Quarterly Investment Perspective

Midyear Check-In: Expectations, Reality, and the Path Forward

BESSEMER TRUST

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Executive Summary

- **As anticipated, 2025 has been a year of transition, marked by sharp market swings driven by evolving trade policy, proposed tax changes, and heightened geopolitical tensions.**
- **Looking ahead, we anticipate slower, but still positive, economic growth, supported by easing inflation, a resilient labor market, and the potential for further Federal Reserve rate cuts.**
- **Market volatility is likely to persist, with policy uncertainty and the outcomes of global elections continuing to influence investor sentiment.**
- **Our portfolios remain positioned with balance and flexibility, emphasizing high-quality companies with strong fundamentals, earnings visibility, and exposure to enduring structural themes. Key focus areas include artificial intelligence (AI), infrastructure, and healthcare innovation, alongside a more globally diversified allocation reflecting strength in select international markets.**

In our year-ahead outlook, "*2025: A Strong Foundation for a Year of Transition*," we set expectations for the economy and markets. We anticipated that several favorable trends from 2024 — robust earnings growth, easing inflation, and supportive monetary policy — would carry through into 2025. At the same time, we acknowledged that elevated valuations, trade and fiscal policy uncertainty, and geopolitical tensions could present meaningful challenges.

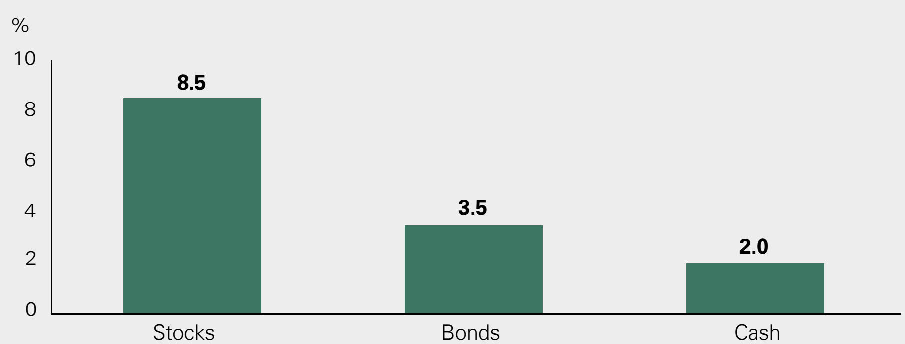
With these factors in mind, we entered the year with a constructive stance, maintaining an overweight to equities based on our belief that strong corporate profits would continue to drive market gains.

With S&P 500 earnings growth of 14% in the first quarter and a solid 8.9% return for stocks quarter to date, our positioning supported portfolio performance as stocks outperformed both bonds and cash (Exhibit 1).

Now at midyear, 2025 has certainly fulfilled its characterization as a transition year — marked by sharp swings in sentiment and market performance. Evolving expectations around trade policy, a new tax bill, and global political developments have fueled volatility, while investors faced a surge in policy uncertainty, underscored by a record 142 executive orders issued during President Trump's first 100 days. This uncertainty culminated in a historic two-day market drop in early April — down 10.5%, the fifth-largest in 75 years — followed by a 9.5% single-day rebound, the third-largest one-day gain since 1950.

Exhibit 1: Stocks Outperforming Bonds and Cash Year-to-Date

Key Takeaway: Despite elevated uncertainty and recession fears to start the year, strong equity fundamentals and easing trade tensions have supported performance.



As of June 24, 2025. Stocks are represented by the MSCI ACWI Index; bonds by the LBUSTRUU Index (includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS); and cash by the ICE BofA US 3-Month Treasury Bill Index. Source: Bloomberg

Despite this dramatic volatility, the market's foundation has held. From its April lows, the S&P 500 rebounded more than 20%, a powerful reminder that obvious risks don't always lead to obvious outcomes.

Even during the market's 20% decline, we held steady in our fundamentally driven outlook. We believed that concerns over extreme trade policy proposals and perceived threats to U.S. leadership in artificial intelligence would ultimately give way to a more balanced medium-term narrative. We continue to monitor ongoing risks — such as the potential implications of the "Big Beautiful" tax bill on fiscal deficits and the bond market — but also note important offsets. For instance, the Congressional Budget Office recently projected that the combined effects of tariffs and tax cuts could reduce the federal deficit by $400 billion over the next decade.

Amid the volatility, compelling investment opportunities have emerged. For example, Bessemer portfolio holding CME Group — the world's largest derivatives exchange — benefited directly from heightened market turbulence, with April trading volume rising 36% year-over-year. This reflects our strategy of identifying companies well-positioned to benefit from dislocation. We continue to emphasize long-term compounders with growth prospects less dependent on short-term macroeconomic trends, enabling us to construct portfolios resilient to near-term uncertainty.

