

Q1 2025

Wealth Wise Partners



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Q1 2025 Summary in Charts

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The first quarter of 2025 didn't quite turn out as many investors thought it would, with US President Donald Trump's trade wars upending the rosy outlook for the economy.

After the stock market hit record highs to start the year, tariff threats spooked investors and dimmed the outlook. The result was a 10% slide from February's peak into "correction territory."

On the plus side for investors, bonds gained as concerns about the economy offset disappointment over stubborn inflation and shrinking expectations for Federal Reserve interest rate cuts.

Q1 2025 Summary

If there was a catchphrase for the first quarter, it was "market rotation."

Looking at sector and style returns, investors could simply hold a mirror up to 2024 and see its trends reverse. Growth stocks fell sharply while value rallied. Technology and communications stocks stumbled, while basic materials, healthcare, and energy jumped.

Moving Forward

On the equity side, S&P 500 valuations remain high despite the recent heavy sell-off and volatility. While we expect earnings growth to continue, investors should keep an eye on the direction of earnings revisions, which are generally trending lower and face pressure from international trade conflicts. After an early extension of 2024's strong returns, the shift away from growth and momentum stocks is evident.

The direction of travel certainly seems to be toward higher trade barriers. This year, we see growth slowing by more and inflation rising by more in the US than they would have without tariffs.

Unemployment could rise, but because of our strong starting point, the US economy will likely avoid a meaningful recession. And if inflation expectations stay anchored, expect several Fed rate cuts this year.

We are back to stock picking and finding real income. To shareholders, this should mark a change in investors merely buying broad market ETFs.

Concentration in the S&P remains an fundamental issue with the top 10 companies representing over 30% of the S&P index. The value style strategy has typically outperformed in these conditions, and active managers have fared better than passive.

Classic quality value factors still seem attractively priced, and we see many opportunities, including "growth in value" and dividend equities with rising income.

In Europe stocks now trading at a 7% discount to their fair value estimates since the tariff announcements. And despite the potential of a trade war, Europe's macroeconomic situation has been improving with the German parliament's 500 billion EUR infrastructure fund potentially further boosting broader European economic growth in the coming months.

Bond Markets

Questions resurfaced over US Treasury demand and international investor demand for USD debt.

Fundamentally, the US Treasury is a cornerstone of domestic US investor playing field and will always be seen as a safe haven asset.

As underlying Treasury yields fell, investment-grade credit spreads stayed largely put while high-yield credit spreads noticeably widened.

Technical conditions for high-yield bonds have weakened, but fundamentals continue to provide support, with both interest-coverage and debt to balance sheet ratios starting from positions of strength.

Defaults are low, bear in mind that the high-yield index is of much higher quality today, with fewer lower grade issuers than before the global financial crisis.

This could make high yield an option to reduce portfolio risk by replacing some equity exposure.

While macro risks could cause more widening in spreads, high yield has historically held up better than equities in terms of peak-to-trough declines during large equity sell-offs.

Recession or Resurgence?

This remains a critical and, for now, unsolved mystery.

I would hazard that maybe the answer is both: the US economy has been hit with a wall of uncertainty (tariff talk, geopolitics, stock market volatility, constant news flow; policy uncertainty fatigue) - and recession is a *real* possibility.

