Quarterly Newsletter

Benefit Financial Services Group

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Market Overview

All three major averages experienced first quarter losses. However, it was the Dow Jones Industrial Average[3] that outperformed, followed by the S&P 500[2], and the Nasdaq Composite Index[1]. The S&P 500 sold off from all-time highs on Feb 19th, 2025 due to economic uncertainty regarding tariffs and stagflation. The Nasdaq led the first quarter stock declines, finishing down -10.26%, with the S&P 500 Index and the Dow Jones Industrial Average performing slightly better at -4.27% and -0.87%, respectively.

During the first quarter of 2025 and year to date, energy was the best performing sector, gaining 9.94%, followed by healthcare at 6.54%, and utilities by 4.91%. The worst performing sectors year to date at the end of the quarter were consumer discretionary, finishing down -11.75%, followed by technology at -11.05%, and lastly industrials, which narrowly finished in the red, down -0.22% in the quarter. At the time of this writing on April 7th, 2025, all sectors are negative year to date. The sell off accelerated after the president showed his tariff board for all countries, which were significantly higher than the market expected. The digestion phase of this news has led to fears about a global economic slowdown, deglobalization, increased inflation expectations for the future, and a trade war.

The Federal Reserve ("the Fed") decided to pause interest cuts throughout the quarter. At the January and March meetings, the Fed left interest rates unchanged, leaving the effective federal funds rate at 4.25% to 4.50%. The Fed Chair, Jerome Powell, reiterated his cautious stance on inflation as services inflation remains sticky and goods inflation turned positive again. Now the remaining questions are: 1) how is the Fed going to respond to inflationary tariff policies? and 2) how will the Fed react if the economy does slip into a recession? (for example, cutting rates too early risks reigniting inflation) All of these situations have likely left the Fed stuck in a box. During the first quarter of 2025, the 10-year Treasury yield reached a high of 4.80% on 01/14/2025 and a low of 4.10% on 03/04/2025. Yields continued to fall as investors ran to bonds in a flight to safety.

Turning to international markets, international and emerging markets experienced first quarter gains. The falling U.S. dollar and Chinese stimulus helped contribute to international and emerging market outperformance disparity vs the United States for the first time in a few decades. Turning to commodities, gold continued its march higher during the quarter, hitting $3,000 per ounce for the first time. The move stemmed from global economic uncertainty and was backed by foreign central bank buying as other countries attempted to derisk from the United States Dollar. Oil was positive year to date but quickly reversed after the tariff announcement.

Mark L. Blom, CFP® — Brent Miller, CFA® — Kirk Masci

U.S. Equity Returns Table
Source: Tamarac

Index	Q1 2025 Returns	2025 Returns
Dow Jones	-0.87%	-0.87%
S&P 500	-4.27%	-4.27%
NASDAQ	-10.26%	-10.26%
Russell 2000	-9.48%	-9.48%
MSCI World	5.36%	5.36%

U.S. Treasury Yield Table
Source: Treasury

	03/2025	03/2024	03/2023
3 month	4.32%	5.46%	4.85%
2 year	3.89%	4.59%	4.06%
5 year	3.96%	4.21%	3.60%
10 year	4.23%	4.20%	3.48%
30 year	4.59%	4.34%	3.67%

Other Indices Table
Source: Morningstar

	Q1 2025 Returns	2025 Returns
Gold (GLD)	19.00%	19.00%
Brent Oil (BNO)	3.87%	3.87%
U.S. Dollar Index (UUP)	-2.99%	-2.99%
Int'l Equity Markets (EFA)	9.06%	9.06%
Emerging Equity Markets (EEM)	4.50%	4.50%

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How Will Restrictive Trade Polices Affect Market Returns?

Since reaching respective all-time highs on February 2025 and December 2024, the S&P 500 Index[1] and the Nasdaq Composite Index[2] have sold off by 17.5% and 22.9%, respectively. While the Q1 2025 market environment was also characterized by a material shift away from growth-oriented and more economically sensitive stocks to value-focused and defensive equities, April has thus far represented a more broad-based market selloff in response to the Trump Administration's announcement of more restrictive than expected tariffs.

