SANJAC ALPHA'S QUICK TAKE

Mid-Year 2025 Market Review & Outlook

Where We Are Now

As we hit the midpoint of 2025, markets have once again shown that macro narratives rarely play out in straight lines. Despite a flood of upcoming Treasury issuance, tariff uncertainty, sticky base inflation, and one geopolitical flashpoint after another, risk assets remain buoyant and the credit market is holding the line — for now.

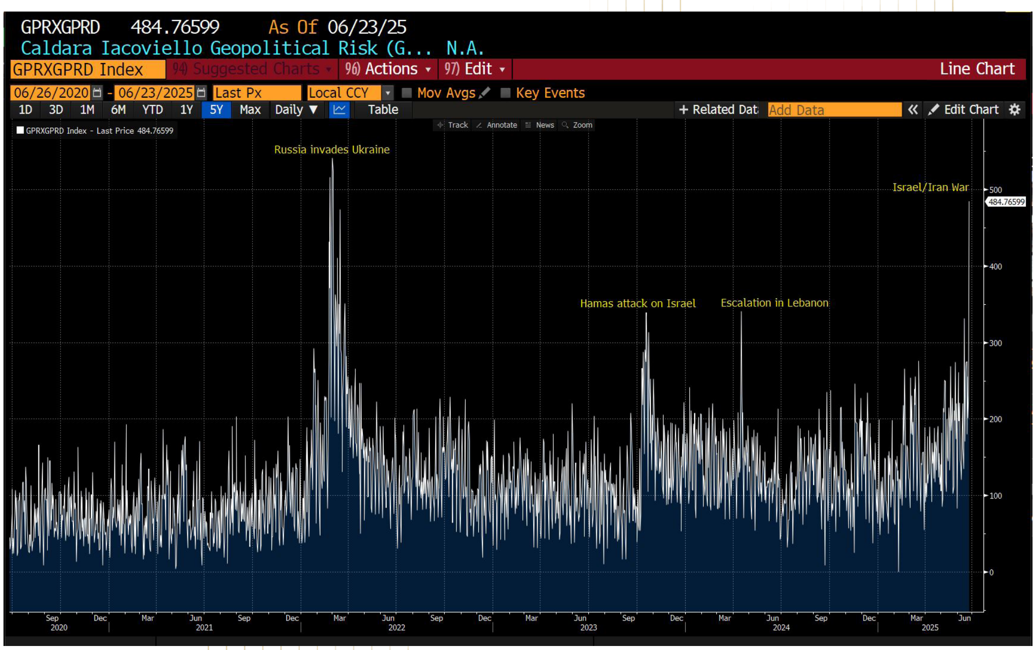
As we enter the second half of the year, we think the real story is about what's not moving. Treasury auctions are being digested, the dollar is quietly rallying, and inflation break-evens are stubbornly well-anchored. But cracks are starting to show in pockets of credit, and liquidity is not as deep as it appears on the surface. Our stance for the remainder of 2025 is one of liquidity vigilance.

Geopolitics & Market Psychology

The resilience of markets in the face of geopolitical risk is remarkable — or depending on your view — complacent. We have a fragile ceasefire between Iran and Israel, an escalation in Russia/Ukraine and an uneasy trade truce between US and China. None of these events have resulted in lasting price action.

Our take is that markets are no longer pricing in tail shocks. Instead, they are assuming pricing delay and diffusion. Delay because the lag in time between events and their economic effects (if any) have punished those traders who have reacted quickly. Diffusion because the market sees risks being diluted over a large series of assets, sectors and timeframes.

From an asset preservation objective, we are not ignoring it; but we are not trading around headlines either.



Caldara Iacoviello Geopolitical Risk Index, 5-Year Chart (06/26/20 - 06/23/25) Source: Bloomberg

Inflation: Bumpy Descent but No Freefall

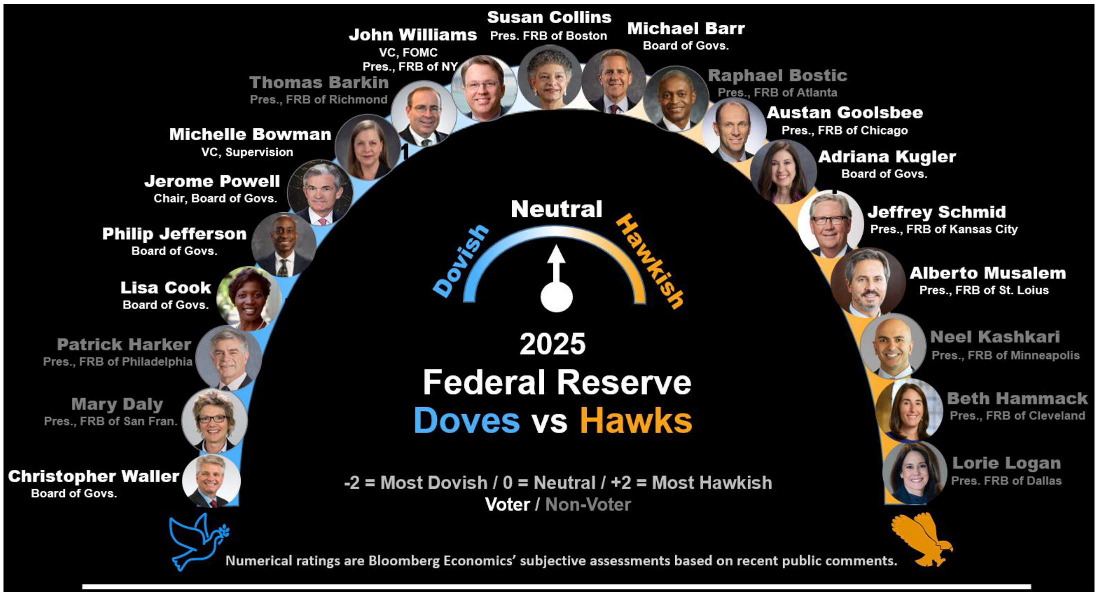
Overall, inflation is decreasing, but not in a straightforward manner. Core services inflation remains sticky, driven by labor cost pass-through and slower shelter disinflation than expected. Goods prices have normalized, but goods are a minority player in inflation prints[1] with services and shelter carrying much higher weights. The easy wins against inflation are likely over.

