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B Capital Commentary and Outlook Update 2Q2025 - Growth Amid Discord

Navigating Choppy Waters - Steady as She Goes

As we venture into the second quarter of 2025, markets find themselves navigating rather choppy waters. US equities have experienced a correction of roughly 10% since mid-February, driven by twin forces that have reshaped the investment landscape.

First, January's release of Chinese AI DeepSeek prompted a fundamental reassessment of the multi-year AI infrastructure trade that had propelled markets to dizzying heights. This technological leap suggests a more competitive global AI landscape than previously anticipated, with implications for market leadership and valuations.

Second, policy uncertainty from the US President has taken centre stage. Market concerns have broadened considerably, enveloping cyclicals like retailers, financials and industrials as worries about trade policy and consumer spending take hold. This policy-induced volatility has created both risks and opportunities for discerning investors.

A Closer Look at Market Dynamics - Tech Giants: A Changing of the Guard

The "Magnificent 7" tech titans appear to have temporarily relinquished their crown, with none posting positive returns year-to-date. Since mid-February, this popular momentum trade has declined approximately -16% compared to the S&P 500's -8% drop.

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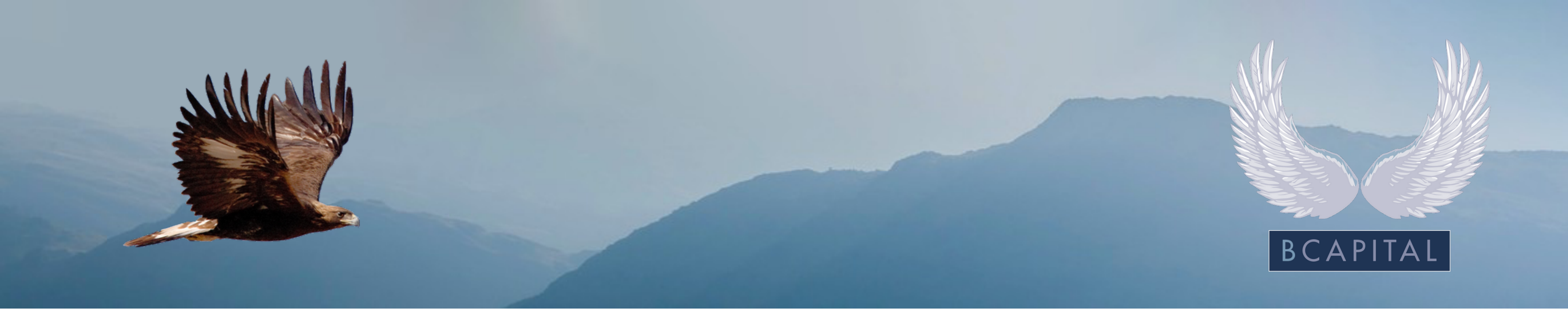

