Q1 2025 Investment Letter

with Kevin Arenson, Akshay Krishnan & Tim Beck

Market Commentary

Equities	Q1 2025	2024
MSCI World (USD)	-2.1%	17.0%
MSCI EM (USD)	2.4%	5.1%
S&P 500	-4.6%	23.3%
STOXX Europe 600 (USD)	9.9%	-0.9%

Fixed Income	Q1 2025	2024
FTSE Global Bonds	2.6%	-2.9%
Investment Grade	2.5%	1.2%
High Yield	1.1%	7.9%
Bloomberg Global Agg Bond	2.6%	-1.7%

Currencies	Q1 2025	2024
USD (DXY)	-3.9%	7.1%
EUR (vs USD)	4.5%	-6.5%
JPY (vs USD)	5.0%	-10.5%
GBP (vs USD)	3.1%	-1.9%

Commodities	Q1 2025	2024
Gold	18.8%	27.0%
Oil (WTI)	-0.3%	0.1%
Natural Gas	13.4%	44.5%
Bloomberg Commodity	7.7%	0.1%

Source: Bloomberg as of 31 Mar 2025

Q1 events in markets have been superseded by what has happened in April with the imposition of a wide range of tariffs, the levels of which far exceeded almost anyone's expectations. Markets began to price in the risk of tariffs following the 25% tariff on imports of foreign vehicles and auto parts, this following the imposition of 25% tariffs on Mexico and Canada. By expanding from specific countries, this had the feeling of being something more permanent; the S&P 500 fell 3% in the last days of March and credit spreads widened. This whole debate accelerated in April with wide-ranging tariffs announced on 2 April ("Liberation Day"), which led to significant volatility and wild intra-day moves. Initially, the volatility was felt in equity but spread to fixed income where corporate credit spreads widened and US government debt saw an increase in yields even when markets were down, indicating that US government debt was not acting as a safe haven but more the cause of the risk.

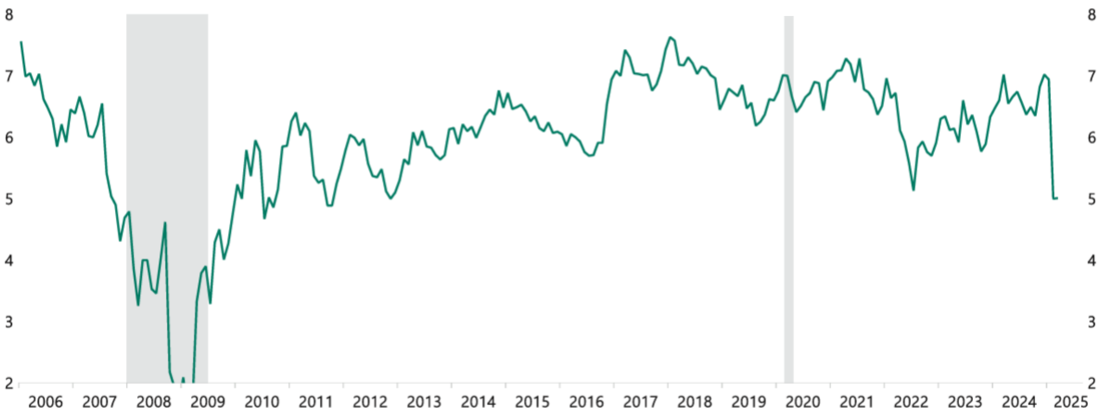
Overall, asset returns were mixed for the quarter. Reversing the trend of the last number of years, non-US assets outperformed US with the S&P 500 falling 4.6% while STOXX Europe 600 rose 9.9%. The Magnificent 7, which represents approximately one third of the S&P 500 market capitalisation and have driven recent returns, fell 16% impacted at least in part by the announcement of surprisingly powerful and relatively inexpensive AI models developed by China's DeepSeek. Credit markets were more resilient with the high yield bond and leveraged loan indices ending the quarter 1.1% and 0.5% respectively. Yields on government debt were reasonably steady with the US Fed keeping rates unchanged and with year-end forecasts also unchanged, implying two 25bps cuts. The ECB did cut rates by 25bps. Commodities were mixed, though gold was a standout performer rising 18.8%.

