

MARKET COMMENTARY - MARCH 5, 2025

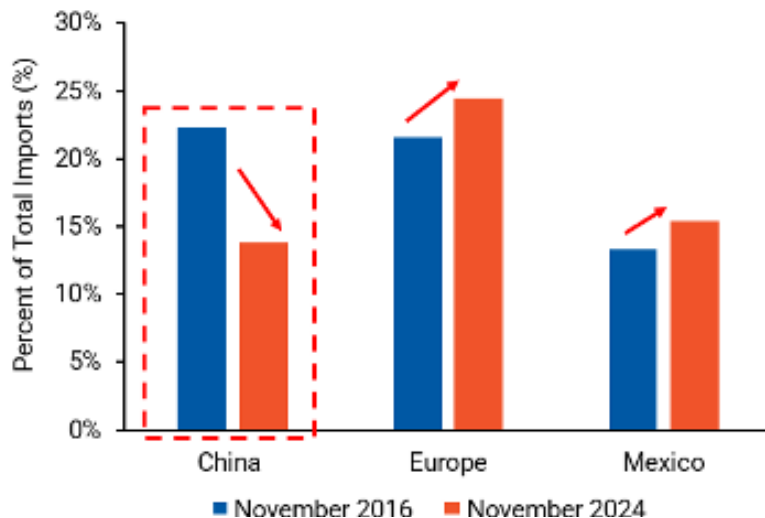
Tariffs, Tech, and Turning Tides: A Market in Flux

As a new round of tariffs went into effect on a wide-range of goods and some disappointing economic data points were released, markets were sent on a wild ride. Over the past year, we've noted that the individual in the White House has limited impact on the market over the long term, but that person can have a short-term effect, and that's exactly what we are seeing today. More importantly: Should investors be worried? Why or why not?

Tariffs

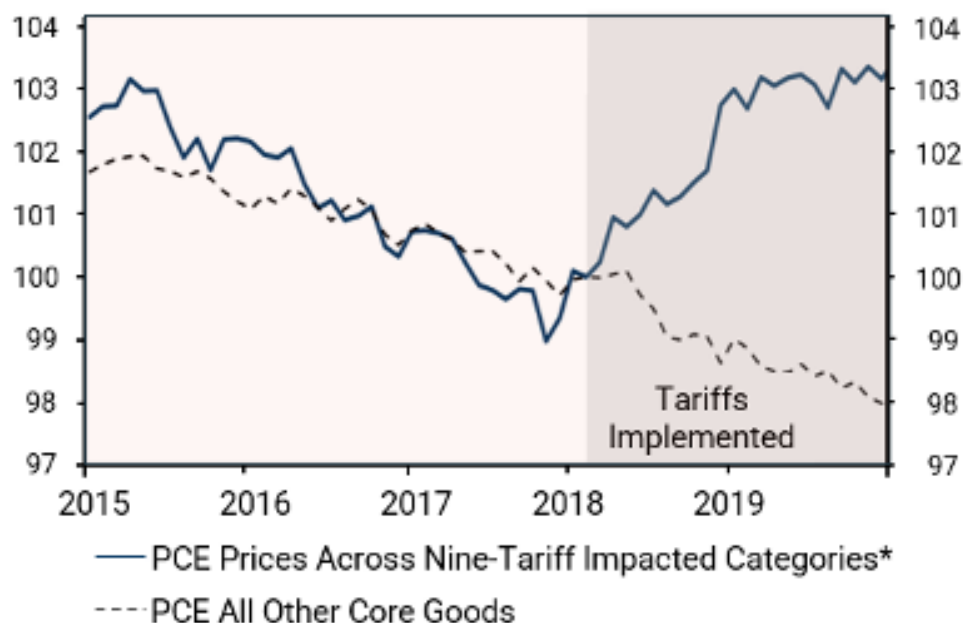
We know from our experience with tariffs during Trump's previous administration that they do have an impact. Namely, consumers and businesses shift their buying to countries not impacted by tariffs, and those products most targeted by tariffs see their prices rise more than other goods. That said, from 2018 when the first round of tariffs was introduced, most businesses and individuals did not notice a difference because the impact was modest.