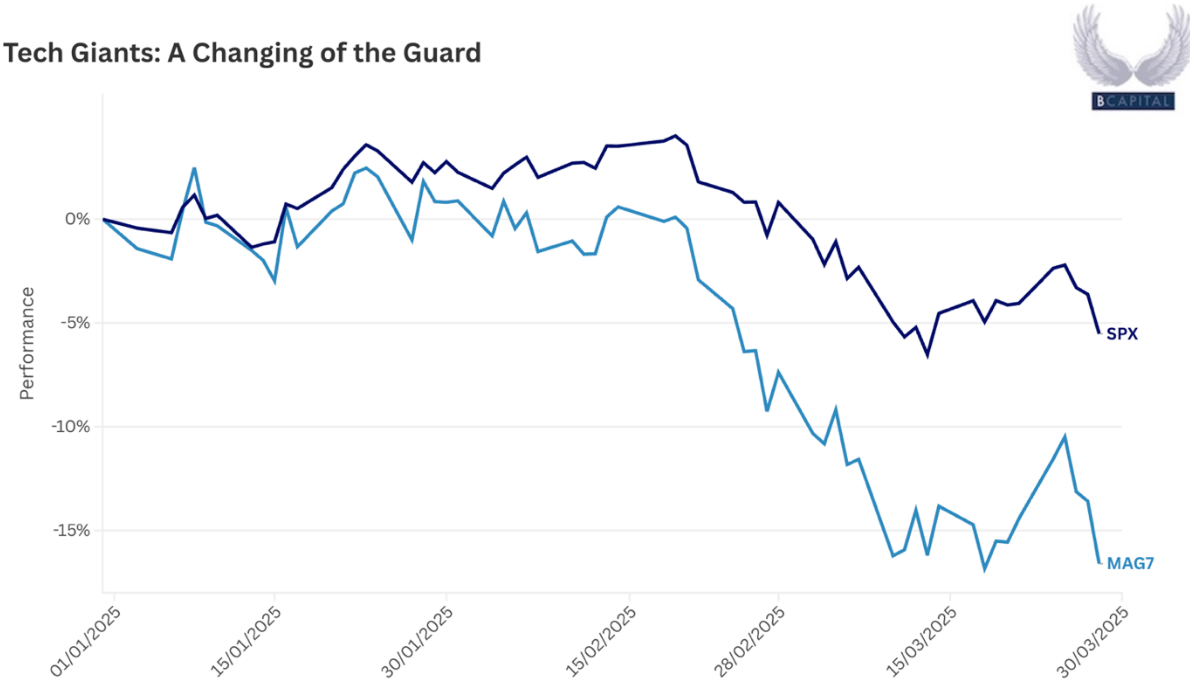

Magnificent 7 performance vs S&P 500 YTD
Source* - Bloomberg, Factset

While their earnings may prove more resilient than most in a potential US slowdown, the evidence suggests excessive positioning in these former darlings has yet to fully unwind, warranting continued caution.

Resilient Sectors Emerge

Rather surprisingly, energy and healthcare shares have remained remarkably steady since the market peaked in mid-February. Healthcare's stability makes sense given its underperformance relative to other defensive sectors in 2024, but energy's impressive +8% rally year-to-date despite falling oil prices demands explanation.

The sector's dramatically improved fundamentals tell the tale: healthier balance sheets, attractive free cash flow yields, potential deregulatory tailwinds, and persistent under-ownership among global investors. These factors create a compelling case for selective exposure to the sector.

