

ECONOMIC OUTLOOK

Summary

Uncertainty in government policy has shaped consumer and business behavior for months and the Trump administration's sweeping tariff announcement on April 2, 2025 will only intensify this trend. The tariff rollout includes a 10% universal charge on nearly all imports, with much steeper country-specific rates such as China (54%), Vietnam (46%), and Taiwan (32%). This major change in trade relations has created a cautious environment that will define the economy in the months ahead.

Consumers' unease was evident as the University of Michigan Consumer Sentiment Index fell to a two-year low of 57 in March. Retail sales data has been consistently below analysts' estimates over the past three months. This spending restraint stems from consumers' fear of higher prices for essentials like groceries, electronics and automobiles due to tariffs. The savings rate climbed from 4.3% to 4.6% in March. This is a positive sign indicating it is not immediate financial strain pushing families to favor saving over discretionary purchases, but the threat of tariff-driven cost increases.

Businesses are equally apprehensive. The ISM manufacturing index, at 49.0, signals contraction, while the ISM services index (50.8) has hit a nine-month low. The NFIB Small Business Uncertainty Index hovers near a record high, which could stifle investment and hiring. Companies now face the dual threat of rising input costs and potential retaliation from trading partners. This cloudy outlook may make businesses hesitate to expand even though the White House claims this will be a boon for U.S. manufacturing.

For now, the labor market remains well positioned following the March payroll data. The unemployment rate rose slightly

(4.2%) but that was mainly due to an increase in the labor force participation rate (62.5%), which is a net positive. Still, tariffs threaten to stall economic momentum at a pivotal moment. The administration may be using them as a negotiating tool, but the length of time these policies are in force will determine whether businesses and consumers regain confidence or retreat further. Time will tell if the administration's bold trade strategy has the desired results or further deepens the wait-and-see approach that could dampen both consumer spending and business investment throughout the American economy.

Positives

Nonfarm payrolls surprised to the upside in March (228k vs. 140k est.)

Durable goods orders beat expectations (0.9% vs. -1.0%)

Fourth-quarter GDP was revised 0.1% higher (2.4%)

Negatives

Year-over-year Core PCE (inflation) rose more than anticipated (2.8% vs. 2.7% est.)

Retail sales missed expectations for the third straight month (0.2% vs. 0.6% est.)

ISM prices paid data jumped to the highest level since mid-2022 (69.4)

EQUITY OUTLOOK

Summary

The month of March saw a sharp uptick in volatility. The S&P 500 Index declined 5.6% over the month as tariffs, recession and inflation dominated the news feed. Large U.S. growth stocks once again bore the brunt of the pain. The Russell 1000 Growth Index fell 8.4%, while the Russell 1000 Value Index held up better but still lost 2.8%. International stocks fared much better during the month. The developed MSCI EAFE Index dipped 0.3% and the MSCI Emerging Markets Index rose 0.6%.

Uncertainty has become quite elevated in recent months. There are many questions about the use of tariffs, the economic impact and the response from our trading partners. Corporate America also is tiring of the situation as it is clearly difficult to navigate a business when targets keep moving. Executives will breathe a collective sigh of relief when the tariff dust finally settles.

Still equity market volatility is very likely to remain elevated while the uncertainty persists. It will also take some time for markets to recalibrate to a new financial reality. Equity markets are already reflecting the possibility of a shallow recession, although a recession is certainly not a forgone conclusion. It will likely be up to consumers to keep the U.S. economy from slipping into a recession, but consumer sentiment seems shaken.

Despite the current conditions, corporations are still generally in good financial shape and should be able to prosper once the

new rules of the game are firmly established. Long-term investors should view the market dip as a buying opportunity.

Positives

Corporate balance sheets

Lower deficits should improve long-term GDP and earnings growth

Higher productivity from technological investment

Negatives

Consumer confidence falling

Tariffs higher than expected

Global tariff reaction

Unknowns

Inflation path forward

FIXED INCOME OUTLOOK

Summary

Coming into the year, very few economists were expecting a recession for 2025. In fact, most were raising their estimates for GDP growth. But that optimism faded with the new administration's effort to make significant changes in trade, immigration, fiscal policy and regulations. Most controversial and concerning for the economy have been efforts to reduce government spending and new tariffs against our largest trading partners, Mexico and Canada. These changes have ushered in a new level of anxiety and "uncertainty," which has become the new buzzword for forecasters, investors and consumers alike. Now, most economists reduce their GDP estimates and increase the probability a recession will begin this year.

After bond yields fell sharply from mid-January through the end of February, they traded in narrow ranges in March as investors have taken a wait-and-see approach to additional policies, particularly regarding tariffs. The 2-year Treasury note traded in a 16 basis point (bp) range before closing the month 11 bps lower at 3.88%. Ending unchanged at 4.20%, the 10-year Treasury note traded in a 20 bp range which was substantially smaller than the average monthly range of 33 bps. The yield curve steepened slightly as the 30-year bond increased by 8 bps to end March at 4.57%. Credit spreads increased by about 7 bps for the investment-grade market as corporate bond returns trailed Treasury returns for the second consecutive month. Overall, the Bloomberg U.S. Aggregate Bond Index delivered a return of just 0.04% for March. Without the longer maturity bonds that rose in yield, the Bloomberg Intermediate Government/Credit Index had a more favorable monthly return of 0.44%.

A few days into April, one of these uncertainties plaguing investors has been unveiled. On April 2, "Liberation Day," President Trump announced broad new tariffs with all of our trading partners. Larger than expected, they are likely to result in more inflation and slower growth than previously expected, at least in the near term. Consistent with the plunge in equity prices, Treasury yields moved sharply lower and investment-grade credit spreads materially wider. The futures market is now

expecting four rate cuts this year from previously expecting just one in mid-February. Undoubtedly this is a tough situation for Chairman Jerome Powell and the Fed. While downside risks have risen, as of now, the hard data indicates the economy is still relatively healthy. One would have to look to soft data such as sentiment surveys to see dimming expectations. Regarding inflation, it is likely to increase due to the new tariffs, but by how much and for how long is unknowable. Future policy changes are likely to be determined by which of their mandates is further from their goal and an estimate of how long it will take for each to get back to goal.

With this uncertainty, we continue to recommend a neutral duration policy and will be using the increase in credit spreads to increase the duration of our credit position and therefore add more exposure without increasing out percentage allocation.

Positives

Tariffs are likely to create further economic disruptions

Efforts to cut government spending will slow economic activity and reduce borrowings

Negatives

Tariffs are likely to increase inflationary pressures in the near term

Foreign investors could reduce purchases of U.S. Treasury debt

Unknowns

DOGE's ability to reduce budget deficit by a meaningful amount

Resolutions of Israeli conflict and Russia/Ukraine war