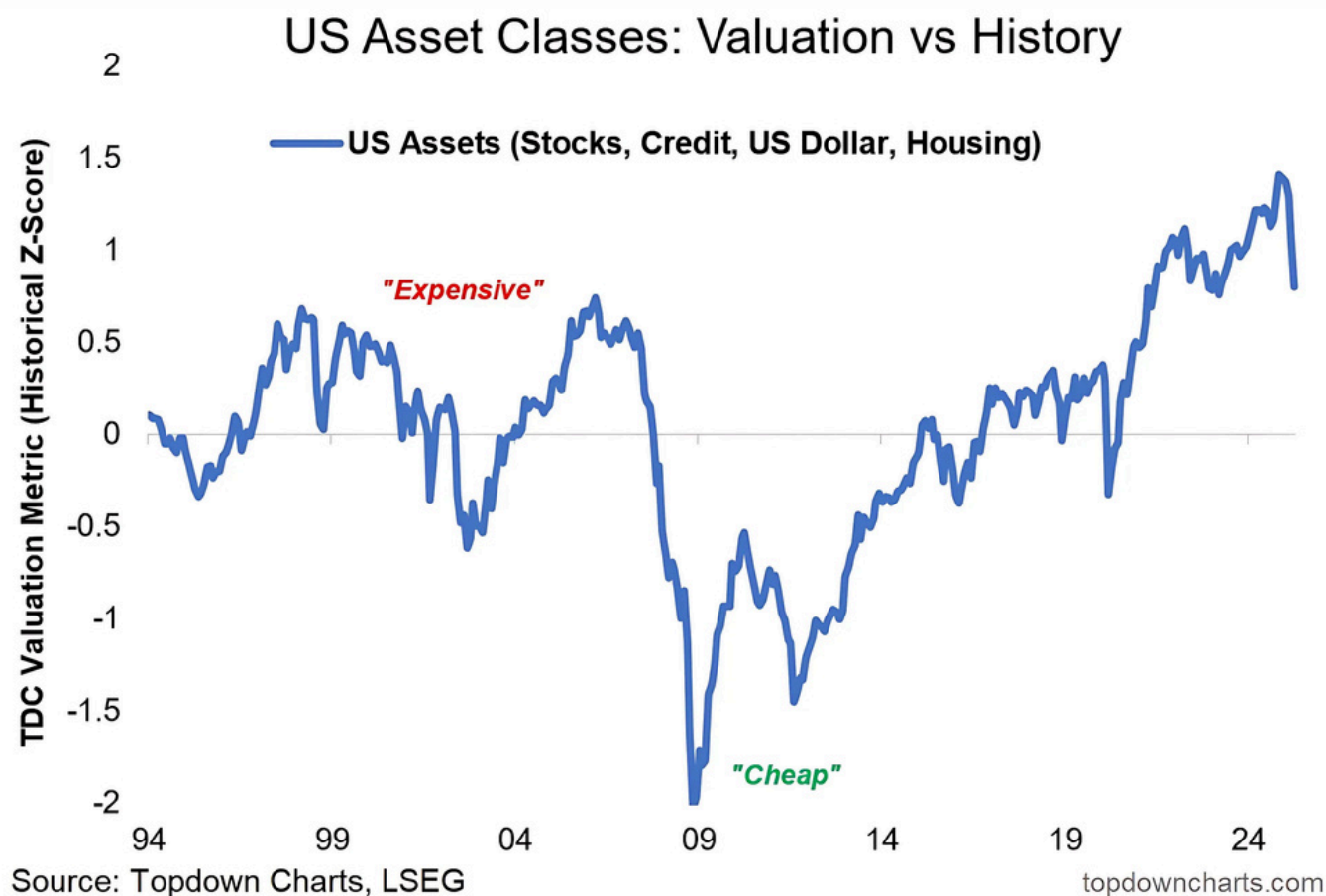
Investors have had it good for a long time! Basically, we went from one of the best buying opportunities in history back in 2009, to one of the worst around the turn of this year. They say *don't bet against America*, however, I would say that's more of a statement about the long term.

The key point to make with the chart below is that it probably doesn't make sense for US asset classes to trade at such a premium when political risk is now a lot higher and recession risk is rising - (*now at least 50%*).

In short, when you price for perfection and then find yourself in an increasingly imperfect world, it's time to pause and think.

Meanwhile, elsewhere in the world, Japan has broken out of economic stagnation, and Europe and China are turning up from slowdown (helped by stimulus).

Resurgence is credible for the rest of the world - (*and yes, you can get a global expansion and US contraction; set your conventional wisdom aside — we are in an unconventional world now*).



