TREE TOP

Managers' Letter
2nd Quarter 2025

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Economic and Market Environment

For most investors in the world, April started like a bad joke with the words and actions on trade of the American president Donald Trump, which caused the S&P500 and the US dollar to fall and created wobbles in the global debt markets. We observed in our last newsletter that in times of panic, such as during the early stages of COVID, the Ukraine invasion and now the global trade war, **panic selling** generally leads to significant wealth destruction. Another observation was that most political leaders, except maybe Vladimir Putin and Kim Jong Un, generally have to adjust when bad decisions are made, otherwise their political days are numbered. So far, this has proven true for the American administration, with tumult in global markets leading to global negotiations and a climb-down on the most outrageous tariffs. The last few weeks have also confirmed our intuition that it is generally better to wait and see, as global equity markets have rallied, with many now close to all time highs.

As we can see in the table below though, there is wide discrepancy in global stock market performance, ranging from a 1.5% increase over the first six months of the year for the Nikkei 225 and the Magnificent Seven to +20% for the Hong Kong stock exchange, the Hang Seng Index. It does show the importance of being globally diversified and not overlooking major regions. It is also important to notice that these performance numbers are in **local currency** and while the US stock market has rebounded very strongly following its mini-crisis in April, the US dollar has fallen significantly against a number of major currencies in the world.

	Equity Market Performance (in local currency)							
	MSCI ACWI	S&P 500	NASDAQ	Magnificent 7	STOXX Europe 600	Nikkei 225	Hang Seng	NSE Nifty 50
01/01/2025	841	5,882	19,311	26,067	508	39,895	20,060	23,743
30/06/2025	918	6,205	20,370	26,461	541	40,487	24,072	25,517
Change	9.1%	5.5%	5.5%	1.5%	6.6%	1.5%	20.0%	7.5%

Figure 1 Source: Bloomberg

As we can see on the table below, the US-dollar is down 8.4% compared to the yen and 12.1% compared to the euro over the first six months of the year and hasn't rebounded so far. Currency movements can be difficult to analyse and are even harder to forecast, as they depend on future policies and economic shocks. We can only observe that the actions of Donald Trump, such as undermining the independence of the American central bank (the Fed) and potentially stoking higher inflation with tariffs, have put pressure on the US-dollar over the last few months.

	Government Bond Yields			Currencies		Commodities (USD)		
	US 10yr (%)	Japan 10yr (%)	German 10yr (%)	USD-JPY	USD-EUR	Brent	Gold	Copper
01/01/2025	4.57	1.10	2.37	157.23	0.97	74.64	2,625	402.65
30/06/2025	4.23	1.43	2.61	144.03	0.85	67.61	3,303	503.00
Change	-0.34	0.33	0.24	-8.4%	-12.1%	-9.4%	25.9%	24.9%

Figure 2 Source: Bloomberg

While it is unfortunately impossible to make reliable foreign currency forecasts, it does not mean that Belgian-based investors in the global stock market should take no action. As you can see on the graph below, the euro nearly doubled in value compared to the US-dollar between 2001 and 2008 and then subsequently lost 26% of its value. At TreeTop, we first and foremost recommend **consistency**. If an investor decides to fully hedge his/her foreign currency exposure or alternatively don't hedge it, don't change the strategy mid-course! A bit like market timing, there is nothing worse than going in and out of foreign currency exposure, as it can quickly destroy most of your portfolio returns.

Another way to think about hedging and foreign currency exposure is to consider the **investment horizon.** A young person saving for his/her retirement in a few decades can think differently about hedging than someone investing for five to ten years. Generally, as the years go by, the hedging cost can accumulate, while major currencies (euro and USD mainly) tend to move in cycles. On the contrary, someone with a shorter investment horizon (less than 10 years) and with debt/significant expenditure in euros should probably hedge a large part or all of his/her foreign currency exposure. Having **a discussion with your financial advisor** is generally the best thing to do to take into account all your personal parameters.

Figure 3 Source: Bloomberg

The small and hopefully short-lived crisis in April was a good reminder that market timing/panic selling is a bad idea most of the time.

