Sit Investment Associates

Global Investment Outlook and Strategy

April 2025

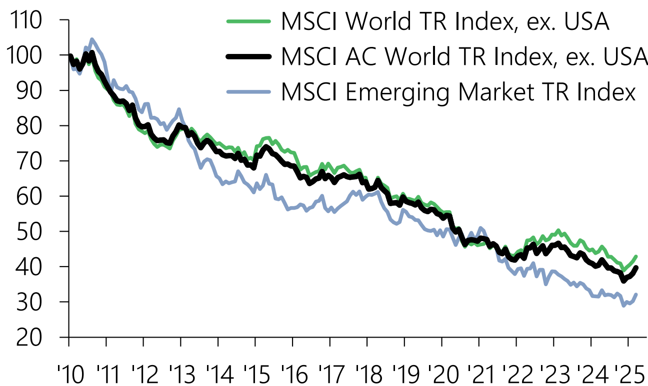
Key Points

- U.S. Economy Barreling Toward Self-Inflicted, Policy-Driven Downturn
- Tariffs Could Lead to Fewer Trade Barriers if the President Takes That Path
- Good Start to Year in China; More Stimulus Needed to Sustain Momentum
- Federal Reserve Retains Wait-And-See Approach Amid High Uncertainty
- Tax Reform Negotiations Likely Increase Municipal Bond Market Volatility
- Opportunistically Upgrading Equity Portfolios as Dislocations Emerge

In Focus: Higher Allocation Into International Equities Appropriate as Market Broadens

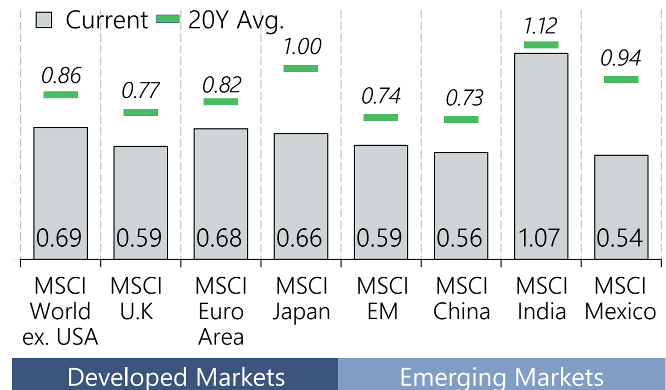
1 Non-U.S. Equities Have Lagged Since 2010

Performance Relative to the MSCI USA Total Return Index
In U.S. Dollars, 12/31/2009 = 100



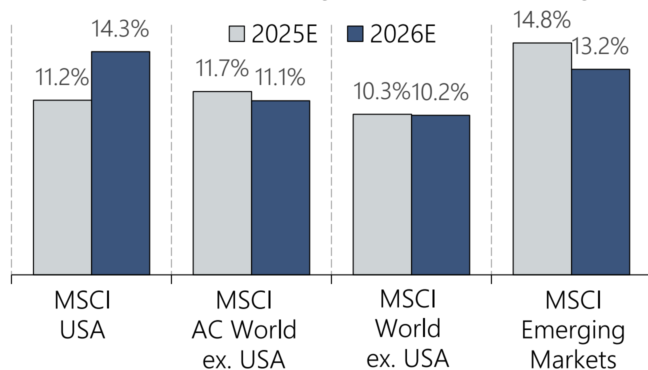
2 Non-U.S. Relative Valuations Are Depressed

NTM Relative PE Multiples, by MSCI Region/Country
Relative to MSCI USA Index



3 Outsized U.S. EPS Growth Coming to an End

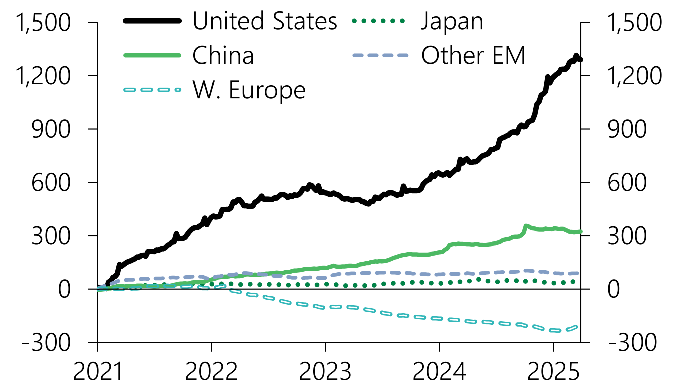
Consensus Estimated Earnings Growth, Y/Y % Change*