Trump Tariffs 1.0: Trade Patterns Shifted



Source: Goldman Sachs Global Investment Research with data from the U.S. Census Bureau and Haver Analytics

Tariffs Boosted Consumer Prices



Source: Goldman Sachs Global Investment Research with data from the U.S. Census Bureau and Haver Analytics. *Includes laundry equipment and other appliances, furniture, auto parts, and housekeeping supplies. Items are weighted by relative importance to headline index. Data as of January 28, 2025.

For investors, the key question is how big will the impact from this newest round of tariffs be? In Trump's first term, tariffs were quite targeted and only impacted a small portion of the country's imports. This time around, the tariffs that have been announced have a much larger potential impact because the rates are sometimes higher and they affect a wider range of goods.

That said, we are less concerned about tariffs as a broad economic headwind. Tariffs are an attractive tool for a President because they can be implemented with the stroke of a pen, compared to many other initiatives that require Congressional approval. They're easy to put on. By the same token, they're also easy to take off. If it becomes clear that tariffs are large enough to negatively impact economic growth, they can be undone swiftly.

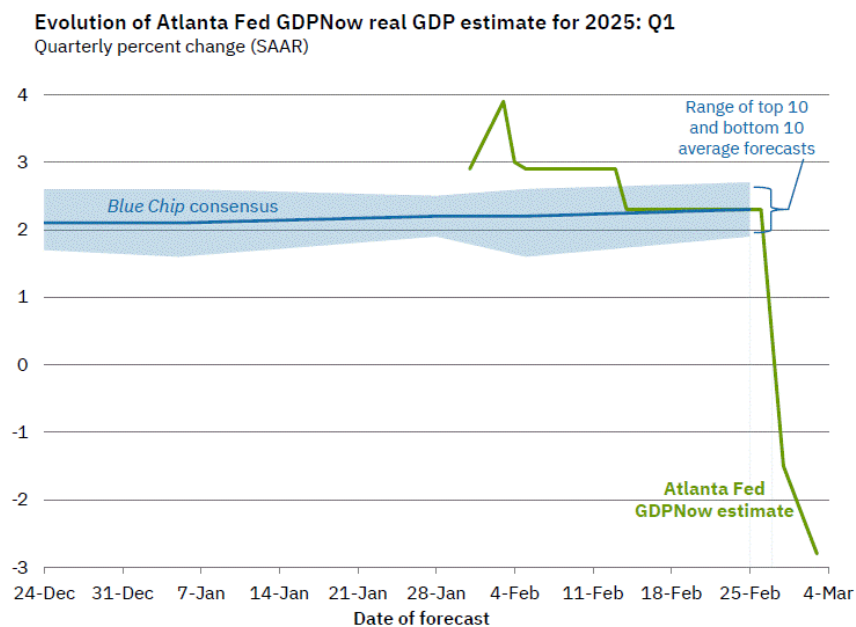
The level of uncertainty around economic policy is likely to remain elevated and highly subject to headlines. This volatility makes it even more critical that investors not react to every move.

Economic Data and its Impact

In addition to tariff talk, some recent economic data has added fuel to the market fire. A recent sharp downward revision of Q1 GDP estimates—from a positive 1.8% to a negative 3%—has caught the market's attention. This estimate, from the Atlanta Fed's GDPNow model, is highly sensitive to incoming data.

The revision was driven largely by a significant spike in imports, as businesses and consumers rushed to stockpile goods ahead of potential tariffs. This increase in imports is likely a response to tariff fears, not necessarily indicative of a broader economic slowdown. As such, we don't view this revision as signaling a dramatic contraction in economic activity but rather as a temporary distortion due to short-term behavioral shifts in buying by businesses and individuals.

