Nordwand Capital LLC

Second Quarter 2025 Market Commentary

Grinding higher

July 2025

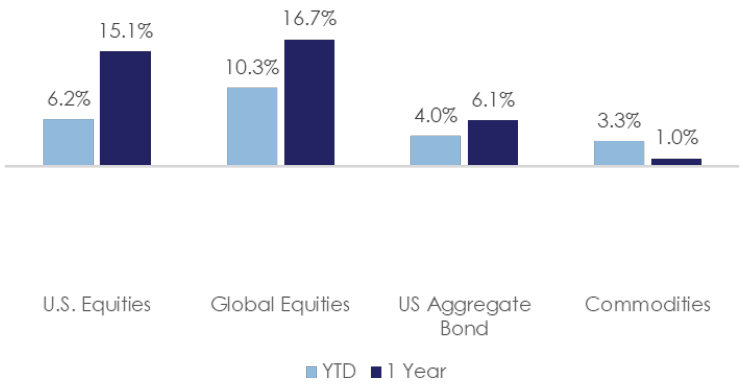
Checking in at the turn: markets post solid first half in 2025

Through the first six months of 2025, markets were broadly higher across all asset classes (Figure 1). Equities, bonds, and commodities all moved higher as markets found their footing after early concerns over a Trump transition including lingering concerns about tariffs and trade tensions, The new administration's push for interest rate cuts at the Federal Reserve, combined with legislative wins and tax cut extensions, helped support sentiment and stabilize markets.

A few highlights to consider:

- Almost all major global equity markets were higher in 2Q'25. The S&P 500 and Nasdaq were up 10.9% and 18.0%, respectively.
- Global stocks in developed and emerging markets continued their climb.
- Growth and value stocks both worked in 2Q, and while the tech leaders certainly had their moment, we're starting to see some notable shifts beneath the surface.
- Fixed income posted gains as absolute yield levels and interest rate spreads moderated
- The focus in markets moved back and forth between macro factors like global trade and US tax policy, to the ability of companies to continue posting solid earnings growth, and also to the maturation of the AI revolution as it moves beyond the first inning.
- Overall, we think markets remain pricey but without a negative event changing risk profiles for investors, we expect general optimism to support valuations as the focus on thematic elements like AI will continue to provide support. We remain cautious participants in this case with an eye toward long-term goals and discipline.

Figure 1: Asset Class Returns
(YTD and 1 Year)



Source: Bloomberg, Nordwand Capital as of 6/30/2025.
Note: US equities = S&P 500 Index; Global equities = MSCI ACWI Index.

Moving past tariffs, moving past macro?

Since Covid dominated the global landscape in early 2020, it feels like the market has been entirely – or at least predominantly – driven by macroeconomic forces that overtook fundamentals. The same was true to begin 2025, although we wonder if things are beginning to ease, or normalize, as we move into the back half of the year. Either way, it's been eventful and generally positive for markets and investors across multiple asset classes in the first half of the year.

Recapping the Macro Madness

Let's go back 5 years: first, there was Covid, and then the global supply and demand unwind and explosion post-Covid. That explosion and enormous fiscal stimuli repeatedly unleashed by the federal government created a massive inflationary shock, prompting a series of belated interest rate hikes from the Fed in 2022 and 2023. At the same time, the world saw a Ukraine-Russia regional war breakout in 2022, and the Israel-Hamas-Iran regional war since late 2023. To top it off, we had a consequential presidential election in the US in late 2024 and a shift in Fed monetary policy that saw a rapid 100 basis-point rate reduction going into the election. Coming out of the election the biggest macro driver was, and remains, the trade policy uncertainty unleashed by the new administration in Washington.

This backdrop has contributed to an increasingly complex investing environment. Thematically, AI-fever gripped markets, and returns were concentrated into a very few mega-cap stocks that drove the market higher. The "Magnificent 7" stocks surged a combined and cumulative 246% over 2023-2024, dwarfing returns for the rest of the equity markets.

Looking ahead, if the geopolitical environment calms down and inflation remains contained, the foundation will be in place for a calm and steady reduction in interest rates – all of which qould provide room for earnings growth and cash flows to drive returns for the first time since perhaps 2019. Here's hoping!

