First Quarter 2025 Key Takeaways:

Global stock market quarterly results were widely dispersed with U.S. Large Growth stocks (Russell 1000 Growth) down 10% for the quarter, while U.S. Large Value stocks (Russell 1000 Value) added 2.1% and developed international stocks (MSCI EAFE) and emerging market stocks (MSCI EM Index) earned 7% and 3% respectively.

Interest rates also experienced volatility as the yield on the 10-year treasury bond fell from 4.57% to 4.36%, resulting in a positive quarter for investment grade bonds (Bloomberg U.S. Aggregate Bond Index), which clocked in a 3% gain for the quarter.

The quarter served as a reminder of the benefits of having a diversified portfolio and routinely rebalancing to avoid attaining excess exposure (risk) to any particular investment category.

President Trump announced his "Liberation Day" tariffs, which far exceeded the expectations of most economists and triggered a sharp selloff in global markets in early April.

In response to the announced tariffs, many economists have reduced their prior GDP growth projections for the U.S. economy, most indicating the odds of the U.S. economy suffering a recession are now at 50%, up from previous forecasts of 10% to 20%.

Since 1950, the S&P 500 has suffered a correction of the magnitude of the current decline 34 times, or roughly one every other year (note: the S&P 500 *index* inception date is 1957 but the S&P 500 existed prior to the index), so declines in stock prices are not uncommon and should be expected.

How an investor responds to a stock market decline can make a big difference. Missing the 10 best days in the S&P 500 performance since 1950 would result in a portfolio worth less than half the value of a portfolio invested throughout.

The ever-changing tariff landscape is creating uncertainty, which is weighing on consumer and business sentiment. In this environment, it is challenging to make decisions about long-term hiring and capital expenditures.

European fiscal stimulus and accommodative monetary policy have created an attractive backdrop to stimulate economic activity and bolster European markets.

Market Recap

Global stock markets displayed a wide dispersion of performance across regions and styles in the first quarter of the year. After reaching a new all-time high in mid-February, U.S. stocks (S&P 500 Index) suffered their first 10% correction since 2023 before recovering to end the quarter down 5%. Smaller-cap U.S. stocks (Russell 2000 Index), which tend to be more volatile than their larger-cap counterparts, declined further, ending the quarter down 10%. Large-cap growth stocks (Russell 1000 Growth Index), which have led the market higher for several years, finally lagged this quarter with a 10% decline as investors rotated into U.S. large-cap value (Russell 1000 Value) and foreign stocks (MSCI EAFE) amid economic uncertainty.

In contrast to the U.S., many European and Asian markets rose sharply. Developed International stocks (MSCI EAFE Index) gained nearly 7%, driven in large part by a fiscal policy shift in Germany focused on increased defense spending. Emerging market stocks (MSCI EM Index) also fared well, finishing the quarter up 3%. Gains in emerging markets were bolstered by China which delivered solid, double-digit returns of 15% (MSCI China Index).

Interest rates experienced significant volatility throughout the quarter, fluctuating amid shifting inflation expectations, Federal Reserve policy signals, and broader market uncertainty. Overall, the 10-year treasury rate declined from 4.57% at the start of the year to end the quarter at 4.36%. The decline in rates benefitted investment-grade bonds (Bloomberg U.S. Aggregate Bond Index), which gained 3%. High-yield bonds (ICE BofA High Yield Index) also ended in positive territory gaining just under 1%.

