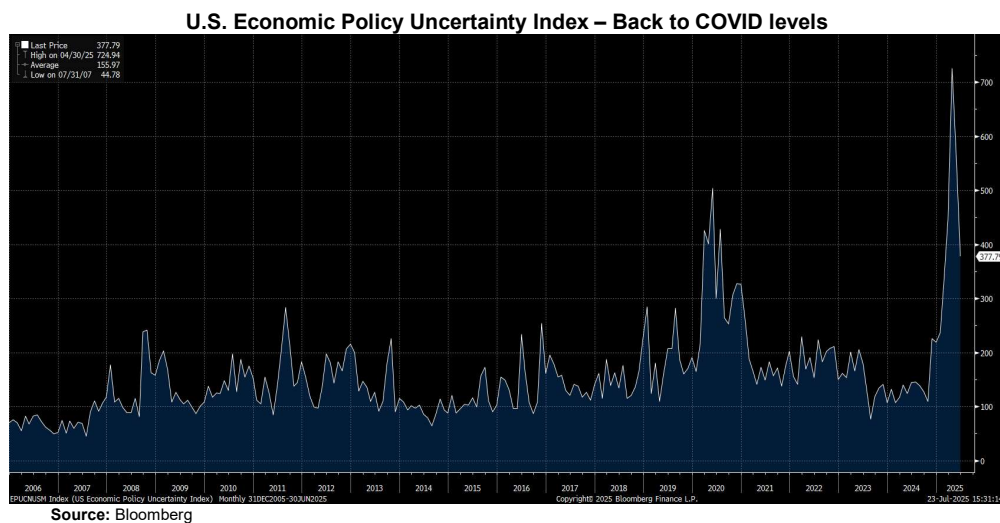


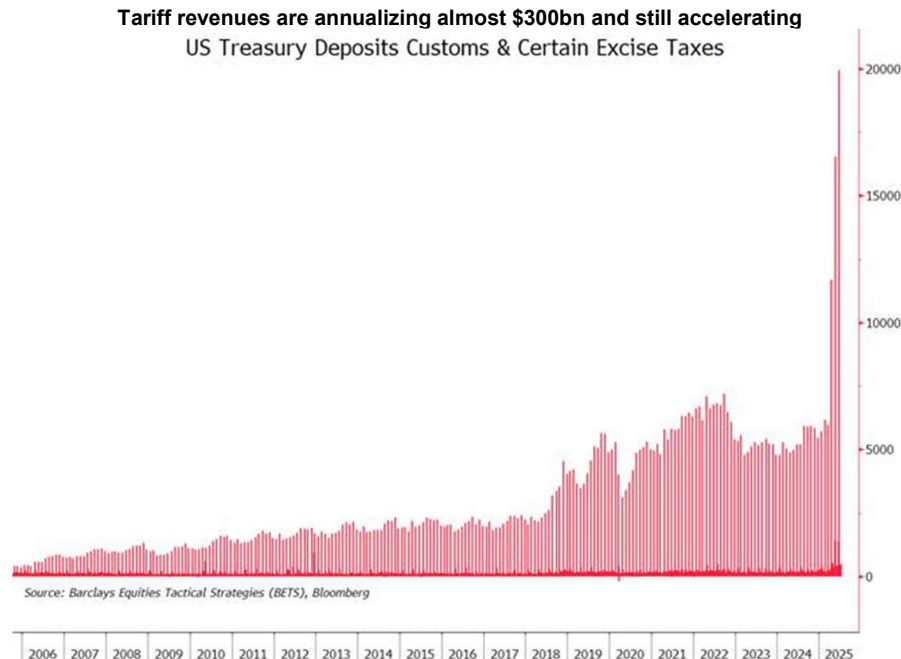
## 2Q 2025 – Market Commentary

The market rebounded this quarter after the worst start to a year since Covid. The level of U.S. Economic Policy Uncertainty has retreated from its peak post Liberation Day in early April but remains elevated today compared to recent history. The implementation of extreme reciprocal tariffs proposed by President Trump on Liberation Day were initially postponed until early July but now are set to take effect on August 1<sup>st</sup>. This delay pulled the market and U.S. economy from the precipice of a bear market and potentially a recession in April. While we are not signaling “all clear”, we believe the new administration is starting to pivot towards its pro-growth agenda and away from the initial policies that stymied economic growth and reduced market risk taking. The second quarter of 2025 was a tale of two halves. Liberation Day and peak market uncertainty in April transitioned to the re-opening of the capital markets in the second half of the quarter, with a meaningful improvement in equity capital market issuance and a rebound in mergers and acquisitions announcements. By quarter end, CEO confidence improved, and companies were making capital allocation decisions after the initial period of Liberation Day uncertainty. Despite the recovery in equity markets, we are mindful of potential tail events given this administration’s penchant for confusion. Thus, we remain balanced with our portfolio construction, yet we are long-term bullish on the opportunity for small and mid-cap stocks. We continue to believe that investing in companies that have strong management teams with the ability to effectively improve the returns of their businesses should drive compelling long-term returns over this and future