LEGACY BRIDGE
PRIVATE FAMILY OFFICES®

LEGACY BRIDGE ASSET ALLOCATION SUMMARY

- **Within U.S. equities**, we will maintain our overweight position in **large-cap stocks**, focusing on high-quality growth names. We continue to monitor market breadth and will rotate selectively into adjacent beneficiaries of the AI cycle, such as industrial automation and data infrastructure.
- **In mid-caps**, we see attractive relative value supported by domestic growth, deregulation, and infrastructure policies. We are moving toward an overweight position and will selectively add exposure to cyclical sectors including industrials, healthcare, and financials.
- We believe **small-caps** are poised for a cyclical rebound as the Fed begins easing late in the year and deregulation policy heats up, looking to build a tactical exposure to rate-sensitive segments and domestic-focused names, with a preference for quality balance sheets and strong cash flow generation.
- **For international equities** an improving backdrop driven by a weaker dollar, monetary easing, and rising fiscal outlays—especially defense-related, has us on hold to slightly higher allocations in portfolios.
- **In fixed income**, we are constructive, with expected Fed rate cuts in Q3 and Q4 supporting total return. Continuing to stay in high quality and looking to extend durations in the face of coming rate cuts.

As is often said, there's never a dull moment in global markets, and we wouldn't have it any other way. With uncertainties surrounding tariffs, the Fed, and various geopolitical events, we believe investors should be prepared for more volatility in global markets in the second half of this year. We believe an active approach is the best way to exploit opportunities and navigate risks in a dynamic market environment.

1H 2025 Global Markets Review in Brief

The first half of 2025 delivered strong but uneven gains across global markets. The MSCI All Country World Index (ACWI) returned 9.8% year-to-date, bolstered by a weaker U.S. dollar—down 10.8%—which amplified returns in international markets. International developed equities led global performance, rising 19.5%, while emerging markets climbed 15.3%, benefiting from commodity tailwinds, policy stimulus, and renewed investor flows. Despite heightened volatility, global investors largely maintained a risk-on posture in what remains a fragmented but resilient macro environment.

U.S. Equities: A Tale of Two Markets

The U.S. equity market experienced one of its most turbulent but ultimately rewarding halves in recent memory. The year began with enthusiasm around disinflation, a global soft landing, and Fed rate cuts, fueling a broad rally led by artificial intelligence (AI) themes and strong earnings from mega-cap tech. By February, investor sentiment was riding high.

That narrative quickly unraveled in March and April. A sweeping new wave of tariffs from the U.S. targeting China, Europe, and select emerging market trading partners triggered sharp selloffs. The S&P 500 fell into bear market territory by early May, down over 20% from its highs. Concurrently, persistently sticky services inflation and robust wage growth kept the Fed's tone hawkish, further rattling markets.

Yet, June brought a dramatic turnaround. The catalyst? Major hyperscalers—Amazon, Microsoft, Alphabet, and Meta—committed to a new wave of capital spending in AI infrastructure. This reignited the "second wave" of the AI investment cycle and powered a sharp equity rebound. Tech led the way, but gains broadened to include mid-cap cyclicals and industrials as trade policy clarity improved, and rates stabilized. Even small-caps, which lagged earlier due to tighter credit and domestic sensitivity, began recovering—helped by easing financial conditions and support for regional banks.

Energy stocks were a rollercoaster, reacting to fluctuating oil prices amid Middle East tensions and uncertain demand. Geopolitical flashpoints in the Taiwan Strait and shifting NATO dynamics, driven by increased European defense commitments, also added complexity—but boosted U.S. and European defense stocks.

In sum, U.S. equities weathered macro shocks and policy pivots to finish strong, buoyed by resilient consumers, powerful secular trends, and a reminder that innovation continues to reward patient capital.

International Developed Equities: A Global Comeback
Developed international equities outperformed expectations, gaining 19.5% in the first half. A weakening U.S. dollar improved the earnings outlook for exporters in Europe and Japan, while dovish pivots from the ECB and Bank of Japan provided additional tailwinds. These early rate cuts helped reflate valuations that had lagged their U.S. peers.

European defense and industrial names surged as NATO allies responded to renewed pressure from the U.S. with accelerated defense spending. Meanwhile, easing inflation helped fuel consumer resilience. Trade tensions remained a headwind, particularly in autos and clean energy, but selective tariff exemptions and bilateral deals helped mitigate downside risks. All told, international developed markets turned in one of their strongest first-half performances in years.

