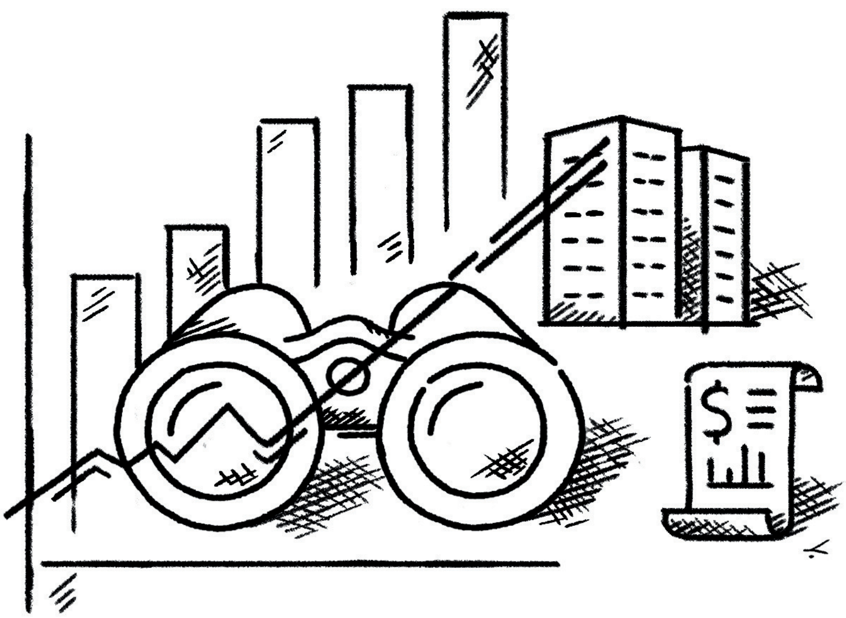
The Nexus Report

Portfolio Gains Despite Tariff Turmoil



Second Quarter 2025

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You Can't Make This Stuff Up

As we enter the second half of 2025, it seems appropriate to cite the over-used phrase, "we live in interesting times."[1] Few could have imagined the financial market tumult in the most recent quarter and the year-to-date. As we discussed last quarter, the aggressive implementation of protectionist trade policy in the early days of the Trump presidency cast a dark shadow over markets. However, no one imagined the scope and scale of the "reciprocal" tariffs introduced on "Liberation Day", April 2. From the 2025 high in February, to the low on April 8, the S&P 500 Index declined by 18.9%, to the precipice of a bear market.[2]

Clearly unnerved by the market reaction, the Trump administration quickly backpedaled on many of the tariff announcements. Equally quickly, investor sentiment shifted from despair over the potential for economic catastrophe to growing confidence that the Trump bark will be worse than the bite. From the April 8 low to June 30, the S&P 500 Index roared higher by 24.5%, and closed out the quarter at an all-time high.[2]

Perhaps even more improbable was the strength of the Canadian stock market. Seemingly unconcerned with the possibility of a trade war that could cripple the Canadian economy, the TSX Composite has soared – up 8.5% in the last three months, 10.2% year-to-date, and 26.4% in the last year.

Similarly, international stock markets have been strong in 2025 as investors seem to have dismissed the risks to global growth that a protracted trade war would present. Few could have predicted the sanguine attitude exhibited by international investors given the rhetoric coming out of Washington.

Notwithstanding the rebound in U.S. stock markets since Trump backed off his initial tariff announcements, the U.S. stock market has been noticeably less exuberant than others. It is also important to note that the U.S. dollar declined more than 10%, to a three-year low, in the first six months of 2025, the largest first half decline since 1973.[3] It seems clear that investor confidence in U.S. markets has been shaken by what can only be described as chaotic behaviour of the Trump administration. In 2024, many in the investment world discussed the idea of "U.S. exceptionalism", following a 15-year period when the U.S. economy and markets strongly outperformed others in the developed world. Investors now seem to be questioning whether this era is coming to an end.