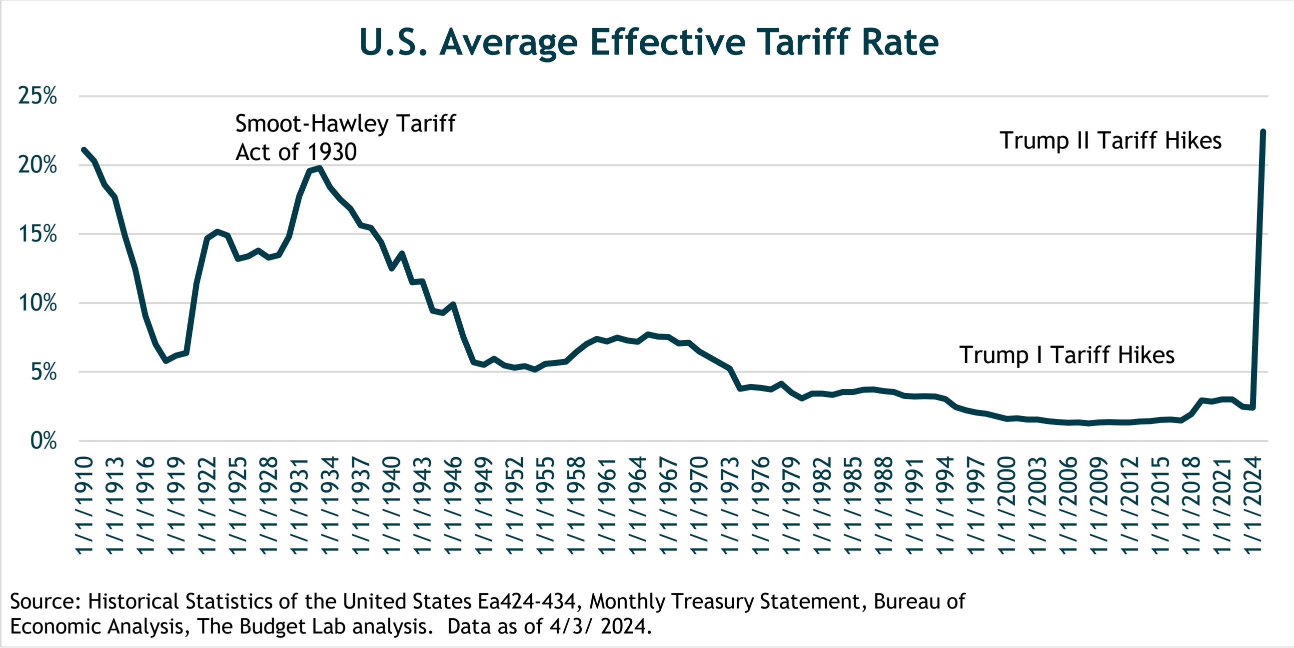
The wide dispersion of results in the first quarter was a great reminder of the benefits of diversification. Unexpected losses in U.S. stocks (growth stock in particular) were offset by gains in U.S. large cap value stocks, foreign stocks, and investment grade bonds.

Investment Outlook and Portfolio Positioning

Heading into the year, I expressed caution that elevated stock market valuations, especially for U.S. technology companies, combined with policy uncertainty, could leave the market vulnerable to volatility. Indeed, this is what transpired over the first quarter of the year.

After hitting new highs on February 19th, U.S. stocks suffered their first "correction" since 2023, when the S&P 500 index declined a total of 10% through March 15th. The narrative around U.S. stocks started to shift in late-January beginning with the release of DeepSeek, a Chinese built Artificial Intelligence model that is seen as a direct threat to U.S. tech company dominance of the Ai industry. The selloff was continued in early February amid tensions around trade, tariffs and policy uncertainty.

President Trump further shocked investors on April 2 (what he declared "Liberation Day") by announcing a comprehensive set of much higher-than-expected tariffs. While technically President Trump's action is outside of the scope of *first quarter 2025* commentary, this decision is significant enough to merit immediate coverage. The announced tariffs included a 10% baseline tariff on all imports, which was widely expected, and unexpected and significantly higher tariffs for certain trade partners, such as 54% for China and 20% for the European Union. As I pointed out in my tariff commentary last week, these tariffs in aggregate and, if implemented and maintained, would result in the effective tariff rate on all imports rising to 24%, putting it at a 125-year high.



Source: Historical Statistics of the United States Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis. Data as of 4/3/ 2024.

In response to Trump's announcement, equity markets suffered sharp declines, with the S&P 500 Index suffering its second correction of the year, dropping roughly 10% in the two days following the announcement. European and Asian stock indexes also fell meaningfully. The U.S. dollar weakened against major currencies, and longer-term interest rates plummeted over fears of an economic slowdown.

Perhaps the most surprising aspect to the announcements was the equation used to arrive at "reciprocal" tariff levels. This so-called "reciprocal tariff" is a bit of a misnomer because they do not truly reciprocate the existing tariff levels imposed on the U.S. by other countries. Instead, the administration simply took an economy's exports to the U.S. as a percentage of its trade balance with the U.S. and assigned that as the tariff, meaning that countries with larger trade surpluses with the U.S. are being subjected to higher tariffs -- whether or not they impose high tariffs on U.S. goods. In this way, the announced tariffs seem to be more of a blunt tool aimed at reducing trade deficits. (Perhaps this lack of effort suggests the administration doesn't intend for the announced tariffs to be in place for long or to be significantly reduced – let's hope so).

