

FROM THE OFFICE OF THE CIO

Quarterly Market Commentary

1Q 2025 Review

KEY TAKEAWAYS

- ♦ U.S. equity market volatility increased and major U.S. indices posted negative returns, as investors reacted to tariff policy out of Washington. Value-oriented sectors outperformed growth across market capitalizations.
- ♦ U.S. fixed income prices moved higher as interest rates fell. The U.S. Aggregate Index posted positive total returns, led by long duration U.S. Treasuries and high-quality corporate debt.
- ♦ International developed equity markets led global indices higher as European equities outperformed. Emerging markets were also generally higher as equity markets of several countries generated strong positive returns. A weaker U.S. dollar contributed to international performance.
- ♦ Major commodity indices finished higher as gold and natural gas prices rallied. Real assets, including infrastructure and select real estate assets, also posted positive returns.

Overview

Coming into the new year, there was a strong consensus that the prolonged period of U.S. economic expansion and market exceptionalism would continue. Expectations were that President Trump's administration would follow the playbook from his first term — tax cuts, tariffs, deregulation and U.S. protectionist policies — creating a pro-growth environment, supporting above-trend economic output, equity market outperformance and a stronger U.S. dollar. In hindsight, the markets overpriced these expectations. Additionally, one of the key themes that emerged

in the first quarter was fading U.S. exceptionalism. Policy uncertainty, mainly around the effects of tariffs, began to negatively impact investors as major U.S. equity indices fell while international markets generally rose alongside U.S. fixed income and most commodity indices.

The conflict between perception and economic reality took center stage during the first quarter of 2025, creating a sense of uncertainty among investors. Talk around tariffs and federal spending cuts took a toll on the mindset of consumers and businesses, leading to increased market

volatility. Consumers became more pessimistic about future business conditions and less optimistic about future income and employment prospects. Several businesses indicated curtailed spending and hiring, which is expected to negatively impact gross domestic product (GDP) in the near term. Investor sentiment waned, as major U.S. stock market indices quickly dipped into correction territory during the quarter after setting record highs just a few weeks earlier.

As of this writing, trade wars show no sign of ending, and near-term expectations for U.S. economic growth and inflation weigh on investors. Cutbacks in the federal workforce have made for attention-grabbing headlines and have been polarizing from a political standpoint. It is unclear when tariffs and federal cutbacks will fully take effect and what their ultimate economic impact will be. However, uncertainty has already affected consumer and business behavior. It is difficult to see how recent events will not lead to a slowdown in the economy.

We anticipate that the U.S. growth rate will moderate to below-trend but avoid a contraction in the near term. Markets are moving quickly to price in the risk of a recession and negative impact of tariffs, as the shadow cast by uncertainty looms large. Accordingly, we expect bouts of continued volatility as policy responses take shape. Though painful at the moment, quarters like this remind us of the importance of diversification and how managing a long-term asset allocation can successfully navigate challenging environments.

Fixed income

In the face of heightened risks to its dual mandate of promoting maximum employment and stable prices, the Federal Reserve kept interest rate policy unchanged at its January and March meetings. The decision to leave the fed funds target rate unchanged at the range of 4.25% to 4.50%, where it has been since December 2024, had been the consensus of market participants, however investors paid close attention to commentary from Fed officials on how tariffs, immigration, and tax policy could potentially sway future decisions on monetary policy. The primary challenge now is predict-

Figure 1: FOMC Summary of Economic Projections – March 2025

Variable	Median			
	2025	2026	2027	Longer Run
Change in real GDP	1.7	1.8	1.8	1.8
December projection	2.1	2.0	1.9	1.8
Unemployment rate	4.4	4.3	4.3	4.2
December projection	4.3	4.3	4.3	4.2
PCE inflation	2.7	2.2	2.0	2.0
December projection	2.5	2.1	2.0	2.0
Core PCE inflation	2.8	2.2	2.0	
December projection	2.5	2.2	2.0	
Federal funds rate	3.9	3.4	3.1	3.0
December projection	3.9	3.4	3.1	3.0