**Does not fully reflect the potential impact of all the U.S. tariffs announced and possible retaliatory tariffs by other countries*

4 Investors Poised to Rebalance Fund Flows

Global Equity Mutual Fund and ETF Flows
$ Billions, Cumulative



Sources: FactSet, EPFR, 3/31/25

International Equities Increasingly Compelling Amid U.S. Policy Turmoil

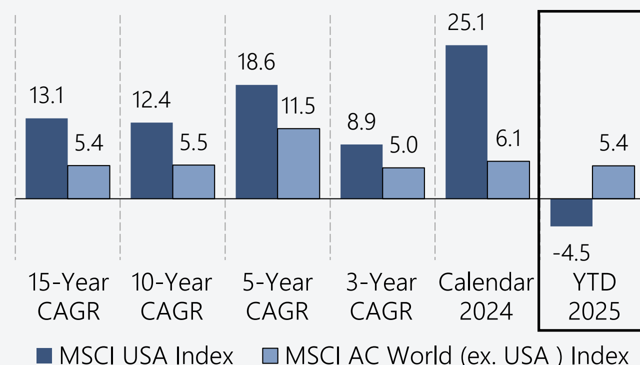
As a result of better relative corporate earnings growth, valuation multiple expansion, and a strengthening U.S. dollar, domestic equity indices have significantly (and consistently) outperformed international counterparts over the past 15 years. As of March 31, the MSCI USA Index generated a 15-year compound annual return of +13.1 percent versus the MSCI All-Country World (ex. USA) Index's +5.4 percent on a U.S. dollar basis. Over that period, international equity indices have had bouts of outperformance, but the long-term trend has stayed intact. Yet, the recent outperformance in international equities could mark a fundamental shift in the outlook for non-U.S. shares.

The MSCI All-Country World (ex. USA) Index gained +5.4 percent in 2025's first quarter, and the MSCI USA Index lost -4.5 percent as the shine came off the U.S. artificial intelligence trade and as intensifying stimulus efforts in Europe and China boosted local share prices. The drop in the U.S. dollar also amplified international returns. The MSCI All-Country World (ex. USA) Index returned +2.8 percent in local currency. In U.S. dollars, China and Europe were the big outperformers, gaining +15.1 and +10.6 percent, respectively, in the quarter.

So, is this merely another short-lived catch-up rally in international equities, or is it the start of a sustainable shift? The answer is yes – to both parts of the question. Some recent gains are vulnerable to profit-taking in the near term, given the murky prospects for global growth in 2025. However, Europe, in particular, is well-placed to benefit from a cyclical upturn in 2026 or after. Now is the time to kick the tires and add on pullbacks.

1Q May Be Inflection Point for Non-U.S. Stocks

MSCI Index Total Returns, In U.S. Dollars, Percent

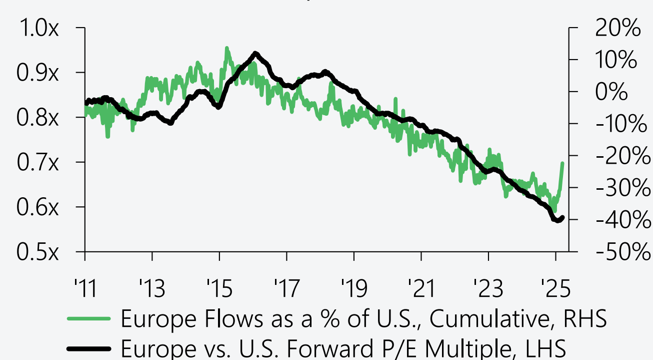


Source: FactSet, 3/31/25

In recent years, European stocks have received little to no love from investors. Since the start of 2021, roughly $210 billion has flowed out of European equity mutual funds and ETFs, compared with inflows of nearly $1.3 trillion into U.S. funds. Over the last decade, the MSCI Europe Index's forward price-to-earnings multiple also went from trading near that of the MSCI USA Index to trading at around a 40 percent discount as the price-to-earnings multiple for the MSCI USA Index expanded to the low twenties from the mid-teens on strong earnings growth, driven primarily by the Magnificent Seven.

