

Quarterly Commentary – 30th June 2025

UK & EU – For professional and institutional investors only

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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 3.2% over the quarter and is up 4.8% year-to-date.

Income

The Fund is fully collateralised by high-grade sovereign debt. As such, its liquidity profile extends to the liquidity profile of the Income portfolio. A key pricing input for the Beta portfolio is rates; when rates are high, the level of return available from the Beta portfolio for a given level of risk is similarly higher than when they are low all else being equal. The current rates environment is continuing to allow the Fund to incept positions with defined returns above the Fund's return target, without taking on more risk than is and has always been stipulated at outset. This has also translated to a period of embedded returns significantly above the Fund's target return. As such, if we were to see a prolonged period of investment not calling, the levels locked in are far in excess of what is needed to return the Fund to its target.

Beta

The Beta Portfolio is the key driver of risk and return within the strategy. This portfolio has a number of investments linked to major developed equity market indices. The investments have strict rules around minimum protection levels such that they contractually earn defined positive returns even in significant drawdowns for the equities to which they are linked.

Within the Beta portfolio currently there are 58 investments with an average coupon of 8.9%.

It is worth repeating what we said last quarter in order to tie it into current market valuations and prognosis:

The portfolio is different in one sense and similar in another to how it entered the 2022 market turbulence:

In 2021, when rates and volatility were both floored by the extraordinary policy intervention that had been enacted post-Covid, the returns on offer for the protection barriers the strategy is able to employ were below the target return of the Fund. This meant that the Fund for a period endured lower returns than target. However, crucially, it did not change its risk profile based on prevailing market conditions, this is style drift.

Once after two or three years those positions had rolled off, they were able to be restruct at much higher levels of return, crucially, without changing the conservative setting of barriers that is and always has been the Fund's mantra. That means that in the event of a repeat event, and the current investments taking more than a year to call, the Fund has embedded within it levels of return to return it to above its overall target since launch.

This is how the strategy was designed at outset, the barriers dictate the short-term return, not the other way around and over time so long as our assumptions about the long-term averages of pricing inputs hold, the Fund will achieve its target.

With markets once more testing their highs, it is a significant point of note that if equities were set for a similarly tough period, this particular Fund is in a vastly different position to that which it entered the last protracted drawdown; a period in which investments within the portfolio did not call would allow the portfolio to embed returns well above target for longer. In other words, versus 2022 when anaemic returns were effectively locked-in for longer than one might have liked, the opposite is now true.

The recovery in markets also means that the Fund has significant levels of protection embedded with both protection of capital and return ~ 35%.

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Risk Overlay – Diversifier + Protection

In spite of the construct of the beta portfolio being carefully considered and designed to make money in all but the bleakest, and to date unprecedented, equity market scenarios, investors in these strategies will be aware that mark-to-market can be volatile, particularly during scenarios during which sizable equity falls are accompanied by spikes in implied volatility. It is for this reason that a risk overlay is employed that should not have a bearing on the final destination of the portfolio but should help on the journey of travel during the most volatile periods as it has already shown itself to do multiple times.

Since launch, the overlay has provided for a very slightly positive return in a period in which global equities have provided for double digit annualised returns. In hindsight it was only truly needed once, during 2020, but remains there in case of a repeat. Currently the protection portfolio is made up of S&P 500 puts as well as CDS.

Outlook

The Fund behaved exactly as expected over the quarter.

With regards to outlook, defined return funds allow for a slightly more prescriptive approach to be taken by investors as at any point one is able to ask of a fund of this ilk:

1. What is the risk
2. What is one currently being paid to take that risk

With regards to the risk at any point in time. Within the Progressive Growth Fund, one takes credit risk to high grade sovereigns given it is fully backed by sovereign debt. That currently extends to the governments of the US , UK, Japan and Canada. With regards to the beta portfolio one is exposed to deep OTM puts on major developed indices, so the key is where the portfolio currently sits with regards to the strikes of those puts. Currently there is plenty of protection as was alluded to in the beta section. So then what is one currently being paid to take on that risk? A significant amount:

Gross redemption yield of Beta portfolio:

Immediate spot moves	-20%	-15%	-10%	-5%	0%	5%	10%	15%	20%
Return (%)	40.7%	33.7%	25.8%	18.2%	12.3%	7.3%	6.1%	5.6%	5.6%
Time to Maturity (Av. yrs)	4.8	3.9	2.9	2.0	1.3	0.7	0.6	0.5	0.5
GRY to Maturity (Av. %)	7.5%	7.8%	8.3%	8.9%	9.5%	10.6%	11.2%	11.4%	11.4%

*Scenarios are net of fees. Assumes no reinvestment of maturing investments.

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