US Equities

Investment comment

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Document intended mainly for professional investors

The facts: The same points, that have been the focus of investors for several months, remained at the forefront in July. Trade negotiations were one of them, as the August 1st deadline was approaching. Meanwhile, the first part of the second-quarter earnings season was less tough than feared.

Economic indicators released in July pointed to a rather resilient activity in the USA. The first estimate of GDP for the second quarter of 2025 suggested that the economy had grown at a 3% annualized pace, after its small contraction in the previous period. The June readings of industrial production (estimated by the Federal Reserve) and durable goods orders (ex-transportation, from the Census Bureau) were both in positive territory month-over-month, and the latest release of factory orders, relating to May, was sharply up (8.2%) sequentially. **Net job creations were roughly in line with those of the previous months, which was sufficient to bring unemployment back to 4.1%**. Consumer spending thus remained steady too. The Bureau of Economic Analysis found that both personal income and personal spending had risen 0.3% month-over-month in June, and the Census Bureau estimated that retail sales had been up 0.6% (0.5% ex-auto) in the same period.

The first part of earnings announcements also seemed to confirm this resilience during the second quarter. It did not include all of the most watched names since Apple and Amazon only reported after the close of July 31, and Nvidia's fiscal quarter only ended that day but, with more than 50% of corporations' results already out, the tone was known. **Sales exceeded consensus forecasts much more frequently than in the recent past**. According to LSEG/IBES compilations, only 22% of announcements missed expectations, when this percentage commonly reached 35 to 40% in the last few years. As for earnings, with 85% of companies meeting or beating expectations, the season was good too, although less different from the previous ones. **Comments about the future were not necessarily upbeat, as many companies stressed the uncertainties resulting from tariff hikes, but growth forecasts were raised anyway**. According to Graphene Investments' calculations on the basis of IBES estimates, the median revision was 0.22% for 2025 EPS forecasts.

It was difficult to say if this resilience was just due to spending being pulled forward to avoid the impact of higher tariffs in the future or if, like equity investors, corporations and consumers were just ignoring that threat. As a matter of fact, **sentiment did not look particularly strong, which suggested that the upcoming inflationary pressures had played a role**. The ISM Manufacturing index remained below 50 for the fourth consecutive month, and the Services index rebounded after its brief drop to 49.9 in May. However, at 50.8, it was still close to its softest levels of the past few years. At 97.2, the Conference Board's Consumer Confidence index was also up slightly, but remained far from strong in absolute terms, and the NAHB index remained close to its recent lows.

As regards inflation, the data released by the Bureau of Labor Statistics showed that production prices were stable but that consumer prices had risen in June at their fastest pace of the last four months. The Federal Reserve held its last FOMC meeting before the August break, and kept its

reference rate steady despite Donald Trump's regular pressures. **It seems however that the decision triggered a tougher debate among committee members than at the previous meetings**.

All this, anyway, was of little help to determine the outlook, given that uncertainty remained high about which countries and products would be hit the most by Donald Trump's tariffs. The US President looked determined to apply higher rates to all countries, with which no deal would have been reached before the August 1st deadline, but the picture kept changing fast. Early in July, key trading partners such as Japan and Korea were threatened of 25% to 40% tariffs, but a few days later, the White House suggested that base rates would be closer to 15-20%, and Donald Trump said it again on July 28. In between, deals were reached with Japan (with a focus on car imports), Korea and Europe. In most cases, the 15% rate appeared to prevail, which suggested that negotiations had had a limited effect. Countries which did not show enough reverence to the US president however got less favorable rates. This was the case for India (25%), Canada (35%, although with many exemptions) and Brazil (50%). Mexico, on the contrary, got a 90-day reprieve. Things were difficult to interpret, though. Beyond the many exceptions granted to specific products to accommodate particular US interests, the discussions were ongoing and the August 1st target looked more like a way of putting pressure than a date beyond which things would become irreversible. Moreover, **deals often involved commitments to buy more US goods, or invest a certain amount in the country, and it was obviously impossible to assess how much of these promises would be kept over time**.