Better Fund Flows Will Buoy Europe Valuations

Relative Forward P/E Multiple vs. Relative Fund Flows



Source: FactSet, EPFR, 3/31/25

On an absolute basis, the MSCI Europe Index currently trades at around 13.8 times the consensus next-twelve-month earnings estimate, above its 20-year average of 12.8 times and a 32 percent discount to the MSCI USA Index. Omitting the Magnificent Seven stocks from the MSCI USA Index, the MSCI Europe Index trades at a 25 percent discount. However, due to compositional differences between the indices, it is still not an apples-to-apples comparison. U.S. large-cap equity indices are weighted more heavily toward asset-light sectors with better margins and earnings stability, thus warranting a higher valuation. Still, although large-cap U.S. equity indices provide little room for multiple expansion, that is not the case for Europe.

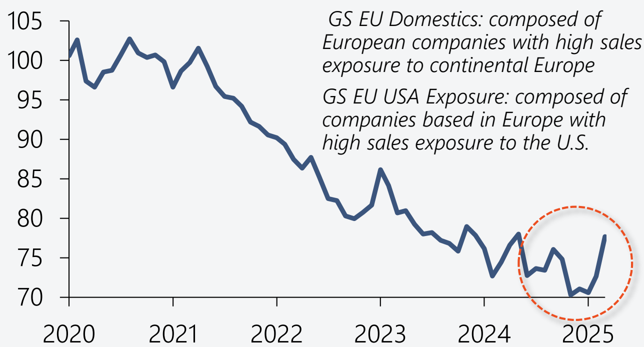
Improving earnings growth will be the key catalyst for healthier fund flows into Europe and higher valuations. The MSCI Europe Index's last twelve-month earnings have trailed those of the MSCI USA Index by a sizable margin since 2010, growing at compound annual rates of +3.0 and +9.1 percent, respectively. Yet, bottom-up consensus estimates indicate that MSCI Europe Index earnings are poised to increase by +8.5 percent in 2025 and +11.0 percent in 2026 after declining -2.8 percent in 2024, putting growth expectations close to those for the MSCI USA Index. Furthermore, earnings revision ratios are on the downswing in the U.S. across sectors, while they are on the upswing in Europe.

Just as U.S. stocks have outperformed European stocks significantly over the last decade-plus, European stocks with high sales exposure to the U.S. have outperformed their more continental-exposed peers. That, too, seems poised for a sustainable shift. The agreement to loosen Germany's debt brake could unleash one trillion euros

of added spending for defense and infrastructure, with positive spillover effects for neighboring nations (most of the higher spending will hit in 2026 and after). Also, the EU is considering an €800 billion "ReArm Europe" package, and Euro Area households have more than $1 trillion in excess savings that can be used as confidence improves.

Europe-Exposed Stocks Poised to Outperform

Rel. Perform. of Europe vs. U.S.-Exposed European Stocks

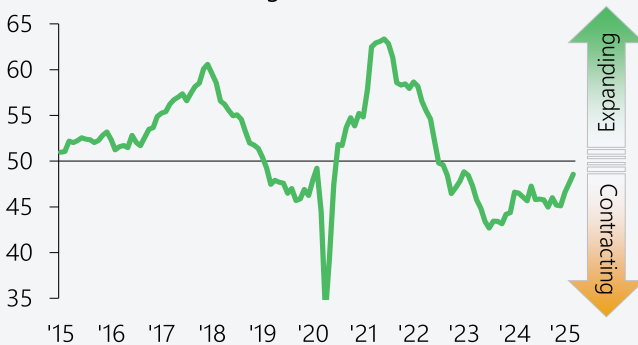


Source: Bloomberg, Goldman Sachs, 3/31/25

Whereas the MSCI USA Index (and the S&P 500) is weighted heavily toward technology, the MSCI Europe Index is more exposed to financials and sectors that will profit from higher defense and infrastructure spending (e.g., industrials and materials). The financials sector, which constitutes nearly a quarter of the MSCI Europe Index, will benefit from improving loan growth and the steeper yield curve. While equity prices and valuations have increased recently, European financials still trade at a sizable discount to their U.S. peers. Increased fiscal stimulus in Germany and China, plus improving trends in aerospace, power, and automation, should also lift the beleaguered industrial sector, which constitutes 18 percent of the MSCI Europe Index, out of the doldrums.

