WestStar
Wealth Management

WEALTH WATCH

2025 First Quarter Review & Second Quarter Outlook

In the January edition of the Wealth Watch we noted that 2025 was beginning with the economy in a very strong position—excellent GDP growth, low unemployment, strong productivity, solid corporate earnings, and inflation below 3%. We also cautioned about factors that could jeopardize this economic strength—specifically mentioning "sweeping tariffs on imported goods" that could "cause a retaliatory trade war…and reignite inflation." Little did we know just how prescient a warning this was.

Tariff-ying Markets

As the first quarter progressed and geopolitical tensions intensified, so, too, did uncertainty surrounding the Administration's intended action regarding trade, regulation, and fiscal policy. Tariff talk began in February, curiously targeting our allies in Canada and Mexico, and soon expanding to China and most of the rest of the world. What was hoped to merely be a negotiating tactic turned out to be what many economists describe as a worse-than-worst-case scenario. The policies outlined on "Liberation Day" were roundly panned by economists and analysts from across the political spectrum. Terrified investors agreed, as evidenced by the early April market meltdown.

Marie Curie once said, "Nothing in life is to be feared, it is only to be understood. Now is the time to understand more, so that we may fear less." In this edition of the Wealth Watch we endeavor to understand the tariff policy, the potential impact on the economy, the outlook for the capital markets, and how investors should position their portfolios accordingly.

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What You Need To Know:

- Early 2025 has been marked by extreme market volatility relating to tariff uncertainty
- Inflation and economic slowdown may result from tariffs and global trade war
- Sustained uncertainty is arising from continually changing tariff policy
- Uncertainty negatively impacts both consumer and business spending, detracts from economic growth, and inflames market volatility
- Market corrections are normal and intra-year declines are not indicative of year-end results
- The Fed may make no immediate rate changes and bonds may exhibit relatively solid performance in various interest rate scenarios

Asset Class Index Performance* Year-To-Date As of March 31, 2025

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Commodities
8.88%

International Developed Market Stocks
6.86%

International Emerging Market Stocks
2.93%

US Investment-Grade Bonds
2.78%

International Bonds
2.53%

Real Estate (REITs)
1.86%

Money Market (Cash)
1.06%

High Yield Bonds
1.00%

Alternative Investments
0.76%

US Large Cap Stocks
-4.27%

US Small Cap Stocks
-9.48%

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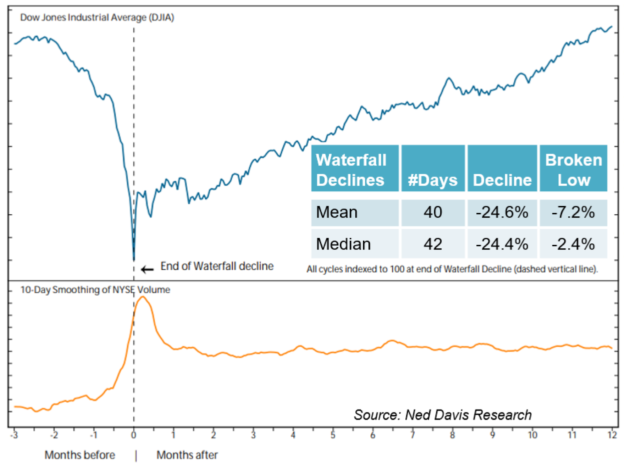
Tactical Positioning & Market Volatility

As previously mentioned, given growing uncertainty on a number of fronts in late February, we anticipated a spike in volatility, the possibility of a market correction, and the potential for inflation reigniting. Accordingly, in early March we made a tactical change in our actively-managed strategies wherein we reduced stocks and increased Alternative Investments (volatility defense), Real Assets (inflation defense), and cash. This was a timely maneuver, as early April experienced a precipitous drop in what we would call a "waterfall decline." The chart at right reflects typical market action around the 14 waterfall declines we have experienced since 1929. They typically last 40 days on average, with the waterfall decline itself falling approximately -25%. Following head fake relief rallies, there is nearly always another decline, or retest, of the waterfall nadir, and in 65% of cases the market drops below that level by an average of about -7%. This would suggest that, while the week of April 7th was actually a positive one for the market, it would be consistent with history if it turned negative again. That said, we would note that the two most recent waterfalls, 2018 and 2020, did not experience a retest of the lows, and positive news on the tariff front might actually trigger a sustainable uptrend. In the meantime, expect volatility to persist.

