Pavlic Investment Advisors Inc.
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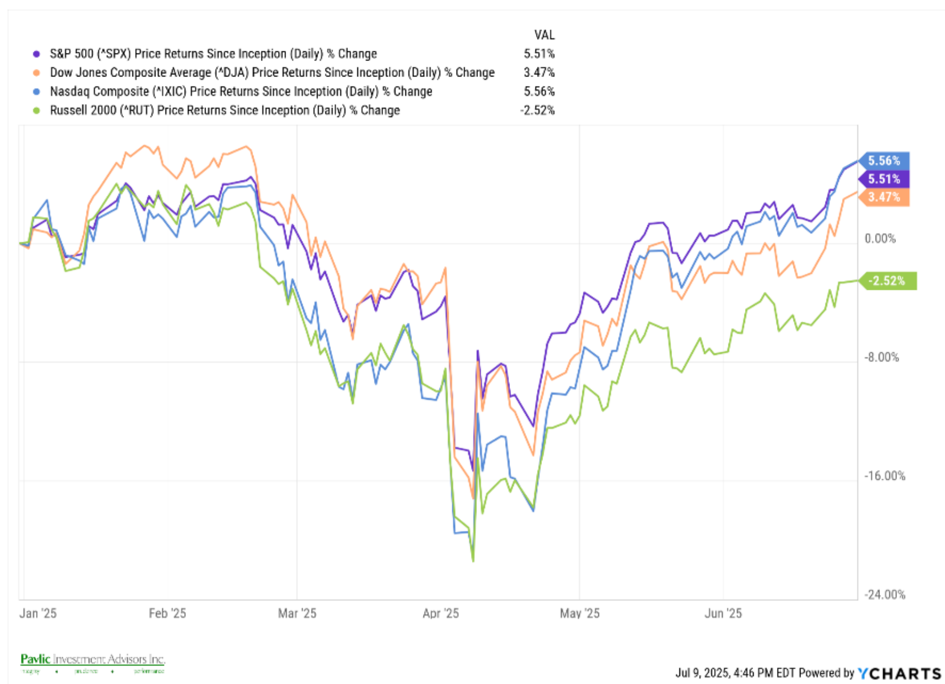
2nd Quarter 2025 Review & Outlook

Dear Client,

The second quarter was volatile for equity markets with initial tariff turmoil followed by a subsequent rally to close the first half of the year near all-time highs. **Our core portfolio of stocks* performed well finishing the quarter up mid-single digits on a year-to-date basis.** While we marginally lagged the all-technology Nasdaq index (+5.5% Year-to-date through quarter end) and the technology-heavy S&P 500 (+5.5% YTD), our core portfolio of stocks outperformed the Dow Jones Industrial Average (+3.5% YTD) and the small cap Russell 2000 (-2.5% YTD). During the quarter the financial markets navigated a dynamic landscape shaped by significant policy shifts, trade developments, and legislative changes. The ever-changing backdrop around tariffs and the passage of the One Big Beautiful Bill Act (OBBBA) commanded most of the media headlines as well as client questions during the quarter. Our objective of this newsletter is to help our clients better understand how these developments will affect both portfolios, and importantly, how the OBBBA will impact your financial plans in place with us.

