Financial Market ViewPoints

April 2025

March Madness: Finding Opportunity in Volatility

To say that the first quarter of 2025 was a "busy" period would be quite an understatement. Between financial markets coming off all-time highs, investors digesting corporate earnings, and trying to keep up with an eager new administration, there has been a lot to stay on top of. At the end of 2024, one of the big questions was, "would financial markets finally run out of steam after two consecutive years of 20%+ returns?" Now, with consumer sentiment falling and continued uncertainty over tariffs building, investors are looking to the horizon for what the next catalyst for a rebound could be. Overall, there is a lot to unpack as we close the books on the first quarter of 2025.

Selected Market Returns: March 2025 and Year to Date

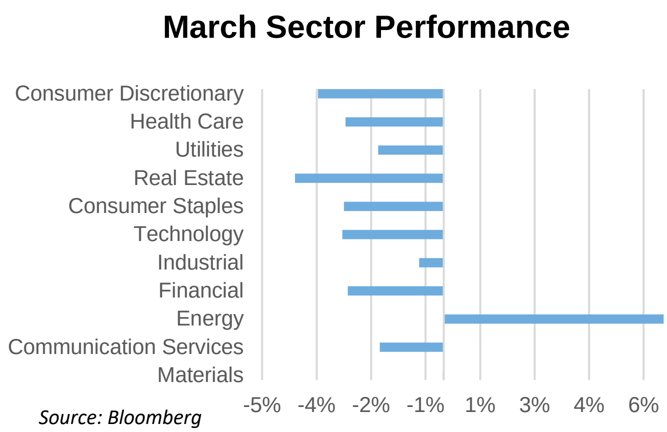
Asset Class	Index	End of 2024 Value	Ending Value (Yield for Bonds)	Total Returns Jan	Feb	Mar	1Q	YTD
Stock Markets								
U.S. Large Cap Stocks	S&P 500	5,881.63	5,611.85	2.8%	-1.3%	-5.6%	-4.3%	**-4.3%**
U.S. Large Cap Stocks	Dow Jones Industrial Average	42,544.22	42,001.76	4.8%	-1.4%	-4.1%	-0.9%	**-0.9%**
U.S. Large Cap Stocks (Tech. Focused)	NASDAQ Composite	19,310.79	17,299.29	1.7%	-3.9%	-8.1%	-10.3%	**-10.3%**
U.S. Small Cap Stocks	Russell 2000	2,230.16	2,011.91	2.6%	-5.3%	-6.8%	-9.5%	**-9.5%**
Int'l. Developed Markets Stocks	MSCI EAFE	2,261.81	2,400.82	5.3%	1.9%	-0.4%	6.9%	**6.9%**
European Stocks	MSCI Europe	169.88	178.91	6.9%	3.7%	-0.3%	10.5%	**10.5%**
Japanese Stocks	MSCI Japan	1,716.10	1,623.25	1.6%	-1.4%	0.1%	0.3%	**0.3%**
Emerging Markets Stocks	MSCI Emerging Markets	1,075.48	1,101.40	1.8%	0.5%	0.6%	2.9%	**2.9%**
Chinese Stocks	MSCI China	64.71	74.31	0.9%	11.8%	2.0%	15.0%	**15.0%**
Bond Markets								
Broad Bond Market	Bloomberg U.S. Aggregate Bond	4.91%	4.60%	0.5%	2.2%	0.0%	2.8%	**2.8%**
Government Bonds	Bloomberg U.S. Government Bond	4.46%	4.11%	0.5%	2.1%	0.2%	2.9%	**2.9%**
Municipal Bonds	Bloomberg U.S. Municipal Bond	3.74%	3.85%	0.5%	1.0%	-1.7%	-0.2%	**-0.2%**
Corporate Bonds	Bloomberg U.S. Corporate Bond	5.33%	5.15%	0.6%	2.0%	-0.3%	2.3%	**2.3%**
High Yield Bonds	Bloomberg U.S. Corporate High Yield Bond	7.49%	7.73%	1.4%	0.7%	-1.0%	1.0%	**1.0%**
Highlighted Commodities								
Oil	Crude Oil (West Texas Intermediate/WTI)	71.72	71.48	1.1%	-3.8%	2.5%	1.1%	**-0.3%**
Gold	Gold Spot Price ($/oz)	2,624.50	3,123.57	6.6%	2.1%	9.3%	6.6%	**19.0%**

Source: Bloomberg.

Sector Shifts

As 2025 began, investors were keen on the prospects of a business-friendly environment that the Trump Administration had promised throughout the campaign trail. Investors, too, looked back to an environment that fostered less regulation from President Trump's previous term, hoping there might be a similar environment ahead. However, President Trump's second term looks to be off to a very different start. As the tariffs the Trump administration has already implemented as well as discussed spooked the markets and increased volatility, investors have begun gravitating towards quality and some of the less "buzzy" areas of financial markets that were the major drivers of yesteryear.

