

Dear friends of Arcus Capital Partners,

We hope this letter finds you well. The second quarter of 2025 was defined by historic volatility and significant shifts across markets and the economy. After a sharp early-April selloff triggered by the Trump administration's sweeping tariffs, equities staged a powerful rebound, led by strong corporate earnings and improving trade relations. While valuations remain elevated—posing risks if earnings slow or multiples compress—investor positioning remains supportive for further near-term gains, though strategic headwinds suggest a challenging decade ahead for U.S. equities. Bond markets saw extreme swings, with long-duration Treasuries ending lower amid inflation concerns and tariff-related uncertainties, while short-term rates priced in a high probability of Fed cuts by year-end. Commodities delivered mixed returns, with precious metals surging on a weaker dollar and rising inflation fears, while energy and soft commodities were volatile. Overall, cautious optimism prevails, with key risks hinging on tariff developments, inflation dynamics, and monetary policy decisions as the market navigates this complex environment.

### I. Market & Economic Overview

The second quarter of 2025 was marked by historic volatility and significant macro shifts. The quarter opened with a dramatic selloff triggered by the Trump administration's announcement of sweeping global tariffs—many exceeding 50%, with some surpassing 100% on Chinese imports. This shock sparked a 12% market decline in early April, followed by a historic rebound once the administration paused tariff implementation.

This initial volatility gave way to a series of supportive developments: a conciliatory trade stance from global leaders, sharp reversals in U.S.

fiscal and foreign policy, and strong market breadth signals. These factors culminated in a Zweig Breadth Thrust on April 24—a historically potent bullish indicator for equities.

Geopolitical risks resurfaced in June, when Israel and Iran engaged in a brief but intense military conflict. A U.S. strike on Iranian nuclear facilities on June 21 appeared to be the conflict's climax, yet the market largely shrugged off the event amid limited fallout.

Domestically, the economic picture evolved rapidly. Q1 GDP, reported during the quarter, was revised down to -0.5%. However, Q2 rebounded sharply, with the Atlanta Fed's GDPNow estimate finishing the quarter at 2.9%. The unemployment rate remained steady at 4.2% throughout.

Inflation continued to moderate: Core CPI rose by 0.1%, 0.2%, and 0.1% in April, May, and June, respectively. Headline CPI annualized at 2.4%, 2.3%, and 2.4% over the same months. Despite easing inflation, the Fed kept rates steady at 4.25%, citing uncertainties related to tariffs, labor market disruptions, and pending legislation. By quarter-end, however, markets were pricing in a 90% chance of at least two rate cuts by year-end—and a 60% chance of three.

**The administration's pivot in mid-April—from attempting to deliberately pressure equities to lower interest rates toward a strategy focused on outgrowing the debt—helped fuel the Q2 economic rebound. However, persistent weakness in consumer metrics, including personal income and spending, along with softness in the housing sector, could temper the recovery's momentum. For now, a recession appears unlikely, but the trajectory in Q3 will hinge on developments around**



**tariffs, interest rates, and commodity-driven inflation, any of which could shift the outlook.**

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## II. Global Equities

Equities staged a powerful recovery following the early-April selloff. The S&P 500 rallied 10.8% in Q2, lifting year-to-date gains to 6.1%. The Nasdaq 100 surged 17.8% in the quarter and 8.2% YTD. Meanwhile, the Russell 2000 climbed 8.5% in Q2 but remained down 1.9% for the year.

However, the breadth of the rally faded toward quarter-end, with the equal-weighted S&P 500 rising just 5.3% in Q2. Still, strong corporate earnings and supportive liquidity helped sustain elevated sentiment. Market internals improved through May amid progress in U.S.–China trade talks, with global equities participating broadly.

Valuations remain elevated across the board. By some measures, they reached their highest levels in at least 75 years, if not all-time.

At quarter-end, the market was pricing in both an aggressive forward multiple and robust earnings growth. Consequently, any multiple compression or slowdown in earnings growth could pose significant downside risk in the second half of the year.

**From a positioning standpoint, institutional investors remain more bullish on equities relative to retail investors. Historically, such a dynamic tends to support further market rallies until the balance shifts. Accordingly, we maintain a tactically bullish stance in the near term. However, from a strategic perspective, equities appear poised for a lost decade, with forward returns and risk premiums expected to be as compressed as during the dot-com era. In contrast, non-U.S. equities offer more attractive prospects over the coming decade, supported by more favorable valuations, stronger demographics, and better growth outlooks.**

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## III. Fixed Income

Bond markets experienced extreme volatility in Q2. Long-duration Treasuries ended the quarter down 2.0%, despite intra-quarter swings ranging from +5% to -7%. Early April saw a flight from U.S. assets as tariff-related inflation fears and capital outflows triggered a sharp selloff. The 30-year Treasury yield briefly spiked to 5%.

Toward quarter-end, bond sentiment improved modestly. Yet, even as inflation continued to moderate, longer-term rates struggled to sustain any meaningful declines. The 10-year yield finished the quarter at 4.24%, essentially unchanged from its 4.23% starting point.

