

Capital Markets Perspective

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EQUITIES & CREDIT ADVANCE UNDETERRED

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The month of July brought with it solid earnings results, improved M&A activity, and better than expected GDP growth, albeit with a caveat. For the second quarter, the economy grew at a rate of 3.0%, materially ahead of the 2.3% that economists surveyed by The Wall Street Journal expected. But a big boost came from a 30% drop in imports, and business investment weakened, as C-suites continue to struggle to plan appropriately in an uncertain environment.

Consumer sentiment improved a bit, according to the University of Michigan's survey, as some of the tariff volatility had subsided (at least temporarily at that moment in time), and inflation expectations 1-year from now came down sharply from 6.6% to 5.1%. But as most are now aware, we have yet another source of uncertainty to contend with, as the jobs numbers weren't to the President's liking (despite a still impressive 4.2% unemployment rate) and the head of the Bureau of Labor Statistics was fired, casting a cloud over government data that is relied heavily upon by businesses and investors. The BLS is responsible for key measures of job growth and inflation, among other things, and due to early retirements, hiring freezes, and budget cuts the remaining BLS staff are struggling to collect the data needed for accurate estimates. Apollo's Torsten Slok reported that the percentage of goods for which estimates are being used to calculate CPI, as opposed to actual prices, has risen from around 10% at year-end to 35% in May.

But positives remain. Consumer and business leverage levels have been in decline for some time now, which may help offset some of the increase in government debt. Analysts have stopped lowering earnings estimates for the remaining quarters of 2025. And the percentage of central banks in hiking mode has dropped from 84% in October of 2022 to well under 20% at quarter end, with KKR circulating an estimate of only 8% by year end, marking a significant improvement in supportive monetary policy.

The markets on the other hand continue to climb higher in somewhat concerning ways. A research note from Goldman Sachs said that, "Our Speculative Trading Indicator has increased sharply during the last few months. The indicator now sits at its highest level on record outside of 1998-2001 and 2020-2021. The rise in the indicator reflects the elevated recent share of trading volumes in unprofitable stocks, penny stocks, and stocks with elevated EV/sales multiples." They went on to mention call option volume, first day IPO performance, and the return of SPACs as other signs of exuberance. Whether that be "rational" or "irrational" will only be known after some time.

What happened in the markets in July?

EQUITIES: EARNINGS AND MARGINS EXPAND ONCE AGAIN

With 79% of S&P 500 constituents reporting 2Q results thus far, operating earnings advanced by 12.3% month-over-month and by 10.6% from 2Q24. As reported earnings grew a bit slower compared with 1Q25 at 11.6%, but better relative to 2Q24 at 13.2%. More notable was the advance in operating margins to a level of 12.6%, which if it holds will be the highest since the end of 2022.

A.I. continues to be the only thing investors seem to be focusing on, and that led five of the Mag-7 stocks meaningfully higher once again, outpacing the overall market and resulting in the S&P 500 “winning” the equity asset class competition for the month. That A.I. focus is also leading to some valuations rarely seen; Palantir, which has become a darling in D.C. is now trading at a P/E of 671 times earnings, 114 times sales, and 412 times the most recent quarters cash flows.

Even with the dollar advancing during the month, emerging market equities put up a solid return of 1.7%, thanks in large part to economic resilience in China (exports keep growing, even as the % going to the U.S. declines). International developed equities were also up 1.4% in local currency terms, but U.S. investors suffered losses amounting to 1.4% because of the aforementioned strength in the U.S. dollar. Rounding out all things non-U.S., international small caps took a pause, ending about flat after a stellar first half.

BONDS: 2Q TRENDS REMAIN IN PLACE

July saw more of the same from the second quarter of the year. With rates rising across the curve, and the all-important 10-year yield advancing by 13 basis points (bps), long-term Treasuries lost ground, returning -0.9%. The yield curve remains inverted when measured by the 10-year minus the 3-month, but the 10-2 year is solidly in positive territory.

High yield spreads came in a bit – 10 bps – helping junk bonds to a gain of 0.4%, while their leveraged loan peers gained 0.9%. Investment grade corporates inched ahead, as spreads narrowed by 7 bps. And the bond market as a whole lost 0.24%.

COMMODITIES: A DISAPPOINTING YEAR CONTINUES

As a group, commodities sank by 0.5%, with agricultural futures and industrial metals contracts suffering losses of 1.4% and 6.3%, respectively. Copper, which is one of the most closely watched commodities for what it typically foreshadows about future economic growth, fell by 14% and was the worst performer. But this time around, it’s hard to separate the signal from the noise, as the Trump administration announced 50% tariffs on copper, which resulted in significant volatility during the month as traders tried to discern the policy threat to the market. Precious metals were up a bit on the strength of silver (gold was down), leaving the energy complex as the sole winner for the month. With Brent Crude gaining 9.5% and WTI Crude not far behind at 8.9%, the energy subsector advanced by 2.5%.

