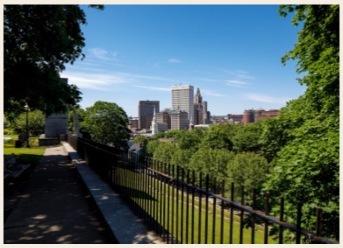
Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management

Quarter 1, 2025

by John Mullen and Ruth Mullen



March went out like a lion, an angry one. A continual flurry of (sometimes contradictory) announcements, proposals, orders and leaks out of Washington, and challenges to many policy pronouncements from domestic and international quarters, left markets reeling in the face of uncertainty. After notching an all-time high on February 19, U.S. markets turned decisively down. The S&P 500 ended the quarter flirting with correction territory after falling nearly -10%. The tech heavy NASDAQ fared even worse, falling -13.7% in the same timeframe, ending the quarter down -14.2% from its own all-time high reached in December 2024. Pain was greatest in the larger index names as evidenced by the S&P 100 falling -6.52% in March, ending the quarter down nearly -6%. Rotation into value stocks was evident; they enjoyed a standout quarter when compared to growth, with a performance spread of over 12 percentage points. International stocks romped higher as various countries moved to stimulate economic activity in the face of shifting U.S. policy. Bitcoin proved to be no safe haven, falling almost -10%.

Data as of March 31, 2025	March '25	Qtr. 1 '25	YTD '25
S&P 500	-5.63%	-4.27%	-4.27%
MSCI AC World Index (incl. US)	-3.90%	-1.22%	-1.22%
MSCI EAFE (Europe, Asia, Far East)	-0.29%	7.01%	7.01%
MSCI EM (Emerging Markets)	0.67%	3.01%	3.01%
Russell 1000	-5.79%	-4.49%	-4.49%
Russell 1000 Growth	-8.42%	-9.97%	-9.97%
Russell 1000 Value	-2.78%	2.15%	2.15%
Russell Midcap	-4.63%	-3.38%	-3.38%
Russell 2000	-6.81%	-9.48%	-9.48%
Bitcoin	-1.06%	-9.82%	-9.82%

Data provided by Tamarac Inc.

Fixed Income Markets

After a tough end to 2024, bond investors weathered a varied market landscape in 2025's first quarter. Interest rates across the Treasury yield curve fell, causing prices to rally. Credit spreads between treasuries and corporates widened modestly from historically tight levels amid renewed concerns about the impact of tariffs and the potential for a recession. The Bloomberg U.S. Aggregate Index logged a positive return of 2.78%. High yield, as measured by the ICE BofA U.S. High Yield Index, had a more muted return of 0.94% but still positive. Municipals were notable as the only major bond index with a negative return, -0.22%. Long dated bonds led the quarter's rally, with the 20+ Year Treasury Index +4.67% versus the 1-3 Year Index at +1.62%. March returns diverged significantly from the first two months of the year. After strong gains to start the year, the Aggregate returned just 0.04% in the final month. High yield and municipal indices both showed negative returns while long dated-bonds sold off, with positive returns in the 1-10 year maturity schedules.

PARSONS
Capital Management, Inc.

www.parsonscapital.com

Corporate Headquarters
40 Westminster Street, Suite 400
Providence, RI 02903
Phone 401.521.2440
Fax 401.521.4870
Toll-Free 888.521.2440

Florida Office
11450 SE Dixie Highway, Suite 205
Hobe Sound, FL 33455
Phone 561.868.2440