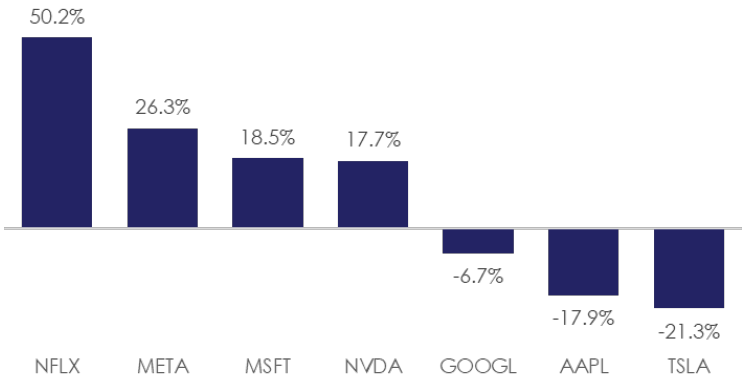
Looking at Markets in 2Q

2025 has been a bit different than the last few years in many ways. Equities have been a roller-coaster ride, while broad-based fixed income has been a positive position in portfolios due to the reduction in headline interest rates. Below, we highlight three key changes that have contributed to market movements in the first half of 2025 in a notable way.

First, the "Mag 7" stocks have been more bifurcated and largely more subdued than in the last two years (Figure 2). For example, the best-performing in this group, NFLX (+50.2%), outpaced the worst performer, TSLA (-21.3%) by a very wide margin.

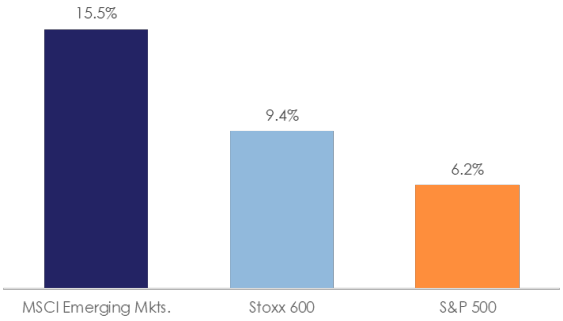
As tariff concerns abated in May and June, all of these names bounced back and helped propel equity markets higher given their outsized weighting influence. Still, the relative "laggards" in this high-flying group (AAPL and GOOGL) were weighed down by concerns having as much to do with macro and tariff issues as they were with competitive positioning (i.e. AAPL's growth strategy and GOOGL's core search business and its future in an AI-dominated world). We take comfort in that, since it's easier to pick stocks and strategies based on fundamentals than it is to predict macro headwinds or tailwinds.

Figure 2: "Magnificent 7" Total Return
(YTD)



Source: Bloomberg, Nordwand Capital as of 6/30/2025.

Figure 3: Equity Market Returns
(YTD)



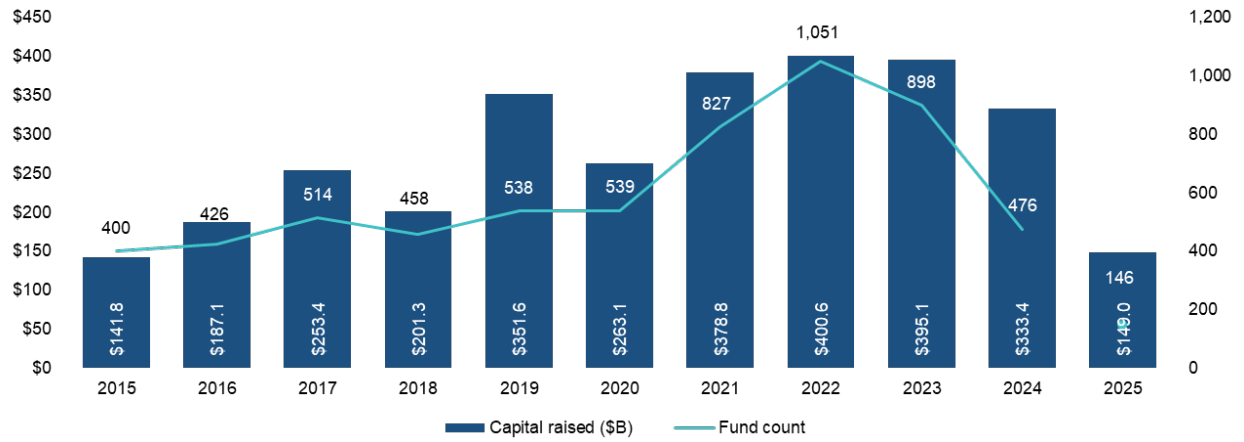
Source: Bloomberg, Nordwand Capital as of 6/30/25.

