First Quarter 2025 Summary & Outlook

First Quarter Recap

The Market

The first quarter started with the bulls running rampant in the market. Our cautionary note and recommendation (in our 2025 annual outlook, published in January) to raise liquidity to take advantage of any potential weakness this year seems at this time to have been well placed. With a changing of the guard in Washington, excessive optimism and extended valuations left the risk reward proposition in the market unappealing. While we anticipated only single-digit returns for the year, the extent to which the new administration seems willing to prioritize tariffs over other market-friendly policies such as deregulations, tax cuts, and lower energy prices has come as a surprise. Initially, investors focused on the potential benefits of such growth-oriented policies and tended to ignore the economy-disrupting fiscal policies such as tariffs.

The market continued its twenty-eight-month rally with a post-election surge, peaked on February 19th, and has now sold-off in one of history's fastest corrections, finding itself potentially in bear market territory by the time you read this outlook[1]. For the first quarter, the Dow Jones Industrial Average (DJIA) was down 0.9%, the S&P 500 declined 4.3%, while the Tech-heavy NASDAQ sold off 10.3%. However, at the time of writing (April 6th), the three major indices are down from their all-time highs, 14.8%, 17.4%, and 22.7%, respectively[2].

Year-to-date, the market has seen a big rotation from the growth-oriented segment of the market to the value and defensive areas of the market. Still, all corners of the stock market are down for the year. For example, the growth-oriented Information Technology sector is down 24.4%, while the defensive Consumer Staples sector declined only 4.9% (through Friday April 4th, 2025). Investors took profits on the "Magnificent Seven" stocks, responsible for much of the market's returns over the past two years. An index tracking these seven stocks was down 24.2% year-to-date through April 4th, while the S&P 500 excluding these companies declined considerably less, down only 8.9%[3].

In the bond market, Treasuries shined as investors reduced risk and flocked to safe-haven assets. Long-term Treasuries (proxy ETF, ticker TLT: iShares 20+ Year Treasury Bond ETF) are up 7.4% year-to-date, while the broad-based U.S. Bond Aggregate Index with moderate duration was up 3.6%[4]. Treasuries outperformed corporate bonds. High-quality bonds of all maturities, especially longer-term, helped balanced portfolios offset some of the decline in stocks.

In sum, 2025 to date has been a tough time to be in the stock market. As always, investors should take a step back and study the big picture. The current drawdown, though significant, is just a blip for the long-term secular bull market that started in 2009. Long-term investors should maintain their resolve and ride out the volatility. For those with long-term time horizons and liquidity, these lower prices offer a buying opportunity. Expect more volatility and potentially more downside this year, while anticipating higher prices on the other side of this market reset. Figure-1[5] below shows

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the long-term benefits, with a history spanning more than five decades, of avoiding panic selling and remaining invested in spite of the various headline crises.

Crises and Events

S&P 500 Index: Since 1970

First Trust

This chart shows the growth of $10,000 based on S&P 500 Index performance over the last several decades. We believe looking at the market's overall resiliency through major crises and events helps to gain a fresh perspective on the benefits of investing for the long-term.

The average annual total return of the S&P 500 Index for the period shown below was 10.80%.

Source: First Trust, Bloomberg. Data from 12/31/1969 - 3/31/2025. **Past performance is no guarantee of future results.** This chart is for illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. Stocks are not guaranteed and have been more volatile than the other asset classes. These returns were the result of certain market factors and events which may not be repeated in the future.

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Figure 1 - Markets carry on higher despite all the corrections and bear markets caused by different crises and events.

Q2 Outlook

The Economy

The U.S. Economy entered the first quarter strong. Since then, the severe winter across the country and the wildfires in the West hampered consumer activity while recent tariff announcements have impacted consumer and business confidence, also leading to lower spending and investment. So far, services consumption has weakened while conversely, a spike in goods purchases has occurred, with consumers and businesses attempting to buy ahead of the higher prices anticipated from the upcoming tariffs.

Official first quarter GDP growth figures have not been released, but economist estimates are downbeat. Wall Street economists have lowered their forecasts for first quarter real GDP growth to just 1.1% and lowered their calendar year estimates to 1.9%, down from their prior 2.3% forecast at the beginning of the year (Figure-2 below[6]). Looking ahead, the continued stockpiling of goods to avoid tariffs on items, such as cars and other durables, could boost second quarter GDP.