On 4/2/25, President Donald Trump announced a series of sweeping tariff policies aimed at reducing U.S. reliance on foreign goods and addressing trade imbalances. The key components of this new policy include:

<u>Universal Baseline Tariffs</u>: A 10% baseline tariff imposed on nearly all imported goods, effective 4/5/25.

<u>Reciprocal Tariffs</u>: Higher, country-specific tariffs targeting nations with significant trade deficits or perceived unfair trade practices, effective 4/9/25. These tariffs range from 20% (European Union) to 49% (Cambodia).

<u>Automobile Tariffs</u>: A 25% tariff on all imported cars and auto parts, aiming to encourage domestic vehicle production.

All existing tariffs, such as the 25% tariffs on steel and aluminum, and specific levies on Canada, Mexico, and China, will remain in effect and are unaffected by the new baseline.[3]

The new tariffs were more material and extensive than expected, triggering fears over disrupted supply chains, potential retaliation from trading partners, and the inflationary impact of the new policies. In the two trading days following the announcement, the S&P 500 Index and Nasdaq Composite Index declined by 10.5% and 11.4% respectively. On 4/3/25, the Nasdaq Composite Index crossed into bear market territory, declining more than 20% from the record high reached on 12/16/24. In addition, increased demand for bonds as safe haven assets drove bond prices up and yields down. As a result of this flight to safety, 10-Year Treasury yields plummeted from an intraday high of 4.22% on 4/2/25 to an intraday low of 3.88% on 4/4/25.

We view the current selloff in equity markets as an adjustment period as market participants adapt to the more restrictive trade policies. Going forward, and assuming the tariffs remain in effect as stated, we see this initial correction as likely being followed by "see saw" market action in response to country specific tariff developments relating to our key trading partners. In some cases, the new tariffs result in retaliatory tariffs and increase the prospects of a trade war. The market would likely react negatively to news of this sort. In other cases, the new tariffs could result in a renegotiation of the terms of trade and a tariff détente. The market would likely react positively to these developments.

On a positive note, after some concern about slowing consumer demand in the first month of the year,[4] new data points appear to demonstrate the resilience of the U.S. consumer. On 3/28/25, the U.S. Bureau of Economic Analysis released its February 2025 Personal Income and Outlays report.[5] **<u>In this report, goods consumption outlays rebounded materially, increasing by $56.3 billion or 0.9%. While one positive data point is not indicative of a trend, it does allay concerns about a near-term consumption-driven recession, in our view.</u>**

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How Will Restrictive Trade Polices Affect Market Returns? (continued)

On 4/4/25, the U.S. Bureau of Labor Statistics (BLS) released of the March nonfarm payrolls report.[6] Nonfarm payrolls increased 228,000 in March, easily beating the consensus expected 100,000. Likewise, while the unemployment rate ticked up to 4.2% in March from 4.1% in January due to an increase in the labor force, the result was in line with consensus expectations. **We view the March jobs report as confirmation of a stable and healthy labor market, further buttressing our view that the economy is not likely headed for an abrupt slowdown.**

On the inflation front, the February Personal Income and Outlays report also provided an update on the U.S. Federal Reserve's ("the Fed") preferred inflation metric, the Personal Consumption Expenditures (PCE) Price Index. This report indicated that the overall PCE deflator (consumer prices) increased by 0.3% in February and 2.5% over the trailing 12-month period. The "core" PCE deflator, which excludes the more volatile food and energy categories, rose 0.4% in February and is up 2.8% in the past year. The consensus estimate for both core measures were 0.3% and 2.7% respectively. **In our view, the fact that, 1) February core PCE came in higher than expected, and 2) remained significantly higher than the Fed's 2.0% target, indicates that inflation remains a stubborn treat and suggests a cautious approach to further monetary easing is likely warranted.**

Putting all of this information together, and assuming the restrictive tariffs remain in effect, we see one of the following three economic scenarios playing out in the near future:

1) **No recession, slow and steady inflation progress, and increased volatility:**

In this scenario, the market eventually adjusts to the more restrictive than expected tariffs and we revert to the prior economic environment of modestly slowing but still positive economic growth and slow but steady incremental progress on the inflation front. In this outcome, the tariffs would be less inflationary than expected. **This would potentially be a bullish outcome for equities but with the expectation of higher volatility as the market responds to news (e.g. trade war or tariff détente) relating to our major trading partners. This scenario would likely be a bearish outcome for bonds as yields would likely increase materially as the threat of a recession passes.** At present, we continue to see this scenario as the most likely outcome due to the resilience of the U.S. consumer and a healthy and stable labor market. And of course, if the administration backs off the current tariff plan, the likelihood of this scenario occurring would increase substantially.

