# Stapp Financial Investment Letter

**Stapp Wealth Management, PLLC** **Second Quarter 2025**

*"I view diversification not only as a survival strategy but as an aggressive strategy because the next windfall might come from a surprising place."*

*– Peter Bernstein*

## Market Recap

The 2nd quarter was a quarter of false starts. The announcement of tariffs on April 2nd, what is now called Liberation Day, resulted in a sharp selloff across markets. Then, a few days late on April 9th, a 90 day pause on reciprocal tariffs was announced, which then resulted in a sharp rally. For investors hyper focused on the day-to-day moves, an intra-month drawdown in the S&P 500 of almost -14% was experienced. Meanwhile, investors that only check the monthly numbers merely noticed a less than -1% drawdown in the S&P 500 for the month of April. Then, on June 13th, Israel initiated attacks on Iran. Many speculated we would see broad economic implications as a result of energy market disruption, but a subsequent cease fire declared several days later stemmed any impact to the broader economy as a result of an Israel-Iran war. The market recovery ensued, and on June 26th the US stock market pushed through its all-time highs.

Meanwhile, across the pond, non-US stocks have continued their outperformance so far this year over US stocks. While investors that only invest within the US are fighting to stay above water level, non-US stocks across both developed and emerging market countries are experiencing double-digit returns. A push toward more economic independence and fiscal support to the private sector is greatly benefiting overseas markets. Bonds are, once again, acting like bonds, with somewhat stable single-digit returns so far this year. Gold also continues to be a beneficiary of the increased global uncertainty as demand has increased for both individual buyers and global central banks. Gold pushed another 5.5% higher during the quarter to finish with a total return year-to-date so far of 26%. The trend-following managed futures strategies, unfortunately, continue to be the laggards of the pack. Analysis by operators of these strategies show that this has actually been the worst trailing 12-month period for these types of strategies. Historically, performance of these strategies is cyclical, and poor performance has always been followed by strong performance. Cyclical swings in a strategy's or asset's performance is something every investor experiences, which further cements the importance of diversification. Fortunately, the strategies we use that fall under this category have not done nearly as poorly as the broader managed futures category.

| Asset Class Performance | | |
|---|---|---|
| | 2nd Quarter | Year-to-Date |
| Investment Grade Bonds | +1.21% | +4.02% |
| High Yield Bonds | +3.53% | +4.57% |
| US Large Cap Stocks | +10.94% | +6.20% |
| US Small Cap Stocks | +8.5% | -1.79% |
| Developed International Stocks | +11.78% | +19.45% |
| Emerging Market Stocks | +11.99% | +15.27% |
| Gold | +5.53% | +26.00% |
| Managed Futures | -7.41% | -12.69% |