Emerging Markets: From Caution to Conviction
What started as a cautious environment for EM investors evolved into one of the strongest first halves for the asset class in recent memory. Emerging markets delivered a standout performance in 1H25, with the MSCI EM Index returning over 15%, outperforming U.S. large caps. Several drivers contributed: discounted valuations, favorable capital flows, stronger commodity prices, and a weaker dollar.

China rebounded over 17% on the back of aggressive fiscal and monetary stimulus, which helped reverse multi-year underperformance despite ongoing tariff pressure. Mexico surged 31%, propelled by nearshoring enthusiasm in autos and electronics as global firms repositioned supply chains closer to the U.S. Brazil, after a poor 2024, climbed 29% as inflation fears receded and political stability improved, making its deeply discounted equity market a magnet for capital.

Fixed Income: Positive Performance Amid Macro Noise
The U.S. fixed income market also delivered positive returns, with the Bloomberg U.S. Aggregate Bond Index up approximately 3.7% through June 30. Treasury yields declined modestly—2-year notes fell to 3.7%, and 10-years hovered around 4.2%—as inflation moderated and softer economic data signaled a more accommodative path ahead for the Federal Reserve.

Credit markets outperformed as spreads tightened, aided by solid corporate balance sheets and continued investor demand. High-yield and investment-grade bonds alike benefited from low default rates, strong issuance, and the relative appeal of elevated but stable yields. Despite macro risks—from tariffs to fiscal deficits—confidence was buoyed by the expectation of at least two Fed rate cuts in the second half of the year and the resilience of structured credit markets.

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Legacy Bridge 2025 Mid-Year Outlook and Asset Allocation Summary

In summary, the second half of 2025 presents a complex but investable landscape. Two Fed rate cuts, structural AI-driven productivity gains, and pro-business policy shifts from a constructive backdrop for US equities. However, risks remain—chief among them valuation concentration in tech, the erratic nature of tariff policy, and the still-lingering inflation impulse. For ultra-high-net-worth investors, the opportunity lies in combining core exposure to resilient large-cap growth with tactical allocations to policy-aligned mid- and small-cap equities, infrastructure plays, and select international developed and emerging markets equities. Active management will be essential in navigating this dynamic environment.

With our expectation of 2 Fed rate cuts late this year, we are constructive on fixed income, looking to extend maturities in government agency bonds and certain investment grade corporates.

U.S. Equity Market & Macroeconomic Outlook: H2 2025

As we enter the second half of 2025, the U.S. equity market continues to exhibit resilience in the face of macroeconomic crosscurrents. The backdrop is shaped by moderating inflation, a reaccelerating productivity cycle led by AI innovation, and the increasing influence of fiscal and regulatory shifts under the new administration. Markets are currently pricing in two interest rate cuts from the Federal Reserve, aligning with our house view. This modest easing cycle is expected to support equity valuations—especially in interest-sensitive and cyclically geared segments—without reigniting inflationary pressures. U.S. GDP is projected to grow at approximately 2% for the year, sustained by consumer spending, corporate investment in automation, and steady labor market participation.

Across market capitalizations, the outlook diverges. Large-cap equities, particularly mega-cap tech, remain the dominant force in market leadership. These firms are the core beneficiaries of the generative AI revolution, which is driving sustained investment across data centers, semiconductors, cloud infrastructure, and enterprise software. While valuations for these names remain elevated—trading around 30× forward earnings in many cases—they are underpinned by durable earnings growth, high free cash flow conversion, and entrenched competitive moats. That said, the narrow breadth of market leadership presents a structural vulnerability.

- Two expected Fed cuts, stable inflation, and rising AI-driven productivity set a supportive backdrop for equities, especially cyclicals and rate-sensitive sectors.
- While mega-cap tech leads on fundamentals, narrow market breadth introduces risk—active selection across capitalizations remains key.

With the S&P 500 at All-Time Highs, What's Next?

The S&P 500 closed at an all-time high on February 19, 2025, before retreating sharply on renewed concerns over tariffs, persistent inflation, and widening fiscal deficits. Following its April 8 bottom—coinciding with "Liberation Day" and the peak of tariff-related volatility—the index has rebounded strongly, setting nine new all-time highs since.