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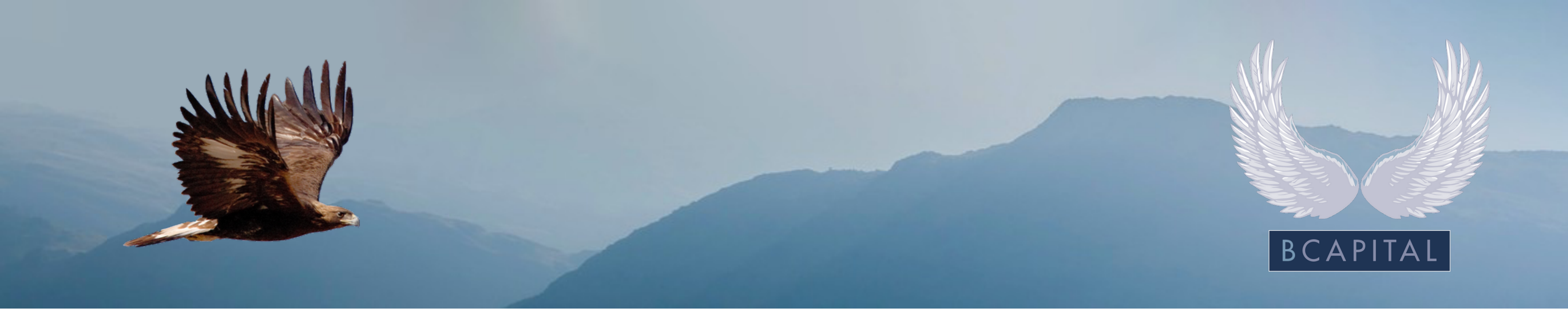
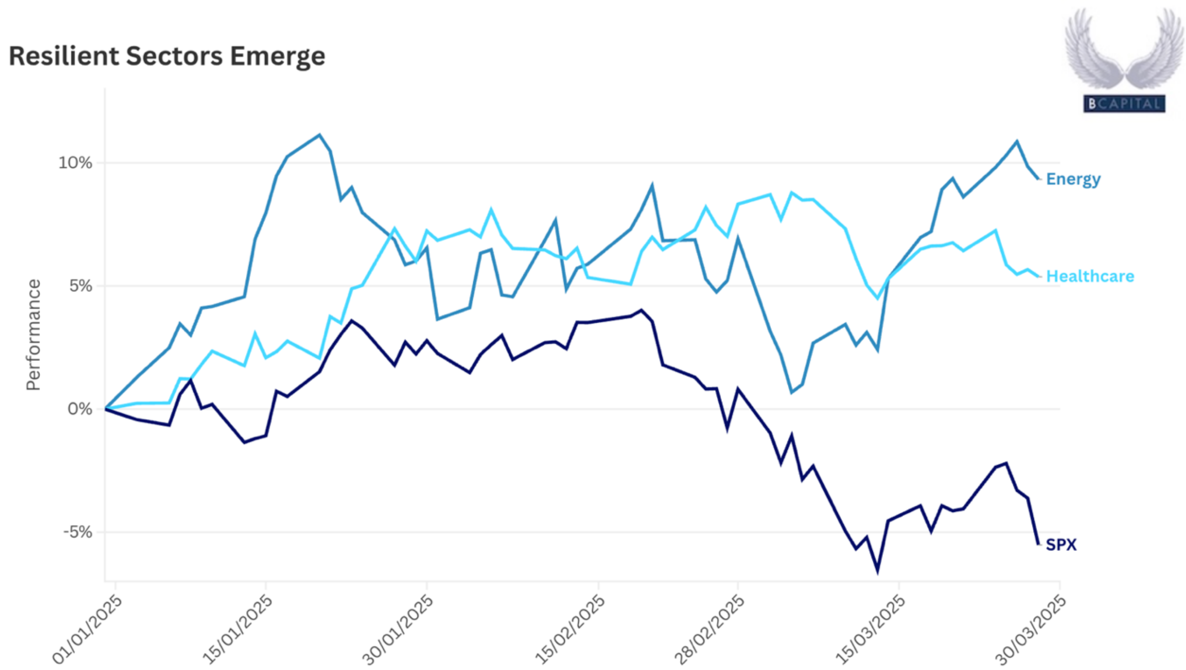
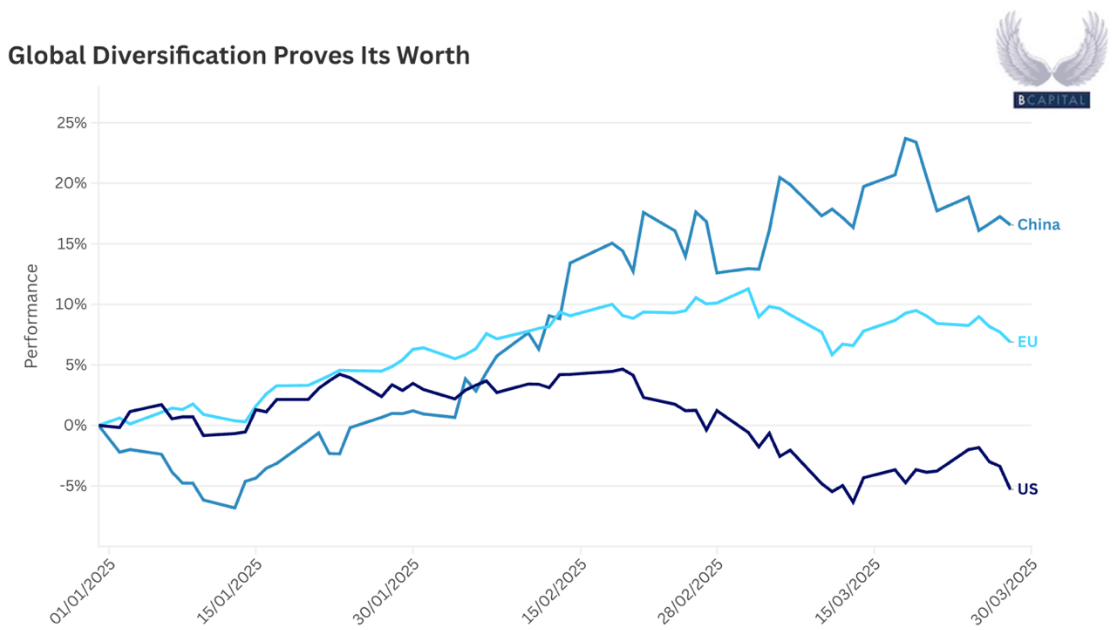




Sector performance comparison chart showing energy, healthcare, and broader market
Source* - Bloomberg, Factset

Global Diversification Proves Its Worth

Year-to-date, geographical diversification has helped dampen equity portfolio downside considerably. More supportive government policies in Asia and Europe have boosted earnings expectations in sectors such as Chinese tech and European cyclicals.



