

# ***Economic Commentary***



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The start of the new year brought continued optimism, with market participants calling for another year of strong U.S. economic performance driven by AI innovation, pro-business policies, and robust economic momentum. As the first quarter progressed, sentiment began to change as headwinds emerged. The focus on deregulation and tax cuts shifted to tariffs, fueling concerns about slower growth, reigniting inflation, and mounting economic risks. These dynamics led investors to seek safety, driving U.S. equities lower, international stocks higher, and triggering a strong rally in Treasuries amid heightened uncertainty and volatility.

## **Domestic Fixed Income Markets**

U.S. government bond yields declined during the first quarter of 2025, as fixed-income markets reacted to escalating trade tensions, tariff concerns, and elevated uncertainty. Bonds played their traditional safe-haven role amid the heightened volatility, with the Bloomberg Aggregate Bond Index returning 2.78% for the quarter. Treasury yields fell across the curve in a “flight to quality”, with the 2-year and 10-year Treasury yields each declining 36 basis points, while the 30-year Treasury yield dropped by 21 basis points. The 2, 5, 10 and 30 finished the quarter at 3.89%, 3.96%, 4.21% and 4.57% respectively. Corporate bond spreads, which represent the additional yield corporate bonds earn above a Treasury, also widened as investor sentiment shifted to a more cautious stance. The investment-grade spreads rose by 15 basis points, while high-yield spreads widened by 60 basis points, reflecting greater perceived risks among lower-quality issuers.

## **Domestic Equity Market**

The broad equity market entered 2025 priced for perfection, with the S&P 500 trading at 22x forward earnings, well above historical averages. Despite a relatively strong earnings season, ongoing uncertainty surrounding tariffs and trade policy weighed on equity markets. The S&P 500 declined by 4.3% on a total return basis, its weakest quarterly performance since Q3 2022. The technology-heavy Nasdaq fell nearly 10% as the "Magnificent Seven", which previously drove much of the market's gains over the past two years, fell roughly 15% during the quarter. Value stocks notably outperformed growth stocks, and large-cap stocks proved more resilient than small caps. Commodities emerged as the standout performers among major asset classes. Copper prices surged 24% to record highs as businesses sought to purchase inventory ahead of anticipated tariffs. Gold also reached all-time highs, gaining 19% as central banks increased their gold reserves to hedge against geopolitical and economic uncertainties.

## **Federal Reserve**

During the March 2025 Federal Open Market Committee (FOMC) meeting, the Fed remained firm in its monetary policy stance, holding the Fed Funds rate steady at 4.25%–4.50% for the second consecutive meeting. The decision followed a February CPI report that showed headline inflation rising 0.2% month-over-month, bringing the annual inflation rate to 2.8%, with core inflation at 3.1%, which was slightly softer than expectations. Meanwhile, labor market conditions indicated modest cooling. February saw the addition of 151,000 jobs which missed expectations but improved from January's figure of 125,000. The unemployment rate ticked higher from 4.0% to 4.1%, while the labor force participation rate dropped slightly from 62.6% to 62.4%, its lowest level since January 2023. The Fed Chair Jerome Powell reiterated the Committee's commitment to assessing incoming data and the evolving economic outlook, emphasizing that there was no urgency to adjust the policy stance prematurely. As the quarter concludes, the market anticipates three rate cuts by year-end, though these projections remain sensitive to evolving tariff impacts and potential trade retaliations.

## **Summary**

The first quarter of 2025 underscored the market's growing sensitivity to policy shifts, inflation concerns, and geopolitical risks. Despite early optimism, tariff uncertainty and softening consumer confidence weighed heavily on sentiment. Moving forward, it will be crucial to monitor the pace of inflation, evolving tariff policies, and emerging signs of economic slowdown that could prompt the Fed to adjust its course. Looking ahead, market participants will seek clarity on the extent and impact of tariff policies on global trade, which will be a primary driver for the market's direction.