European Manufacturing in Bottoming Process

Euro Area Manufacturing PMI



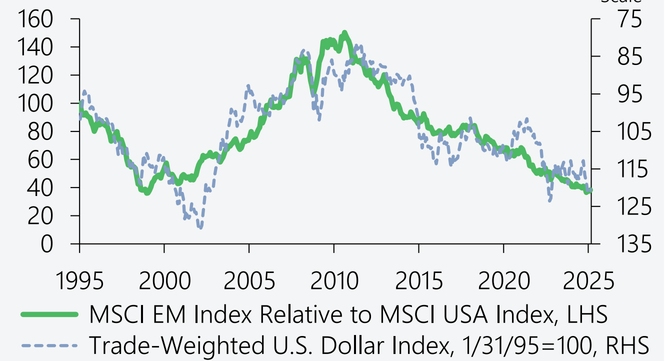
Source: S&P Global, 4/1/25

We also see attractive investment opportunities outside of Europe in select international markets such as India and Japan. India is our favored emerging market at the moment. Favorable demographics, including a highly educated workforce and a burgeoning middle class, are driving strong consumption-led growth. Furthermore, the government also continues to implement structural reforms and pro-growth policies to stimulate demand. While economic growth is slowing somewhat from the torrid pace of the past couple of years, the moderation in inflation facilitates monetary easing, further buoying growth. Despite strong economic prospects, valuations for Indian equities are below long-term averages.

Pressure From Higher US$ Likely Easing for EM

EM Relative Performance vs. U.S. Dollar

Inverted Scale



Source: FactSet, Federal Reserve, 3/31/25

In Japan, progress exiting its decadeslong deflationary funk has lifted interest rates off the zero bound, creating a more favorable environment for investment and risk-taking. Higher inflation and interest rates are prodding households to reallocate cash-heavy savings to stocks. Ongoing governance reform efforts are also prompting a wave of shareholder-friendly actions from cash-flush companies, such as increasing shareholder returns and allocating capital more efficiently. While demographics are a long-run headwind, Japanese stocks, which trade at a discount to those in other developed markets, look appealing given the increased economic dynamism.

The strong relative outperformance of U.S. stocks may have peaked in the short term. Yet, we do not endorse a wholesale shift away from domestic equities. While U.S. economic growth is slowing and tariffs heighten recession risks, pro-growth initiatives, such as tax cuts and deregulation, the details of which will likely emerge later in 2025, could offer a more favorable outlook. In addition, despite signs industry growth is moderating, we believe that U.S. technology stocks, which dominate domestic indices, will continue to perform well over the long term.

To conclude, we firmly believe that recent stock market volatility provides investment opportunities for patient investors. Our research efforts are focused on finding dominant, high-quality firms worldwide that have the potential to deliver above-average earnings growth in both the near term and long term.

Global Macro Developments

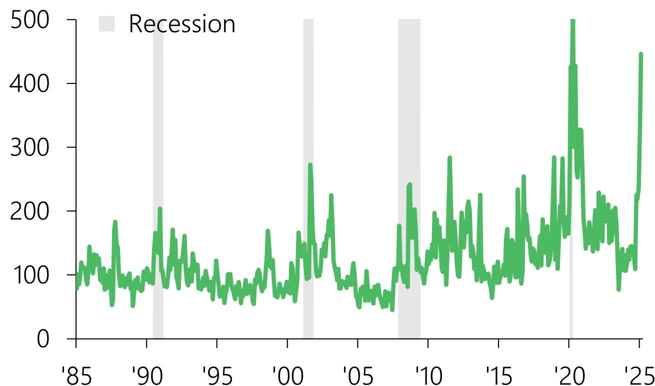
U.S. Economy Barreling Toward Self-Inflicted, Policy-Driven (Mild) Recession

U.S. exceptionalism is poised to hit a speed bump, if not a roadblock, as a widening multi-front trade war, disorderly federal government shakeup, and sweeping immigration crackdown quell animal spirits. We expected economic growth to downshift in 2025 owing to the lagged effects of monetary tightening, stretched household finances, and the drag from reduced immigration. However, if sustained, acute uncertainty due in large part to ever-changing, on-again, off-again tariffs threatens to derail the economy before pro-growth policies take effect (Exhibits 1 and 2). Consumer confidence is waning, and households have begun to cut back amid still-high prices and job worries. Businesses are also delaying capital investments until policy clarity improves. Although macro data show the economy is still in decent shape, the new administration seems increasingly resigned that weak growth or a mild recession in the near term may be inevitable, if not beneficial. After all, it may convince the Federal Reserve to ease more aggressively, aiding tax cuts and deregulation to propel an economic rebound in 2026 and beyond. The risk is that it can be challenging (and costly) to reverse a negative feedback loop once it is established.

