BRIEF INVESTMENT COMMENTARY
April 1, 2025

Market Review

Following a strong year for financial markets in 2024, the backdrop has shifted thus far in 2025. Uncertainty around US government policy—particularly tariffs—has triggered an increase in market volatility while investor sentiment has taken a hit. Not surprisingly, recession fears have resurfaced.

After hitting new highs in mid-February, global stocks have retreated with the MSCI All Country World Index down about -1.3% year-to-date as of March 31st. Underneath the surface, equity markets have experienced a significant reversal in leadership. There's been a rotation away from last year's top performers—mega cap technology and growth stocks—towards more defensive sectors like healthcare and consumer staples, which underperformed last year. The "Magnificent 7" have encountered notable challenges, marking a departure from their previous market dominance. In addition to valuation concerns, the emergence of China's DeepSeek large language model in late January appears to be another reason behind waning exuberance around these stocks.

The "US exceptionalism" narrative lost some steam so far in 2025. The US dollar has declined against other currencies while non-US equities outperformed. Both developed international and emerging markets stocks are in positive territory on a year-to-date basis as the S&P 500 Index has suffered losses. A catalyst seems to be the Trump administration's "America First" agenda that is driving pro-growth policy shifts in Europe and Asia.[1]

The recent weakness in US stocks coincides with a move lower in bond yields. As a reference, the 10-year Treasury yield currently stands at 4.2% after starting 2025 at 4.6%, perhaps signaling market expectations that a tariff war will not change the long-term inflation outlook but will constrain economic growth.

Asset Category Performance (As of March 31, 2025)	YTD 2025	Full Year 2024	Last 5 Years*	Last 10 Years*
Fixed Income				
Municipal Bonds (Bloomberg 1-10 Year Municipal)	+0.7%	+0.9%	+1.3%	+1.8%
Taxable Bonds (Bloomberg Aggregate Bond)	+2.8%	+1.3%	-0.4%	+1.5%
High Yield Corporate Bonds (Bloomberg High Yield)	+1.0%	+8.2%	+7.3%	+5.0%
Equities				
Global Stocks (MSCI All Country World)	-1.3%	+17.5%	+15.2%	+8.8%
US Large Cap Stocks (S&P 500)	-4.3%	+25.0%	+18.6%	+12.5%
US Small Cap Stocks (Russell 2000)	-9.5%	+11.5%	+13.3%	+6.3%
Non-US Developed Markets Stocks (MSCI EAFE)	+6.9%	+3.8%	+11.8%	+5.4%
Emerging Markets Stocks (MSCI Emerging Markets)	+2.9%	+7.5%	+7.9%	+3.7%
Real Assets				
Commodities (Bloomberg Commodity)	+8.9%	+5.4%	+14.5%	+2.8%
Natural Resources (S&P Global Natural Resources)	+7.1%	-8.3%	+16.2%	+6.3%
Global REITs (S&P Global REITs)	+1.7%	+3.9%	+9.0%	+3.9%

*Note: Data provided by Addepar. *Indicates annualized return. Past performance is not indicative of future results.*

Macro Backdrop

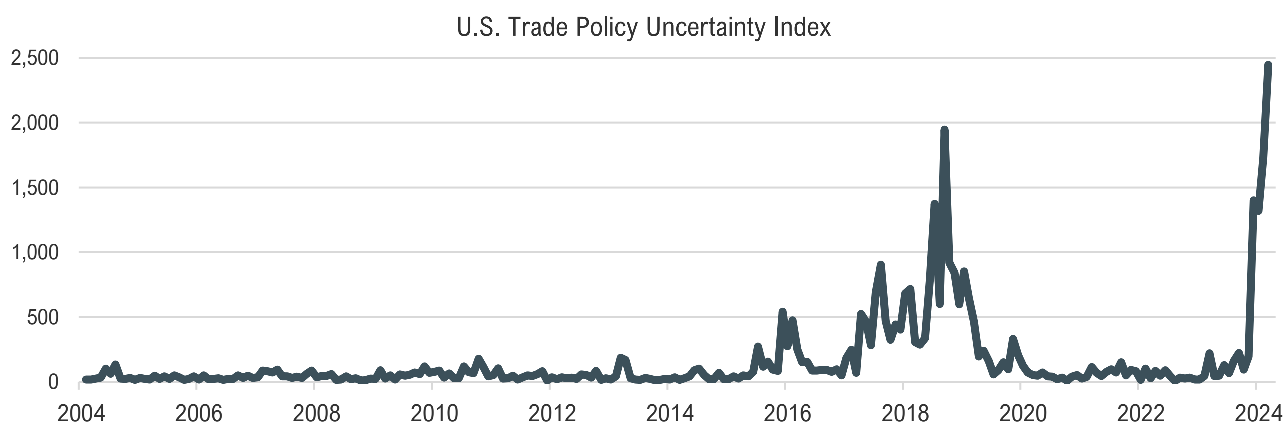
Growing uncertainty around the impact of tariffs, immigration, government spending, and the ongoing war in Ukraine is set to test what has been a very resilient US economy. Indeed, there have been signs of slowing in recent months, but it is to be expected given the lagged effects of monetary policy tightening. While job growth has slowed, the labor market remains generally healthy and a key support for the economy. The unemployment rate remains low at 4.1% and wage growth has outpaced inflation for 21 consecutive months—a positive for consumer spending.

Yet, there is plenty of evidence that policy uncertainties have already dampened household and business confidence that could depress spending and investment. In March, the University of Michigan's Consumer Sentiment Index dropped to its lowest level since 2022. Two-thirds of consumers said they expect higher unemployment in the next year, the highest reading since 2009.[2] The National Federation of Independent Business (NFIB) reported a significant decline in its Small Business Optimism Index, indicating that business owners are increasingly cautious, potentially scaling back expansion plans and bracing for potential economic challenges ahead.[3]

While there's no definitive evidence that the economy is on the cusp of recession, the downside risks have clearly increased. And many professional economists have increased their odds of a US recession in 2025. The tariffs currently in place include a 25% broad-based duty on steel and aluminum, a 20% increase on Chinese imports, and a 10-25% tariff on certain Canadian and Mexican goods that do not comply with the United States Mexico Canada Agreement (USMCA). Collectively, these measures have raised the US effective tariff rate by roughly 3%, not necessarily a big risk to total economic output.[4]

The biggest risk is the extraordinary level of uncertainty, which has spiked well above the previous trade war episode in 2018-2019 (see chart below). The longer the tariff turmoil and related uncertainty about trade policy lasts, the more likely economic growth and corporate earnings may take a hit.[5] The ultimate endpoint of tariff policy is unknowable. But based on his first term, President Trump has a history of rapid changes in policy and tariffs could come and go quickly, particularly if primarily being used as bargaining tool. If the strategy results in other nations lowering their trade barriers on US goods, then the long-term outcome could be beneficial to growth. And should economic risks intensify, the administration may also adjust its approach further.[6]

- Note: On April 2nd, the scale of Trump's tariff plans is likely to be unveiled, even if implementation is delayed. Trump has described it as "Liberation Day" with a promise to roll out a set of tariffs that he says will free the US from a reliance on foreign goods. Dan Clifton, Head of Policy Research at Strategas, believes the administration's announcement will be critical in determining whether future tariff policies will be limited to reciprocal or across the board levies on foreign goods. According to Clifton, reciprocal tariffs will be far less disruptive to the global economic system.



Source: Baker, Bloom & Davis as of February 28, 2025. The index reflects the frequency of articles in American newspapers that discuss policy-related economic uncertainty and also contain one or more references to trade policy.

Market Outlook and Portfolio Strategy

Heading into 2025 we noted that stretched US equity valuations combined with the potential for slower economic growth could leave financial markets vulnerable to increased volatility. The cause of the market's recent volatility, according to Richard Bernstein, is dramatically increased unpredictability. As he puts it, "The US stock market is simply resetting its risk premium and valuation based on a sudden and broadening range of uncertain outcomes. Perceived certainty drives higher valuations, but policy fickleness drives multiple contraction."[7]

Despite the recent declines, US equity valuations remain elevated. The S&P 500 Index is currently trading at 21x forward earnings, well above the longer-term average. This suggests that future gains will likely be driven by earnings growth rather than multiple expansion (or increased price-to-earnings ratios). Consensus earnings growth expectations remain optimistic at +10% in 2025, but falls to +2% if all the current proposed tariffs are put into place, according to Strategas Research Partners.[8] Importantly, earnings growth has broadened outside of mega-cap technology stocks.

While US stocks trade near peak valuations, various international developed and emerging markets appear more reasonably priced, either trading near or below their longer-term average price-to-earnings multiples. As a result, the valuation disparity between US and non-US equities is much wider than usual. And the "US exceptionalism" theme may continue to unwind as we worry US large cap stocks and the dollar are not yet priced for downside growth risks.

The rapid shift in performance so far this year—away from some of the market's prior leadership—is a reminder of the value of diversification, which can both dampen volatility and provide a broader opportunity set. As we've communicated in the past, successful investing requires not only patience and discipline, but also an ability to live with uncertainty. While market declines can cause discomfort and test investors' resolve, they can also create opportunities to enhance longer-term returns through selectively increasing allocations in areas that become compellingly undervalued. In the current environment, we recommend minor tilts away from an appropriate strategic asset mix, but a readiness to take advantage of opportunities that may arise. Our current portfolio positioning themes are summarized below.

- **Remain fully invested in core/investment grade fixed income.** After a period of ultra-low interest rates following the 2008 Global Financial Crisis, yields across most fixed income categories are still near the highest levels in 15 years and close to their long-term historical averages. Therefore, we believe the asset class offers both attractive income and potential downside cushion.