Throughout the month, there have been plenty of signals pushing investors to other areas of the market. Moving from the high growth names that have become commonplace in daily conversations to the value names that investors and consumers alike have always trusted. Even from a more granular perspective, we have seen some sector rotation take shape as well, as investors have set out to find both undervalued and traditionally "safe haven" areas of the market. For example, the tech sector has experienced a difficult month, with many of the big names that have dominated the AI space throughout the last year beginning to falter. These declines, a result of heighted volatility, new competition, and lofty valuations have persuaded investors to move to more defensive sectors like utilities, consumer staples, and healthcare. To contrast, energy has experienced a stellar month as rising oil prices and increased demand helped bolster momentum for the sector.



Source: Bloomberg

All in all, with a constantly evolving macroeconomic landscape, we are not suggesting growth stocks are out by any means. Instead, that a more balanced market likely lies ahead as both sector and sub-asset class leadership continue to fluctuate due to investors pricing in the evolving environment.

Consumer Sentiment and Tariffs

Since the start of President Trump's second term, the outlook on tariffs has been quite murky as official plans for said tariffs on both specific products, industries, and countries have been unclear time and time again. This uncertainty has not only put industry professionals and the Federal Reserve on their heels but has naturally impacted overall consumer sentiment. Another, new drumbeat from strategists and investors is the concern that these new changes could lead to higher inflation, slower economic growth, and a negative impact to the labor market.

As for a brief synopsis on tariffs for the final weeks of March and what is expected to come at the beginning of April, here is what we know as of publication. For starters, some of the main tariffs that are currently in effect are as follows.

March Tariff Headlines:

- **Canada:** 25% tariff on all imports from Canada except for USMCA[1] qualifying goods and a 10% tariff on energy and critical mineral imports.
- **Mexico:** 25% tariff on all imports from Mexico except for USMCA[1] qualifying goods however there are no energy exemptions like Canada.
- **China:** Tariffs of 10% to 20% on all Chinese imports.
- **Steel & Aluminum:** Global 25% tariff on steel and aluminum imports.
- **Autos:** Global 25% tariff on foreign autos as well as some foreign drivetrain components.

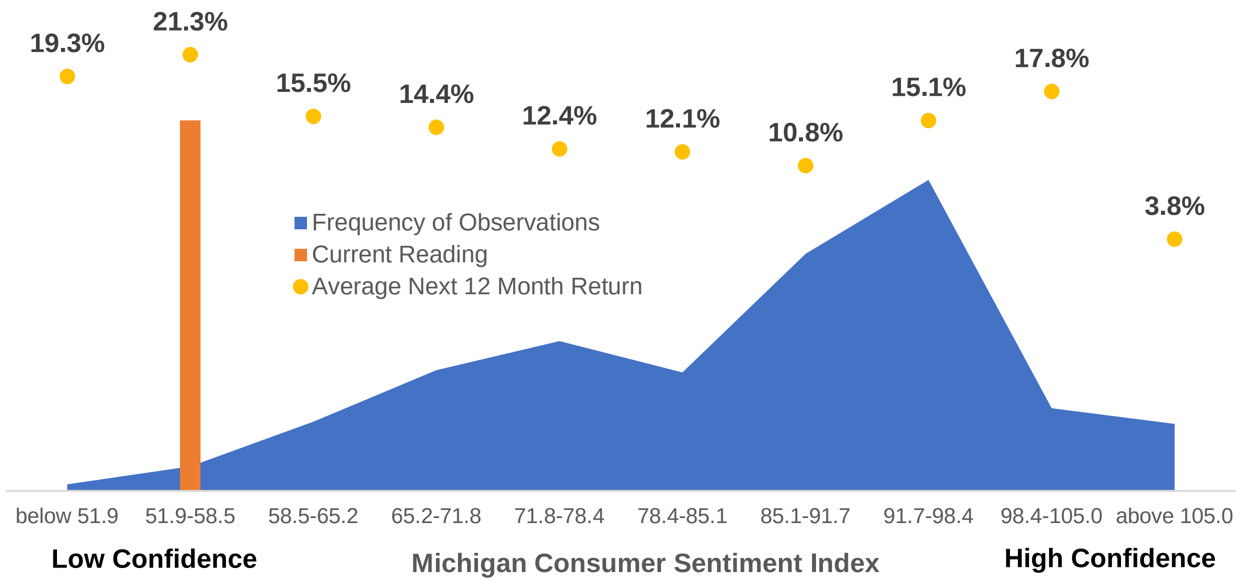
On April 2, President Trump introduced reciprocal tariffs in response to other countries' trade policies. There have also been rumblings of a 25% tariff on imports from the European Union, however specifics remain unclear. Additionally, there are expected to be more product specific tariffs introduced such as a 25% tariff on imported lumber, copper, semiconductors, and pharmaceuticals. After these tariffs are implemented, there is some short-term pain to be expected, however the current administration's plan is to use tariffs as a tool to bring back

[1] A free trade agreement between the United States, Mexico, and Canada.

manufacturing and labor to the United States. This will undoubtedly be a long road ahead and it will be important to follow closely as the situation continues to unravel.

All of this tariff news has not only been one of the main drivers of financial markets over recent months but has also weighed on consumer sentiment. Overall, consumers are understandably becoming uneasy over the prospects of higher inflation, slowing economic growth, and how this will all affect the labor market. Looking at University of Michigan Consumer Sentiment Index data, sentiment currently lies in the mid-50s. This is much below the long-term average using data going back to 1980.

