FSA INSIGHTS

TAKE IT EASY: NAVIGATING PROGRESS & POLICY POTHOLES

"Don't let the sound of your own wheels drive you crazy."
— The Eagles

The road to recovery is rarely a smooth ride, and 2025 has proven no exception. After the sharp pullback in the beginning of April, markets bounced back in May on positive developments, including a surprise trade truce with China. Yet despite this progress, uncertainty still hangs in the air. Tariff negotiations with other nations remain unresolved, the U.S. debt downgrade looms large, and renewed discussions around campaign-season tax cuts have begun to shape market expectations.

In a world of mixed signals and mounting noise, our message remains clear: stay disciplined, stay diversified—and take it easy.

Economic Crosscurrents: Fragile Gains and Global Friction

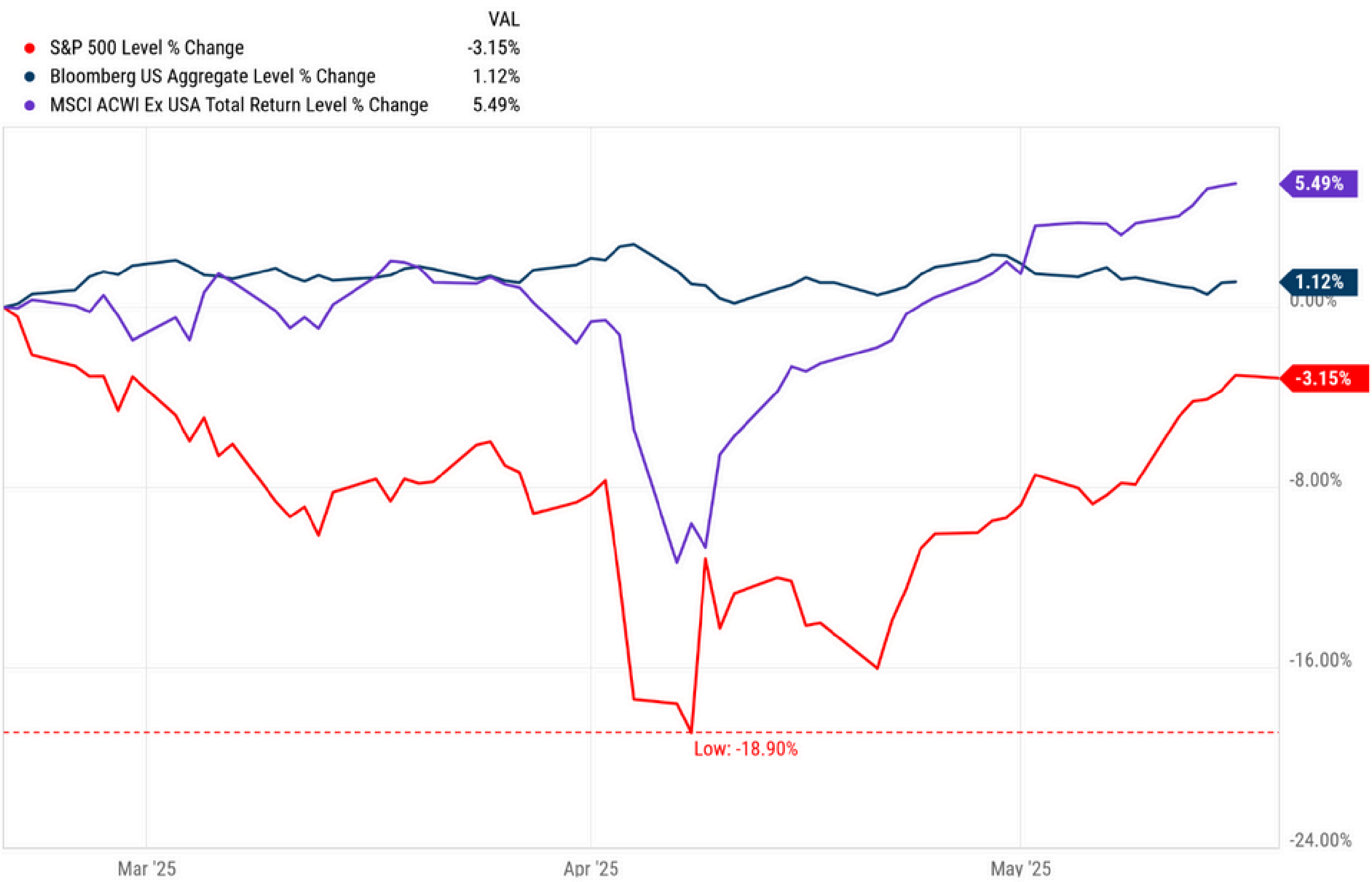
The U.S. economy contracted by 0.3% in Q1, largely due to a surge in imports ahead of anticipated tariffs. When we look at other measures from the GDP report, such as final sales to private domestic purchases, we see that growth remained on a similar trajectory as last year. For the quarter, sales increased 3.0% compared to 2.9% in the fourth quarter 2024. Furthermore, inflation eased further in April, with headline CPI dropping to 2.4% annualized, giving investors some optimism on the Fed's path forward.