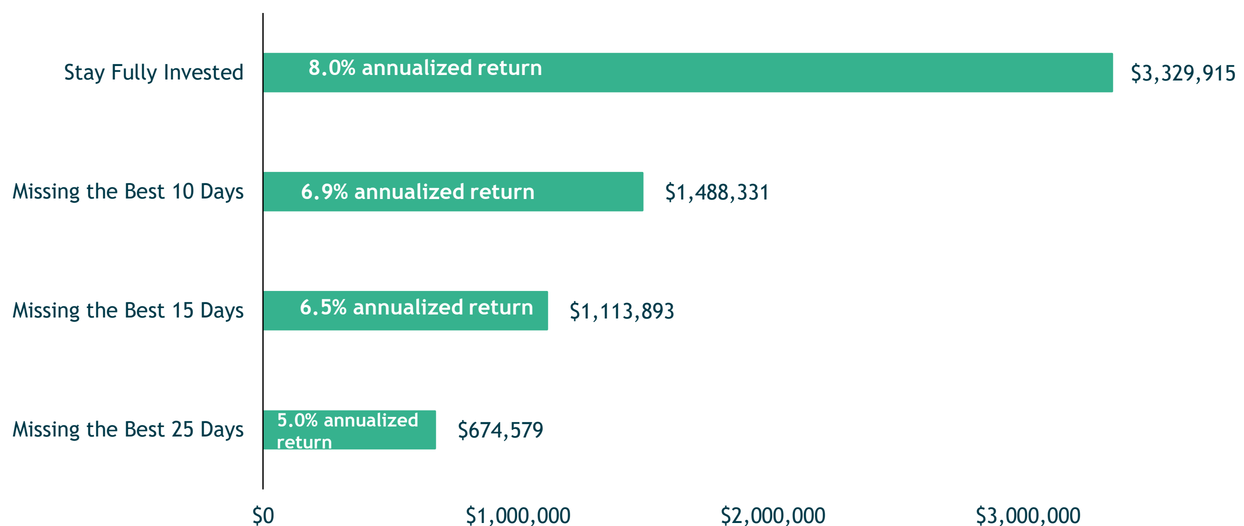
Looking ahead, one of the key questions facing investors is whether tariffs will push the global economy into recession causing further declines in global stock markets. If left intact, I believe this is a likely outcome. According to the IMF and Ned Davis Research, a 10% universal tariff, coupled with retaliation abroad, would reduce global economic growth by 0.5%. This latest announcement puts the tariff at least double that (i.e., 24%), doubling the damage if not more so. One saving grace is that the global economy was in good shape prior to the tariff announcement.

My expectation is that trade partners will retaliate to varying degrees, if not simply for their own political motives. Moreover, I believe there is a valid possibility, given President's Trump's penchant for bargaining, that reduced tariffs will be negotiated over the coming weeks and months that could

lead to a more optimistic outcome for all involved. The administration has already signaled an openness to negotiations.

The decline in stocks and increased uncertainty has led to heightened anxiety, but history suggests that corrections (and volatility) are a normal part of long-term investing and do not always signal a crisis. Since 1950, the S&P 500 has experienced 34 corrections of this magnitude, yet only about a third have escalated into bear markets with losses exceeding 20%.

During periods of heightened volatility, I find it valuable not to overreact to the latest headline that could tempt investors to sell their equity exposure. Historically, stock market corrections recover within a few months, and investors who stay the course often benefit as markets rebound. As illustrated in the chart below, panic selling during risk-off markets can be a significant drag on long-term returns – as the old saying goes, "*time in the market is more important than timing the market*."