Comparing the Michigan Consumer Sentiment Index to Total Returns of the S&P 500 Index Over the Forthcoming Year



Source: Bloomberg. Using monthly S&P 500 Index and University of Michigan Consumer Sentiment data since 1980.

Using this data as well as total return data on the S&P 500, we found that there appears to be a relationship between consumer sentiment and the next twelve months total return for the S&P 500. Looking at the 544 months since 1980, it is evident that when consumer sentiment is low, the S&P 500 total return over the next twelve-months tends to be significantly higher than when consumer sentiment is high. Of course, past performance doesn't guarantee future results, however using historical data as a guide to lend perspective and manage expectations tends to be a helpful strategy.

Looking Ahead

Overall, we remain optimistic about the year ahead. Despite the number of headwinds we are experiencing currently, the overall economy remains in a healthy spot when looking through a number of lenses. We believe that the current volatility in the marketplace should create plenty of opportunity in both the stock and bond sides of portfolios as financial market performance is expected to continue to broaden. As a result, we have chosen to position portfolios to capture this trend and have increasingly relied on actively managed strategies to capitalize on unique investment opportunities within markets. With this, we feel portfolios are well positioned for the start of the second quarter of 2025.

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DOGE Cuts and the Labor Market

By Jim McCarriston
Client Investment Analyst

The Trump Administration has brought upon a plethora of changes in a short amount of time since Inauguration Day. Many of these changes can be attributed to President Trump's creation of the Department of Government Efficiency (DOGE) and the appointment of Elon Musk as the department's head as well as his senior advisor. This new department is primarily focused on cost cutting measures across the federal government through reducing government bureaucracy, cutting regulations, and eliminating "wasteful" spending. Ultimately the aim is to accomplish these goals through modernizing outdated federal technology, reviewing contracts and grants, and restructuring federal agencies to enhance efficiency.

DOGE does not have any official government powers but does operate in an advisory capacity to the White House and Congress

At its core, DOGE does not have any official government powers but does operate in an advisory capacity as it makes recommendations to the White House as well as Congress. Before we go any further in breaking down what DOGE has already been busy working on, it is important to understand the history of federal employment in the United States and how it has grown over many decades.

Historical of the Federal Government Context

Nearly one hundred years ago, when the United States was in the depths of the Great Depression, the President at the time, Franklin D. Roosevelt, implemented a major overhaul of the federal government to bring the country back to growth. This overhaul, called The New Deal, rapidly and dramatically expanded the federal government through a series of programs, public work projects, and financial reforms aimed to put the country back on track. Relief programs like the Civil Conservation Corps (CCC), the Works Progress Administration (WPA), and the Federal Emergency Relief Administration (FERA) all helped to stimulate the economy and provide relief and jobs to folks who in many cases, had nothing left. There were also reformative programs like the Social Security Act, the establishment of the Securities and Exchange Commission (SEC), and the Federal Deposit Insurance Corporation (FDIC) to protect bank deposits.

Since the New Deal was implemented by FDR's administration, government payrolls have grown significantly

All of these programs provided U.S. citizens with jobs, added financial confidence, and helped to stimulate economic growth. Since then government programs, contracts, and payrolls have ballooned. Coming back to the present, one of President Trump's main campaign goals was to trim unneeded government programs and jobs to pave the way for a more efficient government.

This isn't a novel idea either. During President Bill Clinton's term, his administration takes credit for a program called the "National Performance Review". This program accomplished many things, but most pertinent to our context here, reduced the federal workforce by over 400,000 employees. This resulted in the lowest federal payrolls since 1966 by the turn of the century. Since the year 2000 however, the number of employees has increased from approximately 2.7 million to now over 3 million.

On the surface, most Americans or even more broadly speaking, people in general would agree that having an efficient government is a good aspirational goal. A government that can work within a set budget while still offering its taxpayers ample benefits is, simply put, one of the main pillars of a healthy and successful government. So, from a high level, DOGE sounds like a good idea. However, where many people are getting nervous today, hence the heightened market volatility, is that they fear the Trump Administration and DOGE are moving much too quickly and "using a chainsaw instead of a scalpel" to cut what they view as unnecessary areas of the federal government.

The Numbers

Of the 163.3 million people employed in the U.S. 14% (23.6 million) are government employees

For the most part, sentiment towards DOGE has tilted negative considering the pace at which cuts are being made and the perceived prospects of how this program could affect the labor market down the road. However, a dive into the numbers may give investors some solace.

Looking at data as of the end of February 2025, there are 163.3 million employed individuals in the United States. Of these individuals, 23.6 million are government employees (federal, state, and local governments combined) which equates to approximately 14% of the current total workforce. Although this sounds like a large part of the working population of the United States, it is important to break out these numbers between federal, state, and local governments. With this greater level of granularity, we note that the federal government only employs roughly three million people, which is only 13% of the overall "government" category and a mere 1.8% of the total working population of the country. Another important item to note is that nearly 11 million of government employees are educators hired by local or state governments.

Detail of Government Workers

Category	Workers	Percent of Government Workers
Federal	**3,006.7**	**13%**
U.S. Postal Service	601.2	
Non-U.S. Postal Service	2,405.5	
State Government	**5,531.5**	**23%**
Educators	2,639.7	
Non-Educators	2,891.8	
Local Government	**15,076.3**	**64%**
Educators	8,206.0	
Non-Educators	6,870.3	
Total	**23,614.5**	

Source: Bureau of Labor Statistics. Data in thousands.