Atlanta GDPNow Estimate For Q1 2025 GDP Growth



Source: Atlanta Fed. Data as of March 3, 2025. Projections may not come to pass

While the media often focuses on the S&P 500, it is important for investors to remember that diversified portfolios hold a wide range of asset classes, some of which have held in even with this tariff talk. Bonds and non-US stocks, for instance, have seen gains so far this year. Sectors such as Staples and Healthcare are also up year to date.

From a portfolio perspective, we continue to balance potential risks (of which the market always has plenty) and opportunities (which also abound). While policy risks will remain, we are more focused on risks within the market itself. In response to the growing concentration of mega-cap growth stocks, last year we worked to lower exposure to those names, by adding some mid-cap and value stocks.

International markets have recently performed better than expected, with developed international equities showing significant strength—up 9% year-to-date, compared to flat performance in the S&P 500 and a 5% decline in the NASDAQ. Non-US equities have benefited from a weaker dollar, which has provided a boost to international stocks. This reinforces the importance of maintaining global exposure, especially given the valuation disparities between the US and other markets.

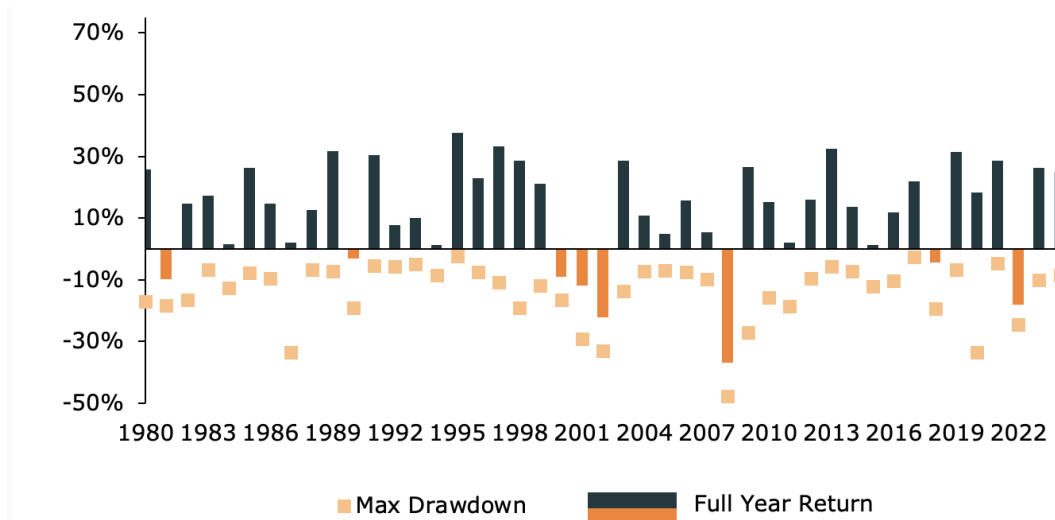
The fixed-income market has also caught a tailwind, with bonds up 3% year-to-date. With the Bloomberg Aggregate Bond index – a broad measure of the bond market – offering much more attractive yields than previous years, we continue to maintain exposure.

Conclusion

In the face of these policy risks, our focus remains on finding attractive market opportunities while managing risk appropriately. While we are mindful of those risks, the underlying fundamentals of the broader economy and markets remain solid.

It's important to remember that knee-jerk reactions in the market are not uncommon and often subside over time. For example, the S&P 500 declined 8% over a short period in July 2024 after a string of softer than expected data points but ended the year up over 20%. Market corrections, defined as a decline of 10% or more, are also not uncommon. In fact, these occur on average once a year.

Max Market Decline in a Single Year vs Full Year 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: S&P 500. Time period referenced is 1980 through December 31, 2024.

This will not be the last time tariff measures will be announced by the administration. As we move forward, we'll continue to monitor these developments closely, especially as the economic landscape evolves and policies shift.

Disclosures

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