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2025 Mid-Year Capital Markets Update

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Contents

Executive Summary

2025 began with broad optimism for economic growth, particularly in the US, despite impending tariffs as well as other economic policy changes.

Yet, in the first quarter, US stocks suffered relative to non-US. Optimism further turned to unease in April, as the US stock market fell significantly following the “Liberation Day” tariff announcements. Since then, equity markets have recovered and reached new heights, though current geopolitical events in the Middle East, tariff uncertainty, the US fiscal position, and other potential risks remain.

We are making two changes to our near-term sentiment:

- We are moving our near-term sentiment on US stocks (and consequently also global stocks, of which the US is the largest component) from Neutral/Positive to Neutral. We believe that US market strength (sometimes referred to as part of “American exceptionalism”) is being tested but has not departed. We are recommending that clients remain with a target of 70% of their total public equity investments allocated to the US.
- We are moving our near-term sentiment on private equity to Neutral from Neutral/Positive, while recommending that clients continue to initiate and build investments in the space. Persistent higher interest rates and economic and policy uncertainty have weighed on private equity, with a difficult exit environment for portfolio investments. Private equity remains a key tool in helping portfolios with long time horizons meet growth objectives.

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Near-Term Sentiment Overview

Asset Class/Segment	3Q 2025 Near-Term Sentiment	1Q 2025 Near-Term Sentiment
Global Equities	**Neutral**	**Neutral/Positive**
US	Neutral	Neutral/Positive
Non-US Developed	Neutral	Neutral
Emerging Markets	Neutral	Neutral
Global Fixed Income	**Neutral/Positive**	**Neutral/Positive**
Short-Term U.S. Bond	Neutral	Neutral
Core U.S. Bond	Neutral/Positive	Neutral/Positive
Core Plus U.S. Bond	Neutral/Positive	Neutral/Positive
Non-US Developed Bond	Neutral	Neutral
Emerging Markets Bond	Neutral	Neutral
Real Estate	Neutral	Neutral
Commodities	Neutral/Negative	Neutral/Negative
Private Infrastructure	Neutral/Positive	Neutral/Positive
Hedge Fund Strategies	Neutral	Neutral
Private Equity	Neutral	Neutral/Positive
Venture Capital	Neutral	--
Private Debt	Neutral/Positive	Neutral/Positive

Mid-Year Themes

In the pages ahead, Syntrinsic's Investment Solutions team has produced four related pieces to contextualize the issues we see materially impacting markets in the months ahead.

Research Analyst Eli Davidoff, in his piece **"Dampened but Resilient Economic Growth,"** highlights the turbulent waters of economic uncertainty that emerge from persistent trade conflicts and the far- reaching ramifications of geopolitical crises, both on the global stage and within the United States. These pressures have reduced GDP growth forecasts and increased inflation predictions. Despite some resurgence in consumer confidence, the effects of diminished GDP growth and rising inflation continue to exert pressure on the economy.

Senior Analyst Jas Chen, CFA, in **"US Exceptionalism Tested Under Heightened Uncertainty,"** revisits expectations for global equities amid evolving macro conditions and policy dynamics. Sustained trade tensions, elevated policy uncertainty, and shifting foreign capital flows have weighed on US equities, contributing to the relative outperformance of non-US markets year to date. Diverging monetary and fiscal policy paths across regions, ongoing trade developments, and rising geopolitical risks have also lowered expectations for global growth. The US economy continues to show signs of resilience—for now—even with the perceived risk overhang. On balance, expectations for US exceptionalism are moderating, as economic, policy, and geopolitical developments unfold.

Regarding the US fixed income market, Robin Meyer, CFA, and Eli Davidoff, in their piece **"Bond Investors Navigate Choppy Waters"** report on the overall health of fixed income markets and current opportunities and risks. They also discuss the state of US monetary policy under the first few months of the new administration, with emphasis on the US Federal Reserve's dual mandate of price stability and maximum employment.

Finally, Senior Research Analyst Matt Kukla and Analyst Aaron Thammathi, in **"The Effects of Policy and Uncertainty on Public and Private Markets,"** discuss the aftermath of the "Liberation Day" tariffs on the economy as well as public and private markets with a particular focus on private equity and venture capital. They further note how the potential goals of tariffs to reduce the trade deficit, raise revenue to pay down national debt, bring back manufacturing to the US, and negotiate lower trade barriers and other concessions would not be easy to achieve, are in some cases conflicting, and would require a cultural change (increasing savings and reduced consumption) to return the US to trade surpluses.

