Quarterly Market Letter

GENTER CAPITAL MANAGEMENT

Second Quarter 2025

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Highlights:

- Despite Tariffs, GDP appears to rebound
- Passage of "One Big Beautiful Bill" removes layer of uncertainty
- Unemployment rises slightly as inflation stays subdued
- Tensions rise between President Trump and Chair Powell
- Curve steepener in bond market
- Equity market sees wild swings and strong recovery
- Cautiously optimistic as economic fundamentals remain solid

Introduction

In military circles, there is a concept known as the "OODA loop": observe, orient, decide, and act. In battle, it is advantageous to come at one's enemies in such a rapid-fire manner that their OODA loop is broken. It marks a big step in overcoming their capacity to make war. Business is not nearly as consequential as warfare, of course, nor is private investment an enemy of the Trump administration. Quite the opposite, easing the way for investors integral to President Trump's theory of economic growth. It sometimes feels, though, as if the pace of policy changes has broken the market's OODA loop.

Since becoming a politician more than a decade ago, Donald Trump has been gifted at articulating ideas believed by broad swaths of the American people. Now that his (formerly unconventional) ideas about trade are combined with the power of the Presidency, it has led to continual and almost dizzying reassessments in the market.

We think President Trump is advancing an agenda—economic nationalism—which is different than what the market has known over the past half-century. Markets are flexible and markets can adjust, but there is no easy way to institute foundational economic change. In the meantime, many investors, perhaps still oriented towards free trade and globalism, are unsettled by the ongoing disruption of their OODA loop.

Quarter in Review

The second quarter got off to a fiery start, with the "Liberation Day" announcements on April 2. Trade policy is at the center of President Trump's economic agenda, and on that day, things got real: a 10% tariff was applied across the board as well as reciprocal tariffs on a country-by-country basis.

As we moved deeper into the quarter and bilateral negotiations proceeded, the Trump administration extended its deadline by 90 days. Some believe Trump blinked over fear that bond vigilantes would push Treasury yields higher. Whether or not that is true, the Trump administration has brokered tentative agreements with countries like China and the United Kingdom, as well as a "roadmap" with India. Key trading partners like Canada and Mexico were granted broad exemptions, and even Vietnam, which has been used by some countries to cloak their exports, has agreed to help us fight transshipments.

Of course, as trade negotiations unfold, it is a topsy-turvy ride for investors, whose capital is tied to their outcome. As we approach the tariff deadline, we think that the bilateral negotiations for many countries will be extended, perhaps with modest penalties, while some countries will be put under more acute pressure. It is worth noting that, according to the Treasury Department's Customs Net Receipts, tariffs have so far boosted monthly government revenues from $6 billion to $22 billion. It is also worth noting that the main purpose behind tariffs—reinvigorating American manufacturing—is impossible until the trade rules stabilize. No businessman is going to drop $25 million, say, to build a factory which competes with foreign industry while tariff policy is still morphing and evolving.

At the end of April, GDP growth for the first quarter was posted at -0.3%. The definition of a recession is two consecutive quarters of negative growth (although there can be some technical issues involved with declaring a recession). And yet, despite the tariffs, *and* the geopolitical uncertainties, *and* the Federal Reserve sticking to its guns on interest rates, GDP looks to turn positive in the second. The Atlanta Fed's GDPNow number, an econometric model which attempts to keep a tab of current quarter GDP growth, estimates 2.6% for Q2 2025.

Unemployment prints crept higher but remain historically low at 4.2%. The JOLTS (Job Openings Labor Turnover Survey) numbers have been steady and are even showing some improvements. Continuing jobless claims, perhaps the most important harbinger of the employment picture, remain low—although, less favorably, claims have recently broken higher from their lateral range.