The last five years are also a good example of why fixed-income investments (bonds), which are supposedly safe financial instruments, can be pretty bad investments especially during periods of elevated inflation. Looking at the last five years on the graph below, we can see that the global stock market in USD (in green below) generated a total nominal return of close to 80% despite two major crises (the COVID pandemic in 2020 and the Ukraine-Russian war in 2022), as well as rising inflation and interest rates. Global credit instruments (in orange below) and European government bonds (in blue below) are roughly flat and down 10% over the same period, respectively. In real terms (after inflation), these numbers are even worse, with the average European and/or American citizen experiencing total inflation of 25% over the same period. A European government bond holder experienced a drop in purchasing power of close to 35% by holding these instruments for just five years.

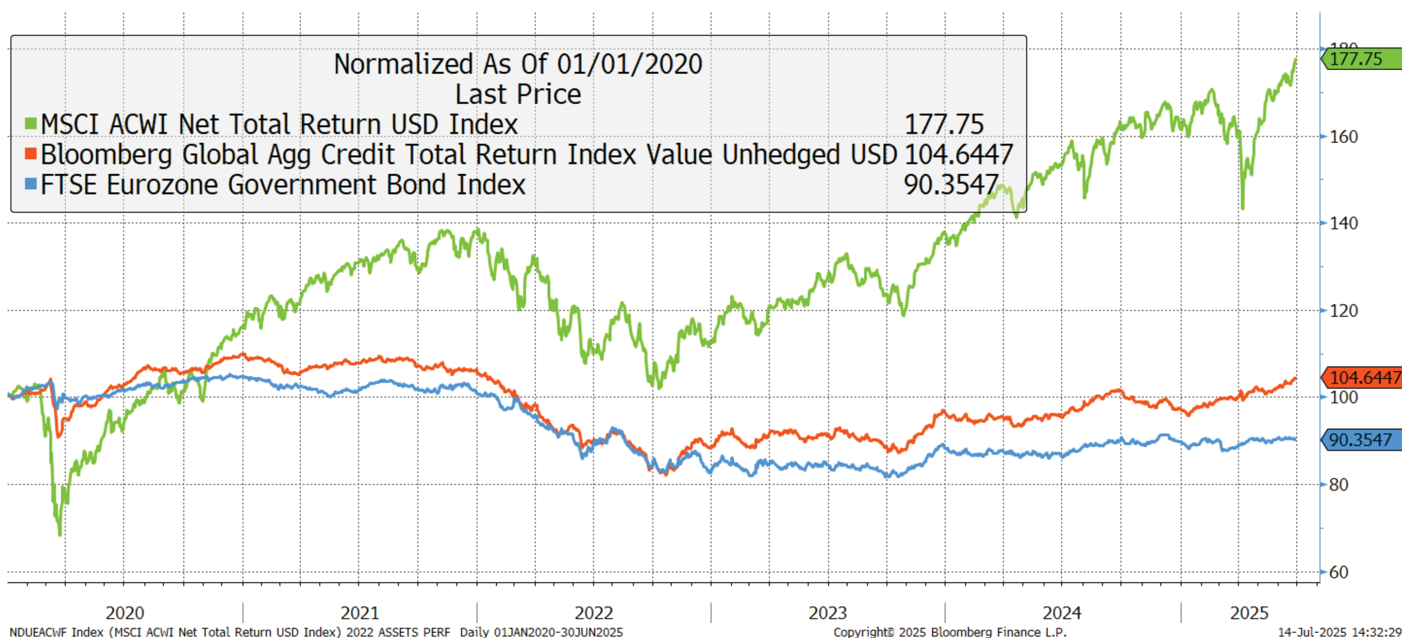
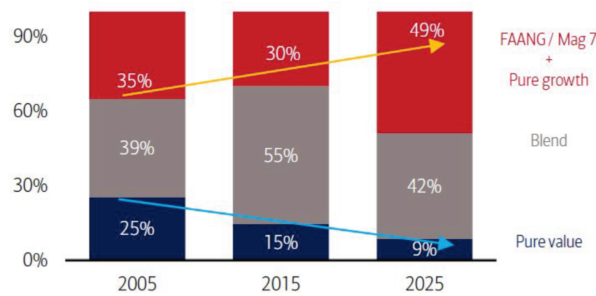


