Mid Cap Equity Strategy 2nd Quarter 2025 Commentary

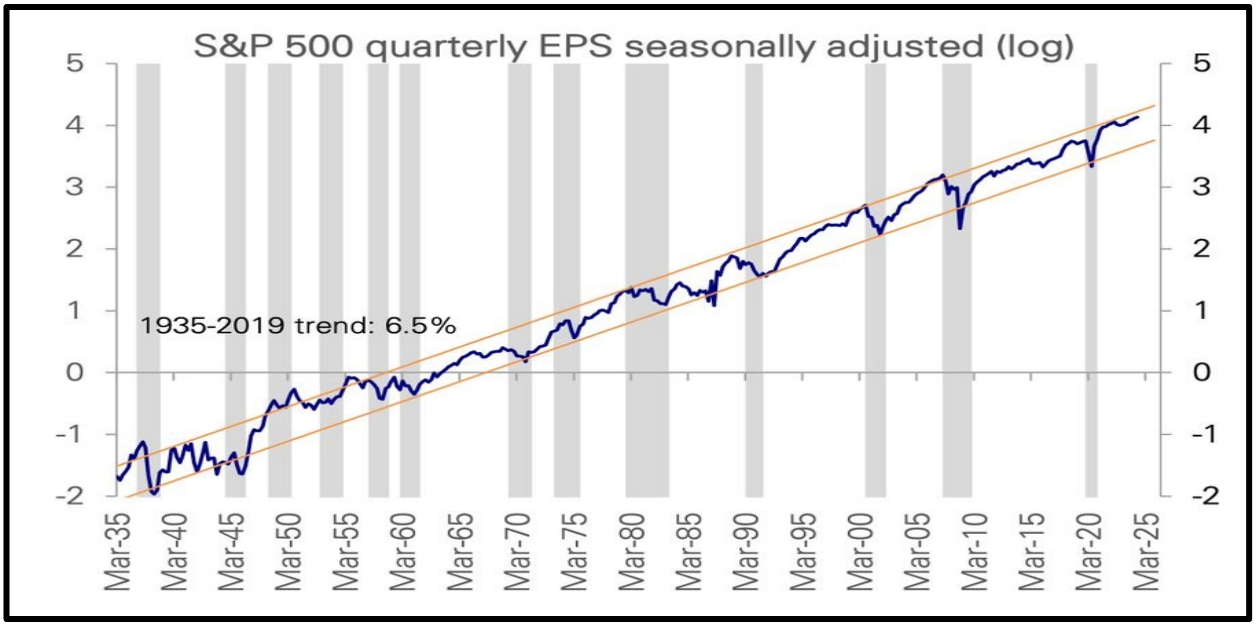
Source: Hedgeye

Fiscal Supremacy – "To Infinity and Beyond"

The second quarter of 2025 was defined by significant policy-driven volatility and an impressive market rebound. The market turmoil began on April 2, when President Donald Trump announced an aggressive tariff plan. Over the following four trading days, the S&P 500 declined more than 12%, its steepest four-day drop since March 2020. However, on April 9, the President announced a "pause" on the most severe tariffs, triggering a dramatic 9% single-day rally, the index's largest one-day percentage gain since October 2008 and the eighth largest on record. This momentum continued through May and June, propelling global equities to new all-time highs by quarter-end.

Despite headline risks, the second quarter delivered broad-based positive returns across major asset classes. U.S. equities, led by resilient corporate earnings, rebounded strongly and outperformed many international peers. Corporate earnings results underscored the strength of the recovery. First quarter earnings (reported in the second quarter) for the S&P 500 grew by an average of 13%, significantly surpassing expectations. While companies acknowledged uncertainty surrounding tariffs, most emphasized a "business-as-usual" approach and highlighted continued investments in AI to enhance productivity and protect margins. This reinforced the view that AI-related capital expenditure remains a durable, long-term trend.

The S&P 500 gained 10.9% during the quarter, bringing its year-to-date return to approximately 6%. The market staged a swift V-shaped recovery after the early April sell-off, as the proposed tariffs were paused and investor sentiment improved.