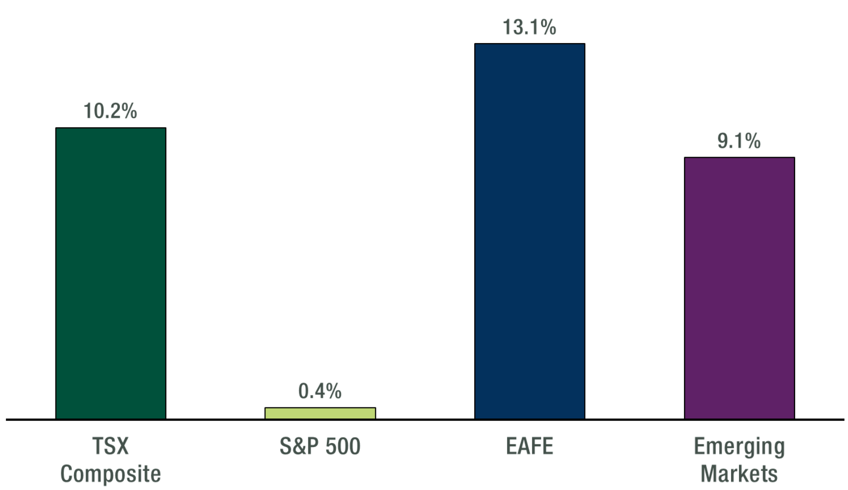
How Slow Will Growth Go?

There is no doubt that the Canadian economy is slowing in the first half of 2025. Growth during the first quarter was +2.2% (quarter-over-quarter), likely receiving a boost from businesses and consumers front-running anticipated tariffs. In the second quarter, growth has slowed to stall speed, tracking at about -0.3% (q/q) according to Scotiabank estimates.[4] For sure, tariffs on steel, aluminum and some autos are starting to bite. Manufacturing and wholesale trade were hit hardest in the April GDP numbers. However, there is a lot of noise in recent numbers on account of the western wildfires and weather.

Even though growth has slowed, Canadian inflation remained sticky at an above-target rate. Core CPI for May was 3% and the number of components in the data running hotter than 3% broadened out. Needless to say, slowing growth and sticky inflation present a troublesome combination for the Bank of Canada to manage.

Potentially positive news arises from Canada's commitment at the recent NATO summit to increase defence spending to 5% of GDP. Many questions remain as to where we will find such vast sums of money to build the military so dramatically. However, the Carney government seems determined to spend a lot of the money in Canada, which should build our industrial base, create good jobs, and grow our economy over time.

Total Returns – 6 Months Ended June 30, 2025 (C$)



NOTE: Unless indicated otherwise, all Nexus returns are compound annual average, time-weighted, total rates measured in Canadian dollars and calculated after deducting such direct and indirect costs as applicable withholding taxes, trading commissions, custody fees and other fund/account expenses, but without deducting Nexus's management fees (which are charged to client accounts and vary by client). Returns for market indices and benchmarks are presented on the same basis, but without any such deductions. Stock-specific returns are price-only returns, and for U.S.-listed stocks are in U.S. dollars. Past performance is not indicative of future results. For more information about benchmarks, please refer to https://tinyurl.com/NexusOnBenchmarks.

[1] This is usually thought to be an ancient Chinese proverb or curse; however, Perplexity insists that it is a Western invention or mistranslation of some other Chinese phrase.

[2] Index returns are price only in USD in this sentence.

[3] USD against a basket of currencies, an index known as the DXY.

[4] Derek Holt, Scotiabank Global Economics, June 27, 2025.

On the surface, the U.S. economy seems to be holding up remarkably well in spite of the trade turmoil. The Bureau of Labor Statistics reported that 147,000 new jobs were created in June, significantly higher than the expectation for 106,000. May's job creation number also was revised higher. The unemployment rate ticked lower to 4.1%. Open and unfilled jobs in the U.S. rose in June in contrast to the expectation for a small decline. While real GDP growth for the first quarter of 2025 was a worse-than-expected -0.5%, this was entirely because of a 38% surge in imports as businesses tried to front-run tariffs. The Atlanta Fed's Nowcast forecasts GDP growth for the second quarter of +2.6%. This solid economic data has caused the Federal Reserve to keep interest rates at a level that is higher than the President would like.

Underneath the surface, however, there are reasons for caution. Despite the big headline jobs number, private sector job growth numbered only 74,000 – much weaker than recent months and the lowest number of private sector jobs created since last fall. More than half the private companies surveyed reported that they cut jobs in June, typically blaming uncertainty from government policy.[5] Consumer spending has slowed sharply, consistent with the surprising deterioration in consumer confidence in the Conference Board survey in June. While the ISM Manufacturing survey improved very slightly from May to June, it remains at a level that is typically associated with periods of economic contraction.

