Traphagen Q2 2025 Newsletter

The second quarter of 2025 has been a period of stabilization and cautious optimism in the financial markets. After a tumultuous start to the year, markets have shown resilience, supported by progress in trade negotiations, accommodative fiscal policy, and solid corporate earnings. We will provide an in-depth review of market performance, portfolio adjustments, private investment updates, and our outlook for the remainder of the year in this newsletter.

Economic & Market Update

The second quarter of 2025 has marked a turning point following the volatility that defined Q1. As of June 30, 2025, major indices and asset classes have displayed encouraging results. The **S&P 500** has recovered from earlier losses, finishing up 6.1% for the first half of the year and is now up more than 20% off the April 'liberation day panic' bottom. Small-cap US stocks, tracked by the **Russell 2000**, continue to lag, with a YTD decline of 1.9%, underscoring challenges in the index itself and lower quality and lower growth companies. In contrast, international markets have shone brightly: the **MSCI EAFE** (developed foreign markets) surged 20% YTD, while **emerging markets** gained 15.6%. Traphagen has held little to no foreign stocks for more than 6 years. Over that time the US markets have outperformed foreign stocks by roughly 100% in absolute terms despite this year's trend reversal. We are open to looking at an allocation to foreign stocks, however it remains a very high hurdle for us as the rule of law, international revenue diversification offered by US based companies, higher growth, better sector/technology/AI exposures, and superior economic dynamism/resilience all point to US stocks. Fixed income and alternative investments have also played a stabilizing role, with **the US BOND Aggregate** returning 4% with mid-term rates little changed in the period.

Our **alternative/private suite TRPALTS** has kept pace with traditional fixed income during the first half of 2025 (also up 4%) and is currently annualizing at 8% to 9% for the year. This has occurred with very little volatility or correlation to any other asset in the portfolio. A great example of this risk mitigation benefit occurred when the stock market was at its lows in early April (down 21%), while our alternative/private suite was up roughly 1% on the year at that same point.

Equity Market Performance

US equity markets in Q2 have been characterized by a divergence between large-cap and small-cap performance, as well as between growth and value stocks. The S&P 500 recovery was driven by a rebound in technology, AI, and economically sensitive stocks with defensive sectors lagging. **The chart below illustrates the daily closing prices of major US indices over H2 2025, highlighting their distinct trajectories.** *Blue = Nasdaq, Red = SP500, Black = Trap Alts, Pink = Bond Agg, Green = US Small Cap (Russel 2000)*

A closer look at the S&P 500 reveals significant sector-level variation. **The table below provides a detailed breakdown of Q2 returns by sector, offering insight into the drivers of market performance:**

Sector	Q2 2025 Performance	Key Drivers
Technology	**+ 23.0%**	Largest drawdown earlier in year, AI Trade
Healthcare	**- 6.9%**	Weaknesses in large Pharma/HC insurance
Consumer Staples	**+ 1.4%**	Defensive sector that lags in large upswing
Utilities	**+ 3.7%**	Defensive sector that lags in large upswing
Energy	**- 6.2%**	Oil price declines, supply increases
Financials	**+ 6.0%**	Deregulation and market recovery/IPOs
Industrials	**+ 13.4%**	AI related trade & higher Q2 growth
Consumer Discretionary	**+ 11.7%**	Amazon, Tesla, and AI related trade
Materials	**+ 6.9%**	Improved confidence & higher GDP Q2 growth
Communication Services	**+ 11.7%**	META, GOOGL, NFLX, and AI trades

