

Year of the Average Stock, then “Liberation Day” Changes the Narrative

In this quarter’s Investment Review & Outlook there is much to uncover as we highlight the changing dynamic of the selloff in U.S. markets. For ease of thought, we begin at the start of the quarter and work our way through the days and weeks that have sent shockwaves around the globe as investors wait for an end to the policy uncertainty.

First Quarter Review

From the outset of the first quarter, volatility gripped markets and the major stock indices experienced moderate drawdowns as Washington scaled back spending, while projecting trade and tariff policies that caused a decline in business and consumer confidence. The equity market, as measured by the S&P 500 Index, ended the 1st quarter with a mid-single digit decline after briefly entering correction territory in mid-March. Below the surface, the story was a bit different. The average stock, as measured by the Equal Weight S&P500 Index, was down just fractionally for the quarter. However, there were some equity indices and strategies that were firmly in the green at quarter end.

US Equity Indexes	Q1 2025	2024 Total Return
S&P 500	-4.28%	25.00%
S&P 500 Equal Weighted	-0.61%	12.98%
DJ Industrial Average	-0.87%	14.99%
NASDAQ Composite	-10.26%	29.60%
S&P 500 Dividend Aristocrats	3.20%	7.08%
Russell 2000 (Small Cap)	-9.48%	11.53%
MSCI EAFE (International Developed)	7.03%	4.43%
MSCI Emerging Markets	2.97 %	7.97%

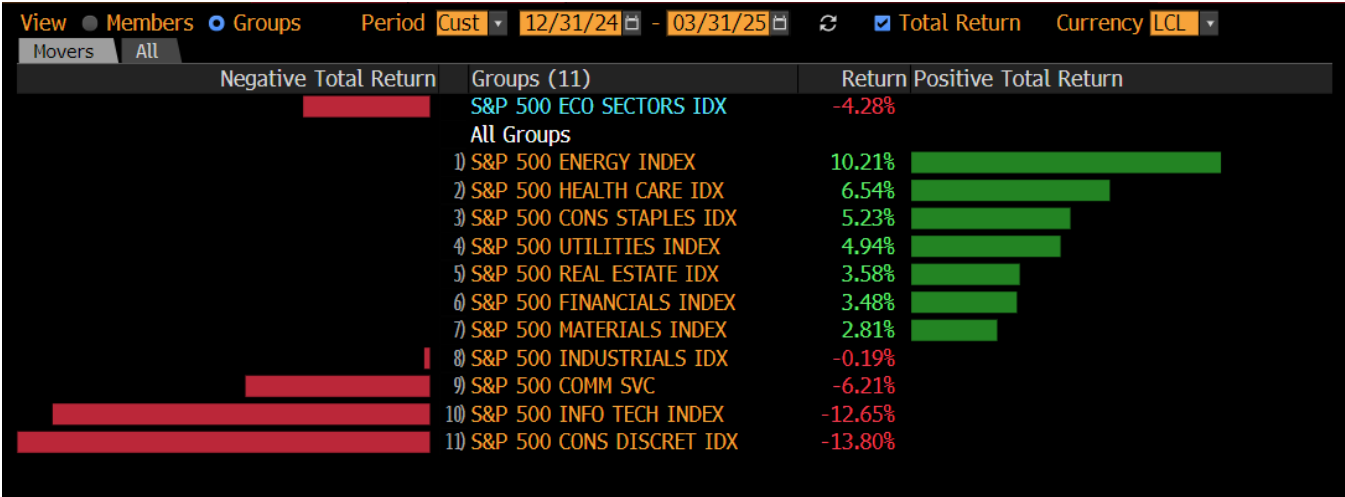
Source: Bloomberg Professional (3/31/2025)

Market internals revealed that while the S&P 500 logged a moderately negative return for the quarter, the declines in the index were mostly due to sharp drops in widely held technology and consumer stocks, as other parts of the market proved more resilient.