However, if enacted tariffs remain in their current form, the odds of recession and/or stagflation in the quarters ahead rise. This is not our base case as our current assessment is that the high-rate tariffs announced on April 2nd are likely to be negotiated down or withdrawn as the administration continues to deal with U.S. trading partners.

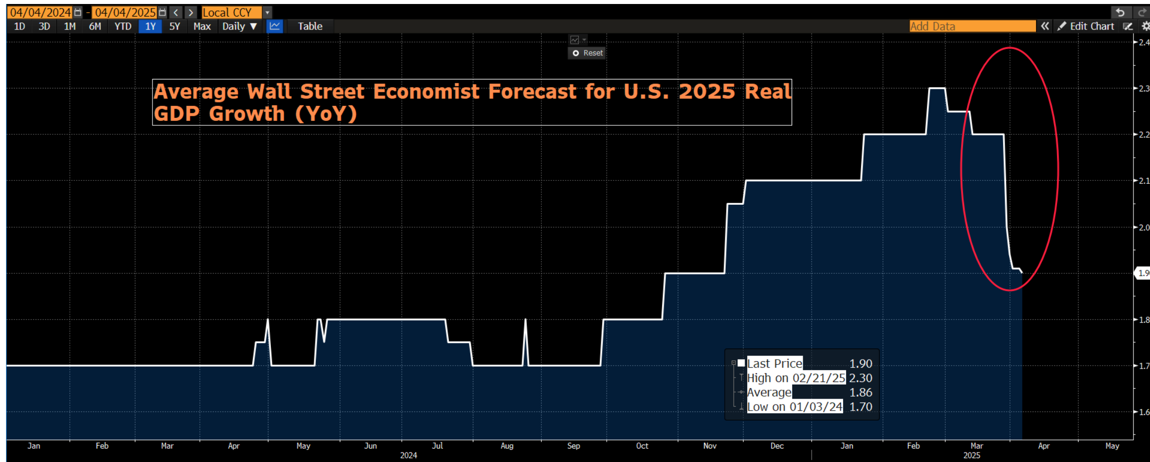

Figure 2 - Wall Street Economists Are Lowering Their GDP Forecasts for 2025

Tariffs

The U.S. administration has made tariffs a major feature of its fiscal policies. The stated goal is to use tariffs to increase revenues for the government, re-industrialize the U.S. economy, bring back manufacturing jobs, and reduce the trade deficit. With the April 2nd tariff announcements, major Wall Street economists have estimated that the average tariff rate would increase to a range of 20% to 25% from a 2.4% rate at the end of 2024 (Figure-3[7] below shows US Tariff Rate since 1900).

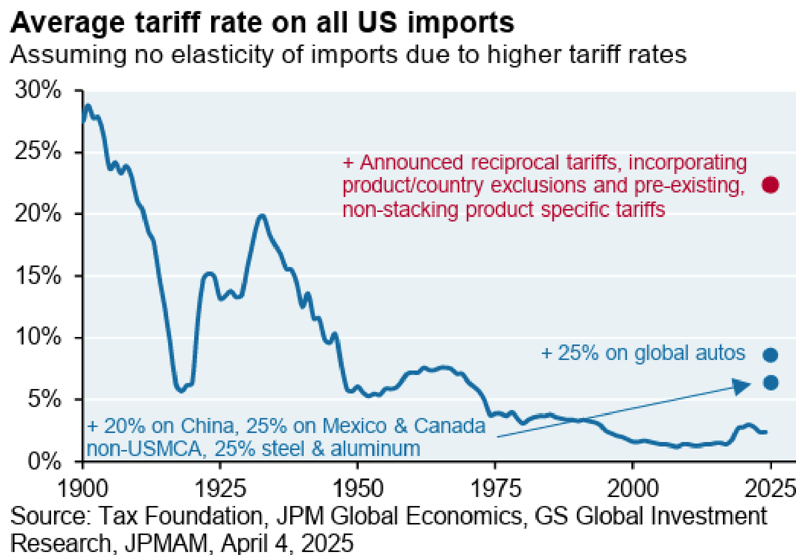

Figure 3 - US Aggregate Tariff Rate Since 1900

Tariff critics maintain that protectionist policies hurt the global economy in reducing trade and that the constant U.S. trade deficit with the world is an indication of the strength and prosperity of the U.S. Economy and its citizens. Further, the trade deficit is offset by our capital account surplus with the rest of the world. That is, many of our major trading partners take much of the proceeds from their sales to the United States and invest these funds in American stocks, bonds, real estate, and other business ventures, making the U.S.A. the capital magnet for the world.

