KENSINGTON MONTHLY COMMENTARY

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KENSINGTON Asset Management

Stock Market

The first half of 2025 has been marked by significant volatility. From its previous high in February, the S&P 500 experienced a sharp 21% drop in April following the "Liberation Day" tariff announcement, before rebounding impressively to new highs in June. Contrary to expectations, retail investors aggressively bought the dip, confounding institutional strategists and challenging traditional Wall Street perceptions of retail investors as "dumb money." Institutions subsequently re-entered the market as volatility subsided and quantitative models dictated increased equity exposure.

The rapid reversal in tariff policy by the Administration, including tariff reductions and extensions on trade negotiations, significantly contributed to the market's rebound. Equally impactful was the swift passage of the Big Beautiful Bill, which extended fiscal stimulus measures into the next decade. The hope is that fiscal spending, corporate tax cuts, regulatory easing, and an "America First" geopolitical strategy will drive robust economic growth, ultimately improving fiscal balances through higher tax revenues.

Despite the latest tariff escalation threats, market reactions have been subdued due to investor confidence that final policy outcomes will be less severe than initial rhetoric suggests. Additionally, a resilient economy has reinforced optimism. The Atlanta Fed's GDPNow model currently forecasts Q2 GDP growth at 2.6%, and recession probabilities, as reported in the Wall Street Journal's quarterly survey, have fallen from 45% in April to 33% in June.

Historically, there have been six prior instances since 1960 when equity markets fell 20% or more, then reached new highs without a subsequent recession. In these instances, markets delivered an average gain of 26% over the following 18 months. While not statistically conclusive, these precedents hint at potential market upside, assuming continued economic strength.

Figure 17: Bear Markets Then New Highs and What Happens on the Rollercoaster Afterward. More Gains, But Volatility Stays Along for the Ride As Well

		Bear Market			New High			
Start Date	End Date	Duration (Mo.)	Drawdown	Recession/ Non-Recession	Date	Mo. from Prior Peak	Mo. to Next Peak	% to Next Peak
12/12/1961	6/26/1962	6.5	-28.0%	Non-Recession	9/3/1963	20.7	29.2	29.5%
2/9/1966	10/7/1966	7.9	-22.2%	Non-Recession	5/4/1967	14.8	18.8	14.9%
11/29/1968	5/26/1970	17.9	-36.1%	Recession	3/6/1972	39.2	10.2	10.5%
1/11/1973	10/3/1974	20.7	-48.2%	Recession	7/17/1980	90.2	4.4	15.7%
11/28/1980	8/9/1982	20.4	-27.3%	Recession	11/3/1982	23.2	57.7	136.5%
8/25/1987	10/20/1987	1.8	-35.9%	Non-Recession	7/26/1989	23.0	11.7	9.4%
7/16/1990	10/11/1990	2.8	-20.4%	Recession	2/12/1991	6.9	89.3	221.3%
7/20/1998	10/8/1998	2.6	-22.4%	Non-Recession	11/24/1998	4.1	16.0	30.4%
3/24/2000	10/10/2002	30.5	-50.5%	Recession	7/13/2007	87.6	2.9	1.3%
10/11/2007	3/6/2009	16.8	-57.7%	Recession	4/10/2013	66.0	65.4	85.1%
9/21/2018	12/26/2018	3.2	-20.2%	Non-Recession	4/29/2019	7.3	9.7	15.1%
2/19/2020	3/23/2020	1.1	-35.4%	Recession	8/18/2020	6.0	16.5	41.9%
1/4/2022	10/13/2022	9.3	-27.5%	Non-Recession	1/19/2023	12.5	25.0	56.7%
2/19/2025	4/7/2025	1.6	-21.3%	Non-Recession	6/27/2025	4.3	???	???
	Average	**10.9**	**-33.2%**			**30.9**	**27.4**	**51.4%**
	Recession	15.8	-39.4%			45.6	35.2	73.2%
	Non-Recession	4.7	-25.4%			12.4	18.4	26.0%

Source: Bloomberg, Evercore ISI Research

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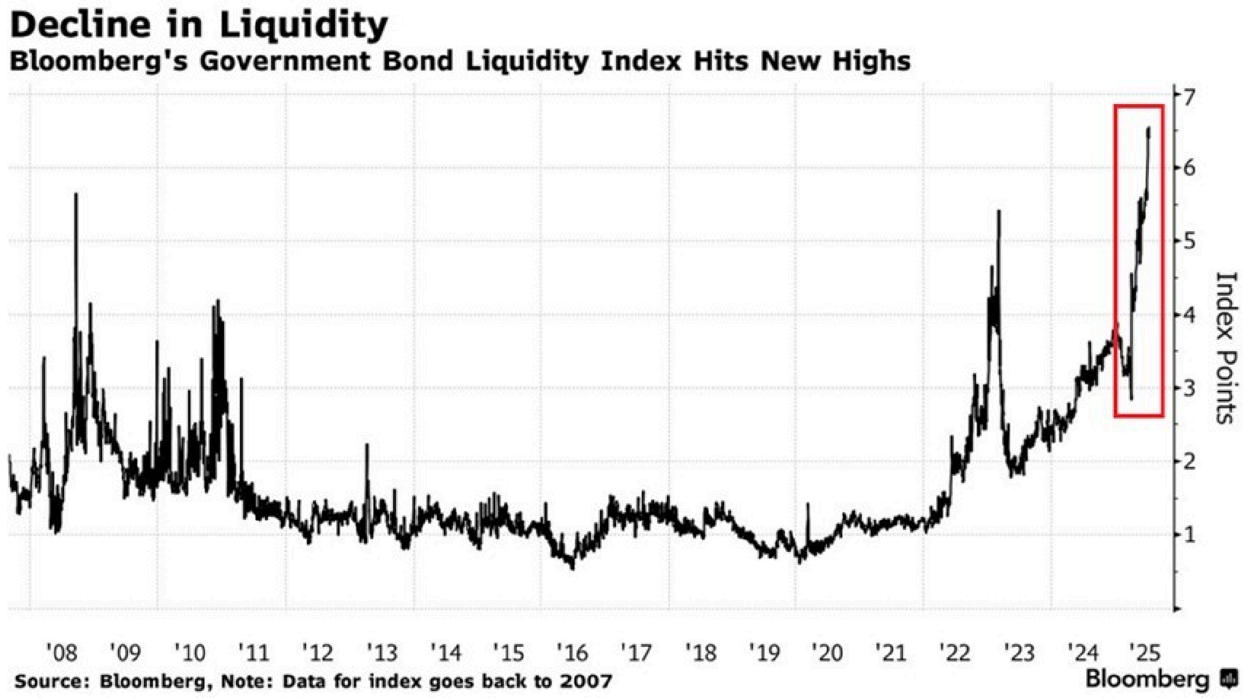
Analysts project S&P 500 earnings growth at 4.8% year-over-year for Q2, marking the slowest growth since Q4 2023. However, a strong recovery in earnings growth is anticipated, with forecasts of 7.3% in Q3, 9% for the full year 2025, and acceleration to 13.9% in 2026.

Fixed Income

US fixed income markets posted solid gains in June, capping a strong first half of 2025. The benchmark 10-year Treasury returned 1.62% in June, up 5.01% year-to-date. Similarly, the Bloomberg US Corporate Investment Grade Index advanced 1.87% (4.17% YTD), and the Bloomberg US Mortgage-Backed Securities Index gained 1.78% (4.23% YTD). Bloomberg US Corporate High-Yield Bond Index rose in tandem, returning 1.84% for the month and 4.57% for the first half. The exception was the 30-year Treasury, which, despite a 2.41% June rally, lagged overall with a modest 2.11% gain YTD.

Fixed income performance benefited from slowing economic momentum, recession concerns tied to tariff uncertainty, accommodative global monetary policies, and stable inflation expectations. Although tariff hikes raised fears of inflationary pressure, consensus views largely dismissed prolonged inflationary risks.

Looking ahead, challenges may emerge from the long end of the yield curve due to increasing Treasury supply. The recently enacted fiscal bill is expected to expand deficits by approximately $3 trillion over the next decade, driving deficits to around 7% of GDP and debt-to-GDP ratios to 124% by 2034, levels unseen outside wartime or severe economic depressions. The added supply will likely strain Treasury auctions and place upward pressure on the rate where yields will clear.



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Such fiscal dynamics could stress Treasury auctions, pushing long-term yields higher. Global bond markets are already experiencing signs of strain. Japanese Government Bond yields at the long end have risen to 15-year highs, while European and UK long-term yields have similarly surged amid increasing fiscal spending and quantitative tightening. Although not immediately alarming, investors should monitor liquidity and auction dynamics closely.

Federal Reserve and Monetary Policy

Chairman Powell. Speculation surrounding Powell's successor has intensified, raising concerns of political interference aimed at prompting rate cuts. Despite this political noise, bond markets remain stable, indicating confidence in the Fed's continued commitment to inflation control and economic stability.

Fed officials have hinted at openness toward potential rate cuts but remain cautious, awaiting clearer signals from labor markets and trade policy impacts. Inflation has remained persistently above the Fed's 2% target amid moderate economic growth and supportive financial conditions.

Federal revenue growth has provided additional optimism, running approximately 6.5% ahead of 2024 levels through July, driven by strong economic conditions and stock market gains in the prior year. While tariff revenues have also contributed positively, their impact remains comparatively modest.

Given these factors, the Fed's cautious stance on rate adjustments seems appropriate for now. Investors will need to closely monitor developments in trade policy, fiscal spending impacts, and inflation dynamics in the coming months.

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Definitions:
Bloomberg US Corporate Investment Grade Index: An unmanaged index that covers the publicly issued US corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg US Corporate High Yield Index: An unmanaged market value-weighted index that covers the universe of fixed-rate, non-investment grade debt in the US. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

Bloomberg US Mortgage-Backed Securities (MBS) Index: An unmanaged index that tracks fixed-rate agency mortgage-backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae

S&P 500: A capitalization weighted index of 500 stocks representing all major domestic industry groups. The S&P 500 TR Index assumes the reinvestment of dividends and capital gains.

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