Stock Market Performance: Resilience Amid Uncertainty

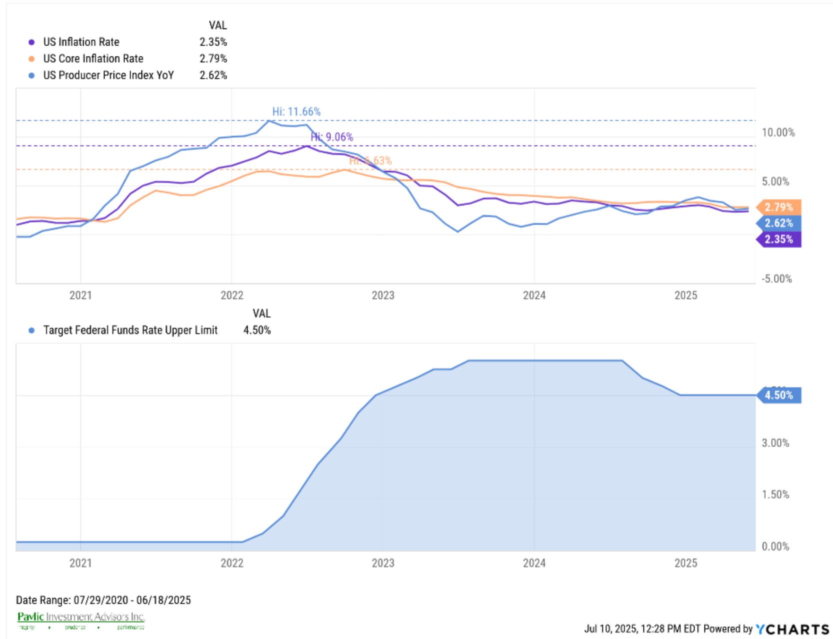
The U.S. stock market exhibited remarkable resiliency in the second quarter despite headwinds from trade policy and fiscal policy changes. The S&P 500 and Nasdaq reached new highs, driven primarily by strength in the technology sector. Information Technology stocks were buoyed by companies like Nvidia—which became the first company to reach a $4 trillion market cap with gains of over +70% off the early April lows. Sectors such as industrials, communication services, and financials also contributed meaningfully to market strength. Small-cap stocks lagged, declining -2.5% year-to-date, as smaller companies faced greater sensitivity to both tariff-related cost pressure and interest rates that didn't come down as quickly as predicted at the beginning of the year.



Market volatility spiked in early April following President Trump's Liberation Day tariff announcements, which introduced uncertainty about global trade. Investors initially reacted with caution, leading to a brief sell-off in sectors like technology, healthcare and energy. However, strong corporate earnings and a robust jobs report in early July helped restore confidence, pushing major indices to new highs by quarter-end. Despite this, tariff-related concerns continue to create choppy trading sessions, including in early July, as investors await clarity on trade negotiations which remain ongoing. The latest news as of this report is that the 90-day extension on global tariffs was extended another 20 days to August 1st. We believe the volatility we experienced in the second quarter is here to stay until we get greater clarity around global trade.

Bond Market Trends: Stability with Tariff-Driven Ripples

The bond market experienced a relatively stable quarter relative to equity markets, though it was not without its fluctuations. U.S. Treasury yields remained elevated with the 10-year Treasury yield hovering around 4.4% as the "higher for longer" interest rate environment persisted. Our corporate bond portfolios performed well in the quarter, with falling credit spreads reflecting confidence in the creditworthiness of high-quality issuers. This put upward pressure on bond prices in addition the coupon payments we collected for clients. Encouragingly with the now normal shaped yield curve, our variable rate bonds have begun to pay interest again after a period of an inverted yield curve.



Tariffs Since Liberation Day: A New Trade Landscape

Since President Trump's Liberation Day announcement on April 2, 2025, tariffs have been a central theme in financial markets. The administration has pursued an aggressive trade policy, with significant developments unfolding over the quarter:

- **April 2025:** The initial tariff announcements targeted a range of trading partners, signaling a shift toward protectionist policies aimed at boosting domestic manufacturing. Markets reacted with a brief sell-off, as investors feared disruptions to global supply chains and higher consumer prices.
- **June 2025:** Tariff discussions intensified with President Trump announcing a 25% tariff on Japanese goods effective August 1, 2025, alongside threats of additional duties on South Korea and BRICS nations, including a 10% tariff on India. These moves dampened investor sentiment for small-cap and import-dependent firms.
- **July 2025:** On July 7, Trump extended the tariff deadline to August 1st, but maintained a firm stance that no further extensions would be granted. This uncertainty led to a 1.1% drop in the utilities sector, as investors grappled with the potential inflationary impact of tariffs.

While tariffs are expected to incentivize U.S. manufacturing potentially benefiting sectors like semiconductors, industrials, and autos through tax credits and deductions, they pose challenges for small-cap firms and import-reliant industries. The U.S. dollar weakened slightly during the quarter, which could support exporters but increase costs for consumers reliant on imported goods. We are closely monitoring trade negotiations, as successful talks could mitigate some of these risks.

