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Market Review and Outlook 1Q25

Highlights

While U.S. stocks began the year riding to new highs, after a 10% intra-quarter correction from the market peak, the S&P 500 Index closed the first quarter with a -4.3% total return loss.

Underlying fundamentals and investor sentiment heading into 2025 appeared resilient, but mixed economic signals, escalating trade policy uncertainty, and stretched valuations spurred the swift pullback in equity prices.

Valuations still remain rich, with the S&P 500 Index ending the quarter at 21x forward earnings, so sustained economic expansion and earnings growth will be critical to equity price support from here.

The odds of a near-term recession/bear market, while higher than the exceptionally low consensus assumptions a few months ago, remain relatively modest based on the still-solid economic backdrop.

Fixed income markets outperformed U.S. equities during the first quarter, with the Bloomberg U.S. Aggregate Bond Index posting a positive total return of 2.8%.

Amid rising economic uncertainty, investors flocked to the safety of fixed income assets. This put downward pressure on treasury yields throughout much of the quarter, which lifted bond prices.

Market Review and Outlook

Global equities reported mixed performance during the first quarter of 2025. While U.S. stocks extended their post-election rally during the first six weeks of the year, that optimism quickly reversed in the back half of the quarter as aggressive fiscal policy shifts (e.g., tariffs and government cost-cutting programs) and slowing economic growth fueled increased market volatility and rising recession concerns. The S&P 500 Index closed March with a first-quarter loss of -4.3%. Conversely, international equities reported solid quarterly returns, with developed markets (EAFE) surging 6.9% and emerging markets (EM) rising 2.9% during the first quarter, as investors rotated into areas of the global market that offered better valuations and more supportive economic policies.

Following back-to-back years of above-trend GDP growth in 2023 (+2.9%) and 2024 (+2.8%), the U.S. economic fundamentals heading into 2025 appeared resilient, with inflation pressures continuing to recede and central banks poised to move interest rates lower. The market consensus entering the year was for economic growth to remain above 2.0% in 2025 and 2026, under the assumption that the new administration would carefully balance potentially inflationary, anti-growth policies with pro-growth initiatives like tax cuts and deregulation. However, evidence emerged during the first quarter that U.S. gross domestic product (GDP)— the sum of consumer spending, business spending, government spending, and net exports (i.e., exports minus imports)—was slowing more than anticipated. Consumer spending, which accounts for 70% of GDP, decelerated to an estimated 0.4% in the first quarter (vs. +4.2% in 4Q24) amid consumers' mounting concerns about tariffs fanning inflation and potentially stalling the economy. A significant spike in imports, due to stockpiling of foreign goods ahead of the tariffs, also put downward pressure on the net exports component of GDP. As a result, the Federal Reserve Bank of Atlanta projects that U.S. GDP contracted at an annualized rate of -2.8% during the first quarter of 2025 (a finalized number will be published April 30th), after forecasting it to grow as much as +3.9% earlier in the year. Most Wall Street economists and strategists still believe GDP growth for the full year will remain positive, but their collective growth estimate for calendar 2025 has moved from an above-trend range of 2.2%-2.5% to a below-trend level of around 1.5%.

The tariff threats espoused by President Trump on the campaign trail were once viewed as negotiating tactics, but broader and more significant tariffs have been announced. The Trump administration has indicated they are willing to accept some near-term economic pain to achieve their longer-term objective of correcting the long-standing U.S. trade deficit (which has persisted every year since 1991). Thus, the so called "Trump put"—the belief that the president would calibrate policies to appease fickle equity investors—doesn't appear to playing out the way many market observers had anticipated/hoped (for now). During the first quarter, the S&P 500 Index moved from an all-time high on February 19th into market correction territory (defined as a 10%-plus decline) in just 20 days—the fifth fastest market correction in 75 years, as shown in the table below.

S&P 500 Index Corrections

(1950-2025)