cycles. We also believe that investing in small and mid-cap stocks today provides the opportunity to generate inherently higher future potential returns, as this part of the market trades at an absolute valuation discount to its long-term average and at an extraordinary discount relative to large cap stocks.



Tariffs have been a centerpiece of the Trump administration’s focus during the first half of this year. The goal is to renegotiate trade agreements to reduce the U.S.’s trade deficits with other countries that have ballooned over the past few decades, and to redomicile the manufacturing of critical goods back to the U.S. This pivot to promote U.S. Industrial Policy will likely be a multi-year transformation in which the government shapes the economy by targeting specific industries or economic activities with subsidies, tax breaks, infrastructure investments, and regulations designed to support their development domestically. While we believe in the potential long-term benefits from this policy change, tariffs in the short-term have been disruptive to U.S. economic growth, and if not calibrated properly, could meaningfully slow U.S. and global economic growth. One of the challenges the Trump administration faces is that a single trade agreement can take years to craft; however, the U.S. election cycle is measured in months. The Trump administration will need some trade deals announced before the mid-term election cycle starts to heat up. We will begin to see how successful the administration is by August 1<sup>st</sup>.

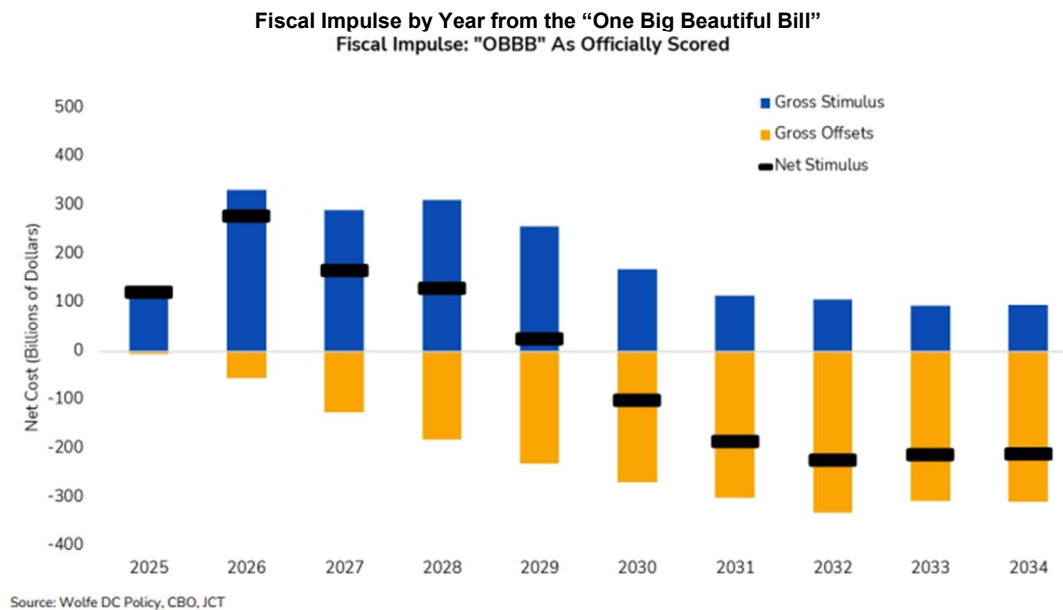
One of the early byproducts of the proposed tariffs is the nearly \$300 billion in annualized tariff revenue the U.S. is collecting which can go to reducing our ballooning debt, which should make the bond market and deficit hawks happy (see graph below).



