Q1 2025
SECURITIES MARKET NEWSLETTER

FLETCHER
FINANCIAL GROUP

Tariff uncertainty drags stocks down to start the year.

The stock market despises uncertainty. This was the story of the first quarter of 2025, which ended up being the worst quarter for stocks in over two years. Markets coming into the year were anxious but optimistic as the presidency changed hands from Joe Biden back to Donald Trump. The question on many minds was which policies President Trump would prioritize right out of the gate; would he take advantage of Republican control of Congress to tackle tax cuts first, or would he resume the tariffs and trade war he started the last two years of his first term? The new president wasted no time in letting the world know that tariffs would be his primary focus as he kicked off his second non-consecutive term (the only other president beside Grover Cleveland to stage such a comeback).

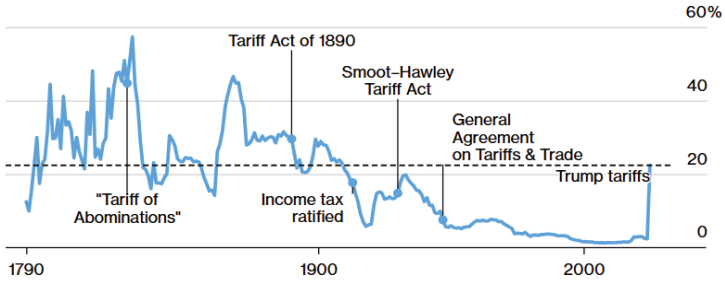
Index	Q1 2024
World ex-United States	6.3%
Aggregate Bond	2.8%
Vanguard Balanced	0.2%
Dow Industrials	-0.8%
S&P 500 Equal Weight	-1%
S&P 500	-4.3%
Russell 2000 Small Cap	-9.8%
Nasdaq Composite	-10.4%

The prospect of a global trade war became the dominant market narrative for much of the first quarter. It rattled markets and sent stocks tumbling to their first correction (a loss of over 10% from a recent peak) since 2023.

Tariffs are top-of-mind, but all the other market-moving topics persist as lingering uncertainties. Inflation remains stubborn and slow to recede back to normal levels. The Federal Reserve is therefore being cautious about cutting interest rates again. At the same time, economic growth is slowing which is leading to an increased threat of recession and the dreaded stagflation (a high inflation, low growth economy). Companies are navigating the uncertain economic environment well and have begun slightly lowering their future earnings estimates. Earnings growth is easing, but expectations are still for double-digit gains for 2025. The stock market has been shocked to the edge of a bear market because tariffs have the potential to negatively affect all of the above.

The key word here being "potential" because there are so many unknowns. Nobody alive today has seen tariff rates as high as President Trump has put forward. The United States last saw a higher effective tariff rate back in 1909.

Effective Tariff Rate
Highest Since 1909



Source: Budget Lab at Yale, US Census Bureau, US Treasury
Note: As of April 2 announcement

The president's use of tariffs as a negotiating tool—he paused most tariffs for 90 days as of this writing—adds to the sense of uncertainty. The stock market is having a hard time pricing in the tariff scenario because we have no historical parallels to look back and learn from.

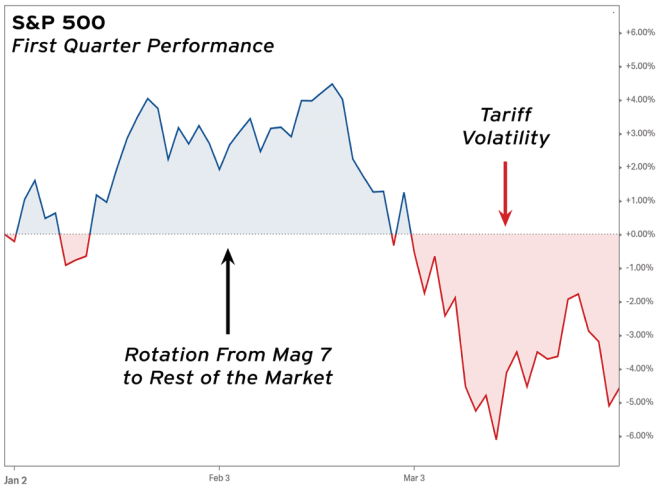
As always with the stock market, uncertainty means volatility. An uncertain economic future means lots of stock market movement with no meaningful trend. With policy changes as significant and immediate as we have seen fewer than 100 days into President Trump's term, it makes sense that we are going through a choppy period of market adjustment. But that doesn't

make it any less stressful. A volatile stock market is irrational. Daily market moves are emotional, impulsive reactions to the relentless newsfeed.

Going forward we will maintain a strategy of cautious patience. The economy is slowing but still growing, and the 90-day pause gives us confidence that tariffs are a negotiating tool for Trump and his team. Inflation is slowly cooling and the Federal Reserve's next move, whenever it happens, will be to cut interest rates to help ease financial conditions (lower borrowing costs stimulate businesses and consumers to invest and spend more). That said, the market's focus and day-to-day reactions will continue to be on the trade war until some sense of stability and certainty is restored.

QUARTERLY ROUNDUP

The first quarter of 2025 can be divided into two halves: before tariffs and after tariffs. It is important to note that even before tariffs dominated the news cycle the stock market was already going through a meaningful corrective rotation. The artificial intelligence ("AI") trade that had captured the stock market spotlight for the last two years paused and began to unwind in the weeks ahead of the tariff announcements. This was a rational market reaction to a trade that had risen very far very fast. Markets took a break from the AI trade to take profits and assess the trajectory of a technology in its infancy.



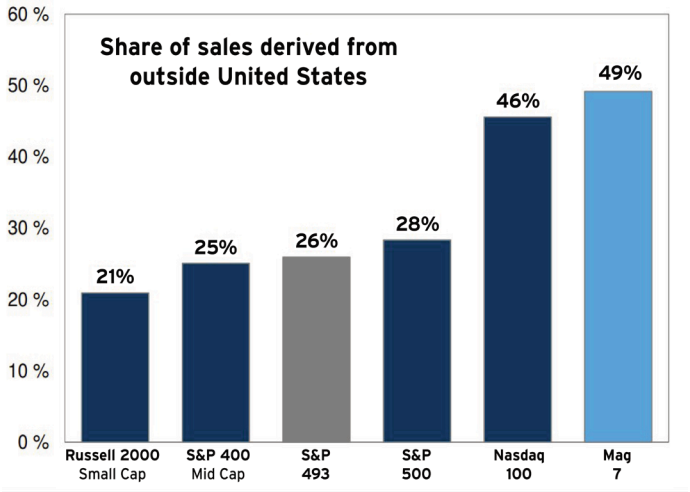
The AI trade "unwind" was intensified by the surprise release of the Chinese AI model DeepSeek. DeepSeek appears to show that AI computing at higher levels can be accomplished with less upfront investment and without the latest, most powerful chips. Richly valued AI beneficiary company stocks got a haircut the Monday following DeepSeek's release. The American chipmaker Nvidia lost half-a-trillion dollars in market capitalization in a single day.

From January through February the only sectors of the stock market with material losses were predominantly Magnificent 7-related. The Magnificent 7 are tech and tech-adjacent stocks that were key to the AI trade. The seven companies are Amazon, Apple, Google, Meta, Microsoft, Nvidia, and Tesla.

Stock market leadership rotations are signs of a normal and healthy functioning market. This is what we saw the first two months of the year: it was a reasonable rotation into other unloved areas of the market. Durable market rallies are built on a wider range of stocks advancing together. In addition to easing off the AI trade, investors were (1) shedding risk by going into defensive stocks (think consumer products and utilities), and (2) showing confidence in the economic outlook by getting into financial sector stocks. The financial sector of the market hit a fresh all-time high in mid-February. This was a testament to the persistent strength of the underlying economy. Financial stocks rise and fall with the economic cycle, so the fact that they were able to reach new highs reflects broad investor confidence in the continued strength and growth of our domestic economy.

And then came the tariffs. On the first business day of March President Trump, utilizing emergency economic powers granted to him by law, instituted tariffs of 25% on two of our largest trade partners and neighbors, Canada

and Mexico. From here the stock market reacted emotionally to every breaking news item and Trump "Truth." March clocked the S&P500's worst monthly performance since September 2022. Stocks fell for five of the last six week of the first quarter. For the first time in two years, the S&P500 fell into a correction—off –10% from its new all-time high reached as recently as February 19th. The Magnificent 7 and tech sector stocks saw their unwind accelerate with the president's follow through on tariffs because they generate half of their sales overseas:

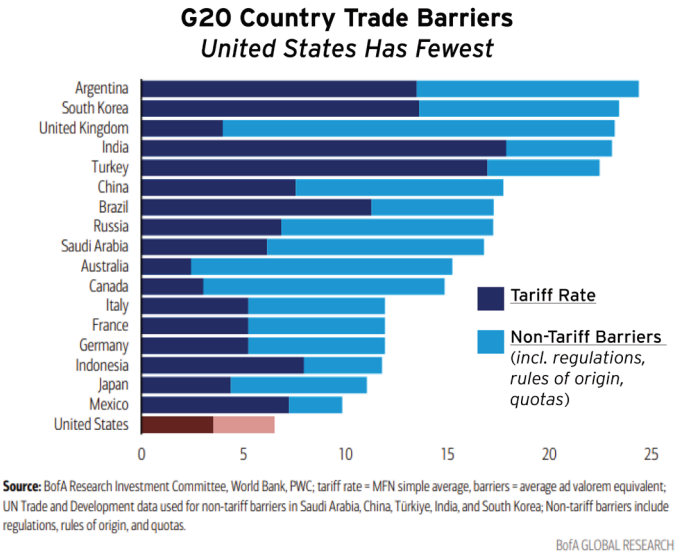


Source: Goldman Sachs Global Investment Research

Due to the massive sizes of these mega tech companies—remember that the Mag 7 stocks alone make up over 30% of the S&P500 index—their losses have an outsize impact on the stock market as a whole. We note that without the Magnificent 7 having fallen into a bear market (off –20% from their December peak) the S&P's quarterly loss would have been a gain of half a percent.

THE ROAD AHEAD

On what was coined "Liberation Day" by the administration, President Trump announced global reciprocal tariffs meant to respond in-kind to the trade barriers set up against the United States (see the next chart).

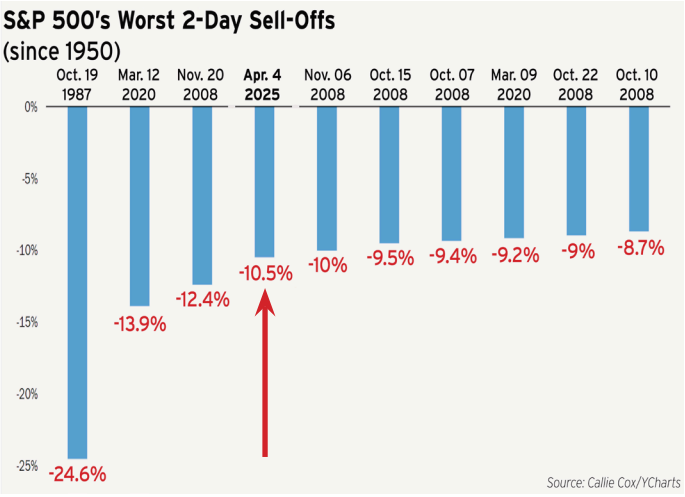


Source: BofA Research Investment Committee, World Bank, PWC; tariff rate = MFN simple average, barriers = average ad valorem equivalent; UN Trade and Development data used for non-tariff barriers in Saudi Arabia, China, Türkiye, India, and South Korea; Non-tariff barriers include regulations, rules of origin, and quotas.

BofA GLOBAL RESEARCH

Among the hardest hit were China (total tariffs now 145%), Vietnam (46% and a major apparel importer with total imports to the US of $136 billion), Japan (24%), and the European Union (20%). Markets had been hoping for a best-case scenario of targeted tariffs against true trade offenders like China. These hopes were dashed when the president shocked markets with his sweeping instead of surgical approach to the trade war.

Whenever markets are hit with an unexpected shock they will react negatively. This negative reaction was swift and severe. Immediately following Liberation Day, the market experienced one of its worst two-day sell-offs in history.



Exactly one week after Liberation Day, with stocks and bonds both falling, the president declared a 90-day pause on his reciprocal tariffs (except those on China). The markets rejoiced and the major stock indexes logged some of their best-ever single-day returns.

The stock market's highest highs and lowest lows always occur in close proximity. Reflexive price swings, in either direction, speak to a jittery market trading on short-term reactive impulses rather than substance. It is crucial during these manic markets to tune out the noise and adhere to an objective, unemotional investment plan.

Occasional periods of volatility are a normal feature of the stock market and they come in waves. Markets remain in the grip of volatility because the tariffs are both tentative (feeding into the feeling of uncertainty) and because their potential repercussions could have far-reaching effects across the economy. Unless and until we see some concrete trade deals or some other tangible positive catalyst, markets will likely continue their emotional knee-jerk day-to-day volatility. The market's current bias isn't up or down; it is aggressively sideways.

It is important to remember that the stock market's current prices represent expectations of future business conditions. Investors are trying to price in the unprecedented and the unknown. We believe the president's 90-day pause to the tariffs proves that he is paying attention to the market's concerns and gives us confidence that his trade war is about bringing countries to the table to negotiate fairer trade terms.

Further, our economy stands on firm foundations. The jobs market is strong: the unemployment rate still sits below its 70-year average while wages continue to rise. Consumer spending is up at the same time financial institutions are reporting a greater willingness to make both consumer and business loans. Inflation is declining slowly and the Federal Reserve under Chair Jerome Powell stand at the ready to cut interest rates should circumstances dictate.

Again, we aim to confront this volatile market with cautious patience. The trade war will continue to play out as more and more countries come to the table to make deals. Meantime the president's pro-growth policies of cutting taxes and deregulation are making quiet progress. Congress aims to have the "Big Beautiful Bill" that includes an extension of 2017's tax cuts and potential for $1.5 trillion more on Trump's desk by Memorial Day. This would be a much-needed sentiment/confidence booster to businesses, consumers, and markets.

We are entering uncharted territory with the trade war, but the economy is well-prepared. Markets are unstable because so much is uncertain. We approach such markets the same way we approach all markets: unemotional and responsive allocations to what is working right now.

PERFORMANCE DISCLAIMER

No investment strategy or methodology can guarantee profits or protect against losses. Investment risk is inherent in every individual portfolio and no computer model or modeling program used or relied upon in making investment choices for a portfolio can eliminate risk.