



**OPTIMUM**  
Global Asset Management

# Financial Outlook

## Third Quarter 2025

### Summary

› Point of View	2
› Bond Markets	3
› U.S. Equities	6
› Our Team	8

## At a Glance

- The S&P 500 staged a surprising rally in Q2 to a new all-time high, led by Information Technology
- The tariff freeze will expire on July 9
- Financial markets appear unconcerned about economic, political and geopolitical issues
- The market now expects the FED to cut rates by between 50 and 75 basis points by the end of the year with more cuts in 2026
- We expect a slow-down in the US economy in the second half of 2025

The information and opinions presented in this report were prepared by Optimum Quantvest Corporation (OQC) and are intended strictly for informational purposes only. Views expressed in this presentation are solely the opinions of the investment professionals at OQC and are subject to change at any time without notice. The information in this document may not be reproduced in whole or in part without the express written permission from OQC. The external sources used in compiling this report have been deemed reliable by OQC, however, we do not assume to reconfirm their absolute accuracy and limitations. Market data presented is provided by third party and OQC is not responsible for any errors or omissions in the data. OQC is a Registered Investment Adviser invests in many of the securities, security types, sector and/or industries discussed in this presentation. The information contained within this report does not constitute investment advice or guidance. Additionally, it should not be utilized as the singular basis for investment decisions.

# Point of View

Jan Erik Warneryd, CFA, Chief Investment Officer



The second quarter of 2025 turned out differently from what would have been expected by an investor who had just looked at the new information surfacing during the quarter. Higher tariffs, increased geopolitical risks with the US attacking Iran, projected increases in the government budget deficit, and a slower anticipated pace of rate cuts from the Federal Reserve (FED) would all point to a weaker equity market, but instead the S&P 500 rallied by almost 11% in Q2 2025. This somewhat surprising move looks even more so in the light of the strong US market outperformance compared to other major markets seen in the last 15 years or so.

Given the strong performance of US equities lately, the theme of “American Exceptionalism” would appear to still be valid, but a closer look at how other major markets around the world have performed so far in 2025 gives some perspective. In US dollar terms, the German DAX index is up 36%, the Hang Seng in Hong Kong is up 19% and the Bovespa in Brazil is up 30%. The US equity market is starting to lag other markets in what could be the beginning of a period of relative underperformance that could last for a number of years. Many investors may have forgotten that there was a time, most recently in 2007, when the US equity market had a lower Price/Earnings ratio (14x) than the MSCI Emerging Markets Index (18x). In 2007, the market clearly thought that growth prospects in Emerging Markets were superior to those in the US. It is no exaggeration to say that, at the beginning of this year, the market consensus was the opposite of that. Investors who have followed the markets over many decades know that periods of outperformance often are followed by underperformance.

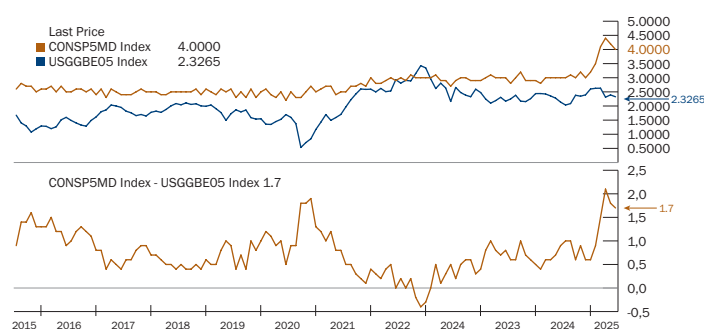
The potential triggers for US underperformance are several. They include big-picture issues such as the future income distribution between Capital and Labor and the impact on US growth from higher real interest rates to more immediate questions about tariff and fiscal policies. Ultimately, anything that threatens the ability of the US economy to grow at 2.5-3% annually could cause US investment returns to lag the rest of the world in the next few years, given the high expectations embedded in today's market valuation.

Currently, the market appears mostly focused on short term issues such as the potential for more easing by the FED. They are now expected to cut rates by an additional 50 to 75 basis points in 2025, followed by another 75 basis points in 2026, taking the Fed Funds rate down to about 3%. Note that the expected pace of rate cuts is now slower than that expected in early April, when the market thought the FED would ease by more than 100 basis points by the end of 2025. The S&P 500 has risen by about 25% since then, presumably on optimism about tariffs ultimately being less of a problem than initially feared.