Most inflation measures have dropped since Donald Trump assumed office in late January of this year. The headline CPI indicator dipped from 2.71% to 2.35%. CPI Supercore plummeted from 4.02% to 2.86%. The "Truflation" gauge, which uses millions of daily data points to provide real-time inflation information, moved from 2.7% to 1.2%, and then back up to 2.03%. Despite the tariffs, none of the key inflation metrics have risen so far, although the Core PCE numbers, the Federal Reserve's bogey, have moved sideways.

Sagging energy costs have played a big role in keeping a lid on inflation. The Trump administration reversed former President Biden's liquid natural gas export ban and has opened more offshore drilling acreage. Obviously, if oil prices remain low, American producers are not incentivized to increase production, but easing the regulatory hand helps maintain downward pressure. Conversely, the Trump administration's reduced support for renewable energy is probably short-sighted; while it may lower inflation and increase growth in the short-term, it could negatively impact grid capacity and reliability in the medium and longer term.

Last, but certainly not least, the dollar is off to its worst start since 1973, which was shortly after the collapse of Bretton Woods. This makes the muted inflation numbers even more impressive. The Bretton Woods agreement, inked in July 1944 (while bullets were still flying in Europe), pegged the world's currencies to the dollar—and the dollar to gold. In August 1971, President Nixon suspended convertibility to gold and introduced a 10% import tax to compensate for "unfair exchange rates." During the following years, the dollar began to drop rapidly in value, particularly relative to the German Deutsche Mark and the Japanese Yen. The current dollar devaluation does not match the aftermath of Bretton Woods, but it has been the sharpest drop since that time.

Of course, there are benefits to a weaker dollar. While a strong dollar makes it easier to travel the world and afford foreign products, it is also an obstacle to exports and making American productivity affordable. Put another way, a weaker dollar is aligned with what the Trump administration is trying to achieve.

Outlook

With the enactment of the "One Big Beautiful Bill," an important tranche of uncertainty has been removed from the market economy. The sprawling legislation includes lower taxes, reforms to Medicaid, an increase in state and local tax deductions (good news for residents of high tax states), a significant boost to defense spending (including the "golden dome" initiative), a reduction in clean energy incentives, and added funding for immigration and border restrictions. Virtually no one likes all its provisions—some do not like *any*—but at least the path forward is clearer.

In terms of that path, the consensus view among professional economists is a 37.5% likelihood of a recession in the next twelve months. Again, jobless claims are flashing a warning sign. Additionally, the one-and-a-half-year uptrend in the index of Leading Economic Indicators appears to be broken, as it has dipped lower over the past four months. And the three month/10 year Treasury curve has inverted again, signaling a market conviction that Fed interest rate policy is too tight.

And yet, despite the uncertainties, especially around trade policy, the Trump administration's "missteps" have not been disastrous. It is premature to draw conclusions, of course, but growth has been better than expected. Negatives such as restrictive tariffs and immigration policies do not appear to be causing any major derailment, and a more business-friendly government seems to be unleashing the "animal spirits." It is too early to know with clarity, but we do not think this economy is in dire straits. It has been four or five decades since the United States became an ardent champion of global free trade. It has also been about that amount of time since the Great Prosperity of the mid-20th century ended in the United States.

One key question, as we make our way forward, is the extent to which investor expectations can stabilize regarding policymaking. The fiscal legislation has just been enacted; from a market perspective, that helps. Nailing down trade policy would be another big step, although that is easier said than done. With trade, other countries get a "vote." Still, this remains a world where the global economy catches a cold whenever America sneezes. We have some cards, and, for better or worse, the new sheriff in town clearly intends to play them.

Federal Reserve

Interest rates are an integral part of President Trump's policy vision. Toward the end of June, Trump wrote a note to Chair Powell pointing to the low policy rates in Switzerland (0.0%) and Japan (0.5%), and claiming that the Fed policy rate "should be here." The body of the note said: "You are, as usual, 'too late.' You have cost the United States a fortune and continue to do so. You should lower the rate—by a lot! Hundreds of billions of dollars being lost. No inflation."

