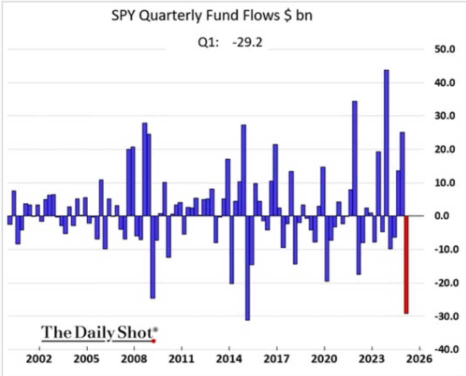
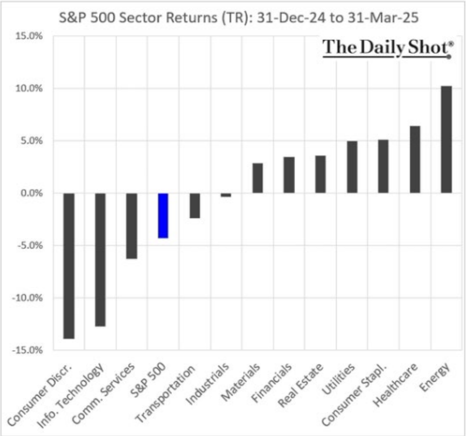
EQUITY MARKET UPDATE

As of 3/31/25 | Volume 14, Issue 3 | FFTAM.com

Markets were volatile in March as uncertainty surrounding new tariff policies and softening economic conditions caused stocks to decline for a second straight month. The epicenter of selling remained high-PE growth names. Meanwhile, the Fed continued to communicate that they are in no hurry to lower interest rates further, unless we see a deterioration in either the inflation or employment picture. Collectively, this signaled to investors that the market was ripe for a deeper pullback given the elevated valuations we have discussed for the past several months.



The S&P 500 lost 5.63%. Nine of the eleven economic sectors declined in value. The sell-off in big tech was harsh. Tesla, Amazon, Alphabet, NVIDIA, Broadcom, and Apple all lost between 8% and 15% in March. As we mentioned in the previous write-up, volatility has been very high. It has not been unusual for some of the largest and best capitalized companies in the world to swing 10% or more in a single trading session based on announcements from the White House. Year-to-date, the S&P 500 is down 4.28%. All sectors are in the green, except technology, communications, and consumer discretionary. Once again, the carnage has taken place inside of technology. The Mag 7 stocks were last year's darlings; however, in 2025, they account for all the losses. To put things in perspective, the index has fallen 4.28%, but it would be up 0.92% if you exclude the largest tech companies. This would lead you to believe that strategies with underweight tech positions would have been widely successful; however, the range in returns between the best and worst-performing stocks is over 70%—unusually high for just one quarter.



The Dow Jones Industrial Average fell 4.06%. Large declines in Goldman Sachs, Salesforce, and American Express weighed on results. Year-to-date, the Dow has been the best performer, down 0.87%. Less tech exposure, along with strong rallies from

Amgen, Visa, and Chevron positively impacted returns.

The NASDAQ plunged 8.14% in March. The index was the best performer the past two years, but it has struggled thus far in 2025. Fears about China gaining ground versus the US in artificial intelligence, along with elevated valuation and the apparent lack of interest rate cuts, have made this area of the market ripe for profit-taking. Year-to-date, the NASDAQ is down 10.26%.

Mid and small-sized stocks also suffered significant losses. The S&P 400 Mid Cap (-5.48%) and S&P 600 Small Cap (-6.15%) indexes fell on concerns that the furious pace of announcements from President Trump on a large assortment of issues is creating fear and confusion among business leaders and consumers that will negatively weigh on economic growth. With little movement on lower taxes and regulatory relief, along with interest rates remaining high, these stocks are down 6.11% and 8.94%, respectively, this year.