2) Recession and slowing inflation:

In this scenario, the restrictive tariffs exacerbate preexisting uncertainty and fear, leading to falling household consumption and lower business investment. The tariffs thus become a self-fulfilling prophecy of sorts, leading to declining economic growth and a recessionary economic environment. In this outcome, the tariffs have a less than expected inflationary impact and cumulative effect of tight monetary policy results in solid incremental progress on the inflation front. **This recessionary scenario would likely represent a negative outcome for domestic equity markets and a bullish development for bonds due to increased demand for bonds in a "flight to safety" and the increasing likelihood of monetary easing by the Fed after victory is declared in the war on inflation.** This outcome would likely take longer to come to fruition as several months of material progress on the inflation front would be required for the Fed to feel comfortable with assuming a more aggressive rate-cutting stance to stimulate the economy.

3) <u>Stagflation (material growth slowdown or recession plus inflation)</u>:

In this scenario, inflation remains sticky and may even reaccelerate in response to tariff-induced price increases. Economic growth decelerates materially or turns negative due to falling household consumption and lower levels of business investment. The Fed is backed into a corner and would need to choose between stimulating the economy via rate cuts or battling inflation by keeping monetary policy restrictive.

My hypothesis is the Fed would likely view inflation as the greater of the two ills (as it did in the late 1970s) and hold the line on additional rate cuts until significant progress is made on the inflation front. If inflation were to reaccelerate in response to the more restrictive trade policies, the Fed may even consider increasing the Federal Funds Rate. **<u>From a market perspective, this would be the worst possible outcome as it would represent a bearish development for both equities (due to slowing or negative growth) and fixed income (due to a heightened probability of rising bond yields).</u>**

Trump's more restrictive tariff policies have certainly thrown a monkey wrench into our economic and market outlook for 2025. While current economic data does not indicate that a recession or protracted slowdown is imminent, neither can we definitely rule that outcome out. While a recession does not represent our "base case," it is entirely possible that the combination of disrupted supply chains, potential retaliation from trading partners, and the inflationary impact of the new policies, may affect consumer demand and business investment to such a degree that the we see an abrupt negative shift in economic growth and increasing labor market disruption.

While the ride ahead will likely be quite bumpy from a performance perspective, we continue to believe our diversified growth at a reasonable price ("GARP") stock portfolios provide some protection against the potential downside of periodic bouts of market volatility and sector rotation. In addition, the recent sell-off has created opportunities in certain segments of the market that now appear attractive from a valuation and growth perspective. And within these undervalued market segments, we believe it is possible to find stocks that trade at a material discount relative to their near and long-term earnings power.

Brent J. Miller, CFA® – Senior Portfolio Manager

[1]The market cap weighted S&P 500 Index is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
[2]The Nasdaq Composite Index includes almost all stocks listed on the Nasdaq stock exchange. The composition of the NASDAQ Composite is heavily weighted towards companies in the information technology sector and is commonly used as proxy for U.S. technology stock performance.
[3]Canada and Mexico are partially exempt under USMCA compliance, but non-compliant goods face existing tariffs.
[4]On 2/28/25, the U.S. Bureau of Economic Analysis released its January 2025 Personal Income and Outlays report, which includes an update on personal consumption expenditures (PCE). The data in the report indicated that consumer spending on goods declined by 1.7% in January compared to a 1.3% increase in December. The abrupt drop in consumer goods spending stoked fears about a broken American consumer and appeared to increase the likelihood of an imminent recession.
[5]https://www.bea.gov/sites/default/files/2025-03/pi0225.pdf
[6]https://www.bls.gov/news.release/empsit.nr0.htm

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