Source: S&P Global Inc.

Mega-cap technology and AI-focused companies—the so-called "Magnificent Seven" led the rebound, with the sector gaining over 20% during the quarter. Robust corporate earnings and strong bank stress test results bolstered investor confidence.

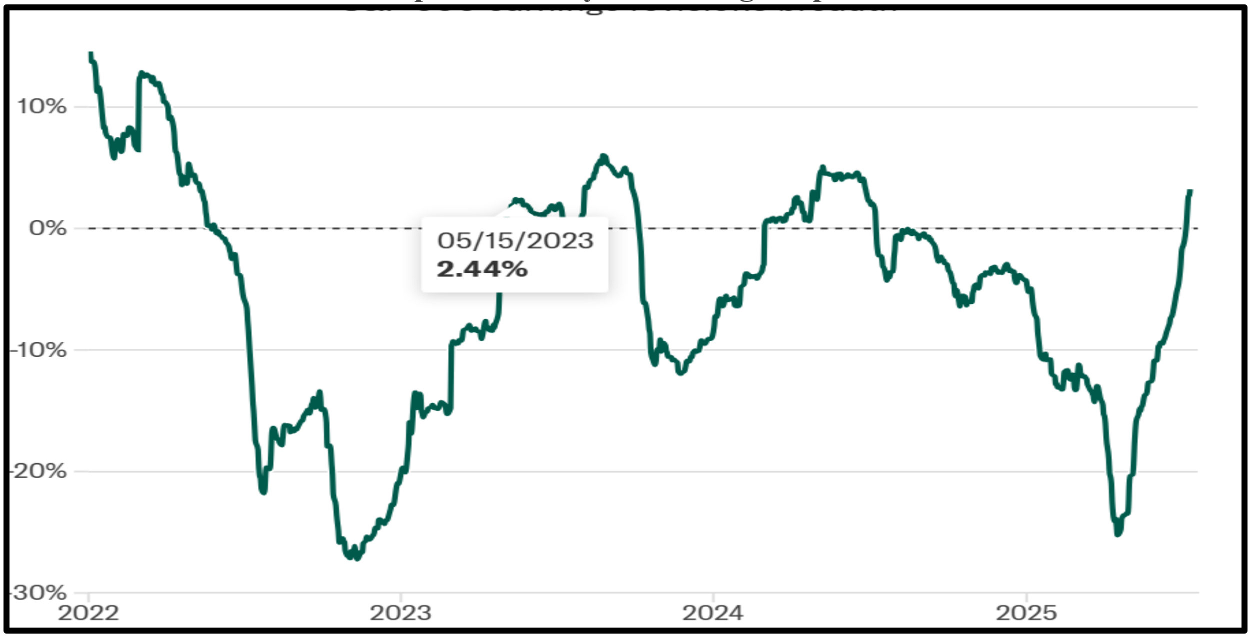
Underneath the hood of the U.S. equity benchmarks, the rebound off the April lows and overall quarterly performance was led by large-cap growth (+17.8% Q2) and small-cap growth (+12% Q2). At the large-cap sector level, Technology (+23.7% Q2) and Communications (+18.5%) led the outperformance while Energy (-8.6% Q2) and Healthcare (-7.2% Q2) deeply underperformed. Notably, Energy and Healthcare were the top performing sectors in Q1. Along with Technology and Communications, new highs were reached by the Industrials and Financials sectors, which may suggest the economy is stronger and holding up better than expected amidst the widespread uncertainty.

The quarter was dominated by the economic fallout from "Liberation Day" tariffs. The U.S. imposed sweeping new levies on multiple countries, triggering retaliatory threats and rattling global markets. While some tariff pressures have eased amidst ongoing negotiations, the current environment remains volatile. The resulting inflationary shock and earnings pressure have led to cautious guidance across retail and manufacturing sectors.