Here is a summary[8] that outlines the tariff plan so far as of April 3rd, 2025.

Key Components of Trump's New Tariff Plan

1. Baseline 10% Tariff On All Imported Goods (Effec. April 5)
2. Roughly 60 Countries Will Be Subject To Tariffs Above 10% (Effec. April 9)
    A. We do not read rate for countries in #2 as additive to #1
3. Existing Tariffs Will Remain In Place (China, IEEPA, Autos, etc.)
4. Mexico & Canada Not Subject To The New Tariffs But Existing 25% Tariff On Non-USMCA-Compliant Goods Remains In Place
5. Tariff Exemption For Goods Loaded Before April 5th. Products Loaded After April 5th But Before April 9th Will Be Subject to 10% Tariff, But Not Higher Rate
6. Products Related To Commodity and Sectoral Tariffs Are Exempted (Steel, Aluminum, Lumber, Copper, Pharma, Autos, etc.) **$100bn**
7. China Faces 79% Tariff Rate & Could Be 100% If New Tariffs On Countries Purchasing Venezuela Oil Is Enacted

Figure 4 - Summary of Announced Tariffs

Total tariffs announced since President Trump's inauguration would increase the federal government's revenues to about $620 billion, or roughly 2% of GDP.[9] The administration's hope, ostensibly, is that such revenues could decrease the government's annual budget deficit from more than 7% of GDP to 5% within a year[10]. Significant cuts targeting federal government spending are also projected to reduce the budget deficit, working on the other side of the ledger.

However, the impact of slower economic growth stemming from tariffs and budget cuts could drag down tax revenues from other sources, offsetting some of these benefits within the next 12 months. In a worst-case scenario, the economy experiences a downturn with notable job losses, leading to always-politically-popular fiscal spending, and thus undoing much of this administration's intent.

Nonetheless, as investors we do not control the economic order, and we must analyze and make investment decisions based on the current political situation. The announced tariffs are worse than expected and have presented a shock to the global trading system. They have major short-term and potential long-term consequences to the world economy should they stay in their current form. Their enactment has been very draconian; thus, most market observers find it hard to believe they will remain at these levels. We do agree there will be changes negotiated over time.

As the saying goes, "*Prediction is very difficult, especially if it's about the future*"[11]. This is particularly the case in these unusual times. While we do not possess a crystal ball, below are our thoughts concerning the current situation. It may be helpful to break the outlook into three plausible economic scenarios:

Best Case Scenario: Tariffs Are Dialed Back

The best scenario for the markets and the economy sees the administration getting some concessions from our trading partners and declaring victory. This would involve either our trading partners lowering or removing their tariff rates and/or promising to make more Foreign Direct Investment (FDI) in the U.S. Subsequently, the administration would move on to tax cuts, banking deregulations, and regulatory reform. In such a scenario, the market is likely to stage a strong rally, and the impact of the trade debacle could be limited and ideally seen in the rearview mirror.

Recall the economy has been resilient coming into the tariff situation. While soft data has recently been weak due to trade war threats, hard data has shown the U.S. Economy moving along just fine as recently as the end of March. To further explain, economic data can be categorized into two types of data: hard and soft data. Hard data are quantifiable, objective metrics such as employment figures, retail sales, and industrial production, while soft data are survey-based, subjective indicators like consumer confidence, business sentiment, and Institute of Supply Management (ISM) surveys.

Currently, the soft data are very negative: consumer sentiment and expectations are printing COVID-low readings, while CEO and CFO confidence surveys depict paralyzed leaders unable to make investment decisions. On the other hand, hard data are still resilient and do not show any cracks in the economy as seen in the March jobs report released on April 4th. Figure-5[12] shows the divergence between hard and soft data. We should note, while soft data can be volatile, economists look at soft data as precursor of what future hard data may be.