If DOGE was to cut 10% of the federal workforce, that would result in a reduction of nearly 300,000 jobs

Both President Trump and Elon Musk have said on multiple occasions that they plan to cut 10% of the federal workforce. However, as illustrated in the chart above, the vast majority of government payrolls are state and local government employees. Cutting 10% of the federal workforce would result in a reduction of approximately 300,000 jobs, less than President Clinton achieved with his "National Performance Review" program in the roaring 1990's. Yes, 300,000 is a large group of individuals, but only equates to a change of only 1.3% of all government employees (federal, state, and local). Going a step further and looking at this change relative to the total number of people employed in the U.S., it only has a 0.18% impact.

Enough to Move the Needle?

As we have seen throughout history, even just a small change in the U.S. unemployment rate can represent a significant change in the number of payrolls in the overall labor market. Given that the generally accepted full employment threshold is 4.0%, let's talk about what a 0.1% change in the unemployment rate would translate to regarding the actual number of employed individuals it would impact.

The federal government would need to cut 1.7 million jobs in order to material change the unemployment rate

Knowing that there are approximately 163.3 million employed individuals in the U.S. currently, a 0.1% increase in the unemployment rate would require about 163,300 people to lose their jobs. Now, for the unemployment rate to spike materially[2], payroll cuts would have to take place at a much larger scale. Let's take a look at the example of 300,000 job cuts from earlier. If hypothetically, DOGE was to cut 300,000 federal payrolls (10% of the federal workforce), that math would result approximately in a 0.18% increase to the overall unemployment rate. For context, with the unemployment rate currently at 4.1% as of the February report, assuming no other movement in the labor market, would only move the overall unemployment rate up to 4.3%[3]. Taking it a step further, and assuming no other movement in the labor market, DOGE would have to cut approximately 1.7 million payrolls to move the unemployment rate 1% higher to 5.1%.

Let's look at another example just to illustrate this magnitude from the not-too-distant past. During the early stages of the COVID-19 Pandemic, at the beginning of 2020, the unemployment rate rocketed from 3.5% (below the generally accepted threshold of full employment) to 14.7% in April. This huge increase took place in just over two months and resulted in approximately 20 million job losses. Of course, using the COVID-19 pandemic is an extreme example, but it is useful when illustrating the magnitude at which job losses have to occur in order to materially move the unemployment rate.

[2] A material spike in the unemployment rate is generally defined as an increase of at least one full percent.
[3] Rounded to the nearest tenth of a percent.

Conclusion

The news is full of all sorts of information and discussion around the rapid changes taking place as well as those that are being considered. Hopefully, putting these conversations into perspective relative to the overall U.S. workforce should help investors navigate the turbulent markets. It is important to note that this is still an evolving pillar of the Trump Administration, but that their goal of reducing the federal workforce by 10% translates to a minor impact for the overall unemployment rate alone. While the follow-on impact of certain jobs being eliminated may have further consequences for the economy, it is too soon to tell if that will be the case or if we are entering another era like the 1990's in which the footprint of the federal government shrank, and the economy grew dramatically.

Analyzing Shifts in GDP under the Trump Administration

By Ryan Gallagher
Client Investment Analyst

Since President Trump's inauguration in January, his administration has moved swiftly to reshape the Federal Government and the broader economy of the United States. Given that this is President Trump's second term, his Administration understands the importance of decisive action to help ensure the President can leave behind the legacy he envisions. Two of his main points of focus thus far have been improving the balance of trade and increasing efficiency within the Federal government with regard to spending and its workforce. These topics have circulated through financial news for months, but people are now starting to consider the effects of these changes as the projection for the upcoming first quarter's Gross Domestic Product or "GDP" have turned negative[4]. For many, this can be disconcerting as after nearly three years (eleven quarters) of uniterupted growth, it appears that the first quarter of 2025 might break this streak. Although this is a normal reaction to a weaking economy, as the saying goes, "the devil is in the details."

GDP Overview

GDP is released quarterly and only includes finished goods and services produced within the country

GDP is the monetary value of all the finished goods and services produced within a country. Which means that products that are in process/unfinished or sold as used are both excluded from the calculation. This indicator of economic performance is released on a quarterly basis and is typically analyzed on a quarterly or annual basis. Quarterly GDP can be used to evaluate the short-term effects of specific market events such as the implementation of tariffs as well as changes in monetary and fiscal policy. As opposed to annual GDP, which is often used by analysts to compare national economies of similar sizes.