Economic growth expectations in the US moderated in Q2, with GDP forecasts revised downward to a range of 1.5%–2.5% for the year. The slowdown reflects the drag from elevated tariffs, political uncertainty, and a softening in consumer and business spending. Analysts noted that front-loading of imports in Q1 — in anticipation of tariff implementation — likely pulled forward some economic activity, leaving Q2 on weaker footing.

The following chart shows the earnings revisions breadth for the S&P 500. It leads to actual earnings estimates, and as you can see, we are currently experiencing one of the strongest V-shaped recoveries in history, rivaling the COVID rebound in 2020, the last time we were so out of consensus on the market. The more bearish market participants did not appreciate how strong this very fundamental driver has been over the past several months, which helps to not only justify the rally to date, but also why the outlook remains strong for the balance of the year.

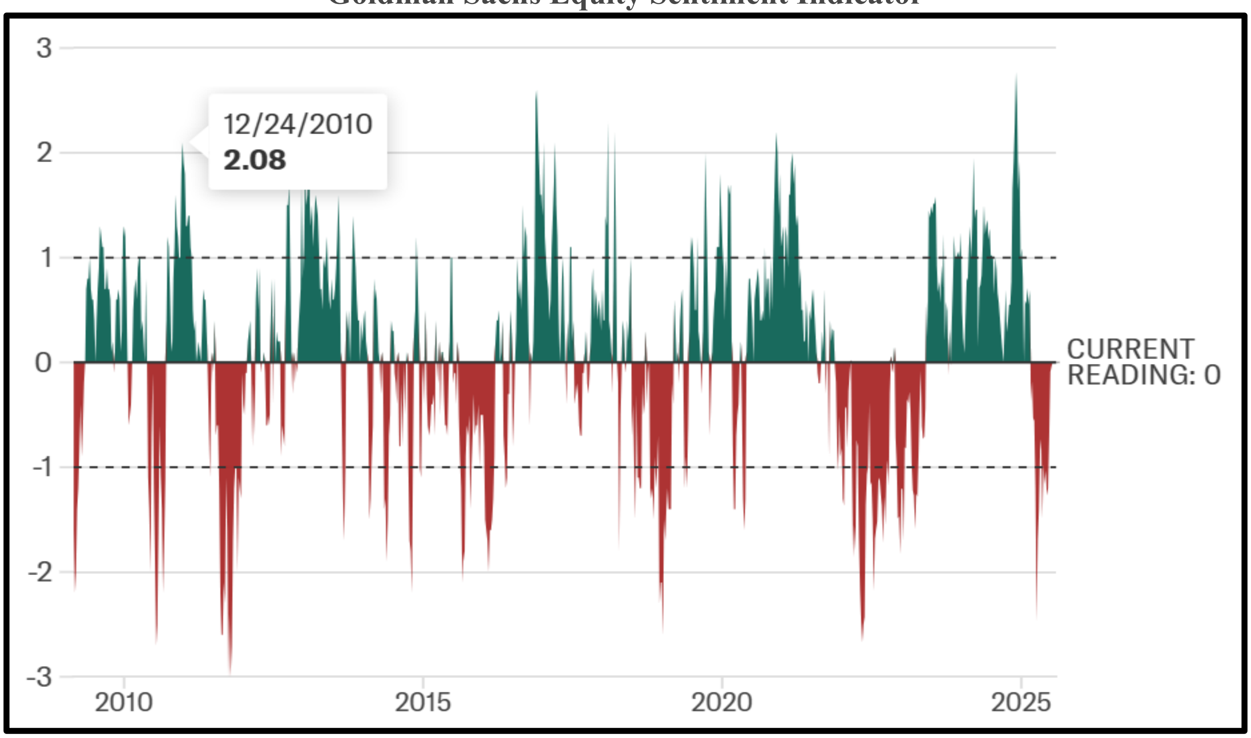
A V Shaped Recovery in Earnings Expectations