Recently, FED Chairman Jerome Powell has indicated that the Federal Open Market Committee, the rate-setting part of the FED, is waiting for more clarity on the inflationary effects of President Trump's tariff policies before committing to rate cuts. The market is hoping that the inflationary impact will be minimal and therefore give the FED the green light to cut again. The equity market seems to take solace in this scenario as well, seemingly without

worrying about who will bear the cost of the tariffs. If increased costs aren't passed on to consumers in the form of higher prices, then presumably margins will be under pressure, resulting in lower earnings for affected companies. For an illustration of how consumers view the inflationary environment going forward, the chart below shows 5-10 year inflation expectations according to the University of Michigan Survey versus the 5-year market-based inflation (CPI) expectations implied by pricing of TIPS (Treasury Inflation Protected Securities).

Consumer vs. bond market inflation expectations



Source: Bloomberg and Optimum Quantvest

As can be seen above, the general public appears much more worried about inflation than the financial markets. The market's inflation forecast has averaged just over 2% except for a drop in 2020 followed by a temporary spike in 2022, whereas consumer expectations have tended to run a bit higher while staying remarkably stable until the beginning of 2025. In what could be a worrying sign for the FED, it appears that there has been a significant change in where the US public sees inflation heading over the medium term.

Economic data have lately started to show weakening in consumer demand as declining sentiment and uncertainty is starting to impact decisions. A slowdown in housing and car sales appear to be under way and this is happening even before we've seen the full impact of the coming import tariffs. Under the relatively calm surface of the US economy, fractures are starting to appear in credit markets, including higher delinquency rates on auto loans and credit cards as well as anecdotes from the world of Leveraged Finance about highly indebted borrowers increasingly being unable to service their debt.

Given the continued uncertainty around major policies and heightened geopolitical tensions, we expect economic activity to slow gradually over the next several quarters. While the US economy is likely to avoid a recession, investors may well be disappointed that the pace of GDP growth falls well short of current market-based expectations.

# Bond Markets

Mark McDonnell, Senior Portfolio Manager



## May You Live in Interesting Times

The second quarter of 2025 met that criteria and then some. The United States economy and markets were hit with the specter of tariffs, war, and looming deficits. Through all that risk assets closed the quarter at or near all-time highs. Risk assets were saved by the last month of the second quarter as two of the three threats were mitigated. As shown in the following chart, the 3-month return for the Bloomberg Aggregate Index was 1.21%, saved from negative returns by the 1.54% return earned in June. Looking at the returns of the corporate bond market, one can see the excess return of 0.46% for June pushed the year to date excess return positive by 0.28%. Lastly, one can see that the 3 to 7-year sector of the bond market was the overwhelming contributor with the maturities past ten years negative for the quarter. We will look at the reasons for this by first examining the moves in the US Treasury market and then dissecting the corporate credit market that trades atop the underlying Treasury curve.

### Bloomberg aggregate index returns

	Number Issues (Returns)	Returns Mod Adj US Dur	Daily Total Return	MTD Price Return	MTD Coupon Return	MTD Other Return	MTD Total Return	Since Inception Tot Ret	Index Value	Inception (or Start) Date	Currency	Return Type
U.S. Aggregate	13,841	6.00	0.36	1.20	0.32	0.02	1.54	2,177.06	2,277.06	1/1/76	USD	Unhedged
Intermediate	10,304	4.36	0.24	0.95	0.30	0.03	1.28	2,029.04	2,129.04	1/1/76	USD	Unhedged
Quality												
Aaa	1,762	4.18	0.24	0.80	0.31	0.00	1.11	285.65	385.65	1/1/93	USD	Unhedged
Aa	3,557	5.86	0.33	1.12	0.29	0.03	1.44	343.52	443.52	1/1/93	USD	Unhedged
A	4,040	6.75	0.50	1.47	0.38	-0.00	1.85	398.89	498.89	1/1/93	USD	Unhedged
Baa	4,482	6.66	0.43	1.53	0.41	-0.00	1.94	519.95	619.95	1/1/93	USD	Unhedged
Maturity												
1-3 Yr	3,244	1.80	0.09	0.38	0.27	0.00	0.64	202.90	302.90	1/1/93	USD	Unhedged
3-5 Yr	2,999	3.53	0.19	0.75	0.30	0.01	1.06	279.05	379.05	1/1/93	USD	Unhedged
5-7 Yr	1,847	4.94	0.27	1.11	0.30	0.01	1.42	312.77	412.77	1/1/93	USD	Unhedged
7-10 Yr	2,152	6.56	0.38	1.46	0.35	0.06	1.87	376.31	476.31	1/1/93	USD	Unhedged
10+ Yr	3,599	12.53	0.80	2.23	0.36	0.03	2.62	481.93	581.93	1/1/93	USD	Unhedged