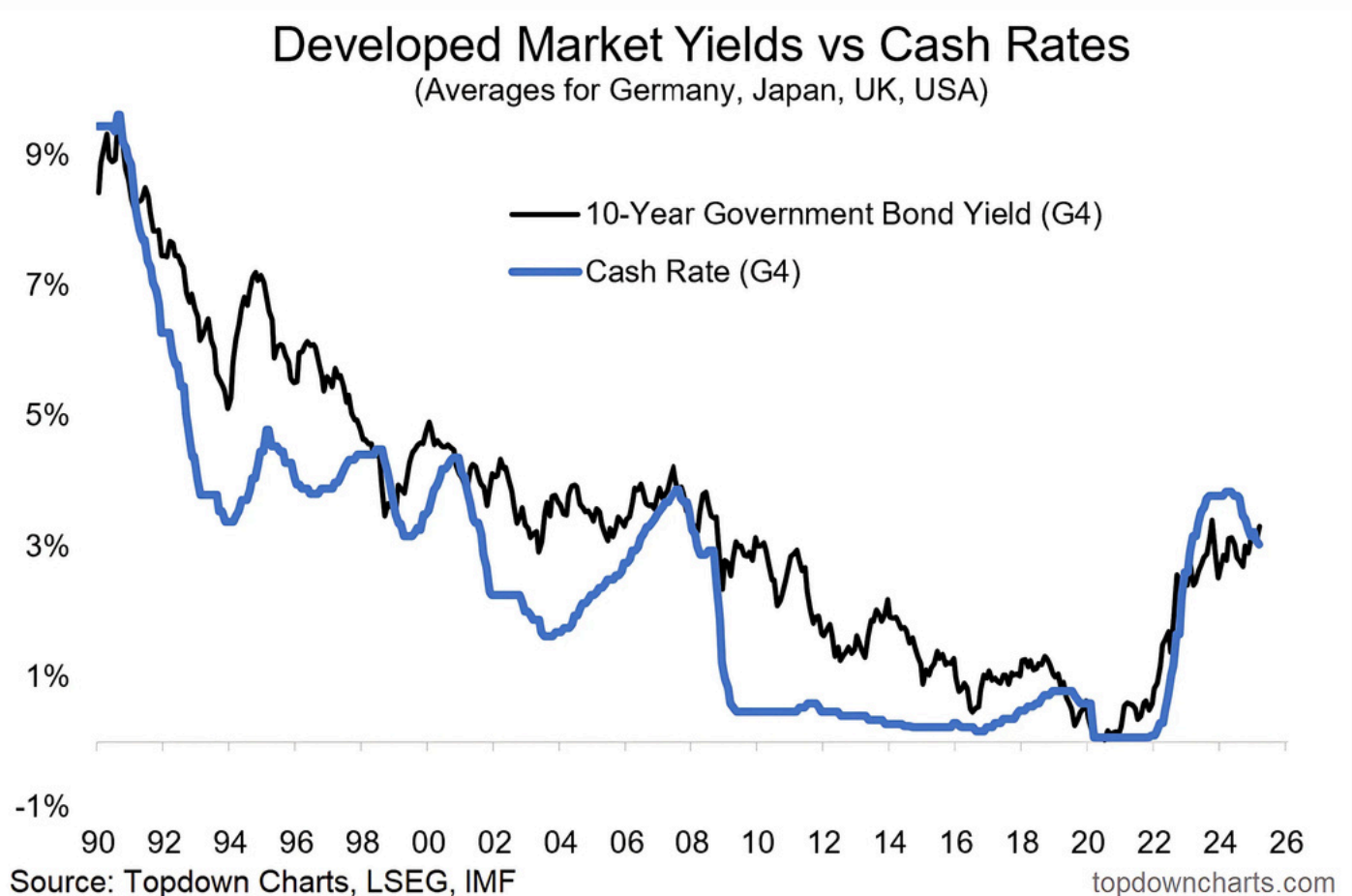
Developed Bond Yields indicate a global disconnect

Here's the thing, the more you cut policy rates without some kind of recession or deflationary crisis/shock coming along, the more you raise the odds of growth reacceleration and inflation resurgence, and the more the bond market prices that into the form of higher bond yields.

But again, there is nuance here — developed markets ex-US have seen a steady surge in bond yields (vs US lower); that's consistent with global resurgence + US recession (or at least a US growth scare and asset repricing).

Both lines in this chart are going to be at the mercy of the macro-risk-sandwich: (recession = down, reacceleration + inflation resurgence = up).