Source: Federal Reserve

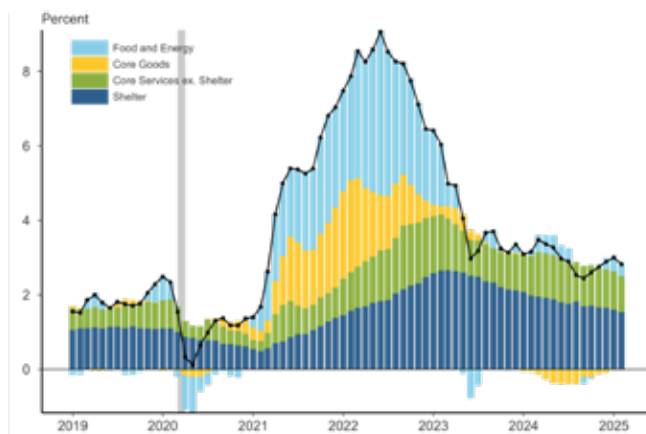
ing how the Fed will respond to tariff policy in an environment of elevated inflation with below-trend growth.

The Fed's updated Summary of Economic Projections (Figure 1), released after its March meeting, provided some insight into the committee's views on key economic data and interest rates. Updated projections showed lower growth across the board for the next three years, with inflation ticking slightly higher over the next two years. Against those crosscurrents, the Fed continued to signal two rate cuts in 2025 of 25 basis points each (bps), which would bring the fed funds rate down to a range of 3.75% to 4.00%.

In his latest post-meeting press conference, Fed Chair Powell acknowledged that tariffs have contributed to the Fed's higher inflation projections, which may delay progress toward its 2% inflation target, however he noted that any increase in inflation would be short-term and transitory in nature. Taking a closer look at inflation data, significant progress has been made in bringing it down from the 2022 peak, but overcoming the final hurdle has been challenging. As shown in Figure 2 (see next page), the biggest contributors to inflation continue to be shelter and core services. Upward pressure on inflation from core goods, food, and energy have largely dissipated as consumers ex-

hausted fiscal stimulus and supply chain disruptions were largely corrected. As we have communicated previously, one of the biggest reasons for increased pessimism about future economic conditions is inflation expectations. Recent survey data from the University of Michigan and the Conference Board indicate an increase in inflation expectations due to tariffs, particularly around the cost of core goods, food, and energy. We are closely monitoring these trends, as well as how a stretched consumer navigates this environment as these are the significant components in shaping our forward-looking investment outlook and portfolio positioning.

Figure 2: Contributions to Consumer Price Index Inflation (year-over-year, not seasonally adjusted)



Source: Federal Reserve Bank of San Francisco

Fixed income markets responded favorably to the Fed's wait-and-see position. Following a challenging fourth quarter, the Bloomberg U.S. Aggregate Bond Index delivered a 2.78% total return in the first quarter. While the fourth quarter saw U.S. Treasury yields move higher in response to a diminishing outlook for monetary easing and expectations of the new White House administration's pro-growth policies, the direction of yields reversed course in the first quarter, sparked by tariff policy uncertainty and U.S. equity market volatility. The Bloomberg U.S. Treasury Index returned 2.92% as yields fell across the curve, with longer duration being a key contributor to returns. On a related theme, the Bloomberg U.S. TIPS Index advanced 4.17% as U.S. Treasury Inflation-Protected

Securities (TIPS) rallied as well and outperformed nominal Treasuries due to increasing inflation expectations during the quarter (See Figure 3).

Municipal bonds continued to demonstrate lower sensitivity to the movements of the Treasury market. After outperforming Treasuries in the fourth quarter, municipal bonds underperformed Treasuries by 222 bps in the first quarter. The Bloomberg Municipal 1-10 Year Index returned 0.70% as interest rate volatility, seasonally higher-than-expected new issue flow, tariff discussions, and concerns over potential changes to the tax-exempt status of state and local debt eroded support during the latter half of the quarter. Market uneasiness may linger as these headwinds remain amidst significant unknowns regarding potential changes to tax policy.

