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First Quarter Review - 2025
Happy Liberation Day!

The first quarter was packed with an unusually large number of natural disasters and notable events. We witnessed fires, floods, hailstorms, tornadoes, and the inauguration of a new administration, to name a few. As it turns out, the first quarter was just a prelude to the real fireworks that were unleashed just after quarter's end on "Liberation Day," April 2, 2025. But first, let's look at the numbers through March 31st.

After peaking in mid-February, stock market indexes declined during the first quarter, with the S&P 500 index falling 4.3%, the NASDAQ sliding 10.3%, and the Russell 2000 (small company) retreating 9.5%. The Dow Jones Industrials Average posted a more modest loss of 1.8%, reflecting more exposure to energy and financial stocks and less exposure to the large technology stocks formerly referred to as "The Magnificent 7." (For those following Wall Street jargon, the "Mag 7" has since been dubbed the "Lag 7.")

On the fixed income side, bonds rose as the iShares 20+ Year Treasury Bond ETF (TLT) delivered a return of 4.7% for the quarter. This performance was bolstered by declining consumer confidence and economic uncertainties, which led investors to seek safer assets.

Gold prices surged remarkably during the first quarter, rising by roughly 20%. That is usually regarded as an economic red flag. Gold usually spikes due to some combination of geo-political turmoil, inflation, a weak dollar, falling interest rates, and currency debasement. The move in the yellow metal appears to have foreshadowed some of the developments to come in April.

Liberation Day and the Tariff Tantrum

I'm sure you have heard and read much about the imposition of the "reciprocal tariffs" on April 2nd, and I will attempt to not rehash too much. Suffice it to say that investors (here and abroad) were generally shocked by so much of what transpired, including the tariffs' severity, method of calculation, timetable of imposition, confused and conflicting justifications, and flip-flopping implementation with "on again, off again" exceptions and "carve outs." In fact, the tariffs are not "reciprocal" in the normal sense of the word as they are based on trade imbalances, not existing tariffs on US goods elsewhere. My favorite quote from the week was, "Now economists know how doctors felt when he talked about injecting bleach." The immediate effect of "Liberation Day" was to "liberate" about $10 trillion of value from investors' holdings. What made the sell-off especially rare was that it involved large drops not only in the stock market, but also in the bond market and the US dollar to boot (partially fueling the rise in the price of gold quoted in US dollars.) This may mean that US stocks and bonds are no longer considered the "safe assets" that they have historically been for international investors.

A phrase that you have probably heard repeatedly at times like these is that "markets don't like uncertainty." I have always taken issue with that statement since I have never, in my entire investing life, experienced a time of certainty. What is more accurate to say is that investors don't like *increasing* uncertainty. And, unfortunately, that is exactly what we now have.

After the election, another popular phrase heard around Wall Street implored us to "Invest with the oligarchs!"; the idea being that those industry titans who had aligned themselves with the new regime would benefit, as would their shareholders. That seemed to work for a while. More recently a phrase sometimes heard is the half-joking warning to "Beware the tweets of the mad king." Much truth is said in jest, however, and we are now faced with the task of investing "between tweets" which can change the economic context of an investment immediately and drastically. That increase in uncertainty is exactly what will postpone and eliminate many companies' investment decisions to build for the future, since even the immediate future is more uncertain than ever. Accordingly, analysts are lowering their expectations for growth in the economy, companies (especially small ones) are bracing for the impact of tariffs on their sales and profitability, and economists are raising the probability of an economic recession this year.

Last week was the most volatile for financial markets in recent history and, although things may calm down a bit, we should be prepared for sharp swings in prices in the future. After a brutal decline like the one we have just witnessed, we often see a very strong rally that partially recovers the lost ground. We intend to use any such rally to reposition investments for the new normal. We should also remember that the greatest one-day gains in the stock market have almost all occurred within the context of a bear market, with the trend continuing down afterward. We should not be fooled into thinking the "all clear" has been sounded after any sharp but brief recovery.

In response to these developments, we have reduced exposure where appropriate in order to take into account a wider range of potential outcomes than were previously anticipated. We are adding to fixed income investments in anticipation of the Federal Reserve lowering interest rates later this year. We have increased cash reserves and short-term US Treasury notes for more conservative clients to serve as a buffer to market volatility. And we continue to seek out individual investments that take advantage of over-reactions based on investor fear and panic.

Enclosed you will find your quarterly reports and statements. I would encourage you to review them at your leisure. We are constantly working to navigate the changing economic reality with investments that match your investment goals and risk tolerance. As always, feel free to give us a call at any time to discuss current conditions, any changes to your goals or financial circumstances, or with any questions or suggestions you may have.

Best regards,

Claude

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