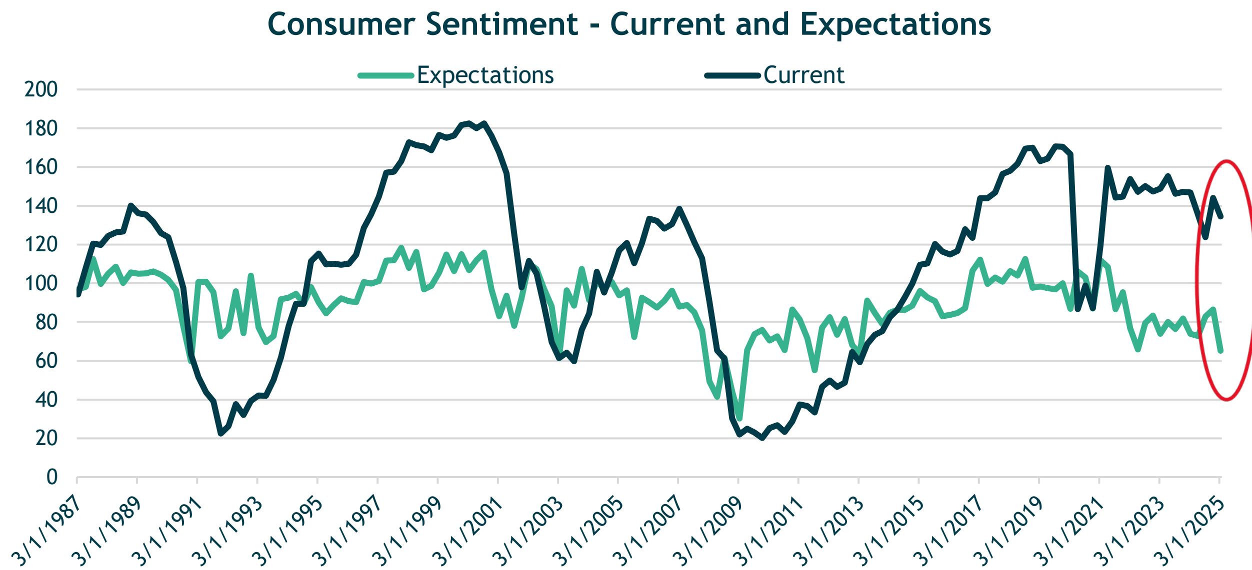


Standard & Poor's 500 Index growth of $10,000 since its March 1957 inception

Leading up to "Liberation Day," economic conditions in the U.S. were reasonable and the overall economic backdrop was relatively stable. Despite ongoing volatility and concerns about slowing economic growth, we still saw some supportive underlying economic fundamentals. For example, corporate earnings continue to surprise to the upside, with many companies exceeding expectations and maintaining strong profit margins. GDP is still expanding, albeit at a slower pace, reflecting a resilient economy even in the face of higher interest rates. Meanwhile, the labor market remains in decent shape, with unemployment at historically low levels and key sectors such as construction, healthcare, technology, and professional services still adding jobs. Furthermore, consumer spending has remained relatively steady, and businesses have yet to signal widespread distress.

That said, rising uncertainty among consumers and businesses acts as a significant headwind to economic growth and I'm monitoring several factors that could lead me to become more defensive. Specifically, there are some soft data points such as consumer confidence that have weakened materially. Consumers drive about 70% of U.S. economic activity, making their sentiment an important factor to monitor. While consumer confidence is a "soft" indicator, meaning that it reflects

feelings rather than hard data, it has historically declined ahead of recessions. I track the Conference Board Consumer Confidence Index (below), which equally weighs current conditions and future expectations. I find it a more useful gauge of sentiment, as future expectations tend to be much more volatile. Right now, current sentiment is holding up, but it's no surprise that it has weakened a bit amid today's uncertainty. When both current and future expectations fall together, it signals broad pessimism, often leading to reduced spending and slower economic growth.

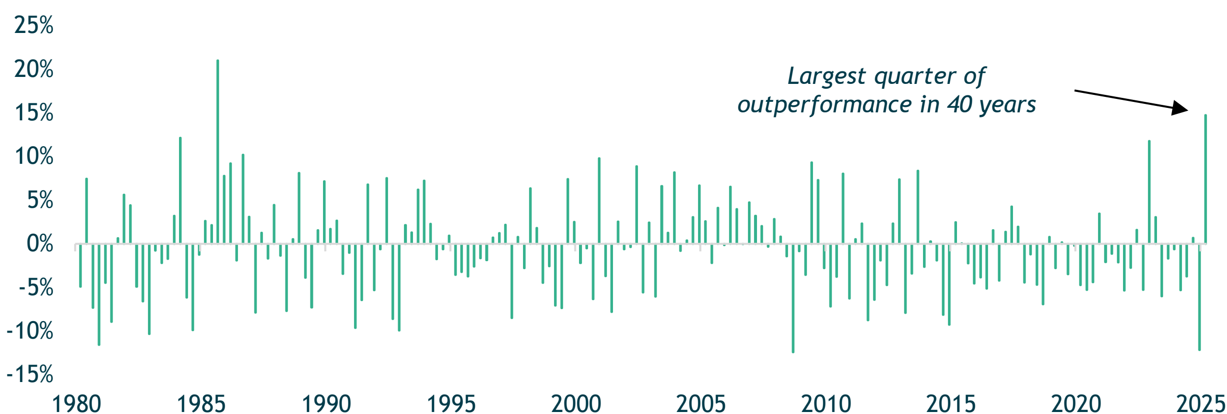


Source: The Conference Board. Data as of 3/31/2025.

