fIRST® | word on the market
by Yellow Cardinal Advisory Group

MARKET UPDATE
March 2025

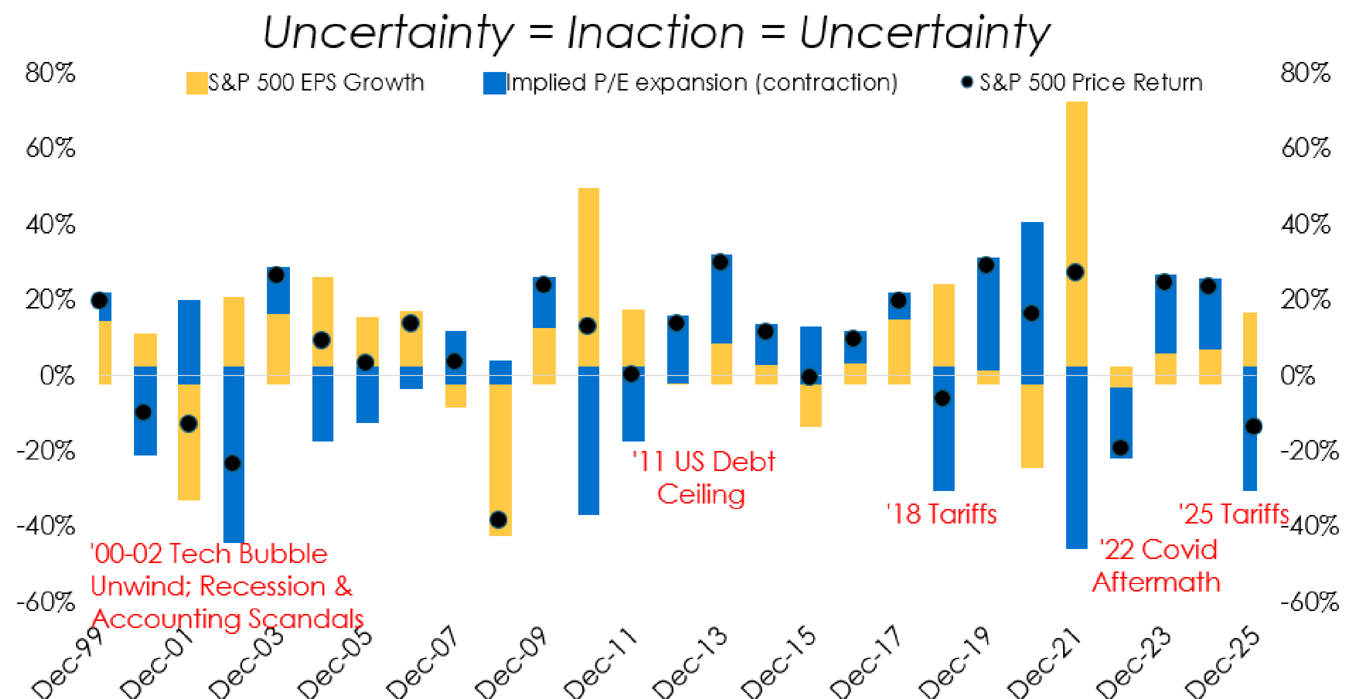
Uncertainty = Inaction = Uncertainty

“There are two kinds of forecasters – those who don’t know and those who don’t know they don’t know.”

– John Kenneth Galbraith – economist and diplomat (*1908-2006*)

Recently, we were reminded of the quote attributed to the ancient Greek philosopher Socrates – arguably one of the greatest thinkers at the time – “I know that I know nothing”.