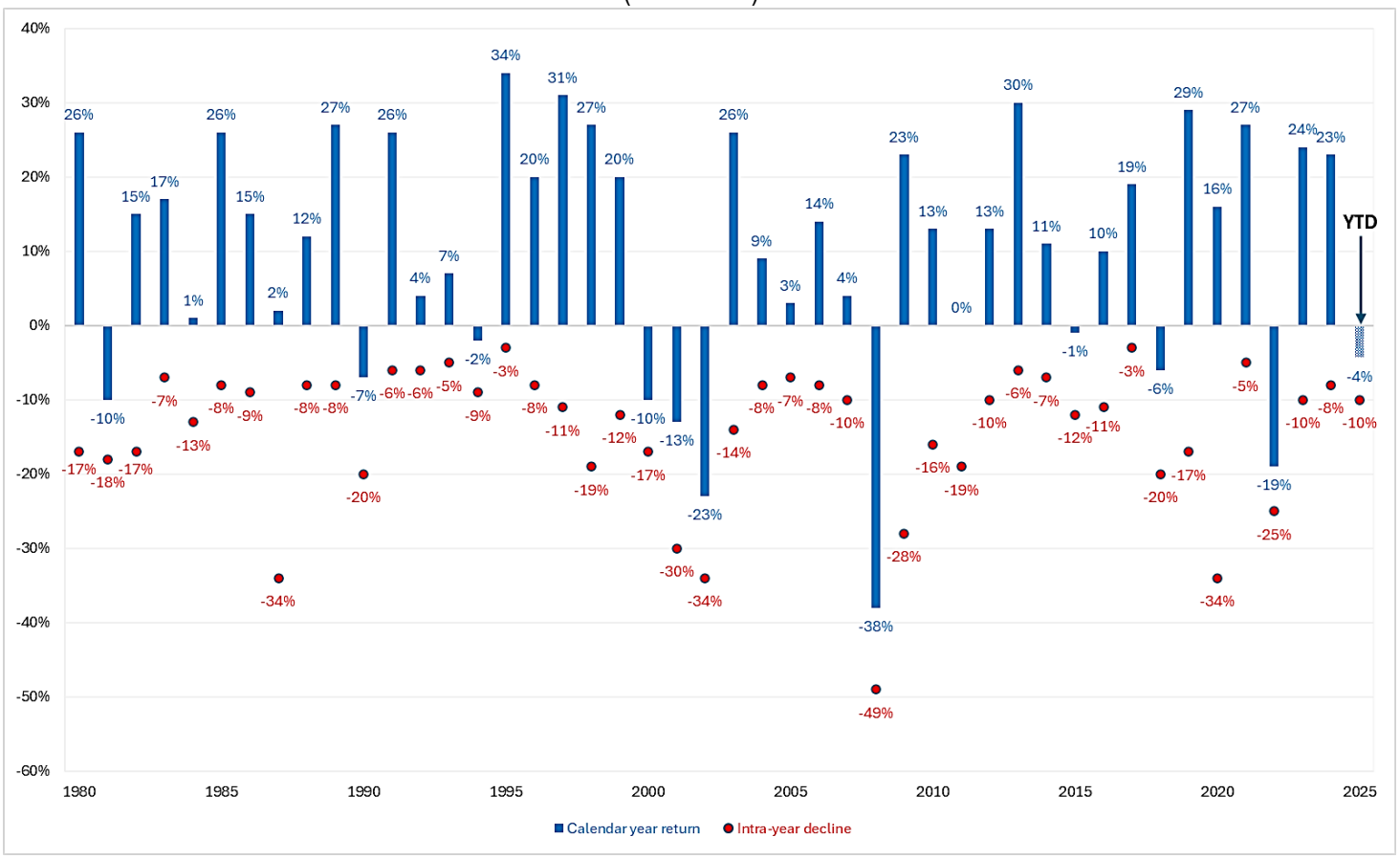
Fastest 10% Correction Cycles					S&P 500 Forward Return Post 10% Decline Date			
Rank	52-week High	10% Decline	# of Days	Cause	1 month	3 months	6 months	12 months
1	2/19/2020	2/27/2020	8	COVID	-14.7%	1.9%	15.6%	27.9%
2	1/26/2018	2/8/2018	13	Trump Trade War 1.0	8.0%	4.5%	10.7%	4.9%
3	6/12/1950	8/29/1950	17	Korean War	1.4%	11.3%	14.2%	20.2%
4	9/23/1955	10/11/1955	18	Eisenhower Heart Attack	9.6%	9.1%	19.7%	14.8%
T5	**2/19/2025**	**3/11/2025**	**20**	**Trump Trade War 2.0**	**???**	**???**	**???**	**???**
T5	10/5/1979	10/25/1979	20	Volker Shock	4.7%	13.4%	3.4%	29.5%
T5	10/7/1997	10/27/1997	20	Asian Financial Crisis	8.5%	9.2%	26.3%	21.5%

Source: Fundstrat, Bloomberg

The rapid selloff sparked concerns about the market's near-term prospects, particularly the risk of slipping into a more punishing bear market (defined as a 20%-plus decline). While no two downturns are the same, and past performance is no guarantee of future results, investors can take some comfort in the fact that the fastest-developing corrections outlined above have historically been relatively short in duration. In fact, all six of the prior fastest-correcting market cycles more than fully recouped their losses within three months of the 10% decline date.