The four components of GDP are Personal Consumption Expenditures, Private Investment, Government Spending, and Net Exports

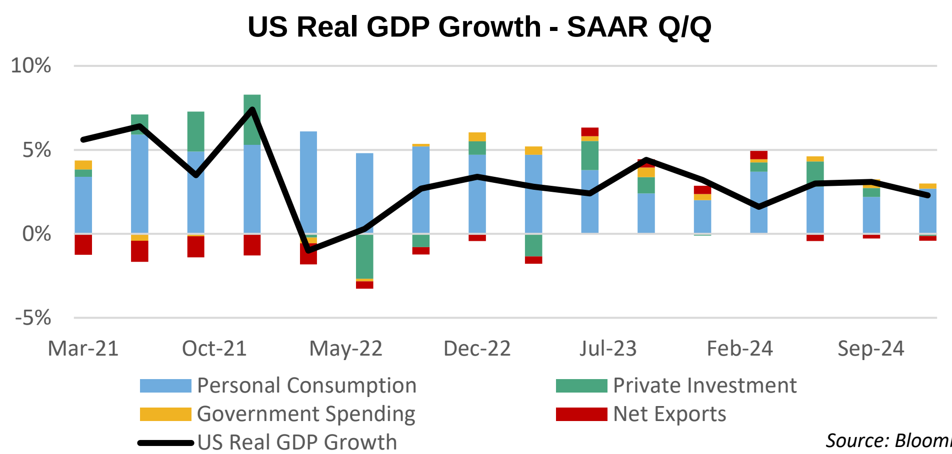
Taking it a step further, there are two main types of GDP. First, Nominal GDP, which measures the total value of all goods and services produced at current market prices. For this calculation, there are no adjustments for inflation, which can create complications when comparing two economies with drastically different inflation rates. In contrast, Real GDP measures the total value of goods and services but adjusts for any inflation or deflation. To put more simplistically, Real GDP measures actual growth as it adjusts for the rise in values associate with inflation. Whereas Nominal GDP is the full rise in values (growth + inflation). For this reason, Real GDP is the preferred measure for economic activity as using "constant prices" rather than "current prices" allows for a more accurate measure of economic change over time without the added impact of inflation.

Components of GDP

While GDP is reported as a single figure, it represents the sum of four distinct areas of economic activity. These components include Personal Consumption Expenditures, Private Investment, Government Spending,

[4] Projection based on the Atlanta Fed's GDPNow Forecast of GDP for the first quarter of 2025.

and Net Exports. Each of these components are calculated independently, with no overlap in spending or products, to make sure that GDP is an accurate representation of economic activity. The detailed breakdown of each component's contribution to total GDP can be used to identify trends in which areas of the economy are growing or shrinking. This information is essential to investors as it can be used to better understand economic trends and mitigate potential risks.



Source: Bloomberg

Personal Consumption Expenditures represents the largest portion of GDP among the four components

Personal Consumption Expenditures is the total amount of spending by consumers on goods and services during a given period. Over the past 50 years, personal consumption has always represented the majority of GDP. It accounted for about 60% of GDP at the end of 1974 but has since trended higher reaching a peak of 69% in mid-2021 and settling at 68% by the end of 2024. This shows that the U.S. economy is driven in large part by consumer spending as it had made up more than 59% of total GDP since 1975. Taking this a step further, its rising contribution shows the U.S. economy's growing reliance on persistent consumer spending.

While change in private inventories is often discussed, the true driver of the Private Investment component is fixed investment

Moving onto the next component, Private Investment is the total amount of spending companies made to produce their goods and services. This component is made up of two sub-components, fixed investment and change in private inventories. While financial news often emphasizes the impact of a change in private inventories, the sub-component only accounted for about 0.29% of total Private Investment, and 0.052% of total GDP in 2024. It's clear that the true driver of private investment is actually fixed investment which represented 99.71% of Private Investment and 17.75% of GDP at the end of 2024. This falls right near the middle of its 50-year range from 13-21%.

Impact of Reduced Government Spending

Government Spending is the third component that makes up GDP. This value encompasses Federal, State, and Local government spending and has historically ranged from 17-23% of total GDP. While the range is fairly tight, the impact of government spending has been declining as its highest contribution of 23% occurred in 1975. To contrast, its lowest contribution of

17% was seen in the most recent quarter and has strictly occurred in years after 2015.

Breakdown of U.S. GDP in Q4 2024

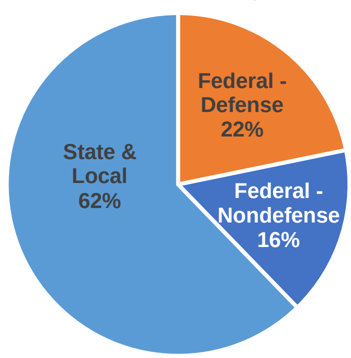
Components of GDP	Nominal Contribution	Percent Contribution
Personal Consumption Expenditures	**$20,262.70**	**68.2%**
Goods	$6,352.50	21.4%
Services	$13,910.20	46.8%
Private Investment	**$5,289.90**	**17.8%**
Fixed Investment	$5,274.40	17.7%
Change in Private Inventories	$15.50	0.1%
Net Exports	**-$931.10**	**-3.1%**
Exports	$3,218.60	10.8%
Imports	-$4,149.70	-14.0%
Government Spending	**$5,098.10**	**17.2%**
Federal	$1,924.70	6.5%
National Defense	$1,110.60	3.7%
Nondefense	$814.20	2.7%
State and Local	$3,173.30	10.7%

Source: Bloomberg. Data in billions.

The Federal government only accounted for 38% of the total government spending in the United States in the final quarter of 2024

Given the Trump Administration's emphasis on reducing the size of the federal government, we decided to further analyze the data to understand the magnitude these changes could have on GDP. At the end of 2024, Federal spending accounted for 38% of total government spending, which means that 62% of government spending was done by State and Local governments. Federal spending can be further split into two sub-components, national defense (22%) and nondefense (16%).