Source: Factset, Morgan Stanley

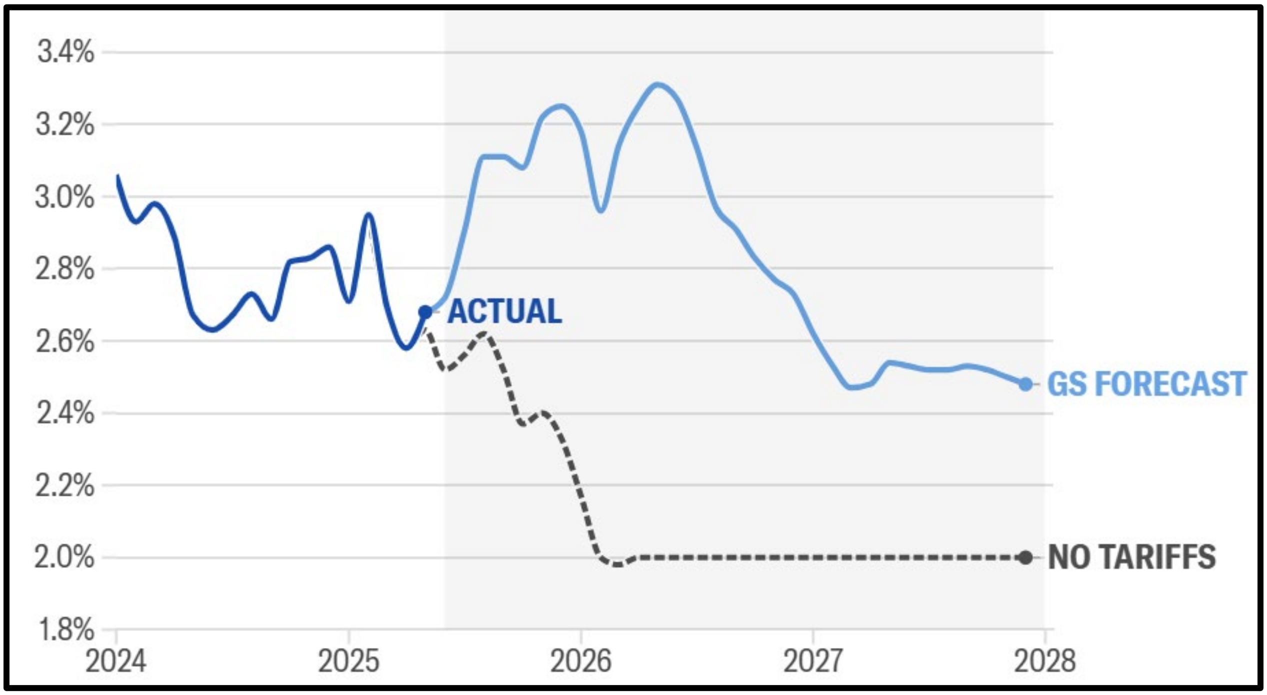
In addition, despite the recent new record highs notched by the S&P 500, investor positioning data show no sign of exuberance. The GS Equity Sentiment Indicator combines nine measures of positioning in US stocks across investor groups, including hedge funds, mutual funds, and retail investors. Today, the indicator stands at a 0, reflecting a neutral stance in US stocks on average across investors. While valuation multiples sit at elevated levels relative to history, constrained positioning indicates room for the recent equity rally to continue.