On the geopolitical front, after occasionally giving the impression that he was no longer interested, Donald Trump got back into the game to try and end the conflict between Russia and Ukraine. He initially warned Moscow of serious economic sanctions if no deal was reached within 50 days, and later shortened that timeframe after seeing that Vladimir Putin could not care less and kept striking civilian populations in Kyiv and other large Ukrainian cities. **The US president even threatened to take action against countries, which would be buying Russian oil and gas**, and his deal with Brussels included a commitment by Europe to buy more energy from the USA, thus reducing imports from Russia. On the contrary, he seemed to adopt a more patient stance with China, and went as far as denying the Taiwanese president the right to stop over in New York to speak at a conference. **This was widely interpreted as a sign that the US support to Taiwan may have suffered from the pressure of economic pragmatism**. Finally, in the Middle-East, the situation did not change much on the ground. However, a few countries announced their intention to recognize a Palestinian state in the next few months.

The effects: The many uncertainties did not seem to cause too much concern, and the S&P 500 index rose relatively consistently throughout the month to post a 2.22% net return. Our strategy did well for most of the period, but many stocks' weird behavior on July 31 changed this dramatically.

It is difficult to summarize what drove the US market in July because, due to earnings announcements and political comments, there were many exceptions to every potential general explanation. **AI however continued to appear everywhere, and trigger upbeat comments and steady investments**.

In appearance, styles played a role, since the S&P 500 Growth index outperformed its Value equivalent by approximately 270 bps, and the gap was even larger in the "pure" family of indices. However, there were mostly fast-growing companies among the bottom 30 performers in the S&P 500 index. These ranged from "medtechs" Baxter International and Intuitive Surgical to technology players

Micron Technology and Palo Alto Networks to consumer-driven stocks such as Netflix and Lululemon Athletica. Admittedly, Technology was once again the market's best performer (+5.2%) but it was closely followed by one of the most emblematic "value" sector, Utilities (+4.9%). The group, which had been in the bottom three categories in June while IT was already at the top, rebounded when **investors suddenly decided that power generation would benefit from the development of energy-intensive datacenters**. This is how it was the only defensive category that performed well, while Healthcare and Consumer Staples were respectively falling 2.5 and 3.5%.

Size also appeared to have an influence, and the official, market-cap weighted version of the S&P 500 index again outperformed its equal-weighted version by about 130 basis points over the month. **A large part of the gap actually came from the usual Mag7s, and more precisely, those with a big AI exposure.** Nvidia, Alphabet, Microsoft, Amazon, Broadcom and Meta Platforms all outperformed significantly after Google Cloud's and Azure's growth revived confidence in the sustainability of demand. On the contrary, Tesla was down amid production data and mixed feedbacks on the launch of its "robotaxi" service. Apple, the only perceived laggard in AI among the Mag7s, was about in line with the market. The constant flow of top experts leaving to join Meta or other leading players in this specialty was mitigated by views that the company might use external solutions to power Siri in the future and, probably more importantly, by the US president's more accommodative tone with China.

Performance did not seem to have a very strong correlation with results announcements this time. If IT arguably produced one of the best showings in earnings reports (with a marginal miss rate on revenue and no disappointment at all in earnings within the S&P 500 index so far), Utilities were much worse and obtained almost the same return. On the contrary, Healthcare was the worst-performing sector (-3.4%) despite reasonably solid results. Consumer Discretionary companies reported results that were generally less good than among Consumer Staples, and however did much better in terms of return. This poor correlation between reported fundamentals and returns was largely due to the diverse interpretations of political uncertainties and their potential effects on the business. **Even after strongly beating the consensus, many companies only reaffirmed their guidance or made cautious comments about the coming quarters**. This was particularly frequent in Healthcare, which was impacted by Donald Trump's plans for Medicaid, but also by his comments inviting the sector, and particularly drug-makers, to cut their prices.

We ended the month with a 147 basis points gross underperformance against the S&P 500 net return index, but only 20 basis points behind the average (equal-weighted) return of its components. Weirdly enough, the lag on our benchmark was entirely generated on July 31.

