee | May Lose Value



The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.