The Trump presidency was welcomed by many in the belief that it would foster stronger economic growth, built on the foundations of lower regulation in particular, as well as some fiscal reform and a reduction in government spending, which is on an unsustainable path. What was not expected was an upending of the global free trade system, which has lasted for the past 50 years. Many have seen the imposition of tariffs as the first stage of a negotiation. The risk is that this goes beyond that and causes lasting damage to the US and indeed the global economy. Confidence in the consistency of rules in doing business with the US has been damaged; the question is how, and indeed if, it can be repaired. From a narrative of US exceptionalism in Q1, the world has quickly moved to one of how to reduce exposure.

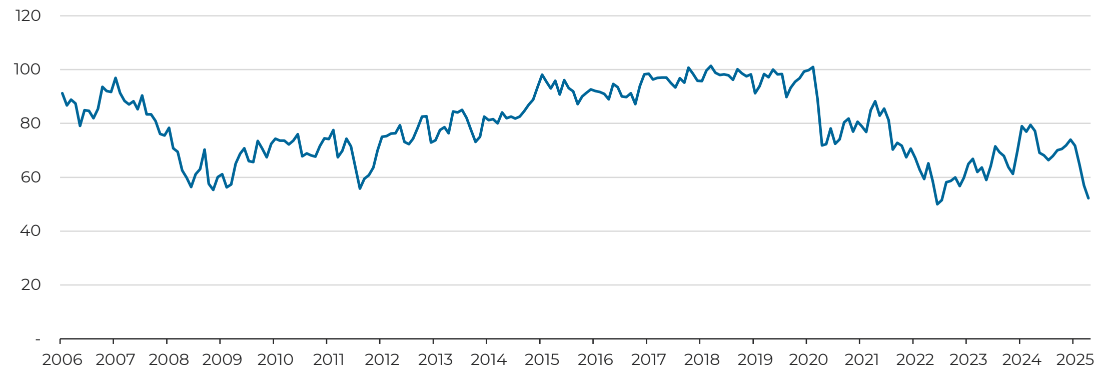
This is an ongoing, and potentially much longer-term, risk which could continue to depress asset prices. Institutions have been overweight US assets and also USD. Given the lack of transparency from some of the very largest investors here (sovereign wealth funds, endowments, etc.) the scale is unclear. Some data from Deutsche Bank suggests that this could be significant – they reference the Swedish pension funds and how underhedged they are against USD. If institutions look to just bring US exposure to market weight, and to increase their USD hedge, there could be continued and significant selling of US assets. These institutions do not always move rapidly and it may not be a fire sale – more an ongoing process, e.g. by not rolling maturing debt into new issue.

The impact of the tariffs has raised the potential of a US and global recession. Sell-side banks and asset managers have all increased the likelihood, though the depth and severity cannot in any way be foreseen as there is so much uncertainty over policy. The future levels of tariffs, and so the impact on price levels/inflation and corporate profitability are completely unknown. So are broader economic questions; witness speculation over whether the administration would try to remove Jay Powell from the role of Fed chair early. According to the University of Michigan's latest consumer survey, US consumer sentiment has fallen to the second lowest level ever on record. Both short- and long-term inflation expectations have soared to multi-decade highs.

CEO Confidence Index: confidence in the economy in 1 year from now[1]



US consumer sentiment[2]

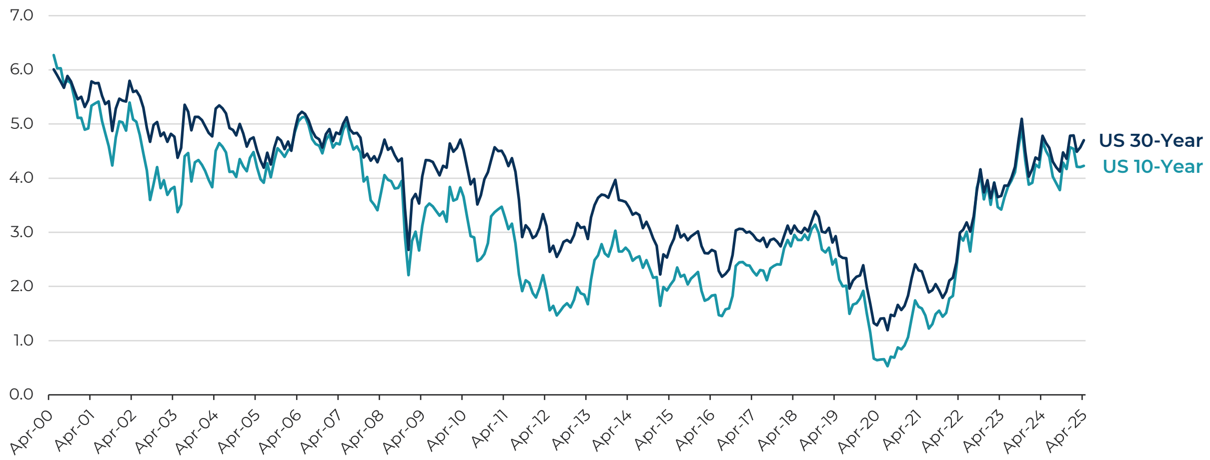


[1] *Source: Chief Executive Magazine, Bloomberg, Macrobond, Apollo Chief Economist, April 2025. Shaded areas indicate US recessions.*
[2] *Source: University of Michigan via FRED.*