Figure 4 Source: Bloomberg

Despite the recent rise in yields, the future for fixed-income investors might still be disappointing especially for those with long-dated European sovereign bonds offering low single-digit yields. After tax, transaction costs and inflation, the net real yield remains perilously close to 0, meaning the purchasing power of your savings in government bonds will likely continue to decrease. There might be some corners in fixed income offering better prospects like high yielding corporate bonds, but we advise investors to tread carefully, as the default rates could negate the positive impact of higher yields.

All that doesn't mean that the global stock market is a panacea. As we have explored in previous paragraphs and newsletters, the global equity market will continue to be volatile and the market will test the nerves of investors. Picking the right index will remain crucial as some stock markets, like South Korea and most European markets, have delivered pretty poor performance in recent years, as we explained in more detail in our 2Q 2024 newsletter. Excessive concentration in very large American technology companies could eventually become a problem, as analysed in our 3Q 2024 newsletter. The investment bank Merrill Lynch, in one of its most recent reports, observed that the S&P500 has significantly changed over the last decade with far fewer 'value companies' and a lot more 'growth companies' (see graph below). At TreeTop, we have become somewhat concerned about this evolution, especially since these very large technology companies are investing massively in 'artificial intelligence', which could drag down earnings growth if monetisation does not materialize as expected.



For all these reasons, our team has been actively looking for alternatives and continues to do so. While we still believe that the American equity market will offer great stocks, we want to avoid the most expensive ones. As explained below, we launched the S&P500 Buyback Free Cashflow strategy two years ago and have been very happy with the performance so far[1]. We also continue to work on exciting new strategies and are looking forward to sharing more information in the next few months. In the meantime, please feel free to contact our team for any question you may have.

Our convictions

Figure 5 Source: Bloomberg

So far this year, the S&P500 Buyback Free Cashflow strategy has delivered better performance than the American market overall and has a pretty good five year track-record[2] despite the outstanding performance of ultra-growth stocks like **NVIDIA,** which are not in the strategy. As we thoroughly explained the theory behind the S&P500 Buyback Free Cashflow strategy in our previous newsletters, we thought it would be more interesting to analyse how the strategy works practically through the example of three investments in the last three years. Here are our major observations:

[1] *Past performance does not guarantee future results. No guarantee of result or performance*

[2] *No guarantee of result or performance*

(1) The strategy **is highly flexible** and **adjusts quickly:** it holds large positions, sometimes more than 8% of the portfolio, and sells most of them in just one quarter if there are better relative opportunities elsewhere

(2) It owns very **diverse names** and moves in and out of sectors depending on the fundamentals: the three examples below should give a better idea of how the strategy works.

Figure 5 Source: Bloomberg

Wells Fargo & Co is one of the largest retail banks in the United States. Although not as well-known as its high-flying counterparts, such as JP Morgan and Goldman Sachs, it has consistently generated high returns over the years and is a very profitable business. The strategy had a very large position between January and July 2024. It re-initiated a small position in October 2024.

Figure 6 Source: Bloomberg

Paypal Holding is one of the world's leading electronic payment providers. Once a high-tech darling trading on lofty valuation multiples, it has lost some of its shine post COVID and is now a much cheaper stock. It is a highly profitable business though, has a sticky userbase and has the ability to buy back a significant chunk of its shares. The strategy traded the stock very well, by having a sizeable position in July 2024 and captured a large part of the rerating in 3Q 2024.

Figure 7 Source: Bloomberg

HCA Healthcare is the largest private hospital chain in the United States. It is an interesting case study, as the strategy nearly perfectly timed the stock, initiating a position in October 2023 and holding it for 12 months just before the stock started to drop significantly. It is a good example on how the two major criteria in the strategy (Free Cashflow yield and share buybacks) result in automatic selling when the fundamental investment criteria deteriorate.

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