To that point, on a sector level, only four of the 11 S&P 500 sectors finished the quarter with a negative return and one of those four sectors saw only fractional declines (see graphic below). As mentioned, the Consumer Discretionary and Information Technology sectors were by far the worst-performing

sectors in the first quarter as both saw substantial declines. To note, the Information Technology and Consumer Discretionary sectors carry a combined approximate weighting of 40% in the S&P 500, which dramatically impacted the overall performance of the index. The Consumer Discretionary sector was the worst performer for the quarter as the sector was hit by weakness in one of the largest consumer stocks (Tesla) combined with general concerns about lower consumer spending in the face of policy uncertainty. The Information Technology sector was one of the other highly touted negative performers in the first quarter as Technology and Semiconductor stocks fell following the debut of the Chinese AI program DeepSeek, which challenged assumptions about the future economic benefit of AI for major tech firms.

Looking at sector outperformers, Energy was the top-performing sector in Q1 thanks to rising demand expectations following strong Chinese economic data and after some European countries committed to increasing debt to fund economic growth. The Healthcare, Utilities, and Consumer Staples sectors logged modest gains in Q1, as those traditionally defensive sectors were viewed as more insulated from any new trade wars and tend to be more resilient in the face of an economic slowdown.



Source: Bloomberg Professional (3/31/2025)

From an investment style standpoint, Value sectors and Value strategies significantly outperformed Growth in the first quarter as Growth names are heavily weighted to Tech and Consumer stocks. Value strategies logged a slightly positive return over the past three months and benefited from exposure to a broader array of sectors that trade at lower valuations and a lower beta to the market. Finally, looking at performance by market cap, small caps declined sharply in the first quarter and lagged large caps thanks to a combination of rising worries about economic growth and still high interest rates. Large cap indices also declined in the first quarter, although those losses were more modest.

Internationally, foreign markets massively outperformed the S&P 500 and finished the quarter with a positive return. Foreign developed markets saw the largest gains and outperformed emerging markets

after Germany and other EU countries signaled a willingness to increase deficit spending to boost economic growth and defense. Emerging markets logged more modest gains thanks to better-than-expected Chinese economic data.

US Bond Indexes	Q1 2025	2024 Total Return
Bloomberg US Aggregate Bond	2.78%	1.25%
Bloomberg US T-Bill 1-3 Month	1.04%	5.32%
ICE US T-Bond 10-20 Year	4.87%	-3.96%
ICE BofA US High Yield Index	0.94%	8.22%

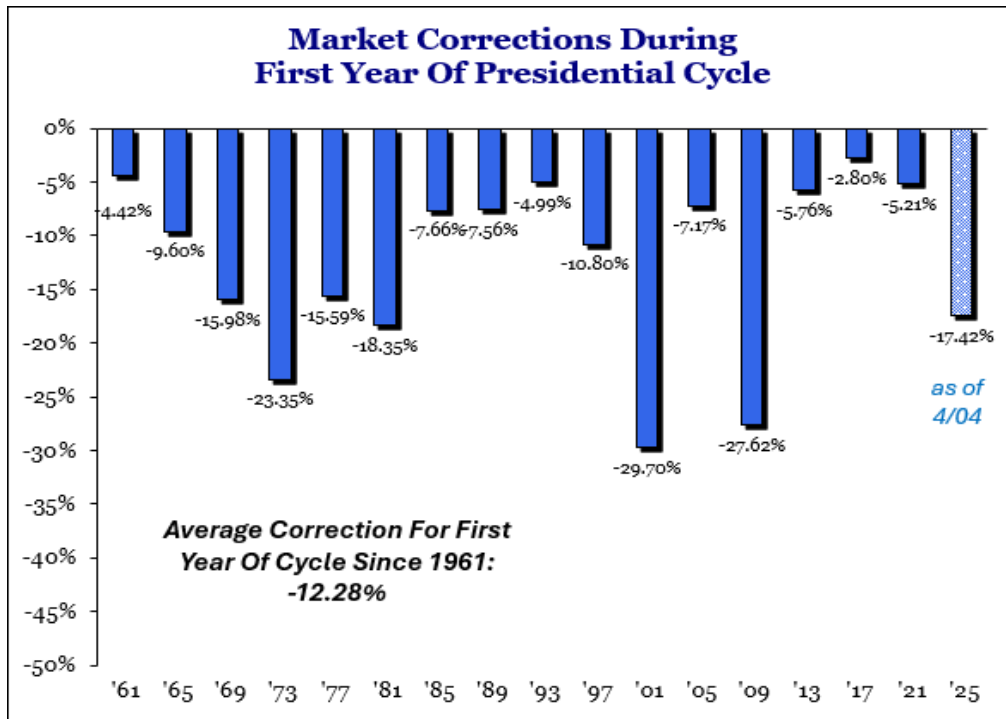
Source: Bloomberg Professional (3/31/2025)