Figure 3: Fixed Income Market Performance

Index	Total Return Q1 2025	Total Return Trailing 1 Year
Bloomberg U.S. Aggregate Bond Index	2.78%	4.88%
Bloomberg Municipal 1-10Y Blend 1-12Y Index	0.70%	1.99%
Bloomberg U.S. Treasury Index (1972)	2.92%	4.51%
Bloomberg U.S. Treasury US TIPS Index	4.17%	6.17%
Bloomberg U.S. Corporate Bond Index	2.31%	4.90%
Bloomberg High Yield Corporate Index	1.00%	7.69%

Source: Morningstar, data as of March 31, 2025; Total Return Index

The U.S. corporate credit sector delivered positive results as the Bloomberg U.S. Corporate Bond Index returned 2.31%. Investment-grade corporates lagged U.S. Treasuries as credit markets didn't benefit from the flight to quality offered by government debt and credit spreads widened slightly during the final weeks of the quarter. Higher-quality corporates outperformed high-yield bonds and leveraged loans as they benefited from a longer duration profile. Still, both the Bloomberg U.S. Corporate High Yield Index

advanced 1.00% and the Morningstar LSTA U.S. Leveraged Loan Index advanced 0.48% for the quarter.

Despite geopolitical uncertainty, foreign debt markets delivered strong returns in the first quarter, benefiting central bank easing and a softening U.S. dollar. The FTSE World Government Bond Index non-USD advanced 2.33%.

Equities

Following two consecutive years of strong gains, U.S. equity investors entered 2025 with questions about the sustainability of this momentum. Despite early strength in the quarter, sentiment shifted to a fearful risk-off position as concerns about consumer health and trade tensions overwhelmed U.S. equity markets, leading to weakness in the month of March.

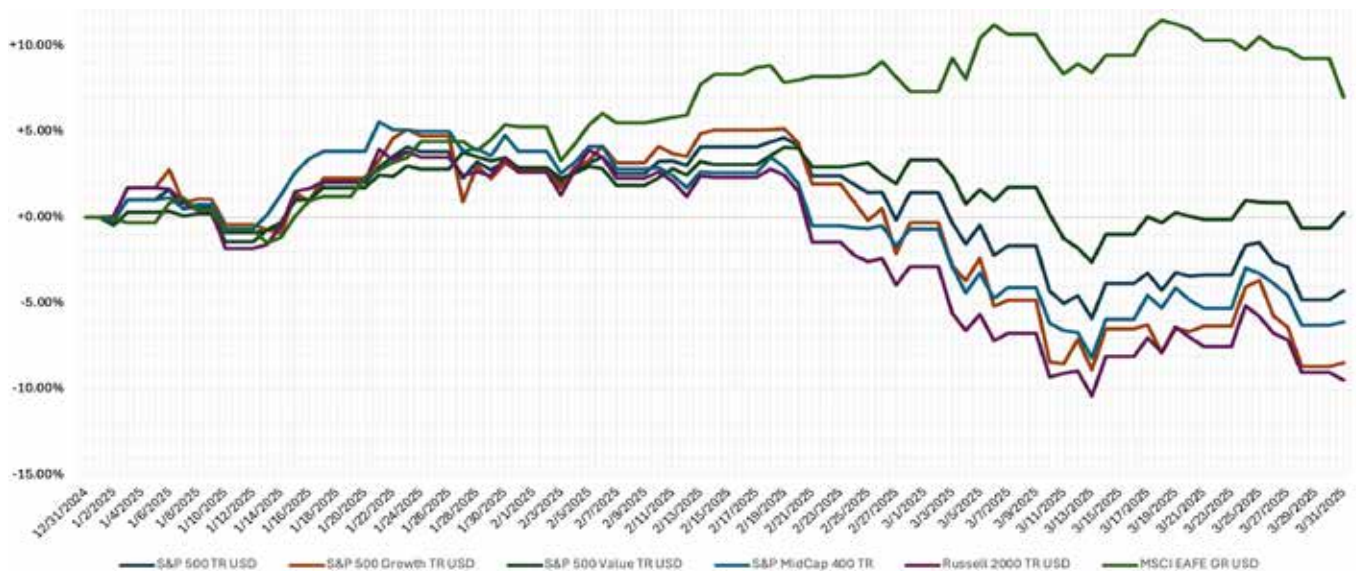
The first quarter of 2025 delivered a choppy ride for U.S. equities, with large-cap, mid-cap, and small-cap stocks each navigating unique pressures and opportunities. The market cadence followed a clear pattern: January-optimism, February-revaluation and March-recalibration.