We appreciate your confidence, welcome your questions, and look forward to our next conversation.

Sincerely,

Mike Sebastian
Head of Investment Solutions
Syntrinsic

Global Themes

Theme	Syntrinsic Perspective	Allocation Effects
Dampened but Resilient Global Economic Growth	Global expectations for GDP growth have diminished, while expectations regarding inflation have risen. In the United States, GDP growth forecasts have also been reduced, accompanied by an increase in inflation expectations. Consumer behavior has demonstrated resilience; however, current trends underscore the prevailing uncertainty concerning economic prosperity on both domestic and international levels.	• Keep a long-term perspective in public equities, focusing on a risk posture sufficient to meet return needs over multi-year periods, and minimizing unnecessary risk and cost in fairly efficient markets
US Exceptionalism Tested Under Heightened Uncertainty	US structural advantages (innovation, depth, resilience) remain, at least for now. Global trade and US fiscal position bear watching closely, while international equity markets are benefiting from a weakened dollar, continued valuation discounts, earnings strength, policy support, and trade realignments.	• Maintain 70% allocation to US equities within total public equities, given liquidity and depth of US capital markets, in line with typical US nonprofit portfolio exposure.
Bond Investors Navigate Choppy Waters	Treasury rates, credit spreads and volatility spiked post-tariffs, though have mostly moderated. The dollar has weakened, the US downgraded, and the Fed still hopes to cut rates. Bond market opportunities remain, and the focus is on US fiscal position and trade.	• Continue to pursue below investment grade bonds opportunistically through core-plus active portfolios • Stay on the course of moving out of dedicated short-term positions if and when 2025 US rate cuts begin
Economic Policy and Uncertainty Shake Public and Private Markets	Reductions in new tariffs and in-progress deals have helped public markets recover and thrive, though much policy and geopolitical uncertainty remains. Uncertainty weighs more on long-term-oriented private markets.	• Continue to initiate and grow allocations to private markets, with heightened focus on manager selection • Maintain a program of gradual investment over time (vintage year diversification) where drawdown vehicles are used in private market investments • Stay strategically focused through geopolitical events

THEME: Dampened But Resilient Global Economic Growth

ELI DAVIDOFF

The global economic outlook remains uncertain, due in large part to heightened trade tensions resulting from US tariffs. This situation has dampened growth expectations worldwide, including in the US. Real GDP growth from OECD member countries was 0.1% in the first quarter (down from 0.5% in Q4 2024) and 1.6% for the trailing one year (down from 1.9%), according to the Organization for Economic Co-operation and Development (OECD).

Focusing specifically on the United States, quarter-on-quarter GDP growth in Q1 2025 decreased to -0.1%, while year-on-year growth increased to 2.0%. These figures represent a significant deceleration from the preceding quarter, with year-on-year growth at 2.5% and quarter-on-quarter growth at 0.6% in Q4 2024. An increase in imports ahead of the tariff announcement drove much of the decrease.

The OECD's most recent economic outlook forecasts a slowdown in global real GDP growth for 2025. (The OECD outlook assumed that the tariffs as of mid-May would remain constant.) Similarly, global growth is anticipated to decline year-on-year to 2.9% from 3.3%. The principal factor behind this forecasted reduction in real GDP growth is, once again, the uncertainties surrounding trade policy. Real GDP growth for the United States is expected to diminish from 2.8% year-on-year to 1.6% for 2025.

The World Bank projects a 2025 global inflation rate of 2.9%, lower than 2024 but above pre-pandemic levels due to ongoing upward pressures from trade tensions and constrained labor markets. The global unemployment rate is 4.9%, the lowest level observed in data going back to 1991. Furthermore, the global jobs gap, which reflects the disparity between the labor force and the number of available employment opportunities, continues to diminish , signifying a strengthening trend toward reduced unemployment. Due to the tight labor market conditions, wage growth has been strong in some areas, escalating costs for businesses. Consequently, companies are obliged to raise prices to protect their profit margins, further exacerbating inflationary pressures worldwide.