The Federal Reserve has moved to the fore given President Trump's public dismay that Chair Powell has not cut interest rates since its December 2024 meeting, while other central banks around the globe are providing accommodation to their economies. The Fed has remained on hold as they await incoming hard data to gauge the impact that tariffs will have on core inflation. This watchfulness is backstopped by the belief that the Fed can be patient given the healthy U.S. economy and U.S. labor market. Fed fund futures are currently pricing in a little less than two 25 basis points cuts by year-end 2025. If we don't see a material step-up in inflation over the next few months, we believe the Fed will need to restart the rate normalization campaign and cut short rates. The Fed's hand may be forced later this year as its balance sheet shrinkage causes it to fall below pre-pandemic levels relative to GDP which will be considered an implicit tightening action. As an analyst from Jefferies explains, "With its current size around ~22% of GDP, down from the lofty peaks of ~40%, it is now within spitting distance of its late 2019 level. Looking ahead though, if we assume nominal GDP growth of around 5% over the next couple years, along with \$40b per month in QT roll off, the balance sheet would fall below 17% of GDP by 2027. And that is a place which is decidedly restrictive by post-GFC standards." Either way, we expect short-term interest rates to be lower over the next 12-months, which would be highly supportive for small and mid-cap stocks.

On July 4<sup>th</sup>, President Trump signed his One Big Beautiful Bill (OB BB), thus ushering in his administration's pro-growth agenda. This bill extends the tax cuts from his first term and avoids the largest tax increase in U.S. history but also provides additional incentives for corporate investments (acceleration depreciation) along with tax cuts on tips, overtime, social security for seniors and auto loans amongst other provisions. Economists forecast this bill could be about 100 basis points stimulative to GDP next year (see graph below). In addition to the OB BB, the Trump administration has been hard at work on deregulation and reducing the size of the government, which should allow the private sector to grow faster. As history has shown us, deregulation lowers the costs of operating a business, allows more competitors to enter a market, and lowers the prices for

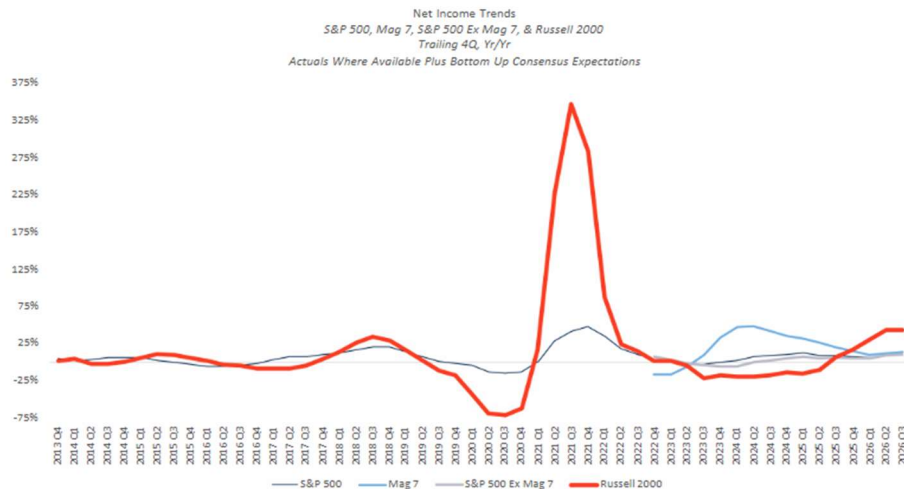
consumers. Deregulation is more helpful to small and medium sized businesses than large corporations, as it reduces barriers to entry and allows new businesses to emerge and compete with established players.



Merger and acquisition (M&A) activity ground to a halt post Liberation Day, but announcements picked up by the end of the second quarter as the tariff implementation was postponed. As we have discussed in past letters, a meaningful improvement in M&A activity has historically been beneficial to small and mid-cap stocks. We believe the new Trump administration and a less combative Federal Trade Commission (FTC) will be supportive of a more robust recovery in M&A activity. As indicated below, global M&A volumes are significantly below trend and are poised for a cyclical and secular rebound. We view the elevated level of sponsor dry powder as pent-up activity that will provide additional support to small and mid-cap stocks. Lastly, we expect the historically large discount that small and mid-cap stocks are trading relative to large cap stocks will spur higher consolidation until that spread compresses.