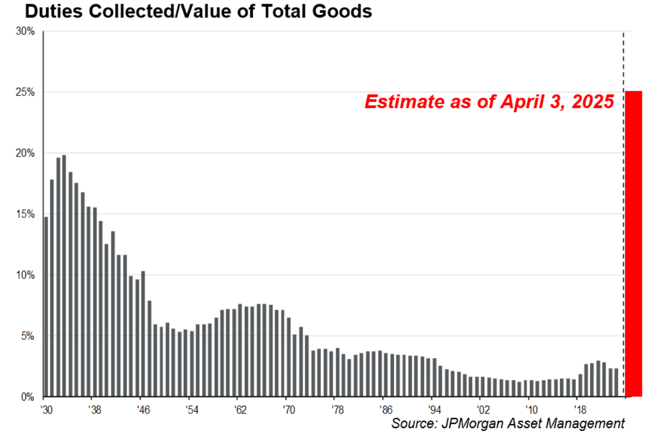
Historical Performance of DJIA Around Waterfall Declines



Tariffs, Uncertainty, & Economic Fallout

Tariffs are a regressive tax, are inherently inflationary and, particularly if applied in a blanket manner, detrimental to economic growth. In the January edition of the Wealth Watch we presented a chart illustrating the level of tariffs should campaign trail pledges come to fruition. As it happened, that estimate was overly optimistic. We reproduce an updated chart at right indicating that the "reciprocal" tariffs are far beyond the infamous Smoot-Hawley levels of the Great Depression era and, as noted by JP Morgan Chief Economist Bruce Kasman, equate to the "largest tax hike in 57 years." Yet it is the way the Administration defined "reciprocal" that shocked markets. Economists and analysts were perplexed by the figures shown on the chart displayed at the "Liberation Day" announcement. As an example, Japan had an average tariff rate on the US of around 3% at the beginning of the year, yet the chart showed a rate of 46%. Astute analysis soon determined the formula used was simply a country's trade deficit divided by its exports to the US. Collective head-scratching remained unabated, however, as this methodology was widely described as being nonsensical. First, trade deficits are not intrinsically bad. For example, the US has a population of 340 million people with an average annual income of around $65,000; Vietnam has a population of 100 million with an average income of $8,000—it stands to reason that a larger, wealthier country would buy more from a smaller, poorer one. One recent estimate suggested every man, woman and child in Vietnam would have to buy 3 Ford F150 trucks to equalize this trade deficit.

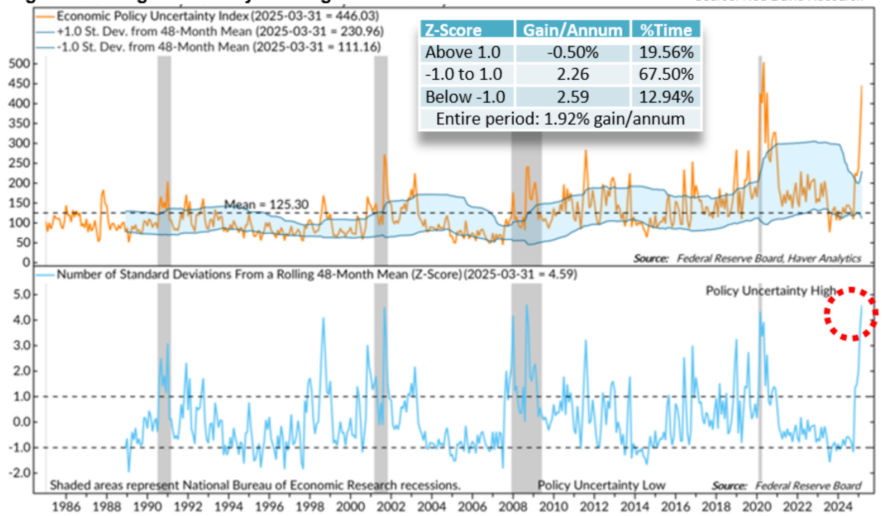
Average Tariff Rate on US Goods Imports for Consumption
Duties Collected/Value of Total Goods



*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Developed: MSCI EAFE Index; Int'l Emerging: MSCI Emerging Markets Index; US Inv-Grade Bonds: Bloomberg Aggregate Index; Int'l Bonds: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodities: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

Secondly, the calculation itself is monumentally simplistic and seemingly may have been derived by AI chatbots (hence tariffs on countries populated only by penguins.) Further exacerbating an already capricious situation is the continual and ever-evolving application of tariffs. At the time of this writing, "fentanyl tariffs" remain in effect, said "reciprocal" tariffs have been postponed, the 10% baseline ones still apply except on Canada and Mexico which remain at 25% on non-USMCA goods, and tariffs on China were increased to 145% except for exemptions on semiconductors, smartphones, and computers—exemptions which may or may not actually be in effect depending on which administration official one asks. This lack of clarity and expanding uncertainty is only amplifying volatility and further damaging the economy. The chart at right shows the Economic Policy Uncertainty Index (orange line) and, in an effort to gauge extremes, the standard deviation of the rolling 4-year average of the Index, or "z-score" (blue line). Historically, when the z-score has been above 1, the economy contracts by -0.5% per year. At present the z-score is at an all-time high near 5, indicating the potential for recession. Further bolstering this concern is the impact of uncertainty on both consumers and businesses. Tariffs will have a disproportionate impact on the middle and lower classes and a curtailment of spending will damage economic growth. Likewise, businesses may postpone capital expenditures, hiring, etc.—all amid an already slowing economy. And though March inflation actually declined, it may merely be the calm before the storm.

