



The S&P 500 continued its post-election rally until peaking mid-February as trade and policy uncertainties began to weigh on investor sentiment. Through the end of the quarter, equity indices corrected substantially from all-time highs. Notably, large tech stocks led declines as investors rotated from concentrated positions in the so-called Magnificent Seven stocks to mid-cap value stocks and European equities. Investors also sought protection from volatility in money market funds and gold. On a year-to-date basis, the S&P 500 posted a single-digit decline while the benchmark bond index provided moderate returns.

Historically, American trade policy limited the use of tariffs to ensure low prices on imported consumer goods. The Trump Administration's preference for tariffs represents a drastic policy shift away from post- Cold War global trade agreements. Some of the first quarter's volatility reflects investor adjustments to a new paradigm that establishes tariffs as a key component of economic and foreign policy. As the Trump Administration has demonstrated, tariffs provide effective leverage during negotiations. They are also a source of revenue that could offset, at least in part, anticipated tax cuts. Long term, tariffs could catalyze global trade rebalancing.

Economic data have been clouded by adjustments to anticipated tariffs. For instance, reports indicate importers accumulated excess inventory during Q4 2024 to lock-in costs prior to tariff effective dates. During Q1 2025, there was a "pay back" impact in certain sectors as importers drew down existing inventories. We expect Q2 GDP should benefit from inventory re-accumulation and advanced purchases of goods subject to tariffs. However, there is considerable uncertainty whether higher costs

will be absorbed by manufacturers or passed on to consumers. In addition, US tariffs could divert imported goods to other countries that could, in turn, impose their own tariffs. These are second and third order effects of a policy shift that add considerable uncertainty to the outlook. The full economic impact of new trade policy, therefore, lacks visibility.

Most economists believe the net impact of the new trade policy will be higher inflation. In an environment of cost increases, the Fed could face a dilemma to the extent their recalibration policy (i.e., lower rates) conflicts with generally higher inflation. Currency flows should provide insight as to near-term market impacts. The relative value of the Dollar, for example, should adjust to global trade and capital flows.

We believe investors will favor countries that engage in fiscal expansion over countries that contract fiscal support. At the same time, higher costs and policy uncertainties could contribute to a loss of confidence that manifests in reduced consumption. The combination of rising inflation and moderating growth has corresponded with a substantial increase in stagflation forecasts.

The US economy remains robust, with relatively low unemployment. Corporate and household balance sheets are strong, with stable credit trends. When uncertainty increases, we advocate a well-diversified strategy to offset short-term volatility. We maintain a long-term approach to asset allocation. More important, we caution against over-reacting to announcements and proposals. Instead, we emphasize objective, critical analysis. We look forward to discussing our outlook with you. Please contact the firm to schedule a meeting or video conference to review your accounts.