We spent most of the month modestly ahead of the index. **We faced a number of disappointed market reactions to earnings or guidance announcements by our holdings, but these were offset by positive contributions from other stocks**, as a majority of our picks were doing well. We managed to overcome the weakness of Fiserv (which issued a cautious guidance about its merchant business), Iridium (which reduced its revenue growth guidance due to softness in government subscriptions) and HCA (which reported and guided well above expectations but stressed that visibility was low). We even managed to offset the impact of Centene, which was by far the market's worst performer after suddenly announcing that it was withdrawing its 2025 guidance, which had been reaffirmed on multiple occasions since last December. The health insurer blamed new morbidity data suggesting that it had overestimated its entitlement to "risk adjustment transfer", a mechanism meant to compensate insurers who accept members with riskier, costlier profiles, which otherwise would remain uninsured. Among the positive contributors who helped offset these incidents were Baker Hughes in equipment and services to the energy industry, Iqvia in research services for the pharmaceutical sector, and others, which issued strong results and impressed with their guidance.

Unfortunately, though, **the last session of the month was very tough on our portfolio, and we suffered from a massive underperformance**. A little part of that effect was logical as two of our stocks were falling that day after issuing their guidance. ATI, in special steels, raised its guidance marginally, but analysts' expectations were even higher for the third quarter and the stock lost more than 18%, all the more easily as it remained well ahead of the market since the beginning of the year. Meanwhile, Itron's earnings strongly exceeded forecasts in both reported and guided numbers, but had less impact than the slight disappointment on its sales of smart meters, which sent the stock down 10%. However, given all the positive news that had come from other companies at the same time, we expected at least part of that effect to be offset elsewhere, but this is not what happened. A comment from Donald Trump on drug prices sent all pharmaceuticals down 2-3%. More importantly, for some reason which we fail to explain fully rationally given the balanced profile of our portfolio, **more than 75% of our holdings underperformed that day, and many of them were one or two percentage points behind the index, on no news or good news**. These included companies whose results had been out (and upbeat) for several days, like Alphabet, Flex or Vertiv, as well as some whose next announcement was not expected any time soon, like Bath & Body Works or Burlington Stores.

Our decisions: The portfolio had slightly more turnover than usual in July. We sold health insurer Centene following a major surprise in its "marketplace" business, and we realized our hefty profits on long-held United Rentals. Their replacements were picked respectively in Finance and Materials.

Although our quantitative screening considered that the stock was cheap enough to be kept, we elected to sell Centene after the above incident. The 40%+ collapse might have suggested that all bad news was discounted, and the company's announcement that it was preparing to revise its Marketplace rates in 2026 left hope for an improvement next year. However, **we considered that the implications of the announcement were too uncertain, all the more as other headwinds had appeared in the recent past**. Various players have reported a rise in healthcare utilization rates ahead of Donald Trump's reforms, which will substantially cut federal funding for the Medicaid program, thus forcing states to either reduce reimbursements or strengthen eligibility criteria. Benefits paid out by insurers are therefore expected to rise as a percentage of premiums received, and we do not think that this pressure is fully understood by the market.

We also sold United Rentals, which had been held in our portfolio since the origin of the strategy eight years ago. For the long-term, we continue to like this equipment rental operator, which offers a rather resilient business model compared to other industrials during economic downturns, and boosts its growth through carefully selected, swiftly integrated acquisitions when the operating environment is favorable. **We have benefited from its strong execution and its disciplined management, and the stock outperformed consistently throughout our holding period**. However, this also translated into a higher valuation, with a P/E ratio almost six points higher than when we bought the position at twelve times forward earnings. The typical valuation of S&P 500 stocks hardly moved over the same period. Given that we did not see any catalyst that could help growth surprise on the upside in the foreseeable future, we decided to take our profits, and replace United Rentals by a new pick with, hopefully, more growth potential over the next few years.

The two holdings we selected were, on paper, very different from those they replaced, since one is involved in Finance and the other one belongs to the Materials sector. However, an analysis of their profiles in light of the various

economic scenarios suggests that the trades probably did not significantly alter the portfolio's sensitivity to global activity.

For more details about our recent stock picks, please refer to the fund's detailed report or contact us.

These trades did not materially alter the general characteristics of our stock selection, which are consistent with our investment style and its structural effects on the portfolio's and its benchmark's compared data. We hold companies whose median EPS growth is expected to reach 12% in 2025 (almost five percentage points more than for the market according to our calculations based on IBES data) and accelerate to 13.4% next year (still 240bps faster than market average, even if the gap doesn't grow over time as it usually does). Although not our priority usually, their valuation is also attractive. We have a five point advantage in P/E ratios (17.4 vs 22.5), which should protect the portfolio in volatile periods.