Top-line unemployment remains healthy, but the aggregate level masks nuances impacting different age cohorts. Unemployment among the youngest group of workers, aged 16-24 years, is more than double the overall level. This is not entirely new, but the trend is worsening for younger workers. This group also does not yet include the most recent class of college graduates where anecdotal evidence suggests they face one of the most difficult hiring environments in recent history. While no single factor can be identified as the cause, it is unsurprising that macro uncertainty could at least put a pause on meaningful corporate investment spending and, specifically, corporate hiring plans. The US administration's immigration policies have the potential to affect labor market dynamics as a whole and certainly within service-based economies that have come under the focus of Trump's policies (i.e., sanctuary cities).

The United States has experienced disinflation (a decreasing rate of inflation) in recent months. However, the projected inflation rate for the United States for 2025 remains above the Federal Reserve's 2% target. The OECD anticipates a CPI figure in the United States of 3.2%, primarily due to businesses experiencing the repercussions of tariffs in the latter half of the year. In comparison, the International Monetary Fund (IMF) forecasts a 2.7% inflation rate for the United States in 2025. While this projection is lower than that of the OECD, it still represents a significant increase and a substantial divergence from the Federal Reserve's target.

In analyzing current inflation data alongside forecasts, it is essential to consider the impact of increased “front loading” by companies prior to the implementation of tariffs. Notably, current inflation metrics appear to remain stable, lacking indications of tariff-related costs reflected in the current rate of CPI in the U.S. However, both the OECD and IMF have incorporated tariff-related impacts into their inflation predictions, contributing to the anticipated increases by year-end.

Current consumer concerns prominently include inflation and escalating prices, alongside economic uncertainty stemming from trade barriers and tariffs. Despite these challenges, consumers are exhibiting a degree of resilience by adapting their spending habits, which involves "trading down" —that is, purchasing less and seeking value across various consumer segments. Additionally, there is a noticeable trend toward localism, particularly in preferences for US goods over foreign products. A JP Morgan forecast suggests that global consumer spending is anticipated to grow by 2.3% year-over-year by 2025.

US recession likelihood increased in the early part of 2025, particularly following the tariff announcements. More recently, this probability has diminished as trade negotiations have progressed favorably, especially following the United States' announcement of a trade agreement with China. Although challenges related to slower economic growth and rising inflation continue to affect the U.S. economy, the recent trade negotiations have mitigated the potential severe impact on recession likelihood initially anticipated from the tariffs.

At the time of this writing, a ceasefire is holding in Iran. This conflict has progressed so far without significant securities market impact, but as with other geopolitical events, future volatility may occur and we continue to recommend keeping a strategic focus.

THEME: US Exceptionalism Tested Under Heightened Uncertainty

JAS CHEN, CFA

At the start of 2025, our Capital Markets Forecast expressed a Neutral/Positive sentiment for global equities, driven largely by the continued expectation for "US exceptionalism" (resilient economy, innovation, higher growth). Our US outlook rested on expectations for moderating interest rates, attractive corporate earnings, and structural advantages in technological innovation, particularly within artificial intelligence. Since then, the global macroeconomic landscape has evolved in ways that challenge our expectations for sustained US outperformance. Overall, rising trade tensions, policy uncertainty, and geopolitical risks have increased near-term headwinds for equities—particularly in the US. As a result, market performance year to date has been volatile, and international equities have outperformed the US by a wide margin—marking a reversal from historical US dominance for the first half of the year.

Under those developments, global growth is softening. The Organization for Economic Co-operation and Development (OECD) downgraded its global GDP projection to 2.9% for both 2025 and 2026, down from 3.3%. This revision reflects a confluence of headwinds—trade tensions, tighter financial conditions, and increased policy uncertainty. Despite these challenges, the US is still expected to maintain higher growth than its international developed market peers, while emerging markets continue to exhibit a higher rate. Certain regions may also benefit from shifts in supply chains, as global firms diversify sourcing.

For much of the past 15 years, US equities led global markets—supported by innovation, scale, and access to capital. A heavy allocation to growth sectors such as technology pushed the US share of global equity market capitalization above 66% at the start of the year. However, an unpredictable US policy backdrop and the potential for rising fiscal burdens are now driving capital flows toward international markets. Additionally, corporate earnings expectations in the US are beginning to soften. The number of S&P 500 companies issuing negative earnings revisions in Q2 2025 has increased above average (though there has been some recovery very recently). In contrast, revisions among international equities remain within normal range.