Tariffs Could Lead to Fewer Trade Barriers if President Trump Takes That Path

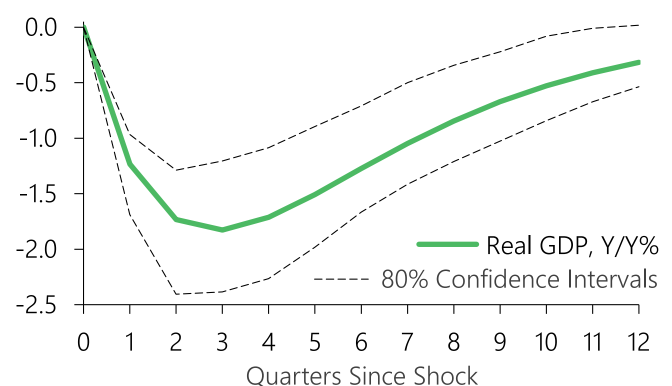
Despite hopes for the contrary, President Trump has come out swinging (really hard) on tariffs – the scale, scope, and swiftness have been astonishing. As illustrated in Exhibits 3 and 4, the effective U.S. tariff rate could skyrocket to nearly 27 percent in 2025 from 2.3 percent in 2024, as per Oxford Economics. The President's attempt to rebuild the U.S.'s manufacturing base by

Exhibit 1: U.S. Economic Policy Uncertainty
Index, 1985 = 100



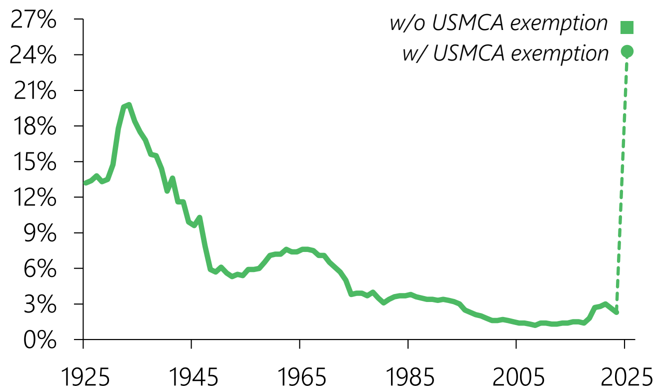
Source: Baker, Bloom, & Davis, 3/31/25

Exhibit 2: GDP Response to Uncertainty Shocks
Response to 100%+ Y/Y Eco. Policy Uncertainty Shock



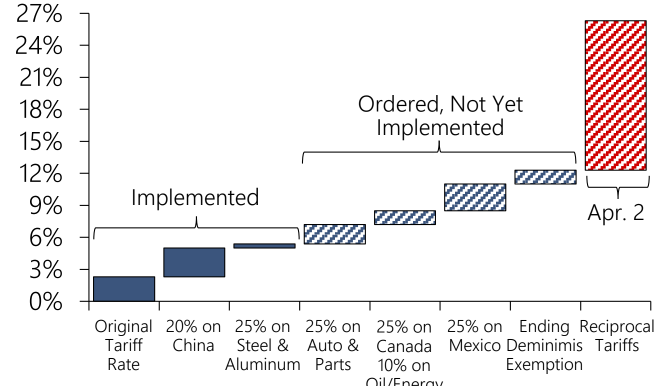
Source: Piper Sandler, 3/20/25

Exhibit 3: Estimated Effective U.S. Tariff Rate
Percent



Source: International Trade Commission, Oxford Economics, 4/3/25

Exhibit 4: Contributors to Effective Tariff Rate
Estimated Impact of Tariff Increases on Effective Tariff Rate



Source: Oxford Economics, 4/3/25

unwinding 80 years of global trade liberalization with a stroke of the pen will prove disruptive, if not also economically painful. The outlook for the economy hinges on whether the President is using tariffs as a negotiating tactic or to deconstruct the global trade order. Even if his intent is the latter, market forces could push him to the former (leading to fewer global trade barriers). Given the considerable unknowns and likely knock-on effects, predicting the economic impact with precision is difficult. At least for 2025, the economy is set to slow considerably and could contract by the end of the year if tariffs remain in place and other nations retaliate (Exhibit 5).

Adverse Effects of Federal Government Shakeup Spilling Into Private Sector

As of March 31, President Trump has "flooded the zone" with 109 executive orders on far-flung issues, many of which are being challenged in the courts and contributing to the high degree of uncertainty. More worrying, at least in terms of the economy, is the extent to which the adverse effects of the government's chaotic overhaul spill into the private sector and undercut potential growth. Led by DOGE, the executive branch is gutting federally funded programs and slashing payrolls. Over 120 thousand, or around 5 percent of the 2.4 million civilian federal employees (ex., postal workers), have been shown the door or will soon be. Some estimate the final figure could reach half a million. Given the still-tight job market, those workers may be absorbed into the private sector if no recession surfaces. Even so, a Brookings analysis reveals that over seven million private sector jobs are linked to federal contracts and grants, exposing those institutions and their entire orbits to federal spending cuts. Notably, non-government positions comprised 38 percent of the 447 thousand job cuts announced in February and March (Exhibit 6).