Jerome Powell responded the following day by arguing that lower rates would have been more feasible were tariffs not in the mix: "In effect, we went on hold when we saw the size of the tariffs and essentially all inflation forecasts for the United States went up materially as a consequence of the tariffs." Of course, tariffs are a key part of President Trump's agenda, so Powell is essentially claiming that the higher policy rate is a function of Trump himself.

Certainly, Powell's days as the Fed Chair are numbered. They have been numbered since Donald Trump was elected in November. The question has always been, when does Powell leave? Is it on the scheduled May 2026 date? Or sooner? President Trump wants it to be sooner. Chair Powell would just as soon stick around.

For a moment in late May, when the Supreme Court issued its decision on the Wilcox case, it looked as though the question was resolved. *Wilcox* affirmed the President's "unitary" authority over the executive branch—in this case, an independent government labor board—but the Supreme Court also carved out an exception for the Federal Reserve, calling it "a uniquely structured, quasi-private entity that follows in the distinct historical tradition of the First and Second Banks of the United States." Their civic reasoning leaves something to be desired, but the bottom line is that the Supreme Court says Donald Trump cannot fire Jerome Powell.

The matter went to the back burner as the Trump administration focused on the war between Israel and Iran, and on shepherding legislation through Congress. But in late June, as Jay Powell made his semiannual monetary policy report to Congress, he was challenged on a renovation project at the Marriner Eccles Building in Washington—the Federal Reserve's headquarters. Tim Scott, senator from South Carolina, likened the $2.5 billion upgrade to the "Palace of Versailles." Powell rejected that characterization and is now accused of "lying to Congress." The Supreme Court was clear that Federal Reserve officials cannot be fired because an administration disagrees with their decisions, but there is always provision, with every government job, that an official can be fired for illegal or unethical conduct.

If the effort to convince Americans that Powell is a shady operator fails, then we would expect Trump to name Powell's successor sooner rather than later. Such a move would accelerate Powell becoming a lame duck, as the chair-elect could provide alternative commentary to shape market expectations in a direction more aligned with Trump's own views.

A complementary strategy would be to place Powell's successor on the Board of Governors in January 2026, when Governor Adrianna Kugler's term expires. That would plant a flag during Powell's final months. Interestingly, since Chair Powell is also a Governor, and since the terms of Governors are 14 years, Powell could remain on the Board of Governors until January 2028. It would be highly irregular, as most Fed Chairs leave the central bank when their tenure as chair expires. There is an important exception: Marriner Eccles, who was fired by President Truman, stayed on the Board of Governors to advocate the cause of central bank independence. This is the same Marriner Eccles whose name adorns the Federal Reserve headquarters—currently under renovation.

The two men can, and probably will, make life very uncomfortable for one another in the year ahead. In the meantime, and barring a sharp expansion of inflation, we expect an acrimonious debate over whether the Fed is playing it right, or if the target rate can be significantly lower without creating undue risks.

Fixed Income Report

The Treasury curve has undergone a bull steepener in 2025, with Fed rate cuts being priced on the short-end, and inflation fears, growth momentum, and a partial "buyer's strike" leading to a sideways trade on the long end. Here is the broad shape of the yield curve over the first half of 2025:

Change in U.S. Treasury Yields

	Yield 12/'24	Yield 3/'25	Yield 6/'25	Change (BP) YTD
3mo	4.27%	4.29%	4.29%	2
2yr	4.24%	3.88%	3.72%	-52
5yr	4.38%	3.95%	3.80%	-58
10yr	4.57%	4.21%	4.23%	-34
30yr	4.78%	4.57%	4.77%	-1

In terms of credit spreads, the second quarter was dramatic, with spreads widening from 89 basis points to 110 basis points in the early weeks of April. When President Trump paused the tariffs on April 9th, credit spreads began compressing and ended the quarter at 80 basis points, tighter than where they started. The major driver of demand for investment grade credit has been the high "all in" yields. If rates were to fall further, investors may demand more spread to compensate. For now, though, despite elevated uncertainties surrounding trade policy, the market has readjusted spreads to reflect lower levels of risk.