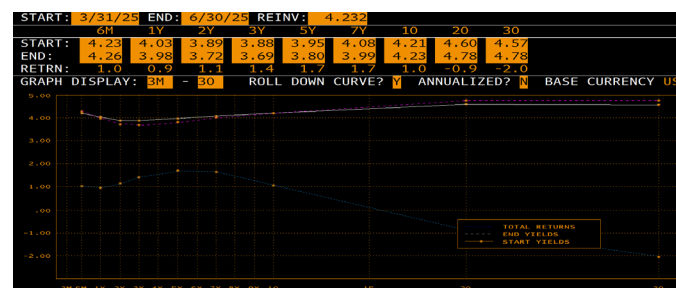
Source: Barclays for Bloomberg LLP

## Twin Deficits and the End of American Exceptionalism

The United States runs twin deficits that are linked. We spend more than we take in with tax revenues resulting in a *budget deficit* of about 6.5% of GDP. We import more than we export, resulting in a *trade deficit*. We have sustained the unsustainable for a number of reasons. Our bond market is the deepest and most liquid bond market in the world. The US dollar is the reserve currency of the world. Our equity market is over-owned by foreign participants by most measures. In part, this was due to vendor financing. China would manufacture finished goods and, due to the trade imbalance, accumulate US dollars. Rather than sell them, driving up their currency and on the margins making China less competitive, China would invest in Treasuries. Thus, a combination of factors, deep liquid markets, tremendous innovation, and vendor financing worked to allow twin deficits to continue. However, we need that multitude of factors held under the loose term American Exceptionalism to continue if we want to run the twin deficits. At the beginning of the year, market participants began to opine about the end of American Exceptionalism. The markets started to price in the end of that American Exceptionalism in the first quarter and it accelerated on Liberation Day. The US dollar weakened, though mainly against

the Euro, equities swooned and interest rates rose. The US Treasury market can be broken into a number of maturity buckets but for now we'll focus on a simple model; shorter than ten years and longer than ten years. As mentioned before, the intermediate maturities from 3 to 7 years performed the best during the second quarter. The long end performed the worst as rates rose in what bond market participants call a *Steepening Trade*.

### U.S. treasury returns



Source: Bloomberg

Broadly speaking, the shorter end of the bond market reacts to expected changes in the Federal Funds rate both at the next meeting and for several years into the future, the longer end is focused on inflation and deficits. Larger deficits mean more bonds need to be sold. At the beginning of the year, the market priced in 3 cuts for 2025 starting around June or July. Now, the markets are pricing in only two cuts this year with further and deeper cuts in the future. Here we see a rise in the yields of shorter maturities but lower yields in the intermediate or belly of the curve. However, the long end sold off as rates rose. There are two reasons for the steepening of the curve; impending inflationary pressures and the end of American Exceptionalism. Tariffs are inflationary; they may be temporary or may be persistent but some inflation should be expected. Yet in the days immediately after Liberation Day the curve flattened. Much had been priced into Liberation Day. When that over-subscribed steepener had been unwound long end rates rose markedly through May, peaking around the time Treasury Secretary Bessent flew to Japan to discuss their bond selloff. While George Soros is widely credited with breaking the Bank of England, the trade itself is widely ascribed to his underling, Scott Bessent.

Putting it all together, Treasury Secretary Bessent famously describes himself as the world's best Treasury Salesman. He is quite vocal about where he wants the 10-year note to settle in, at around 4%. He also speaks quite openly about having a very large toolbox. He has the knowledge, skills, and position to effect changes. Japan's bond selloff was historic as long rates rose to multi-decade highs. After Bessent visited Japan, they reduced their issuance of longer JGBs and the selloff both in Japan and our long end subsided. As we have seen in the past with Treasury Secretary Hank Paulson, there is a willingness to use a "Big Bazooka" should market fundamentals extract too large a toll on the present economy.