While these dynamics remain fluid, they are supported by diverging policy responses. International central banks are expected to remain accommodative to cushion slowing growth, while targeted fiscal spending is anticipated to deliver further stimulus—creating favorable tailwinds for international equities. Meanwhile, interest rates in the US remain elevated, with rate cut expectations and timing tempered. The diverging policy dynamics have supported the recent outperformance seen in international developed and emerging market equities.

Beyond cyclical growth, structural changes in global trade are reshaping the investment landscape. The US has increasingly pivoted toward targeted bilateral agreements with individual countries in efforts to reclaim national interests. This leaves US companies with global trade exposure at risk for margin compression in the near term, as supply chain changes take time to implement. At the same time, China is pursuing increased economic self-reliance and strengthening trade relationships with Southeast Asia, Latin America, and Africa. As global trade becomes more fragmented, new supply chain routes could emerge, creating opportunities for companies in this region. Emerging markets are increasingly deepening intra-regional trade ties, while China's reduced economic reliance on trade with the US has diminished the influence of traditional trade corridors. Over time, these shifts could lead to the formation of two parallel trade and technology ecosystems.

As a consumer-driven economy, the US has historically benefited from low-cost imports supported by a strong US dollar. That dynamic is changing. Tariffs have meaningfully disrupted trade flows, even after more extreme proposals were walked back after "Liberation Day". According to The Budget Lab at Yale, the average effective tariff rate on US imports has risen to 15.6% pre-substitution and 14.5% post-substitution—the highest level since the 1930s.

The modest gap between pre- and post-substitution rates suggests substitution efforts have been limited—likely due to supply chain limitations, lack of viable alternatives, or elevated substitution cost. Businesses face potential margin compression if they are unable to pass on the tariff expenses. As an early indication, the Federal Reserve Bank of New York's May 2025 Regional Survey found that 75% or more of businesses at least partially passed on tariff-related cost increases to consumers.

Global trade is primarily settled in US dollars, but elevated tariffs, policy uncertainty, and financial stability concerns have weighed on the dollar's valuation. A weaker dollar raises import costs, adds upward pressure to inflation, and reduces the purchasing power of dollar-denominated revenue. At the same time, because the US runs a fiscal and a current account deficit, it relies on foreign capital to fund government borrowing, which in turn supports financial markets.

Additionally, when foreign investors purchase US assets, they convert their local currency into US dollars, supporting the dollar's value. When foreign investors pull back, as suggested by April 2025 Treasury International Capital (TIC) data showing a $14.2 billion net outflow—driven by $17.3 billion in official foreign (central banks and sovereign wealth funds) outflows—Treasury yields may need to rise to attract capital and the US dollar may fall. This could increase borrowing costs across the economy and pressure equity valuations through higher discount rates and compressed margins. While anecdotal, the TIC data reflects some growing caution among foreign investors amid heightened uncertainty and perceived risks in the US.

But the US economy may be more resilient than some think. US real GDP contracted in the first quarter, but this was largely due to front-loaded imports and inventory drawdowns in anticipation of tariffs. In the near term, growth could stabilize as those effects normalize and inventories are replenished. Moreover, economic growth remains relatively higher in the US compared to international markets. Retail spending in core areas is growing, albeit slowly, as consumers previously made advance purchases to get ahead of tariffs. Core retail sales grew 0.4% in May, supported by wage growth, even as discretionary and tariff-sensitive categories came under pressure.

Fixed investment in intellectual property assets also remains strong, particularly in software, R&D, and automation. According to Q1 2025 data from the Bureau of Economic Analysis (BEA), investment in software and information processing equipment rose—providing a constructive signal for long-term productivity, particularly from AI adoption. Lastly, fiscal policies tend to impact the economy faster than monetary policies. While debt-related concerns regarding potential fiscal spending and financial stability are warranted, the Congressional Budget Office (CBO) estimates positive economic growth effect from the proposed fiscal package over the next ten years. On balance, the fundamentals underpinning US equities remain constructive, while heightened uncertainty surrounding tariffs, policies, and geopolitical risks warrant caution.

