Q1 2025 Stock Market Update

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A Change of Tone

The first quarter was very eventful and brought a change of tone to markets. We started the year on a decent foot, but stocks weakened in mid-February amid political and economic uncertainty. While the S&P 500® Index finished the quarter down only 4.3% year-to-date (worst start to a year since 2020), other indices were worse as evidenced by declines of 9.5% and 10.4%, respectively, for the Russell 2000® Index and NASDAQ Composite® Index. Furthermore, the S&P retreated 8.7% from its highs and temporarily entered "correction" territory (down 10% or more) in early March. According to CNBC, 203 stocks in the S&P 500 were down more than 20% from their highs as of March 10th.

Even the much loved "Magnificent 7"[1] cooled off. In fact, this collection of technology leaders was down 15.8% in Q1 after leading markets higher in 2024. Of note, the "Mag 7" has underperformed the broader market for 12 of the last 13 weeks as of this writing. We have posited that markets were due for a rotation away from hot, momentum-oriented areas and this proved to be the case as the artificial intelligence (AI) trade faltered. However, many segments of the market were weak. Economically sensitive stocks, especially those in the consumer discretionary sector, were hit particularly hard as recession fears mounted. Notable safe havens included traditionally defensive sectors such as consumer staples, health care and utilities. The same can be said for shares of businesses thought to be relatively immune to policy shifts.

Like him or not, it appears the Trump administration has brought uncertainty to markets. President Trump was elected in part under pretense of providing a boost to the economy, but markets are now down since the election. Perhaps this is a case of short-term pain for long-term gain, but every day seems to bring a new surprise and the economic outlook has become murkier. The biggest issues are tariffs and DOGE (Department of Government Efficiency). As currently planned, the tariff rate would be the highest since 1946 according to PSC Macro. Tariffs may or may not be necessary, but will clearly lift inflation and could weigh on economic growth. For its part, DOGE may bring efficiency and reduce waste, but it also means reduced government spending and large-scale layoffs.

Some early cracks in the economy have emerged. Employment data has weakened a smidge, manufacturing data has slackened, spending has slowed and consumer confidence recently fell to a four-year low. Many fear the tea leaves are pointing towards stagflation, the undesirable scenario of low economic growth combined with stubborn inflation. A March 28th inflation reading that came in above expectations didn't help matters. What's more, a recent Wall Street Journal article noted that CEOs were fretting over "whipsaw policy changes" and that corporate deal activity is actually down 9% from the prior year versus initial expectations for a merger & acquisition frenzy under Trump. Historically, the President has been very sensitive to economic conditions as well as stock prices. Recently, however, Trump himself has cautioned of a transition period and has not dismissed the possibility of a recession while on a journey to a stronger economy. Treasury Secretary Scott Bessent has warned of a "detox period" as we migrate from government spending to private spending.

What now? It seems to us markets have already discounted some duress. We aren't saying investors should ignore the risks presented by rapid fire policy changes. However, prices have quickly adjusted to at least partly reflect potential threats. We also think the Trump agenda could moderate if economic and/or market weakness becomes more pronounced (we think he is still sensitive to market action). Finally, bear in mind the Federal Reserve has more than ample room to lower interest rates to stimulate the economy. Its job has been made more complicated by Trump's agenda and the potential inflationary impact of tariffs, but the Fed seems ready to move if economic data weakens. Fed Chairman Powell recently noted that policymakers were aware of increased economic uncertainty. "Easier" monetary policy should provide support to stocks if its effects aren't overwhelmed by other policy changes.

[1]The Magnificent Seven ("Mag 7"), stocks are a group of high-performing and influential companies in the U.S. stock market: Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla

We stand by our case for this year to bring more moderate returns than the banner years of 2023 and 2024. That said, we are carefully monitoring the landscape and selectively leaning into some areas that have been hit hard. We can't promise we won't be early in doing so, but we can say we are getting better prices than just a few months ago. Recognizing things could get worse before they get better, we are doing our best to tread carefully. Thank you for your trust and we look forward to reporting back to you at the year's halfway point.

Sincerely,

George L. Smith III

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