Regional Equity Returns % YTD showing outperformance of non-US markets - Source* - Bloomberg, Factset

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The vulnerability of these markets to a potential US-led slowdown varies significantly by region. UK and European companies generate roughly a quarter of their revenues in the US, whilst emerging markets have substantially less direct exposure.

The Trump Tariff Tumult

President Trump's recent flurry of tariff announcements has introduced significant uncertainty to markets. With the 2nd April deadline for "reciprocal tariff" announcements now here, trade policy uncertainty looks set to reach a crescendo in the coming fortnight.

The administration's approach has been characterised by bold statements like the President's assertion that "Tariffs are going to be the greatest thing we've ever done as a country. It's going to make our country rich again." But the economic reality appears more nuanced.

As The Economist aptly noted in its recent analysis: "The unpredictability of Trump's tariffs will increase the pain. Businesses hate policy uncertainty because it complicates planning and deters investment." This unpredictability creates a particularly challenging environment for both corporate decision-makers and investors, especially as the President appears to view tariffs not merely as negotiating tools but as positive economic policy.

After Ontario's decision to impose a 25% tax on US electricity exports, President Trump threatened to raise Canadian steel and aluminium tariffs to 50% from 25%. This tit-for-tat escalation suggests we could be entering a period of increasing trade friction rather than resolution.

Even in an optimistic scenario where some US tariffs are reduced through negotiations, the heightened trade uncertainty is likely to result in a cooling of the US economy in the next couple of quarters as production and investment moderate. The Economist warns that these measures risk "unravelling globalisation," with potential long-term consequences for global supply chains and economic growth. However, early indicators such as small business confidence (down less than 5% in Q1) suggest a measured rather than severe slowdown in the immediate term.

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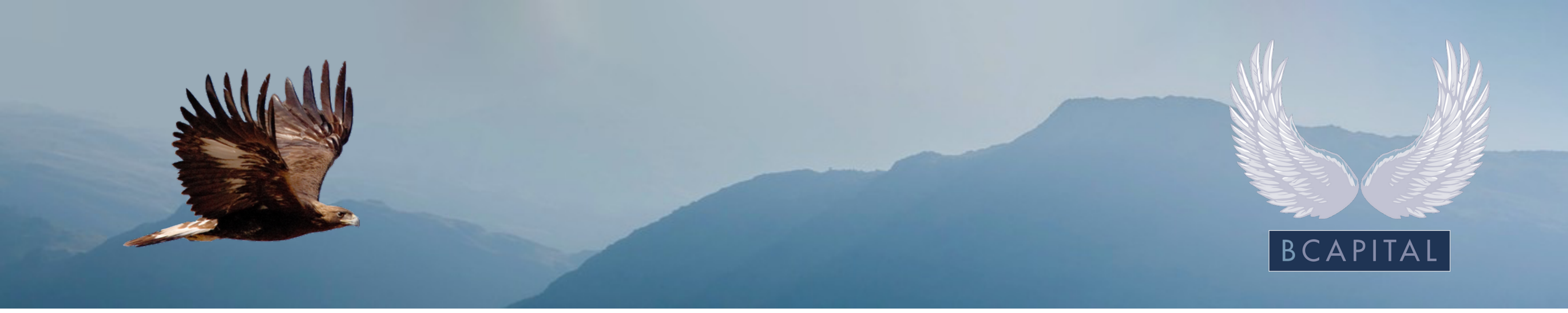

