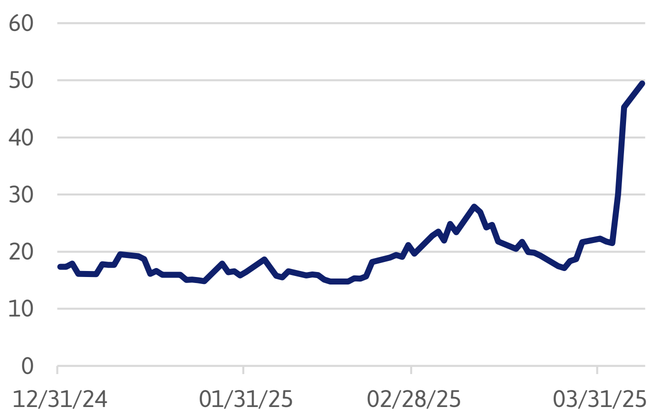
Market Update

April 7, 2025

This April is shaping up as the cruelest month for investors since the Covid pandemic. Market volatility has surged, with the CBOE Volatility Index (VIX), the so-called fear index, up about 120% since the beginning of the month and up 180% year to date. The sweeping tariffs announced on April 2 were more significant than just about anyone expected, a tenfold effective increase to the highest rates in a century. (See the chart below from our colleagues at Evercore ISI). And conflicting communications from the Administration since have further eroded market confidence. The tariffs represent a resetting of the global economic order and, if maintained, could reset the trajectory of global economic growth.

CBOE Volatility Index



Country	Tariff to be Imposed
China	34%
European Union	20%
Vietnam	40%
Taiwan	32%
Japan	24%
India	26%
Korea	25%
Thailand	36%
Switzerland	31%
Indonesia	32%
Malaysia	24%
Cambodia	49%
United Kingdom	10%
South Africa	30%
Brazil	10%
Bangladesh	37%
Singapore	10%
Israel	17%
ROW	10%

Note: Individual country rates based on list shown in press conference; others may be added.

It's early days yet, but so-called *Liberation Day* could be as consequential to the economy and capital markets as the Great Financial Crisis and the Covid-19 pandemic, depending on the following:

- The global response. We continue to wait for a full response from the European Union. China has already retaliated, with a 34% tariff hike on U.S. goods, and President Trump now appears to be considering upping the stakes even further, threatening another 50%. Vietnam, much smaller and more vulnerable, has relented, offering to cut all tariffs on U.S. goods. Japan, South Korea and India appear to be negotiating.
- The U.S. response. Will various legal challenges, already underway, lead to the Supreme Court ruling the tariffs illegal, and if so, will that lead to the administration finding new statutes with which to impose tariffs? While Congress has the authority to step in, the will is not yet in evidence.

- The Administration's resolve. Will market declines and slowing economic growth surpass the comfort level of the Trump administration, leading to more negotiations?

The market, as always, has a view. All told, the S&P has declined 13.4% from January 1 through April 4, and the Russell 2000 is down 17.8%. Both indices continued to slide on Monday, April 7. The Barclays Agg is up 3.7% and the Barclays Muni index is up 1.7%, reminding investors that diversification can be the best hedge against market surprises.

We have also seen a weakening in the U.S. dollar, down 6.7% against a basket of global currencies from the two-year peak on January 13 to April 4. Most economists earlier predicted that higher tariffs would lead to a strong dollar, but forecasts are now for weaker relative growth and lower relative interest rates versus peer countries.

Rising bond prices suggest that longer-term inflation expectations are not rising materially, also counter to market expectations. It may be that these tariffs will erode the value of services, which represent 75% of the U.S. economy, more significantly than they increase inflation on goods. This balance will be determined by the eventual impact on the labor market, commodity prices, and consumer and capital spending.

As we communicated last week, if tariffs are maintained at these rates the likelihood of recession rises significantly – to around 50%, according to many economists – as U.S. business and consumer confidence continues to erode and spending is likely curtailed. There could also be significant foreign policy repercussions. It is possible that consumers in other countries will avoid U.S. products, further impacting growth. In any case, the markets are likely to remain volatile for some time.

There is greater consensus among economists that the government must reduce its spending, which far exceeds revenues (24% and 17% of GDP in 2024, respectively). The tactics employed by Elon Musk and DOGE in cost cutting to date also have been controversial, contributing to market volatility. And while tariffs should in theory raise significant revenues, as much as $600 billion annually based on what has been announced and implemented so far, economics don't work in a vacuum. At least some of the potential revenue benefits from the tariffs are likely to be offset by less trade, slower growth and lower tax revenues. As to the President's goal of bringing back manufacturing jobs to the U.S., major capital projects take years, not months, to build and deploy and many goods made overseas (think iPhones and apparel) would be cost-prohibitive to make domestically.