Investors remain cautious about the inflationary risks posed by tariffs and the administration's stated goal of running the economy "hot."

At the short end, despite the Fed's stated lack of urgency to lower rates, markets priced in a 90% probability of at least two 25-basis-point rate cuts—and a 60% chance of three or more—by year-end.

Credit spreads, a key gauge of the corporate bond market, tightened significantly in line with the quarter's broadly "risk-on" sentiment.

By quarter-end, the Fed appeared to be in a wait-and-see stance regarding tariff-driven inflation. Given the economic and market rebound, the Fed's current policy does not seem meaningfully restrictive. Therefore, barring a weakening labor market, we expect the Fed to remain on hold until clearer data on tariff passthrough emerges.

**Given the fragile U.S. fiscal situation, policymakers are unlikely to tolerate a sustained rise in long-term interest rates, as that could destabilize the system. Consequently, with long-duration bonds priced richly relative to the secular environment—one characterized by persistent inflation over years—they are likely to deliver negative real returns throughout this cycle. For these reasons, we favor shorter maturities and inflation-protected securities.**

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## IV. Commodities

The commodity complex delivered a mixed performance in Q2. Precious metals led the pack, supported by a weaker dollar, which fell 7% during the quarter. Gold miners surged 13.2%, while gold itself gained 5.3%. Silver rose 3.1%, and platinum soared 31.0%.

Crude oil prices declined late in the quarter after an initial spike amid Middle East tensions. WTI ended down 2.3%, and Brent fell 7.3% for the quarter. Natural gas plunged 31.3%, dragging the broad commodities index down 3.2%.

Soft commodities and grains were volatile. Coffee dropped 17.1%, sugar fell 18.2%, and corn declined 9.6%, while cocoa (+22.0%) and oats (+22.9%) were notable outperformers.

The dollar's weakness in Q2 initially reflected global investors' waning confidence in U.S. policy amid the unpredictable tariff rollout under the Trump administration, triggering selloffs in both the dollar and U.S. Treasuries. Following the tariff pause and a return of risk appetite, the dollar continued its downward drift, aligning with easing financial conditions.

Gold reached a quarterly high near \$3,500, underscoring its resonance with the prevailing secular macro environment. We contend that U.S. equities are in a secular bear market driven by persistent high inflation—where equities will only keep pace with inflation over the cycle, while commodities, particularly precious metals, are poised to significantly outperform.

In Q2, we observed nascent breakouts across the precious metals complex. Gold miners, silver, platinum, and palladium all breached prior resistance levels, ending the quarter near their highs.

**We believe commodities have been in a secular bull market since crude oil briefly turned negative in April 2020. The past three years served as a consolidation phase following an extraordinary near-300% rally over 26 months**

**(April 2020 – June 2022). Commodities appear to be forming a rounded bottom and beginning a gradual ascent. We expect the next leg of their secular bull market to intensify in the coming quarters.**

## V. Looking Ahead

The macro environment remains complex, with the administration likely to sustain strong stimulus through deficit spending while continuing to pressure the Federal Reserve to lower interest rates. We remain agnostic on recession risk; certain sectors like manufacturing have likely experienced recessionary conditions for some time, while others such as housing may be entering one now. However, the overall economy still shows signs of growth. Market valuations are elevated and pose significant risks that could weigh on sentiment once institutions shift toward a more bearish stance relative to retail investors. We expect volatility to rise over time as valuations become a focal point for investors.

Within equities, technology remains a favored sector but much of the future growth appears priced in. Challenges around monetizing AI and the likely emergence of only a few dominant players contrast with the broad premium currently applied across the sector. The secular environment favors energy, materials, and gold miners over other market segments.

Long-duration Treasuries face an unfavorable backdrop and are likely to deliver negative real returns over the cycle, especially if the Fed is ultimately forced to enact yield-curve control to suppress long-term rates to prevent bond market dysfunction. Consequently, we prefer shorter-term Treasuries and inflation-protected securities for their relative stability and inflation resilience.

We view commodities as being in a secular bull market that began after oil's unprecedented negative pricing in April 2020. Following a multi-year consolidation phase, commodities may be poised to enter the next leg higher, led by precious metals, which align closely with current macro and



geopolitical conditions. A weakening U.S. dollar is likely—driven by the necessity to ease financial conditions, support debt sustainability, and promote trade rebalancing and reindustrialization. Efforts by the Trump administration to counter the BRICS’ moves to circumvent the dollar may end up accelerating this trend.

Geopolitical risks remain elevated, with the potential for major conflicts adding further uncertainty. Inflation is expected to continue surprising to the upside, complicating the policy outlook.

Overall, we maintain a cautiously optimistic stance, advocating patience and selective positioning in sectors and assets aligned with these secular themes.

As always, we are available to discuss these topics and address any questions. Thank you for the trust you have in our firm.

Sincerely,

**Arcus Capital Partners**

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### **Important Risk and Disclosure Information**

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