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Investment Perspective

First Quarter 2025

U.S. equity markets adopted a bearish tone with the S&P 500 Index and the Russell 2000 Value Index declining 4.27% and 7.74%, respectively. However, the MSCI ACWI ex-USA Index increased 5.23%. Equity markets were pressured by three factors: a declining liquidity environment, repatriation of capital by foreign investors, and the administration's focus on reducing the federal deficit with spending cuts and tariff revenues.

The liquidity environment should improve once the budget reconciliation process is complete, and the debt ceiling is increased. We expect foreign investors to continue to divest from U.S. markets as they focus on local investment initiatives that are being driven by domestic fiscal policy expansion and the rising risk of capital controls. The efforts to reign in excess U.S. deficits will continue to weigh on equity markets and earnings growth, until we reach a point of stable tax and trade policy and begin to see an increase in investment by the private sector. Therefore, we believe equity markets could remain volatile until late 2025 and will remain vigilant of rising risks in economic fundamentals.

The Bloomberg Aggregate Index advanced 2.78% for the quarter while the ICE BofA 1-10 Year AAA-A Municipal Index advanced 0.61%. During the quarter, the Federal Reserve paused cutting rates leaving the target rate at 4.50%. The Fed indicated that more cuts are likely, but it will be a meeting-by-meeting decision based upon the data. Currently, the market is pricing in three additional 25 basis point cuts, which would lower the target rate to 3.75%.

During the quarter, Treasuries on the intermediate and long end of the curve rallied as investors embraced the risk-off environment driven by tariff concerns and slower economic growth. Treasuries rallied at approximately 40 basis points along the intermediate portion of the curve and approximately 25 basis points on the long end.

Investment grade credit spreads widened 12 basis points during the quarter, ending at +89 basis points over Treasury yields. Credit spreads are likely to trade in a relatively tight range as growth and tariff risks are offset by strong demand for corporate bonds and potential "puts" by policymakers. With spreads still trading inside historical averages and with volatility levels low, we look to add to corporate bonds opportunistically in 2025.

There were no material changes to duration during the quarter. The news flow continues to change daily, resulting in increased headline-driven volatility in most major markets, which should create opportunities for patient investors.