Breakdown of Government Spending



Source: Bureau of Economic Analysis.

Going further down the rabbit hole of GDP contributions, when breaking down the contributions from the federal government, we note a few key observations. First, the majority of the contribution comes from defense spending at roughly 58% of the federal government's contribution as of the end of 2024. Second, and equally important is that nondefense spending represented 42% of the federal government's contribution in the last quarter of 2024. This equates to a contribution of less than 3% or about $814 billion to GDP. Compared to defense-focused spending, this subcomponent covers funding for Medicare and Medicaid, Social Security, and the salaries of federal government employees. With the current proposed workforce cuts and agency budget reductions, this sub-component looks to be impacted the most. Thus far, the newly

The reported $16.5 billion cut in federal spending will have a negative impact of less than 1/10th of a percent on GDP established Department of Government Efficiency (DOGE) claims to have cut $55 billion from federal government spending, but based on published receipts this amount is closer to $16.5 billion. This would result in a miniscule -0.056% impact on total GDP.

Impact of a Rise in Net Exports

Net exports contribute the lowest nominal amount to GDP of the four total components

The final component of GDP is Net Exports. This is calculated by subtracting total imports or the goods we purchase from outside the U.S. from total exports or the goods we produce in the U.S. and sell abroad. Historically, net exports are the only component that has consistently produced a negative figure over the past 50 years. While its impact on total GDP has ranged from -6% to +1%, the difference in nominal terms from 1975 to 2024 is astounding. Net exports at the end of 1975 represented a trade surplus with a (+) $13.8 billion impact on total GDP, compared to the current quarter where the U.S. had a (-) $931 billion trade deficit.

Impact of Net Exports on GDP

Decade	Net Exports	GDP	Impact
1980's	-$78.68	$4,173.16	-1.89%
1990's	-$100.92	$7,577.18	-1.33%
2000's	-$577.61	$12,601.26	-4.58%
2010's	-$539.22	$18,030.00	-2.99%
2020's	-$880.54	$26,648.15	-3.30%

Source: Bloomberg. Data in billions.

The last time the United States had a trade surplus was in the third quarter of 1980

As illustrated, the impact of the trade balance over the past 50 years has significantly fluctuated in terms of percent of GDP. While a trade deficit has become increasingly more normal, it has been widening in recent years. Throughout the 1980's and 1990's, the trade deficit averaged less than 2.0% of GDP. This significantly changed in the 2000's, when it jumped to 4.6%. The average drags on GDP later settled in the 2010's around 3.0% before beginning to rise again in the current decade where they have averaged 3.3%. For these reasons, it is understandable that the Trump Administration is focused on reducing the deficit and balancing trade.

While specific tariffs have already been implemented, in preparation for the frequently discussed broader implementation of reciprocal tariffs, many companies have "front loaded" their imports through bulk purchases prior to the implementation of these new tariffs. This was generally done to avoid the additional costs associated with tariffs in the future and to conceivably provide some flexibility in the near term as companies adjust to potentially higher costs. Consequently, this unusual increase in imports has resulted in a largely negative projection for net exports in the first quarter of 2025. While this figure has had a minimal impact on GDP in the past, net exports are projected to push GDP growth into negative territory for the first time since 2022.

The projected decline in GDP for Q1 2025 is driven by an influx of imports as companies stocked up prior to the implementation of additional tariffs

The expectation for negative growth in GDP has led to renewed recession fears for some market participants. The reason for this is because two consecutive quarters of negative GDP growth was previously considered an indicator of a recession. However, situations such as these show the importance of truly understanding the data. If you were to strip net exports out or replace it with last quarter's value, the upcoming change in GDP is expected to be positive as all other components look to be growing as of this publication. This shows that the projected decline in GDP was driven by the significant inflow of imports that were "front loaded" to avoid the upcoming tariffs and may only be temporary. The other takeaway is that the rest of the economy appears to be healthy as the other components of GDP have remained stable, which should help to put some investors at ease.

Conclusion

Putting it all together, measuring the growth of any economy, especially the largest one on the planet, is overly complex and challenging. Investors are astutely aware that any changes to how such a complex system operates has the potential to have a widespread impact. While the pace and magnitude of the changes coming from the Trump Administration have not been seen in over a generation, it is important to also put them in perspective of the overall economy and the true drivers of growth: consumers and businesses.

Will the Correction Lead to Bulls or More Bears?

By Jason Orlosky
Head of Investment Strategy & Platform

The past month has been a challenging one for investors. While any seasoned investor is quick to talk about the long-term growth of the stock market and the oscillations they experience over their investment horizon, living through each of these periods can easily challenge one's resolve. The current stock market correction[5] for the S&P 500 Index occurred on March 11th and only lasted less than an hour before the market closed above "correction territory". Two days later, on March 13th, the stock market once again entered correction territory, and this time closed near its lows. Since then, the stock market has been slowly grinding higher, until the end of March, in which it rapidly reversed course once again and entered correction territory for a little more than an hour on the 31st.