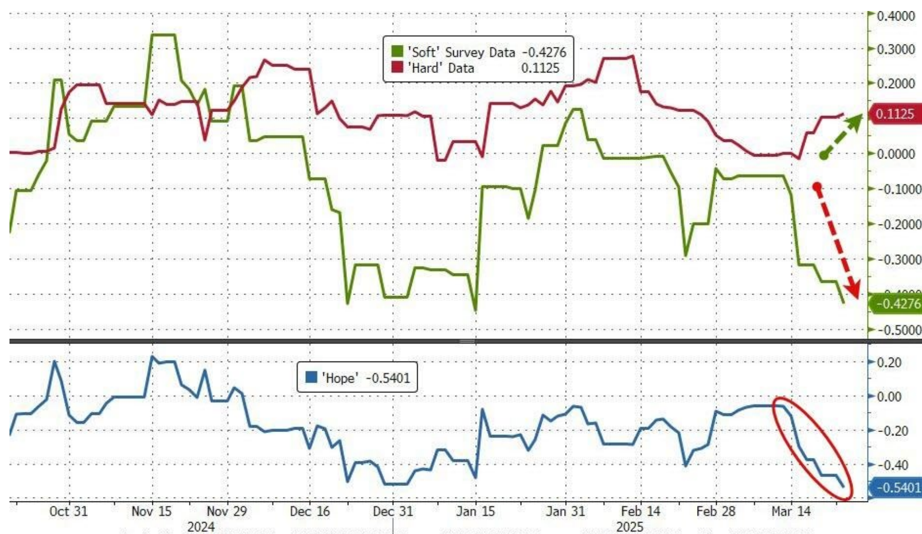

Figure 5 - Deteriorating Soft Data vs. Resilient Hard Data

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Political pressure is already mounting on the administration to reverse course. Thus, the administration could start looking for an exit ramp by getting concessions that remove the reciprocal tariffs from the table and create a fairer trading environment. Again, such a scenario would be bullish for risk assets such as stocks, especially given that the economic hard data remains robust.

Worst Case Scenario: Announced Tariffs Stay in Place

The worst-case scenario would see the tariffs remaining in place, trading partners retaliating as China has done, and the U.S. administration retaliating in kind. Many economists are issuing global and U.S. recession forecasts reflecting such a scenario. They state that if the economy slows to just below 2% inflation-adjusted growth, the current 2025 consensus earnings estimate for the S&P 500 (as a whole) of 10% may be too high as can be seen in Figure-6[13]. The area within the red circle shows the considerable drop in GDP estimates, which will most likely be followed by a drop in profit estimates.

