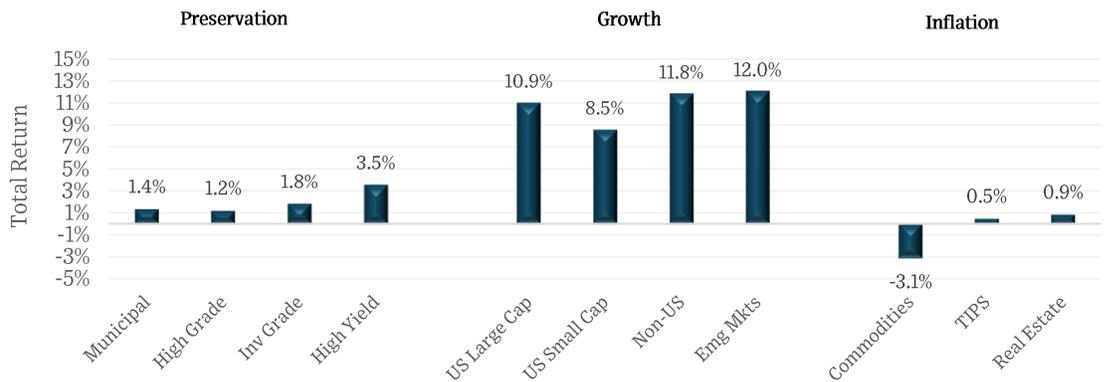


Quarterly Investment Letter

2nd Quarter 2025 Summary

Despite a substantial drop in risk assets in early April, equity markets rebounded after delays of tariff implementation and optimism on US trade negotiations. US economic data remained stable with modest job growth and subdued inflation while investors focus on corporate earnings. Markets were also comforted by the likely passage of President Trump’s signature tax bill that would extend the 2017 tax cuts.



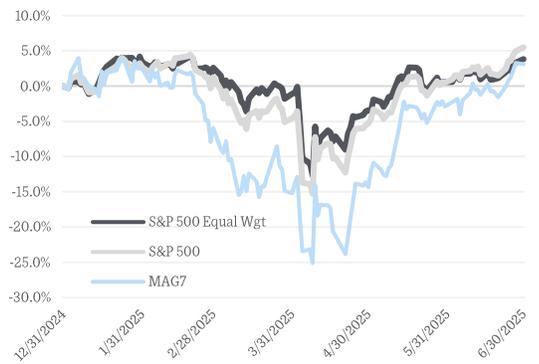
2nd Quarter 2025 Market Index Performance
 Source: Bloomberg, S&P, MSCI, NCREIF data is lagged 1 quarter.

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2nd Quarter 2025 Market Recap

Equity markets delivered strong overall returns in the 2nd quarter despite steep losses in early April driven by Trump’s “Liberation Day” tariff announcement. The Trump administration delayed implementation of the tariff increases just a week after their April 2nd announcement and focused the market’s attention on trade negotiations. Despite few concrete trade agreements, the market accepted the administration’s optimism despite higher levels of tariffs in the framework of the few deals that were outlined and President Trump’s continued use of higher tariffs as a cudgel in trade negotiations. US economic data remained intact keeping recession odds low despite the higher levels of tariffs on US imports. The MSCI All Country World Index returned 11.5% for the 2nd quarter and is up just over 10% for 2025 through June 30th. Foreign markets maintained their 2025 leadership over US stocks in the 2nd quarter, with the MSCI EAFE index adding 11.8% for the quarter versus 10.9% for the S&P 500



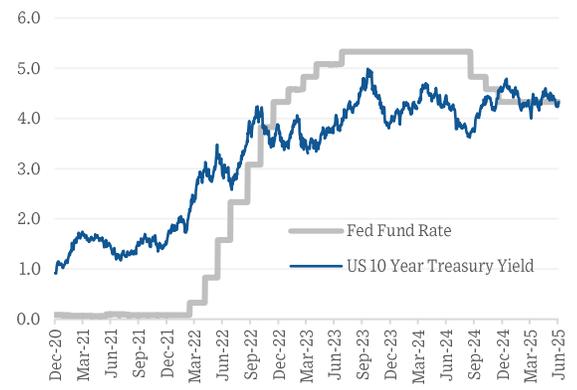
1st Half Market Performance by Capitalization Weighting
 Source: Ycharts!