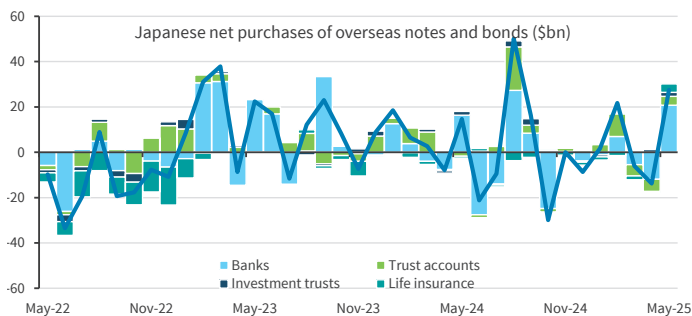
# Bond Markets (cont'd)

Mark McDonnell, Senior Portfolio Manager



The end of American Exceptionalism did not go as planned, at least if one defines it as a reversal of flows that fund our twin deficits. While there has been a reduction in US holdings of Treasuries on behalf of other central banks, data supports a rebound in investment flows for bonds in the subsequent months after an awful Liberation Day inspired repatriation. For example, Japanese Life Insurance companies resumed purchases of longer dated corporate bonds.

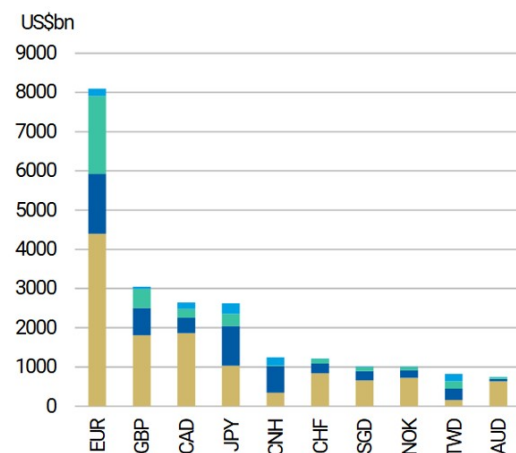
Japanese purchases of foreign bonds by investor type



Source: Japan MoF, Barclays Research

Returning to the weakness in the dollar and reminding the reader that said weakness has mainly been against the Euro, we note that the overhang of investments in the Eurozone is less of an issue for Treasury investors, somewhat less for corporate bond investors as unhedged yields on 5-year maturity debt still favors the United States. However, equity investors' attention should be drawn to that currency.

Ten largest holders of US securities



Source: US Treasury, Haver Analytics, Morgan Stanley Research

Should there be an end to American Exceptionalism in markets? Should the repatriation trade happen? That's open for debate. Has it happened? That isn't supported by the data.

## Whistling Past the Graveyard

Corporate bonds are evaluated based on a spread over comparable Treasuries. The spread is simply the additional yield one asks for above the risk-free Treasury rate. There are a host of factors that corporate bond investors must weigh in the determination of whether that spread is adequate. What does the future look like for the company's earnings and ability to service the debt is an easily understandable metric. That in turn is both idiosyncratic, will that company execute on its business plans, and systemic, are we heading into a recession. These are just two of a multitude of factors. But changes in either one will result in changes in the spread over Treasuries. If company A trades at a yield of 5% and the underlying Treasury yields 4%, that 1% might assume an economy that is facing no recession for the foreseeable future. If spreads remain unchanged, at 1% over the Treasury you earn that 1% or as we call it, the carry. Should the economy take a downturn, that spread should expand as investors demand more compensation as the business risks increase. That increase in spreads results in an underperformance of that corporate bond relative to its Treasury peer. Conversely of course, should spreads tighten the bond will outperform its maturity matched Treasury. We view those changes in spreads as excess return. Should spreads tighten, then the excess return is positive and the opposite is true as well, both netted against the carry. The following chart shows this excess return over each month this year. As you can see, for the first few months of the year through Liberation Day spreads widened, resulting in negative excess returns. After that, corporate bonds performed *better than* their corresponding Treasuries.