Fed in a wait and see period…

Major shift in the curve over the past year…

Bifurcated returns for commodities…

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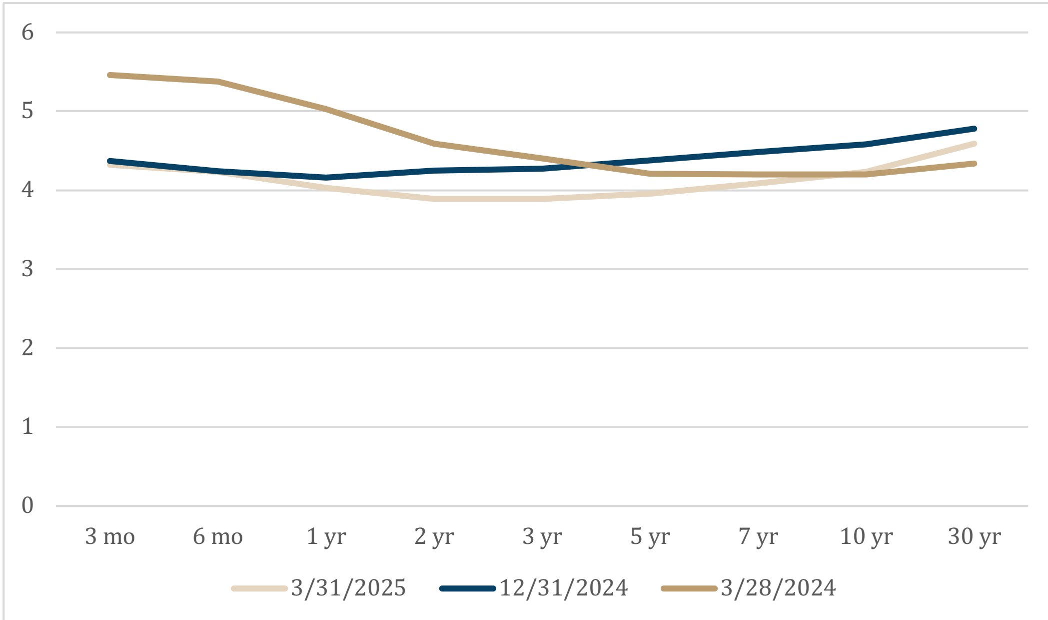
US Treasury Yields

The U.S. Treasury yield curve looks markedly different from a year ago. Short rates have fallen by over a full percentage point, while at the long end rates are just a touch higher. The decline in short rates over the previous 12 months shows the effect of the rate-cutting cycle the Fed has engaged in, though one that has been on pause since the last cut in December. With the domestic economy, particularly the labor market, still on solid footing through the end of the quarter, inflation that has stopped declining, and concerns about the inflationary impact of higher tariffs, the outlook for further rate cuts in the near term is uncertain.



Data from U.S. Treasury

Commodities

Commodity returns were a mixed bag for the quarter. Oil prices began the year by continuing to march higher, ultimately topping out near $81/barrel in mid-January. Prices then steadily dropped for two months, bottoming out near $66, before a late March rally back to $72.

Food prices saw a welcomed retreat in the quarter, with the CRB Food Index posting a -3.5% return.

Commodity gains were concentrated in the metals, with the Metals Index +12.5% and the Raw Industrials Index +6%. Gold continued to benefit from investor demand, both domestically and abroad, as a hedge against uncertainty.

Commodity	Qtr. 1 '25	Year to Date '25
CRB (broad index)	1.98%	1.98%
Oil	-0.79%	-0.79%
Gold	10.52%	10.52%

Economic Overview

Economy entered 2025 primed for a slowdown…

Coming into 2025 the domestic economy was, relatively speaking, quite strong. GDP growth for the year was roughly 3%, above the consensus trend of closer to 2%. Inflation had continued to moderate, and unemployment remained steady in the low 4% range. Against this backdrop, the prevailing expectation was that this year could see slightly slower growth (it is hard for an economy to continue to grow above trend, especially with a mildly restrictive monetary policy) but that the foundation remained strong.

Much of the data, especially hard data, that has been reported for the first quarter indicates that growth has continued but forward-looking data points (soft/survey data) indicate rising risks.

Heightened risk for a slowdown to turn into something more…

Employment, which has been the sturdy foundation on which the economy has grown, remained healthy in March. For the month, nonfarm payrolls increased by 228,000 (though prior months were revised down a cumulative 48,000). The unemployment rate rose slightly to 4.2% but, importantly, the underemployment rate slipped lower to 7.9%. Labor force participation and average hourly earnings both grew as well. Weakness in the labor market, if it comes, and an expanding unemployment rate will be early indications that government policy is weakening the economy.

Strong labor market not leaving consumers feeling better…

While the job market still looks to be an asset to the economy, consumers are clearly concerned with what could come. Consumer expectations of higher unemployment in the year ahead are at their highest level since 2009. Consumer spending plunged -0.6% in January compared to December, while staging a muted rebound of just 0.1% in February. This spending restraint has sent the savings rate up to 4.6%, its highest reading in a year. With the March Conference Board Consumer Confidence Index dropping by over 7 points to 92.9 (future expectations are at a 12-year low), it seems likely that consumer spending will remain constrained in the months to come.