Last but not least, we believe that caution is warranted because the big effect of tariffs has not yet been felt in the streets of America. Raw materials were stockpiled, but eventually the tariffs on steel and aluminum will find their way into automobiles and washing machines. JP Morgan has estimated that of the $30 billion per month that the U.S. is currently collecting in tariffs, 60% will be paid by American consumers. It is a massive tax increase, larger than the relief offered in the Big, Beautiful Bill.[6]

Market Outlook

Everything depends on the unpredictable path of U.S. trade policy. President Trump has declared a love for tariffs, a policy that virtually every economist believes will disrupt global economic growth and be bad for the U.S. economy. On the other hand, Trump is inclined to reverse course quickly when financial markets decline noticeably in response. The outlook, therefore, depends entirely on this tension between implementing protectionist trade policies and the political fallout from doing so. The midterm elections are only 16 months away. The market is betting that Trump will blink. It is our view that a bad outcome for the Canadian economy and markets is possible, but that the probability of this is low. A much higher probability is that Canada gets a "deal" some time before long. That would lift a dark cloud of uncertainty.

We continue to feel that the U.S. stock market is more vulnerable than others. Its current valuation is 22x earnings over the next 12 months. This compares to the 10-year average of 18.7x and longer term averages lower than that.[7] Foreign investors own 20% of U.S. equities, a 20-year high.[6] Perhaps the chaos in Washington will lead them elsewhere? Gold is up 25% so far in 2025, the largest such first half gain since 1979. Gold prices are signalling that investors are worried about something.

The good news is that we don't buy "the market". We look for attractive opportunities with individual stocks. The current environment is unsettling, particularly for Canadians. However, the chaos created by the Trump administration has created investment opportunities that have found their way to client portfolios. We expect there will be more. We also don't try and time the market and react to the daily news flow. We invest for the long term. We remain optimistic that at some point down the road we'll all look back on this period with a smile and think, "You can't make this stuff up."

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[5] *The Wall Street Journal*, July 4, 2025.
[6] Dr. David Kelly, JP Morgan Guide to the Markets, July 2025.
[7] *The Wall Street Journal*, July 1, 2025.

On Again, Off Again

In the second quarter, North American equity markets experienced significant volatility. Markets swooned in April, due to trade tensions and tariffs. Trump's "Liberation Day" announcement, which proposed unprecedented new tariffs on imported goods, led to the biggest one-day selloff since COVID upended markets in early 2020. At one point in April, the S&P 500's cumulative decline from its February peak reached 18.9%, putting it very close to bear market territory (defined as a 20% decline from a recent high). Consumer sentiment subsequently plunged on fears of inflation and potential recession.

In May, however, markets staged a strong rebound after the U.S. administration dialed back its tariff rhetoric, inflation data cooled, and consumer confidence recovered. Market gains continued in June, even as conflicts in the Middle East escalated, including a U.S. bombing run on Iran's nuclear sites. Amidst all of this, U.S./Canada trade talks – which appeared to be progressing – were abruptly halted over the digital services tax, only to be restarted once the tax was repealed.

When the dust settled at the end of the quarter, the S&P was up a remarkable 5.1% in Canadian dollar terms (and 10.9% in U.S. dollar terms), while the TSX had gained 8.5%. The quarter was a vivid reminder that markets have a flair for drama. Looking forward, uncertainty remains elevated, and it is anyone's guess as to whether the situation will stabilize or, in the words of Canada's Randy Bachman: "you ain't seen nothing yet".

North American Equities

Nexus's Canadian stocks rose 7.5% this quarter and 21.6% over the year. The main contributors to the quarterly gains were our Industrial and Financial holdings. In Industrials, Finning gained 43% after reporting a strong quarter, including a record backlog of orders for heavy machinery. In Financials, TD Bank increased by 16% during the quarter and is up 31% year-to-date as it rebounds from its recent anti-money laundering issues. These benefits were partly offset by a challenging quarter for our Energy stocks, due to a softening of crude oil and natural gas prices as investors grappled with slowing demand, geopolitical uncertainties and near-term oversupply concerns.