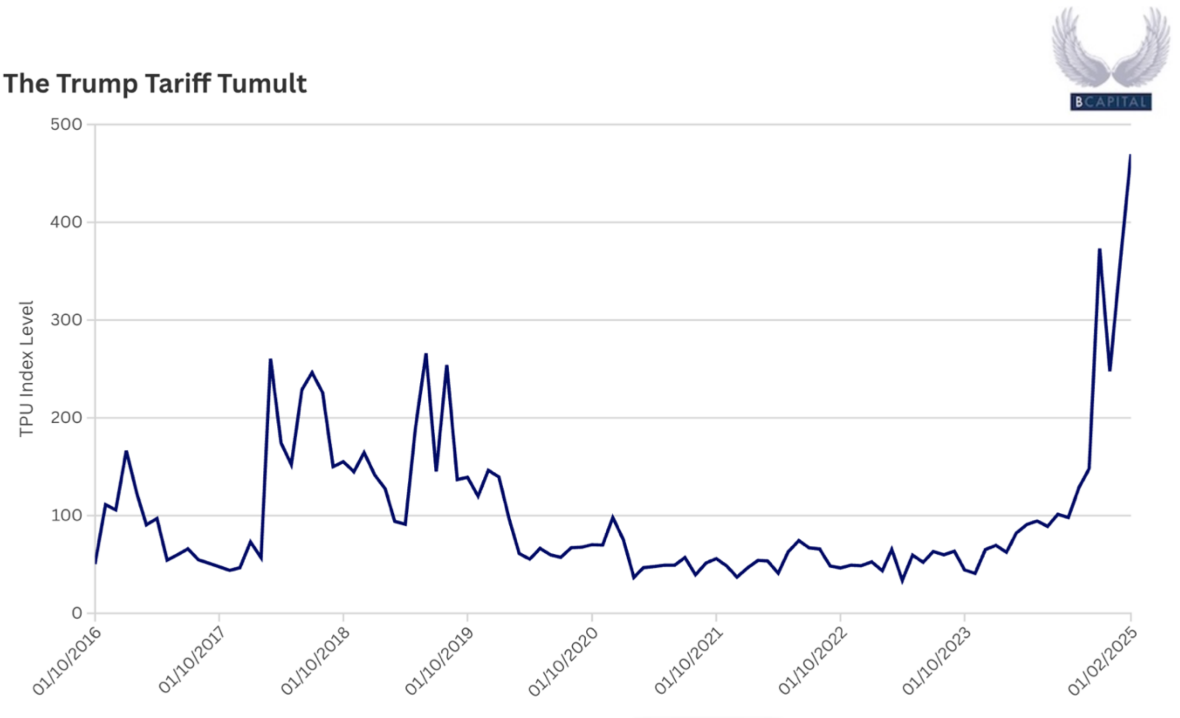

US Trade Policy Uncertainty Index showing recent spike
Source* - Bloomberg, Factset

Investment Strategy: A Framework for Decisions

For fully invested portfolios, quality is paramount amidst uncertainty. Barring extreme market dislocations like those witnessed in 2008-09 or early 2020, we generally advocate seeking quality investments. Our addition to existing China tech exposure was somewhat contrarian but in fact the unloved region is resilient and showing improving growth rates. Indeed, diversification away from the US has this time been an advantage as European, Asia and EM exposure has been positive in the first quarter. We would point to long-term holdings such as BYD, Tencent and Alibaba as exciting constituents in our Global Tech Leaders strategy and recommend further allocations to that model.

Credit spreads remain surprisingly tight, lagging the jump in equity volatility. For investors with a long-term horizon, we recommend prioritising:

1. Strong free cash flow generation
2. Prudent leverage levels
3. Earnings stability

Earnings Outlook: Expectations vs Reality

Following last year's 10% EPS gain for the S&P 500, the consensus expectation of an 11% EPS increase for 2025 appears rather optimistic. Our more conservative estimate of 7-8% growth seems achievable based on strong Q4 2024 results, but the consensus figure exceeding $270 may prove challenging.