Goldman Sachs Equity Sentiment Indicator



Source: Goldman Sachs

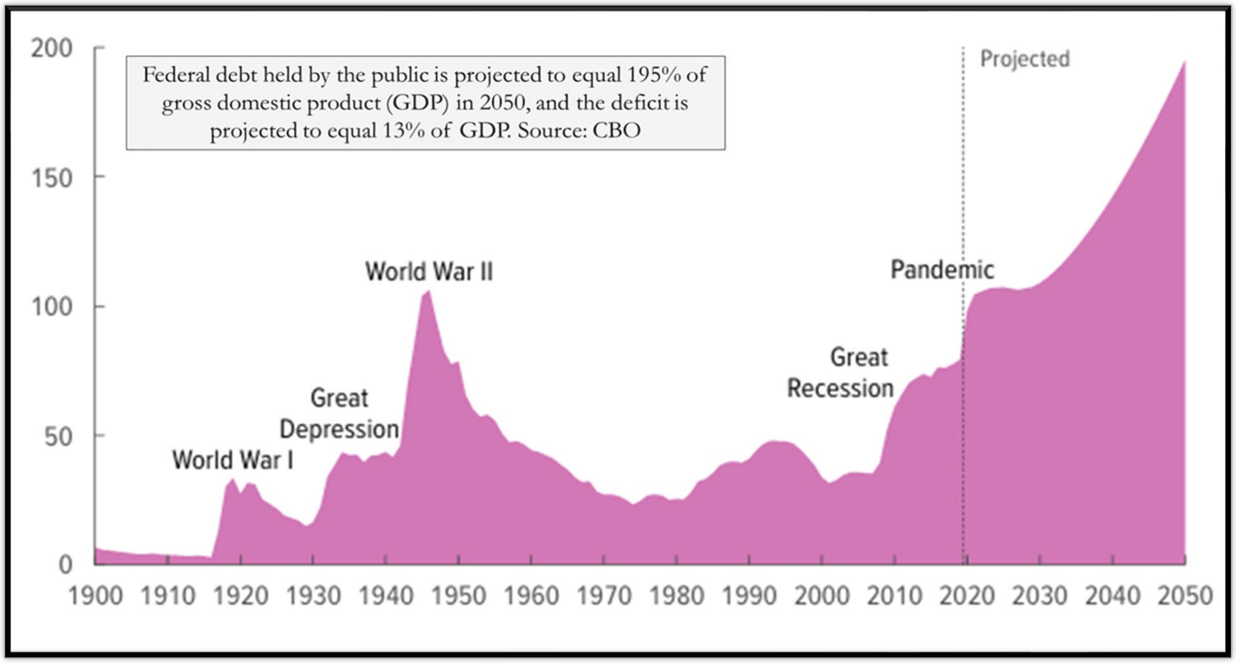
Inflation showed signs of easing but remains above the Federal Reserve's target. April's CPI rose 2.3% year-over-year, the lowest since early 2021, before ticking slightly higher to 2.4% in May. Core CPI and PCE have hovered around 2.6%–2.8%. However, tariff-induced price pressures – especially on imported goods – threaten to rekindle inflation in the second half of the year. Goldman Sachs estimates that tariffs have boosted consumer prices by 0.2% cumulatively so far but thinks that the largest effects are still ahead. Tariff effects are likely to push core inflation back above 3% over the next year, despite an underlying trend that we see as steadily moving back toward 2%. Tariffs are expected to have only a one-time effect on the price level rather than igniting persistent high inflation, and consequently inflation is expected to resume its decline toward 2% down the road as the tariff effects drop out of the year-over-year calculation.



Source: Goldman Sachs

There is little doubt that the United States is a going concern, but its financial operations do raise questions. The U.S. government received approximately $4.9 trillion in revenue but spent $6.8 trillion. Despite the enormous gap between operating revenue and expenses, the U.S. government finances itself without issue. The primary concerns focus on the future. The U.S. Treasury owes $37 trillion, gross, including $9 trillion to foreign holders of U.S. debt. Brett Loper, executive vice president for policy at the Peter G. Peterson Foundation, recently summarized the state of fiscal policy:

> "Even keeping Medicare on autopilot and Social Security on autopilot and Medicaid on autopilot, not making any changes, increasing or decreasing the cost of those programs, you're looking at an amount of debt increasing by $22 trillion over the next ten years just to fund the government. You're talking about the cost of interest payments on the debt doubling. Interest payments this year are going to cost more than the entire amount we spend on national defense, and yet they're going to double over the next ten years. If you think of interest payments on outstanding Treasury debt as a program of the federal government, it's the fastest-growing program in the federal government."



