



2nd Quarter North American Market Commentary – 2025

Key Take-aways:

- In June, U.S. Headline CPI rose to +2.67% YoY, marking a +28basis point sequential acceleration from March 2025. Core CPI was reported at +2.93% YoY, representing a +14basis point sequential acceleration from March 2025.
- On the topic of the U.S labour market, the July 2nd negative ADP print was the worst since March 2023. Jobless Claims eased to 233k for the week ending on 6/28. Continuing claims held flat at 1.96M. Unemployment rate dipped from 4.2% to 4.1% on lower participation (62.3%). The labor market is cooling, but still at a very gradual level.
- Moody's downgraded the U.S. government's long-term credit rating from Aaa to Aa1, citing persistent fiscal deficits, a ballooning national debt now at \$37 trillion, and a lack of credible structural reforms to stabilize debt dynamics. This downgrade, the first from Moody's since 1917, aligns its rating with those of S&P and Fitch, both of which had previously lowered theirs.
- The FED has maintained interest rates steady at 4.25%–4.50% across four consecutive FOMC meetings. Meanwhile, the Bank of Canada opted to hold its overnight rate steady at 2.75% unchanged since its 25basis point rate cut in March 2025.

Positioning:

- The CBOE Volatility Index (VIX) started 2025 at 11 and has since hovered around the 16 level, still below its historical average of approximately 19.5. We continue to believe that the floor for the VIX will remain structurally higher compared to prior years, particularly in an environment where a single headline or tweet has the potential to trigger sharp market reactions.
- Markets continue to be preoccupied with concerns over tariffs, reported CPI figures, labor market health, and the implications for the FED's potential rate-cutting cycle.
- For Q3 2025, the focus remains on US secular growth aligned with a stagflation outlook. The CPI likely bottomed in April 2025 at 2.31%, with inflation re-accelerating to 2.67% YoY in June, up from 2.39% in March. Highest conviction asset allocation is to inflation re-accelerating and government spending and money supply increasing. The FED 2pct target is fictitious, we have been above this target for 52 straight months. In response to ongoing global uncertainty and the effects of financial repression, demand has grown for alternative stores of value such as Gold and Bitcoin. In this environment, prioritizing robust risk management focusing on investable volatility, is crucial.



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In the U.S., the June Headline CPI was reported at 2.67% YoY, representing a +32basis point sequential acceleration from May and +28basis points higher than in March 2025. The June release reflected a continued softening of the deflationary impulse from energy, alongside waning shelter disinflation. Adding to this, food-at-home inflation accelerated, and core goods inflation picked up—driven primarily by strength in transportation commodities. Headline CPI measures the total change in the cost of all goods and services purchased by households. This includes all categories, such as food, energy, housing, apparel, transportation, medical care, recreation, education, and other goods and services. In contrast, reported Core CPI excludes food and energy prices and includes all other categories, such as housing, apparel, transportation (excluding fuel), medical care, recreation, education, and other goods and services. Core CPI is often used by policymakers, like central banks, to gauge underlying inflation trends and to make decisions about monetary policy. It is considered, by them, to be an appropriate measure for setting interest rates because it is less affected by transitory price shocks, such as weather conditions and geopolitical events. We argue that their choice of CPI measure makes the extent of price increases and currency debasement less obvious. The Core CPI was reported at 2.93% YoY in June, representing a +14basis point sequential acceleration from May and +14basis points

higher than in March 2025. We expect July to mark a temporary pause within a broader reflationary trend projected to unfold throughout the second half of 2025. From August through November, we continue to anticipate that the inflationary trend will be driven by accelerating core goods inflation as well as the diminishing deflationary impulse from energy commodities and the fading disinflationary momentum in shelter.