Bloomberg aggregate index total and excess returns



Source: Bloomberg

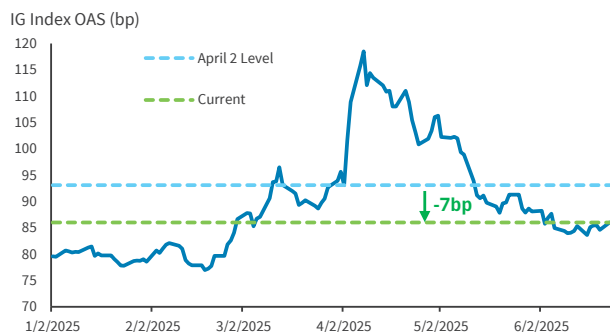
The second quarter was marked by credit spreads moving in sharply after an initial Liberation Day spike, closing 7 basis points tighter, despite information being considerably worse than expected. Therefore, it couldn't already be reflected in spreads.

# Bond Markets (cont'd)

Mark McDonnell, Senior Portfolio Manager



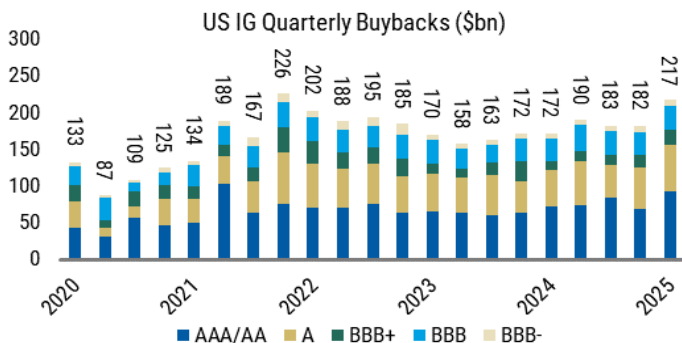
Spreads are inside Liberation Day levels



Source: Bloomberg, Barclays Research

In fact, most widely watched metrics like gross and net leverage deteriorated modestly in the beginning of the year as well as cash on corporate balance sheets, which was put to work by companies mainly to fund buybacks of equities. The cash levels are nowhere near alarming levels. However, as bondholders, we find that particular use of cash to be troubling. Bondholders should not be sanguine when CFOs believe the best use of cash is to prop up equity earnings multiples via buybacks.

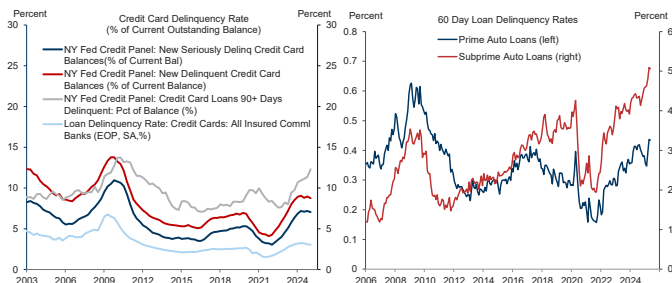
Quarterly buybacks increased sharply in 1Q25



Source: Bloomberg, Morgan Stanley Research

Economic data is on the margins starting to weaken and we are paying particular attention to delinquencies.

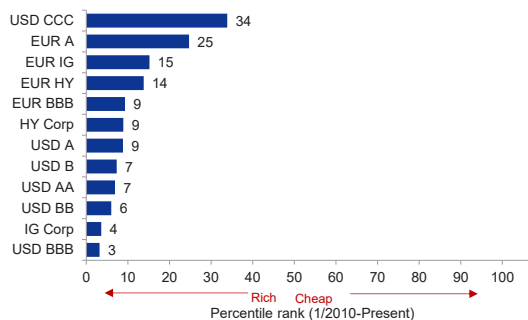
Credit card delinquency rate / 60 day loan delinquency rates



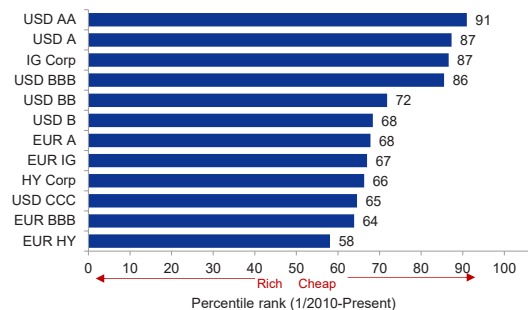
Source: Federal Reserve Board, US Federal Reserve Bank, Goldman Sachs Global Investment Research

If credit metrics are moderately worse, not better, and the consumer is starting to show strains as evidenced by rising delinquencies, how does one explain credit spreads as tight as they are? We believe it is a continuation of a trend we saw several quarters ago; investors buying yield, regardless of the spread to underlying Treasuries. We see this in the flattening of credit curves, longer dated corporate debt from the same company performed better than shorter dated issues as fundamentals deteriorated slightly. This is probably driven by Liability Driven Investment, LDI which looks to lock in yields for pensions and insurance companies while they still can.