While the underlying fundamentals of the U.S. economy remain strong, with unemployment at 4.2% and corporate earnings forecasts for 2025 still around 9%, we would expect unemployment to rise and earnings growth rates to erode if these tariffs stay in place.

There are still pathways to better days for investors. If the Administration now turns to negotiating lower tariff rates and focuses more on its pro-growth deregulation and tax-policy pledges, we could see a corresponding bump in business and consumer sentiment. And the Federal Reserve does have room to cut rates if needed.

The longer uncertainty around policy persists, however, the greater the risk to economic growth.

CASH AND DEFENSIVE ASSETS

Taxable cash and cash equivalents continue to yield around 4%, meaning investors can still earn enough to keep up with the rate of inflation after tax. If the current uncertainty continues and the Fed ends up cutting rates in response to signs of economic weakness, investors will generate better returns through a portfolio of long-dated bonds.

We continue to modestly extend the duration in our municipal and corporate bond client portfolios. Municipal bonds are attractive after underperforming Treasuries, due to increased supply and concerns that federal spending cuts will negatively impact revenues for certain municipalities. We remain focused on the underlying credit quality.

CREDIT ASSETS

Although they are still below long-term average, policy dramas have also caused credit spreads (the difference between Treasury yields and lower-quality, more credit-sensitive fixed income) to widen, pushing the yield on high-yield corporate credit to over 8.3%. We continue to believe that investing in corporate credit remains a good long-term allocation within a diversified portfolio and that diversification within the credit asset class is also prudent.

For example, asset-backed loans seem to us an attractive addition at present to a balanced portfolio. The underlying range of collateral, such as residential and commercial real estate, auto loans, aircraft leases, and music and media royalties, is more diversified than corporate-backed loans and therefore less economically sensitive – and the exposure can generate high yields.

GROWTH ASSETS

After two years of historically strong, if concentrated, returns, the S&P 500 fell 4.2% in the first quarter of 2025, with the Magnificent Seven tumbling 16.0%. (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla). The stocks have since taken a beating, down 12.1% in two trading days since April 2, with Apple alone falling 15.9%. We believe that the narrowing valuation between these stocks and the broader market makes some of these companies more attractive, along with other likely beneficiaries of the productivity enhancements associated with the rollout of Artificial Intelligence. If the economy weakens, companies are likely to focus more on productivity-enhancing investments to sustain margins.

U.S. retrenchment on the global stage has forced allies to reconsider their own policies. Fiscal stimulus in Europe, notably on defense and infrastructure spending, should provide a meaningful boost to its companies. We have maintained a significant underweight to international stocks for over a decade, to the benefit of our clients, but have been selectively increasing our exposure this year to both Europe and Japan, where corporate and regulatory reform has been a catalyst for a positive turnaround in corporate earnings and valuations are attractive.

PRIVATE ASSETS

We continue to believe that a portfolio of private market investments, including private credit, private real estate, private equity and venture capital, can enhance portfolio returns while adding diversification.

Identifying high quality investment managers is essential, as private fund capital is locked up for a significant period and because the difference between the top quartile managers and the median manager in private equity is much greater than in public markets. An appropriately diversified portfolio of hard-to-access managers with strong track records is, we believe, an important addition to client portfolios with the appropriate risk appetite and liquidity profile. This market decline may present an attractive entry point for private equity managers to deploy long-term capital, although during periods of volatility, private funds will make fewer distributions and may make more capital calls. We work to ensure that our clients maintain sufficient liquidity when investing in private markets.

CONCLUSION

At about 19x price-to-forward earnings (the long-term average is around 16x), U.S. equity valuations are still high. Even after the recent market pullback, the S&P 500 Index is only back to price levels of April 2024 (a time when no one was worried about the markets). We continue to caution our clients to expect relatively high volatility and low U.S. market returns. Still, it's important to keep in mind that the equity markets are generally resilient and that well-run companies should rise to these challenges. It is also worth remembering that when markets experience high downside volatility, it is often followed by high upside volatility. In other words, staying invested while maintaining liquidity and sufficient income over the near to intermediate term to manage through these times is essential.

Finally, we continue to see value in diversification, as fixed income, international markets and private markets, especially private credit and private equity, become increasingly appealing.

We remain focused on helping our clients build portfolios that can withstand a range of economic and market scenarios, providing short- and medium-term liquidity, and satisfying long-term financial goals.

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Disclosures: