VUCA 2.0

> "The world seems increasingly complex, uncertainty is rising and change is happening at an accelerating pace."
>
> - LNW Economic Commentary, July 2024

When we titled last July's Commentary "*VUCA at the Gate*" – shorthand for Volatility, Uncertainty, Complexity, and Ambiguity – we were acknowledging what felt like a historic inflection point. That shift was consistent with the *regime change* thesis we outlined back in January 2022: that the decades-long tailwind of globalization was giving way to something very different – a world marked by a higher steady state of inflation, interest rates, and, inevitably, volatility.

We don't claim to have a crystal ball. But revisiting those earlier insights serves to highlight the secular shift still unfolding – one now amplified by sweeping changes in U.S. policy that are likely to leave a lasting imprint on the global economy and capital markets.

The good news? Our mindset and approach are built for exactly this kind of environment. VUCA, after all, is always lurking – investors just tend to ignore it when risk assets are climbing. We remain grounded in what we can know and control, vigilant about our own biases, skeptical of conventional wisdom, and attentive to the opportunities – and risks – that this higher-VUCA world creates.

In this Commentary, we unpack the factors driving this elevated state of VUCA and explore what they mean for portfolios now.

The New Normal? More Like the New Unfinished

The new macroeconomic regime we outlined in our January 2022 Commentary is taking clearer shape – and doing so in an environment that's proving more volatile as the Trump administration's rapid-fire policy changes continue to unfold. Financial markets and corporate executives alike are being forced to continuously adapt to a paradigm marked by headline-driven trade negotiations, ambitious (if uneven) fiscal restructuring, and ongoing geopolitical realignments – all still in motion, with endpoints far from certain.

We're seeing evidence of a higher steady-state for U.S. interest rates – not necessarily "high" by historical standards, but higher than what we grew accustomed to in the pre-Covid era. Inflation outcomes are more volatile, and economic growth trajectories less predictable. U.S. monetary policy, while still consequential, has arguably taken a back seat in driving market sentiment within this evolving paradigm.

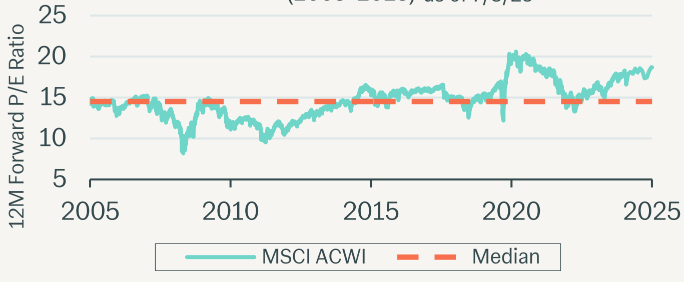
Meanwhile, global trade dynamics are shifting – not toward outright deglobalization but toward a more nuanced "reglobalization," one that emphasizes diversification of supply chains rather than retreat. While recent data suggest U.S. inflation has moderated, price volatility may well persist as the structure of the global trade and capital markets framework continues to evolve.

As a result, investors – ourselves included – are rethinking the usefulness of the post-World War II playbook for valuation, risk premia, and portfolio construction. This reengineering won't happen overnight, of course – structural shifts never do. But for now, we find ourselves in a market that seems to care less about cash flows and balance sheets, and more about who last tweeted what. Fundamentals still matter; they're just harder to hear over the din of policy pronouncements and geopolitical plot twists. In other words, until the dust settles, markets appear more attuned to social media than to earnings calls.

First-Half Asset Summary

- **Global Equities.** Stocks are back to looking relatively expensive. After dipping into bear-market territory in April, the S&P 500 clawed back to finish up roughly 6% in the first half of 2025. Still, foreign equities stole the show, rising 17% (MSCI ACWI ex-U.S.) – the worst U.S. relative performance in over two decades. A weaker dollar (-10%), more attractive valuations, and easier monetary policy abroad finally reminded investors why global diversification matters.

Price/Earnings Ratios on Global Equities*
(2005-2025) as of 7/8/25



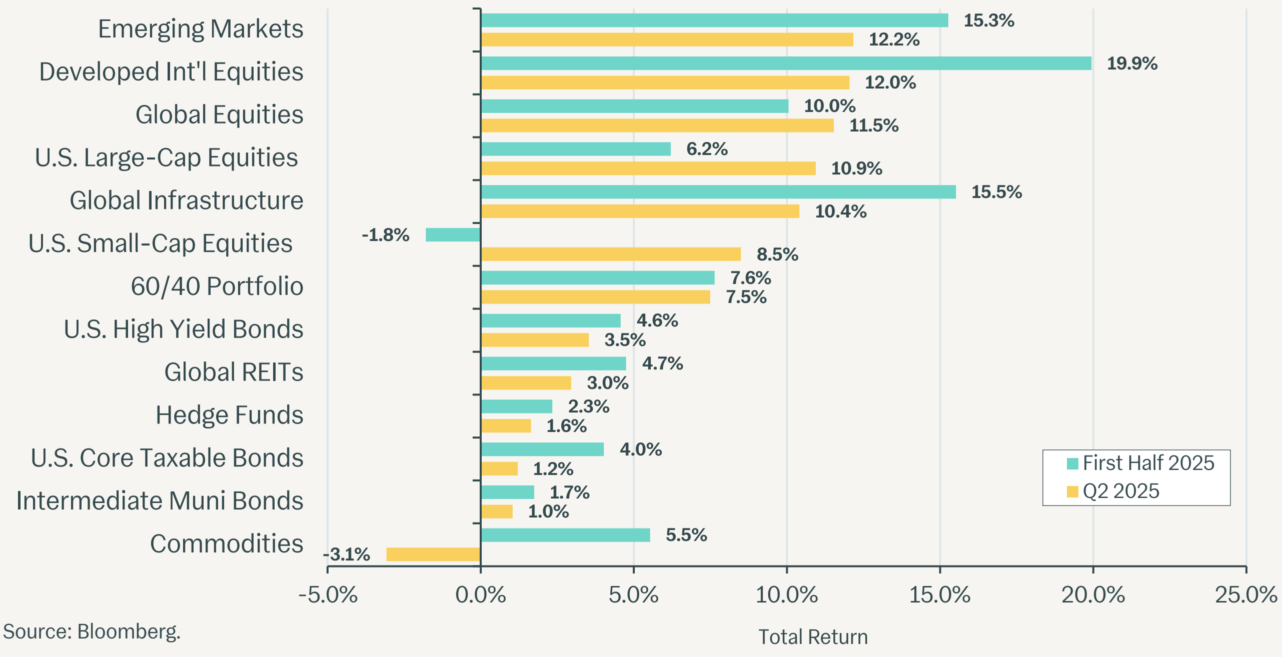
*The MSCI All-Country World Index. Source: Bloomberg.

- **Global Fixed Income.** U.S. bonds weathered volatility to gain roughly 4% (Bloomberg Aggregate), as investors focused more on stimulus and potential Fed cuts than on deficits. Municipals lagged (+1.8%) amid heavy issuance as local governments raced ahead of possible tax and spending changes. Foreign bonds outperformed, aided by the weaker dollar.

- **Real Assets.** The S&P Real Asset Index (+9%) outpaced U.S. stocks, with gold (+26%) standing out as investors sought safety amid geopolitical risk. Global infrastructure continued to deliver equity-like returns (+15.9% over two years) with less volatility, while REITs struggled under competition from bonds, tight financing, and lingering post-COVID challenges.

- **Diversifiers.** Hedge funds and private credit delivered returns in line with fixed income, providing ballast amid strong equity markets. Private markets, meanwhile, are thawing – transaction activity and distributions are picking up, helped by the passage of the One Big Beautiful Bill Act (OBBB) and rising investor optimism.

Asset Class Total Returns: First Half of 2025 & 2nd Quarter
(through June)



Source: Bloomberg.

Tariffs: The Tax That Roared (But Hasn't Bitten... Yet)

Since April, U.S. trade policy has been a dizzying loop of extended deadlines, dramatic threats, walk-backs, and "imminent" deals that remain just out of reach. Are tariffs an effective bargaining chip? Maybe. But what's undeniable is that the post–World War II trade framework – built to serve U.S. interests and, incidentally, everyone else's – is long overdue for an overhaul.

Decades of accumulated distortions have made a reset inevitable. The open question is whether the Trump administration's unilateral, sometimes bare-knuckled tactics can both protect U.S. interests and keep the benefits of global trade intact. The risk that these threats harden into more punishing, reciprocal tariffs shouldn't be dismissed.

Tariffs are, at the end of the day, just a tax – and like most taxes, modest ones are an irritant, not a crisis. But if they spiral, they can sap investment, curb spending, and sour sentiment. Already, some companies and consumers have scrambled to front-load purchases, but more often we see corporate decision-makers in limbo – waiting for the rules of the game to settle before putting capital to work.

Beneath the noise, serious negotiations are underway. Any credible breakthrough – particularly in U.S.–China talks or relief for other trade partners – could buoy sentiment. At the end of June, China and the U.S. even endorsed the Geneva framework from May 2025, which could unwind the current 115% reciprocal tariffs – though that's far from guaranteed.

It's also worth keeping the math in perspective. First, not all announced tariffs are implemented. Second, even if enacted, they may stick closer to the more manageable 10% baseline – which markets, supply chains, and consumers can absorb in pieces. And third, tariffs are applied to the wholesale price, not the final retail price. A $3 wholesale item sold for $15 would see its retail price rise just 6% – to $15.90 – under a 30% tariff, not 30%.

So yes – tariffs create friction, and left unchecked, they can bite. But their impact is often more nuanced than the headlines suggest. For now, they're a tax that roars – but hasn't yet drawn blood.

Growth with Hairline Cracks - Assessing the Path Forward

As we head into the second half of 2025, markets remain in adjustment mode – digesting a world of higher real interest rates, tight monetary policy, headline-fueled trade negotiations, ambitious fiscal proposals, and an increasingly tangled geopolitical backdrop. In the near term, markets seem likely to remain driven less by fundamentals and more by news cycles about actual – or merely rumored – shifts in U.S. policy.

U.S. Economy & Job Market

The $30 trillion U.S. economy remains surprisingly resilient, though growth has slowed. The biggest tariff-related impact so far was a first-quarter surge in imports – as businesses scrambled to get ahead of higher tariffs – which distorted GDP data to the downside. Since then, trade flows have normalized.

To counter the drag from tariffs and spur growth, the Administration rolled out the "One Big Beautiful Bill" (OBBB) Act on July 4 – a mix of tax cuts, ramped-up defense spending, and funding for border security and immigration enforcement.

The net impact of OBBB is still hard to pin down. On one hand, growth may be underestimated: the Congressional Budget Office (CBO), in its analysis, did not factor in second-order effects like increased spending power from exempting tips and overtime from taxes – which could boost consumer spending, the backbone of the economy. Nor did it account for the return of accelerated depreciation rules, which could encourage capital investment and onshoring.

On the other hand, the Administration may have overstated the upside. Extending the 2017 tax cuts – a big headline item – is arguably more of a continuation than fresh stimulus.

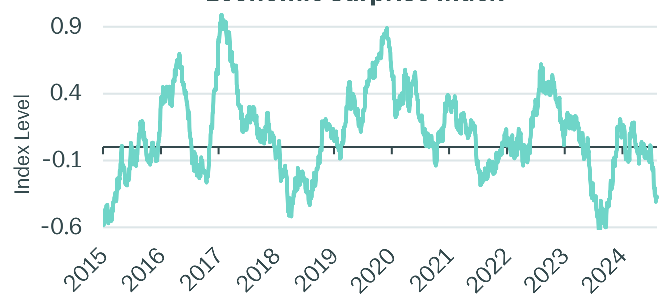
So far, both the U.S. and global economies have weathered the tariff storm better than many expected. But some cracks are beginning to appear in the growth picture. While overall financial conditions remain roughly balanced relative to history, the Fed's policy stance is restrictive. In other words: the economy is holding up – for now – but the mix of higher rates, policy uncertainty, and geopolitical friction is starting to leave its mark. In short, the economy is still standing – but the floor is starting to creak.

As we enter the second half of 2025, the "softer" data that comes in the form of consumer surveys, sentiment, etc. has projected a slowdown for the U.S. economy. While the "hard" data such as retail sales and employment has not collectively taken a turn for the worse, that, too, is starting to show cracks. For example, credit card balances are pinching consumers and job openings have moderated. The labor market in particular suggests a weaker picture (see box).

Monetary Conditions* in G7 Countries Lean Restrictive

*Central bank policy interest rate deflated by core CPI inflation. GDP weighted aggregate for G7 countries (US, UK, Canada, Japan, France, Germany, Italy). Gray bars indicate recessions. Source: MRB, OECD.

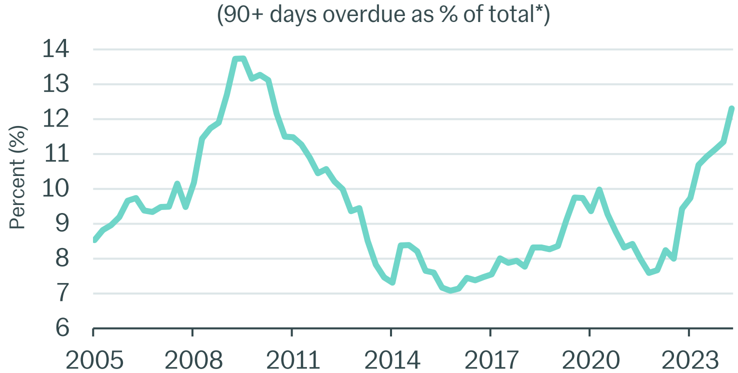
Economic Surprise Index*



*Through July 9, 2025. Source: Bloomberg.

Delinquent Credit Card Balances: On the Rise

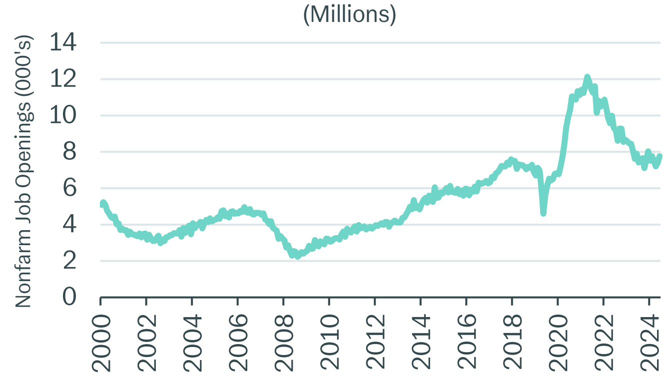
(90+ days overdue as % of total*)



*Through May 2025. Source: Bloomberg.

US Total Job Openings*

(Millions)



*Non-farm payrolls through May 2025. Source: Bloomberg.

Softening "Hard" Data

- U.S. jobless claims* (permanent job losses) ↑
- U.S. consumer sentiment about the job market* ↓
- Online searches for "how to file for unemployment"* ↑
- Spending on big ticket items aka "durable goods" (cars, kitchen appliances, etc.) adjusted for inflation, over the past five months ↓
- Spending on services (including hotels, sporting events, concerts and airfare) adjusted for inflation, over the past six months ↓

*As of June 2025. Source: Bloomberg.

The Rate of Inflation

So far, inflation has stayed unremarkable – even with U.S. tariffs averaging closer to 10% internationally (not the planned 15%, thanks to the usual starts, stops, and walk-backs). The impact has been either absorbed across producers, distributors, and consumers—or simply hasn't fully materialized yet.

That said, the next round of higher tariffs still under negotiation could nudge inflation upward—especially if surprises or false starts in policy shake sentiment and revive volatility.

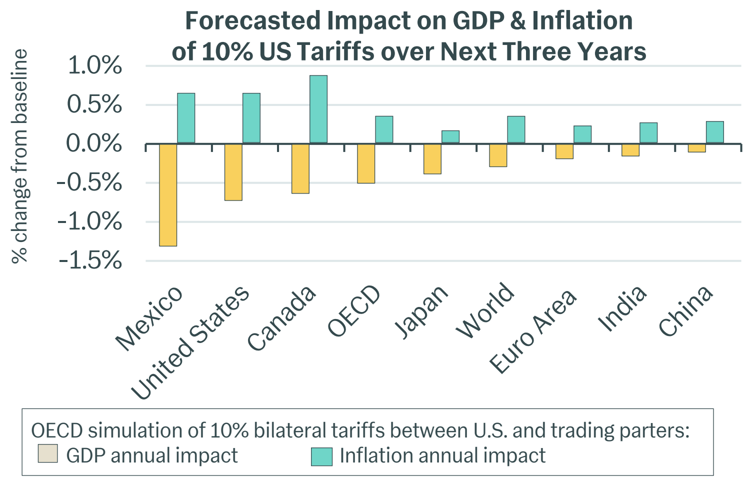
Another wildcard: immigration policy. Crackdowns are in motion, though key industries – agriculture and hospitality – have managed carve-outs. If labor markets tighten further, though, wage and price pressure could follow.

What matters most now are expectations for long-term inflation, which are still firmly anchored around 2.3% to 2.4% and were at 2.34% as of July 15 (according to the St. Louis Fed's measure of the expected five-year inflation rate extrapolated five years out). That anchor point keeps stagflation risks in check – at least for now.

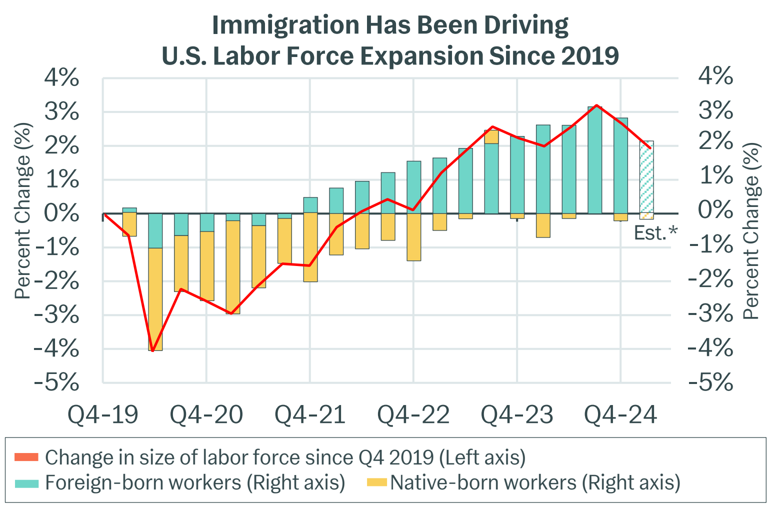
Government Borrowing & Bond Yields

We previously flagged the Treasury yield curve as key to sustaining the post-2022 equity bull. That still holds: this year alone, over $9 trillion in U.S. Treasury debt matures and must be refinanced. Add a projected $1.9 trillion annual deficit, and total new debt issuance tops $10 trillion for the first time ever. Treasury auctions that disappoint could rattle markets hard.

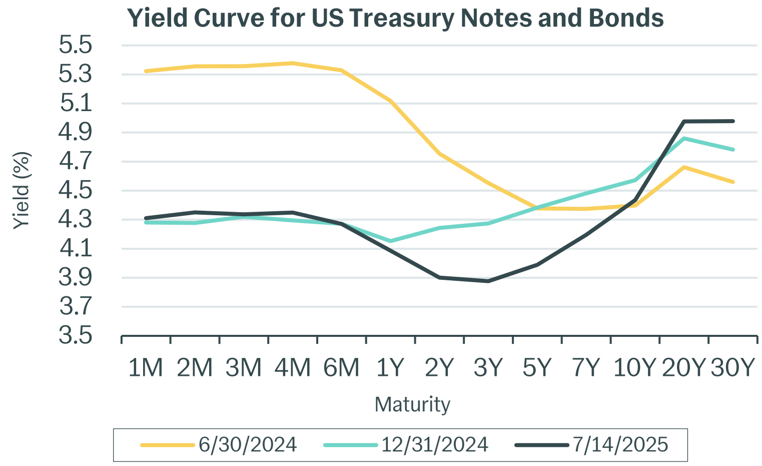
So far, investors appear to be banking on growth – especially productivity gains via AI – to dilute the debt burden. And the Treasury curve hasn't inverted (see chart to the right); longer-term yields still outpace shorter ones. Despite the splashy fiscal moves under the OBBB Act, long yields haven't surged—suggesting markets aren't panicking about debt...yet.