So, what's next? While no market moves in a straight line, history shows that all-time highs often beget more highs over time, rather than signaling a top. A 5–10% correction in the second half would be well within the norm and, in our view, should be treated as a buying opportunity—not a signal to retreat. We remain constructive on U.S. equities, supported by robust fundamentals across several key sectors. The AI investment cycle continues to be a powerful secular driver, particularly for technology and data infrastructure, while financials are poised to benefit from deregulation and steeper curves as the Fed begins its expected rate-cutting cycle. Consumer spending remains resilient—defying earlier predictions of weakness—with real wage growth and low unemployment supporting demand. Inflationary pressures from tariffs are notable but appear increasingly likely to be offset by productivity gains stemming from enterprise AI adoption. Additional tailwinds include the fiscal stimulus embedded in the sweeping budget and tax reform bill and a pro-business regulatory environment, both of which are lifting corporate sentiment and capital investment. As of this writing, second-quarter earnings season is off to a strong start, with nearly 90% of S&P 500 companies reporting results ahead of expectations. While near-term volatility is possible, we believe the long-term trajectory remains upward, underpinned by innovation, earnings strength, and economic resilience.

- Historical precedent suggests that new highs often lead to further gains, not immediate reversals; a pullback would likely be healthy, not ominous.
- Sector leadership is broadening beyond tech, with financials and data infrastructure plays benefiting from Fed easing and policy support.

AI Is Not A Theme—It's A Structural Transformation
A key structural driver across all segments is artificial intelligence (AI). Far from being a passing trend, AI is evolving into an infrastructure-scale theme. Demand for compute power is fueling a multi-year CapEx cycle in data centers, semiconductors, and power-intensive infrastructure—benefiting utilities, industrials, and select energy names. Meanwhile, enterprise AI adoption is accelerating productivity across verticals—from financial services to manufacturing—creating revenue opportunities for application software and cloud service providers. However, these gains come with growing energy demands and supply chain dependencies, which must be monitored as part of any investment thesis. The Administration's desire to win the "AI race" is also fueling investment across the entire AI infrastructure, adding an additional tail-wind.

- AI is driving multi-year CapEx cycles in data centers, semis, and cloud—impacting everything from utilities to industrials.
- Enterprise AI adoption is accelerating productivity gains across sectors, with policy support amplifying infrastructure investment.

Policy Tailwinds and Fed Rate Cuts Make Mid and Small-Caps More Attractive
Mid-cap equities offer a compelling relative value opportunity. These companies are more tethered to the domestic economy and thus better positioned to benefit from policy tailwinds such as deregulation, tax reform, and proposed infrastructure spending. Financials, industrials, and healthcare firms in this space stand to gain meaningfully from lighter regulatory burdens and increased capital spending. However, they remain exposed to tariff risk and potential cost inflation from supply chain disruptions—particularly if the administration's trade agenda re-intensifies.

Small-cap stocks, essentially the most rate-sensitive segment, are poised for a cyclical rebound if the Federal Reserve delivers on its anticipated cuts. Historically, small-caps outperform in the early stages of monetary easing, and 2025 may be no exception. Additionally, the rollback of regulatory frameworks like Dodd-Frank is expected to ease credit conditions for regional banks and capital-intensive small enterprises. Yet, small-caps face headwinds from elevated wage pressures and limited pricing power—making bottom-up selectivity crucial.

- Mid- and small-caps stand to benefit from deregulation, infrastructure stimulus, and early-cycle rate relief.

- Selectivity matters: watch for names with pricing power, clean balance sheets, and exposure to domestic demand or fiscal catalysts.

You Don't Need Multiple Expansion When You Have Strong Earnings Growth
Policy developments under the current administration are also shaping investor sentiment. The extension of 2017-era tax cuts and a new wave of deregulation are broadly constructive for corporate earnings, particularly in financials and industrials. However, the administration's unpredictable tariff stance remains a material source of volatility. Earlier in the year, the announcement of steep new tariffs triggered a sharp market drawdown. Although later partially walked back, the episode underscored the risk premium investors must now assign to trade policy uncertainty. Additionally, fiscal hawkishness via the proposed Department of Government Efficiency (DOGE) could introduce spending constraints in defense and other federally supported sectors.

Earnings outlooks for the second half are generally constructive, with S&P 500 earnings expected to grow in the high-single digits, led by tech, healthcare, and select industrials. Our base case favors a balanced allocation strategy: maintain overweight exposure to high-quality, large-cap technology leaders, while incrementally adding to mid-cap cyclicals and domestic small-caps poised to benefit from policy and monetary tailwinds.

- Earnings growth is expected to carry the S&P 500 higher in H2, particularly in tech, healthcare, and industrials.
- Policy volatility (e.g., tariffs, DOGE reforms) adds noise but hasn't derailed the upward trajectory of high-quality earnings stories.