Bond Market Insights

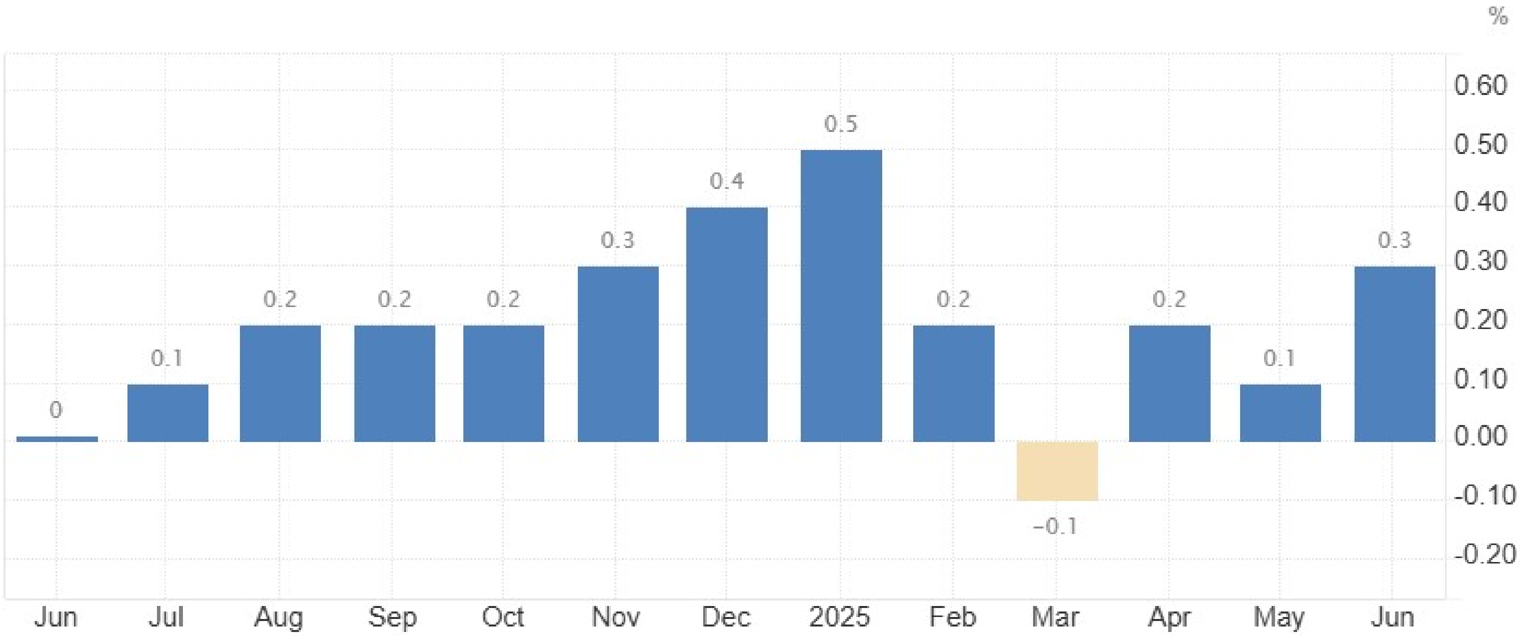
The bond market has been quite boring in 2025 (which is their main purpose and is a welcome change). **Treasury bonds** are generally little changed in price over the course of the first half of 2025. Although if you dig deeper, you will see some material rate moves. The shorter end of the curve (1mo – 2-year rates) are either near unchanged or down slightly on the year. The middle of the curve (3- year to 10-year) is down between 0.25% and 0.4%, while the longer end (20-year to 30 year) rates are up slightly. This has caused a steeper shaped yield curve which is more 'normal' in most economic environments and usually associated with positive economic growth. The FED to this point has held short term rates (also known as the Fed funds rate) steady at around 4.3% for the entire year. We think this changes over the next 6-9 months (in the form of rate cuts) and that could have a large impact to several asset classes in the near future.

Economic Indicators

Broader economic data also provides context for these market movements. **GDP growth** accelerated to an annualized rate of 3.0% in Q2, up significantly from – 0.5% in Q1, reflecting a modestly growing economy. The **unemployment rate** ticked up to 4.2% from 4.0%, though job creation remained slightly positive.

As many know, the BLS came out with an unprecedented revision to May and June jobs numbers that could alter the FED's plans for the rest of the year. Originally May and June recorded a combined 286,000 new job openings, however on August 1st, the total number changed to just 26,000 (a 91% downward correction). This of course paints a much weaker jobs picture than originally thought. This prompted President Trump to fire the head of the BLS the same day, and the economic community awaits to see and if and how changes (hopefully improvements) will be made to the data collection and reporting processes. Regardless if you agree with the firing itself (or its pretense), many can see value in an updated process as the data has not been reliable since COVID.

Inflation, as measured by the Consumer Price Index (CPI), continues to be roughly steady between 2.5% and 3.0% over the past year, with no clear trend in place. The most recent reading of + 0.3% in June 2025 and + 2.7% year over year was consistent with this range. **Below is a chart of month-over-month inflation for the past year**. Over this period the average year-over-year levels remain modestly above the 2% target with no strong visible trend.



Real Estate and Alternatives

Non-Single-family home real estate continues to be the poorest performing asset class over the past 2-3 years with the NCREIF real estate index down close to 15% from top to bottom over the past several years. This performance has been almost purely a result of higher interest rates and leverage costs. The actual fundamentals of most real estate (outside of legacy office) have remained strong with very high occupancy rates and solid rent growth.

Traphagen's Private/Alternative investment suite **(TRPALTS)** continues its well above target performance, very low volatility, high cash flows, and little correlation to the economy or stock/bond markets. **TRPALTS** was up roughly 4% through the first half of 2025, and through July it looks like an 8% - 10% total return for the full year is possible if the current pace continues.

Over the past 5 years, this suite has averaged + 7.9% per year net of fees with almost no volatility. We continue to use this part of the portfolio as an extremely valuable tool to both build and protect client wealth in uncertain and rapidly changing times.

Major Factors Impacting Markets in Q2 2025

Five primary factors have shaped the market landscape this quarter, each with significant implications for investors:

1. **Reconciliation/Tax Bill Passage**
   On July 4th (just after Q2 2025 concluded) the 'Big Beautiful Bill' passed Congress and the President signed it into law. Although there are many items in the bill, we highlighted what we feel are the most impactful on the economy and clients below:
   - **a)** Various tax law changes include no tax on tips or overtime, increased child tax credits, senior tax deductions, and increase in the 'SALT' deduction. All of these have income limits and therefore tend to help lower to middle income earners with children and a home. For some clients (especially those making under $200,000) this could mean thousands of additional dollars saved come tax time.
   - **b)** Full expensing of certain types of equipment starting in January 2025. This will produce higher cash flows for these businesses in 2025 and beyond vs. prior law.
   - **c)** Making permanent the original 2017 tax brackets/laws that will prevent reversion to higher tax rates for all individual tax payers and much higher estate tax thresholds.

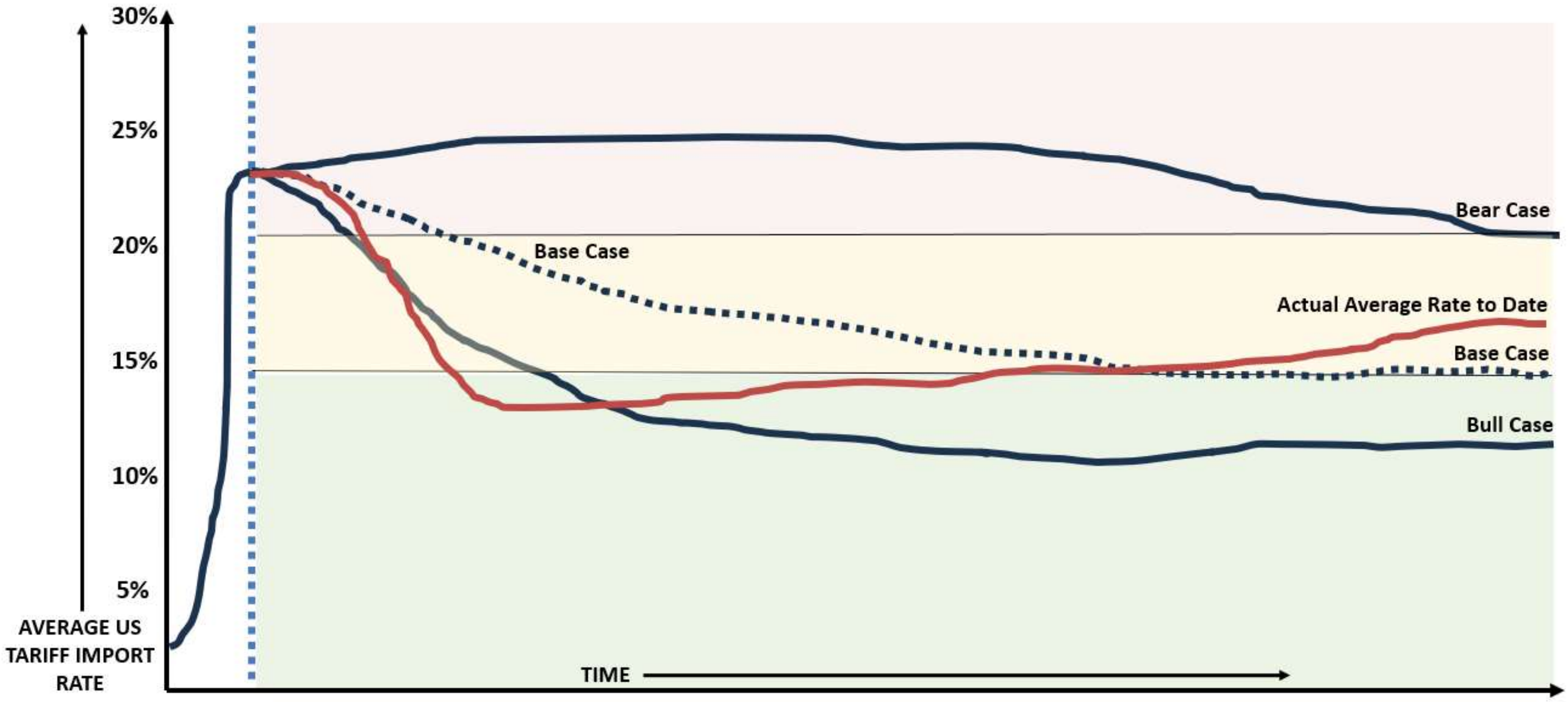
   Generally, this looks to be stimulative to the economy (all else equal) as it adds potential tailwinds to certain corporate earnings along with additional tax savings for lower- and middle-income individual taxpayers. This will add to the Federal deficit by between $1.8T and $3.3T (depending on assumptions) over the next decade. As a counterbalance in July 2025 there was $29.6B in tariff revenue received by the Federal government. If that level of revenue continues, that would cover in full or exceed the cost of the bill over the next 10 years. Therefore, it is possible we can get stimulative impacts from the bill with lowering the total deficit on the margin.

2. **Progress in Trade Negotiations**
   Q1's tariff escalation rattled markets significantly with a quick 20% drawdown, but in Q2 we had a sharp reversal of these tensions for three reasons:

   a) The impact of tariffs on economic growth, inflation, and disruption to business have (at least to this point) been significantly less than originally feared/estimated. Q2 GDP growth was + 3% with stable inflation between 2.5% and 3% and a slowing but still relatively stable labor market.

   b) The US has struck several trade frameworks and/or deals with both major economies and smaller countries. To date, some level of agreement has been struck between the US and China, the European Union, Japan, South Korea, Indonesia, the UK, Vietnam, Philippines, and Australia. Other countries are still in 'active negotiations', having tariff rates 'set' by the US with a minority of larger countries still 'in flux'.

c) Given the above, the overall global tariff picture is quickly becoming much clearer, with the 'final' tariff rate likely somewhere in the 14% - 18% range. This clarity is starting to allow governments and corporate leaders to plan for this new regime with significant import tariffs, lower or absent export tariffs, and different supply chains.



Above: Chart created by Traphagen in April 2025 (original assumption/base case as dotted line) with actual path of average tariff rates as red line. The actual average tariff rate seems to be very close to our original base case (within 3%).

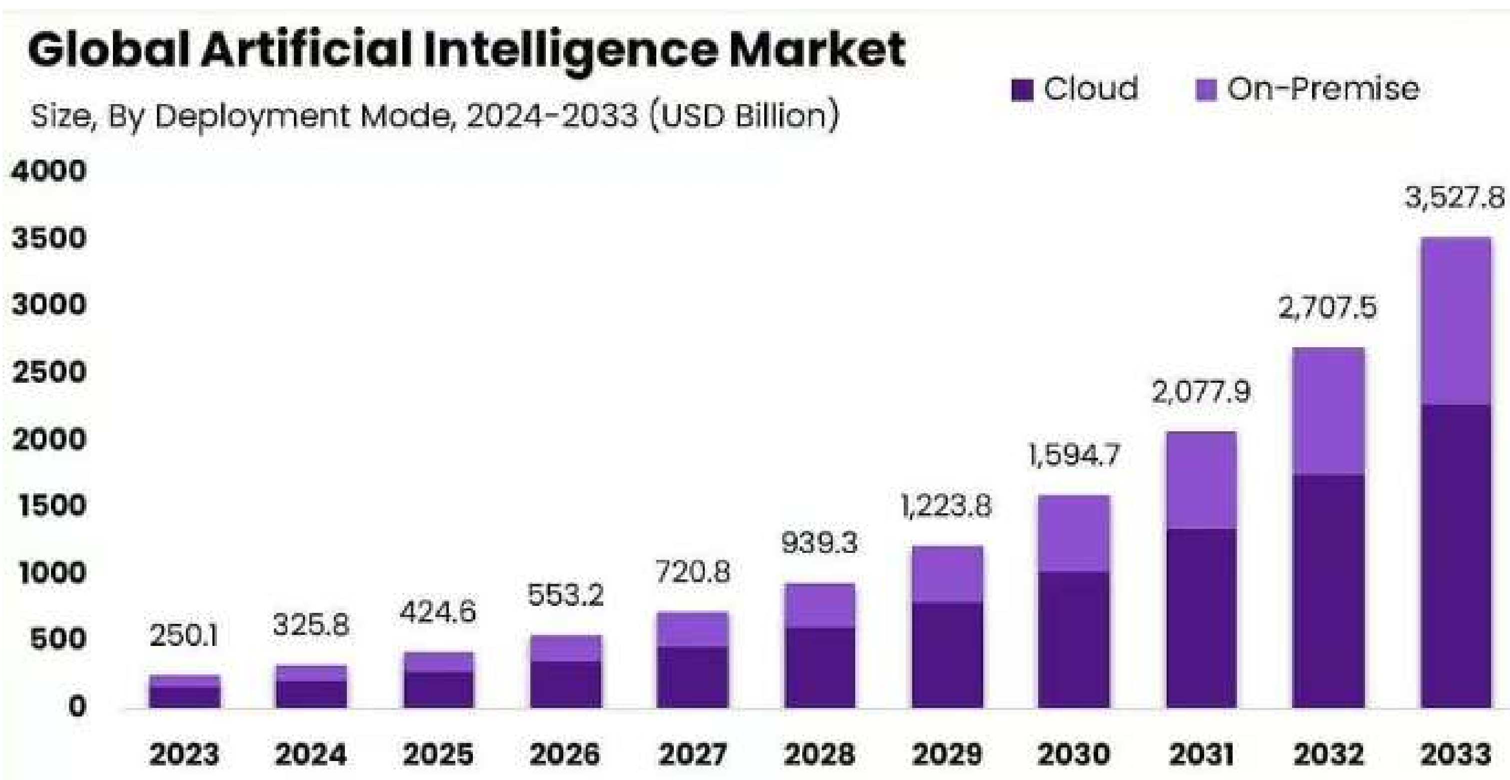
Since this tariff level has not been seen in a century, Traphagen is looking for evidence of any possible negative impacts on the economy. Tariff costs that are not absorbed by the foreign company/entity or the domestic importer could be passed down to the end US consumer. This could cause increased inflationary pressures and/or a reduction in consumer spending/ confidence. To this point, we have not seen this occur, but as time goes on and recent tariff rate increases pass through the system, we are ready to act if needed.

