KESTRA INVESTMENT MANAGEMENT

FROM THE PM DESK - APRIL 3,2025

Tariffs 2.0: Implications for Your Portfolio

On April 2, 2025, the President announced a major change in U.S. trade policy: a new 10% baseline tariff on nearly all imported goods. While there are many more details in the announcement, the new policy marks a significant departure from previous, long-standing trade policy. The administration has framed this shift as a way to shrink the U.S. trade deficit (which stood at -2.8% in 2024), boost American manufacturing, and reduce our reliance on foreign-made goods.

While the administration says it's open to negotiating, the structure of these new tariffs makes it tougher for trade tensions to cool down quickly. And while the long-term goal is to strengthen the U.S. economy, in the short term this policy could mean potentially higher prices for consumers and slower economic growth. But what does this mean for your portfolio?

The initial market reaction to the new tariffs has been swift and negative, with many stocks taking a hit. That said, we've built our portfolios with this possibility in mind, embracing a wide range of asset classes to help buoy returns in times of stress. Last month, we adjusted our KIM model portfolios in anticipation of heightened volatility.

These adjustments included:

- Across our dynamic models, we reduced our equity overweight and increased our allocation to developed international markets with a value tilt. Within our strategic models we maintained a modest equity overweight and implemented similar changes within the equity exposures
- We continued to reduce exposure to U.S. large growth, while increasing our position in U.S. value and international stocks
- We added to our mid cap positions while reducing small caps in recognition of small cap stocks' propensity towards higher volatility and mid caps' relatively healthier financials
- Across our dynamic models, we increased our allocation to fixed income across risk profiles, viewing it as a trade towards diversification given equity volatility while maintaining our modest fixed income underweight in our strategic models
- Within bonds, we reduced exposure to intermediate and longer duration US treasuries in favor of shorter duration and higher quality investment grade bonds with a focus on corporates and mortgages
- We have also increased our allocations to actively managed fixed income funds, allowing for greater flexibility in navigating market volatility while capturing attractive yields

These adjustments were designed to enhance portfolio resilience over time given our assessment of current risks and opportunities. Within equities there remains a significant number of reasonably priced companies in value indices relative to the concentration that still exists in the higher valuations we see in growth indices.

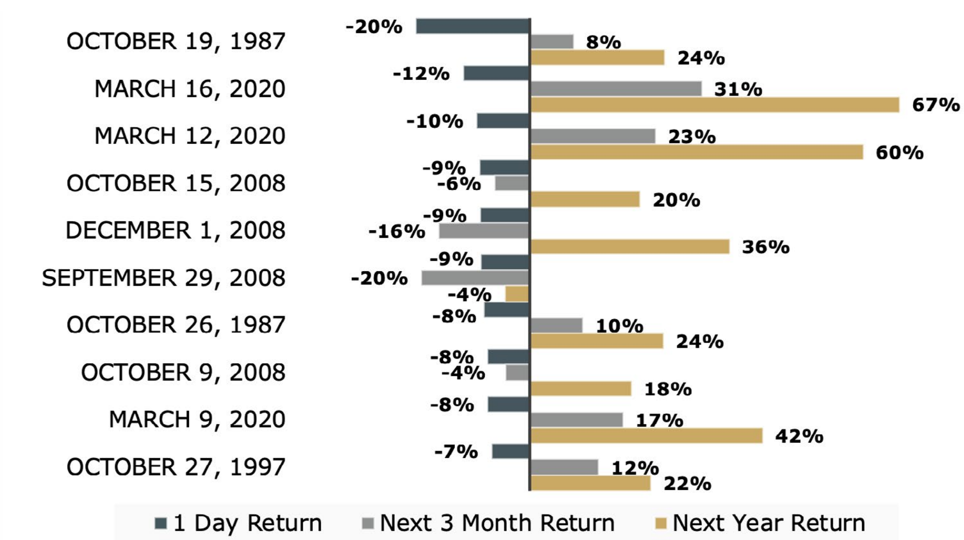
The bond portion of our portfolios helps offset the volatility that stocks can bring. In recent weeks as stocks have taken a hit, bonds have rallied. As such we are mindful of how bonds perform relative to stocks, and the risk present in different areas within fixed income. We maintain exposure to bonds of varying duration, and favor those with higher credit quality.

