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2025 First Quarter Commentary

Market Cycles and Volatility

As financial advisors, we have seen many periods of high volatility and market decline. Some of those periods were very prolonged, while others were more short-lived. Every time markets fall apart, we add to our body of understanding. Most importantly, we substantiate how and why an allocation to bonds helps to minimize portfolio decline, thus shortening the time for portfolio recovery. Known as "recapture ratio," this metric is particularly important to those drawing upon financial capital in or near retirement.

At the end of 2024, we knew economic fundamentals were strong, stock valuations were high, and our portfolios were coming off two strong back-to-back years. No one knows how to gauge the impact tariffs will have on company revenues, profits, or the economy at large, but history and the stock market will again be our teachers. As the Ides of March were upon us, tariff uncertainty was gaining momentum amidst weakening but still pretty good economic data suggesting that if a recession were to materialize, it could be short and shallow.

Investment Strategy in a Climate of Uncertainty

As markets tried to unpack the President's tariff comments, we began increasing our allocation to bonds rotating away from companies with stretched valuations, adding capital to more defensive sectors and reasonably priced stocks. The high-flying tech sector was hit particularly hard, at one point down approximately 13%, while the S&P 500 was not far behind, dropping almost 10%.[1]

As of this writing, the President has delivered his "liberation day" tariff policies, and in response, the fear of the unknown and the probability of recession have increased. "Certainty" is hard to come by right now. As volatility spikes and markets decline it is reassuring to watch how our investment process works, and as a result, how our portfolios perform. Our steps to lower exposure to stocks and/or rotate to undervalued companies, dividend payors (SCHD, VIG, SPYV) and international stocks (SGIIX, VEA) proved effective for the first quarter, as each risk-based portfolio model met our expectations.

[1] YCharts. (n.d.). *Nasdaq Composite (^IXIC), S&P 500 (^SPX)*. YCharts. Retrieved April 4, 2025, from https://ycharts.com/indices

Portfolio Allocation Going Forward

We maintain exposure to growth stocks, including artificial intelligence, robotics, and the mega-cap space (SCHG, FFLC, AIQ, and MGK). Small-cap companies (TMSL) remain some of the hardest-hit stocks and could be hit even harder if interest rates reverse course and trend higher, as these companies typically rely more heavily on debt financing and are thus sensitive to rising borrowing costs**.** Bonds found in all but the 100% stock model, continued to provide stability, good yield (4-6%), and welcomed negative correlation (in other words, they went up when stocks went down). Roughly 40% of our fixed income remains in the hands of our actively managed PIMCO ETF (PYLD), paired with our ladder of investment-grade bonds (IDDQ, IBDR, and IBDS) maturing in 2025, 2026, and 2027. Shorter duration in our bond holdings will help should interest rates rise. Cash remains in our U.S. Treasury fund, USFR.

Looking Ahead: Navigating Tariffs and Recession Risk

Market volatility and further portfolio decline are likely as the chance of recession increases. We expect markets worldwide to remain very uncertain as investors, corporations, and likely the Federal Reserve will respond to the administration's new and at times confusing message regarding the use and purpose of tariffs. Corporate earnings and revenue forecasts will be important, revealing to what extent businesses and various industries project how they are affected by trade policy. The Trump administration is betting deregulation and tax relief, both of which should begin to materialize in the coming months, will help offset any negative implications of tariffs which could position markets to improve in the back half of 2025. Messaging out of the oval office is generally very simplified, and for the most part their goals are difficult to argue with. Who doesn't want to make our government more efficient, level the playing field for exports, or bring manufacturing back to the U.S.? However, President Trump's policies are also resetting the stage for markets and economies worldwide in a cloud of uncertainty leading to an increased chance of unforeseen consequences. As I mentioned in the past, implementation and execution of his strategies will be very important to avoid the appearance of a policy misstep. Only time will tell what degree economic growth is affected, and if there is an ensuing recession, will it be more than short and shallow? If you are invested in our moderate or conservative portfolios, they have been positioned defensively to minimize decline.

Continuing to Evolve as a Fiduciary Firm

As fiduciaries, we are always searching for ways to improve our services to you and always conduct our activities centered around what is in your best interest. Over the past two years we have accomplished many of our goals as a small advisory practice: we created a team culture of CFP advisors, transitioned to a fee-only practice, successfully integrated our clients' assets into Schwab, improved our website, and incorporated a state-of-the-art tech stack, including performance and integrated client management software. We continue to elect independent oversight of our advisory practice by affiliating with a Registered Investment Advisor (RIA), Novem Group.

In the meantime, please call us if you ever need to discuss your personal circumstances or review the impact that short or long-term portfolio declines could have upon your financial goals and objectives. We are always here to help, particularly during stressful market conditions.

Thank you,

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