Source: Charles Schwab, Organization for Economic Co-operation and Development (OECD).



*Estimate for Q4 2025. Source: Bloomberg.



Source: Bloomberg.

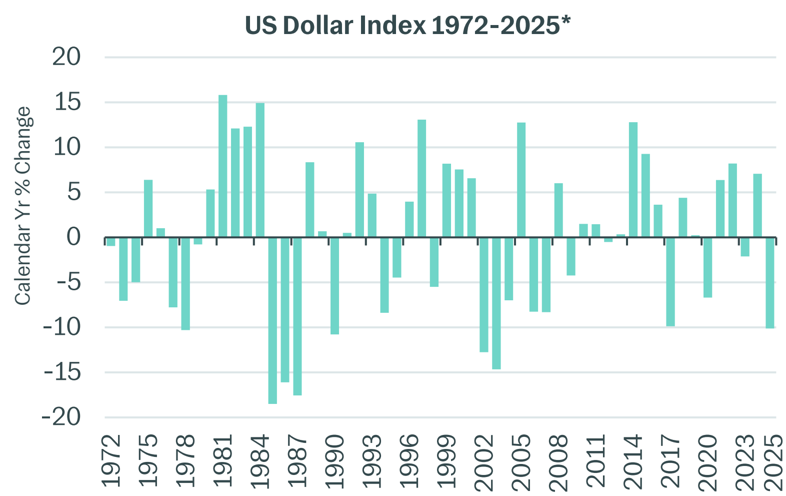
Rate-cut expectations are also simmering. A few Fed officials are leaning toward earlier easing; if inflation cools and growth softens, rate cuts could be a welcome tailwind.

What could spook markets? A messy public debate within the Fed over rate policy, or premature speculation about Powell's successor (his term ends May 2026), which could undermine Fed credibility and shake confidence.

Decline of the Dollar and U.S. Exceptionalism

The idea of the U.S. as a magnet for global investors came under attack in the first half of 2025, as the dollar experienced its worst first-half sell-off in 34 years (the U.S. Dollar Index, comprised of a narrow group of developed market currencies, dropped 10.5% in the first half of 2025).

There has been some movement away from U.S. assets as central banks reduce their reserve allocations to dollars and institutions rebalance portfolios to reduce U.S. overweight positions, but nothing representing a meaningful attitude shift away from U.S. dollar reliability. One could argue that the U.S. dollar was likely overvalued, and it only declined 4.2% on a trade-weighted basis, which is a more accurate view of greenback sentiment in the global financial hierarchy. Trump administration advisers have also advocated to devalue the dollar in an attempt to help U.S. exports.



*Through July 9, 2025. Source: Bloomberg.

Corporate Profits

U.S. companies have defied inflation fears, tariffs, and shifting supply chains – and maintained solid profit margins. That resilience owes a lot to the way firms adapted post-COVID supply disruptions: they built playbooks for volatility, redundancy, flexibility – and those are paying off now.

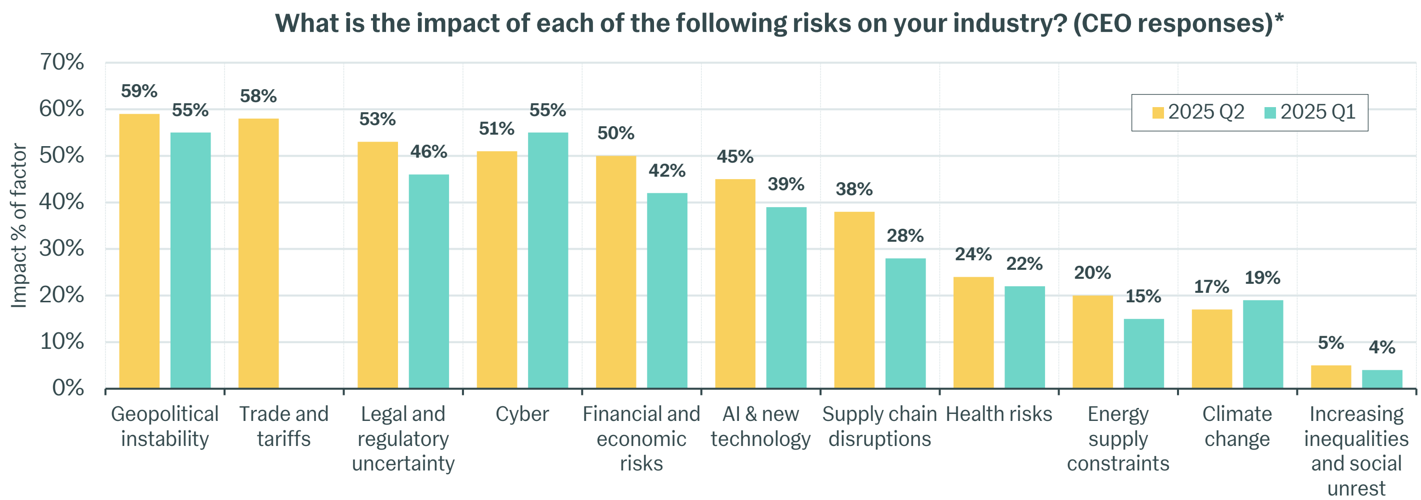
Q2 earnings (July–August) could surprise to the upside: earnings estimates have been marked down, and some firms stopped issuing guidance – leaving room for pleasant surprises.

