NEVILLE, RODIE & SHAW, Inc. / INVESTMENT COUNSEL
Established 1933
200 MADISON AVENUE, NEW YORK, N.Y. 10016

TELEPHONE: (212) 725-1440
FAX: (212) 689-8746

March 31, 2025

Quarterly Review and Outlook

After a strong finish in 2024, equity markets experienced volatility in the first three months of the new year. Investors have been met with a head-spinning barrage of Presidential activity related to tariffs, immigration restrictions and the downsizing of the Federal government. The latter is reflected in government agency funding cuts and large number of Federal worker layoffs announced by the Department of Government Efficiency (DOGE). The combined effect of these activities has rattled investor confidence and raised concerns about the economy and outlook for inflation. The market impact of these actions is being felt currently, while the perceived benefits of President Trump's policies regarding lower taxes and reduced regulation are further out in time. The rise in uncertainty caused by Trump 2.0, particularly with respect to the impact tariffs will have on inflation and corporate earnings, has created downside volatility in stocks and erased the post inauguration gain in the market. The rise in "animal spirits" initially engendered by President Trump's election has given way to widespread concerns about an economic "growth scare." Having peaked on February 19th with a gain of ~4% at the time, the S&P 500 index has since been under pressure. From its peak in February, the stock market experienced a decline (i.e. correction) of 10% into mid-March and finished the quarter with a loss of ~4%.

In addition to the whirlwind of activity from President Trump, the stock market has been impacted by concerns about economic growth, interest rates and inflationary pressures. The Atlanta Fed is currently forecasting a decline of over 2% (quarter over quarter annualized) in first quarter GDP. The decline reflects a surge in imports by businesses trying to front run the Trump mandated tariffs. In March, the President announced tariffs of 25% on goods imported from Canada and Mexico and set a tariff rate of 20% on imports from China. Imports detract from our trade balance and are a drag on economic activity. The President has further indicated that "reciprocal tariffs" on select European and Asian countries (i.e. tariffs in place in these countries will be met with reciprocal tariffs in the US) will be implemented in early April. Importantly with respect to the economy, the underlying trends in employment and personal consumption remain healthy, but tariffs act as a retardant to economic growth. They are in effect a tax on imported goods which cause prices to rise for consumers or profit margins to shrink for businesses. Neither is welcome by investors. The aim of the President with tariffs seems to be twofold: 1) to induce the affected countries to minimize the flow of illegal migrants as well as fentanyl into the US, and 2) to compel companies to increase their manufacturing and production activity in the states. However, this comes at the cost of higher prices or reduced corporate profitability. Both are anathema to his economic goals.

With respect to monetary policy, the Federal Reserve's stance on interest rates has remained status quo since late last year. The Fed held rates steady at its March 19 meeting, keeping the Fed funds rate at 4.25-4.50%, down 100 basis points from its peak last summer. At his press conference, Fed Chairman Powell acknowledged that the short-term impact of tariffs is inflationary; however, he viewed the impact as transitory and pointed out that "long-term inflation expectations remain well anchored." He stated that the Fed will remain vigilant about inflation which is currently running at about 2.6% based on the core personal consumption deflator, the Fed's preferred inflation measure. The central bank's targeted level of inflation is 2%. Powell indicated the Fed will also keep a close eye on its other mandate - i.e. maximizing employment. He stated that "labor market conditions remain healthy," but this bears watching given the recent uptick in unemployment claims. Although the Fed has maintained status quo with respect to short-term rates, the yield on the 10-year US Treasury bond declined by ~55 basis points from its January peak to ~4.25% currently. The decline reflects recent signs of a slowdown in the domestic economy and concerns about the economic impact of President Trump's tariff policy.

Corporate earnings overall have been a bright spot. In 1Q 2025, S&P 500 index earnings grew at a 14% rate which largely exceeded expectations. Looking ahead corporate earnings are forecast to increase by ~11% this year. That is a healthy rate of growth, but investors have been marking down their earnings forecasts of late given the uncertainties associated with Trump's tariff policies and their "stagflationary" (slower growth, higher inflation) implications.

Underlying the first quarter stock market loss have been a number of significant changes. The technology sector, which had been a leader in 2024, was an underperformer in the first quarter. Despite strong earnings from key companies, the valuation multiple assigned those earnings shrank, particularly for companies involved in Artificial Intelligence (AI). A key question being asked by investors relates to the return on investment (ROI) of the large capital expenditures being made by AI related companies, including Amazon, Google and Microsoft. The companies' management teams have indicated they are investing to meet demand and that the digital (AI) transformation will drive gains in corporate productivity and new revenue streams. Defensive sectors of the market, including consumer staples, healthcare and utilities, performed well in an uncertain economy. The more cyclical sectors, including industrials and consumer discretionary, struggled as recent data releases suggest that economic growth may be losing some steam.

After years of underperformance, international markets in Europe and Asia posted much better returns than the US in the first quarter. These markets are benefitting from more aggressive central bank easing and market valuation levels which are starting from a lower base. An easing of tensions in the Middle East and negotiations to end the war in Ukraine have also helped investor sentiment.

Despite recent volatility, we believe markets will eventually settle down once investors more fully digest President Trump's agenda and its implications. Positive corporate earnings growth and a Fed expected to ease rates later this year (assuming ongoing improvement in inflation) should help to bolster investor confidence. Furthermore, unemployment is low, the economy is growing (on a year over year basis) and inflation has returned to historically more acceptable levels. In this market environment, we continue to invest in companies which we believe have competitive advantages and sustainable earnings growth outlooks. It's our belief that it is earning growth over time that drives long-term capital appreciation. Other metrics we look for in the companies we own are strong managements teams, conservative balance sheets and good cash flow generation. Our investments remain focused in the technology, healthcare, industrial, specialty finance and select consumer sectors.

In the fixed income area, we view our bond holdings as serving two primary purposes: the generation of income and the reduction of portfolio volatility. Bonds play defense as our stocks play offense. We focus on investing in investment grade securities which include corporate bonds, government securities and municipal bonds where appropriate. Our fixed income holdings are typically laddered by maturity dates which allows for flexibility in terms of reinvesting the proceeds when bonds mature.

As always, we are grateful for your support and encourage you to reach out to us with any questions or concerns you may have regarding your investments or portfolio structures.