

CURBSTONE FINANCIAL MANAGEMENT CORPORATION

From the Curb

Letter to Clients

Quarter Ending June 30, 2025

The stock market completed an impressive rebound from the sharp declines of early April as steps by the administration to ease the tariff burden boosted investor confidence, while corporate earnings came in mostly ahead of expectations. President Trump's announcement of sweeping and substantial tariffs on U.S. trading partners took investors by surprise in early April, sparking fears of a trade-war-driven economic slowdown and causing a 10% decline for the S&P 500 in the days that followed. The remainder of April saw the administration take numerous steps to ease the practical impact of the announced tariffs, including a 90-day delay where tariff rates would be 10% for most partners along with an exemption for key imports such as smartphones, semiconductors, pharmaceuticals and computers. These steps, in addition to news of negotiations with Chinese trade officials, renewed investor confidence and combined with a solid first quarter earnings season to push the S&P 500 to a new all-time high by quarter end. Tariff rhetoric has created a more volatile market amid a slow growth economy where GDP is projected at 1.8% in 2025, but the underlying economic fundamentals have proven resilient. Unemployment remains low, initial jobless claims have been stable, and the Purchasing Managers Index (PMI) has remained at healthy levels.

Gains during the second quarter were impressive as investors were rewarded for staying the course. A closer look at the results suggests that investors become increasingly selective as demonstrated by the wide range of returns across economic sectors. The dispersion of returns between leading sectors (Technology & Communications) and laggards (Energy, Health Care & Consumer Staples) was significant and driven by the underlying fundamentals. Earnings and profitability estimates have defined sector leadership this year as net profit margins are expected to increase the most in the Technology sector. On the earnings front, we continue to see positive guidance offered by Wall Street analysts with greater frequency for tech companies. These results highlight the transformative impact that capital spending to develop AI capability is having on earnings growth and profitability trends at the company level.

Fixed income markets were positive for the quarter as a modest pace of economic growth and geopolitical tensions kept buyers at the window. More stable inflation readings with the consumer price index (CPI) increasing +2.4% year over year in June gave confidence to investors that inflationary pressures continue to gradually recede. Weaker energy prices also played a role in stabilizing inflation as slower growth eased demand and consumers continued to look at alternative sources. Progress on the inflation front increases the probability of a soft landing for the economy as it gives the Federal Reserve flexibility to lower rates should the economy begin to slow in the months ahead.

From a longer-term perspective, there were a couple of noteworthy issues related to credit markets that surfaced during the second quarter. Moody's became the third of the major rating agencies to downgrade U.S. Treasury securities from the Aaa level to Aa1 citing the growth of the national debt and lack of progress in managing deficit spending. The market impact of the downgrade was largely muted as the U.S. continues to offer institutional strength as the largest and most liquid bond market in the world. The concern lies in the fact that the deficit is projected to increase significantly over the next several years as the Congressional Budget Office (CBO) estimates a \$13.1 trillion deficit by 2032, which means a far greater amount of government revenue will be needed to pay the interest going forward. The market concern is that some capital could migrate to other countries that maintain high quality debt ratings leaving the U.S. with higher rates as a result. The second concern is that both higher debt burdens and higher rates could further weaken the US dollar. This could result in both challenges and

opportunities for portfolios. When the dollar declines, international investments become more attractive relative to US stocks, and foreign investors see better returns when they convert back to their home currencies. This shift in currency values affects where money flows in global markets. For your portfolio, this means we need to be strategic about balancing US and international holdings. We are actively monitoring these currency trends to position your investments in a way that protects your wealth, while capturing growth opportunities, regardless of which direction the dollar moves.

The first half of the year highlights the importance of focusing on long-term objectives amid the noise and volatility that is often generated with day-to-day headlines. While the U.S. competitive advantage in the technology sector has driven outsized returns for several years, we are reminded of the value in building well diversified portfolios that help manage risks inherent in investing. As we enter the second half of 2025, we remain focused on the fundamental drivers of long-term investment success: identifying companies with sustainable competitive advantages, maintaining appropriate levels of diversification, and staying disciplined in our approach to valuation and risk management. The market's recovery from April's volatility demonstrates that temporary disruptions, while uncomfortable, often create opportunities for patient investors. We continue to monitor economic indicators, corporate earnings trends and geopolitical developments while maintaining our commitment to helping you achieve your financial objectives