Small and mid-cap companies have been in an earnings recession for the past 2 years, and the outlook for earnings in 2025 is still below the level achieved in 2022. Going forward, we expect a meaningful recovery in earnings growth to emerge later this year into 2026. Over the past 3 years, small and mid-cap companies have absorbed the highest inflation rate and the fastest and steepest Fed tightening since the early 1980s. This year, the group was hindered by the announcement of the largest tariff rate in nearly 100 years on Liberation Day. However, we expect faster GDP growth, lower interest rates, the eventual easing of inflation, additional domestic manufacturing, and lower taxes will provide a strong tailwind to earnings growth for small and mid-cap companies after a 3-year hurricane of headwinds. This earnings acceleration should provide a nice catalyst for the group.

### Consensus Expects Small Caps to Surpass S&P 500 on Net Income Growth in Late 2025

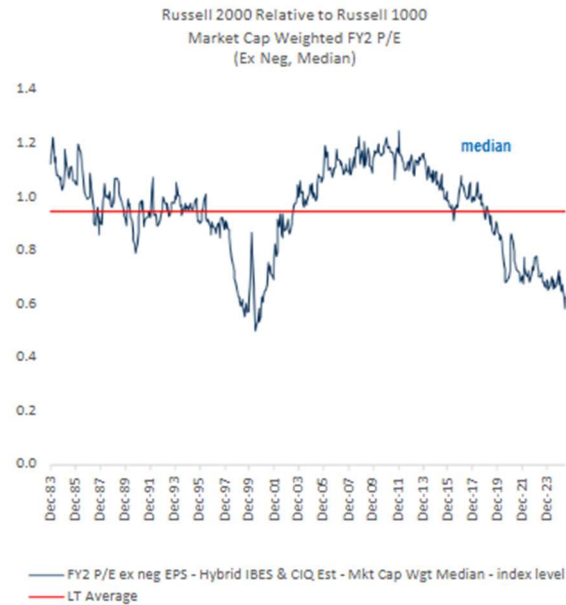


We continue to monitor the global geopolitical environment for sources of stress and/or potential easing. The U.S. took a more active role in the Iran/Israeli conflict this quarter by dropping bunker busting bombs on Iran's nuclear sites. Thankfully, tensions de-escalated quickly after the event, but that was not a given prior to the bombing. The Trump administration remains highly engaged in brokering a resolution to the conflicts in the Middle East and Russia/Ukraine. We are hopeful for a peaceful resolution, but we should be prepared for these conflicts to expand into a larger regional engagement. We need to remain vigilant to direct and indirect factors that could negatively impact our portfolios from these conflicts. As we are reminded periodically, China remains a wildcard as it relates to geopolitical unrest as well as its own economic future. How will China react to the current proposed tariffs and how will they respond to our global partners?

We remain highly constructive on small and mid-cap stocks from a fundamental and technical perspective. While the new tariff policies by the Trump administration have increased "uncertainty" over the short term, we understand the long-term benefits of a more domestic oriented manufacturing economy and a better balance to global trade. We also believe less regulation and a smaller government will likely be highly productive for the markets. The removal of the regulatory tax across a multitude of industries should create a more level playing field for small and mid-cap companies to effectively compete against large cap companies. In addition, small and mid-cap companies have been in an earnings recession for the past two years due to the negative impact of higher interest rates and higher inflation. The group is poised to benefit from lower interest rates and the re-shoring and near-shoring of critical infrastructure, and the reorientation of supply chains, which should accelerate domestic economic growth. We also expect a recovery in M&A activity will be supportive of small and mid-cap stocks. We still believe stock selection will be an important driver of alpha, as the Fed is not likely to return to a zero interest rate policy anytime soon. Rather, we continue to construct our portfolios with stocks that have pricing power, healthy balance sheets, and areas of self-help. In other words, stocks that are under-earning and can generate alpha in various interest rates and inflationary environments. While uncertainty clouds the short-term outlook, we believe this is an opportunistic time to invest in down-cap strategies given the inherent higher future potential returns. This part of the market trades at an absolute valuation discount to its historical levels and at an extraordinary discount relative to large cap stocks. At the same time, this part of the market is highly under-allocated and neglected to by investors. We believe much of today's uncertainty is priced into small and

mid cap stock valuations, and there are several potential tailwinds that could make this asset class a very productive place to invest over the next several years.

### Small Caps Look Deeply Undervalued vs. Large Caps on P/Es



Source: RBC US Equity Strategy, Russell, S&P Capital IQ / CIBC, CIQ estimates, IBES estimates; as of 7/16/2025