Taking these factors into consideration, the global macro landscape has evolved meaningfully since the start of the year. International markets are benefiting from continued valuation discounts, relative earnings strength, policy support, and trade realignments, while uncertainty around policy and trade remains an overhang on US performance. Trade policies and potential fiscal spending are key watchpoints for the second half of the year. That being said, the structural advantages of the US—from investments in innovation and capital market depth to consumer resilience—remain intact, for now at least. Against this backdrop, a more moderate form of US exceptionalism may emerge, with near term opportunities globally as policy and economic developments play out. Reflecting the above, we are shifting our near-term sentiment on US equities (and therefore also global equities, including the US) to Neutral from Neutral/Positive. We recommend maintaining the current target within public equities of 70% US / 30% non-US—a modest overweight to the US, in line with peer practices.

THEME: Bond Investors Navigate Choppy Waters

ROBIN MEYER, CFA, AND ELI DAVIDOFF

Throughout the year, Treasury bond yields in the United States have remained elevated, reflecting ongoing economic uncertainty related to tariffs and associated trade barriers, domestic fiscal policies, and expectations concerning the actions of the Federal Reserve. This period has been characterized by volatility, with yields responding to indicators of inflation, fiscal developments, and global economic trends. The MOVE index (a measure of bond volatility) effectively illustrates this, having surged in April due to the macroeconomic challenges arising from tariffs. The fluctuations in Treasury bond yields are also seen in the 10-year maturity, which has experienced large yield changes of as much as 0.07% within a single day this year.

Specifically, a comparison of yields from the beginning of the year to the present reveals a decline in yields of shorter-term Treasury bonds, particularly those with maturities ranging from one to ten years. In contrast, yields for longer-duration Treasury bonds, specifically those maturing in 20 to 30 years, have experienced an increase.

The decrease in yields for shorter-duration Treasuries can be attributed to investor sentiment regarding anticipated interest rate cuts by the Federal Reserve in the near term, which has led to heightened demand for these shorter-to-medium-term Treasury securities.

Conversely, the increase in yields for longer-duration Treasuries is largely due to concerns surrounding a proposed tax-and-spending bill that would elevate government debt levels through new issuances of Treasury securities.

The consequence of these two things together is a structurally steeper US yield curve across the length of short through long duration maturities. The US yield curve does retain a slight inversion from the Fed Funds Rate through the two- to three-year portions of the curve, reflecting broad consensus expectations for forthcoming policy reductions, though these remain elusive for the time being.

The US dollar's movement has been a strong driver of performance of non-US sovereign debt markets. While central bank policy decisions and interest rate movements in other countries are not to be dismissed, the dollar's decline has explained the bulk of the relative performance for a US-based investor.

At the start of the year, historically narrow credit spreads had been a tailwind for performance across bond sectors and credit qualities. This tightness in spreads was driven by strong earnings, strong demand and risk-on sentiment fueled by optimism about possible AI-driven productivity gains. After the announcement of the "Liberation Day" tariffs, and the subsequent rapid drop in market sentiment, we saw spreads widen abruptly and drastically. This widening marked a period of heightened volatility and repricing across the bond market. Credit spreads have since tightened again, narrowing almost to the levels at which the year began. Given the prevailing volatility and constrained credit spreads, we continue to assert that active management and specialized selection are critical for effectively navigating the current bond market.

While recent inflation data has shown incremental progress lower toward the Fed's target (or at least a maintenance of lower inflation levels), the Fed is in a bind reconciling this positive news with the uncertainty of global tariffs' impact on the broad US economy and, in particular, inflation.

What we do know is that—in a potentially new chapter for the US economy—tariffs are, in effect, being collected and represent meaningful sums. As previously mentioned, early evidence shows that much of the business community has at least partially passed on these additional costs to consumers through price increases. A manageable rise in inflation from here would suggest that companies are indeed passing along tariff costs to consumers; a lack of this expected inflation, conversely, might suggest tariffs are impacting corporate margins—which would likely not be a development welcomed by markets.

Bond market participants are digesting a number of developments that, at the margins, have the ability to decrease the attractiveness of the bond market, all else equal, including an additional US debt downgrade by Moody's, the inability of Congress to address the US fiscal situation, and the not-too-distant changing of the guard at the helm of the Federal Reserve. Undoubtedly the most critical among these, the lackluster US fiscal situation, is the one for which US lawmakers have been kicking the can down the road for years, and we expect will do so again. If recent US Treasury auctions are any indication of concern impacting demand, mid-June's large three-, 10- and 30-year US Treasury auctions proceeded without any fanfare.

Opportunities across broad fixed income segments remain robust and yield levels across government and credit securities continue to hover at levels well above the pre-pandemic "zero rate" environment. We continue to find all three primary segments of the Bloomberg US Aggregate Bond Index attractive with some relative advantages in and among them. These three segments include Treasury securities, corporate credit, and MBS/securitized credit. Within the securitized segment, we find a unique environment where prepayment risk among outstanding mortgages issued prior to the Fed rate hiking cycle of 2022-2023 is much more muted with current mortgage rates remaining well above 6%. Said differently, the average mortgage holder would require a roughly 2% drop from current mortgage rates for refinancing to make financial sense.

We continue to have a favorable view of the Treasury segment as yields of US government debt and the relative liquidity advantages of Treasury securities remain attractive.

Spreads on traditional fixed-rate corporate credit remain tight (richly priced). The balance between additional coupon earned, while carrying the risk of spread widening, is delicate. Ultimately corporate fundamentals remain healthy for now while a potential tailwind of support for corporations could come from the new administration's One Big Beautiful Bill Act (OBBBA).

We continue to emphasize a higher-quality bias, particularly as our clients tend to employ public fixed income exposures for their defensive characteristics and/or lower correlation diversification benefits. We do, however, also continue to embrace below-investment grade (IG) exposures selectively as a means for intra-segment diversification and due to more structural dynamics that have led to a higher overall quality profile of the below-IG market (specifically the BB quality segments) relative to pre-pandemic environments. We believe active management becomes even more relevant the lower the quality levels in which investors navigate.

Current option pricing as of late June (6/24/25) indicates markets are predicting roughly two and a half 0.25% interest rate cuts to occur during the remainder of 2025. The Fed's 6/18/25 Summary of Economic Projections indicates similar opinions among FOMC voting members—aggregate votes show most participants foreseeing two 0.25% rate cuts with individual votes spanning zero to four total cuts. While Fed Chair Powell continued to emphasize uncertainty and data-dependence in the near term, other FOMC members toward the end of June publicly expressed openness to rate reductions as soon as the July 2025 meeting.

THEME: Economic Policy and Uncertainty Shake Public and Private Markets

MATTHEW A. KUKLA AND AARON THAMMATHI

On Wednesday, April 2, President Trump enacted a wide range of new and increased tariffs, labeling the day "Liberation Day." The size of the new tariffs, and the uncertainty around current and future US policy, led to a period of significant market volatility.

Subsequently, tariffs were reduced, removed, and negotiated, and discussions were held between the US and other countries, leading to a variety of deals. Additionally, there have been legal challenges. On May 28, the US Court of International Trade ruled that many of President Trump's tariffs were invalid, based on a misuse of emergency powers. A day later an appeals court reviewed the case and sided with the President and gave a temporary reprieve.

President Trump has been a consistent, long-term opponent of US trade deficits and a fan of tariffs. While it may be difficult to discern all the specific goals of the tariffs, some logical ones include reducing US trade deficits, restoring US manufacturing, raising revenue/paying down national debt, and negotiating lower trade barriers and other concessions.

All else equal, utilizing tariffs without negotiating for lower trade barriers/other concessions or considering other nation's reactions (tariffs/export controls) could slightly reduce the US trade deficit, minimally raise revenue to pay down national debt, and marginally restore US manufacturing (over time) through protectionism. However, the retaliatory policies from trading partners could result in slower GDP growth, a possible recession—or even stagflation—and negating the intended benefits.

The erratic nature by which the tariff policies have been enacted coupled with drawn-out negotiations creates a lot of uncertainty for businesses (domestic and foreign) to make longer-term investments in the US. This also makes it difficult to restore US manufacturing, most of which would likely be automated anyway and not lead to meaningful job growth while also taking years to construct.

It is likely that getting rid of trade barriers completely, along with other concessions, would lead to freer and more fair trade and cause the trade deficit and US national debt to further increase. This would be particularly acute with countries that have a comparative advantage in manufacturing (e.g., China) relative to the US, leaving the US essentially at square one again.

Overall, returning to persistent trade surpluses would likely require the US and its citizens to save more, consume less, and borrow less. However, these changes would be politically unpopular and require cultural change in the case of consumption.