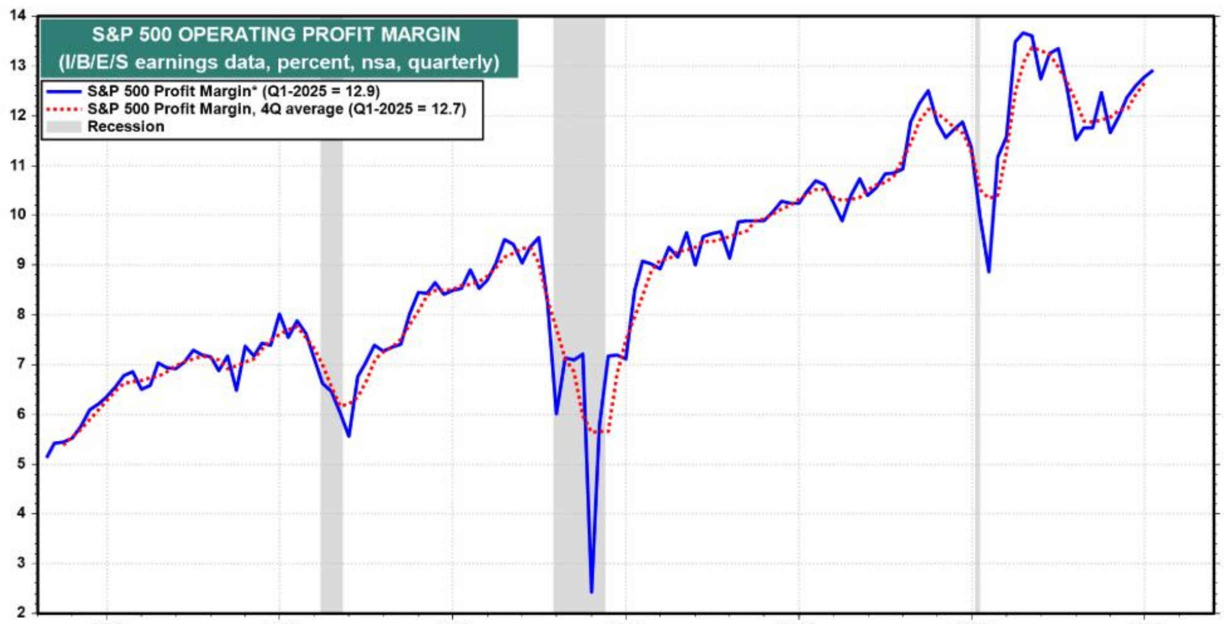
*Data as of 6/30/2025. Source: Kwanti Analytics[1]*

*[1] Indexes used: Bloomberg US Aggregate Bond Index, Bloomberg US Corp High Yield, S&P 500 TR, Russell 2000 TR, and MSCI EAFE TR, MSCI Emerging Markets Index TR; Gold represented by the change in the gold spot price; Managed futures represented by a 50/50 allocation to ASFYX and PQTIX set to rebalance quarterly.*

## Investment Outlook and Portfolio Positioning

The economic trends in place continue to further entrench themselves. AI continues to advance at a rapid pace. Models like OpenAI's o1 and DeepSeek's R1 now toggle between fast heuristics and step-by-step logic, improving performance in math, coding, and scientific reasoning. Major labs have also rolled out features enabling AI to remember facts and preferences across sessions, making AI more context-aware and collaborative. Tools like OpenAI's Sora and Google's Veo can now generate dynamic video clips with consistent characters and motion, pushing generative AI beyond static images to dynamic storytelling. These are significant jumps that are enabling increases in efficiency and quality in business outputs.

With valuations remaining stretched, corporate tax rates at historical lows, and investor participation at all-time highs, AI has become a critical source of value creation in the economy and markets that is necessary to continue the upswing in economic growth. The continued improvements and increased adoption of AI is almost certain to lead to improvements in goods and services available in the economy, but we continue to have questions. For one, how will society rebalance itself when human labor contributes much less to society? Corporate profit margins are once again pushing historical highs. Will corporates continue to take a larger share of the economic pie? That would be good for the stock market, but bad for the individuals producing within society. We view Zohran Mamdani, an avowed socialist, winning the Democratic party ticket for New York mayor as being a clear sign of the policy pushback we will see in opposition of these trends. If the global capitalist system will not enable individuals to extract value from their labor, people will look to policymakers to provide solutions.




Source: LSEG Datastream and © Yardeni Research.
* S&P 500 operating earnings per share divided by revenues per share.

Our working thesis of the global economy at this time is captured by a theme we call the reversal of the Washington Consensus. The Washington Consensus was a series of policies and the establishment of several global organizations that grew out of the stagflationary 1970s, and was essentially deflationary – and caused unemployment in the US to be structurally higher. The Washington Consensus centered on three key areas: Trade liberalization (reduce tariffs, allow foreign competition, remove government guarantees), privatization (move government owned corporations to private sector, reduce government influence on wages), and financial liberalization (allow markets to set exchange rates and bond yields). Now, tariffs are on the rise – President Trump issued a pause on the tariffs, which caused markets to rally, but negotiations are now resuming. Capital controls and sanctions are more likely – section 899 of the One Big Beautiful Bill, for example, penalizes individuals and entities from countries whose tax regimes are deemed discriminatory against U.S. interests. Secure supply chains have become politically imperative – The DoD recently acquired a 15% stake in MP Materials to support their acquisition of rare earth minerals. Fiscal spending is surging – look no further than the One Big Beautiful Bill.