Although risks such as slower economic growth and rising inflation have intensified, the underlying U.S. economy remains robust. Labor market conditions are healthy, and corporate earnings estimates continue to be solid. That said, what matters from here is the impact of this new tariff policy stance on these conditions going forward. In our view, there is likely to be some near-term slowing in the macroeconomic data, but the jury is still out on longer-term implications. It is also important to remember that policies like tariffs don't impact every area of the market in the same way, and we should recognize that while today's market reaction seems myopically focused on the negative effects, there will also likely be some assets that will benefit going forward.

We are closely monitoring these policy developments and assessing implications for your investments. As difficult as market downturns can be, they also present opportunities. History has consistently shown that time in the market (not timing the market) remains the most reliable path to long-term wealth creation.

To illustrate, consider the worst 10 days in the S&P 500 since 1950, and the returns that investors received over the following 3 months and 1 year period, as shown as below. Each of these single-day drawdowns (the dark blue bars) was painful, but disciplined investors who maintained their investment plan were generally compensated over the following year. Investors would be prudent to remain committed to a diversified portfolio across sectors, regions, and asset classes.

S&P 500's 10 Worst Days Since 1950 and Subsequent Returns



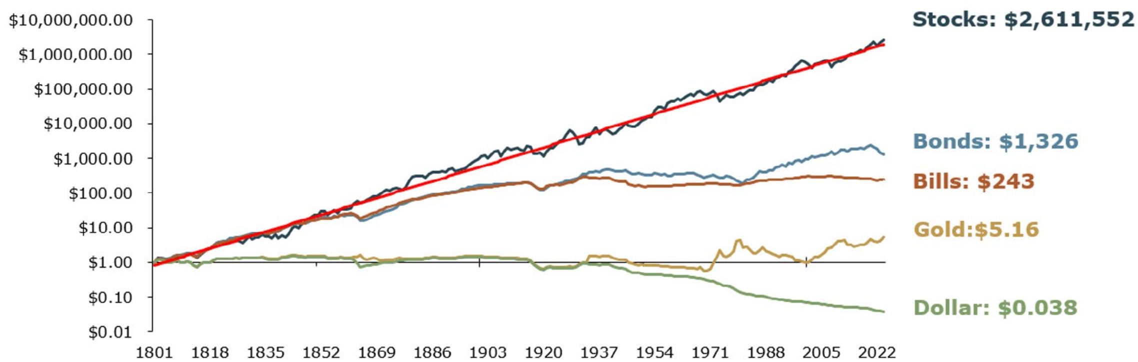
Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Note: views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. Source: Kestra Investment Management with data from FactSet. Index data from January 1, 1950 through March 31, 2025.

Conclusion

Despite current policy uncertainties, our priority remains identifying compelling market opportunities while managing risk with care. We're staying attentive to potential challenges, but even if the currently strong broad economic and market fundamentals deteriorate from here, this doesn't mean that all assets will lose value.

It's also worth remembering that market pullbacks are a normal part of investing and often prove temporary. As Professor Jeremy Siegel tells us, "Stocks tend to be the most volatile asset class in the short run, but the most stable over the long run."

Growth of $1, Adjusted for Inflation (1802-2024)



NOTE: Values are indexed to 1, log scale. **Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.** Source: Siegel, Jeremy, Stocks for the Long Run (2022), 6th edition with updates to 2024.

We remain committed to navigating these challenges and maintaining a diversified, long-term approach to your investments. Please feel free to reach out with any questions or for further insights into your portfolio strategy.