What has been surprising about this correction is the sheer speed at which it occurred – taking only 14 trading days or roughly three weeks[6] to go from a new all-time high to a correction. Further challenging investors is that some markets, namely those in the developed international segments, have been positive during this time. The disparate level of returns really comes from the key factors driving the current correction and might possibly give investors some insight as to when a recovery might take place.

Correction Contributors

The pace at which the new administration has moved on policy changes has certainly contributed to lower sentiment, higher volatility, and greater uncertainty

Undoubtedly, one of the largest contributing factors has stemmed from the potential changes for the United States as the Trump Administration rolls out their ambitious plans. As with all new presidential administrations, there are always changes to how the United States operates and the priorities in which it is focused. The sheer speed and magnitude at which the current administration has been moving has certainly caught most by surprise and created a roller coaster ride for investors in the first quarter of 2025.

In our view, there are three main pillars of the current administration's agenda that is resulting in large swings across markets. These are:

- Federal government employment
- Federal government spending
- Trade or the balance of imports and exports

The Trump Administration is focused on reducing Federal Government employment and spending, as well as the balance of trade

For each of these areas, there are volumes that can be written about the changes made as well as those that are on the horizon. At a high level, these three primary areas of focus are intended to shrink the size of the Federal Government, improve the country's trade balance with the world, and ambitiously return to a balanced budget. While many would feel that at least the last two are aspirational goals that would make sense for most

[5] A correction is when the market is at least 10% below its high.
[6] February 19, 2025 to March 11, 2025.

administrations, the details are what matter here. This is why both the stock and bond markets have been on a wild ride since the start of the year.

In addition to the governmental changes unfolding within the federal government, a second, more nuanced factor, has also created headwinds for the stock market. Up until the latter part of 2024 there has been an “arms race” amongst many large corporations to bring Artificial Intelligence or “AI” solutions into their workstreams to improve efficiency. This has led to a 21st century “gold rush” in which companies are vying for the most powerful chips to run increasingly complex AI models. In turn, the creation of enough data centers to house this computing power, as well as the energy needed to keep it running around the clock has been a boom for many technology companies, with NVIDIA Corporation leading the charge.

DeepSeek shook the industry with its ability to produce AI models at a fraction of the cost compared to the current industry leaders

What has happened in recent months has been a shift in the AI space from the need for the most computing power at any cost to a more pragmatic approach. This was initially seen by the lackluster investor response from NVIDIA’s earnings over the past couple of quarters, indicating that the first inning of the AI revolution might be coming to a close. It became more apparent when a new competitor, DeepSeek, entered the market with blazing fast speeds that cost less to purchase as well as operate. Further confirming the start of the second inning for AI was a recent announcement from Microsoft and others that they were scaling back their plans to open new data centers as the demand for computing power looks to be less than they had anticipated.

About 2% of the recent 10% market correction was driven by the decline in NVIDIA which was the second largest company in the S&P 500 on January 6th

The reason why this shift is so important is that many of the major indices that investors use to track the market, such as the S&P 500 Index, are based on market capitalization. As a result, the ballooning values of companies participating in the AI space have propelled them towards the top of the index. For example, the leader in this space, NVIDIA, was the second largest company in the S&P 500 Index on January 6[7] of this year at 7.22% with only Apple Inc. larger at 7.30%. Since then, NVIDIA’s stock has fallen more than 27% through the end of March. This means that nearly two full percentage points of the S&P 500’s correction (10% decline) are a result of only NVIDIA’s stock price collapse. Adding in the declines for the stock prices of other players in the AI space, and it is easy to see how the changes in this segment have significantly contributed to the correction for the S&P 500 Index.

Understanding the drivers of the recent stock market correction is the first step in creating a plan to navigate any turbulent market. The next step in this process is to identify the most likely scenarios for the bear case (i.e. continued declines) and the bull case (i.e. recovery and a resumption of the bull market rally).

[7] January 6, 2025 was the all-time closing high for NVIDIA’s stock price.

The Bear Market Scenario

Arguably the easier scenario for most strategists and investors to envision during a stock market correction is the case for a bear market. Traditionally, the drivers that brought the market into correction territory were relatively unknown until the market took a turn. This "surprise" and the fear that followed tends to amplify the possibility of a correction turning into a bear market. This time is no different as the two main drivers of the correction were, for the most part, not on the minds of investors at the beginning of the year.

The three main areas that could breakdown due to the Trump Administrations recent changes are economic growth, employment, and inflation

In this scenario, the clear progression is that the Trump Administration continues with their rapid and widespread restructuring of the federal government and the U.S. economy, but instead of only "cracks" in the economy as a result of these changes there is a major breakdown. This could materialize in a number of different ways. For most strategists, these breaks tend to come in three main areas:

- Economic Growth, generally measured by GDP
- Employment, generally measured by the unemployment rate
- Inflation, generally measured by the Consumer Price Index, although the Federal Reserve or "Fed" is more focused on Personal Consumption Expenditures ex. Food and Energy or "Core PCE"

Economic growth is usually the first component that comes to mind as a prolonged decline (i.e. more than one quarter) is a recession and large declines (generally more than 10%) are considered a depression. The implications of either can be widespread and generally takes years to recover. While it is hard to identify a recession (or depression) ahead of time or even at its onset, there are a few indicators that can show a weakening in the economy. These tend to show up in the Atlanta Fed's estimate of current GDP in the GDPNow Index. This tool amalgamates the relevant economic data as it is released to estimate the economic growth or GDP rate for the current quarter. While there is plenty of lag between when certain economic reports are released after a month is over, it is the closet gauge that is available to measure "current" levels of growth. Reviewing the reports on the GDPNow Index could be one way to see if the economy is going through more than just a few bumps.