For investors, the implications of this thesis are nuanced. We do not view this environment as a panic sell or a go all in type of environment. We think it's an environment of investment winners and investment losers.

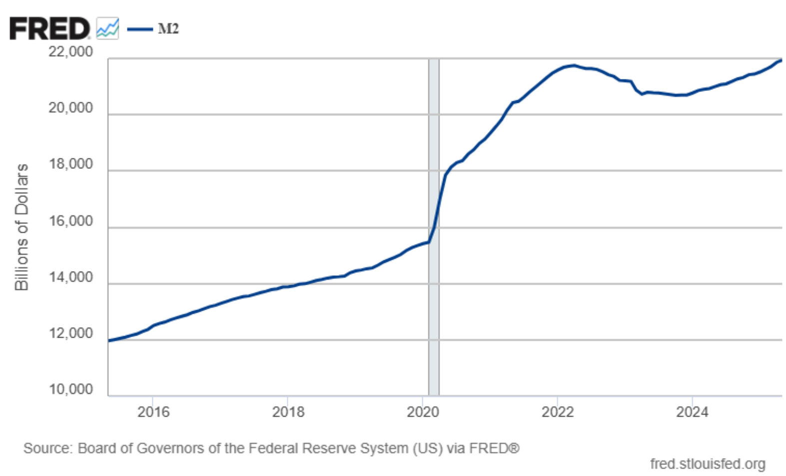
**We want to own –**

- Insurance against US government error (Gold, maybe bitcoin)
- Non-US assets in everything except consumer discretionary
- Political utilities and national champions
- Non-capex reliant tech
- Real assets
- Long/short strategies that can identify winners and losers

**We want to avoid/underweight –**

- Financial system business models that break if the USD or US treasuries decline
- High capex businesses
- Premiumization/wealth effect business winners
- Dominant US brands that face consumers that may become global political targets
- Interest rate sensitive bonds

These are our favored areas, but one chart we would draw your attention to is a chart showing the M2 money supply, which is an estimate of all U.S. liquid assets, including cash on hand, money deposited in checking accounts, savings accounts, and other short-term saving vehicles. The amount of money in the economy has breached its all-time highs again after a brief period of decline. This is perhaps the most powerful force supporting all assets. As the supply of money increases, it decreases the value of all money, which increases the value of everything else, favoring investable assets and all assets in general. We expect a well-constructed, diversified

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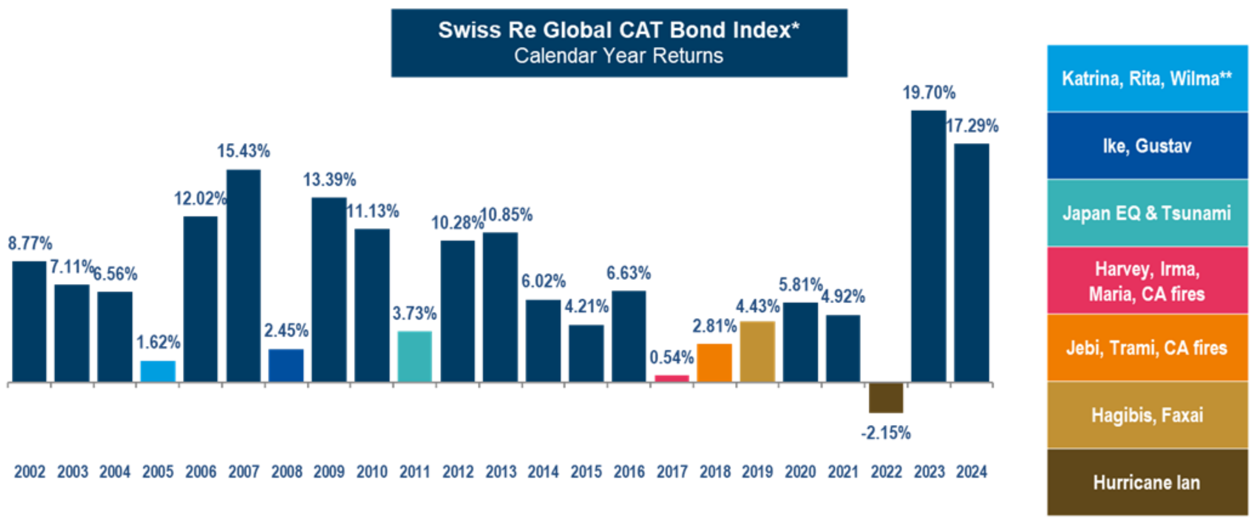
portfolio should continue to produce solid returns. We would expect that investing in a way that favors our highlighted winners and minimizes the losers should do even better.