Second, emerging markets (MSCI EM Index) and Europe (Stoxx 600 Index) are outpacing US equities thus far in 2025 (Figure 3). Through the first half of the year, EM is on pace to outperform the S&P 500 for the first time in 5 years. Europe, which has outperformed the S&P 500 only once in the last decade, is likewise posting strong results at the halfway point of 2025. We have been increasing allocations to EM and international stocks gradually over the last couple of years in light of what we saw as an attractive risk-reward environment for those areas and are pleased to see it beginning to bear fruit. Proper diversification, as a wise man may once have said, is often a great tool for long-term investors.

Third, the macro news-making machine has slowed a bit from its feverish pace. The Fed has paused its rate-cutting, supply constraints have eased, tariff concerns ebb and flow, and with any luck cease-fire agreements will take hold and allow for negotiations and peace to break out in parts of the world badly in need of it. Our macro-forecasting crystal ball is busted, and it's impossible to tell whether tariff talks will spark a trade war or if Eastern Europe or the Middle East will deteriorate yet further, but the lack of reliance on Fed rate cuts to drive investor appetite is surely a welcome change to the cycle of fiscal and monetary stimulus to which we've all been witness over the last 5 years. In equities, if that allows for undervalued markets, sectors, and stocks to gain favor relative to their more popular – and expensive – peers, that should bode well for lengthening positive returns for clients.

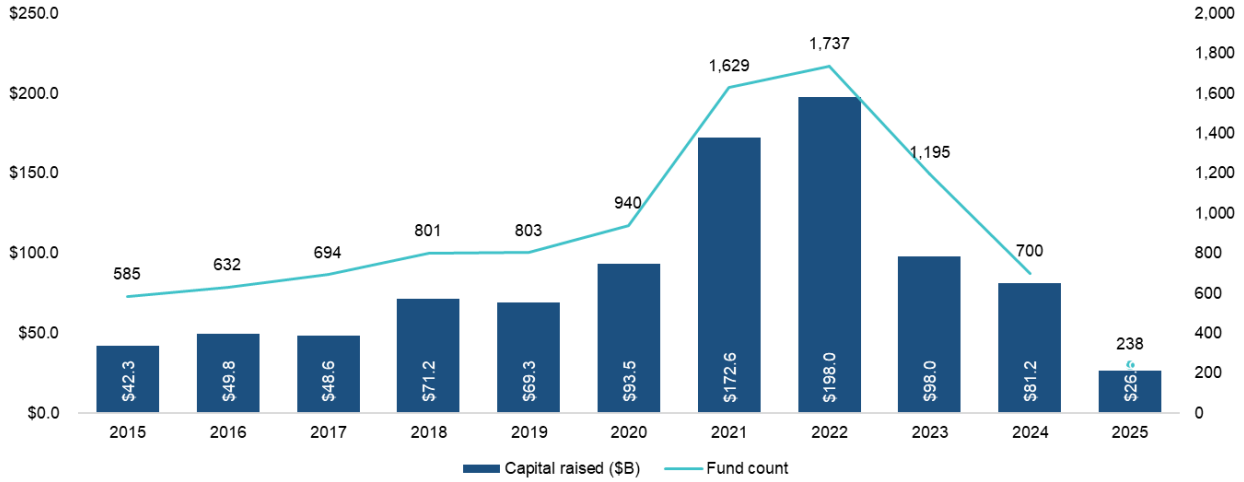
In private markets, the story remains one of muted exit activity across private equity and venture capital, and even more muted fundraising activity as a result.

Figure 4: US Private Equity Fundraising Activity



Source: Pitchbook, Nordwand Capital as of 6/30/2025.

Figure 5: US Venture Capital Fundraising Activity



Source: Pitchbook, Nordwand Capital as of 6/30/2025.