For a market hooked on rate cuts, 2025 could present a wake-up call; we may need to be prepared for pauses and “unpivots” instead of just consensus cuts.



Allocations and Valuations

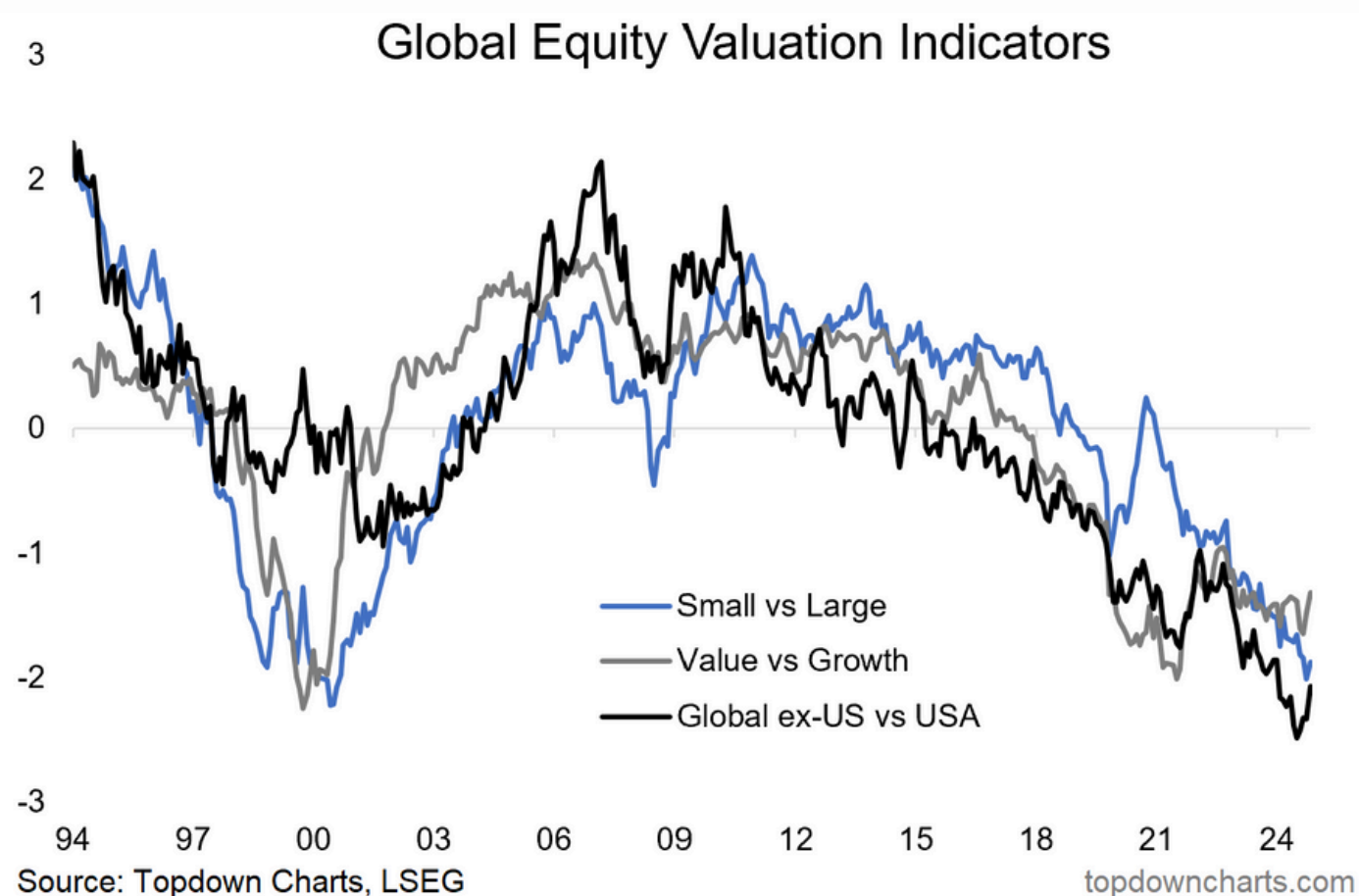
Higher allocations to equities have been key in pumping up valuations — this is why extremely high allocations also serve as a longer-term warning signal. It's also why valuations will matter more as sentiment and allocations begin to shift under the weight of recession risk, and the same kind of self-reinforcing feedback loops that initially drove valuations higher — are now reversing.