How are Frontier strategies positioned?

ALLOCATION CHANGES

Due to the complexities of attempting to generalize about allocation changes across our Core, Specialty, Tax-Managed, Income, Active ETF, and Faith-Based Strategies, and the additional difficulties of properly conveying how those asset allocation changes flow through to trade level activity, we instead direct clients to our monthly trade summaries, which describe in detail what trade activity occurred by strategy, and why.

Focusing on our Core Strategies, relative to their long-term asset allocations, which serve as policy portfolios guiding our dynamic allocation decisions, we favor U.S. and international small caps, emerging market equities, TIPS, and cash/short term bonds in more conservative strategies. We are generally underweight U.S. large cap stocks, and both high-yield and high-quality bonds at the asset allocation level, but differences between the asset allocations and actual exposure at the fund level can and will occur. ***At the beginning of August, asset allocation changes were quite minimal for the second straight month, after a period of transition during which Frontier implemented changes to our long-term allocations, as we've periodically done every 3-5 years.***

Expected returns for international large caps, investment grade debt, and municipal bonds all improved modestly month-over-month, while those for emerging markets, U.S. large caps, and U.S. small caps experienced slight declines.

PERFORMANCE ATTRIBUTION

With five of the Mag-7 stocks far outpacing the broad market and dragging the return of the S&P 500 along, Frontier's underweights to U.S. large caps was again a detractor to relative performance. But emerging market equities, which we are overweight, held their own and REITS, which we are underweight had another rough month, all of which helped the performance of our total equity exposure. International small caps, which have given our strategies a big boost for the year, took a breather, ending about flat and that hurt relative performance.

Within fixed income leveraged loans were helpful in our more conservative strategies, as they outperformed all other sectors. Our overweights to TIPS were also beneficial, as they managed to eke out a small positive return while the broader bond market lost ground. And in general, carrying less duration than the market in most of our strategies helped, as long-term Treasuries (a pure duration play) lost almost one percent.

Despite a rally in the oil markets, commodities, which are largely absent from our portfolios were down, benefitting both absolute and relative returns.

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Inflation is the decline of purchasing power of a given currency over time. A quantitative estimate of the rate at which the decline in purchasing power occurs can be reflected in the increase of an average price level of a basket of selected goods and services in an economy over some period of time. The rise in the general level of prices often expressed as a percentage, means that a unit of currency effectively buys less than it did in prior periods.

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ASSET CLASS	INDEX	INDEX DESCRIPTION
U.S. Large Cap Growth	S&P 500 Growth	Measures the performance of the large-capitalization growth stocks in the U.S. equity market.
U.S. Small Cap Growth	S&P 600 Growth	Covers roughly the small-cap growth range of US stocks, using a capitalization-weighted index.
U.S. Infrastructure	S&P Global Infrastructure	A stock market index that tracks the performance of 75 of the biggest publicly listed companies in the global infrastructure industry.
International Developed Equity	MSCI EAFE	An equity index which captures small-cap representation across 21 Developed Markets countries around the world, excluding the U.S. and Canada.
Chinese Equity	MSCI China	Captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).
Global Equity	MSCI All Country World	A stock index designed to track broad global equity-market performance
Emerging Market Equity	MSCI Emerging Markets	Captures large and mid-cap representation across 24 Emerging Markets (EM) countries.
Investment Grade Corporates	Morningstar US Corporate Bond	Measures the performance of fixed-rate, investment-grade USD-denominated corporate bonds with maturities over one year.
High Yield Bonds	Morningstar U.S. High Yield Bonds	Measures the performance of USD-denominated high-yield corporate debt. It is market-capitalization weighted.
TIPS	Morningstar US TIPS	Represents inflation-protected securities issued by the U.S. Treasury.
Leveraged Loans	S&P / LSTA U.S. Leveraged Loan 100	Designed to reflect the performance of the largest facilities in the leveraged loan market.
Long-Term Treasuries	Morningstar US 10+ Yr Treasury Bond	Measures the performance of fixed-rate, investment-grade USD-denominated Treasury bonds with maturities greater than ten years.
Municipal Bonds	Morningstar US Municipal Bond	Measures the performance of fixed-rate, investment-grade USD denominated tax-exempt debt issued by U.S. state, U.S territory, and local government entities with maturities greater than one year.
REITS	FTSE NAREIT Equity REIT	A free-float adjusted, market capitalization-weighted index of U.S. equity REITs.
Commodities	Bloomberg Commodity	Broadly diversified index that allows investors to track commodity futures through a single, simple measure. The DJ-UBSCISM is composed of futures contracts on physical commodities.

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