In both the USD and EUR, valuation constraints are again binding for spreads



But the yield support provided by the USD market is stronger



Source: Bloomberg, iBoxx, ICE-BAML, Goldman Sachs Global Investment Research

## STRATEGY

We see a slowing in hard data and headwinds for the consumer. Real wage growth, wage growth adjusted for inflation has slowed. Lower income earners face additional challenges as programs that boosted disposable income are sunseting. Therefore, we are reinforced in our belief and positioning of a modest underweight in credit. We offset that loss of current yield to some extent with an overweight in mortgage-backed securities. We are longer than index in duration as the potential exists for a more aggressive series of cuts than are currently priced.

# U.S. Equities

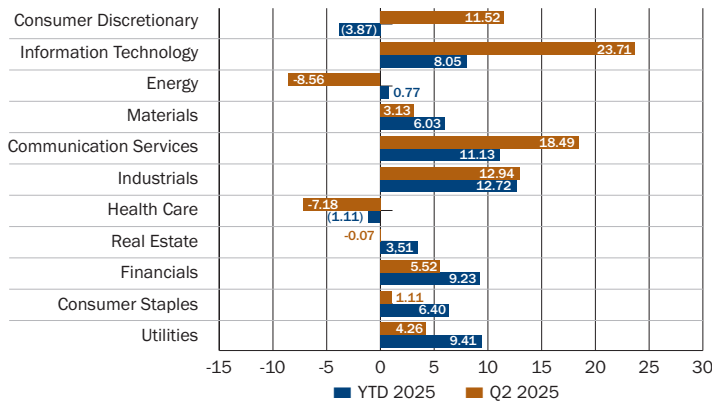
Jan Erik Warneryd, CFA, Chief Investment Officer



In the second quarter of 2025, the S&P 500 had a roller-coaster ride as the first few weeks in April were dominated by fears of what the new tariffs presented on “Liberation Day” (April 2) would mean for the economy and the markets. From March 31 to April 7, the S&P 500 fell almost 14%, only to recover and end the quarter up 10.94%. Year to date, the S&P 500 is up 6.20%. Large-cap momentum stocks dominated returns once again, with Information Technology and Communication Services the leading sectors. Energy and Health Care were the worst performing sectors, down -8.56% and -7.18%, respectively.

## S&P 500 Index

Total return (%) by sector - quarter end June 2025



Source: Optimum Quantvest and S&P Global

The positive performance in Q2 is somewhat puzzling given that many of the issues that led the market lower earlier in the year remain unsolved: the 90-day tariff freeze will expire on July 9, higher inflation may still be in the cards and questions persist about FED policy and how the economy is doing underneath the trade-driven quarter-on-quarter volatility.

A possible explanation would be that the market is taking solace from the fact that there appears to be no fiscal tightening planned by the Trump administration after the largely abandoned DOGE effort to save as much as \$2 trillion in annual spending. If one believes that fiscal (over)spending, especially starting around the time of the Pandemic in 2020, has been one of the main drivers of the bull market in US equities, then it appears reasonable that the outlook for continued spending would be a benign backdrop for the market going forward. The administration now seems to believe that any improvement in the annual budget deficit will come from higher GDP growth resulting in higher tax revenue, rather than from any cutbacks in net spending. A further supportive factor for the equity market is the weak US dollar. The Bloomberg US Dollar Index is down about 9% so far in 2025, providing an earnings tailwind for US exporting companies.

What the previous explanation fails to take into account is how stretched the valuation of the S&P 500 has become. The chart below shows a measure of the Equity Risk Premium defined as the spread in percentage points between the inverted CAPE (Cyclically Adjusted Price/Earnings, also known as the Shiller P/E) ratio and the real yield on 10-year TIPS (Treasury Inflation Protected Securities).