Observations and insights from large public companies can often provide a better idea of economic performance than economic reports

Another way in which strategists and investors attempt to track the health of the U.S. economy is by following some of the largest public companies in the country. The idea here is that these companies are closely attuned to the habits of consumers and the growth of the country, whether it be by shipping goods around the country, selling high demand products, or simply providing funds for people to purchase homes and live their daily lives. Often times the comments and insights coming from these companies can provide a better idea of how the economy is performing compared to economic reports.

Employment is another major category to follow as high unemployment can be a sign of prolonged trouble. Often, it can take quite some time as well as additional support from the federal and state governments to bring people back to work. Fortunately, investors get closer to a real time update on this major area as unemployment data is published on a weekly basis. If the bear case scenario is playing out, one would expect to see a significant rise in unemployment (well above 5%).

While inflation has fallen below its long-term average, it remains an area of focus as the potential impact of the newly implemented tariffs are considered

Inflation is the final major component that can potentially indicate a major breakdown for the economy. The most recent bear market was a result of generationally high inflation, not an economic recession. Not surprisingly, investors are still hyper focused on inflation as it is not clear if the war on inflation is over. Over the course of each month there are various measures of inflation that are reported and can provide some view for the entire country. Personally, though, each person can "feel" the impact of inflation in their everyday life as they shop for groceries, put gas in their cars, and pay their utility bills.

In practice, it will be a combination of the three main factors that we identified, as well as potentially others, that will confirm if the bear market scenario is becoming a reality. Ultimately, while bear markets are challenging, it is important for investors to focus on the long term and make decisions for their portfolio not only based on current events.

The Bull Market Scenario

Conversely, there is also a scenario in which this is just another stock market correction along the path of the current bull market's rally. In this scenario, the concerns that drove the market to a correction turn out to be less painful than originally feared. Using the same components as in the bear market scenario, there are a clear path of indicators to give an early sign that this has become the more likely scenario.

Net exports soared as companies front loaded purchases ahead of the retaliatory tariffs resulting in a projection for negative GDP growth in the first quarter

On the economic front, the big indicator for the bull case would be a strong rise in GDP. As of publication, GDP for the first quarter of 2025 looked fairly healthy across all components with the exception of an outsized decline coming from Net Exports, resulting in an overall GDP decline for the first quarter. Not surprisingly, many companies imported a number of their goods from abroad ahead of the imposition of high tariffs at the beginning of April. Seeing this pattern reverse over the next quarter or two, all while the other components of GDP continue to grow would be a strong indication for the bull case.

Another main area of focus for the economy would come from corporations as they address their recent performance as well as outlooks. With the next round of quarterly earnings starting in the middle of April, we should soon start to hear how these changes will impact corporate America. By the next earnings season (starting in mid-July), we will see the impact of those changes in corporate earnings. As executives discuss how consumers are shifting their habits around these changes, investors should get a better grasp on whether the bull case is becoming more likely.

Lastly, employment and inflation can go hand-in-hand here. If these major indicators stay near current levels or even improve, it is also supportive of the bull market scenario becoming a reality for investors.

Conclusion

Unfortunately, there is no crystal ball to help guide us through this challenging period. As a result, it will be prudent to closely follow the various key elements of our economy to identify which scenario is becoming more likely. Despite this uncertainty, the one thing that is certain is that there will continue to be high levels of volatility as investors, strategists, and the market struggle to identify which path we are on. The one area in which we take solace is that historically, recessions and bear markets tend to be brief, albeit quite painful. Once they have reached their bottom, recoveries tend to be equally swift and lead to extended periods of growth beyond just a mere recovery of losses. As a result, we continue to focus on the long term, while adjusting for the rough waters that we currently find our portfolios navigating through.

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Index definitions

S&P 500 Index: is a capitalization weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 500 of the leading large cap U.S. companies.

Dow Jones Industrial Average Index: is a price weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 30 blue-chip stocks that are generally regarded as the leaders in their industry.

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MSCI EAFE Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of developed international markets. The EAFE region includes developed market countries in Europe, Australasia, the Far East, and Israel.

MSCI Europe Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of European developed markets.

MSCI Japan Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Japanese market.

MSCI Emerging Markets Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

MSCI China Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Chinese market.

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Crude Oil: is represented by the generic front month futures contract for West Texas Intermediate (WTI) crude oil.

Gold Spot Price: is represented by the current spot price of one Troy Ounce of gold in U.S. dollars.

Inflation: is measured by the year-over-year change for the Consumer Price Index or “CPI”. This index represents the changes in the prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer) and sales and excise taxes paid by consumers are also included.

Fed Funds Rate: is the target interest rate set by the U.S. Federal Reserve (Fed) or “Central Bank”. This index reflects the Fed’s efforts to influence short-term interest rates as part of its monetary policy strategy. The index value is calculated by using the midpoint of the Fed’s rate policy when they target a rate range (i.e., 0.25% - 0.50%).

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