The ever-changing tariff landscape is clearly weighing on consumer sentiment adding to overall uncertainty. The rapidly changing policies make it difficult to keep up in real-time, and frequent reversals can make any analysis moot within hours. Uncertainty seems to be a tactical tool in Trump's governance toolkit, presumably to give him political leverage to achieve his desired outcome. Without details, the long-term market impacts are unclear, and the broader investment implications will take time to play out.

To put it simply, the stock market hates uncertainty. And uncertainty around trade and tariffs will continue to be a headwind for U.S. stocks.

However, while I'm seeing headwinds in the U.S., I'm seeing better news in other parts of the world. European stocks have been a bright spot this year, significantly outperforming U.S. stocks – their widest quarterly outperformance gap versus U.S. stocks in 40 years (see chart below). Fiscal stimulus, particularly from Europe's largest economies in Germany and France, increased defense spending, and accommodative monetary policy could stimulate economic activity and bolster equity markets.



Source: Morningstar Direct. Data as of 3/31/2025.

Closing Thoughts

It goes without saying that tariffs and trade policy have injected a big dose of additional uncertainty in the financial markets, and I understand that such developments can be worrying. There are still many lingering questions, including what potential retaliatory measures will come from countries hit with tariffs, whether the announced tariff levels will remain in place or possibly be lowered, and what their ultimate impact will be on the financial markets. Until there is more clarity, the volatile environment will likely continue.

Stock prices may already reflect most of the bad/unexpected news regarding tariffs, leaving room for the possibility of a nice rebound should some of my more optimistic scenarios come to pass. While many foreign and U.S. economies were in relatively good shape prior to the Liberation Day, Trump's tariff announcement has led several prominent economists to raise the probability of a recession. I am actively assessing a range of economic outcomes and their impact on markets.

At the portfolio level, our fixed-income exposure continues to favor positions in shorter-dated bonds, most of which is high-quality and earning yields comfortably above the benchmark. It remains anyone's guess where Treasury yields are headed next and in this uncertain environment, I am maintaining a bird-in-hand approach, prioritizing attractive absolute returns over trying to predict the timing and magnitude of interest-rate moves, which is notoriously difficult.

Within all BCA Flexible portfolios, we remain diversified across U.S. and foreign stocks, and across growth and value stocks. The benefits of diversification were apparent in first quarter performance, and my analysis suggests there continue to be opportunities in areas outside of U.S. large-cap growth stocks, like U.S. large cap value, European, and emerging-market stocks where valuations are more compelling.

Within the BCA Dividend Payers portfolios, we remain concentrated in U.S.-domiciled stocks, with 10% exposure to stocks domiciled outside of the U.S. or U.S. territories, a 0% *direct* exposure to emerging markets. However, the objective of the Dividend Payers portfolios is to invest in large, mature companies that are comfortably able to share profits with shareholders in the form of a dividend payment and in some cases share buybacks. As you might expect, many companies fitting

this description have expanded to markets outside of the United States. A look at the geographic origin of revenue for many of these companies reflects their global reach. In many cases, more than 50% of revenue originates outside of the U.S., from both developed international and emerging market economies. So, while the domicile of the companies owned in the Dividend Payers portfolio is almost entirely in the U.S., the origin of their revenue/profits is decidedly globally diversified. As such, these companies are especially exposed to the economic impact of the announced tariffs.

The current market environment is noisy, volatile, and frankly, too tough to call with confidence. More than ever, I believe it's important to stay disciplined and avoid making reactive portfolio shifts. This is a challenging environment, but one that reinforces the importance of diversification, patience, and a clear investment process.

As always, I appreciate your trust and invite you to call to discuss your personal financial situation.

Best,

Kelly D. Kane, ChFC, CFP©

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