Additionally, it looks like we've turned the corner on this global equity mega-theme — especially when comparing global vs. US stocks. **This shift was inevitable, given the stretched valuations.**

And yes, I know a lot of people are talking about it — and for good reason — but that comes after a long period of people really not wanting to know anything about it. *(It used to be that if you brought up global vs. US stocks, you'd be argued out of the building.)*

We're still so early on this one — this theme will be measured in years, not months or weeks.

Bigger picture across global equities: small caps are cheap vs. large caps, value is cheaper than usual vs. growth, and global is at record-cheap levels vs. the US.



What's the story for the dollar?

It's looking more and more like the US dollar has peaked — and that would make fundamental sense if the US goes through a bit of a growth or confidence shock while the rest of the world plods along.

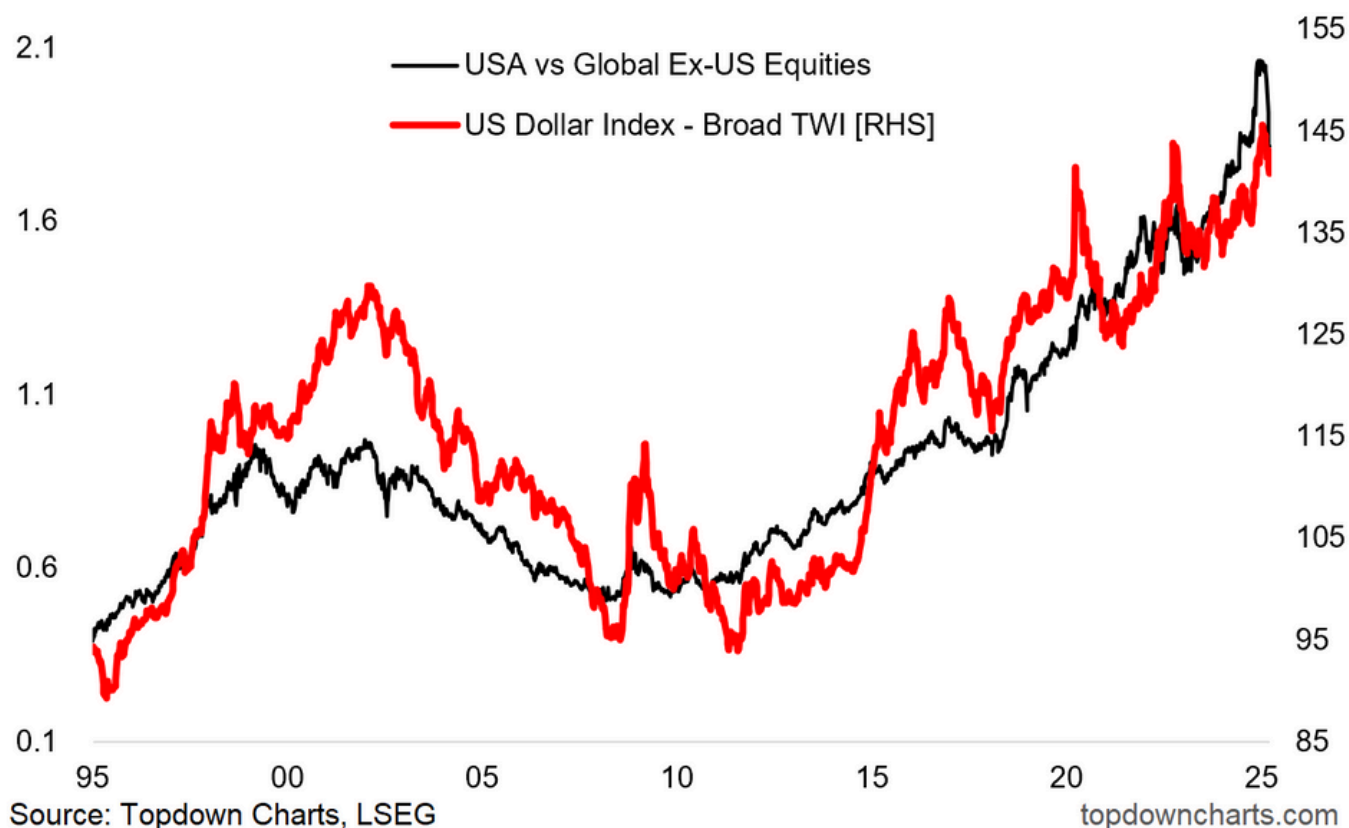
Ultimately, that's what exchange rates reflect: relative macro strength. This shift also reinforces and ties in with the turning point we've seen in global vs. US stocks.