Figures 4 & 5 tell the story of investor reluctance to commit fresh money to private equity and venture capital. The untold story – but one which many investors will know well from personal experience – is that years of depressed exit activity has left many investors over-allocated to illiquid investments and many are awaiting distributions before re-committing to this particular segment of the market.

We sympathize with this view, as we've worked to balance client liquidity needs with the attractiveness of gaining exposure to worthy and differentiated investments on their behalf. We do see evidence of a turning point in this regard as green shoots are starting to emerge with respect to more exit activity, but it's too early to call this trend durable.

Looking Ahead: What's in Store for the Second Half?

With all of these conflicting data points, it's worth taking a step back. Equity markets – at least for the most-followed large cap indices – just set all-time highs at the end of the 2nd quarter. Even discounting the macro noise around tariffs, the forward return picture for large cap stocks should be more muted.

Figure 6: S&P Forward P/E & Returns
(3 Year & 10 Year)

Source: Bloomberg, Nordwand Capital as of 6/30/2025.

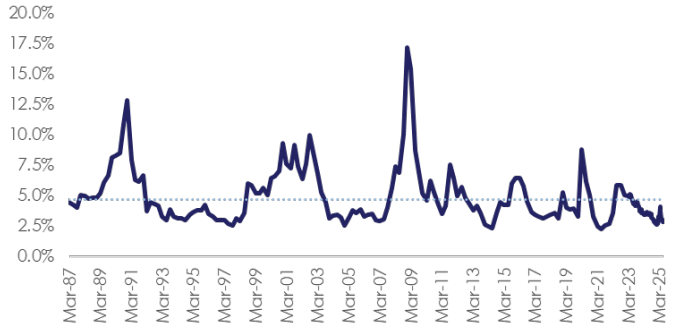
Figure 6 highlights a point that we have made many times over the last few years. The S&P 500 is trading around 23x 1-year forward earnings, which implies meager returns over 3- and 10-year periods based on historical performance. While historical performance is no guarantee of future results, it can provide helpful context for what investors might expect to achieve investing new capital here. The investment firm Blackstone notes that, as of May 31st, the S&P 500 was trading at the 97th percentile when looking at its cyclically-adjusted price-to-earnings ratio (CAPE), dating all the way back to 1881. Since May, of course, the S&P has trudged higher. In other words, this is a historically expensive market.

Looking shorter-term, we are mindful that earnings expectations are significant drivers of stock performance and valuations. An unavoidable truism of investing in equities is that stock prices rise either due to increasing earnings or expanding multiples. Recent revisions of earnings have been modestly negative, and as we move into the biggest part of earnings season we will watch to see whether company comments and updates to earnings guidance causes a little weakness in an otherwise well-bought and expensive market.

We are long-term investors, and we believe some of the trends emerging in the market around automation and AI-infused workflows and productivity are generationally game-changing – but we don't feel that argues for pushing all the chips into the middle of the table irrespective of prices or valuations. It is true that, over time, markets tend to go higher; but finding smart tactical entry points can be a worthwhile addition to portfolio management. This is the approach we would argue for and implement here and now. This is also why we have been leaning more towards international and small cap allocations for clients with excess cash in their liquid investments bucket.

In fixed income markets the story is much the same as it's been over the last 2+ years: the amount of yield an investor can get in liquid fixed income versus investing in the 10-Year Treasury Note is below the long-term average. This is a rather boring point that we harp on with some regularity, but it shows the level of market concern over credit default risks and overall macroeconomic health in the US.

Figure 7: High Yield Bond Spreads
(vs. 10-Yr Treasury, 1987-Present)

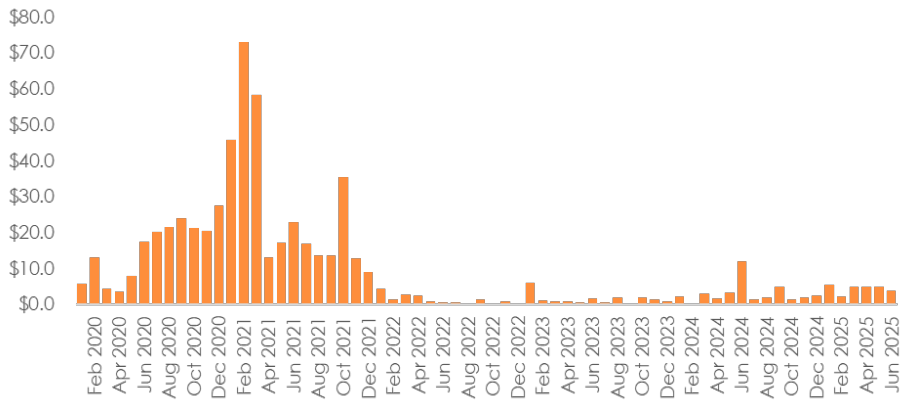


Source: Bloomberg, Nordwand Capital as of 6/30/2025.