## Equity risk premium (CAPE earnings yield vs. TIPS)



Source: Bloomberg and Optimum Quantvest

As we can see, the current risk premium of about 96 basis points is, thanks to lower bond yields, slightly higher than just a few weeks ago, but still among the lowest since 2002. This means that the forward-looking return from US equities is likely to be significantly lower than at any time in the last 20 or so years. The period of relative “cheapness” of US equities after the 2008-09 Global Financial Crisis is long since over and equities are now in potentially dangerous territory from an ex-ante return perspective.

Market expectations for corporate earnings growth continue to be very optimistic. While 2025 earnings growth estimates (Thomson Financial Consensus EPS Estimates), currently at 7.5% year-on-year, have come down lately, for 2026 analysts now expect earnings growth of 14.1%. As mentioned previously, many potential headwinds persist, and the current market valuation leaves very little room for disappointment. In our other piece, “Our Point of View”, we mention that many other equity markets globally have outperformed the US so far this year, especially on an unhedged currency basis. Even after this relative outperformance, with for example the German DAX index up about 36% in 2025 in USD terms, most international markets are still trading at lower valuations than the S&P 500.



# U.S. Equities (cont'd)

Jan Erik Warneryd, CFA, Chief Investment Officer



## STRATEGY

The US economy is likely to slow as tariffs raise the cost of imported goods to businesses and consumers. The effect of higher prices will be widespread since even domestic manufacturers have a significant import content in their products. There is almost no such thing as an “American-made car,” for example. Parts are sourced globally and now that President Trump has, in effect, cancelled the MCUSA free trade agreement, supply chains that included Mexico and Canada have been severely disrupted. The impact on earnings is unclear at this point, but it seems reasonable to assume that the cost of the tariffs will be shared between consumers and producers and possibly partly absorbed by exporters to the US. Whatever the split looks like, profit margins are likely to be under pressure and inflation should be higher than otherwise. This backdrop is likely to put a damper on market sentiment in the second half of 2025.

We believe a more cautious tone in the US equity market will eventually lead to a change in leadership in favor of sectors that have lagged the multi-year equity rally. Cyclical and Value sectors such as Financials, Health Care, Utilities and the Telecom sub-sector could outperform the overall market if large-cap technology related stocks give up their leadership. The timing of this shift in leadership has been difficult to predict but the catalyst could be a likely economic slow-down coupled with ongoing uncertainty about future Washington policy.

The high valuation for US equities after the strong performance in the last few years makes it more likely that recent policy changes and general uncertainty will act as a catalyst for more subdued performance going forward.

# Our Team



**Jan Erik Warneryd, CFA**  
Chief Investment Officer  
Telephone: 469 802-8493  
[jwarneryd@optimumquantvest.com](mailto:jwarneryd@optimumquantvest.com)



**Mark McDonnell**  
Senior Portfolio Manager  
Telephone: 469 794-0011  
[mmcdonnell@optimumquantvest.com](mailto:mmcdonnell@optimumquantvest.com)

## OPTIMUM QUANTVEST CORPORATION

We take a different approach to traditional US fixed income and equity investing by using a combination of macroeconomic and fundamentally based analysis. With a track record of over 30 years, we have assisted pensions, insurance companies, corporations, endowments, foundations and high-net worth individuals with their investment needs. Our approach to investing combines a macroeconomic perspective with an inherent value bias. We collaborate with our sister companies in Montréal and Paris to enhance our analysis of the markets. While our expertise is investment management, becoming a trusted partner and advisor defines our purpose.

Optimum Quantvest Corporation is a subsidiary of Optimum Group, a private and diversified financial group with international operations.

### OPTIMUM QUANTVEST CORPORATION

📍 1345 River Bend Drive, bureau 100  
Dallas, TX 75247, U.S.A.  
☎ +1 263 381-5677  
✉ [info@optimumquantvest.com](mailto:info@optimumquantvest.com)

To subscribe to a quarterly distribution list for our Financial Outlook report, please email a request to [info@optimumquantvest.com](mailto:info@optimumquantvest.com) or call us at 263 381-5677. We would be pleased to send it to you personally.

 [optimumgam.com](http://optimumgam.com)

**OPTIMUM.**

® Trademark of Optimum Group Inc. used under license.