The US economy took a step backward in March with several key indicators suggesting the looming tariffs are creating paralysis among consumers and business leaders. Consumer spending is firm, but it is primarily coming from the highest income households. For months, many metrics have shown financial stress building among lower-income households, and recent consumer sentiment surveys indicate the potential for higher prices from tariffs has led to lower consumption from middle-income families too. Labor, which has been the bright spot for the past two years, appears to be returning to more normalized conditions. March payrolls showed that another 228,000 jobs were created. Unemployment ticked up to 4.2%. Wages were up 3.8% from one year ago, an amount that continues to exceed both the Fed's expectations and the pay raises seen pre-COVID. The labor market is tight, but competition to recruit and retain employees has obviously waned. The JOLTS report showed that there are 7.56 million jobs open but unfilled. There are currently 1.1 job openings for every unemployed person. This is below the levels seen pre-COVID, and it indicates that getting a new job is becoming harder for people on unemployment.

Consumer inflation continues to be stubborn, with prices increasing 2.8% from one year ago. Core inflation that removes food and energy softened to 3.1%. PCE data, the Fed's preferred measure of inflation, showed total prices climbing 2.5%, while prices ex-food and energy rose 2.8%. These statistics are much better than the high-water marks seen in 2022, and they are within reach of the Fed's 2% target. However, the pace of improvement has slowed dramatically the last several months. This is fueling a large debate among investors on how much room the Fed has left to lower interest rates, especially if the threatened tariffs push prices higher.

Despite wage growth and relatively low unemployment, clouds are forming over select segments of the consumer population. Personal income grew 0.8% in March. Total spending rose 0.4%, while retail sales gained 0.2%. The savings rate improved but remains below pre-COVID levels. Consumers have increasingly funded their expenditures with the use of debt. Credit card balances are at record amounts, and debt delinquency has climbed from one year ago in both credit cards and auto loans, especially among people with lower credit scores. Until President Trump provides greater details on his economic policies, monthly job reports and weekly unemployment claims are vital pieces of information to watch to gauge the strength of the consumer.

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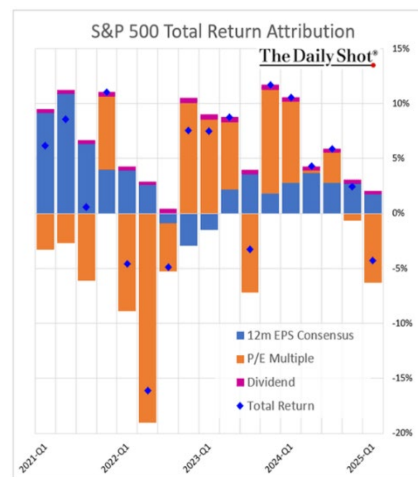
Business investment which appeared to be thawing took another step backwards in March. The ISM Manufacturing PMI Index was 49.0. This index has contracted 26 of the last 29 months, and it stopped its four-month streak of improvement. Employment data (44.7) contracted once again. Manufacturing jobs have fallen in 22 of the last 26 months, something that historically happens only during recessionary periods. New orders (45.2) plunged after expanding for three straight months. This provided skeptics with fuel that the previous three months of growth was due to businesses ordering products and components before the proposed tariffs from President Trump took effect. Unfortunately, prices paid (69.4) spiked to their highest level since June 2022, adding to fears that inflation from proposed tariffs could be bubbling. Services have been the engine powering the economy, but it too slowed significantly. The ISM Service PMI Index barely expanded with a reading of 50.8. Service employment (46.2) dropped significantly, which could spell trouble for future payroll releases. New orders (an indicator of future demand) softened to 50.4. Just like its manufacturing cousin, prices paid for services (60.9) was really hot.

Collectively, the data shows the Fed is winning the battle with inflation, although as stated above, the pace of improvement has waned. The FOMC held interest rates steady at 4.25% to 4.50%. Dot plots indicate the central bank believes rates will be between 3.50% and 3.75% by the end of 2025, implying rates will only be cut twice in 2025. The Fed appears to be entering a new wait-and-see phase given stubborn inflation and uncertainty surrounding President Trump's threatened use of tariffs against major trading partners.



The S&P 500 currently trades at 19.4x forward earnings estimates. This is down from 20.1x one year ago, and it is in line with the 5-year (19.9x) average, while still slightly above the 10-year (18.3x) level despite the higher interest rate environment. The equity risk premium that compensates investors for the excess risks associated with stocks compared to bonds remains thin, although it has improved with the sell-off of the past two months.