One of the key metrics to watch in the months to come will be inflation. Through March, inflation remained tame and consumers were not expecting a major acceleration. In the final month of the quarter, U.S. CPI fell 0.1% from February (+2.4% from the same point last year) while core CPI, which excludes food and energy, was up 0.1% month-to-month and 2.8% year-to-year. Both readings came in lower than expected but the path forward is now clouded.

Global economies stimulating…

Looking abroad, the global uncoupling looks to be accelerating. Faced with the prospect of less U.S. support (whether economically or militarily) countries are beginning to take stimulative measures. The Chinese government is working to pass additional fiscal support packages aimed at spurring local consumption. In Europe, Germany (for years a fierce deficit hawk) has passed legislation exempting increased defense spending from their constitutional "debt break" and at the same time established a €500 billion infrastructure fund.

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Investment Implications

Animal spirits retreating…

The election of Donald Trump was initially met with enthusiasm from the investor class as market participants began to price in a similar playbook as was witnessed during Trump 1.0. Markets notched continued all-time highs as investors focused on the anticipated stimulus that would come from lower taxes and lighter regulation. As the quarter unfolded it became increasingly apparent that, at least early in the administration, investors would be confronted with more policy headwinds (tariffs) than tailwinds (lower taxes/regulations).

Economic participants operate best with some level of certainty. If consumers feel certain that their job prospects are strong, they are likely to continue to spend in lieu of saving. If corporations feel certain about the regulatory environment, they are more likely to make investments to grow their business. If investors have certainty, they are willing to pay a higher multiple for equities, moving markets higher.

Uncertainty on the rise…

The first hints of rising uncertainty were seen in consumer polls, followed by surveys tracking business leaders and finally a downturn in the domestic stock market in the closing weeks of the quarter, picking up speed in early April.

Uncertainty spiked and losses accelerated with the announcement of unexpectedly large tariffs by President Trump on April 2. Stocks that had led the market higher now led it lower. Perhaps more worrisome, the yield on U.S. government debt began to rise and the dollar began to fall, reflecting an emerging change in the global perception of Treasuries as a safe haven.

Fed in a tough spot…

The Federal Reserve is in a difficult position: Do they address inflation concerns by continuing restrictive rates, or do they respond to a potentially weakening economy with a pre-emptive rate reduction? So far, their rhetoric is "wait and see."

The introduction of the high tariff policy has changed everything. The universal 10% is multiples higher than the current U.S. weighted mean tariff on all products, which has been under 2% since 2003. It appears that the administration plans to use the projected tariff revenue to pay for the extension of the 2017 tax cuts and, potentially, take tax rates even lower. Therefore, expectations that they may be negotiated away or down significantly may be misplaced.

Tariffs the clear driver of clouded outlook…

The largest risks at this point center around domestic consumer sentiment and international capital flows. Consumer sentiment is falling rapidly, and in April, consumer inflation expectations for the year ahead moved up to the highest point since 2009. The wealthiest 10% of Americans represent nearly half of all U.S. consumer spending; besides the higher everyday prices expected from imported inflation, their wealth is taking a hit.

The uncertainty/volatility/credibility mixture engendered by recent administration policy statements is prompting some "sell America" sentiment, evidenced by the fact that the S&P 500 is one of the worst performing major indices in the world year to date through April 10. That matters, since the U.S. receives nearly $2 trillion yearly in foreign capital inflows. Foreign investors hold 33% of U.S. Treasuries, 27% of U.S. corporate bonds, and 18% of U.S. stocks. To be sure, billions are still pouring in from abroad to build new auto factories, data centers, etc. And a reduction in the overall tax structure will probably be designed to make the U.S. a more competitive place to do business. Potentially, lower corporate taxes can offset higher input costs. However, the risks to growth, corporate earnings, inflation, interest rates, and price/earnings ratios – all of the elements that affect stock and bond market returns – are higher than they were a month ago.

As we have learned especially this year, both upside and downside surprises can come at any time. Therefore, it remains prudent to stay invested but exercise caution and maintain liquidity.

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