

Quarterly Commentary – 30th June 2025

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14th July 2025

'I might do it, I might not do it, I might have done it already...nobody knows.'

Trump Tzu

The second quarter of 2025 was extraordinary; global equity finished the quarter around 12% higher than it began it, while global bonds posted a similarly impressive 5%. However, the numbers themselves conceal more than they reveal. The real story lies in policy, policy u-turns, volatility and a growing sense that markets remain euphoric against a backdrop that is mixed at best.

Rarely has there been more flux for investors to contend with, driven by a non-exhaustive list that includes growth, inflation, tariffs, wars, and the increasingly entangled web of Fed policy and politics. Price moves in copper in the past week show just how quickly and materially markets can change based on as little as a passing comment. In the Trumpian world in which we live, it remains prudent to keep positioning relatively light and be ready to act when required and indeed update views when necessary.

The original plan of the US administration:

- Frontload pain via tariffs and fiscal austerity
- Reprice global growth downward, creating a disinflationary backdrop
- Force the Federal Reserve's hand into a meaningful cutting cycle
- Come to the rescue by reigniting the private sector through lower rates, tax cuts and deregulation

March 2025:

Whether the administration are playing '3D chess' or overseeing the most shambolic policy of modern times comes second to the fact that the administration's stated policy and aims are anti-growth and, without a significant policy pivot, an economic slowdown is unavoidable this year. The question has become how deep that slowdown will be.

The US policy stance has since undergone something of a pivot; what began as an outline of fiscal restraint and a clear aim to shrink the size of government has lost its ambition. However, the Big Beautiful Bill is fairly neutral in aggregate; what is cut in spending is offset in tax. The fiscal austerity piece of the frontloading of pain has been lost, but importantly not reversed.

Tariff uncertainty remains and has been reborn in July. It transpired that the frontloading of pain was exclusively for trading partners rather than domestic voters, at least that is the idea. However, in that sense a 50% tariff on copper when the US is responsible for 5% of global supply & 7% of demand seems particularly unhinged; copper cannot simply be onshored. The point investors must remember with regards to the realignment of global trade is that tariffs are a tax and are unequivocally anti-growth and if price increases cannot be passed on to a weakening consumer, margins will be where they show up.

Although we are now seeing signs of a slowing, it has not translated thus far into a fully blown slowdown in the data, although this will always lag. Even against a tariff-heavy backdrop, inflation has remained subdued. However, again there are arguments that any price increases are yet to be felt. Investors should question who will pay for this; consumers or margins. Neither would be good news.

The administration have not slowed growth sufficiently to force the Fed's hand, at least yet. Instead, we are witnessing a very public dressing down of the supposedly independent Fed with the looming appointment of the next chair encouraging trump appointees to publicly back the administration over the institution. The Fed's drift into politicisation risks any central banks single non-negotiable asset; credibility. Once credibility is eroded, expectations become unanchored, markets second guess, and the transmission mechanism breaks down. A politically influenced Fed is no longer an institution there to guide through storms but rather becomes the weather itself.

Total Return	2025	Q2
UK 100	9.5%	3.2%
US 500	6.0%	10.8%
Europe 50	10.4%	2.7%
Japan 225	2.4%	13.8%
Hong Kong 50	22.7%	5.7%
US 2000	-1.8%	8.5%
Swiss 30	5.9%	-3.7%
Global Equity	9.5%	11.5%
Global Bond	7.3%	4.5%
Commodities	3.3%	-4.1%
PGF	4.8%	3.2%
AGF	3.3%	0.7%
DGF	2.6%	1.9%
USI	5.7%	10.6%
ARF	3.4%	2.8%
CARF	3.8%	1.7%

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What has also not changed is that economic data neither justifies markets re-testing their all-time highs nor does it yet look poor enough to justify monetary intervention through lower rates. However, as has become customary, the market is front-running the Fed aided by comments coming from the White House. There can be no mistaking that market participants now see the role of policymakers as including being supportive of asset prices irrespective of the financial stability mandate.

Wherever one cares to look asset prices look stretched; equities, commodities, credit and this is at a time when we are now beginning to see slowing show up in the data. There remains three possible outcomes:

- Soft landing
- Hard landing
- Higher for longer

The market has returned to pricing the first scenario with near certainty, it stands to reason that the value is in the others.

The Fund returned 2.8% over the quarter and is up 3.4% year-to-date.

Income

The Fund is fully collateralised by very short-dated, high-grade debt. As such, its liquidity profile extends to the liquidity profile of the Income Portfolio. The Fund has a 70% overhang of cash to deploy within the Income portfolio. Therefore, when the risks free rate is high so is the base level of return available to the strategy. It allows investors to somewhat ‘have their cash cake and eat it’ within an alternative allocation.

Beta

The Fund makes no allocation to the Beta Portfolio.

Diversifier

The Fund’s Diversifier Portfolio consists of an US dollar equity long / short strategy with a low and stable beta of ~0.2 to global equities. That beta has been very stable through time and environments and is maintained through monthly rebalancing of the long and short legs back to target weights.

The long leg, which overweights the factors of quality, value, momentum and size (favouring smaller companies) whilst maintaining the same ex-ante volatility of the parent index has outperformed the heavily large cap and growth biased parent index over the first half of 2025 by ~2%. This has allowed the beta overhang to perform well in absolute terms. However, the equity long short is global, and dollar exposed, thus the Fund will pick up some mark-to-market from dollar moves. This year the mark-to-market has not been in the Fund’s favour as the dollar exposure has cost ~2.6% in sterling terms.

Within the factor exposures during the quarter, trend suffered unsurprisingly given the whipsaw nature of markets that could be turned completely on their head by as little as a tweet. Interestingly, value was the biggest contributor and shows just how much the market is willing to look through any potential negatives to growth that might be on the horizon; TACO is fully priced.

Outlook

While the beginning of this year saw some reversal in the fortunes of growth versus the Fund’s equity factors, more recently growth has come roaring back. The delta1 equity component of most multi-asset portfolios simply must be fairly growth dominated or else it takes on huge benchmark risk. It stands to reason that the risk to the equity component in most portfolios moving forward remains a reversal in the tailwind provided to mega-cap growth stocks, whether brought about by a change in the prognosis for growth, policy or both, they are clearly neither mutually exclusive and more likely causative.

The Fund’s factor exposures have served it well through the year thus far, as has the low and stable beta. What has acted as a significant drag is the dollar. Ordinarily, the dollar overhang acts as a useful added defence given the dollar’s defensive attributes. This has not been the case this year but as and when the dollar does find its bottom, if it has not already, then the headwind the Fund has fought while still producing positive low beta returns will become a tailwind. In the meantime, the Fund continues to stack up well against the equity long/short peer group, the majority of whom have costs that are double or more from an OCF perspective.

Fortem Capital Absolute Return Fund



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