One key clue in the global vs. US market relative performance debate will be the US dollar. It plays both a direct role (via currency translation effects) and an indirect role (as it reflects relative macro strength and impacts the world through financial conditions).

We can see this playing out clearly in the chart below — a stronger dollar is consistent with US outperformance vs. global.

It's an important chart because we need to keep close track of the USD (especially in case of an upside breakout, which it is currently in the process of attempting). But it's also important because of the black line, and what it means for both global and domestic investors.

Relative Equity Market Performance: USA vs RoW



US Asset Valuations

US assets had a golden decade-and-a-half following the big reset in valuations after the financial crisis. 2009 was the quintessential generational buying opportunity. Now, we're sitting at the opposite end of the spectrum — a generationally risky moment for US assets.

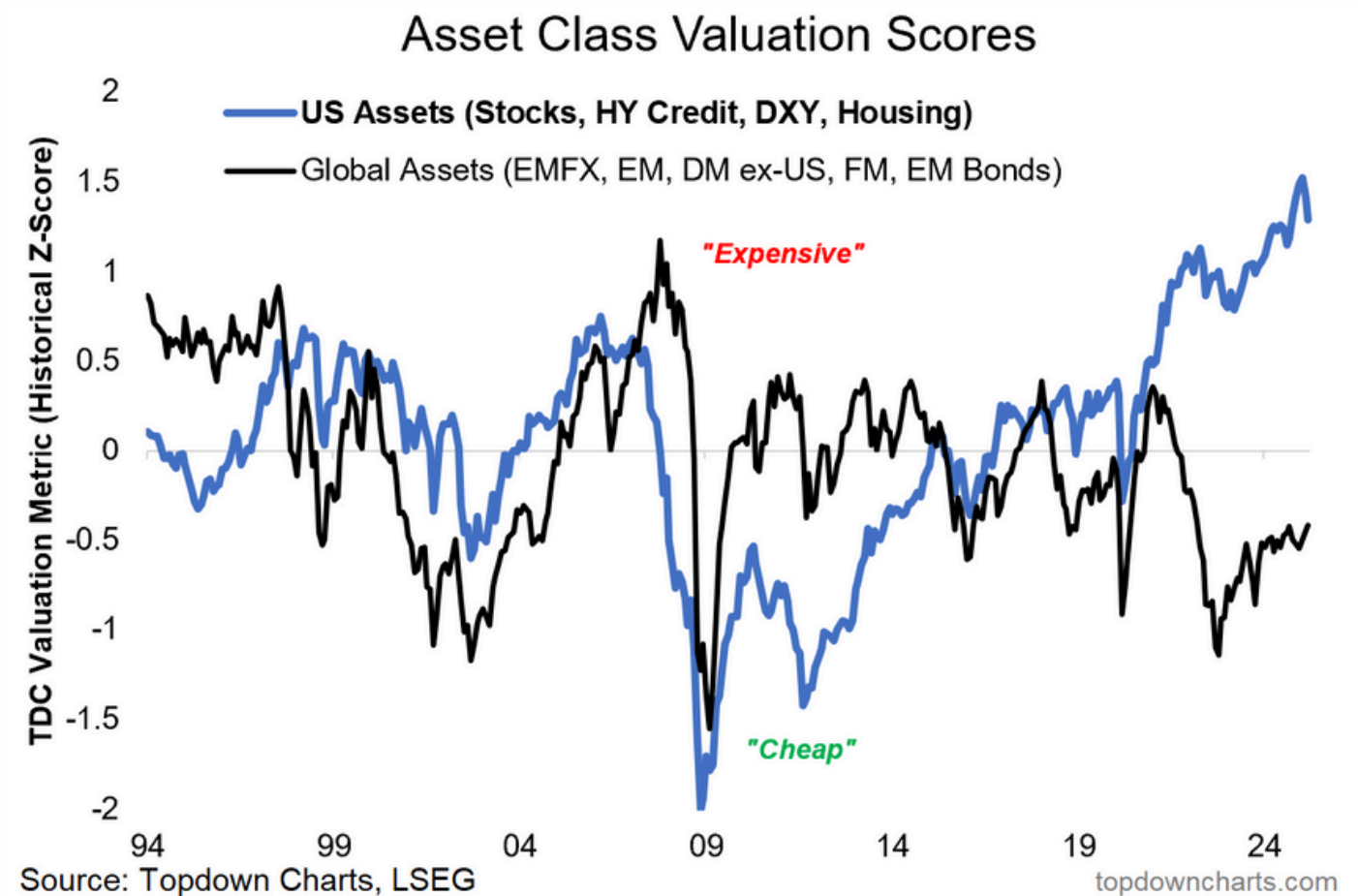
That said, global assets are still cheap.