The S&P 500 started the quarter strong, fueled by enthusiasm over potential tax cuts and deregulation from the

new administration with investors embracing a risk-on sentiment that pushed the index to record highs. Sentiment shifted in late January when Deepseek, a Chinese AI startup, introduced advanced capabilities at significantly lower costs. This move sparked fears of competitive disruption in the U.S. tech sector, which had gained 36.6% in 2024 and was now on fragile footing amidst high valuations. The remaining enthusiasm gave way to caution in early February, as market volatility surged following proposed tariffs targeting key trade partners. Recession fears rose as U.S. consumer sentiment plunged to its lowest level in years. This shift triggered a market sell-off, with large-cap stocks falling more than 10% from the February highs. Despite the correction in U.S. equities, the broader equity landscape remained underpinned by stable corporate fundamentals and a resilient labor market.

Market performance in the first quarter can be divided into two phases: The first half was a continuation of a very strong 2024 and risk-on sentiment, while the back half was risk-off, driven by fear and uncertainty. U.S. equities saw the higher-quality large-cap stock cohort decline the least as investors positioned for economic turbulence. (See Figure 4.) The S&P 500 posted a negative return of 4.27% for the quarter. The growth stock outperformance of 2024 reversed

Figure 4: U.S. Equity Performance (Q1 2025)



Source: Morningstar as of March 31, 2025

Figure 5: U.S. Equity Market Performance

Index	Total Return Q1 2025	Total Return Trailing 1 Year
S&P 500 Index	-4.27%	8.25%
S&P 500 Value Index	0.28%	4.21%
S&P 500 Growth Index	-8.47%	10.46%
Russell 2000 Index	-9.48%	-4.01%
Russell 2000 Value Index	-7.74%	-3.12%
Russell 2000 Growth Index	-11.12%	-4.86%

Source: Morningstar as of March 31, 2025; Total Return Index

as the S&P 500 Value Index outpaced the S&P 500 Growth Index by 8.75%. At the sector level, energy was the standout, up 10.21%, while health care also performed well, up 6.54%. Meanwhile, the information technology and consumer discretionary sectors were the laggards by a wide margin, down 12.65% and 13.80%, respectively. Mid-cap equities (S&P 400 Index) posted a 6.10% decline. Small-cap equities (Russell 2000 Index) recorded a 9.48% drawdown (Figure 5). Valuation multiples have been reduced as price declines were largely driven by uncertainty and fear, rather than declines in earnings. As of this writing, large-cap equities were trading at a forward price-to-earnings ratio (P/E) of 20.1 compared to a 15.9 for its 20-year historical average. U.S. mid-cap equities are trading at a P/E of 16.7 and U.S. small-cap equities at 22.6 compared with their 20-year averages of 16.4 and 21.6, respectively.

Despite the economic uncertainty, earnings remained a bright spot. Q4 2024 S&P 500 earnings rose 18.3%, beating forecasts of 14.0% while revenue grew 5.3%. This marked the sixth consecutive quarter of bottom-line growth and the 17th consecutive quarter of revenue growth for the index. Looking ahead to Q1 2025 results as of this writing, analysts project 7.1% earnings-per-share (EPS) growth on 4.2% revenue growth. Projections for full-year 2025 remain strong for large-cap equities, with analysts anticipating 11.7% EPS growth on 5.3% revenue growth, including quarterly EPS growth of 9.2% in Q2 and 11-12% in Q3 and Q4. At the index level, small-cap (S&P 600) is expected to grow earnings at 13.3% in 2025, while mid-cap (S&P 400) is expected to grow

earnings at 8%. We note that earnings estimates continue to be revised downward since the start of the year.

Looking ahead, investors are desperate for stability and clarity from the administration on tariff policy as the fog of uncertainty impacts financial decisions for corporations and consumers alike. As the first half of the year unfolds, volatility and noise are likely to provide patient, disciplined, and longer-term investors opportunities to buy solid companies at attractive levels.