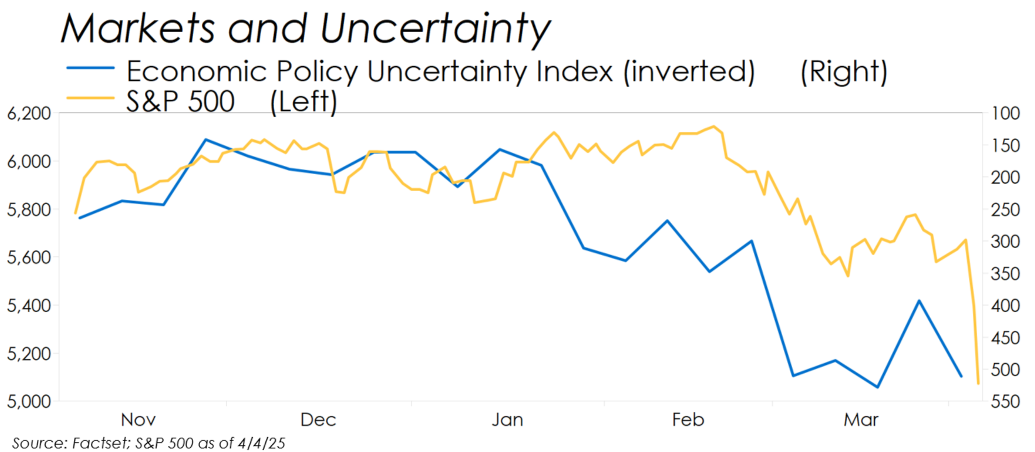
In light of the heightened policy uncertainty, investors might be channeling their inner stoicism in starting to recognize that “they know they don’t know”. Anxiety over trade policy and recently announced tariffs is creating a shakedown of confidence among consumers, corporations and investors. To read more about those specifics and our thoughts on the tariffs, please click the link here – (https://www.bankatfirst.com/personal/discover/flourish/tariffs-galore.html).



Source: S&P Price Return from Factset; S&P 500 EPS Growth is based on S&P 500 operating earnings from S&P Global. 2025 earnings growth is projected based on consensus expectations as of 3/31/25. 2025 price return as of 4/4/25.

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

Uncertainty can often lead to inaction which in turn can lead to more uncertainty. For risk assets, this uncertainty frequently takes the form of a lower valuation multiple. That's because investors are less willing to pay as much for every dollar of earnings that a stock generates when they're unsure what the earnings might be. As can be seen in the chart on the prior page, annual price returns have been de-composed into that which is derived from both earnings growth (contraction) and P/E expansion (contraction). Prior periods of pressured returns due primarily to valuation compression include: the 2000-02 Tech Bubble Unwind and Recession, the 2011 US Debt Ceiling Downgrade, the 2018 Tariffs, the 2022 Covid Aftermath and most recently the 2025 Tariff announcements.



Source: Factset; S&P 500 as of 4/4/25

As can be seen in the chart at right – it seems pretty clear that as policy uncertainty has increased (blue line is inverted on the right axis), the S&P 500 has felt the weight of that anxiety. Investors have been quicker to react first and ask questions later – especially in the domestic markets where some of the most expensive stocks reside. While earnings expectations have seen a limited impact so far, uncertainty is causing investors to demand a higher premium in the form of a lower valuation multiple in trying to anticipate a lower earnings result.

After the pronounced selloff following the tariff news in early April, near term sentiment measures for domestic equity markets have reached extreme (bearish) conditions so a bounce in risk assets would not be surprising and the composition of the rally important to monitor. From here, the fundamentals remain paramount. Make no mistake, tariffs are expected to be a hit to growth (in terms of both earnings and GDP) as markets are starting to price in rising recessionary fears. To what extent are offsets being considered (tax advantages, de-regulation, lower energy prices and looser monetary policy)? These are things we'll be monitoring in deciphering the direction of travel. Above all else, we find investors should keep in mind the following:

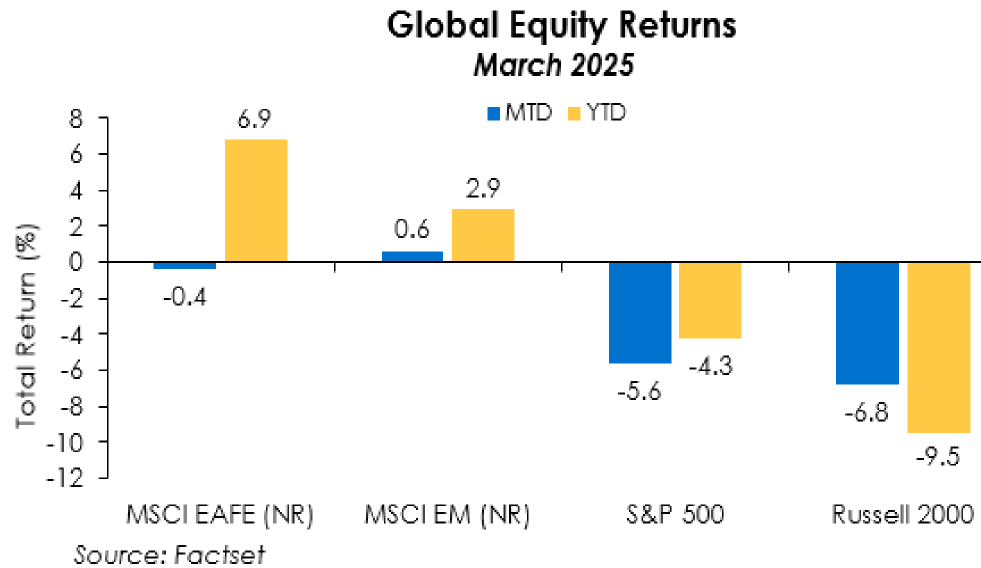
- Stay focused on the things you can control like ensuring you have adequate 6-12 month liquidity needs which should allow your long-term investment monies to stay invested.
- Has the structural integrity of your plan changed (purpose of money, time horizon, liquidity needs, risk tolerance)? If the answer is no, then recognize that the economy and the market run in cycles that diversified portfolios are there to help mitigate.
- Short term volatility is often the price one pays for the benefit of higher long-term returns.

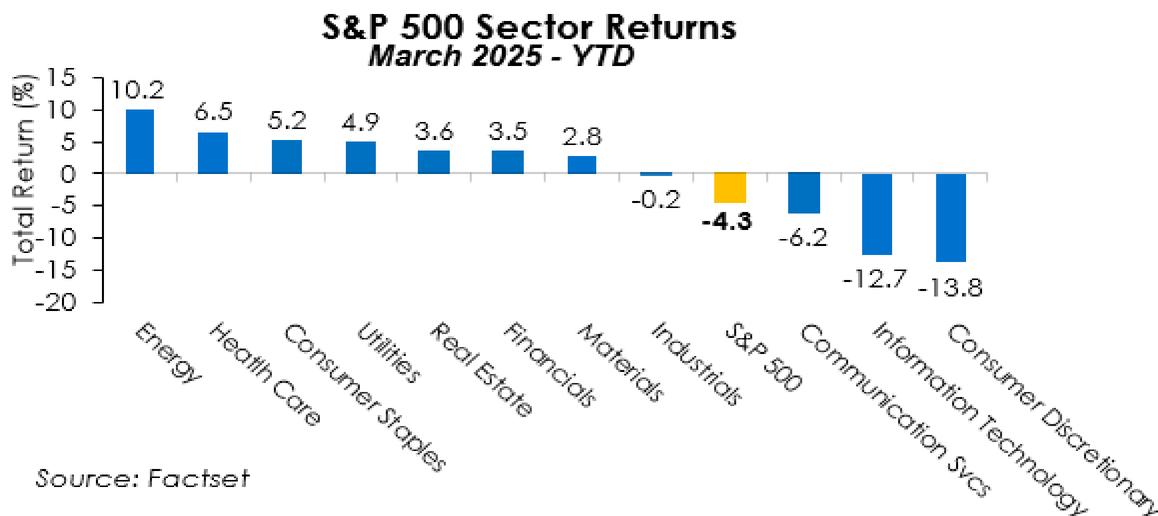
The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

Stocks and REITs sold off during March on growth, tariff, and inflation concerns. Bonds held up better with high quality generally outperforming low quality as investor appetites for risk waned given increased economic and policy uncertainty. Commodities were the standout, posting another month of strong returns led by precious metals, industrial metals and energy.