We may not see another extreme correction, but when you spot extremes like this in financial market charts, it becomes a no-brainer for asset allocators.

The hurdle for US assets to continue outperforming from here is so high that the risk/reward payoff just isn't worth it. To get anything close to the past 16 years, you'd either need another major valuation reset or an economic miracle. **Or — you could just go global!**

Last but not least, call it the US Asset Premium — US assets (stocks, the US dollar, housing market, credit spreads inverted, and US Treasuries' valuations inverted) are trading at their combined most expensive level on record. This is well beyond what we saw in 2021.

Meanwhile, global assets are cheap — across developed, emerging, and frontier market equities, EMFX, and EM bonds.



Uncomfortable truths and tough questions

We are living through one of the most dynamic geopolitical landscapes in recent history. There are uncomfortable truths and tough questions that could shape the future of our investment strategies.

Even with lower bond yields, the forward-looking prospective equity risk premium is still negative for the USA. It's hard to argue for a sustainable rally in US stocks when you have medium/longer-term indicators like this still sounding warning signals *(and the prospect of a recession or growth scare looming)*.

We need to ask ourselves; Is MSCI World still my equity benchmark?

With nearly 70% of the index tied to US equities, does this concentration make sense in a world where the US is no longer the unquestioned economic leader? Should we rethink our reliance on an index that has historically been a proxy for global growth, but is now vulnerable to the shifting balance of power?

Are US Treasuries still the "risk-free" asset?

In an era of rising geopolitical tensions, massive fiscal deficits, and an ever-weakening dollar, can we still rely on US Treasuries as the gold standard for safety? The notion of risk-free is no longer as clear-cut as it once was.

Should commodities play a bigger role in my portfolio?

Given the volatility in global supply chains and the geopolitical weaponization of trade, it might be time to think differently. With inflation pressures, energy security concerns, and political risks driving the price of commodities, should we be increasing our exposure to this asset class? Commodities are more than just a hedge; they're becoming an essential part of a resilient portfolio.

What does a truly diversified currency basket look like now?

The US dollar's dominance is being challenged like never before. With tensions between the US and its trading partners, and countries looking for alternatives, is your currency allocation as diversified as it should be? **A multi-currency strategy is no longer optional, it's imperative.**

Could dollar-pegged currencies break free?

It's a radical thought, but what if some dollar-pegged currencies could break free from the dollar and appreciate in response to local economic conditions or a shift in global sentiment?

Countries with stronger fundamentals might be poised to decouple from the dollar's fate, and this could be a game changer for global trade and investment.

As the second quarter of 2025 gets underway, what's the outlook for the stock and bond markets?

What should investors do from here?

We've gathered insights and perspectives from analysts and specialists about market performance, individual stocks, sectors, and mutual funds.

To receive updates, please contact us at: info@wealthwisepartners.org

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