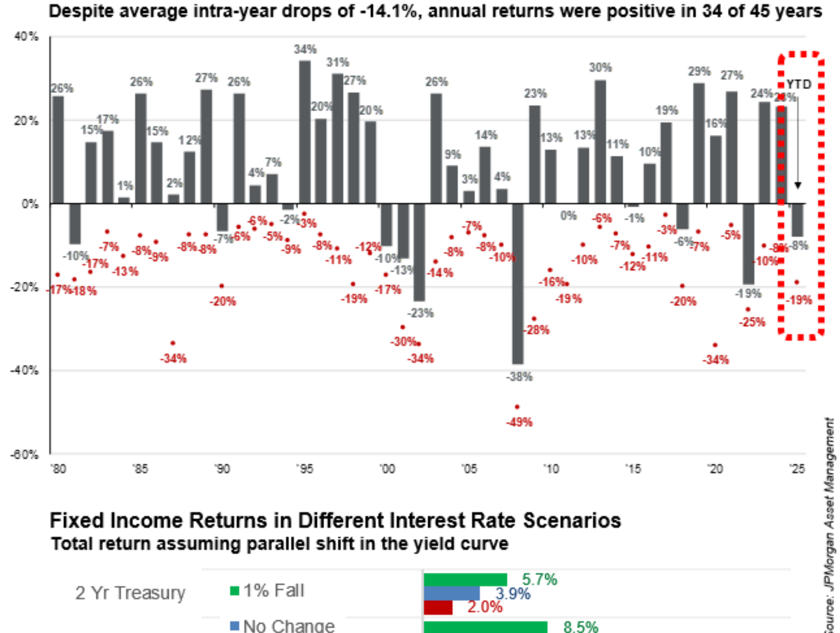
US Economy vs. Economic Policy Uncertainty Index
High and Rising Uncertainty is a Negative for Economic Growth
Source: Ned Davis Research



Q2 Investment Strategy

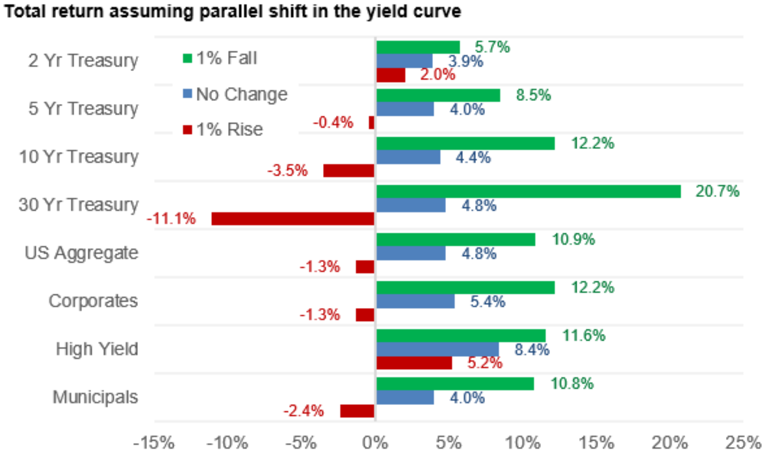
H.P. Lovecraft wrote, "The oldest and strongest emotion of mankind is fear, and the oldest and strongest kind of fear is fear of the unknown." There is no doubt that the unknown pervades the global economy at present. While in these environments it is natural to be fearful, its is important to remember that volatility is to be expected in investing and even corrections are relatively common. The chart on the upper right reflects historical calendar year stock market volatility. We find that despite the market being down at some point in nearly every year (red dots) it ended positive 75% of the time (gray bars). The same may well apply to 2025.

S&P Intra-Year Declines vs. Calendar Year Returns
Despite average intra-year drops of -14.1%, annual returns were positive in 34 of 45 years



Recent events have reminded us that bonds can also experience volatility when interest rates are moving. The Fed might ordinarily cut rates amid economic slowdown, yet their charge is to raise rates amid inflation. Being that we are facing both scenarios, the Fed may make no changes until additional clarity on developments is attained. The chart on the lower right suggests that most types of bonds will fare relatively well in any of these scenarios. Whatever transpires, we will remain steadfast in our philosophy, prudent in our determination, and proactive in our strategy positioning. As Shakespeare wrote, "Things done well, and with a care, exempt themselves from fear."

Fixed Income Returns in Different Interest Rate Scenarios
Total return assuming parallel shift in the yield curve



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Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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