Stocks

Emerging Markets (MSCI EM) outperformed in March and year-to-date as speculation of AI democratization has breathed new life into China's tech stocks. International Developed Markets (MSCI EAFE) were down marginally for the month but lead all equity classes for the year as investors begin to embrace the idea of diversification and reduce portfolio concentration/valuation risk. Meanwhile, domestic stocks came under pressure again with U.S. Large Caps (S&P 500) and Small Caps (Russell 2000) down mid to high single digits on tariff and stagflation fears. From a sector perspective, performance has been much broader year-to-date with the notable exception of Information Technology, Communication Services, and Consumer Discretionary all having lagged significantly.

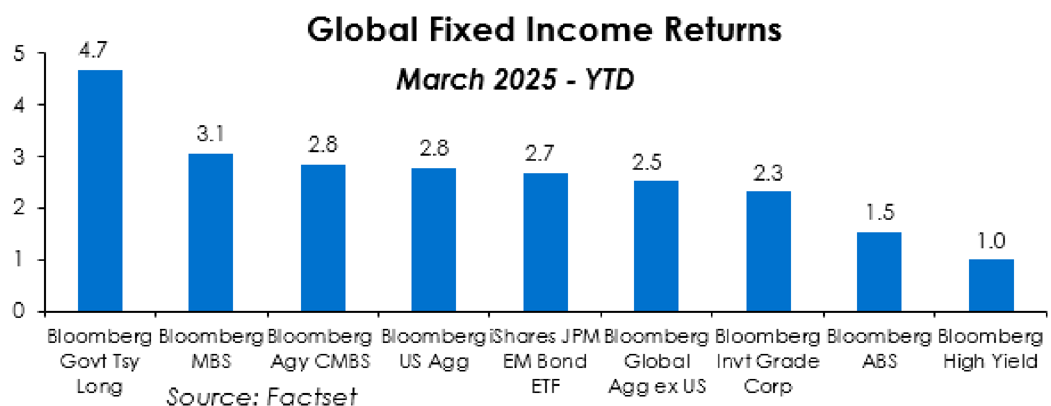




The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

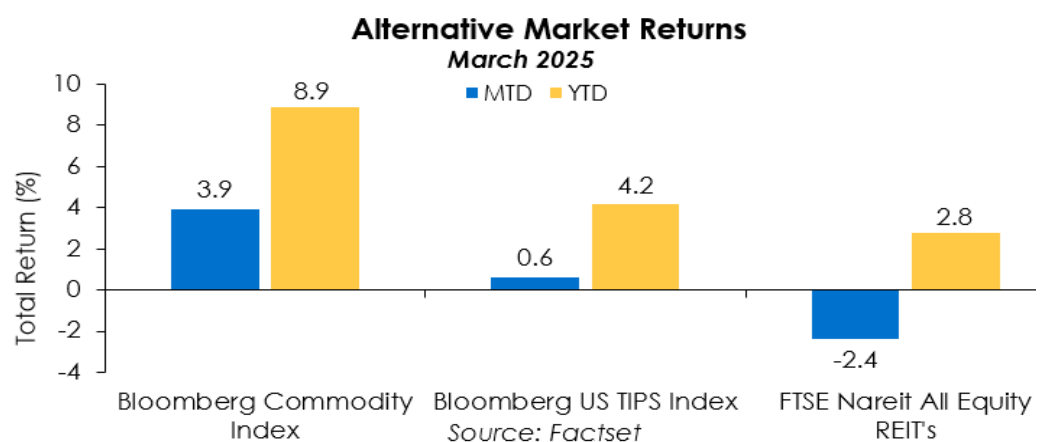
Bonds

Policymakers pivoted to an easing bias by reducing the Fed Funds rate by 50 basis points at their September meeting and another 25 basis points each at their November and December meetings (Fed Funds at 4.25-4.50%). While this easing bias is the first in over four years, policymakers left rates unchanged at the January and March meetings. Since December, the Fed has reduced the number of expected 2025 rate cuts from four to two (25 basis points per) and indicated they expect slower growth and higher inflation by this year's end. With that as the backdrop, Bond returns held up better than Stocks in March as investors embraced a risk-off stance with high quality generally outperforming low quality and long duration. Year-to-date, interest rates peaked mid-January and have steadily declined. Long Duration Treasuries (Bloomberg Govt Tsy Long) have been the standout for the year with Asset Backed Securities (Bloomberg ABS) and High Yield (Bloomberg High Yield) lagging.