During the second quarter of 2025, Canada's economy continued to face significant headwinds, characterized by slowing growth, persistent inflation uncertainty, and escalating trade tensions. Economic activity was increasingly hampered by weak domestic demand and declining output across half of the country's industries. Real GDP contracted by 0.1% in April, following a modest 0.2% increase in March, with preliminary data signalling another 0.1% dip in May—pointing to broad-based economic stagnation. In June, employment rose by 83,000 jobs (+0.4%), lifting the employment rate to 60.9%. The national unemployment rate is 6.9%, remaining a concerning statistic, this current government must seriously address.

The Bank of Canada opted to hold its overnight rate steady at 2.75% following a rate cut in March. Policymakers expressed caution over additional reductions, citing concerns over potential inflation pressures linked to new U.S. tariffs and a need to maintain price stability. However, deeper



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structural issues remain unresolved. Persistently low productivity, mounting fiscal deficits and no tabled fiscal budget continue to weigh heavily on economic performance. Until these longstanding challenges are effectively addressed, the outlook for both the broader economy and the Canadian dollar is expected to remain subdued.

Inflation is often (and in our view correctly) attributed to expansive monetary policies and the printing of money. Since 1999, the U.S. money supply has grown at an annual rate of 6.26%. The extent of currency debasement globally since 1999 is remarkable. While the U.S. has seen a 78% debasement of the dollar, averaging 6.26% annually since 1999, it is not the most extreme case. Canada has experienced an even greater erosion, with an 81.5% reduction in purchasing power and a 7.1% annual increase in its money supply since 1999. In the U.S. large fiscal deficits mainly flow toward Social Security, Interest Expense, Medicare, and Defense. Politicians are happy to promise more free stuff by endlessly spending because they know they won't pay for it and that it will make citizens and businesses more dependent and submissive to political power. No government can truly reduce debt without cutting spending. More government debt means lower growth, more taxes generate weaker receipts, and more government spending perpetuates inflation. Governments worldwide are collectively

devaluing fiat currencies, thereby diminishing their purchasing power. Underlying inflation remains elevated, and the continued decline in purchasing power of both U.S. and Canadian dollars is a growing concern for consumers and investors. Given that this trend is likely to continue, with nations persistent on printing money and devaluing their currencies, it is unsurprising that individuals and corporations are increasingly seeking refuge in assets like gold, bitcoin, and real estate.

Gold has already overtaken the Euro as the second largest asset after the US dollar in global central banks. Bitcoin, on the other hand, has shown investors and citizens that a decentralized currency can gradually become a generalized means of payment and a unit of measurement. As global citizens see Bitcoin as an increasingly viable alternative to fiat money, more are using it to store value and protect themselves against inflation.

Cumulative inflation reflects the total percentage increase in prices over a period, accounting for compounding effects. In the U.S., cumulative inflation since 1999 now approximates 91.09%. This means that today's prices are 1.9109 times as high as average prices since 1999. In Canada, cumulative inflation since 1999 is 72.15%. This means that today's prices are 1.7215 times as high as average prices since 1999. Inflation is a regressive tax, impacting households regardless of income, yet doing



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so with varying degrees of relative magnitude, is gradual and cumulative. As such, disinflation from record-high price levels offers little relief. Costs are not deflating; they are simply inflating less. Inflation for each person is individualized and cumulative. Real inflation simply means the destruction of the purchasing power of the currency. Consumers are not focused on what Wall Street is focused on which is the rate of change from M/M, Q/Q, Y/Y or the different categories. They are focused on the level of inflation on 'needs' and 'wants' and how things are drastically more expensive. The level of arrogance out of the FED, Washinton, Ottawa and the Bank of Canada is at all time highs (rising money supply and ridiculous deficit spending leads to persistent inflation prints). The point is underlying inflation has remained elevated and the cumulative decline in purchasing power of US and CDN dollars remains a major concern for consumers and investors.