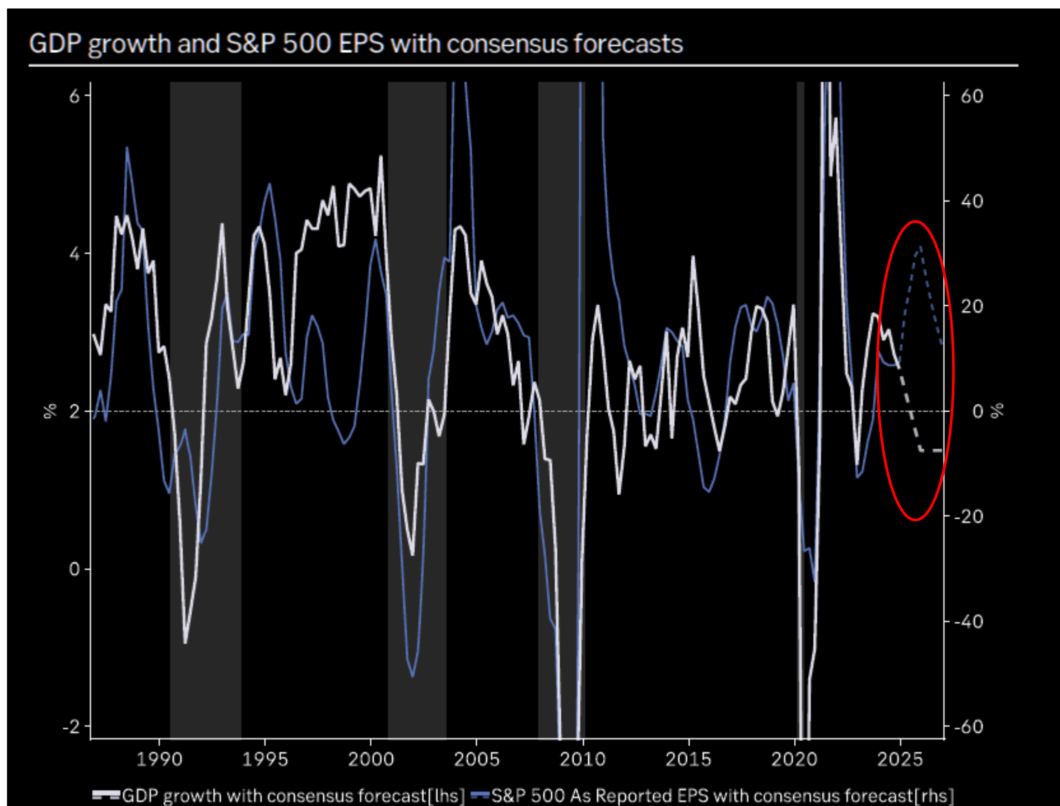

Figure 6 - Lower GDP growth would result in lower earnings growth for stocks

In the event of a full-blown recession, it would lead to a major hit on corporate profits. Using history as guide, S&P 500 earnings have dropped by a median of 13% during recessions since WWII as seen in Figure-7[14].

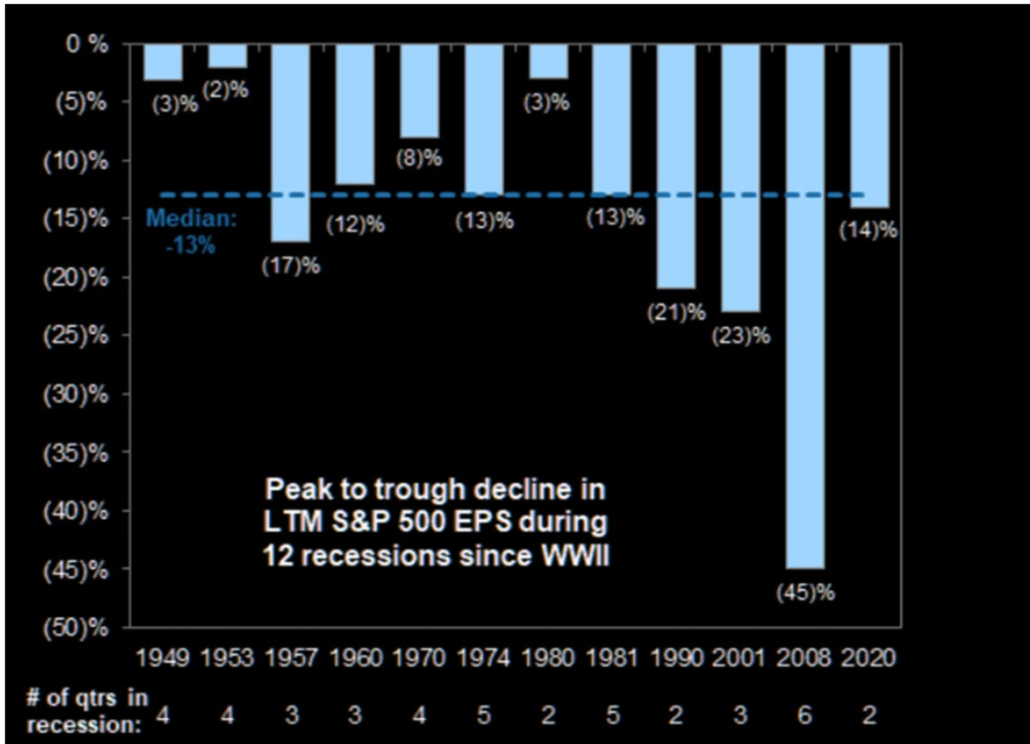

Figure 7 - In a normal recession, earnings could decline 13%

Coming into the current selloff, valuations were expensive, not at "dot-com" or 2021 levels, but surely stretched, with the S&P 500 trading at a trailing 12-month price-to-earning (PE) ratio of 28 times earnings. At the time of writing, valuations have come down to 22 times earnings, but nothing close to average 15.6 P/E multiple seen during past market declines that preceded economic downturns, shown via the yellow line in Figure-8[15]. The S&P 500 is considered a leading economic indicator, hence market valuations are still not predicting a recession.

