FSA INSIGHTS

UNDER PRESSURE

NAVIGATING MARKET DYNAMICS AMID INFLATION AND POLICY SHIFTS

As we progress through the early stages of 2025, the financial landscape presents a complex interplay of robust market performance, sticky inflationary pressures, and significant policy developments. Drawing inspiration from Queen and David Bowie's classic "Under Pressure," we recognize the mounting forces shaping investment strategies and the importance of adaptability in these times.

Equity markets posted a strong start to 2025, with the S&P 500 gaining 4.2% through February 18th, fully recovering from December's decline. Mid-cap stocks outperformed large caps, as the Russell Midcap Index rose 5.0% during that period. Signs of shifting market leadership emerged as the "Magnificent Seven" tech giants posted only a modest 0.6% gain, trailing the S&P 500's broader advance – potentially signaling a shift away from mega-cap leadership. This broad-based rally signals that investor confidence has strengthened, supported by resilient corporate earnings and sustained consumer spending. With fourth-quarter earnings season nearly 75% complete, year-over-year earnings growth stands at 16.9%, the highest since Q4 2021. Notably, companies with greater international exposure are reporting earnings growth above 20%, according to FactSet.

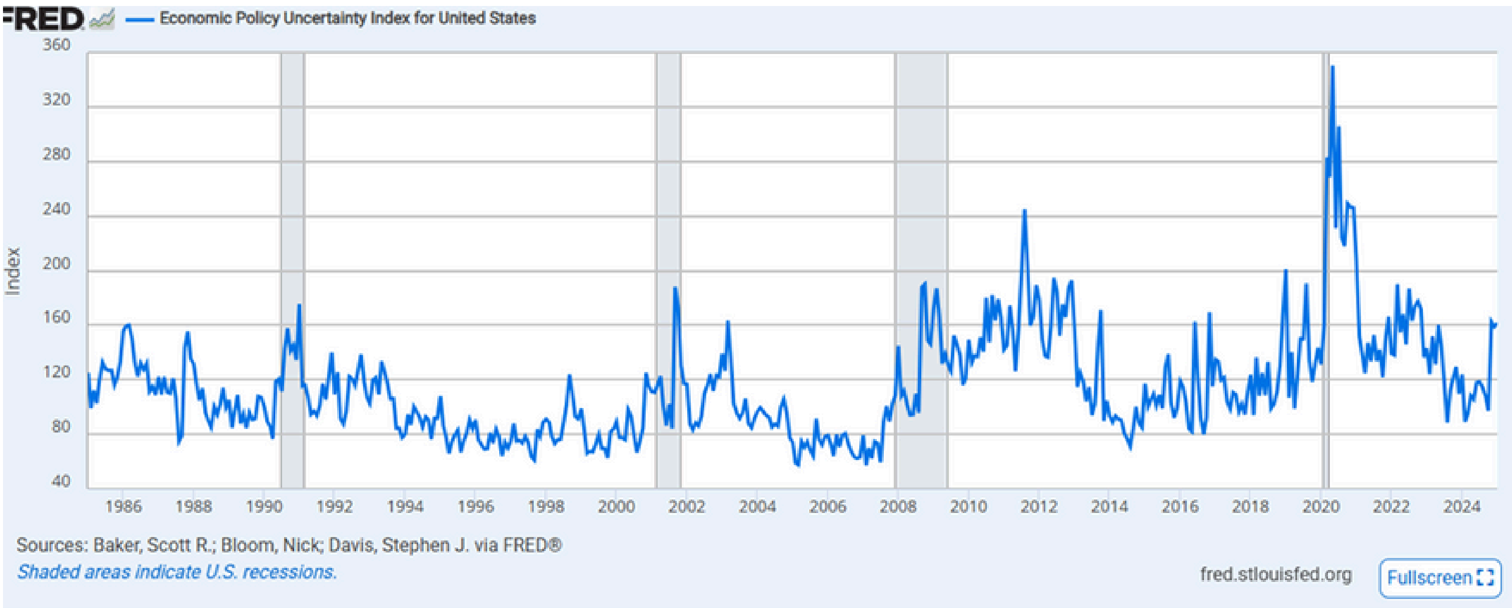
Meanwhile, European equities have significantly outperformed

U.S. markets year-to-date, with the Euro Stoxx 50 index rising by 12.3%. Factors contributing to this surge include improved corporate earnings, attractive valuations, and cautious optimism surrounding potential geopolitical resolutions. Coming into the year, the last time Europe had been as cheap on a relative valuation basis was 2000. Also, there is some hope that Europe will have to counter any tariffs with fiscal stimulus. Historically, the bloc has been reticent to run large government deficits, but the Trump administration may force its hand. Furthermore, any change in geopolitics or energy policy that would reduce oil and natural gas prices would see a big benefit for the European economy. This trend highlights the importance of geographic diversification in investment portfolios. While our positioning in portfolios still favors US equities over international, our Investment Committee is actively debating and monitoring whether we should shift to a more neutral approach.

On the economic front, recent data in the U.S. has shown a potential resurgence in inflationary pressures, creating new economic headwinds. The Consumer Price Index (CPI) rose by 0.5% in february, marking the most significant increase since July 2023, and bringing the year-over-year rate to 3.0%. While energy costs boosted the overall headline, it was used vehicles, insurance and airline fares that drove core inflation higher. While some of these increases are temporary, the stickiness in core inflation is more worrisome. Concurrently, the Producer Price Index (PPI) experienced a 0.4% monthly uptick, driven by higher costs in sectors such as hospitality and energy. These developments have tempered expectations for near-term interest rate cuts, with the Federal Reserve adopting a cautious stance in response to evolving economic indicators.

However, not all news warrants concern. The manufacturing sector has shown positive momentum, with the Manufacturing Purchasing Managers' Index (PMI) rising to 50.9, thereby exhibiting only the 2nd month of expansion since October 2022. Notably, the New Orders Index increased to 55.1, the 3rd straight positive month, indicating strengthening demand, which is usually a positive sign for future earnings growth.

Complicating the Fed's decision-making, the current administration has introduced a series of policy measures, including new tariffs on imports from Canada and Mexico (which are on hold for 1 month), as well as China. While these actions aim to protect domestic industries, they also introduce potential inflationary pressures and supply chain disruptions. The Economic Policy Uncertainty Index has surged since Trump's election (see Figure below) reflecting heightened uncertainty surrounding recent policy shifts. This complex and quickly changing policy environment necessitates vigilant monitoring, as these factors collectively influence market volatility and investor sentiment.



Despite these domestic economic and political pressures, there are areas in which to look for opportunity and growth. Global infrastructure investment presents promising opportunities driven by trends such as digitalization, electrification, and deglobalization. Significant public and private investments are funneling into data centers, renewable energy, and transportation sectors. These developments align with the evolving needs of modern economies and offer potential avenues for long-term growth.

As always, we emphasize disciplined asset allocation and long-term planning. While near-term market and geopolitical forces remain "under pressure," history shows that staying the course through uncertainty leads to long-term success. We appreciate your continued trust and partnership. Should you have any questions or wish to discuss your portfolio in greater detail, please do not hesitate to contact us.

Respectfully,

Andy Webb
Chief Investment Officer

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