Our U.S. stocks gained 4.3% this quarter and 17.1% over the year. Tech holdings like Microsoft (+33%) and Meta (+28%) led gains in the quarter, while Financials such as Citigroup (+20%) and JPMorgan Chase (+18%) also performed well. CarMax (-14%) detracted due to concerns about tariff-related inflation and used car affordability. Ferguson Enterprises, acquired last quarter, was our top performer in the U.S., gaining 36%.

We introduced a new holding, Thermo Fisher Scientific (TMO), a high-quality and broadly diversified company with significant exposure to the essential tools and services of the healthcare industry, including life science tools, diagnostics, and lab services. TMO stands out as a market leader with a strong track record of innovation and commercialization, underpinned by a culture of continuous improvement and a robust financial profile. The company is deeply embedded in healthcare innovation, playing a crucial role in the development and manufacturing of advanced life science tools. While there are near-term challenges – particularly around U.S. government funding for medical research and ongoing geopolitical tensions with China, a significant market for the company – we believe these issues have created an attractive valuation opportunity. The enduring long-term trends in demand for advanced healthcare solutions and next-generation biopharmaceutical development remain strong, positioning TMO for continued growth well into the future.

International Equity Investments

We continue to hold two externally-managed pooled funds.[8] In the quarter, EQIT (international developed market equities) rose 4.2% and EMEC (emerging market equities) gained 7.4%.

International markets mirrored North America's trajectory, experiencing a decline following the initial tariff announcement but subsequently rallying after the suspension of the tariffs. Given the fundamental role of global trade in driving economic growth and financial market outcomes, the reaction of international markets to both the implementation and suspension of tariffs was understandable.

After performing well in Q1, Europe maintained its momentum as a top-performing region. Industrial stocks helped drive gains, bolstered by an agreement at the NATO summit to increase defense spending. There has been a notable shift in sentiment and policy across Europe to increase fiscal spending in areas like defense and infrastructure, and this is generating optimism among investors regarding future growth prospects.

Emerging markets also saw strong performance in Q2, supported by reduced U.S.-China trade tensions, a tariff pause, and a weaker U.S. dollar. Key long-term drivers—including rising consumer spending, favourable demographics, appealing valuations, and solid earnings potential—remain intact.

International investments continue to offer portfolio diversification benefits and present compelling relative value, particularly when compared to the elevated valuations in U.S. markets.

> *The quarter was a vivid reminder that markets have a flair for drama.*

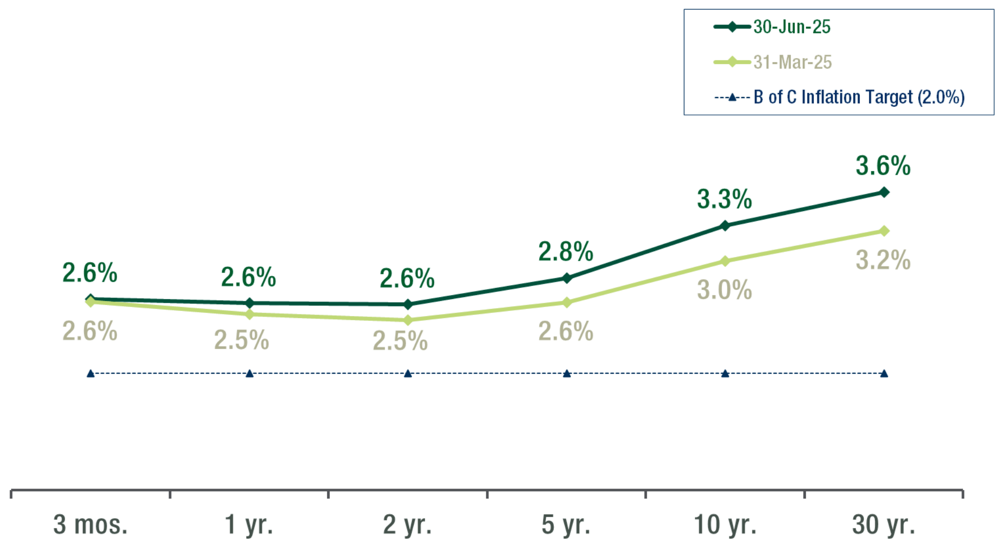
NOTE: The overall and geographic level return data in this section are for the Equity Fund. Equity returns within the Balanced Fund were similar. For specific performance, please refer to your own quarterly report.