3. **Federal Reserve Policy**
   The Fed lowered short term rates by a full 1% in 2024 and has been 'on hold' since that period. It seems likely to us that the FED will begin another round of rate cuts within the next couple of months. The current Fed Funds rate (ultra short-term) is 4.2% with a likely rate in the 3.2% - 3.7% range within 6-9 months. This should be a good boost to commercial real estate and possible other interest rate sensitive securities. It is unclear if lowering of short-term rates would also lower longer-term rates, but we will be closely

watching that relationship. Longer term rates would impact many other assets (including the struggling housing market).

4. **Corporate Earnings Resilience**
S&P 500 companies reported a 13.7% increase in earnings from Q1 2024 to Q1 2025. This is above average growth despite all the underlying fear and volatility surrounding tariffs and geopolitics experienced during that time period. Although only about 65% of companies have reported earnings for Q2 at this point, signs are pointing to another 13% increase in earnings from Q2 2024 to Q2 2025. The tariffs have had little to no impact on corporate earnings or margins as of this writing, but we will be closely watching to see if at some point in the coming months this metric changes.

5. **Artificial Intelligence Investments and Trade**
After a significant correction of 20% - 30% earlier in the year, the AI trade has come back with a vengeance across all aspects of the spectrum. Semiconductors (specifically NVDA), GOOGL and META, the electrical grid/generation complex, data centers, and AI application companies on the private side have all benefited. **Below is an estimate of direct AI computing infrastructure demand spending (both on premise and cloud) over the next 8 years.** This implies an average annualized growth rate of nearly 30% over the period.



Traphagen 2025 Portfolio Changes & Performance Update

In 2025 we made several new investments that we will summarize below. We feel these changes help maximize risk adjusted returns for our clients.

2025 Portfolio Adjustments/Security Changes:

- **'COWG' US large cap growth stock purchase:** This new ETF focuses on a concentrated collection of the highest free cash flow margin companies in the country. This tends to be technology heavy and very high 'growth' and quality oriented. The top holding in the ETF is currently Palantir and the ETF has been a great performer since its inception and year to date. It has returned + 9.6% in 2025, besting the SP500 by a little more than a percent. In the depths of the April downturn, we added 1% to COWG and 1% to IVV and are now up close to 30% on both these purchases since April.

- **Sale of Treasury Bonds & Redeployment into 'AAA'/'A' rated CLOs and securitized loans:** At the same time we purchased 2% of additional stocks near the April lows, we sold off our long-term Treasury positions for almost all clients. Later, we redeployed these funds into two different ETFs (JSI & JAAA) that, when viewed as one allocation, offers extremely diversified exposure to 'AA' rated investment grade debt, virtually no interest rate risk, and a cash yield of just under 6%. To this point, these have performed exactly as we would have expected.

- **Creation and purchase of new Alternative/Private Asset Manager ETF (GPZ):** Over the past month or so, we have introduced a special stock ETF for the vast majority of clients. As all our clients know, we have garnered immense value from our allocation to private and alternative investments over the past decade. We see the trend of these investments moving to more advisors, individual investors, and possibly 401(k)s continuing for many years to come. We want to not only invest in the underlying strategies but also in the companies that manage the assets. There was no ETF or fund that did this, so Traphagen (along with VanEck) created our own ETF to capture this opportunity. The ETF (GPZ) was approved by the SEC in May 2025 and started to trade on the NYSE in early June. We have allocated to the ETF along with other investors and in the first 2 months it is gathered just shy of $50M in assets. Since we purchased the fund for our clients last month, the average gain is around + 10%.