We are on the brink of another earnings season. Analysts are projecting profit growth of 7% from one year ago. If this comes to fruition, it will mark the seventh straight quarter of year-over-year earnings growth. Analysts remain bullish about the future. They are forecasting 2025 earnings growth of 11.3%, a downward adjustment from last month's 12.1% view given concerns about a slowing economy. With tariffs looming, investors will be paying close attention to CEO comments and whether companies need to guide future results lower.

With the market trading near valuations of the past decade, it is fair to say plenty of good news has come out of stocks the last two months. The S&P 500's return the past two years exceeded profit growth, resulting in back-to-back years of PE multiple expansion. This told us investors were fully convinced that inflation and interest rates would be coming down while overall demand for goods and services would remain intact (i.e., soft landing or "Goldilocks" scenario). This is not impossible, but it sets a very high hurdle for both the Fed and the market as President Trump embarks on a global trade fight with major economic partners.

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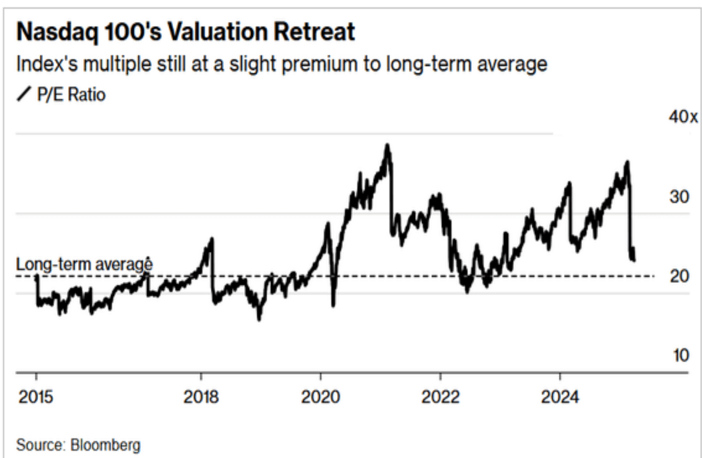
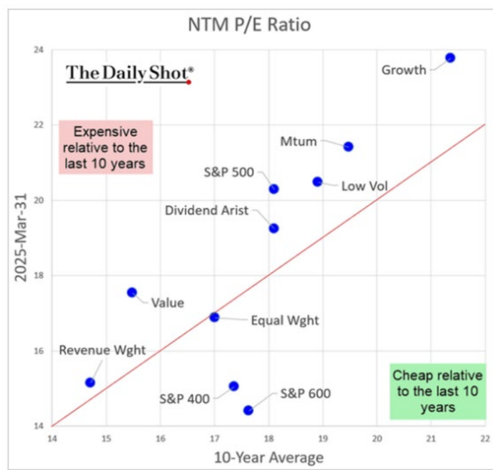
The sell-off over the past eight weeks has been very deep in some pockets of the market. Investors are taking chips off the table given the elevated valuation entering the year, along with the whirlwind of fiscal, tariff, and monetary policy announcements coming out of Washington DC. It appears there are simply too many items in motion for investors and business leaders to ascertain the end result. This has weighed on near-term sentiment for both investors and consumers as mentioned above. However, we believe the clouds hanging over the market will lift once Congress presents substantive facts regarding taxes and regulatory relief. Any announced trade agreements with major trading partners from the White House will also calm fears.

For months, we have written about the large difference in valuation between the big tech companies at the top of the index and everybody else. Currently, if you equal weight the names inside the S&P 500, the forward PE ratio drops from 19.4x to 16.7x. Although the margin remains wide, it has closed significantly in the past eight weeks. When you factor in future growth opportunities, several pockets within technology look attractive at current levels. Therefore, we have begun adding back the technology exposure we trimmed during the late summer and early fall. We also remain bullish on financials as they have also experienced a significant pullback. Defensive positions have outperformed so far in 2025, but they possess limited future growth potential. This makes these areas vulnerable should investor sentiment shift. Finally, our preference for quality companies with strong balance sheets and growing dividend streams to enhance performance remains strongly intact.





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