Figure 8 - S&P 500 Price-to-Earnings

In this scenario, defensive positioning in the equity side by overweighting consumer staples, utilities, and healthcare would be highly advisable.

Base Case Scenario

In our view, the most likely scenario is one in which tariffs stay in place but at lower rates than currently suggested. For example, if reciprocal tariffs are lowered dramatically due to negotiations and concessions, but an across-the-board 10% tariff on all countries remains in place. In such a scenario, the average tariff rate increases to 10%-to-15% instead of the current announced 25% rate. If this occurs, congress will work rapidly to sterilize the economy against the tariff shock by extending and introducing new tax cuts by the summer recess.

The "Fed" is stuck between a rock (higher inflation in the short term) and a hard place (anticipated weaker growth) from the tariff shock. However, the Fed may come to the rescue by cutting interest rates several times this year to fight a rise in the unemployment rate. In fact, prior to the selloff, market pundits had been predicting two cuts this year, and are now predicting five cuts due to the heightened uncertainty.

In this case, stocks and corporate bonds are likely to outperform safe-haven assets. A potential silver lining out of the recent selloff is forward returns have been phenomenal. Thursday and Friday of the first week of April were the fifth largest two-day decline since 1950. As Figure-9[16] shows, 1-, 3-, and 5-year returns after such occurrences have been substantially higher.

S&P 500: Biggest 2-Day % Declines and Forward Total Returns (1950 - 2025)							
Biggest 2-Day % Declines					Forward S&P 500 Total Returns		
Rank	End Date	Start S&P	End S&P	2-Day	1-Year	3-Year	5-Year
1	10/19/1987	298	225	-24.6%	28%	55%	119%
2	10/20/1987	283	237	-16.2%	24%	47%	108%
3	3/12/2020	2882	2481	-13.9%	62%	63%	144%
4	11/20/2008	859	752	-12.4%	49%	73%	164%
5	**4/4/2025**	**5671**	**5074**	**-10.5%**			
6	11/6/2008	1006	905	-10.0%	21%	48%	119%
7	10/15/2008	1003	908	-9.5%	24%	44%	109%
8	10/7/2008	1099	996	-9.4%	9%	24%	88%
9	3/9/2020	3024	2747	-9.2%	44%	50%	127%
10	10/22/2008	985	897	-9.0%	25%	48%	119%

Figure 9 -S&P 500 Returns after the Largest Two-Day Declines

In sum, this tariff shock is a serious development, and the situation is fluid as we write this outlook. No one has a crystal ball or knows how the future will unfold, but we are hoping the above scenarios equip you with insights to navigate a difficult investing environment. Many of the market's best days in history come in tandem with, either before or after, the market's worst days.

Although we often do not realize it at the time, history shows that investors should treat bear markets as a buying opportunity. We recommend that you stay with your investment strategy, do not allow short-term swings and emotions to alter your plan, and focus on your long-term financial goals. It is during times of heightened uncertainty that staying disciplined matters most. Reacting impulsively to market downturns will often do more harm than good. You must be in the market to earn market returns.

We are here to support you, so if you have any questions, please do not hesitate to contact us.

Respectfully,

The Westminster Financial Investment Policy Committee

Resources

[1] Bloomberg
[2] Total Return numbers through Bloomberg
[3] Total Return numbers through Bloomberg
[4] Total Return numbers through Bloomberg
[5] First Trust
[6] Seventy Economists Surveyed By Bloomberg
[7] JP Morgan Asset Management
[8] Strategas
[9] Strategas Calculations
[10] US Treasury, Congressional Budget Office
[11] Niels Bohr, Yogi Berra, Mark Twain, or Winston Churchill
[12] Zerohedge through Bloomberg
[13] Macrobond
[14] Goldman Sachs
[15] CFRA and Bloomberg
[16] Charlie Bilello

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