[8] Both pooled funds are managed by teams from J.P. Morgan Asset Management in the U.K. and are held in our International, Equity, and Balanced Funds.

Curve Finds Its Slope Again

After a strong start to the year, Canadian bond markets paused in the second quarter, with the FTSE TMX Universe Bond Index slipping 0.6%. In contrast, Nexus's bond portfolio delivered a positive return of 0.4%. Over the 12 months ending June 30, 2025, the Index delivered a solid gain of 6.1%, while Nexus's bond portfolio outperformed with a 7.8% gain.

Government of Canada Yield Curve



The Nexus Income Fund, which includes up to 20% in income-oriented equities, returned 1.2% in Q2, and 10.8% over the last year.

Tariff uncertainty remained the dominant theme in the second quarter. The U.S. delayed the implementation of the tariffs announced on "Liberation Day" to negotiate bilateral trade deals and walked back the egregious tariffs it had proposed on China – tariffs that, if enacted, would have been tantamount to an embargo. While some announced tariffs were scaled back, they remain elevated. As of June 30, 2025, JPMorgan estimates the average U.S. import tariff rate at 15%, a sharp increase from the 3% average that prevailed prior to the start of Trump's second presidency.[9]

This tariff-related uncertainty weighed on the Canadian economy. While Q1 GDP growth of 2.2% was surprisingly strong, it was largely driven by temporary factors – a buildup of inventory and an increase in exports to the U.S., as buyers rushed to get ahead of anticipated tariffs. However, final domestic demand, which includes consumption, government spending and investment and serves as a better gauge of underlying economic strength, was flat. Monthly GDP estimates for April and May showed modest declines, pointing to a reversal of the temporary boosts seen earlier in the year. That said, recent economic data has been noisy, influenced by the impact of western wildfires and unusual weather patterns, as mentioned in the Outlook section. While economic growth has slowed, the Canadian economy has been more resilient than many anticipated.

The Canadian labour market continued to soften but has held up better than most expected. Sectors exposed to trade headwinds – manufacturing, transport and warehousing – shed jobs, while hiring increased in areas less affected by trade. The unemployment rate in Canada increased in the quarter but was primarily driven by an expansion of the labour force, which isn't necessarily a negative development. Although headline inflation eased to under 2.0%, core inflation, which excludes volatile components like food and energy, remained at 3.0% at the end of May, above the central bank's target.

Against this backdrop of slower economic growth, a moderating but still firm labour market, and persistent core inflation, the Bank of Canada kept its policy rate unchanged in the second quarter. This pause followed seven consecutive rate cuts since initiating its easing cycle in June 2024. The path ahead remains challenging for Canada's central bankers. While tariffs may dampen growth and employment, potentially easing inflation, they could also push consumer prices higher as companies pass on increased costs, making inflation dynamics more difficult to manage.

In the quarter, short-term yields remained anchored by the Bank of Canada's policy rate. Two-year T-Bills finished the quarter 13 basis points higher at 2.59%, close to the Bank of Canada's 2.75% policy rate. In contrast, long-term government bond yields rose more substantially, driven by fears of higher inflation resulting from the announced tariffs and expectations of increased fiscal spending by the new Canadian government. Expectations of increased fiscal spending in the U.S., following the passage of the "Big, Beautiful Bill", also contributed to the rise in long-term yields across developed markets. Yields on 10-year, 20-year and 30-year Canadian government bonds all increased by more than 30 basis points in the quarter, resulting in a steeper yield curve. The 10-year Government of Canada bond ended the quarter yielding 3.27%. These moves in longer-maturity yields are only normalizing the shape of the yield curve that was previously inverted or flat.

The steepening yield curve benefited our bond portfolio and was a key reason it generated a positive return in the quarter, while the Index declined. Our portfolio's shorter duration relative to the Index helped mitigate the impact of rising yields on longer-dated bonds. We selectively added provincial and municipal bonds, capitalizing on higher yields in the quarter. These trades were modest and did not materially change the overall structure of the portfolio, which continues to maintain a significantly shorter duration than the Index.

[9] JP Morgan Guide to the Markets, June 30, 2025.

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