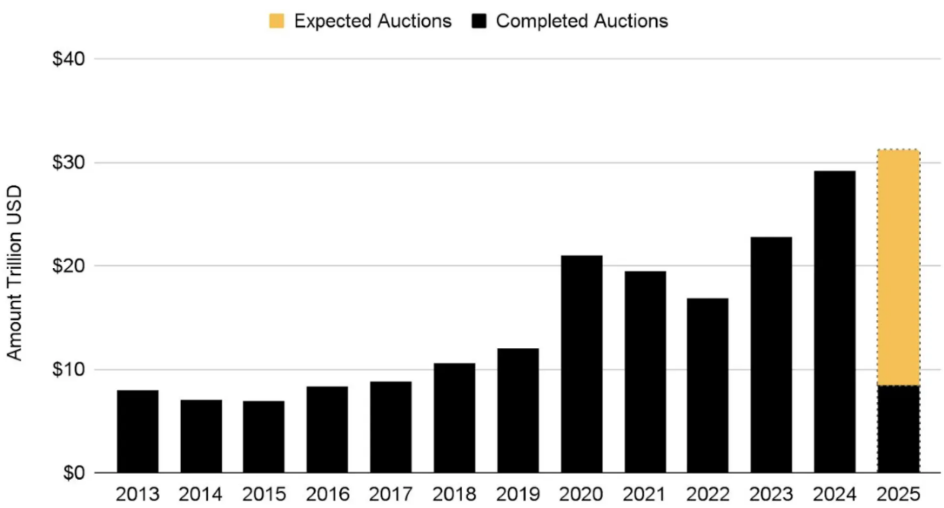
What is clear is that traditional asset classes are not at levels which are consistent with a recession. High yield credit spreads have widened, but remain in the mid-400s, whereas in prior recessions they have greatly exceeded this. Equities also are not reflecting the associated downturn in profits. We would expect traditional assets to fall significantly in the event of a recession.

Yields on US treasuries have risen with the US 10-Year reaching above 4%. This really matters; the US has a large amount of debt to refinance in the coming 12 months along with the need to finance a still significant budget deficit. With interest rate costs representing an ever-growing proportion of the US budget, this is of critical importance.

US yields (%)[1]



US Treasury auctions set to exceed $31 trillion in 2025[2]



It is not just protectionism which is a massive change from prior administrations. In late February, the US paused military aid to Ukraine after a televised and fractious meeting between President Trump, Vice President Vance and Ukrainian President Volodymyr Zelensky. Following pressure on Europe to increase defence spending this again indicated a difference between threats acting as a negotiating tool to hard actions indicating a change to world order. In both trade and geopolitics/defence, we have seen seismic change. The framework that has existed for the last half a century is changing, potentially irrevocably.

[1] *Source: Bloomberg as of 29 Apr 2025.*
[2] *Source: fiscaldata.treasury, Binance Research, as of 14 Apr 2025.*

Strategy Allocations

Our portfolios performed well in Q1, generally rising 2-3%. We continue to run with limited (if any) beta to markets. We see no reason to change this stance, given the significant uncertainty which exists, and continue to believe that a target return of high-single digits with no beta to markets is highly attractive. We are not changing our strategy mix; currently, market moves have not created a compelling opportunity to add significantly to a particular strategy over another. We are in constant dialogue with high-quality funds which have been closed to new investment should they themselves see redemptions from stressed investors (witness the press reports on US endowments looking to raise funds from more liquid investments given the lack of return of capital from private equity investments in particular).

Discretionary and Systematic Global Macro

Uncorrelated strategies had a strong quarter with discretionary macro, relative value and quantitative strategies all performing well. Increasing market volatility created more attractive trading opportunities across various asset classes.