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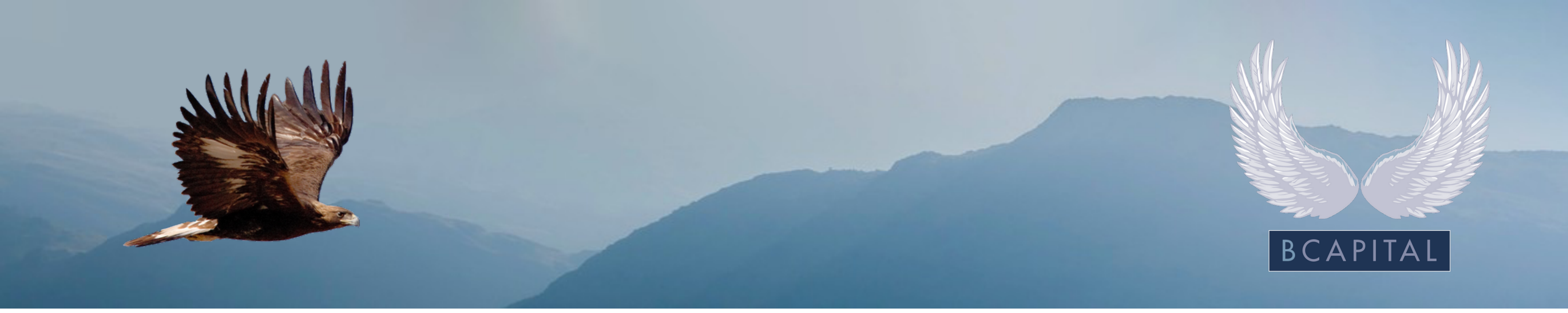
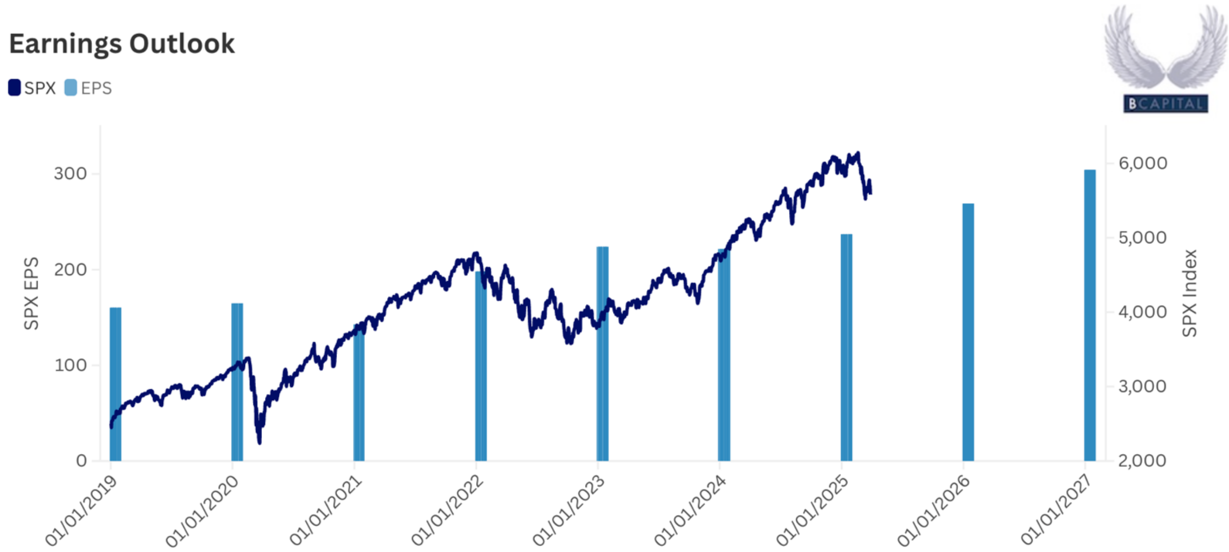


As tariffs begin to impact US profits in Q2 2025 and beyond, many exposed companies will likely revise their profit forecasts downward. However, the silver lining is that analysts have already significantly reduced their Q1 2025 estimates, potentially setting the stage for positive surprises when companies report in April. Nonetheless, there is a sense of investor fatigue over the unpredictable nature of President Trump on the world stage. Sentiment is important and nerves are getting a little frayed at the edges.



S&P 500 EPS Estimates chart showing quarterly projections
Source* - Bloomberg, Factset

Our Strategies: Navigating the Crosscurrents

Our actively managed strategies have demonstrated resilience amidst this volatility. The Global Tech Leaders portfolio strategy has delivered an impressive +2.66% YTD, significantly outperforming broader tech indices. Meanwhile, our USD Equity Core portfolios strategy has demonstrated resilience with -2.14% YTD performance.