Overall Portfolio Performance

Traphagen's portfolios through the first half of 2025 were generally up between 3.5% and 6.5%. The SP500 was up 6.2% in the same period with the ACWI up 10.3%. We are pleased with our portfolio performance, as like in 2024, all three pillars of the portfolio are firing, and we are currently on pace for another upper single digit or low double digit positive year. This is despite all the uncertainty and headwinds we faced earlier. Just as importantly, when the stock market was down around 20% in early April, client portfolios were only down 1% to 6% depending on strategy. This level of total returns and protection is not easy to achieve and the way we have obtained it is uniquely 'Traphagen'.

Private Investment Update (For Accredited Investors Only; $1M+ with Traphagen)

- **Private Equity (GPB Fund II):** In May 2025, this fund completed an approximate 40% cash distribution to investors, marking a significant milestone in its wind-down process. The remaining cash is scheduled to be liquidated over the next 12-18 months, with the latest estimate for final total returns on the fund within 5% - 10% either side of breakeven.
- **I-Direct Private Markets Fund:** Up 5.5% through May 31st, this fund has benefited from the addition of two new managers specializing in mid-market buyouts and growth equity. Its diversified approach has mitigated volatility in public markets.
- **KKR Private Equity Fund:** Up 8.6% through June 30th with direct ownership of roughly 60 portfolio companies (vast majority being profitable).
  BREIT: Up 3.1% YTD through June with large allocations to data centers, industrial properties, and residential with a 4.8% cash yield
- **JPM REIT:** Up 2.1% YTD, this real estate fund offers a 4.5% annualized yield, driven by strong occupancy rates in industrial and multifamily properties.
- **STEPSTONE Funds:** Our suite of Stepstone investments includes private equity (XPMIX, + 7.3% YTD), infrastructure (STRUX, + 11.0% YTD), and Venture Capital (+10.8% YTD). Both our private equity and infrastructure Stepstone funds have been performing very well in 2025 year to date and are on pace for solid double digit returns.

These private investments provide diversification and income, aligning with our goal of delivering long-term value to accredited investors.

2025 Market and Economic Outlook Update

Looking ahead through the second half of 2025, we maintain a generally optimistic stance with two meaningful headwinds in mind. Several positive factors support this view, including progress and much more clarity in trade negotiations, lower interest rates likely in the near future, stimulus through the new tax bill, and corporate earnings strength. However, risks are present (as is always the case).

Key Risks

The table below outlines the risks we are monitoring, along with their potential impacts on portfolios, and the mitigation strategies we are using to reduce any possible impact:

Issue/Risk	Importance	Potential Portfolio Impacts	Mitigation Strategy
Tariff/Trade Policy	Moderate	Certain stocks/USD	Sectors with little tariff impact / High Alternative exposure
Stock Valuations	High	Stocks (especially Tech)	Value/free cash flow focus stocks / lower overall allocation to stocks
Recession Risk	Low/Moderate	Most risk assets	High alternative exposure/AA bonds
Inflation/Rates	Low	Real Estate, Bonds	Infrastructure, certain stock sectors, Alternative exposure
Geopolitical Tensions	Low	Select stocks in short term	None taken (only short-term impact)
Slowing Employment	Moderate/High	Most risk assets/Consumer	Lower stock exposure / AA bonds / Alternative exposure

We expect a balanced approach—combining growth opportunities in select higher growth areas with downside protection (namely AAA/A rated bonds and alternatives)—will be key to navigating the remainder of 2025.With our main concerns being higher stock valuations and a slowing employment picture, the majority of our portfolio defenses continue to be in the form of lower overall public stock exposure, a focus on high free cash flow companies, a large allocation to alternative/private investments, and some exposure to very high quality bonds with a near 6% yield.

Conclusion

Q2 2025 has been a period of recovery and recalibration, and Traphagen's proactive approach has positioned our portfolios to weather challenges and seize opportunities. We remain committed to delivering tailored investment solutions that align with your financial goals and through our recent trades and rebalancing we have continued to align portfolios with that goal. As we move forward through a complicated second half of the year, we feel our portfolios remain well defensed against the two largest risks, while at the same time can deliver solid total returns and cash flows within the overall positive economic environment Thank you for your continued trust—and we wish all our clients a great end of summer and early fall.

Best regards,
Your Traphagen Investment Team