International Developed Equities – Diversification Opportunity Persists
The outlook for international developed equities in the second half of 2025 is increasingly favorable, buoyed by a weakening U.S. dollar, coordinated central bank rate cuts, and a surge in fiscal spending—particularly on defense—following President Trump's recent NATO summit. A softer dollar, driven by the Fed's anticipated rate reductions and widening fiscal deficits, enhances the competitiveness of foreign exporters and boosts returns for U.S.-based investors holding international assets. Concurrently, the European Central Bank and Bank of Japan have initiated rate cuts to support growth amid easing inflation pressures, creating a more accommodative backdrop for equities.

Fiscal dynamics are also shifting, with European governments accelerating defense budgets in response to U.S. pressure to meet NATO commitments—benefiting industrials, aerospace, and cyber defense sectors across the continent. However, the reemergence of U.S. tariffs, particularly those targeting European autos, green energy technologies, and other strategic imports, introduces complexity. While some firms face direct earnings headwinds, the broader impact may catalyze localized supply chain investment and policy-driven sector support within Europe.

Net, the combination of monetary easing, fiscal expansion, a weaker dollar, and relative valuation discounts positions international developed equities well in H2 2025—especially for investors seeking diversification from concentrated U.S. market leadership.

- Weakening dollar, synchronized rate cuts, and defense-driven fiscal stimulus in Europe and Japan are improving the outlook.
- Relative valuation discounts vs. U.S. equities remain attractive—especially in industrials and defense-linked names.

Emerging Markets Equities – Weaker Dollar Should Help, But Remaining Selective

Emerging market equities enter the second half of 2025 with a cautiously optimistic outlook, supported by a weakening U.S. dollar, improving global liquidity, and selective tailwinds from trade diplomacy and commodity stability. A softer dollar—driven by anticipated Fed rate cuts—eases financial conditions for EM sovereigns and corporates, while boosting capital inflows into local equity markets.

Country leadership is likely to emerge from India, Mexico, and Brazil. India benefits from robust domestic demand, strong tech and services growth, and continued structural reforms. Mexico is positioned to gain from nearshoring trends and a recently negotiated tariff agreement with the U.S. that preserves favorable access for autos and industrial goods. Brazil, with relatively high real yields and fiscal discipline, is benefiting from stabilizing inflation and investor-friendly policies. Southeast Asian economies like Vietnam and Indonesia may also see upside from supply chain diversification away from China. However, risks remain: persistent trade tensions between the U.S. and China could spill over into EM supply chains, commodity price volatility could impact resource-dependent economies, and domestic political instability in key markets could dampen investor sentiment. Nonetheless, for enhanced portfolio diversification, select EM markets offer attractive valuations and improving macro fundamentals heading into H2 2025.

- EM equities benefit from improved liquidity, dollar weakness, and strong country-specific narratives in India, Mexico, and Brazil.
- Selectivity is critical as trade tensions, political instability, and commodity volatility remain key risks.

Fixed Income – Locking in Rates in Higher Quality Extended Maturities

In the second half of 2025, the U.S. fixed income market is expected to deliver modest total returns, supported by an anticipated pair of Fed rate cuts and a broadly stable economic backdrop. With policy rates set to gradually decline, intermediate-duration bonds—particularly in the 5- to 10-year range—offer the most attractive balance of yield and price appreciation potential. Investment-grade corporates should perform well as credit spreads remain contained amid steady growth and improving corporate balance sheets, while securitized assets such as agency MBS may benefit from a more stable rate environment. High yield remains supported by low default rates, though valuations leave less room for upside. Overall, a slightly longer-duration, up-in-quality bias appears prudent, with opportunities concentrated in intermediate credit and select structured products.

- With rate cuts on deck, intermediate-duration bonds and high-quality credits offer attractive risk-adjusted returns.
- Favor up-in-quality positioning in IG corporates and agency MBS; high-yield remains supported but fairly valued.

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Please feel free to call us anytime, as we would be more than happy to speak with you about our 2025 Outlook, Fact Sheet and investment strategies.

We look forward to continuing to earn your trust and confidence.

Tim Kadlec
Chief Investment Officer

Steve Musser, CFA®
Portfolio Manager

DISCLOSURES

The S&P 500 generally represents performance of 500 large companies listed on exchanges in the U. S. It is one of the most commonly followed equity indices. The MSCI ACWI captures Large and Mid-Cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. With 2,921 constituents, the index covers approximately 85% of the global investable equity opportunity set. FactSet Research System is a financial data and software company that provides research for Wall Street professionals and individual investors.

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