Financial Implications of the One Big Beautiful Bill Act (OBBBA)

Signed into law on July 4th, 2025, the OBBBA represents a sweeping overhaul of U.S. tax and spending policy with significant implications for the economy and financial markets. The bill is projected to add $3.3–$3.4 trillion to the federal deficit over the next decade, according to the Congressional Budget Office (CBO). Key financial impacts include:

- **Economic Growth:** The CBO estimates the bill will boost real GDP by approximately 0.5% over 10 years driven by tax cuts and increased defense spending. However, this growth may be offset by negative multiplier effects from cuts to social programs like Medicaid and SNAP, which could reduce consumer spending among lower-income households.
- **Market Impacts:** The bill's tax incentives, such as a 35% tax credit for semiconductors and immediate deductions for new manufacturing facilities have bolstered investor confidence in manufacturing and defense sectors. However, the repeal of clean energy tax credits has weighed on solar and wind energy stocks.
- **Deficit and Interest Rates:** The increased deficit raises concerns about long-term fiscal sustainability. Higher borrowing could pressure interest rates to move higher, making financing more expensive for consumers and businesses. This risk is particularly relevant for bond investors who hold maturities greater than 10-years out, as rising yields could lead to capital losses on fixed-income holdings.

Tax Implications for Our Clients

The One Big Beautiful Bill Act introduces several tax changes that may directly affect your financial plan:

- **Tax Cuts from 2017 TCJA Extended:** The bill makes the 2017 Tax Cuts and Jobs Act (TCJA) permanent, preventing tax increases for 62% of Americans that would have occurred if the OBBBA was not signed into law. This includes maintaining lower marginal tax rates across all income thresholds. Many filers especially value the 22% and 24% brackets, which stretch from about $100,000 to $400,000 for married joint filers and half that for single filers.
- **Standard Deduction Increase:** The standard deduction increases to $15,750 for single filers and $31,500 for joint filers, with future adjustments for inflation. This would have reverted to $8,350 (S)/$16,700 (MFJ) if the OBBBA was not signed into law. Nationally, those that take the standard deduction increased from ~70% to ~90% of filers after the TCJA passed in 2017 thereby simplifying taxes for most Americans.
- **Higher SALT Cap Deduction Limit:** The cap on state and local taxes (SALT) increases to $40,000, up from $10,000, through 2029 for households with adjusted gross income (AGI) up to $500,000. The $40,000 limit is scheduled to return to $10,000 after 2029.
- **No Tax on Tips and Overtime.** Hourly workers will no longer pay federal income tax on tips or overtime pay.
- **Senior Bonus Deduction (Social Security tax break work-around).** To claim social security income will go untaxed, seniors over 65 will be able to claim a "senior bonus" deduction of $6,000 (S)/$12,000 (MFJ) subject to income limitations.
- **Estate Taxes:** For 2025, the estate tax exemption is $15.0 million per individual which was set to drop to ~$7 million in 2026. The new law sets a permanent base of $15 million per person ($30 million for MFJ) starting in 2026, with inflation adjustments after that.

Looking Ahead: Strategic Considerations

As we move into the third quarter, we remain focused on positioning your portfolios to navigate this evolving landscape. We continue to recommend the following:

- **Stock sector diversification:** Maintaining exposure to all sectors—both sectors current in favor and not in favor--while monitoring small-cap and import-sensitive stocks that would "bounce hardest" if tariff issues continue to subside. Technology continues to be the life blood of our economy, and as such, it continues to be our largest sector weight.
- **Fixed-income strategy:** We are maintaining exposure to shorter-duration bonds to mitigate risks from potential yield increases driven by higher federal deficits. The yield curve is relatively flat, so we are not giving up much yield by staying shorter to maturity.
- **Financial Planning:** We will be reaching out with clients over the next quarter to review your dynamic financial plans to determine how the OBBBA tax law changes will impact your finances. The large portion of income taxed at 22% and 24% will create clarity around Roth IRA conversions and/or stock-option exercise decisions for clients.

We remain committed to proactively managing your wealth and adapting to the ongoing marketplace changes. Tax law changes are a great time to review your financial plan, and we believe we have the best software on the market to help us navigate the changes mentioned above together. Please don't hesitate to schedule a comprehensive review of both your portfolios and your financial plan and we thank you for your continued trust in Pavlic Investment Advisors.

"The Big Money is made not in the Buying and in the Selling, but instead in the Waiting."
- Charlie Munger