Alternatives

Commodities were positive for the month and have been the best performing asset class year-to-date with strength in precious metals, industrial metals, and energy. Meanwhile, publicly traded Real Estate (REITs) have posted positive returns for the year though declined in March on increased concerns of stagflation. Finally, year-to-date returns on Treasury inflation protected securities (TIPs) outperformed nominal Treasuries amid rising short to intermediate term inflation expectations.



The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

Market Outlook

"It's Tricky to rock a rhyme, to rock a rhyme that's right on time. It's Tricky."

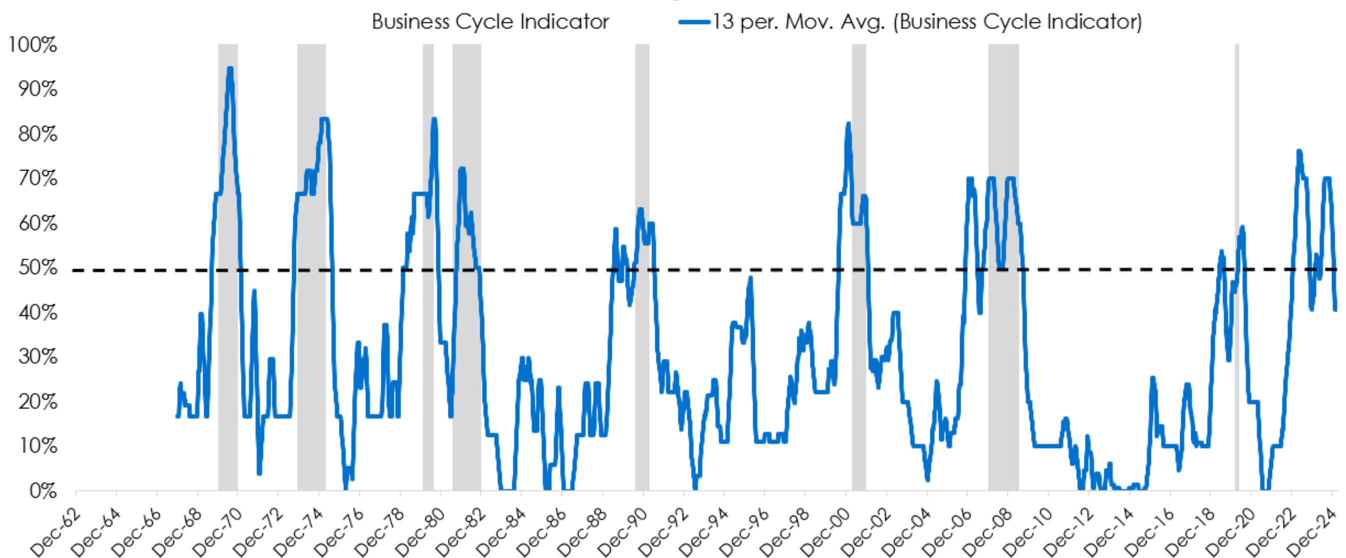
– Run DMC, *It's Tricky* (1986)

As the page turns further into 2025, we remain focused on the ever evolving Tricky "Tri-Cycle" – the "three cycle" framework we're using to assess the landscape. A stagnating (and late) Economic Cycle, quickly maturing Profit Cycle and wildly reversing Policy Cycle – makes for the continuation of a Tricky backdrop that requires investors to keep their proverbial eyes up and "Head on a Swivel". Let's explain.