Six out of seven of our taxable strategies are beating their index, with the laggard trailing by a single basis point. We expect to keep the strategies in their fairly neutral duration posture. Given our baseline outlook for slow (but positive) growth, high (but not out of control) inflation, and worsening (but not recessionary) unemployment, we are comfortable maintaining our overweight allocation to corporate bonds. While we still see good relative value in individual credits and sectors, we recognize that the corporate bond market is no longer "cheap" and may look for opportunities to reduce our exposure. That being said, an economy which is middling along is not bad for "carry" strategies (extra yield).

On the tax-exempt side, the low municipal issuance over the past two decades has resulted in infrastructural underinvestment at the state and local level. The scale of this underinvestment becomes clear when one considers the broader economic context. In 2004, municipal debt outstanding totaled just under $3 trillion against a $12 trillion GDP. By the end of 2023, debt outstanding had grown to only $4 trillion, despite GDP more than doubling to $28 trillion. Household wealth tells the same story. Federal Reserve figures show that average net worth nearly quadrupled since 2003, from $45 trillion to $169 trillion in 2023. The outstanding municipal debt, in contrast, grew by just 35%. This is a pattern which holds when comparing municipal debt to other fixed-income sectors as well.

We think 2024 marked a turning point for debt issuance, and the first half of this year continued the pattern with a vengeance, unleashing the strongest six-month period of new issuance since 2002. Despite last year's robust levels of new supply, we are currently running 14% ahead over the same period last year, with supply in Q2 up 33% on a quarter-over-quarter basis. After decades of underinvestment relative to economic growth, the flood of new issuance shows municipalities beginning to play catch-up.

For the most part, the new supply has been digested by tax-exempt investors. Some loans were met with tepid interest, leading to further price discovery—an important and healthy market dynamic. Like the taxable market, the tax-exempt space saw a shift in investor sentiment in terms of duration positioning. The demand tilt to the shorter end resulted in a steepener; for munis, it was a bull steepener on the shorter end and a bear steepener further out. The tax-exempt AAA curve has not been this steep since August 2017.

At the onset of negotiations for the "One Big Beautiful Bill," there was some talk that tax exemption itself would be rescinded. This chatter always seems to accompany tax reform efforts and may have contributed to the surge in new issuance. Far from tax-exemption being rescinded, though, Congress even added a new sector for tax-exempt eligibility: spaceports. It remains to be seen how big this sector becomes, but spaceports can include any facility near a launch site or re-entry site used to manufacture, assemble or repair spacecraft. There are also sectors, notably healthcare and higher education, which could come under pressure due to the recently enacted legislation. We have scaled back our representation in those sectors.

2025 has been a strong year for municipal bond returns, with the Bloomberg Five Year index being the outperformer. Intermediate duration investors have been rewarded. Here are the numbers:

Municipal Bonds

	Q1	**Q2**	**YTD**
Muni Bond Index	-0.22%	-0.13%	-0.35%
1-yr	1.05%	0.83%	1.88%
3-yr	1.01%	1.07%	2.08%
5-yr	0.91%	1.36%	2.27%
7-yr	0.75%	1.29%	2.04%
10-yr	0.26%	0.78%	1.04%
15-yr	-0.60%	-0.39%	-0.99%
20-YR	-1.29%	-1.44%	-2.73%
Long Bond (22+)	-1.46%	-1.92%	-3.38%

Although the ongoing curve steepening continues to penalize long-duration bonds while rewarding short and intermediate maturities, the modified barbell for our flagship intermediate strategy is outyielding its benchmark by 45 basis points. The main vulnerability of non-modified barbells is further curve steepening. In that scenario, belly-based indices deliver superior returns compared to the barbell strategy. To prevent this, we continue transitioning accounts away from the more pronounced barbell structure.