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Index. S&P 500 performance narrowed in terms of leadership during the quarter after strong breadth early in 2025. Equity markets began focusing again on artificial intelligence (AI) spending and beneficiaries like Nvidia. Nvidia reported robust earnings in May that pushed aside DeepSeek concerns and highlighted continued demand for the company’s chips with no sign the AI arms race would be slowing down anytime soon. Magnificent 7 stocks were up on average 22% in the 2nd quarter, but still lag the broader S&P 500 index for the 1st half of 2025.

The Trump administration delivered their signature legislation in early July through the One Big Beautiful Bill (OBBB) Act. Markets had been disappointed by the administration’s focus on tariff policy and lack of progress early on with tax cut extensions and other fiscal stimulus. OBBB had generally been priced into the market since soon after the 2024 election outcome, but the bill’s actual passage brought policy certainty to tax rates as OBBB is one of the few recent tax bills that will not expire at a set date in the future. The bill also strongly incentivizes capital investment in the US by allowing for full expensing, which may further drive technology and industrial spending related to AI. These policies are likely to favor the largest US companies given they are more capable of making significant capital investments. The new bill, combined with steady elevated interest rate levels has further cemented headwinds for small cap performance.

Bond markets did exhibit some concerns over the increase in deficits from the new bill. Republicans’ mantle as the party of fiscal conservatism has morphed into populism under President Trump’s leadership and OBBB’s passage was only mildly in peril from a handful of more traditional Republicans. The Congressional Budget Office (CBO) scored the bill numerous times during the legislative process with 10-year estimates for OBBB adding \$2.0 to \$3.4 trillion to the deficit depending on how one accounts for interest costs and other items. However, the CBO estimates do not take into account the increase in tariff rates, given tariffs are not part of OBBB and sit under President Trump’s executive authority. Tariff revenues over the next 10 years are estimated to be over \$2 trillion, offsetting a significant portion of the extension of tax cuts that is driving OBBB’s deficit scoring. The 10-Year Treasury Yield began the 2nd quarter at 4.25% and ended at 4.23% despite interest rates being at higher levels due to concerns on government spending for most of the quarter. As the chart illustrates, bond markets have spent much of the last five years signaling a view on the direction of Fed policy: rates were too low from 2020 to early 2022, and then rates were too high from 2023 to 2024. Bond markets now appear to be looking for direction from the Federal Reserve on whether rate cuts are



Fed Funds Rate vs. 10-Year Treasury Yield
Source: Bloomberg

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plausible in-line with the Fed’s “dot plot” projections. President Trump certainly believes rates should be lower, and two recent Fed appointees agree with him. Yet, expectations for the July meeting are still for the Fed to sit tight and market attention will focus on the next Fed meeting in September.

Between now and that September Fed meeting, markets will receive two more inflation reports for July and August. Inflation numbers have come in below expectations over the past 5 months despite the substantial increase in tariffs on US imports. Headline inflation has been subdued by areas like Energy costs, leaving economists who predicted higher inflation from tariff policy to defend their predictions on tariff impact. As a starting point, the US economy is heavily service-oriented, which protects inflation to some degree from tariff policy on imported goods. June’s inflation report, while slightly below expectations, laid out a case that we may start to see tariff impact show up in inflation numbers. Excluding automobiles, core good prices increased in June by 0.55%, the largest increase since 2021. Goods like toys and appliances that are heavily weighted towards imports saw the largest monthly inflation increase in 5 years, which includes the previous inflation spike in 2022. We do not expect a return to 2022 and 2023 levels of inflation, that period was a combination of incredibly loose monetary policy with aggressive fiscal policy and global supply chain disruption. But “disinflation”, which is the slowing growth of inflation may be hard to achieve if tariff policy is increasing prices for capital goods. Annual inflation levels are already above the Fed’s long-term target of 2%, cutting rates as the market expects without further disinflation seems unlikely. At least while Fed Chairman Powell is in the picture until May of 2026.