Generally, tariffs on imported goods tend to be inflationary in nature for individual consumers and business producers. The ones who absorb the inflationary prices are determined by the businesses who import these materials or products for consumption, either absorbing the material or goods import price increases themselves or passing it along to consumers by raising final product prices on shelves.

Will businesses simply pass the costs onto consumers and potentially hurt their product sales, or will they absorb the increase themselves but hurt their margins? Apple, in a different approach from one of the world's largest companies, tried to be ahead of the curve, having built up iPhone inventory in the US ahead of the tariffs, and shifting production for its US market iPhones to India.

Consumer confidence has been erratic following the back-and-forth action of tariffs being implemented and then placed on hold, having fallen significantly after the original imposition of tariffs, and recovering subsequently. Furthermore, markets have been volatile, as the world saw Treasury yields rise while the Nasdaq and S&P 500 recorded their worst quarters for performance since 2022.

Many at the time feared a looming recession. Despite these concerns and conditions, the US market was able to make a recovery, with indexes returning to pre-“Liberation Day” levels.

Private market assets are not immune to the impact of tariffs and trade policies. Recent headlines have had a particular focus and negative sentiment towards both private equity and venture capital—with some merit.

Private equity portfolio company exits (mergers/acquisitions and initial public offerings) have been generally lackluster in number and size since the Federal Reserve began its tightening cycle in late 2022, although the broader private equity market did improve in terms of value and count (middle market still lags) towards pre-pandemic averages in 2024 from the lows in 2022 and 2023. This was driven in part by the Federal Reserve reducing base rates, interest rate spreads narrowing on floating rate loans, dry powder (undeployed capital) being put to work, and expectation of pro-growth policies and deregulation from the incoming US administration.

That said, the backlog of PE inventory has swelled to 12,379 companies, with particularly high numbers among investments that are 4-9 years old, which translates to a seven-to-eight-year inventory at the observed pace of exits in 2024 compared with typical holding periods of three to five years. Exit activity to corporates, sponsor-to-sponsor, continuation funds, and/or initial public offerings need to accelerate meaningfully to bring down the backlog of PE inventory while providing much needed liquidity to limited partners.

We would expect the difficult exit environment to continue if interest rates remain higher for longer due to higher inflation from tariffs, trade policies remaining uncertain, and/or the disconnect between buyers and sellers’ perception of value widening. This would continue to strain liquidity for limited partners, who are more focused on distributed-to-paid capital (DPI) as opposed to internal rates of return (IRR) since the former represents actual cash returned to investors from exits as opposed to returns generated from unrealized gains until exit. Despite an uncertain macroeconomic backdrop, there are still investment opportunities in private equity.

The secondary market remains an attractive space given the discounts that are available for purchasing an individual or portfolio of assets from general partners or limited partners. Add-on investments in platform companies (buy-and-build) remain attractive given that these investments tend to be smaller and require less leverage. Co-investments have relatively lower cost structures and are attractive as they allow GPs to make larger investments with less capital. Growth equity is promising given deals are all equity and do not require any leverage for companies to continue to scale. The lower middle market continues to have exit (sponsor-to-sponsor) opportunities given the amount of dry powder among sponsors up-market. However, given the headwinds facing the broader private equity market, we are shifting our near-term sentiment to Neutral from Neutral/Positive.

Like its private equity cousin, the venture capital market lacks exits (buyouts, public listings, or acquisitions). This has constrained liquidity for limited partners due to the lack of distributions, which has also negatively impacted fundraising. The venture capital market has also seen an increase in flat or down rounds with longer time frames between fundraising rounds. This has caused investors to focus more on earlier stage startups that are profitable, with less cash burn, as opposed to the growth-at-all-cost mentality that had prevailed.

This new focus is largely due to the increased uncertainty in the market from tariffs and trade policy which has led to greater volatility in the public equity markets. The increased volatility has caused many startups to remain on the sidelines for initial public offerings, which has been further exacerbated by the poor subsequent returns of those few startups that have gone public. Until markets stabilize, the estimated $3 trillion backlog of unicorns will not be able to drive fund returns higher.

In the past, our view on private equity was inclusive of venture capital. For clarity, we now have two separate views on private equity and venture capital. Our initial venture capital sentiment is Neutral.

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