Tricky "Tri-Cycle"

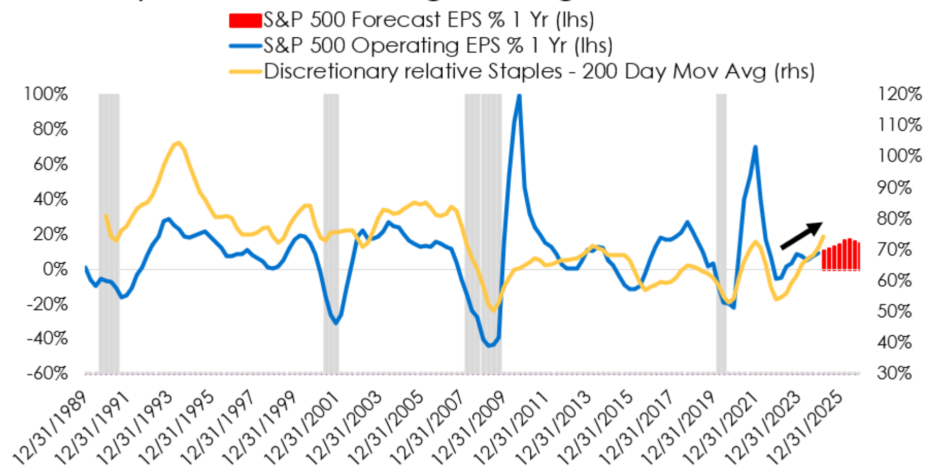
Cycle	Stage
Economic Cycle	Stagnating
Profit Cycle	Maturing
Policy Cycle	Reversing

Economic growth in the first quarter is expected to slow materially, in part, from the inaction related to elevated uncertainty. Slowing growth might also come with sticky inflation of higher priced (tariffed) goods until demand recalibrates into disinflation. What's more, we believe there's fundamental evidence – including the yield curve, leading economic indicator composites, certain survey relationships and especially labor market measures – that point to being on the later side of the economic cycle. As can be seen below in our business cycle indicator, an increased percentage of measures being triggered is a good illustration that we remain at comparable late cycle levels in the economy (with recessions designated by shaded regions).

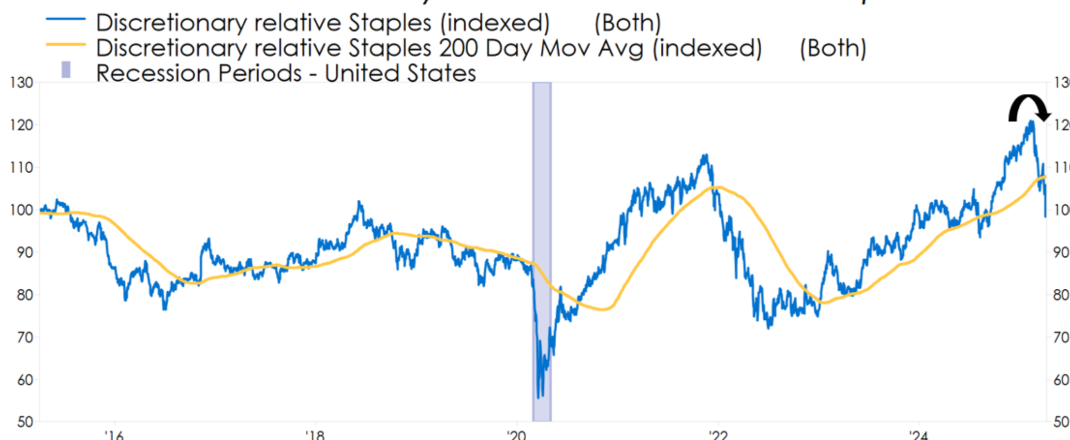


The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

At this point, the profit cycle doesn't look as late as the economic cycle but changes in the policy setup – namely higher potential taxes imposed from tariffs – suggest a quickly maturing backdrop. As can be seen in the chart at right – profit growth (blue line) continues to ramp off of the earnings recession trough in 2022 with the consensus forecast (red bars) not suggesting a peak in growth until 2Q26. Also note, that when comparing the Consumer Discretionary sector against the Consumer Staples sector (both on an equal weighted basis using the relative 200 day moving average – yellow line), the pro-Discretionary tilt implies a cyclical bias that tends to coincide with an acceleration in earnings growth. However, we'd caution that the earnings numbers are likely stale with analysts expected to revise estimates lower as growth is negatively impacted. Lower stock prices is the market's way of trying to anticipate this move. The chart below shows the daily price change against that 200 day moving average measure. The recent weakening of Discretionary stocks relative to Staples stocks (blue line) is material enough to suggest that we may be nearing the peak in the forward earnings growth rate faster than the consensus expects. Such a change would suggest a downshifting in the profit cycle that has historically come with some rotational leadership changes. The bottom line is that the equity market is anticipating that the abrupt policy changes of late will have a negative impact on the fundamentals.



