



FIRST QUARTER 2025 ECONOMIC AND FINANCIAL MARKETS REVIEW

During the first quarter of 2025, the stock market became more volatile than it has been over the past couple of years. This is primarily due to competition between positive economic factors and uncertainty regarding recent news events. On the one hand, better-than-expected corporate earnings and positive economic growth, in addition to a Federal Reserve Board that is expected to be accommodative by lowering interest rates in the future, have been supportive for stocks. However, these positives have been offset by political and geopolitical uncertainty, including international trade wars. As a result, the stock market declined during the first quarter, with the S&P 500 Index down 4.59% and the Dow Jones Industrial Average down 1.28%. The Bloomberg Intermediate U.S. Government/Credit Bond Index increased 2.42% during the first quarter.

The expectation has been that the Fed will no longer raise interest rates to fight inflation and will actually lower rates in the future. Lowering interest rates helps the economy to grow. However, recent comments from Fed officials regarding exactly when and how much rate cutting will take place have made investors nervous. Investors anticipated that the Fed would lower rates a significant number of times this year as inflation was coming down from its highest level in decades. However, inflation has proven to be stickier than the Fed initially predicted, and expectations have receded toward fewer rate cuts in 2025 than originally thought. Even though it is unlikely that the Fed will raise interest rates this year, the slower-than-expected pace of rate cuts has become a headwind for the financial markets.

At the same time that inflation has struggled to come down to the Fed's target rate of 2%, President Trump has been aggressive in imposing and threatening to impose tariffs on other countries. Tariffs can be inflationary, as higher costs for foreign companies exporting goods to the U.S. would likely be passed on to the consumers buying those goods. It remains to be seen how many of these tariffs are just threats being used for leverage in negotiating other political matters that may benefit the U.S. and how many will actually be imposed for the long term. Nonetheless, even President Trump has said these tariffs and possible trade wars may cause some economic "disturbance." Monitoring these global trade developments will be meaningful for assessing the short-term direction of the stock market.

Despite nagging inflation, the economy has generally been more resilient than expected. In fact, corporate profits and most economic indicators were positive in the first quarter. The potential for lower taxes and fewer federal regulations also boosts the confidence of investors and corporations. However, the labor market has slowed a bit, and inflation can't quite decline to an acceptable level. Additionally, investors worry that expectations for future economic progress may be too high. Ironically, except for inflation data, bad economic figures may actually be a good thing for the stock market, as the Fed may feel compelled to decrease interest rates again if the economy starts to lag. It will be important to see how the economy reacts to potential headwinds as the year goes on.

In the meantime, we are watching for a shift in investment trends that has not occurred for many years. For a long time, investing in certain areas of the stock market has made little sense, such as small-size companies or emerging markets stocks that have been riskier with lower returns. Also, value stocks have mostly underperformed growth stocks, like the big technology and communications companies that have such a significant weighting on the stock market indexes. Foreign stocks, in general, have mostly

underperformed for a long time relative to U.S. stocks. If things change, we may recommend shifting investments to different areas of the markets that we believe can add value. Additionally, if short-term bonds, which are generally considered safer than longer-term bonds, start to underperform, we may extend the duration of bonds for certain investors who can tolerate additional interest rate risk.

We are hopeful that the positive factors that can impact the financial markets will provide meaningful support for any additional choppiness in the markets in the near term. However, we expect the environment to remain volatile as long as uncertainty persists. That said, we do not think a long-term bear market in stocks or bonds is upon us.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg on April 1, 2025.*

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