The Truflation Index (chart below as of June 24), a real-time index of thousands of inflation data points would suggest that inflation bottomed out in April.

Truflation, U.S. Daily Inflation Index, 6-month chart. Retrieved June 24, 2025, https://truflation.com

The futures market is betting that the Fed will come through with at least two rate cuts this year. We are not convinced. One-year break-evens are pricing inflation to be 2.52% one year from now. This is a moderated number considering that this indicator was over 3% in May, but one or two upside surprises on monthly prints could place the Fed on guard against further rises.

Our take: The Fed is more likely than not to be overly cautious in doing anything that could stoke inflation in light of the uncertainty around final trade agreements. However, the most dovish Fed members currently outweigh the hawks (see Fed Doves vs Hawks chart below). Tip: Assume the June payroll (July 3) and CPI [2] (July 15) reports as critical for near-term monetary policy. If either or both are weaker than expected, this will turn up the pressure for a July cut.



Federal Reserve Doves vs Hawks – 2025, based on subjective assessments of public comments.
Source: Bloomberg Economics, retrieved June 24, 2025

Treasury Supply High – Demand is Uncertain

The elephant in the room is supply. The Treasury is on pace to issue $3T+ in gross debt in the second half of 2025. Auction coverage remains resilient but there's no room for error.

If real yields break materially higher, it's unlikely to be related to Fed action, rather it could be auction fatigue. Without a strong bid from foreign buyers (historically Japan, UK and China) and a surging supply of treasury debt that needs to be termed out, we see the yield curve continuing to steepen. The buyers have always been there but we are watching for auction tails that could send long term rates higher.

Our take: Be cautious in buying long duration bonds, but be generous in buying the shorter maturities. There is plenty of yield yet in the short end of the curve, and any Fed rate cut action will only help bond prices two years and shorter in maturity.

Credit & Equities: Expensive, but Durable

We share everyone's amazement at how well credit has held up amidst a host of volatility in the economy. Investment grade credit spreads are near cycle tights as illustrated in the CDX chart below (CDX is a credit default swap index which measures risk price in the credit markets.) This is not to insinuate that there is little risk in credit — just that there is not a lot of future risk currently priced in.

Chart of the CDX Investment Grade Credit Default Swap Index (CDX IG CDSI GEN 5Y) 6-month chart.
Source: Bloomberg, retrieved June 25, 2025

Equities are still expensive by historical standards, but we're seeing better earnings support underneath what most analysts expected at the beginning of 2025. Volatility as measured by the VIX[3] is low, which should spur caution in that markets could correct again violently should we encounter another true risk off event.

Our Positioning for 2H 2025

We're positioned defensively but not passively. Here's our top-down strategy for the second half:

- Duration: Short duration, selectively moving out to 3-4 years on a duration selloff.
- Credit exposure: Higher quality, more liquid. We are a hold on BBB/BB crossover names, watching for entry points if spreads gap.
- Cash & liquidity: Maintaining a meaningful allocation to T-bills[4] and ultra-short strategies to stay nimble and allow for opportunistic buying.

We think the second half will be about managing downside optionality — being ready for a possible credit dislocation while still capturing excellent income in a yield-rich environment.

Closing Thoughts

The narrative of 2025 is a push-pull between resilient fundamentals and overstretched valuations. Markets want to believe in a soft landing for the economy, and so far, they've been right. But with inflation not yet defeated, Treasury supply ballooning, and credit spreads tight, the margin for error is narrowing.

A big selloff in a momentum-heavy market like this is not likely, but it pays to be prepared for one.

[1]**Inflation prints:** official data on the rate of inflation, usually measured by the Consumer Price Index (CPI) or the Personal Consumption Expenditures (PCE) Price Index. These prints provide a snapshot of how prices for goods and services are changing over a specific period, most commonly year-over-year. [2]**Consumer Price Index (CPI):**measures the monthly change in prices paid by U.S. consumers. [3]**CBOE Volatility Index (VIX):** real time index that represents the market's expectations for the realtive strength of near-term price changes of the S&P 500 Index.[4]**T-Bills:** Short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less.