This divergence stems from our disciplined approach to quality, valuation, and sector balance, providing meaningful downside protection while allowing participation in pockets of strength. The Global Tech Leaders strategy, in particular, has benefited from our emphasis on software and services companies with recurring revenue models and limited exposure to supply chain disruptions or direct tariff impacts. Non-US exposure has also lifted the portfolio as the US tech sector hit turbulence.

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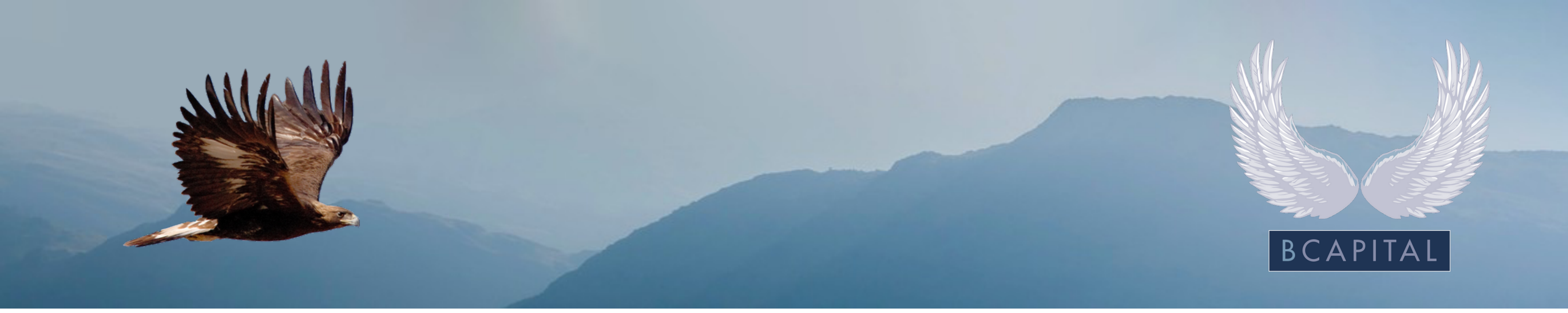


Opportunity in Uncertainty

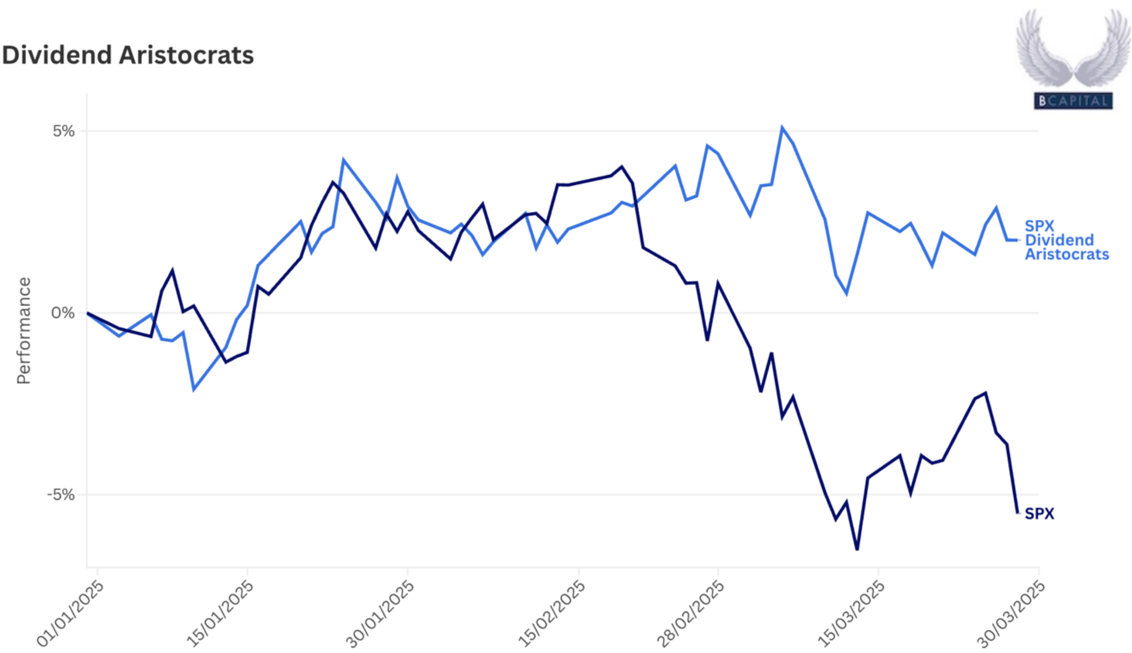
Periods of uncertainty often provide the most attractive entry points for long-term investors. Historical data consistently shows that investing during periods of elevated volatility and policy uncertainty has generally led to above-average returns over subsequent 12-24 month periods.