Markets remain dominated by concerns over trade tensions, inflation data, labor market health, and the FED's evolving policy stance. Record levels of trade uncertainty persist due to incomplete tariff deals, with the average effective U.S. tariff rate now roughly six times higher than last year, currently around 22.5%—the highest since 1909. This elevated tariff environment is expected to impose significant economic headwinds: the U.S. faces approximately a 0.8 percentage point reduction in real GDP growth for 2025 alone, with a long-run GDP impact of around

-0.4% (equivalent to about \$135 billion annually). Canada is expected to be the most adversely affected, facing a roughly -1.9% GDP drag due to spillover effects and trade disruptions.

Market currently anticipates a delay in the imposition of reciprocal tariffs, with resolutions hoped for between July and December 2025. However, many tariff arrangements remain unresolved, and their eventual implementation or extension could destabilize financial markets, which currently show underlying fragility despite the S&P 500's record highs post-Q2. This fragility, coupled with persistently high volatility in bond markets, creates an environment where the Trump Administration may shift negotiating postures dynamically. When markets are strong and volatility is low, the Administration tends to adopt a more aggressive tariff stance. Conversely, deteriorating market conditions could pressure a retreat on tariffs to stabilize financial markets. Market participants may be underestimating tariff-related risks, risking complacency ahead of potentially impactful political and trade developments.

On the topic of the fiscal package of the Trump administration, the "Big Beautiful Bill" ("BBB"), a sweeping fiscal package passed through Congress and the Senate, has generated a deeply polarized response. Critics argue that the bill adds significantly to the federal deficit while failing to curb



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spending meaningfully. Supporters contend it ignores the broader economic benefits of deregulation, tax reductions, and trade negotiations, focusing instead on projections from the Congressional Budget Office (CBO) and other agencies. According to these projections, the BBB could increase the federal deficit by \$2.4 trillion to \$3.8 trillion over the next ten years, mainly due to approximately \$4.5 trillion in tax cuts offset by only \$1.2 trillion in spending reductions. While these projections account for modest boosts to GDP—estimated at around 0.5%—they also predict that increased interest payments and borrowing will push the national debt-to-GDP ratio to over 124% by 2034. Notably, most of the bill’s significant spending cuts are scheduled to take effect after 2030, with minimal reductions occurring in the near term.

Despite this criticism, supporters argue that the BBB represents the most ambitious fiscal overhaul since the Reagan era. They claim that critics are unfairly judging President Trump based on the fiscal position he inherited from what they describe as reckless spending under the Biden administration. From this perspective, the BBB is a vital effort to reverse that trajectory through enhanced fiscal discipline, regulatory rollback, and economic liberalization. Proponents highlight that the bill includes \$1.6 trillion in mandatory spending cuts and \$2.6 trillion in discretionary reductions—the largest in U.S. history in both categories—along with \$4

trillion in expected revenue gains from trade negotiations and \$7 trillion in investment commitments. The Trump Administration also reports having already cut \$541 billion in discretionary spending in the first six months of 2025, with the deficit shrinking between March and May. Their long-term plan aims to cut the deficit by \$11.1 trillion by 2034, combining spending cuts with increased revenues from trade, growth-stimulating policies, and new business investment.

Supporters also criticize the official deficit projections for failing to account for potential economic gains from supply-side reforms, such as increased labor participation, productivity improvements, and higher private investment fueled by deregulation and tax incentives. They argue that these positive effects could generate enough tax revenue to significantly offset the projected increases in the deficit. Treasury Secretary Scott Bessent has emphasized that the bill is designed to spur growth strong enough to counterbalance the nominal rise in debt. Furthermore, proponents argue that alternative deficit forecasts—if adjusted for expected trade benefits and dynamic growth—suggest the U.S. could see a \$6.6 trillion reduction in the deficit over the next decade.

Nevertheless, most independent experts and the CBO maintain that the BBB will widen fiscal deficits in the near and medium term. Some projections estimate the deficit



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will rise from 5.5% to 7.0% of GDP in 2026, and again to 7.0% in 2027, potentially adding nearly \$1.1 trillion in debt across those two years alone. Crucially, these projections assume no real government spending cuts before 2030, with only minor reductions forecasted for 2028 and 2029. While the Trump Administration's supporters blame the worsening fiscal outlook on the policies of the previous administration, analysis shows that the deficit impact stems largely from the BBB's own tax cuts and limited early spending reductions.