Diversification remains a cornerstone of our philosophy. One of the most surprising developments so far in 2025 has been the outperformance of international markets, which exceeded U.S. equity returns by more than 15%. While few predicted this outcome, it reinforces the importance of maintaining broad exposure across asset classes — including those that may have temporarily lagged. Through a combination of individual stock selection and a broad tactical shift in geographic exposure, we reduced our overweight to U.S. equities from approximately 12% to 6% throughout the course of the first quarter.

Finally, we continue to see strength in long-term secular growth themes. Artificial intelligence remains a powerful driver of corporate profitability. Earlier doubts about the durability of AI have diminished as companies such as Microsoft and Meta significantly increased their AI-related investments, boosting cloud services and capital expenditure growth. With technology now making up 32% of the S&P 500, stability and innovation in the sector are crucial to market performance.

In the sections that follow, we revisit the four key themes from our 2025 outlook — U.S. equity markets, trade policy, economic and earnings growth, and international performance — to evaluate what we got right, where we've refined our views, and how we're positioning portfolios for the second half of the year.

U.S. Equity Markets: AI Boom Meets Temporary Skepticism

What We Got Right

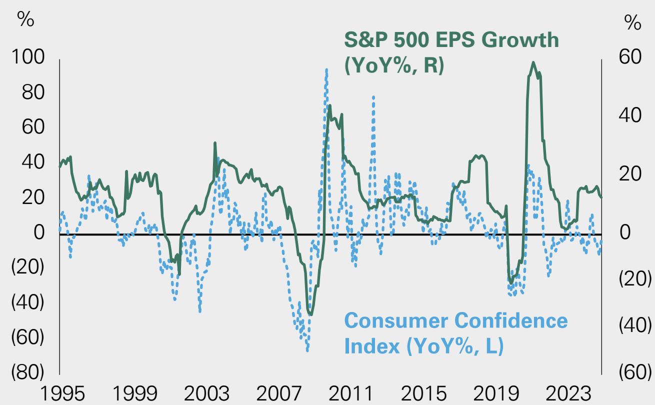
Our constructive stance on U.S. equities proved largely accurate. We believed resilient earnings and decelerating — but still positive — economic growth could support market gains even amid high valuations. By early June, the S&P 500 had surpassed the 6,000 level, rebounding from early-year volatility. First-quarter earnings rose a robust 14% (versus expectations of 8%), fueled by strong consumer demand and accelerating digital transformation, particularly in AI.

Our expectation that investors would look through elevated P/E multiples in favor of strong projected growth was validated. AI-related stocks — such as Broadcom, Nvidia, Meta, and Microsoft — surged past 2024 highs after a short but sharp pullback. Gains were supported by both enthusiasm around growing demand for AI and real earnings strength. Meta raised its capital expenditure plans to a range of $64 to $72 billion for 2025 (up from $60 to $65 billion), while Microsoft confirmed that AI contributed over a third of its 33% cloud services revenue growth during the first quarter.

Market breadth also improved: The equal-weighted S&P 500 roughly matched returns of the technology-heavy capitalization-weighted index — signaling broader participation. This was particularly evident during the April spike in volatility, during which the Magnificent Seven stocks were down an average of 26% at the low, while the other 493 S&P 500 stocks were down only 10%.

Exhibit 2: Earnings Growth vs. Consumer Confidence

Key Takeaway: Earnings growth has remained robust so far, despite trade policy uncertainty weighing on consumer confidence.



As of May 31, 2025. Source: Bloomberg

Overall, our equity overweight added value to portfolios as stocks outperformed both bonds and cash.

What We Got Wrong

We underestimated the volatility embedded in the AI narrative — particularly its geopolitical dimension. In late January, Chinese AI startup DeepSeek launched an open source model that sparked concerns about a potential challenge to U.S. technological dominance. Nvidia's stock plunged 17% in one single session — marking the largest one-day market capitalization loss in U.S. history. Microsoft and Alphabet also experienced sharp declines, triggering a significant sector-wide sell-off.

We had not anticipated the vulnerability of investor sentiment to such shocks. Rather than a steady climb, the AI story proved nonlinear — periods of euphoria interrupted by sharp corrections.