International developed markets

Despite ongoing uncertainties surrounding trade and inflation, the first quarter signaled a potential turning point for international developed equities. Europe's fiscal stimulus tailwinds and Japan's monetary discipline, coupled with favorable earnings dynamics, have supported the region's strong relative performance. Amid fluctuating U.S. policies and concentrated market leadership, developed international markets have rekindled investor interest and underscored the importance of diversification when building equity portfolios.

International developed equities experienced solid gains to start the year, significantly outperforming U.S. markets despite ongoing macroeconomic uncertainties. The MSCI EAFE Index (gross) increased by 7.01% in the first quarter (Figure 6), establishing new all-time highs in the process. The asset class delivered steady gains throughout the quarter, avoiding the large drawdowns that impacted other regions. Performance was fueled by a combination of strong corporate earnings, a

Figure 6: International Equity Market Performance

Index	Total Return Q1 2025	Total Return Trailing 1 Year
MSCI EAFE USD	7.01%	5.41%
MSCI Europe USD	10.64%	7.53%
MSCI Japan USD	0.50%	-1.74%
MSCI United Kingdom USD	9.70%	14.43%
MSCI China USD	15.06%	40.79%
MSCI Emerging Markets USD	3.01%	8.65%

Source: Morningstar as of March 31, 2025; all data shown as gross returns

steady stream of improving economic data, and accommodative policies in Europe and Japan. Currency movements also contributed, with a strong euro further adding to returns for U.S.-based investors. While global volatility remained elevated, more attractive relative valuations and region-specific policies reignited investor interest in non-U.S. markets.

European equities opened the year with renewed strength, driven by improving sentiment surrounding Germany's long-term infrastructure and defense stimulus program. The S&P Global Eurozone Composite PMI returned to expansionary territory after nearly a year of contraction. Services remained robust, driven by tourism, business spending and financial services. Manufacturing showed signs of recovery, helped by a surge in exports to China, and is expected to recover further with additional fiscal spending. Inflation remained contained, prompting the European Central Bank to cut rates by 25 bps in March. Policymakers stressed caution regarding fiscal spending and trade disruptions, indicating the potential for fewer rate cuts in the near term.

In Japan, equities posted modest gains supported by stable macroeconomic data, earnings resilience and continued capital flows. Japan's benchmark index, Nikkei 225, climbed to new heights, finally surpassing its previous record level established in 1989. Investor confidence in Japan was further bolstered by a positive earnings season and corporate governance reform leading to higher returns of capital to shareholders. The Bank of Japan raised policy rates to 0.5% in January while signaling a tightening bias due to rising wage growth and inflation data that continued to exceed expectations. With policy normalization expected to be gradual, Japan stands out as a bright spot within the developed market landscape, attracting attention from global investors seeking stability amid broader uncertainty.

Emerging markets

Emerging market equities began 2025 on a stronger note, experiencing a steady rebound after a tumultuous end to the prior year. The MSCI EM Index (gross) increased by 3.01% in the first quarter, outperforming U.S. large-cap stocks but trailing developed international peers. After months of disruption, capital flows began to recover for the region, sup-

ported by a more balanced monetary policy outlook and a gradual improvement in risk appetite. Softer inflation in several key economies also gave central banks flexibility to shift toward easing. Geopolitical uncertainty, especially regarding U.S. tariff policy and its effects on global trade, remained a persistent overhang and constrained returns.

Performance dispersion across regions and sectors was notable, highlighting the uneven pace of recovery within emerging markets. China led the advance, driven by additional policy support designed to stimulate growth and restore investor confidence. Coordinated monetary and fiscal stimulus measures, including rate cuts, liquidity injections, and lower taxes, contributed to improvements in economic data. Several economic indicators, including retail sales, industrial production and exports, exceeded expectations during the quarter. Reforms aimed at stabilizing the real estate sector have reduced systemic risks, which had been a key drag on China's growth over the past two years. The government's pivot in tech policy — from crackdown to strategic pillar of innovation and economic growth — contributed to sizeable gains among large-cap technology stocks.

