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QUARTERLY INVESTMENT REVIEW & OUTLOOK – Q1 2025

During Q1 the bond market justified its diversification benefits, producing strong returns while US equities declined. Economic data was mixed, but tariff uncertainty and worsening consumer sentiment raised concerns over slowing growth, overzealous corporate earnings growth expectations, and increased risks of recession.

- **Equities:** US stocks were down, driven by declines in March after a positive start in the first two months. Large caps (S&P 500 -4.3%) delivered their worst quarter since Q3 2022, while small caps (-9.5%) declined more aggressively on rising recession fears. With the January DeepSeek announcement, the AI trade saw significant downside pressure within the "Mag 7" (32% of the index). In fact, those seven stocks accounted for the entire drop in the S&P 500 Index, while the other 493 stocks actually contributed positive return for the quarter (+0.6%). This market broadening (62% of names outperformed the overall index) is a healthy development – led by energy, healthcare, utilities and consumer staples. International stocks showed signs of life and produced further diversification benefits. For Q1 developed international (+6.9%) and emerging markets (+2.9%) provided strong returns as capital shifted overseas. Since the opening of Q2, US stocks have seen further declines and increased volatility with the announcement of enhanced tariffs. As a result, valuations are becoming more compelling, but risks remain elevated in the wake of heightened uncertainty.

- **Fixed Income:** As risks increased due to slowing growth and rising fears of recession, investors fled to the safety of fixed income. The US Aggregate Bond Index (+2.8%) had a strong quarter and has delivered solid results over the past 12 months (+4.9%). Investment grade corporates (+2.4%) performed well, while high-yield ("junk") bonds (+1.0%) were positive but less favorable due to credit risks. The Treasury yield curve shifted lower as the 10-year fell from 4.6% to 4.2% and the 2-year from 4.3% to 3.9%, although the short rates remained relatively constant as the 6-month held around 4.2%. FOMC projections suggested additional rate cuts in 2025 and 2026, but the pace and magnitude expectations have been mixed, especially given concerns about the direction of inflation and the economy due to tariffs and slower growth. Given persistent rate uncertainty and volatility, we continue to favor balancing between bonds of longer duration with those of shorter duration ("barbelling"). Also, given rising credit spreads and risks embedded in high-yield, we favor higher quality credit over lower quality.

- **Economy:** Growth slowed in Q1, driven primarily by uncertainty in trade, but data continues to be mixed. The ISM Manufacturing PMI (49.0) reverted to contraction in March, trailing expectations after brief signs of growth (manufacturing contracted throughout 2023-24). The ISM Services PMI (50.8) signaled modest growth although it missed expectations as well. Labor demand cooled as job cuts spiked, although cuts largely related to federal jobs. Initial jobless claims have remained low, reflecting similar

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federal workforce layoffs rather than private sector. Personal income readings remain reasonably favorable. Most strategists have increased their odds of recession, and the drumbeat has been getting louder although consensus anticipates a slowdown and recalibration of expectations. Metrics suggest that inflation may be on a downtrend. In the past 12 months, PCE inflation prices were up 2.5% after experiencing an average of 3.7% over the past 5 years. Additionally, the March readings of CPI (-0.1%) and PPI (-0.4%) indicated declines driven by lower energy prices and mixed food prices. Given tariff uncertainty, the potential for resurgence of inflation bears watching and the data remains above the Fed's 2% target. As such, the Fed faces trade-offs in balancing the risks of recession and persistent inflation.

2025 PERFORMANCE – BENCHMARK INDEXES

Index	Quarter	YTD	5 Yr Ann	10 Yr Ann	15 Yr Ann
S&P 500 (US large cap stocks)	**-4.3%**	**-4.3%**	**+18.6%**	**+12.5%**	**+13.1%**
S&P 400 (US mid cap stocks)	**-6.1%**	**-6.1%**	**+16.9%**	**+8.4%**	**+10.8%**
Russell 2000 (US small cap stocks)	**-9.5%**	**-9.5%**	**+13.3%**	**+6.3%**	**+9.0%**
MSCI EAFE (devel int'l large cap) - US$	**+6.9%**	**+6.9%**	**+11.8%**	**+5.4%**	**+5.6%**
MSCI EM (emerging mkts int'l) - US$	**+2.9%**	**+2.9%**	**+7.9%**	**+3.7%**	**+3.0%**
Bloomberg US Aggregate (US bonds)	**+2.8%**	**+2.8%**	**-0.4%**	**+1.5%**	**+2.4%**

Data as of 3/31/25. Returns represent total returns (dividends & capital appreciation/depreciation). Past performance is NOT predictive of future performance.