The US dollar (USD) delivered its worst performance against a trade-weighted basket of foreign currencies for the first six months of a calendar year since 1973. The US Dollar Index declined by 11.8% as of June 30th, with broad declines against major currencies like the Euro (11%), Yen (8%), Pound (8%), and Canadian Dollar (5%). The USD weakness was strange given that increases in tariffs are typically perceived as strong currency measures and US interest rates and Fed expectations were stable over the period.

Investors (not just foreign investors) seem to be reacting to the uncertainty the Trump administration’s policies are creating and the adversarial relationship they are creating with foreign countries, friend or foe. We commented previously that given foreign investors make up a reasonable portion of outstanding US

Treasury debt, markets may be questioning the wisdom of treating one’s lenders in an adversarial manner. Putting emotion aside, markets are likely on the path to a rational diversification of US dollar exposure. Foreign central banks currently own 60% of their reserves in



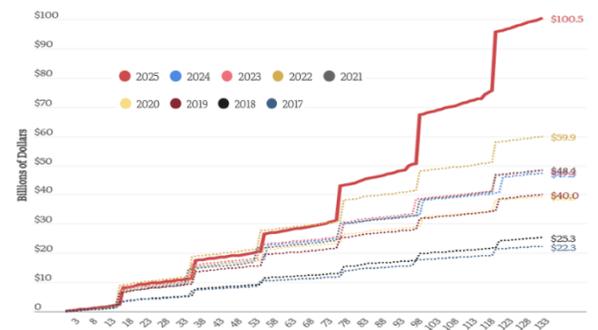
US Dollar Performance vs. Foreign Currencies
 Source: Yahoo! Finance. Data for 1st Half of 2025

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US dollar assets. We believe a continued gradual US dollar decline is likely, especially if the Fed does deliver with Fed cuts. But we do not believe the US dollar’s reserve status is in question, and there are possibilities the USD could stabilize given attempts by the Trump administration to encourage investment in the US as well as the possibility US inflation rates make meaningful Fed rate cuts less likely.

US Customs and Border Protection has collected over \$100 billion in tariffs on US imports so far in 2025, doubling collections from 2023 and 2024 and quadrupling the amount collected on an annualized basis during Trump’s 1st term. While \$100 billion is a relatively small sum in the context of the overall US economy (nominal GDP over \$30 trillion), it is line with fiscal stimulus packages on an annualized basis that we would expect to have economic impact. Given neither

consumption, inflation, nor earnings are showing any clear signs of tariff impact, economists are left with the question of “who is paying for US tariffs?”. Part of the answer may be that we will find out later in the year when companies have exhausted their pre-tariff stockpiles. US imports skyrocketed in the 1st quarter in advance of President Trump’s well publicized tariff deadline. US imports of goods increased by \$158 billion in the 1st quarter of 2025 compared to the 4th quarter of 2024, totaling \$1 trillion according to the Bureau of Economic Analysis. That import increase allowed companies to stockpile goods or product inputs, effectively expanding inventory to delay tariff impact. We would expect those stockpiles will wear off in the 2nd half of 2025. The question that remains is how much of the tariff impact will be taken by companies into earnings margins and how much will be passed along to consumers and show up in higher prices. US Corporate margins remain at elevated levels, but below their peak in 2024. S&P 500 margins overall also somewhat mask the weaker position of many consumer goods companies relative to the margins of a Nvidia, Meta, or Microsoft, given the size of the weighting of those companies in the calculation of overall corporate margins. The average consumer goods company with net margins of roughly 10% may be in less of a position to swallow input price increases than Nvidia and their 50% plus net profit margins. If companies do pass along price increases, then inflation will increase and consumers will adjust behavior. Consumer spending for 2025 has not shown any change in pattern from prior years, and as detailed above there has been little evidence so far in US inflation data. Tariffs being collected in the US are record amounts by any recent standard, that much we know for sure, how the US economy adjusts to the substantial change to global trade remains in question.