Looking at market drawdown cycles more broadly, there have been 48 market corrections since WWII (roughly one every 20 months) and only 12 of them turned into a bear market. In other words, 75% of market corrections turn out to be benign events. And as the chart below shows, when stocks experience a double-digit decline at some point during the year, the S&P 500 Index often (65% of the time) still closes the calendar year with a positive total return.

S&P 500 Index Calendar Price Returns and Intra-year Price Declines
(1980-2025)



Source: FactSet, JP Morgan Asset Management

A garden-variety market correction (when no bear market ensues) takes an average of 133 days to hit bottom, while losing an average of 14% along the way, according to data compiled by CFRA Research. Those figures suggest that the current correction (at 40 days as of quarter-end March 31) could still be in the early innings from a calendar perspective, but the worst may be over from a market drawdown standpoint—assuming a bear market is avoided. The odds of a near-term recession/bear market, while higher than the exceptionally low consensus assumptions a few months ago, remain relatively modest based on the still-solid economic and corporate earnings backdrop.

As noted above, U.S. GDP forecasts for 2025 have moved lower, but they continue to reflect decisively positive growth. It's a similar story for corporate earnings, as S&P 500 profits grew 18% year-over-year in the fourth quarter of 2024—the highest since 4Q21 (or 3Q18 excluding COVID). There has been a notable pullback in earnings growth forecasts for the first half of 2025, which has reduced the full-year 2025 profit growth estimate from 14.1% at the start of the year to 11.7% currently. Nonetheless, the sustained prospect of double-digit corporate earnings expansion this year seemingly provides plenty of buffer against the potential for realized economic and profitability drag if one of the more damaging tariff scenarios ultimately ensues.

Valuation is another consideration though. While tariffs are easy to blame for the market's recent struggles, a portion of the correction likely stems from a reassessment of the steep valuations equities were fetching earlier this year. At its peak in February, the S&P 500 Index was trading at a forward P/E multiple of 22.5x—a 33% premium to the 30-year average of 16.9x. Valuation multiples for mega-cap technology companies, which currently exert a disproportionately large influence on the market-cap weighted index, were even more extreme at an aggregated forward P/E of 31x. A rationalization of those tech companies'—and the broader market's—unsustainably high earnings multiples was inevitable. Valuations still remain rich, with the S&P 500 Index ending the quarter at 21x forward earnings, so sustained economic expansion and earnings growth will be critical to equity price support from here. Even if those factors remain positive, however, the total return outlook for U.S. equities over the next 10 years is likely to be below the double-digit averages reported in recent decades due to today's high starting valuations.

There's no question that trade tensions and economic uncertainty add complexity to the current environment. While a recession/bear market is not our base case assumption, the risk of that scenario does increase if consumer uncertainty spurs weaker spending and lower corporate earnings in the coming quarters. As a result, we continue to approach financial markets with a heightened level of near-term caution. After two consecutively strong years of 25%-plus equity total returns, persistently low volatility, and the market's post-election jubilation around the new administration's pro-growth policies, we noted in our prior 4Q24 quarterly letter that investors should expect stock market returns to moderate and volatility to increase in 2025. Accordingly, we view the recent market pullback as largely warranted and a healthy check on overly optimistic investor sentiment at the beginning of the year. While corrections are painful, a reset of stock valuations will ultimately create more attractive return opportunities for long-term oriented investors.

Core Portfolio

During the first quarter, we initiated a small position in Enovix Corporation (ENVX).

Enovix is a U.S.-based developer of silicon batteries for consumer products—primarily focused on wearables and smartphones. The company is looking to disrupt the ~$13 billion mobile computing and communications battery market with its proprietary technology that enables 100% active silicon anodes, producing dramatically improved performance over the well-established graphite anodes currently used in the majority of lithium-ion batteries. The advantages of Enovix's battery architecture include longer battery life, faster charging, easier sourcing of material inputs, and enhanced safety from its non-combustible properties. While Enovix's existing revenues are limited to conventional batteries (primarily sold to the U.S. defense sector), with seven of the eight largest smartphone manufacturers currently sampling its 100% active silicon anode batteries, the company could see parabolic growth in sales and profits in the coming quarters if one or more of these manufacturers adopts Enovix's battery architecture.