We also continue to seek opportunities in the primary market, with a particular focus on sectors holding value, such pre-paid gas deals and puttable housing bonds. We see our concentration of AMT bonds as being the beneficiary of the recently enacted tax legislation and expect to see some improvement in their relative valuation. Like the taxable team, the tax-exempt team enthusiastically uses the carry strategy to garner extra income, and therefore extra performance.

Equity Report

The second quarter of the year saw a significant increase in volatility. As noted above, uncertainties were driven by extreme swings in tariff and trade policy, as well as heightened geopolitical risks in the Middle East. The swings in the equity market were not for the faint of heart. In the span of three months, many equity investors have experienced a bear market correction *and* a bull market rally.

The S&P hit a post-election high on February 19, on hopes of a pro-growth, pro-business Administration. But it promptly fell 21.3% to an interim trough on April 7, driven by more severe and erratic tariff announcements than expected. These raised significant concerns about the growth outlook for the remainder of the year. But as quickly as the market plunged into bear-market territory, it staged an impressive bull-market rally (+20%) over the next month, as the Administration reversed and delayed much of the newly announced tariff polices. In fact, the S&P finished the quarter with a gain of

10.9% and booked a new record high since February, up 6.2% year-to-date.

As businesses put the first half of the year behind them, they optimistically look forward to regulatory relief and new tax policies. These should help drive the next leg of investment and growth for the American economy. Despite our optimism, we still expect many business leaders to proceed with caution as they begin executing major new investments. Given the strategic ambiguity that the new Administration has embraced on several policy fronts, it makes sense to wait until the rules of the road are better established. Now that the tax legislation is enacted, we expect that, as more trade deals reach some interim agreement, businesses will begin to offer brighter outlooks and less uncertainty about the next 12-18 months.

Much of the available economic data suggests that the economic fundamentals in the United States remain solid, with job growth continuing to grind along, wages still rising at a reasonable (albeit slower) pace, and layoffs at moderate levels. And while consumer sentiment readings have been softer than expected, actual consumer spending remains firm.

The severe and indiscriminate pullback in equities at the beginning of the quarter reflected peak uncertainty about tariffs and the near-term path of the economy. And, given the strong run in equities over the past several years, it highlighted the fragility and anxiety of many investors.

But as true long-term investors, and as we have done during similar episodes of market dislocation, we took advantage of good buying opportunities. We established new positions in washed out Technology names, and added to our exposure in Financials, where we still see good value. And, in accordance with our investment discipline, we added to the existing high-quality, above-average yielding, businesses that we already owned, when they traded at unusually high discounts to their intrinsic value.

While headline returns for the equity market were stronger this quarter, it was something of a mirror image relative to the first quarter of the year, with Growth-oriented stocks outpacing Value-oriented stocks. For the quarter, the Russell 1000 Growth increased 17.6%, significantly outpacing the Russell 1000 Value, which increased 3.8%. Year-to-date, growth and value have delivered similar total returns, up 6.09% and 6.00% respectively. We would highlight that valuation on the Large-Cap Growth side of the market is relatively more elevated than Large-Cap Value. At the end of the quarter, Growth is trading at 30.4x forward estimates (58% above the 20-yr average of 19.3x), while the Value side of the market is trading at 17.0x forward estimates (23% above the 20-yr average of 13.8x).

Mega-cap tech led the charge back up this quarter, on the heels of double-digit declines for the Magnificent Seven(“Mag-7”) stocks in the first quarter. Earnings results, which were largely reported after the tariff-induced sell-off, continued to confirm that AI spending trends remained solidly in place. We would note that, outside of technology, S&P 500 earnings estimates for the full year were marked down from $272 at the beginning of the year to $263 currently.

The Nasdaq recovered all its losses from early in the quarter and hit a new high. Nvidia led the Mag-7 this quarter, up 45.8%, followed by Microsoft, which was up 32.5%. Meta, Tesla, Amazon and Google also rose 28.1%, 22.6%, 15.3%, and 13.5% in the quarter. Apple was the sole Mag-7 decliner during the quarter, down 7.6%. On a year-to-date basis, the Mag-7 stocks have been a bit more mixed, with NVDA, MSFT and META up 17.6%, 18.0%, and 26.1% respectively, while APPL, TSLA, GOOG are still down 18.1%, 21.3%, and 6.9% respectively. Amazon finished flat YTD at the end of the quarter.