Meanwhile, our optimism around a rebound in small- and mid-cap equities has so far only partially played out. The Russell 2000 (small cap) Index outperformed the S&P 500 by 2.0% from mid-April onward, but this modest gain was not enough to overcome its negative year-to-date return. Our view that 2025 could mark a turning point for smaller companies has been slow to materialize, as higher rates and higher-than-expected uncertainty continue to dampen appetite for more economically sensitive companies. However, outside the U.S., the MSCI EAFE Small Cap Index is up 18.3%, keeping pace with its developed international large-cap counterparts.

We still believe that mid- and small-cap stocks can recover as we move through the second half of the year, particularly as trade tensions wane and consensus shifts to believing the economy will avoid a material growth contraction.

Trade Policy: Accurate Direction, Misjudged Severity

What We Got Right

We expected U.S. trade policy to become a key market driver in 2025, and that projection was validated — including the return of U.S.-China trade tensions, the general imposition of higher tariffs, and the potential uncertainty that it would create in consumer confidence and markets — although earnings growth has remained robust so far (Exhibit 2).

We anticipated that trade headlines would contribute to market volatility. Indeed, each new policy or headline triggered swings across equities, bonds, and FX. As a result, we had carefully contemplated various trade policy scenarios, leading us to look past the April 2 "Liberation Day" tariffs. Understanding the magnitude of economic destruction that would have resulted from full implementation, we felt that policy would quickly shift to something ultimately more digestible by markets without weighing on earnings growth.

We were also right to emphasize the growing importance of reshoring and supply chain diversification. Companies accelerated investment in domestic and "friend-shored" production, benefiting countries such as Mexico, India, and Vietnam on the margin.

What We Got Wrong

We underestimated the speed and magnitude of tariff escalation. By early April, President Trump had imposed a 10% blanket tariff on nearly all imports — a scenario we explicitly deemed low-probability (and one that is now also likely to be struck down by the Supreme Court). Tariffs on Chinese goods alone surged above 145%, creating the kind of "tariff shock" we had not forecasted.

As a result, both economic and earnings growth are likely to be slower in 2025 than we initially expected, putting more pressure on valuations to sustain current market gains and likely leading to more muted equity returns.

Economic and Earnings Growth Trends: Growing, But Slowing

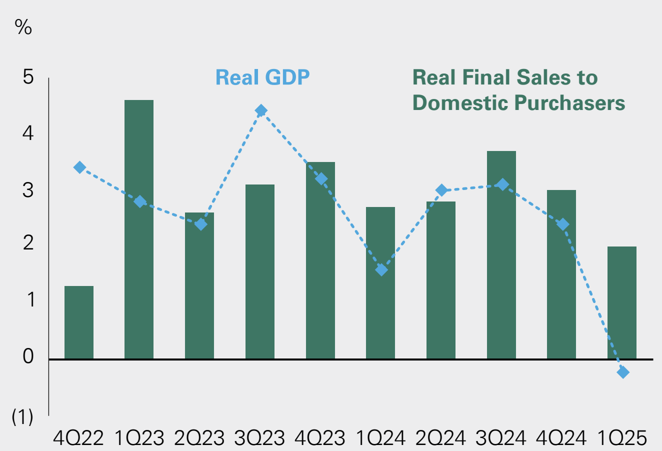
What We Got Right

Our base case called for slowing but solid economic growth, alongside decelerating inflation and stable labor markets — a setup conducive to Fed rate cuts. So far, this has largely materialized. Annualized core CPI inflation eased to 2.79% in May, near the lowest levels since March 2021. Thus far, tariffs have not generated widespread upward pressure on inflation. Unemployment remains at 4.2%, and the May jobs report confirmed a still solid, albeit softening, labor market.

The Fed's pause in early 2025, following several cuts in late 2024, aligned with our forecast that the Fed would "meaningfully slow the pace of rate cuts" in response to growth, inflation, and trade developments. The market is currently pricing in 50 basis points of cuts between now and year-end.

Exhibit 3: U.S. Real GDP and "Core Real GDP"

Key Takeaway: Despite a technical contraction in the first quarter, domestic demand remained resilient.



As of May 29, 2025. Source: Bureau of Economic Analysis

We also accurately projected that growth would moderate from last year's 2.8% pace, particularly as the impact of fiscal stimulus and elevated net immigration waned. Growth during the first and second quarters of 2025 was distorted by large swings in imports as tariff rates jumped, but domestic final demand (Exhibit 3) points to underlying growth of around 2%.

Looking forward, we continue to expect the soft and hard data to converge (Exhibit 4) as the economy grows below trend. We expect the net result to be an improvement on overall sentiment but slower actual growth — trending toward 1% in the second half of the year but avoiding a recession.

