EQUITY MARKET UPDATE

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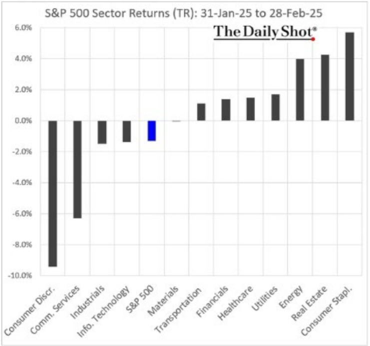
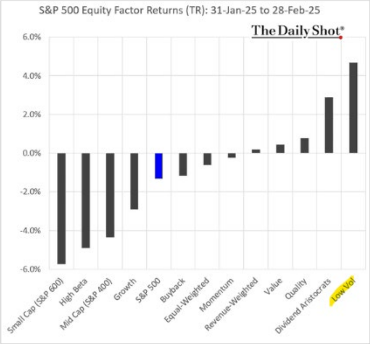
February was a difficult month for stocks. The results were terrible for high-PE growth names. Concerns about tariffs, along with softer economic data, led to investor angst about the vibrancy of the US economy. Meanwhile, the Fed continued to communicate that they are in no hurry to lower interest rates 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 pullback given the elevated valuations we have discussed for the past several months.



The S&P 500 lost 1.30%. Half the economic sectors declined in value. Although the index's monthly drop may seem mild, the sell-off in big tech was harsh. Tesla, Amazon, Alphabet, Microsoft, Broadcom, and Salesforce all lost between 4% and 28% in February. 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 up 1.44%. All sectors are in the green, except technology 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 are costing the index over 3% in performance. To put things in perspective, the index has gained 1.44%, but it would be up 4.46% 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 nearly 80%—unusually high for just two months.



The Dow Jones Industrial Average fell 1.39%. Large declines in United Healthcare, Amazon, Salesforce, and Caterpillar weighed on results. Year-to-date, the Dow has been the best performer, up 3.32%. Less tech exposure, along with strong rallies from Goldman Sachs, Amazon, and Visa, positively impacted returns.

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The NASDAQ dropped 3.91% in February. 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 2.31%.

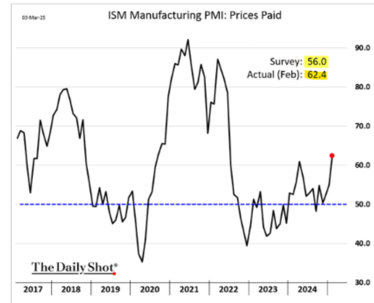
Mid and small-sized stocks were the losers last month among broad-based indexes. The S&P 400 Mid Cap (-4.35%) and S&P 600 Small Cap (-5.72%) indexes fell on concerns that the furious pace of announcements from President Trump on a large assortment of issues is creating fear and confusion among business 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 0.67% and 2.98%, respectively, this year.

The US economy is on solid footing; however, several key indicators suggest there might be some underlying weakness brewing. Consumer spending is strong, 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. February payrolls showed that another 151,000 jobs were created. Unemployment ticked up to 4.1%. Wages were up 4.0% 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 7.6 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 3.0% from one year ago. Core inflation that removes food and energy ticked up to 3.3%. PCE data, the Fed's preferred measure of inflation, showed total prices climbing 2.5%, while prices ex-food and energy rose 2.6%. 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.

Despite wage growth and relatively low unemployment, clouds are forming over select segments of the consumer population. Personal income grew 0.9% in February. Total spending fell 0.2%, while retail sales dropped 0.9%. The savings rate 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.

Business investment which appeared to be thawing took a step backwards in February. The ISM Manufacturing PMI Index was 50.3. This index has fallen in 25 of the last 28 months, but this was the fourth straight month of improvement. Employment



data (47.6) contracted once again after rising in January for the first time since September 2022. Manufacturing jobs have fallen in 21 of the last 25 months, something that historically happens only during recessionary periods. New orders (48.6) also declined after expanding for three straight months. This provides context to investors wondering if 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 (62.4) was the sole reason for the positive composite number. This was the hottest number for prices since June 2022, adding to fears that inflation from proposed tariffs could be bubbling. Services have been the engine powering the economy. The ISM Service PMI Index rose to 53.5 from 52.8 the previous month. Service employment (53.9) signals labor needs are still strong. New orders (an indicator of future demand) increased to 52.2. Just like its manufacturing cousin, prices paid for services (62.6) 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 21.2x forward earnings estimates. This is up from 20.1x one year ago, and it is above both the 5-year (19.8x) and 10-year (18.3x) averages 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.

We are close to wrapping up earnings season. Over 97% of companies have reported results. Year-over-profits are up 18.2%, the highest mark since the 4th quarter of 2021. This is much better than the consensus forecast of 11.9% at the start of the year. Analysts are bullish about the future. They are forecasting 2025 earnings growth of 12.1%, a downward adjustment from last month's 14.2% view given weaker than expected forward guidance by numerous companies.

With the market trading at higher valuations than the past decade, it is fair to say plenty of good news has been priced into stocks. The S&P 500's return the past two years has 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.

The sell-off over the past six 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.

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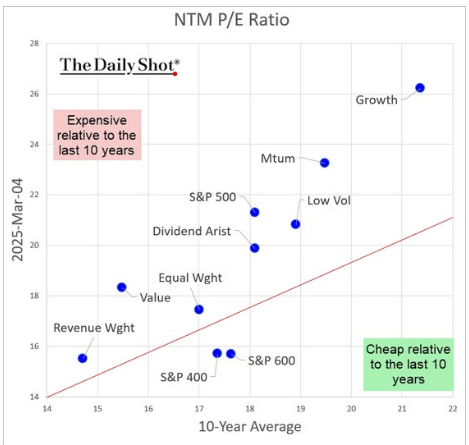
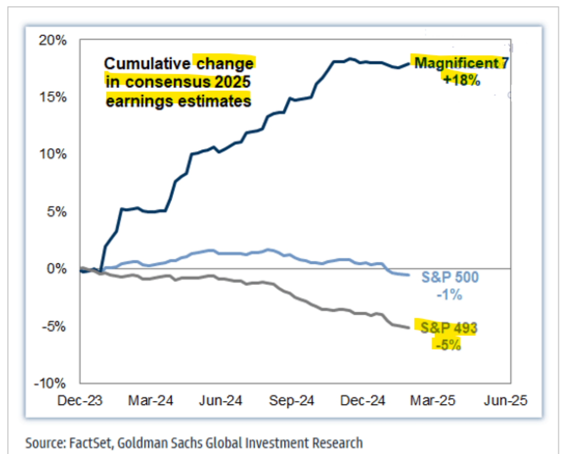
For months, we have written about the large difference in valuation between the big tech companies at the top of the index and everybody else. Currently, if you equal weight the names inside the S&P 500, the forward PE ratio drops from 21.2x to 17.9x. Although the margin remains wide, it has closed significantly in the past six 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 remain bullish on financials, and we have added to our positions in banks and asset managers during the pullback as well. These trades are being funded by reducing our allocation to real estate, consumer staples, and other defensive positions that have outperformed so far in 2025 but possess limited future growth potential. Finally, our preference for quality companies with strong balance sheets and growing dividend streams to enhance performance remains strongly intact.





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