Discretionary macro managers pivoted from long USD to short USD positions. Rates trading was profitable as short positions in Japanese rates and curve steepeners in other developed markets generated gains. A few discretionary macro managers also benefitted from long positions in gold and tactical trading of equities. Long volatility positions in currencies and rates were also profitable. Macro managers have generally shortened holding periods and have adopted a more tactical approach in the current environment. Increased volatility in currencies and interest rates, on the back of the greater macroeconomic uncertainty, should offer good opportunities for these strategies. We continue to prefer discretionary macro managers to systematic trend-following strategies right now, given the uncertainty and choppiness in the market environment.

Relative value returns were led by fixed income strategies. Bond basis trading was profitable across the US, Japan and Europe. Our managers generally held up well amidst the treasury market volatility in early April, which they believe has created an attractive opportunity set on a go-forward basis. Equity volatility strategies were also profitable for one of our managers.

Quantitative strategies had a good quarter with gains led by equity statistical arbitrage strategies. These managers started the year strongly as the momentum factor rebounded in January following a poor December. More elevated market volatility and volume created liquidity provision opportunities. Mean reversion signals also did well.

Our long volatility hedge was up modestly as implied volatility picked up toward the end of Q1. This manager performed well at the start of April and has been active in adjusting exposures to retain asymmetry.

Equity Long/Short

The MSCI World returned -2.1% in Q1, while the HFRI Equity Hedge posted a -1.4% return; its first negative quarter following five consecutive positive quarters.

The period was marked by an active news cycle and elevated volatility. The “Trump rally” that began ahead of the US President’s inauguration extended through the start of January. However, sentiment deteriorated following the release of DeepSeek’s seemingly competitive and cost-effective AI model, which triggered a selloff, particularly across momentum-driven pockets of the market tied to AI. Equity weakness intensified through March, notably in the US, as investor sentiment was further shaken by the aforementioned announcement of new US tariffs on Mexico and Canada. Markets grew increasingly cautious ahead of additional measures expected on Liberation Day. The S&P 500 ultimately posted its worst relative quarterly performance versus the MSCI ACWI (ex-US) since 2009.

Against this backdrop, Stenham's allocation to discretionary equity long/ short managers detracted slightly.

Within our multi-strategy portfolios, allocations to two utilities and infrastructure managers detracted slightly during the quarter. One of them experienced losses in January, driven by exposure to wildfire-affected utility stocks in California. Separately, our exposure to a low net healthcare manager also marginally detracted.

The healthcare sector was pressured by multiple headwinds, including concerns that RFK Jr.'s appointment to lead the Department of Health and Human Services could undermine the FDA's functioning, fears over proposed cuts to NIH research funding, and renewed tariff uncertainty related to pharma.

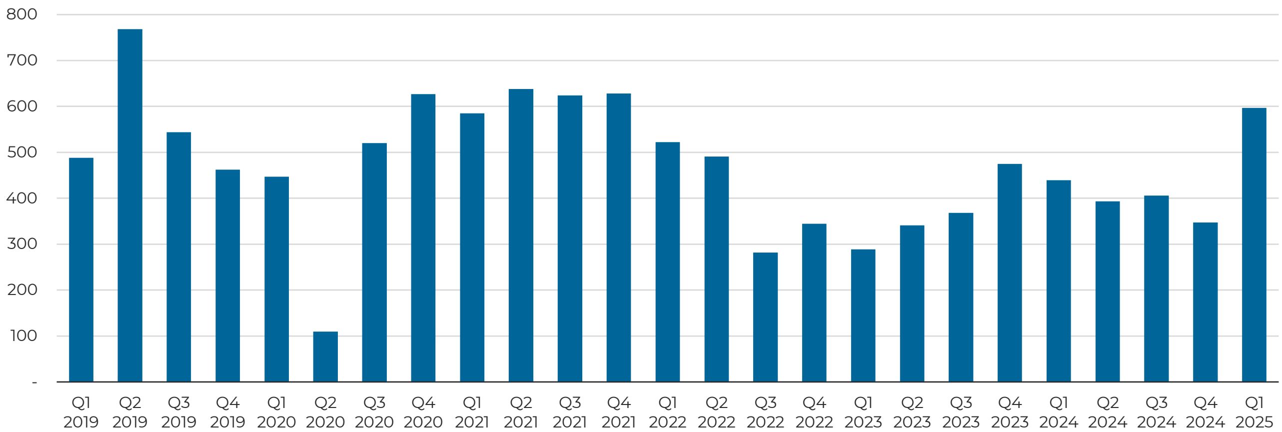
In terms of positioning, we continue to favour managers with low to moderate levels of net exposure and modest gross exposure. In general, there is currently limited visibility in markets, but expecting higher levels of volatility seems reasonable and thus we prefer to be positioned more cautiously.