In combination, this backdrop has validated slightly above benchmark duration positioning, as the 10-year Treasury yield fell from 4.57% to 4.27%, despite concerns of tariff-induced inflation and higher fiscal deficits.

What We Got Wrong

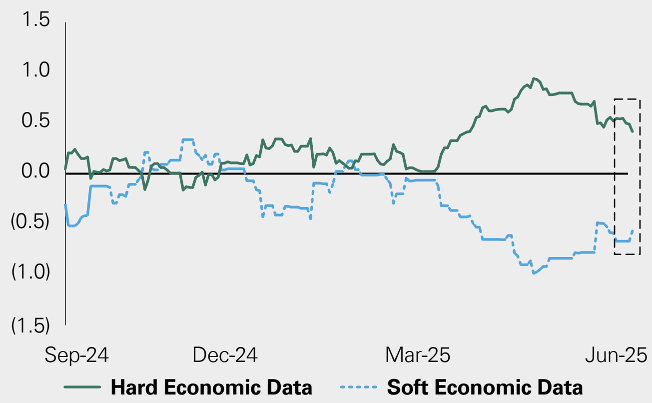
Our earnings growth expectations may have been overly bullish, as we now consider the potential impact of trade policy. While first-quarter earnings beat expectations by a wide margin (14% versus expectations of 8%), growth is projected to slow to 3.7% in the second quarter and 8.7% overall for 2025 — down from over 12% at the start of the year. This downshift in expectations reflects the estimated drag from tariffs, which we estimate at roughly 0.60% for each percentage point increase in the effective U.S. tariff rate. If that rate settles 10 percentage points higher than the previous 2% baseline, current earnings forecasts appear realistic — particularly if court rulings make full implementation of Trump's trade policy agenda more difficult.

That said, earnings are expected to grow 14% in 2026, potentially allowing investors to look through the moderation in 2025 expectations. For context, the average 12-month forward earnings growth rate expectation at the onset of past recessions is 2.3%.

We also expected the Fed to deliver more than two rate cuts in 2025. While that outcome is still possible, the Fed has adopted a more explicit "wait and see" posture — indexing more to the potential inflationary impact of tariffs than we expected or think is justified.

Exhibit 4: Soft and Hard Economic Indicators Begin to Converge

Key Takeaway: Sentiment data is recovering as we move past peak tariff uncertainty, while hard data is softening as growth slows.



As of June 13, 2025. Soft data represents Bloomberg U.S. Surveys & Business Cycle Indicators Index. Hard data represents the Bloomberg Economic Surprise Index less the Bloomberg U.S. Surveys & Business Cycle Indicators Index. Source: Bloomberg

We believe the Fed will still cut rates multiple times this year, as the underlying inflation trend affords it the flexibility to ease current policy from restrictive levels as needed.

International Markets: Unexpected Strength

What We Got Right

We anticipated pockets of resilience in emerging markets that could materialize in 2025. Specifically, we thought regions such as India, Taiwan, and South Korea possessed unique characteristics that could help them outpace broader market challenges. That view has largely played out: Emerging market equities are up more than 14% year to date, validating the benefits of broad regional diversification during an otherwise challenging return environment.

We also recognized the stock-specific opportunities in other developed international markets. Throughout the first half of the year, we initiated new positions in areas such as defense, industrials, financials, and biotechnology, tapping into regionally advantaged themes. This, in combination with a tactical shift in broad geographic exposure, reduced our overweight to the U.S. from approximately 12% to 6% during the first quarter.

What We Got Wrong

We underestimated the extent of strength in developed international equity markets. Our initial framework assumed that relative performance in 2025 would be driven primarily by economic and earnings fundamentals. Instead, policy shifts served as the key catalyst for discounted international stocks to outperform.

While we continue to view the U.S. as structurally advantaged — particularly in areas including technology and innovation, demographics, and capital markets — equity markets in Europe and Japan outperformed during the first half of the year, with Europe leading by over 15% and Japan by 4%.

Developed international markets have been cheap versus the U.S. for many years but lacked a catalyst. This changed in 2025, as a notable shift in the fiscal stance of key economies — particularly Germany's — provided a potential growth spark. In a departure from years of fiscal conservatism, Germany announced a substantial increase in government spending, focused on infrastructure modernization, energy transition projects, and a significant ramp-up in defense expenditures. These developments gave investors a reason to reprice assets that had long traded at a discount, turning structural underweights into active reallocations for many investors. We've used this as an opportunity to add various positions to our portfolios, including a leading European defense contractor poised to benefit from a jump in NATO defense spending.