By contrast, India was a notable laggard after having experienced robust performance over the past several years that pushed P/E multiples to elevated levels. Foreign investors rotated out of India into other emerging market countries with cheaper valuations, where policy support and earnings were accelerating. Uncertainty surrounding India's general elections in May 2024 also contributed to near-term caution, although Prime Minister Modi's party is favored to retain power. Despite the short-term underperformance, India's macroeconomic backdrop remains fundamentally sound, with strong GDP growth, receding inflation, and healthy consumer spending. The pullback appears to be largely valuation-driven rather than a shift in the long-term trajectory for the country.

Looking ahead, the outlook for emerging markets is cautiously constructive. While numerous risks remain, including global growth divergence, lingering inflation, and trade policy uncertainty, selected economies are showing improved fundamentals and increasing investor interest.

China's gradual stabilization and dovish signals from key EM central banks provide a more favorable backdrop. With valuations still attractive and capital flows turning positive, emerging markets may continue to benefit from the gradual rebalancing of global portfolios in the quarters ahead.

Real Estate

The FTSE Nareit All Equity REITs Index posted a total return of 2.75% in the first quarter, outperforming the broader U.S. equity market. (See Figure 7.) The modestly positive gain for REITs can be attributed to a combination of low interest rates, stronger-than-anticipated corporate earnings results for REITs, and a rotation out of U.S. mega-cap tech names that have dominated over the last few years.

Underlying property sector returns were mixed in the first quarter, with eight of the twelve REIT sectors posting gains. Infrastructure, health care, and diversified were the best-performing REIT sectors, while lodging/resorts, data centers, and specialty were the laggards.

It is worth noting that data centers, which had been one of the best-performing REIT sectors over the last five years, declined 15.21% in the first quarter. Data center REIT returns were negatively impacted by the release of a new open-source AI model from Chinese research lab DeepSeek, with markets grappling with how a potential reduction in computing capacity needed for AI would impact the need and potential growth of data centers. We continue to watch this segment of the REIT market carefully as it is a harbinger of the health of the AI trade.

Figure 7: Public Real Estate & Commodity Performance

Index	Total Return Q1 2025	Total Return Trailing 1 Year
FTSE Nareit All Equity REITs TR USD	2.75%	9.23%
Bloomberg Commodity TR USD	8.88%	12.28%

Source: Morningstar direct, all data as of March 31, 2025

Commodities

The Bloomberg Commodity Index posted a total return of 8.88% in the first quarter, besting the returns of several global equity and fixed income indices. Despite growing

uncertainty about how tariffs would impact global trade and economic growth, commodities generated a strong return as a weaker U.S. dollar, falling real yields, and weather-related factors provided a tailwind. Commodity sector returns were mostly positive, with five of six sectors advancing. Led by a 19% increase in the price of gold, which continued to post record highs, precious metals and energy were the best-performing commodity sectors, while agriculture was the one negative-performing commodity.

Crude oil prices fluctuated throughout the first quarter and finished relatively flat as markets grappled with geopolitical issues, tariff uncertainty and supply-demand outlook. Natural gas prices surged, with the index up 33% in the first quarter due to increased demand from a colder-than-expected winter season and falling inventories.

Private markets

Many private equity investors entered 2025 expecting a great resurgence in deal activity, anticipating a strong macro environment and merger-friendly regulatory regime. This proved to be too optimistic in the first quarter as private market transactions were up only modestly over 2024 levels, held back by a falling U.S. stock market and policy uncertainty. The tepid exit environment via the initial public offering market is expected to rein in near-term upside. In general, though, private equity returns are not expected to reflect short-term fluctuations of public equity markets and may buffer portfolios when public markets are volatile (Pitchbook Private Equity Index: +11.6% trailing one-year return as of 9/30/24). We believe that the current environment may provide tailwinds for continued growth of secondary private equity strategies, which serve as sources of liquidity for private markets when traditional exits are deferred (Figure 8).

Figure 8: Private Capital Indexes annualized returns

Index	1-year	5-year	10-year	15-year
Private equity	11.6%	17.0%	15.3%	15.4%
Secondaries	3.6%	12.8%	12.4%	13.3%
Private debt	8.7%	8.4%	7.5%	9.4%

Source: Pitchbook. Data as of September 30, 2024.

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