That optimism has since been tempered. With services inflation remaining sticky and strong wage data complicating the Fed's dual mandate, expectations have narrowed sharply. As of mid-May, the market is pricing in just one to two rate cuts by year-end, and Federal Reserve officials have continued to emphasize a data-dependent path. The Fed held rates steady in May at 4.25%–4.50%, and while the direction of travel is still toward easing, the journey looks slower than markets initially hoped.

The signing of a temporary tariff truce agreement with China delivered a meaningful boost to market sentiment. However, tariff negotiations with other key partners remain unresolved. As a result, business sentiment remains cautious, and global supply chains are still operating with a degree of hesitancy. The China truce also offers a preview of how this administration may approach negotiations with other trading partners—and was a significant hurdle to clear in terms of finding some stable footing.

Overlaying this progress is a resurgence in fiscal policy concerns. The recent U.S. credit rating downgrade and renewed focus on deficit-financed tax cuts under the current administration have introduced new layers of uncertainty—diverting attention from the hard-won recovery since the April lows. (see chart below)

Markets Since February, 19th 2025 (US Stocks, US Bonds, & International Stocks)



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Markets: Hope Rising, but with Restraint

Markets have responded favorably to easing inflation and positive earnings surprises, but optimism remains fragile. The S&P 500 has rebounded meaningfully from its April drawdown, supported by broader equity participation and a cooling VIX, which is called the "fear index" by some investors. Small- and mid-cap stocks, as well as international equities, have shown signs of life after months of lagging.

Still, the economic data remains a mixed bag. While consumer activity and labor markets show resilience, manufacturing remains in contraction, and wage growth is beginning to moderate. It's not yet a turning point—but it's clearly a transition.

Portfolio Positioning: Calm Steering in Choppy Conditions

In this late-cycle, policy-sensitive environment, our approach emphasizes quality, balance, and adaptability:

- **U.S. Equities:** Core exposure remains intact, with emphasis on companies demonstrating pricing power and operational efficiency. We're carefully managing exposure to sectors most vulnerable to policy swings, such as technology and financials.
- **International Equities:** We modestly increased allocations where valuations are attractive and currencies are supportive. Recent agreements with China are a tailwind, but until more comprehensive trade clarity emerges, we are maintaining measured positions.
- **Fixed Income:** We continue to favor high-quality, intermediate-term bonds, which offer steady income and ballast against volatility. The debt downgrade reminds us to remain vigilant on duration and credit quality, even as the Fed remains on a cautious path toward easing.
- **Real Assets & Diversifiers:** These continue to play a role in mitigating inflation surprises and geopolitical shocks. We remain selective but see long-term opportunity, particularly in infrastructure and resource-linked strategies.

Big Picture: Disciplined Flexibility Is the Best GPS

We've made meaningful progress since the volatility of April. A temporary truce with China, slowing inflation, and resilient earnings are steps in the right direction. But unresolved tariffs, fiscal slippage, and mixed economic data remind us that this recovery doesn't come with cruise control. To be clear, we think the past two months have caused some damage, of which we have yet to learn the full extent. It's certainly possible that the economy could be slowing down and potentially incur a self-inflicted recession. And it's certainly possible the stock market could take another leg lower and revisit April lows.

But we are nowhere near convinced that we're destined for an extended, multi-year period of market declines. The economy and the stock market are resilient, and drawdowns in the market are a normal part of investing. What we are focused on from an asset allocation perspective is the deep drawdowns coupled with sharp recessions. These are the ones that are painful and can take years to recover. At this point, we do not see this scenario, so we follow the mantra of not timing the market, but the importance of time in the market.

"We may lose and we may win, though we will never be here again." The path forward won't be linear—but it doesn't have to be. By focusing on what we can control—asset allocation, quality, and investor behavior—we believe investors can continue navigating with confidence.

Take it easy—but keep your eyes on the road.

We'll continue adjusting the wheel—with eyes on the road and hands on the wheel.

Respectfully,

Andy Webb
Chief Investment Officer

Brett Akers
Director of Investments