At a sector level, investors are once again feeling optimistic about the economic outlook, with Industrials, Technology, and Financials leading the market through the first half of the year. Given the “risk-on” rally over the past few weeks, more defensive segments, such as Consumer Staples and Healthcare, have taken a backseat. If investors are correct that the economy is poised to reaccelerate, the two areas of the market we think could play catch-up in the second half of the year would be cyclically sensitive areas like Materials and Energy, which did not participate in the rally this quarter.

Going forward, if the economic growth widens, we expect the broader market to catch up. If higher rates or tariff policies inflict near term economic pain, then we believe that value offers good downside protection at this juncture. We are continuing to maintain the more value-oriented view of the market that we held entering 2025, focusing on increased stock selectivity. Many of the signs of excessive risk taking which we warned about at the end of last year were discounted during the market swoon this quarter, but some of the speculative excesses once again have returned to the market.

Investors still need to pay close attention to valuations, given the rapid recovery from the April correction and new highs reached in the quarter. The risks that we highlighted last quarter, including trade wars, uncertain tax and fiscal policies, and ballooning government debt, are better understood, and the finalized tax legislation should provide more clarity for businesses and individuals. But trade policy and unsustainable government deficits will likely remain a source of anxiety for some time to come. As long-term investors, we will take advantage of these fears when they arise as we still believe that the American economy is one of the most resilient and adaptive economies in the world.

We continue to favor businesses and sectors like Healthcare, with above average cash generation, selling below their long-term averages. We continue to believe that Energy offers good opportunities, with well above average free-cash-flow yields and a much more disciplined industry from a supply/demand perspective. We continue to be more constructive on Financials, which still represent good value as long as the economic cycle appears to be grinding along. We think, despite the near-term concerns about tariffs, that long-term economic prospects for the United States remain above average compared to most major economies around the world.

Our equity portfolios remain well positioned with a balance of inexpensive, high-yielding, cash flow businesses, along with industry leaders with above average growth prospects. The common denominator of all our businesses remains strong balance sheets that provide the dry powder to invest in new opportunities—and weather an economic storm when markets invariably hit a few bumps along the road. It is an approach which worked well for us during the second quarter of 2025.

Conclusion

Once, after Abraham Lincoln had dealt with a difficult and recalcitrant governor, he told a story about an Illinois farmer who had a massive log embedded in the middle of his field. All his neighbors knew about the problem, but one Sunday, the farmer announced that he had solved it. "Solved it?!" his neighbors exclaimed, "How could that be? It is too big to haul out, too knotty to split, and too wet and soggy to burn, so how on earth did you solve it?!" "Well, boys," the farmer replied, "I'll tell you what I did—I plowed *around* it."

Whether one is "fer" or "agin" President Trump, his agenda is not too complicated. He wants more production done here in the United States. He sees private investment as the engine of economic growth—and deregulation, tax breaks, and low interest rates as helping to fuel that engine. And he is willing to use the unvarnished powers of the federal government to achieve his nationalist objectives.

As President Trump attempts to implement structural changes to the American economy—changes sanctioned by the voters last November—we may, as investors, want a greater degree of stability. We may wish that trade policies were managed with a steadier hand. But it is a mistake to think that Trump is random or whimsical. Economic nationalism has been a consistent thread throughout his political career (and in fact, *prior* to his career in electoral politics).

The rapidly changing storylines may feel like Donald Trump is messing with the market's OODA loop, but we do not see it that way. We think President Trump is more like the log in the middle of that Illinois field: we know he is there, and we know he is consequential, but we also know there is still a crop to harvest, and we are open to the prospect that the crop will be bountiful.