Of note, **our latest trades contributed to a modest shift in the portfolio's sensitivity to exchange rates**, and reduced a small bias which had appeared over time. The compared resilience of worldwide economies had often led us to favor domestic businesses rather than exporters in the last few years, but a weak dollar thus represented a slight headwind for the strategy.

The outlook: We still expect pragmatism to prevail in trade negotiations, in the way companies adjust their business… and in the Federal Reserve's policy. All this is poised to weigh on the economy, but the main risk remains the multiplication of erratic announcements in domestic and international politics.

While everyone is focusing on tariffs as if their exact level for each country was going to be key for the future, we believe this is not the point. **The August 1st limit is not an absolute deadline**, and countries subject to an excessive tax rate at that time will always be able to resume a negotiation (or retaliate) if they believe it is in their interest. We would therefore be very surprised if the picture in a few months was still similar to one taken today. The current episode however has two negative consequences for the economy: the lack of visibility and the general impact on global growth.

US companies have always been very good at adjusting to a new business environment. Although their responsiveness probably declined in the past few years, due to an evolution in mindsets towards a less aggressive focus on productivity, we still believe they have an advantage over the rest of the Western world in this respect. However, **to adapt their business, they need to know where the general backdrop is headed and they can't do so as long as things are changing almost every day**. Apple faced that issue in recent months, when they transferred a large part of their US-bound production from China to India, which they felt was a safer bet, only to see the threat of higher tariffs on India grow over time. In addition, whatever the negotiations may lead to, tariffs will be higher than they used to be in the past, and this will take a toll on the US economy. This is not visible yet because the perspective of higher prices temporarily generated some extra demand, but we would be surprised if the business did not slow in the country and overseas in the next few months. The Federal Reserve may then be able to cut rates slightly to alleviate the impact, as everyone seems to be expecting, but we do not think Jay Powell will move as long as there is a risk of inflation. In this respect, production prices have remained surprisingly stable lately, with the help of moderation in energy prices and various other commodities, and despite the evolution of exchange rates. There is no guarantee that this will continue and, with consumer prices already moving higher, **the central bank will probably not have much leeway**… unless the economic

slowdown is so strong that inflation is not a problem anymore

All in all, visibility will remain low for at least another couple of months, but we believe that the worst aspect in the current situation is the way it damages trust in all the relationships among the various players. Bluntly threatening to change the rules for other countries and companies, and often letting personal interests and resentments interfere in those choices, cannot be a viable long-term strategy for a country like the USA. All targets may not have the options of China, which gently brought Donald Trump to his knees by threatening to block rare earth supply, but even the weakest player will sooner or later be in a position to take its revenge. Long time partnership will be broken, others will develop, that will not necessarily have the same view of general interest, nor the same ethics. If the new rule becomes “every man for himself”, with not even an effort to make it look polished, everything is possible. Many of the principles on which the political and corporate systems were built in developed countries may no longer be applicable. **Trust will take a long time to rebuild (assuming that it can be) if the current episode cannot rapidly be recognized as a short, one-time glitch in History**.

There is no ideal solution to manage a situation like this, but we continue to believe that a careful stock picking is the most effective way to weather a lack of visibility. A portfolio of well-managed companies, with attractive products, a strong business model and a responsive executive team, may not be able to avoid all the accidents, but it is poised to do well over time. It may be frustrating to go through days like July 31, which ruined our month in a few hours, but this is just the result of investors’ emotional reactions, which will fade after a while, whereas fundamentals will remain. In this respect, we note two details which confirm the fundamental quality of our selection. In July, the median revision of our portfolio’s 2025 EPS estimates was more than twice as high as that for the S&P 500 index. In addition, in most of the cases **when our holdings fell sharply in reaction to their results announcements or guidance updates, a majority of analysts raised their target price**. Unlike a recommendation upgrade, which might just be triggered by the cheapness of the stock after the correction, this, in our view, is a sign of confidence that fundamentals remain solid, regardless of subjective way investors look at things. We believe in our disciplined, emotionless approach, which has always worked well over time, and will prove fruitful again even if the return to fundamentals takes more time than usual.

Graphene Investments

AMF license #GP-16000022
75 Bd. Haussmann 75008 Paris (France)
T: +33.1.70.82.44.50
F: +33.1.70.82.44.49
E: contact@graphene-investments.com
W: www.graphene-investments.com