- **Target an underweight position in US large cap equities while emphasizing reasonably priced high-quality stocks.** Heightened valuations and greater concertation pose a risk to US large cap stocks. Thus, we recommend an underweight position, along with a tilt towards higher quality companies (those with strong balance sheets, stable earnings, and high margins) trading at reasonable valuation multiples.

- **Maintain an overweight position to small cap stocks.** We believe the asset class appears attractively priced and could benefit from structural shifts in the economy, like deglobalization and reshoring. However, given the number of unprofitable companies in the small cap universe, we also recommend a quality tilt.

- **Maintain a slight overweight position in real assets.** Commodities and commodity-producer stocks can offer a potential hedge against surprise increases in inflation. A prolonged period of limited supply-side investment along with the secular transition toward renewable energy sources could further support commodities prices.

- **Where appropriate, continue to develop private equity and real estate investment programs.** Because of the associated illiquidity and inherent inefficiencies, private assets typically compensate investors with a premium return. Slower fundraising for private equity, especially venture, may offer attractive entry points while a better exit environment is expected as M&A and IPO windows open.

Appendix: Summary of US Tariff Policy

The table below provides a summary of the Trump administration's tariff policy announcements to date. On April 2nd, the US is preparing to announce additional tariffs on a wide range of imports and countries.

Trade Policy	Deadline	Summary
10% tariffs on imports from China	February 4	Trump signed an executive order imposing a 10% tariff on all imports from China effective February 4. China responded on February 10 with retaliatory measures that included 15% tariffs on coal and liquified natural gas, and 10% tariffs on crude oil, agricultural machinery, and large-engine vehicles.
25% tariff on imports from Canada and Mexico, additional 10% on China	March 4	Trump signed an executive order imposing a 25% tariff on all goods from Mexico and Canada, except for Canadian energy exports, which was hit with a 10% tariff. Initially set to take effect on February 4, they were delayed until March 4, following negotiations between countries.
25% tariffs on steel and aluminum	March 12	On February 10, Trump announced 25% tariffs on all steel and aluminum imports, effective March 12, revoking previous country exclusions and impacting Canada, Mexico, and the European Union.
"Reciprocal" tariffs	April 1	On February 13, Trump signed a presidential memorandum ordering the development of a comprehensive study involving tariff and non-tariff barriers imposed by other countries before setting specific rates.
25% tariffs on chips and drugs	April 2	On February 18, Trump threatened 25% tariffs on imports of semiconductors and pharmaceuticals to be confirmed on April 2, after the April 1 trade policy review.
25% tariffs on the European Union	April 2	On February 27 during a press conference after his first Cabinet meeting, Trump mentioned upcoming tariffs on Canada and Mexico, as well as on the European Union.
Agricultural products	April 2	On March 3, in a social media report, Trump said he would be imposing tariffs on imports, or "external," agriculture products. Tariff rates or originating countries were not specified.
25% tariffs on automotive imports	April 3	On March 26, Trump announced 25% tariffs on automotive imports that will cover finished automobiles and automotive parts. Parts that are compliant with the USMCA will remain tariff-free until the Commerce Department establishes a process to apply tariffs to their non-US content.
Reports on Trade Policy Evaluations	April 30	On January 20, Trump issued an "America First Trade Policy" presidential memorandum directing agencies and the USTR to evaluate key aspects of US trade policy and issue reports to the president no later than April 30.
Copper	November 22	On February 25, Trump signed a directive to investigate potential national security risks of copper imports with a report due in 270 days that would recommend action which could include tariffs or other export controls.
Digital service taxes on EU, UK, and Canada	Unknown	On February 21, Trump signed a directive considering actions like tariffs to combat DSTs and other policies that countries levy on US companies. Further details to come.

Source: Charles Schwab and the Wall Street Journal as of March 31, 2025.

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[1] *Jeffrey Kleintop, Charles Schwab & Co., "Making International Great Again?" March 12, 2025.*
[2] *Matt Grossman, Wall Street Journal, "Consumers' Mood Sours in March with Gloomier Economic Outlook," March 28, 2025.*
[3] *Mitch Zacks, Zacks Investment Management, "Why Falling Expectations and Volatility May be Bullish," March 27, 2025.*
[4] *Mitch Zacks, Zacks Investment Management, "Policy Uncertainty Triggers Market Volatility," March 13, 2025.*
[5] *Jeffrey Kleintop, Charles Schwab & Co., "Making International Great Again?" March 12, 2025.*
[6] *Mitch Zacks, Zacks Investment Management, "Policy Uncertainty Triggers Market Volatility," March 13, 2025.*
[7] *Richard Bernstein, Richard Bernstein Advisors, "Certainty is Now a Scarcity in Markets – Financial Times," March 12, 2025.*
[8] *Strategas Research Partners, "Key Takeaway from Strategas' Research Verticals," March 17, 2025.*