Regarding fixed income markets, the leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) realized a positive return for the first quarter of 2025. Better-than-expected inflation readings and general concerns about economic growth boosted bonds broadly and helped longer-duration bonds to outperform shorter-duration bills and notes, as investors sought higher long-term yields in reaction to policy change impacts. Turning to the corporate bond market, higher-quality but lower-yielding investment-grade bonds outperformed higher-yielding non-investment grade bonds in the first quarter reflecting investor concerns about future economic growth amidst policy uncertainty. However, both investment-grade and high-yield corporate bonds finished March with modest gains, reflecting, at that time, a sense of economic contentment from bond investors.

“Liberation Day” & Market Outlook

Then came April 2nd, and since then the market environment has deteriorated following President Trump’s declared “Liberation Day” when he announced multilateral tariffs to usher in a new era for the American economy. He initiated sweeping tariffs on most – if not all- countries trading with the United States. While teetering on a standard correction cycle prior to this day, equity prices cascaded downward as market participants have attempted to model the potential long-term effects on the broad economy. The stock market was thrown into a tailspin, China has taken retaliatory measures and increasing odds of a recession were the result. Making sense of the ensuing economic turmoil is even more difficult due to the daily jawboning coming out of Washington and the media as everyone tries to figure out the negotiation tactics of our leaders and various heads of state from around the world. While corrections are expected and are a normal occurrence in healthy, functional capital markets, a drawdown of this magnitude is challenging due to the geopolitics involved. Meanwhile, investors are worried and confused as understandably one would expect. However, it is crucial to put this all in perspective and when markets are trying to find stability in the face of uncertainty the best financial advice is counterintuitive.

Despite the catalyst, it is not unusual for corrections to occur in the first term of a presidency, as new policies are disclosed and implemented. As the chart below shows, the current drawdown is a few percentage points worse than the average first term correction, as measured since 1960:



Source: Strategas Research Partners

While the current -17-18% downside correction is certainly troubling, it is not outside the realm of normalcy, when you recognize that the “average” largest, intra-year drawdown each year since 1990 clocks in at -14.7%. What does make this more disconcerting is the speed at which these drawdowns took place and the dramatic policy shifts that are causing the significant reaction. Importantly, there are a few other factors at work here than just the policy initiatives including: decimalization of stock pricing, computerized & algorithmic trading, and the proliferation of ETF & inverse ETF products are just a handful of capital market structural changes that have led to the speed of market moves.