Tech – especially AI champions – led the rebound from their Q1 stumble, proving that U.S. exceptionalism isn't dead yet. If companies show AI translating into top- and bottom-line gains, the rally could gain fresh momentum (e.g., reports of Amazon nearing the point where it has more robots than humans working at its warehouses). Just don't ignore the wage and labor questions that come with that.

What could tip the balance? If tariff hikes, tighter labor markets, or slower growth start to squeeze profit margins – especially when valuations sit near record highs – we'd expect to see a sharper repricing ahead.

Geopolitical Risk

When asked about the risks to their businesses, geopolitical instability was the most common response among CEOs. Geopolitical risk remains elevated, as war erupted between Israel and Iran. While it appears the worst may be behind us, it is likely premature to assert that we are on a path toward peace. Instead of peace, we could see a re-escalation of the conflict in the Middle East with Iran remaining defiant as perhaps the bombing of its nuclear sites was not totally effective. At this point, more surprisingly, there is potential for significantly positive developments. For example, the relationship between Israel and its Middle East neighbors could be reshaped in the spirit of the Abraham Accords due to the dismantling of Iran's terrorist arms.



*The Conference Board Measure of CEO Confidence in collaboration with The Business Council. Source: Apollo.

Marshall Plan 2.0? Europe seems to have finally gotten the memo: self-reliance is no longer optional. We've been calling this shift the beginnings of a "Marshall Plan 2.0" – and the early signs are hard to miss. In May, the EU unveiled an €800 billion defense package, while Germany – Europe's economic engine – announced a €500+ billion defense and infrastructure program so ambitious it had to amend its own constitution to allow deficit spending on defense. Germany's pivot is particularly meaningful: as the largest and most influential economy in the EU, its embrace of fiscal largesse could embolden the rest of Europe to open the purse strings too. With Berlin leading the charge, the rest of Europe may finally trade austerity for ambition.

Portfolio Strategy & Positioning

2025 has rewarded disciplined investors so far – but that doesn't mean the path forward is clear. Markets continue to digest soft economic signals, fickle reactions to policy headlines, and the reality of higher-for-longer rates. Against that backdrop, our priority remains the same: managing risk intelligently while staying positioned to capture opportunity.

We think of portfolios as a recipe – a mix of ingredients designed to work together through a variety of market environments. Below are the key components we're focused on today:

Liquidity and Flexibility

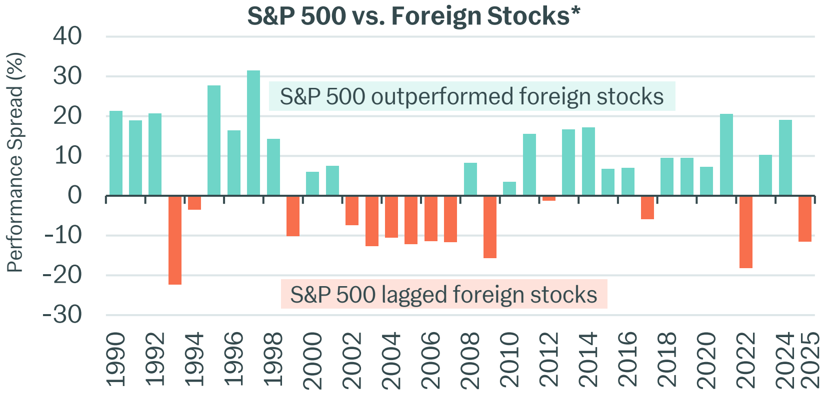
- Cash has earned its seat at the table. With U.S. equities at all-time highs and valuations stretched, longer-term rates threatening to drift upward even if the Fed cuts, and cash yields competitive with core bonds, maintaining a healthy cash allocation makes sense. Cash acts as a stabilizer and gives portfolios optionality.

Resilience and Balance

- Fixed Income remains a stabilizer, particularly if equities cool in the second half. Core bonds – both taxable and tax-exempt – continue to provide ballast, while municipal bonds stand out as underappreciated, offering their most attractive yield-to-Treasury ratios in years after a glut of issuance created dislocations.

Global Growth Opportunities

- Equities remain a central driver of returns, but with nuance. Non-U.S. markets are benefiting from coordinated stimulus, a weaker dollar, and a lack of trade-war headwinds – trends that could persist. That said, U.S. equities shouldn't be written off; the ongoing integration of AI could sustain earnings growth beyond what consensus expects. In the context of history, the degree of recent U.S. market underperformance isn't extraordinary.



*Through July 9, 2025. Foreign stocks = the MSCI All-Country World Index ex. US. Source: Bloomberg.

Real Assets

- Real Assets remain a strategic component, both as an inflation hedge and a source of differentiated returns. Infrastructure equities in particular look attractive after valuations reset as government stimulus tapered but the secular support for the asset class persists, leaving room for selective investors to capitalize.

Diversifiers and Alternatives

- Diversifiers – particularly hedge funds – have shown their value at market turning points and during volatility spikes.
- Private Markets offer another lever. Their slower price adjustments relative to public markets could unlock opportunities as dislocations emerge and valuations "catch up." Looking forward, the OBBB's tax incentives for small businesses and potential deregulation could also catalyze activity in private markets – spurring more transactions, exits, and distributions (DPI) in the quarters ahead.

Expanding the Opportunity Set

We continue to cultivate a robust pipeline of strategies to enhance portfolios – drawing on decades of relationships across global capital markets. Our focus remains on off-the-run, boutique managers with specialized expertise in complex, overlooked, or underappreciated markets. These strategies are often not widely marketed but come to us because of long-standing trust and access.

We're especially interested in ingredients that are uncorrelated – or minimally correlated – to the rest of the portfolio, and that are well positioned to capitalize on structural shifts, including the rise of AI, blockchain applications, and evolving capital market dynamics.

Final Thoughts

In an environment this complex, discipline and diversification matter more than ever. Global, multi-asset portfolios – calibrated to long-term goals and periodically rebalanced – remain the best defense against noise and the best offense for capturing opportunity. While the headlines will continue to jolt markets, we remain focused on positioning portfolios to weather – and exploit – whatever comes next.

ABOUT THE AUTHOR

Ronald G. Albahary, CFA® is Chief Investment Officer at LNW. As head of the investment team (see below), Ron determines the firm's investment strategy, directs the investment selection process, and works in tandem with client advisory teams to deliver investment solutions structured to attain each client's unique goals. Prior to joining LNW, Ron served as CIO or CEO at regional investment firms focused on ultra-high-net-worth families and foundations. Earlier in his career, he held leadership positions in the private client business of major global financial institutions, including Merrill Lynch and Northern Trust Private Bank. Ron has a degree in economics from the Wharton School at the University of Pennsylvania and currently serves as advisor to the Center for High Impact Philanthropy at the University of Pennsylvania.

The LNW investment team is comprised of 10 analysts and strategists working together to design and implement investment solutions for client portfolios. Six analysts at the firm hold the Chartered Financial Analyst® designation, with expertise spanning macroeconomics, public and private asset classes across the global capital markets, and impact investing. Collaborating with each other and with client advisors, the investment team's overarching goal is to help clients and their families preserve and grow their wealth over many generations.

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