We show high yield bonds in Figure 7 (at right) because 1) it's more volatile/reactive than the data for investment grade debt, and 2) incipient credit risks in the economy would naturally show up first in lower-quality companies. So this figure is one way of looking at credit risk in the economy, and it suggests that risk is fairly benign at the moment. The reason to consider moving into investment grade or high yield bonds – or indeed into riskier or less liquid parts of the credit universe – is because in spite of this stingy premium investors might expect, it still looks interesting relative to remaining overweighted to money markets in an environment where the Fed is expected to continue cutting rates later this year and into 2026. Finally, it's worth noting that for most of the credit universe other than sovereign instruments like US Treasuries, UK Gilts, etc., the duration or maturity of the bonds or loans involved is much shorter than 10 years, which limits risk in other important ways. In other words, we think continuing to take advantage of deploying excess cash into these areas helps to fill out a well-rounded portfolio and represents a good risk-adjusted allocation.

In private markets, activity remains subdued. As we noted in Figure 4 & 5 above, activity has bubbled along at a depressed rate since the Fed's rate hiking cycle became evident and is running at 30-50% of prior levels over the past 3 years. M&A activity has shown a similar trend. Since M&A or a public listing are the means for exiting private investments and recycling capital to do further deals and return investor capital, the works have been gummed up effectively for 2-3 years (Figure 8). We watch these data series intently for signs of life (or 'green shoots' to borrow from 2008/2009 Great Recession language). While these levels remain low, smaller deals of the type with which we've been involved for investors and secondary

Figure 8: IPO Activity
($ in billions, 2020-Present)



Source: Bloomberg, Nordwand Capital as of 6/30/2025.

transactions where LPs or GPs re-sell their positions to alleviate liquidity needs both remain very interesting and potentially fertile hunting grounds for new investments.

The other two components that have contributed to anemic deal activity are, 1) the higher rate of post-Covid deals that took advantage of fiscal and monetary stimulus in the form of abundant debt and equity capital and low interest rates, and 2) the Fed's ongoing 4.25-4.50% base interest rate position today. The excess deal-making from Covid should now be considered exorcised from the pipeline, and the Fed's stance on higher rates – clearly driven by concern for the potential for inflationary effects from proposed/implemented tariffs – is beginning to soften.

On that last point, Fed Governor Waller has been out just recently in support of a rate cut at the July 30th meeting, as softening in private payroll figures and expected continued weakness in post-DOGE government hiring suggest that employment could show some cracks in the near future. While we don't expect a cut at the July 30th meeting, if the Fed moves to become more accommodative and borrowing rates come down as a result, it will help to solve the logjam by improving values and encouraging re-financing activity. For now, we watch and wait.

Summary

The second quarter had strong performance across asset classes as performance ramped up following delays in tariff plans led to lower implied risk and allowed investors to focus on fundamentals and growth. The extension of tax cuts removes a short-term worry from markets and allows for an emphasis on earnings to drive investor appetites for the rest of this year.

Within a balanced portfolio, we remain comfortable that exposure to lagging markets – international markets, small cap equities, non-Mag 7 stocks in general, multi-sector short-to-intermediate duration fixed income – represent good choices for fresh investment and rebalancing.

In private markets, while the green shoots are still minuscule, they are emerging. Since aspects of public markets are pricing in perfection in many respects, looking at dislocated segments of private markets still looks reasonable to us, with many available avenues to gain exposure. One in particular that has suffered from investor apathy is venture capital; exposures here with an emphasis on how artificial intelligence, robotics, and automation are going to transform markets and economies over the next 5-10 years is something to continue studying and understanding more deeply for clients. Expect to hear more from us on this point and the larger market environment in coming updates and letters.

We look forward to speaking with many of you soon!

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