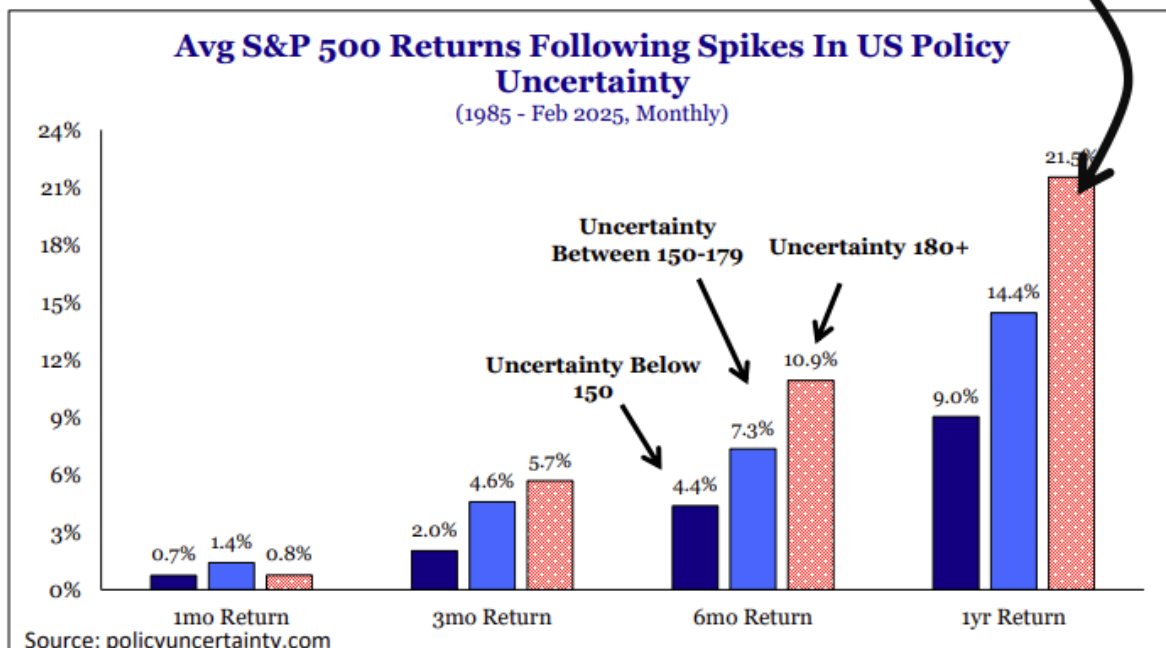
Despite this volatility, the key input for share price performance of equities remains unchanged. This is the quality, predictability, and growth of the earnings stream that the underlying company generates among other fundamental factors. It illustrates why stock selection and asset class diversification are still tenants that we as professionals, and every investor, should manage by. Naturally, the state and health of the U.S. economy is a significant contributor to earnings “generation,” so the concerns that these increased tariffs will negatively impact economic growth are valid. While an economic recession this year is not our base case, the odds have inevitably increased over the past few weeks. As such, it appears that both the fixed income and equity markets have priced in a mid-cycle slowdown / mild recession at current market levels.

Late this week (April 11th), first quarter corporate earnings season kicks off, starting with the large money-center banks and capital markets firms. We anticipate there will be plenty of discussion on the various earnings calls regarding tariff effects and forward guidance. This will paint a clearer picture of the growth consequences and capital allocation plans. It will help to remove some of the uncertainty that the markets dislike and may potentially calm some of the heightened volatility. While current growth forecasts for this year are still at high single-digit rates, we anticipate that these estimates will be guided down by the various company leaders over the coming weeks.

Furthermore, we anticipate that there will be an additional fiscal policy response from both Congress and the Federal Reserve to somewhat offset/sterilize some of the negative economic effects of the tariffs. First, the Tax Cuts and Jobs Act (TCJA) of 2017 is set to expire at the end of this year. We feel that it is important that Congress extend these tax reductions for the next 5 years. The urgency to get this done is now top of mind for those in Washington. Second, it is now apparent that short term policy rates (Fed Funds) are too restrictive given this change in narrative. We believe that the Federal Reserve will move the Fed Funds rate to a more “neutral” stance, which has historically been in the 3-3.5% range. This means four to five 25 basis point rate cuts are coming our way in the near term (through the course of this year).

While there are certainly a number of moving parts, there is a silver lining. Rebounds often accompany volatile trading days and there is also precedence for positive equity market performance after spikes in U.S. policy uncertainty. As the chart below indicates, both 6 month and 1 year forward returns are significantly better after the highest levels of policy uncertainty (10.9% and 21.5%, respectively). While the volatility is unnerving at present, history dictates that better times are likely ahead.

BIG SPIKES OF POLICY UNCERTAINTY USUALLY FORESHADOW STRONG EQUITY MARKET RETURNS



Bottom line, the first quarter did contain several negative surprises for markets, and the second quarter faces the uncertainty about trade policies and legitimate concerns about future economic growth. But there are also positive factors at work that must be considered, including a still-resilient economy and looming positive economic policies such as deregulation and potential tax cut extensions. So, despite depressed investor sentiment, the outlook for the economy and markets is not universally negative.

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SlateStone Wealth Management Investment Committee

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