Strategic Reflections: Process Is Key

Lessons Learned

Bessemer's 2025 outlook captured many of the year's defining macroeconomic and market trends: persistent equity market gains, AI's disruptive potential, inflation moderation, and the reemergence of disruptive policy shifts. Still, the pace and intensity of events — from the AI correction to trade policy shocks — introduced volatility that challenged even the most confident investors.

A Reinforcement of Key Principles

- **Stay invested:** Exposure to high-quality equities, especially those aligned with long-term secular growth in technology, proved rewarding, but required conviction and resilience.
- **Diversify meaningfully**: Regional and size-based performance divergences underscored the importance of maintaining balance and patience in periods of underperformance. International equities, in particular, offered meaningful upside this year after extended underperformance.
- **Remain flexible**: Markets don't always react logically to obvious risks. Maintaining flexibility in interpretation of markets is critical. Fixed outlooks were challenged by fast-moving developments, so relying on our ability to invest in companies that will remain advantaged over the long term is the most effective way to navigate near-term noise.

As we enter the second half of 2025, the "year of transition" remains just that — fluid, nonlinear, and filled with both risk and opportunity. Our strategic framework continues to provide direction, while tactical adaptability enables us to respond decisively and capitalize on market dislocations.

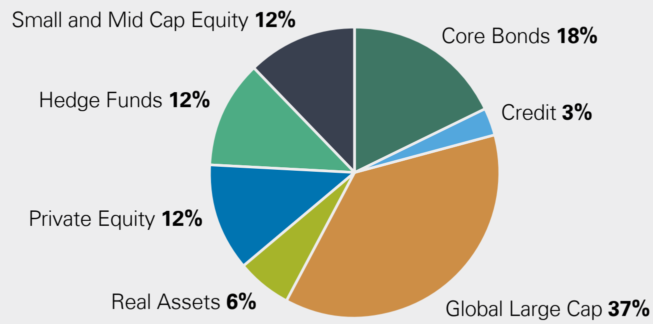
Portfolio Insights: Positioning for Durable Growth

During the second quarter of 2025, Bessemer portfolio managers responded proactively to evolving conditions, focusing on valuation discipline, quality, and long-term growth.

The team leaned into volatility to build exposure to durable franchises — particularly in AI, healthcare, and infrastructure — while rotating out of names with stretched valuations or moderating outlooks. These moves reflect our strategic effort to compound value steadily while remaining attuned to evolving market conditions.

Exhibit 5: Balanced Growth 70/30 With Alternatives Asset Allocation

Key Takeaway: We remain overweight equities relative to bonds, with a continued focus on quality companies with strong management teams that we believe can navigate trade-related challenges and deliver multiyear growth.



As of June 16, 2025. Source: Bessemer Trust

Our portfolios enter the second half of 2025 positioned with balance, earnings visibility, and thematic alignment with some of the most powerful secular trends shaping the investment landscape (Exhibit 5).

A consistent theme in our portfolios has been the rotation out of fully valued or maturing positions and into high-conviction ideas with clearer upside. Artificial intelligence and digital transformation were particularly prominent themes, with additions to businesses such as ServiceNow, Shift4 Payments, Cadence Design, and Onto Innovation that are enabling next-generation enterprise automation, digital payments, and semiconductor innovation.

Healthcare also saw a portfolio-wide recalibration. While positions such as UnitedHealth Group were trimmed due to regulatory headwinds and near-term uncertainty, capital was redeployed into more visible and focused names across market caps, including Boston Scientific, McKesson, and Medtronic.

At the same time, several portfolios leaned into select cyclicals and infrastructure names — such as Construction Partners and Simpson Manufacturing — reflecting a view that certain areas of industrial spending remain underappreciated and structurally supported by policy and demand tailwinds.

Altogether, the second quarter reflected an acknowledgment of both changing risks and opportunity, higher-quality, more-resilient businesses can be bought at attractive prices during times of fleeting negativity. We sold positions in companies where our confidence had diminished, trimmed oversized holdings, and used market disruptions as opportunities to invest more in businesses we believe can grow steadily over time. From large-cap innovators to niche small-cap leaders, our portfolios remain balanced, thematically aligned, and grounded in long-term fundamentals — ready to navigate the next phase of the cycle with clarity and purpose.

Parting Thoughts

Jeffrey Mills, Chief Investment Officer

Thank you for reading this edition of our Quarterly Investment Perspective. As always, we'll continue to monitor market and economic developments closely and share our views through written updates, videos, and interactive forums. We welcome your engagement. Please contact your Bessemer advisor with any questions you may have.

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