As Warren Buffett famously advised, "Be fearful when others are greedy, and greedy when others are fearful." The current environment of trade uncertainty and market volatility has created more attractive valuations across several high-quality segments of the market. For investors with available cash, this may represent an opportune moment to deploy capital at more favourable starting points.

For those underweight equities relative to their target allocation who maintain a long-term perspective, dividend growers merit consideration. Both domestic and international companies with consistent dividend growth have demonstrated the balance sheet fortitude to weather economic uncertainties whilst offering attractive total return potential.

For investors looking to add exposure, we suggest contemplating:

1. Quality - Companies with strong balance sheets and steady earnings, typically represented in the high grade indices
2. Healthcare - The sector has served as a defensive bulwark, positive year-to-date
3. Non-US equities - Have largely maintained their late 2024 recovery trajectory, rising ~7% YTD
4. Energy - Strengthened balance sheets and attractive cash flow yields offer compelling potential
5. Selective technology - Companies with limited tariff exposure and strong recurring revenue models



S&P Dividend Aristocrats vs S&P 500 performance comparison
Source* - Bloomberg, Factset

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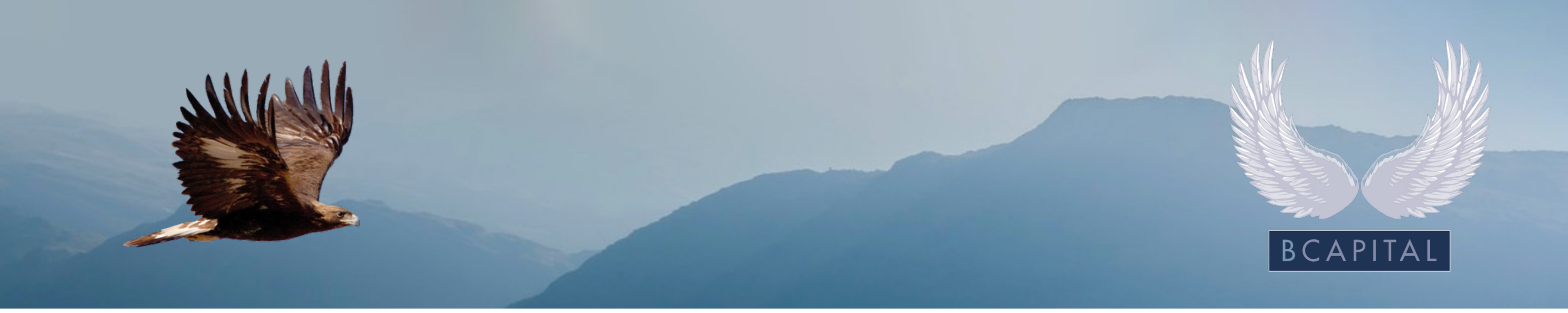

Monitoring the Horizon

As we navigate these choppy waters, we continue to monitor several key indicators:
- The implementation and impact of Trump's tariff policies
- The potential for retaliatory measures from trading partners
- Signs of supply chain restructuring as companies adapt
- Q1 earnings reports with particular attention to tariff impact mentions
- Credit market conditions and signs of stress
- Consumer spending and business investment trends

As The Economist observes, "Tariffs to protect US industry from competition and collect tax revenue would generally move the US toward an economic model most prevalent in Emerging Markets economies." This shift could have profound implications for how we allocate capital across regions and sectors in the coming quarters.

This volatile period may well present opportunities for the patient investor. Market corrections are normal features of economic cycles, and investors with longer time horizons have typically been rewarded for maintaining diversified exposure through periods of turbulence.

Yours sincerely

Lorne Baring
Managing Director