The BBB is a bold and controversial attempt to reshape the U.S. fiscal landscape. While it promises ambitious reforms and long-term savings, its near-term impact, according to most forecasts, is a sharp rise in deficits and debt. The fiscal outcome will ultimately depend on whether the administration's optimistic expectations for trade revenues, investment, and economic growth materialize. If they do, the BBB may lay the foundation for sustained, productive expansion. If not, it risks exacerbating the very fiscal challenges it aims to resolve.

Looking ahead, despite estimates showing YoY GDP growth deceleration in Q2 2025, data suggests the U.S. economy is maintaining sustained non-recessionary growth, supported by expectations of strong nonfarm payroll (NFP) numbers and a reduced likelihood of extensive FED rate cuts. While some slowing in employment data has been observed, the consensus

remains that NFP growth will continue positively, though its notoriously volatile nature—as influenced by tariffs, federal jobs, and other uncertainties—could bring fluctuations in the reported figures.

Current market pricing reflects roughly two rate cuts in the FED Funds Futures market through year-end 2025, down from nearly four cuts a month ago, indicating a shift toward expectations of a less accommodative monetary policy stance. If growth and inflation accelerate as projected expectations for even two rate cuts may come into question.

Simultaneously, Washington appears to be reverting to its historical pattern of expanding deficits and debt after attempts to reshape fiscal policy, raising concerns echoed in the bond and dollar markets. These markets exhibit warning signs including rising inflation expectations, elevated credit risk, and signals of declining U.S. global economic dominance.

While the Q2 GDP deceleration and tariff-related uncertainties pose risks, the overall outlook points toward moderate economic growth without recession, supported by a robust labor market. Monetary policy easing looks less aggressive than previously anticipated, and fiscal policy is trending toward increased deficits. Markets and policymakers will need to navigate these mixed signals carefully in the coming months

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This was a challenging quarter, with large macro forces clearly in the driver's seat and causing a meaningful risk appetite pullback. Markets should be recognized for their complexity, dynamism, and unpredictability, with volatility fluctuating and often behaving unexpectedly over time. Risk is ever-present, even when it is not immediately visible. The biggest overhang continues to be the uncertainty around tariffs and their impact on the global economy. The picture remains highly uncertain.

For Q3 2025 the focus remains on US secular growth and inflation-sensitive sectors like energy, financials, large cap growth and technology, aligned with a stagflation outlook. The bottom for CPI was likely put in April at 2.31%. Highest conviction asset allocation is to inflation re-accelerating and government spending and money supply increasing. The FED 2pct target is fictitious, we have been above this target for 52 straight months.

Many major countries are likely to negotiate favorable trade deals and commit investments to the U.S. over the next few months. This development could lead to a further de-risking scenario, which would be bullish for risk assets. It is crucial to emphasize that a global trade war poses significant risks to both risk assets and the bond market. Barring an exogenous shock, which, as 2025 has already proven remains a possibility, from a market structure dynamic,

we expect the broader setup to continue. We're expecting to see modest wave of buying activity from systematic flows, a trend we expect to see sporadically continue over the next several weeks as the 3-month realized volatility declines. While there are several moving parts to tracking structural flows, we broadly break them down into three main subgroups: passive funds, the options markets, and systematic strategies. While most investors have at least some awareness of these categories, many are still surprised by how large they've become, collectively representing more than \$20 trillion, or roughly half of the investable market. The key thing to remember about non-discretionary flows is that they have virtually zero connection to fundamental, sentient, or macroeconomic analysis. For these strategies, fundamentals simply aren't part of the algorithm. We are navigating unprecedented circumstances, and patience continues to be a key component of our investment strategy.





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Sincerely,

Christopher Panagopoulos, CPA, CA, CFA

The Portfolio Management Team

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