Tactical Portfolio

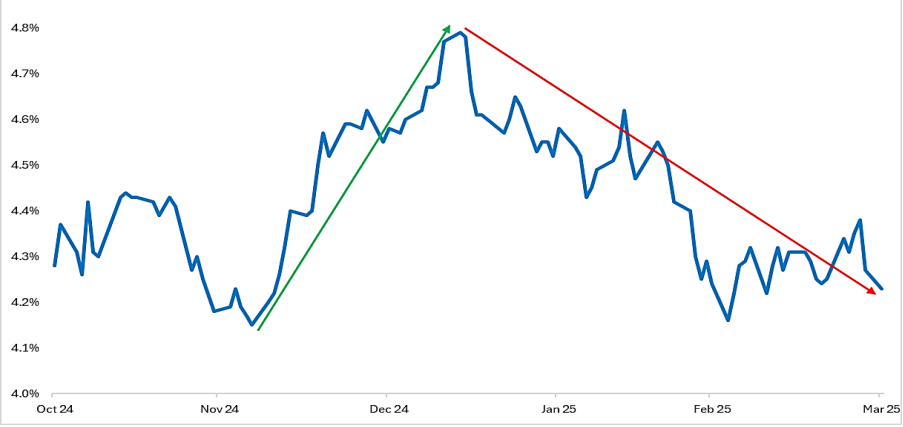
Our tactical investments experienced divergent results during the first quarter. The price of gold surged another 20% in the quarter, notching its biggest three-month gain since 2011, as growing concerns over economic instability, geopolitical tensions and inflation drove another wave of investments into the safe-haven asset. This extended the precious metal's multi-year rally, as gold hit numerous fresh records during the quarter before closing March at an all-time high price of $3,157 per ounce.

Meanwhile, our investment in uranium was negatively impacted by another 12% price decline in the commodity during the quarter. Two factors contributed to the downward price pressure. After surging to a multi-decade high early last year with the artificial-intelligence rally, as tech companies explored nuclear options to power their data centers, uranium prices were already softening when the DeepSeek headlines (January 2025) suggested AI might prove less energy intensive than once believed. This was followed by the negative impact of increased tariff uncertainty, which prompted U.S. nuclear-power operators (the world's largest uranium buyers—who source 95% of nuclear fuel from abroad, including 25% from Canada) to slow purchases and delay new contracts. Despite these short-term moves, we continue to believe the long-term fundamentals for uranium remain solid. Nuclear plant owners will eventually have to buy fuel supplies, regardless of the tariffs. Additionally, uranium demand is expected to rise 25% over the next 15 years based on new international reactor construction plans that are already in place, as well as demand from existing power plants—even without the nuclear-energy boom from AI power demands.

Fixed Income

Bond markets outperformed U.S. equity markets during the first quarter, with the Bloomberg U.S. Aggregate Index posting a positive total return of 2.8%, as investors bid up bond prices by flocking to the perceived safety of fixed income assets amid rising economic uncertainty and increased volatility. This put downward pressure on treasury yields throughout much of the quarter, with the benchmark 10-year Treasury yield ending March at 4.2%, after trading as high as 4.8% in mid-January.

U.S. 10-year Treasury Bond Yield
(10/31/24 - 3/31/25)



Source: U.S. Department of the Treasury

Along the yield curve, we've been emphasizing a preference for short-term to intermediate maturities for some time now. While prospective Fed rate cuts could reduce yields on shorter duration bond yields going forward, we still don't believe yields at the longer end of the curve are adequately pricing in the risk that sticky inflation could push interest rates higher (sending longer maturity bond prices lower). As a result, we continue to believe staying tactical with modest duration fixed income exposure offers the best risk-adjusted return strategy at this time.

Final Thoughts

The scope of fiscal changes out of Washington during the first 10 weeks of the new administration's term has been unprecedented—seemingly raising the execution risks and potential for unintended consequences stemming from such drastic/immediate policy overhauls. We would not be surprised to see the market re-test (or even pierce through) the first-quarter low at another point this year, as the 'detox period' of efficiency, deregulation, and trade may take time to work through the system and subject the market to more pain before the promised benefits materialize. While this would understandably be unnerving to investors, overreacting to short-term volatility tends to be counterproductive because it is notoriously difficult to time markets. During uncertain times like this, maintaining a long-term perspective and staying in the market to capture the power of recoveries often proves more rewarding.

We appreciate your continued confidence in us to manage your assets. As always, please reach out at any time with your questions or concerns.

Enjoy the spring warm-up!

Parkside Investments, LLC

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