Source: Factset; S&P Global Indices with operating EPS defined on a trailing twelve month basis. Discretionary relative Staples is defined as the relative 200 day moving average using the S&P 500 equal weighted sectors indexed back to inception through 4/4/25.



Source: Factset as of 4/4/25.

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

Add to that, the third leg of the stool – a policy cycle that's abruptly reversing from looser fiscal and (relatively) tighter monetary to one that suggests the opposite. An unhealthy deficit setup is leading to reductions in government spending (tighter fiscal) and higher than anticipated tariff rates are likely to cause the Fed to react in lowering rates (looser monetary) – though this might be delayed due to the inflationary nature they initially cause. This abrupt change in policy is causing investors, consumers and companies to re-think the backdrop. With what seems like an increasingly large number of potential scenarios, it's no wonder that the only certainty might be a high degree of uncertainty.

The Certainty of Uncertainty

Past Policy	Future Policy
Looser Fiscal	Tighter Fiscal
Tighter Monetary	Looser Monetary

So what are the implications and key takeaways for portfolios?

From a portfolio positioning perspective, we continue to emphasize the importance of diversification and balance as a way to mitigate the high uncertainty as referenced above. While diversification has previously been an uncontroversial concept, the concentration present in portfolios today – by virtue of the price action over the last couple of years – suggests this notion remains a relic of the past. We respectfully disagree and earlier this year took the opportunity to rebalance portfolios to maintain that degree of balance. In so doing, we took some profits in US Large Caps and added to our overweight (OW) in US Core Fixed Income. In so doing, we have remained UW the most expensive and concentrated areas where we've viewed the long-term risk reward less favorably.

Within equities, our positioning incorporates balance geographically (tilt toward International) and within our US Large Cap exposure especially. Our bias has generally been to have more exposure to less expensive areas (down market cap vs top). As such, we've maintained a larger OW in Cyclical Value and Defensive sectors combined with a smaller sized cap bias. We remain UW the most concentrated and expensive Cyclical Growth areas.

Within fixed income, we remain biased toward the higher quality US Core Fixed Income segment – where we are longer in duration and have previously repositioned our Treasury exposure in acknowledging the steepening yield curve. This exposure remains among our largest OW in portfolios for diversification purposes though we've also added to International Fixed Income (EW), where the end of negative interest rate conditions has led to more attractive opportunities. Maintaining a higher quality bias means that we still remain UW the most expensive part of the bond market (High Yield) where tight spreads have made this unattractive in our view (with that beginning to reverse some).

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

Within alternatives, we remain fairly balanced across the board with neutral positions in Diversifed Alternatives, Real Estate and Commodities.

The information presented in the material is general in nature and should not be considered investment advice, is not designed to address your investment objectives, financial situation or particular needs. Information is gathered from sources deemed reliable but its accuracy or completeness is not guaranteed. The opinions expressed herein may not come to pass, are as of the date of publication and are subject to change based on market, economic or other conditions.

You cannot invest directly in an index. Indexes are unmanaged and measure the changes in market conditions based on the average performance of the securities that make up the index. Investing in small and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Asset allocation and diversification does not ensure a profit or protect against a loss.

Yellow Cardinal Advisory Group, a division of First Financial Bank, provides investment advisory, wealth management and fiduciary services. Yellow Cardinal Advisory Group does not provide legal, tax, or accounting advice. The products and services made available by Yellow Cardinal Advisory Group:

Not Deposits | Not FDIC Insured | Have No Bank or Federal Government Guarantee | May Lose Value