Source: Congressional Budget Office (CBO)

Quarterly Performance

The return for the Hahn Capital Management Mid-Cap Value Composite was ***2.45% gross of fees and 2.20% net of fees in the 2nd quarter of 2025***. For the quarter, we underperformed our primary benchmark, the Bloomberg Mid-Cap Total Return Index, by 4.85 percentage points gross of fees and underperformed by 5.10 percentage points net of fees.

For the quarter, in the representative account, sector allocations to Consumer Staples, Energy, Utilities, Communication Services, Industrials, Materials, Consumer Discretionary, and Healthcare contributed, while those to Real Estate and Information Technology detracted.

In the representative account, the most significant relative performers during the quarter were Virtu Financial (VIRT), InterContinental Exchange (ICE), Emcor Group (EME), Labcorp (LH) and CBRE Group (CBRE), while the most significant underperformers were Brown-Forman (BF/B), Alexandria Real Estate (ARE), Warner Music Group (WMG), Ross Stores (ROST), and Becton Dickinson (BDX).

Hahn Capital Quarterly Performance Attribution – 2Q 2025

LINKED PERFORMANCE BY SECTORS

BENCHMARK: Bloomberg Mid-Cap TR Index
PORTFOLIO: Representative Account

GICS Sector	PORT Weight	BENCH Weight	DIFF Weight	PORT Return	BENCH Return	DIFF Return	SECTOR SELECT	STOCK SELECT	ACTIVE CONTR	PASSIVE CONTR	TOTAL CONTR
Financials	24.66%	14.20%	10.46%	6.30%	7.84%	-1.54%	0.10%	-0.41%	-0.31%	0.00%	-0.31%
Information Technology	6.34%	12.36%	-6.02%	3.94%	17.76%	-13.82%	-0.61%	-0.85%	-1.46%	0.00%	-1.46%
Real Estate	15.90%	7.26%	8.64%	-2.37%	-1.56%	-0.80%	-0.78%	-0.10%	-0.88%	-0.01%	-0.89%
Industrials	19.26%	17.33%	1.93%	14.11%	15.20%	-1.09%	0.14%	-0.17%	-0.03%	0.00%	-0.03%
Health Care	10.43%	10.18%	0.25%	-3.65%	3.84%	-7.49%	0.00%	-0.80%	-0.80%	0.00%	-0.80%
Consumer Discretionary	4.22%	10.01%	-5.79%	0.12%	6.74%	-6.62%	0.03%	-0.30%	-0.27%	0.00%	-0.27%
Materials	0.00%	5.58%	-5.58%	0.00%	4.32%	-4.32%	0.16%	0.00%	0.16%	0.00%	0.16%
Communication Services	5.78%	3.35%	2.43%	-1.45%	16.57%	-18.02%	0.20%	-1.02%	-0.82%	0.00%	-0.82%
Energy	2.33%	5.35%	-3.02%	-14.43%	-4.85%	-9.57%	0.37%	-0.28%	0.09%	0.00%	0.09%
Consumer Staples	2.50%	6.99%	-4.49%	-20.06%	-1.49%	-18.58%	0.43%	-0.49%	-0.06%	0.00%	-0.06%
Utilities	0.00%	7.39%	-7.39%	0.00%	2.92%	-2.92%	0.35%	0.00%	0.35%	0.00%	0.35%
Cash	8.57%	0.00%	8.57%	1.10%	0.00%	1.10%	-0.63%	0.00%	-0.63%	0.00%	-0.63%
Total Portfolio - Net of Fees				**2.64%**	**7.30%**	**-4.66%**	**-0.24%**	**-4.42%**	**-4.66%**	**0.00%**	**-4.66%**

TOP 10 PORTFOLIO HOLDINGS
As of 06/30/2025

Company	% of Assets	Sector	Industry
VIRTU FINANCIAL INC-CLASS A	6.3%	Financials	Capital Markets
CBRE GROUP INC - A	6.1%	Real Estate	Real Estate Management & Devel
EMCOR GROUP INC	5.9%	Industrials	Construction & Engineering
WABTEC CORP	5.6%	Industrials	Machinery
INTERCONTINENTAL EXCHANGE IN	5.2%	Financials	Capital Markets
SEI INVESTMENTS COMPANY	4.5%	Financials	Capital Markets
EURONET WORLDWIDE INC	4.0%	Financials	Financial Services
GENPACT LTD	4.0%	Industrials	Professional Services
KEYSIGHT TECHNOLOGIES IN	3.9%	Information Technology	Electronic Equipment, Instrume
AGILENT TECHNOLOGIES INC	3.9%	Health Care	Life Sciences Tools & Services

HCM COMPOSITE PERFORMANCE HISTORY

% Annualized Returns As of 06/30/2025	2Q 2025	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception 06-30-88
HCM Gross of Fees	2.45%	12.36%	9.22%	11.53%	7.75%	7.87%	12.97%
HCM Net of Fees	2.20%	11.27%	8.15%	10.44%	6.69%	6.81%	11.88%
Bloomberg Mid Cap Total Return Index	7.30%	13.00%	13.28%	12.97%	10.15%	10.16%	11.40%

Link to: HCM Performance Disclosures

PORTFOLIO ACTIVITY

New Positions

There were no new positions added during the quarter.

Positions Added

Agilent Technologies (A) – We added to Agilent during the quarter as we are expecting a reacceleration of growth at the company over the next three years after more than two years of below-trend growth. Agilent is a market-leading, high-returning analytical tools vendor selling at a 25% discount to the market and a 40% discount to our estimate of intrinsic value.

Alexandria Real Estate (ARE) – We added to Alexandria during the quarter as the discount to our estimate of intrinsic value hovers around 50%, making it the single most attractive investment in our portfolio at current prices. This leading supplier of office and laboratory space to the healthcare industry yields over 7% and has grown its intrinsic value at over 10% annually since going public in 1993. It currently trades at only 75% of book value.

Occidental Petroleum (OXY) – We added to our position in Occidental Petroleum as weakening oil prices caused a sell-off in the energy sector. Oxy currently trades at a 25% discount to our underlying intrinsic value estimate with some of the premier U.S. based oil assets in the industry, a healthy chemical business and a number of growth initiatives in place.

Positions Reduced

There were no positions reduced during the quarter.

Positions Sold

SBA Communications (SBAC) – We sold our position in SBA Communications during the quarter as a rally in the stock over the first six months of the year caused the company's valuation to reach our intrinsic value target.

Outlook

Economic & Market Outlook

After growing 2.8% in 2024 (2.5% 4Q/4Q), U.S. economic growth is likely to slow to 1.5% (1% 4Q/4Q) this year and 1% in 2026. Immigration restrictions and policy uncertainty add to tariffs' drag on U.S. growth, and we are skeptical of meaningful support from fiscal policy and question the expectation of significant deregulation to drive corporate performance.

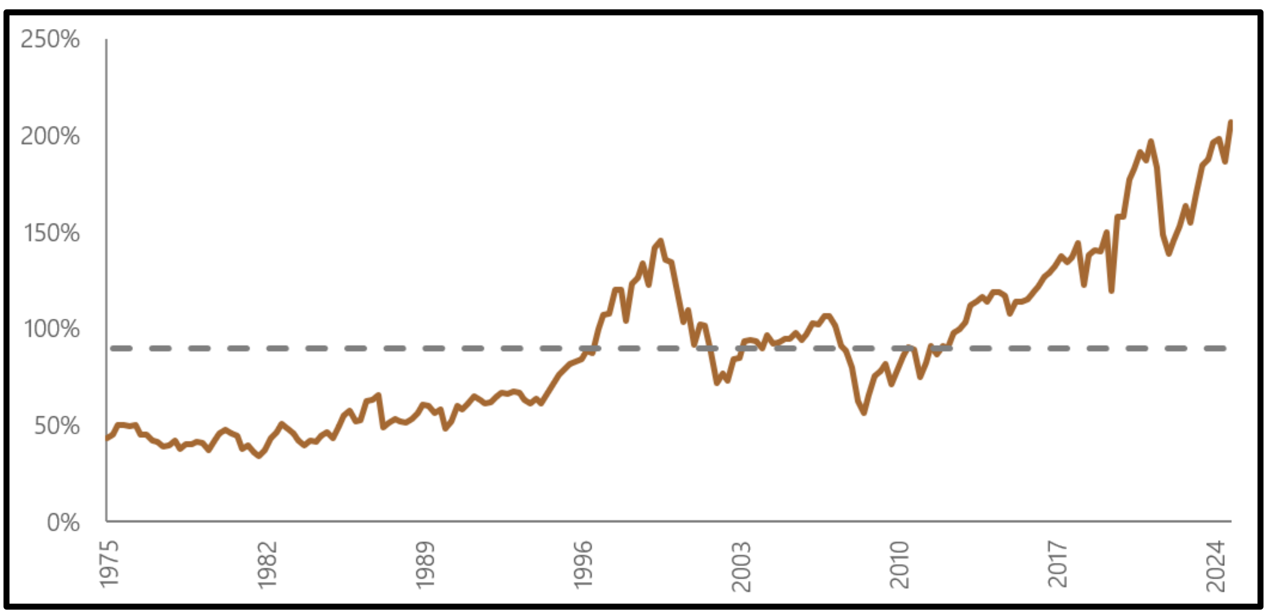
Inflation is likely to accelerate and reach a 2025 peak between 3% and 3.5% for the balance of the year as companies pass some of their tariff-related costs through to customers. Additionally, restrictions on immigration could contribute to labor shortages and lead to inflation in services. Consumer prices should begin to slow in 2026 amid weaker demand and lower business spending.

We believe this inflation uncertainty will likely cause Federal Reserve to keep on hold, and the funds rate should remain unchanged until inflation starts to decelerate more substantively. (Perhaps a change in Federal Reserve Board personnel may change that view.) Tariffs tend to boost inflation before slowing growth, so the Fed will likely worry more about containing inflation than maintaining employment until late this year, when inflation peaks and begins to decline. After inflation starts to fall, the labor market should continue to deteriorate. At that point, we think that the Fed will cut rates past neutral and end up with 100 basis points in cuts by the end of 2026.

At present, the US equity markets appear quite extended, with the S&P 500 trading at a hefty 22 times forward earnings. Furthermore, the Index remains extraordinarily top-heavy, with the largest ten stocks accounting for 38 percent of Index value, close to a 35-year high. Earnings yield on the S&P 500 remains particularly low compared to the 10-year Treasury yield. The stock surge in the second quarter of the year occurred amid a huge explosion of risk appetite that has seen investors once again piling-in to meme stocks, cryptocurrencies and AI-related issues. Shares in the premier AI darling Nvidia recently climbed to such a high level that its market capitalization now eclipses the entire market in the UK, France or Germany individually.

As seen in the chart below, the Buffett Ratio of the broad-based Wilshire 5000 Index to US Gross Domestic Product is currently at 208 percent, the most expensive level in history. Furthermore, the Buffett Ratio doesn't take into account the swelling private-equity space, where SpaceX and OpenAI alone are priced at more than half a trillion dollars. Overall, when equity valuation levels were this high in the past, forward returns were modest, if not disappointing. Staying invested through ups and downs has consistently been one of the most effective strategies for building wealth over time. Market declines can feel unsettling in the moment, but history shows the powerful effect of compounding returns over time.

The Only Chart That Worries Us
The Buffett Ratio – Wilshire 5000 Index to US Gross Domestic Product



Source: S&P Global

Despite the recent volatility, we remain quite bullish in the prospects for our portfolio companies, all of which are market leaders with industry leading management teams, business models and balance sheets. In addition, mid-cap valuations have lagged their large cap peers for one of the longest periods on record, implying a much greater upside for our portfolio compared to the broad market in the years ahead. We continue to find highly attractive investment opportunities across a wide spectrum of industries with excellent long-term potential for superior returns. We wish you the very best in 2025 and thank you for your continued support.

John Schaeffer
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