

The first quarter of 2025 marked a volatile start to the year for financial markets, with investor attention shifting away from economic data and Fed rate cutting expectations and toward growing fiscal policy risks. Markets have interpreted the Trump administration's proposed tariffs as a net negative, a sentiment reflected in weakening consumer confidence, rising forward inflation expectations, and broad-based equity declines. The S&P 500 ended the quarter down 4.3%, marking its first quarterly loss since the bear market of 2022. In contrast, fixed income performed relatively well, with the Bloomberg Aggregate Bond Index (AGG) posting a positive return of 2.7%.

Several investment banks lowered their year-end S&P 500 targets, citing tariffs as the primary headwind, and raised recession probabilities. Concerns over tariffs from CEOs, politicians, and economists prompted the administration to implement industry-specific exemptions and country pauses, which we view as a positive step toward stabilizing markets. However, we remain cautious, as fiscal policy appears likely to remain unpredictable, sustaining uncertainty and volatility in markets. The escalating trade tensions with China are particularly concerning given the reliance of U.S. companies and consumers on Chinese imports.

Recent economic data has shown some weaknesses, especially in sentiment indicators. March's consumer sentiment reading was the second lowest on record at 50.8 (since 1952). Despite poor sentiment, unemployment remains healthy at 4.2%. Inflation trends are encouraging, with year-over-year CPI at 2.4%, nearing the Fed's 2% target. Resilient consumer spending and positive real wage growth also support economic strength. It's possible that the effects of recent fiscal policy changes have yet to appear in inflation and employment data due to reporting lags. Market volatility has increased expectations for multiple Fed rate cuts this year. While lower rates would be a long-term positive, the Fed's reactive approach on policy means timing will be critical, and intervention may come too late. The deterioration in sentiment is concerning, so it will be important to monitor the "hard" economic data for signs of further weakness.

Early-year optimism in equities faded as tariff concerns weighed on markets. Several uncharacteristic shifts occurred in equity markets during the first quarter. International stocks (MSCI EAFE) outperformed the S&P 500 by 11.2%, a rare reversal of historical trends. Another notable shift was the underperformance of the "Magnificent 7," with the MAGS ETF down 15.7% for the quarter, while the S&P 493 (excluding the Mag 7) posted marginal gains—reversing the pattern of the past two years. Defensive sectors like healthcare gained, while small caps and tech

stocks underperformed due to their cyclical nature. These moves emphasize the importance of a diversified portfolio.

The bond market also experienced unusual volatility. Treasury yields initially fell in a flight to safety after tariff announcements but quickly rebounded, with long-term yields rising on concerns about persistent inflation and slower growth (stagflation). There is also speculation that foreign central banks are reducing U.S. Treasury holdings due to waning confidence in U.S. long-term growth. In corporate bonds, spreads have widened, presenting attractive risk-adjusted buying opportunities, especially given the recent rise in Treasury rates.

Looking ahead, we anticipate continued short-term volatility driven by tariff uncertainty. While further market declines are possible, we remain committed to maintaining diversification across asset classes and investing in best-in-class companies with strong balance sheets and robust earnings growth. This approach helps support long-term portfolio resilience.