

Mackenzie Bluewater Commentary: Q2 2025

Overview

The second quarter of 2025 was marked by heightened volatility followed by notable resilience across global markets. While geopolitical tensions and the resurgence of trade protectionism led headlines, markets ultimately demonstrated a capacity to recover, buoyed by steady consumer spending and a cautious central bank stance. This period underscored the importance of a disciplined, long-term investment approach focused on high-quality businesses with durable competitive advantages.

Risk comes roaring back

April opened with a jolt as the U.S. administration proposed sweeping tariffs with up to 145% on Chinese imports and 50% on EU goods. Markets sold off sharply, with volatility spiking to pandemic-era levels. However, the most severe measures were quickly softened: a 90-day reprieve was granted, EU tariffs were scrapped, and a compromise with China reduced effective duties. This pattern of bold announcements followed by partial retreats led investors to discount the likelihood of full implementation. The term “TACO Trade” (Trump Always Chickens Out), coined by the *Financial Times*, captured this dynamic. Equities recovered strongly, with global stocks up ~6% and the S&P 500 returning to near-record highs by quarter-end, reversing the rotation to quality seen in Q1.

The Federal Reserve remained a stabilizing force, holding rates steady while emphasizing a data-dependent approach. Inflation remains above target, and the Fed is wary of repeating the 1970s mistake of easing too soon. Futures markets still price in modest cuts later this year, contingent on softer growth. However, with no major trade deals signed beyond those with the UK and Vietnam, tariff risks and their inflationary potential remain real.

U.S. consumer strength continued to underpin the economy as unemployment fell slightly to 4.1%, overall job creation exceeded expectations, and household balance sheets remained healthy. Q2 GDP growth rebounded sharply with the Atlanta Fed GDPNow model estimating annualized growth near 3.8% as of late June, which we believe partly reflects front-loaded spending ahead of potential tariff implementation.

Nonetheless, risks are emerging. The U.S. unemployment rate has risen modestly from its post-pandemic low, technically triggering the Sahm Rule, a historically reliable recession signal based on a 0.5 percentage point rise in the unemployment rate. However, it is worth noting that the post-COVID low may not have reflected a true labour market equilibrium, given distortions caused by pandemic-era workforce exits and gradual re-entries. As such, the signal may carry less weight in this cycle than in more typical periods. While not yet accompanied by a broader retrenchment in consumer activity, this development adds to the case for increased vigilance.

In Canada, the picture is more mixed. Unemployment rose to 7.0%, the highest in nearly a decade outside the pandemic and while full-time job growth continues, momentum is slowing. Consumers remain resilient, aided by rate cuts totaling 225 bps and policy tools like extended amortizations. Mortgage delinquencies remain low, but stress is building in unsecured credit, particularly among subprime borrowers. Discretionary spending is tightening, but as long as job losses remain limited, consumption should support modest growth.

Portfolio Changes

Notable portfolio additions during the period included adding durable growth companies that fit the Bluewater investment philosophy and that tended to have minimal to no tariff risk with well insulated supply chains.

Across Bluewater portfolios, we initiated a position in **Automatic Data Processing (ADP)**. ADP is a leading payroll and human capital management provider that has steadily transitioned into a software-driven model over the past two decades, expanding operating margins from 18% in 2012 to 26% today. Its scale and purchasing power enable clients to access value-added services, while brand strength and reliability support over 90% recurring revenue. The business benefits from low client concentration, high retention (average client tenure of 13 years), and very high switching costs. Industry growth remains solid at 5–6%, and ADP maintains strong pricing power, with ~100bps of planned price increases in 2025.

With approximately ~90% of revenue being U.S.-based, the company is well insulated from global macro and tariff risks. Overall, ADP continues to demonstrate the characteristics of a long-term compounder—scalable economics, resilience, and operational consistency.

Another recent addition is **Compass Group PLC**. Compass Group is a global leader in food and support services, benefitting from secular outsourcing tailwinds and high client stickiness, with a 96% retention rate. Its competitive moat is anchored by Foodbuy, a centralized procurement engine that aggregates volume and delivers best-in-class pricing and customization that enables superior gross margins and agility. With a decentralized business model, Compass retains entrepreneurial teams while scaling best practices and procurement advantages across sectors. Outsourcing continues to gain share, and Compass is well-positioned in non-cyclical verticals like education, defense, and healthcare.

With minimal exposure to macro risk factors like tariffs, and durable growth that is underpinned by scale, pricing power, operational consistency, Compass is a key example of the type of idiosyncratic, high-quality business we want to own in an uncertain world.

Conclusion

Overall, the second quarter of 2025 highlighted the value of staying invested through uncertainty. Though equity markets recovered strongly in May and June, looking ahead this optimism may soon be tested, as the US tariff truce which was set to expire in early July has been pushed back to August 1st. Headlines drove significant short-term volatility, but the underlying economic data painted a more nuanced picture. In our view, this environment reinforces the merit of owning high-

quality companies with durable business models, strong balance sheets, and the ability to grow earnings across a range of economic outcomes.

By focusing on companies with the ability to grow free cash flow at above-market rates across cycles, and acquiring them at disciplined valuations, we embed downside protection into the portfolio. This enables us to better manage through macroeconomic uncertainty, market volatility, and drawdowns. The strategy has consistently added value by preserving capital during challenging periods while compounding returns for clients—ultimately delivering superior risk-adjusted performance over the long term.

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