US Tariff Revenue by Calendar Year as of July 14th
 Source: Bipartisan Policy Center, Yale Budget Lab

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Despite the uncertainty in the 1st half of 2025 and declining earnings estimates for the S&P 500, stock prices have returned to all-time highs. Lack of earnings progress means the increases in stock prices are stretching valuations. The S&P 500 index as of late July is trading around 6,400, or over 24x calendar year 2025 estimated earnings, and over 21x estimated 2026 earnings. These valuations levels are historically high, reminiscent of the brief 2021 market bubble before the Fed began raising rates and have only been exceeded by the dot-com bubble at the beginning of this century. The S&P 500's largest constituents are leading the valuation party, with the top 5 S&P 500 names (Nvidia, Microsoft, Apple, Amazon, Meta) trading over 32x forward earnings. As the chart illustrates,



S&P 500 Earnings Multiples Over Time
 Source: Strategas, Factset

broad market valuations have been reasonably consistent over time and without earnings improvement, the market may struggle to move higher. Current valuations are just one sign of the speculation gripping markets. Leveraged ETF launches are far outpacing prior years, Bitcoin is at or close to all-time highs, and “meme-trading” driven by social media where companies with no change to their fundamentals see massive surges in their stock prices, have all returned to stock markets in 2025. This speculative behavior suggests an average investor who has little fear of losing money, or even more fear of missing out. Market cycles or downturns can reassert the reality of potential losses, and if investors have a hard time rationalizing what a true value is for company trading over 50x earnings, or a long duration asset with no income, cash flow, or earnings, or a meme stock that has not earned money in its 10-year public operating history, they may not have the stomach for how market value may be determined in a more challenging environment.

Despite the market risk from speculative behavior, concentration, and peak valuations, the US economy appears on firm footing. Unemployment levels remain low, consumers are spending, corporate earnings are growing versus 2024, and the Fed may reduce interest rates. Our base case entering 2025 was corporate earnings growth and improved economic policy support would overcome global trade disruption. While the administration has clear ideological goals that may be at odds with US economic policy going back decades, they are also responsive to market signals. Meaningful market pullbacks (which we define as > 20%) are rare without earnings recessions. Chaotic US trade policy and tariff implementation increased recession odds, but despite the brinkmanship, the administration has found tariff levels markets seem to accept, even if they are far higher than recent history. It is a familiar refrain for higher markets in recent years: worse than expected, but not as bad as it could have been.

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Chart of the Quarter:

US Consumer Stress Indicator (Food at Home Inflation + Mortgage Rates + Gasoline Price Changes)

Often simple indicators can work best at explaining what is going on in the economy and the largest expenses for the average US consumer are putting food on the table, paying their mortgage, and filling their car with gas. This Consumer Stress Indicator can be added to the plethora of charts that showed why recession risk was so high during 2022 and 2023 after the Federal Reserve raised the Fed Funds rate from 0% to over 5%. Previous spikes in inflation, interest rates, and gas prices have been predictive indicators of recessions in the late 1970s and early 1980s, 1990-1991, and even the 2008 Financial Crisis. Consumer stress dropped significantly in 2024 as food and gas prices inflation rates fell dramatically, while mortgage rates remained relatively stable. Year 2025 has brought a slight uptick in the indicator given slightly higher interest rates, and increased food inflation. Given tariff policy, the indicator bears watching. The Trump administration is clearly looking to drive gas prices lower through energy policy and “energy abundance”. The President is also pressuring the Fed and likely to install a Fed Chair who agrees with his view on lowering rates, future inflation be damned.



Source: Strategas

Term of the Quarter:

“Autarky”

Autarky is a noun that references a country, state, or society that is economically independent, or self-sufficient, thus minimizing reliance on imports. The term has become more popular given President Trump’s efforts to significantly change global trade and reverse globalization trends that have been in place since World War II. True autarky for a modern major global economy is impractical, but governments may increasingly focus on self-reliance in certain sectors like defense and military spending. Historically, examples of autarkies were Greek city-states like Athens and Sparta which arguably had high living standards by relative standards. Yet, the best example of a modern economy with autarkic tendencies is North Korea.

Source: Wikipedia.com

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