We are pleased with our investments as the outperformance of our portfolios continued through the 2nd quarter. We made some decently large changes across portfolios during the quarter. We added a few new assets and strategies to portfolios, which further add to diversification in portfolios but also align the portfolios more closely with our macro views. One addition was catastrophe (CAT) bonds. CAT bonds are financial instruments that transfer the risk of natural disasters from insurance companies to capital market investors. Cat bonds create a win-win scenario: insurers gain additional protection beyond traditional reinsurance, and investors access high-yield returns uncorrelated to financial markets. A single CAT bond is risky as they are typically tied to a specific peril, such as a Florida hurricane. In the instance the trigger event occurs, that CAT bond could see significant losses. A diversified CAT bond strategy, however, is highly resilient as it spreads the risk across a wide variety of perils, from Florida hurricanes, to California wildfires or Japan typhoons. The Swiss Re Global CAT Bond Index, which is an index representative of the entire global CAT bond market, for example, has only had one down year since its inception.




***Data represents past performance, which does not predict future results.*** *The Swiss Re Global Cat Bond Index tracks the aggregate performance of all USD, EUR and JPY denominated CAT bonds, capturing all ratings, perils and triggers. The index seeks to hedge out the EUR and JPY currency risk at the inception of the bonds. However, the index does not reflect the full ILS market.*

**Source: Swiss Re Global Cat Bond Index as of December 31, 2024. Swiss Re has calculated index returns for the 5-years prior to the January 2007 inception of the index. There can be no expectation that the returns of the index will match pre-inception returns. **Please note the key to the right corresponds with how the index reacted during those weather related incidents in the chart on the left.*

The other allocation we made was to discretionary long-short investment strategies. Long-short investment strategies have the ability to bet on investments going up (going long) or going down (going short) and to make a profit in either direction. As markets tend to go up 75% of the time, the shorts are often a detractor to portfolio performance, but when the market turns down, they can be very additive to performance. In effect, these strategies have the potential to generate returns in an improving economic environment and in a deteriorating economic environment. Occasionally these types of strategies can have goldilocks periods when the longs go up in value and the shorts go down in value simultaneously, resulting in extremely strong performance. We like long-short strategies right now as we think this is an environment where there will be distinct winners and losers among investments. A strategy that can bet on the winners and bet against the losers should do very well going forward. We made an allocation to these strategies within the global equity space and the non-US bond space. Aside from these changes, we continue to favor non-US stocks, natural resource equities, gold, managed futures strategies, and shorter-term bonds.

## Closing Thoughts

We continue to see a fair amount of turbulence across geopolitics and the global economy. Asset markets, on the other hand, continue to trend upwards and persist through the turbulence. Risk is always present, so we must always account for something going sideways, but as you look back at history, it becomes clear that history was the triumph of the optimists. Hence, as always, we must plan for the worst but hope for the best.

We thank you for the trust you place in us to be the stewards of your capital. If you do have any questions, comments, or if you want to discuss your specific situation, please reach out. We're happy to meet or discuss at any time.