Event Driven

Deal activity was reasonably strong in Q1, continuing a recovery in M&A. The expectation has been for greater deal activity, spurred by more deal-friendly appointments at US regulatory agencies. This narrative has been overtaken by tariffs and general uncertainty. We do not know the impact and deals are less likely, certainly large multinational deals. M&A activity has slowed down in April, but maybe not as significantly as may have been thought and deals are still being done, though typically more domestically focused industries.

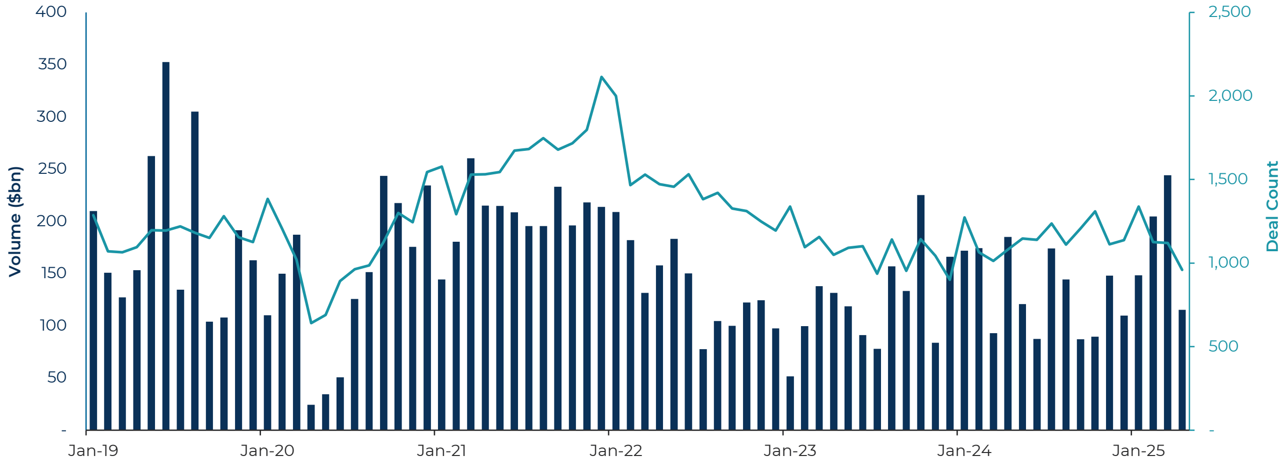
The event driven allocation was positive. Our lower risk manager continued to see deals close and has maintained a higher level of investment than that seen in 2023/4. There were no notable detractors. Our higher-risk manager saw volatility, but was overall positive low-single digits. Two large positions drove returns; Nippon Steel's acquisition of US Steel and Boeing's acquisition of Spirit AeroSystems. The former has been sent back to the Committee on Foreign Investment in the US ("CFIUS") for judgement, chaired by Treasury Secretary Scott Bessent, with a ruling due in the next 1-2 months. Boeing's acquisition of Spirit is seemed likely to complete but has a complex collar structure which leads it to be somewhat volatile and may preclude other arbitrage investors.

US M&A volumes ($bn)[1]



[1] *Source: Bloomberg as of 31 Mar 2025.*

US M&A activity[1]



Credit

Our credit allocation performed strongly. Long/short managers were able to profit from the volatility in markets, rotating into names which had not moved as much as others, as well as dynamic positioning to take advantage of trends in markets. Our European manager rotated successfully into European defence names, while event driven positions, including in Thames Water and Altice, also performed strongly. Generally, our managers are positioned short those names most exposed to tariffs and/or an economic recession, short consumer names and those with multinational supply chains. The managers are confident on their positioning regarding tariffs, but increasingly underwriting the impact of a recession, though with so much uncertainty this is more difficult. Index level hedges have generally been added and overall net positioning reduced. Our convertible bond manager also performed well, benefiting from single-name idiosyncratic volatility as well as successfully trading new issues.

Summary

More than ever, we would encourage you to contact any of us at Stenham to discuss investments and the outlook as we and our managers see it. Uncertainty is high and we acknowledge investors want close contact with us. We believe we are well positioned to deliver attractive returns irrespective of the course of markets and welcome the opportunity to discuss this.

Further information can also be found on our website.

The Executive Advisory Committee

Kevin Arenson

Akshay Krishnan

Tim Beck

[1] *Source: Bloomberg as of 25 Apr 2025.*

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