Stock Market Rout Could Dampen Consumer Spending Via Wealth Effect

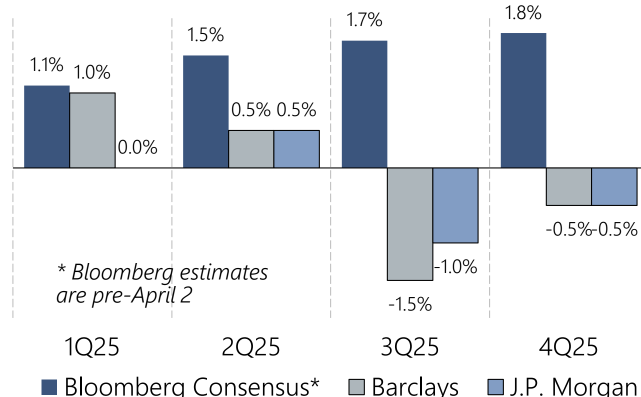
Robust spending by higher-income households helped sustain above-trend real GDP growth in 2023 and 2024, as lower-to-middle-income households exhausted their excess savings. Yet, a stock market correction risks stifling spending by means of the wealth effect. An analysis by Moody's that recently garnered much press claims that the top ten percent of earners currently account for nearly half of consumer spending. Bureau of Labor Statistics data show the figure might be closer to one-quarter. Either way, higher-income households drive an outsized share of spending. Based on Federal Reserve data, the top ten percent hold a more disproportionate share of wealth, controlling 67 percent of household net worth and 87 percent of equities held by U.S. households. Since the end of 2019, rising real estate and stock prices have boosted the (nominal) net worth of the top ten percent by over $30 trillion. Oxford Economics estimates that, for all U.S. households, a one-dollar change in financial wealth leads to a 14-cent change in spending and that a bear market could shave 30-plus basis points off GDP growth.

Reconciliation Bill Should Provide Economic Lift But at Expense of Future Growth

It will probably take congressional Republicans a few more months to pass "one, big beautiful [reconcilation] bill," which will extend many of the expiring provisions of the 2017 Tax Cut and Jobs Act (TCJA) and may include some of the tax cuts the President proposed on the campaign

Exhibit 5: U.S. Real GDP Projections

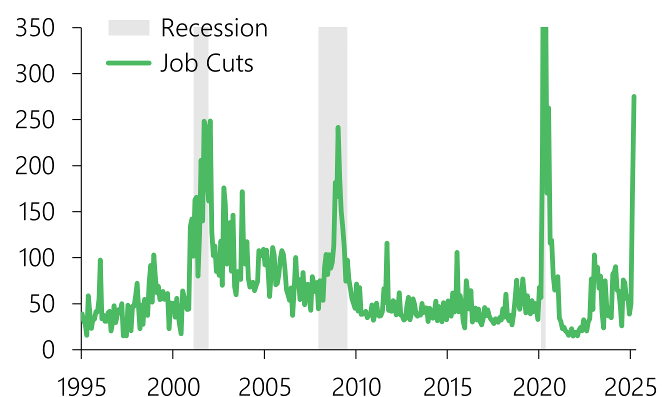
Q/Q% SAAR



Source: Bloomberg, Barclays, J.P. Morgan, 4/4/25

Exhibit 6: Announced U.S. Job Cuts

Monthly, Thousands



Source: Challenger, Gray & Christmas, 4/3/25

trail. The Committee for a Responsible Federal Budget (CRFB) estimates the bill could increase federal debt by $5 to $11 trillion over ten years (Exhibit 7). Thus, Congress must scale back the bill or resort to accounting gimmicks and spending cuts (offsetting the economic upside to tax cuts) to warrant the bill's passage. Analysis by Rubinson Research suggests that additional tax cuts may lift consumer spending by 75 basis points on a probability-weighted basis but that the positive effects will be more than offset by other policies (Exhibit 8). Extending the expiring provision of the TCJA will cost $4 to $5 trillion over ten years and will not boost GDP growth; it just pushes out a big fiscal cliff. The CRFB estimates that making the cuts permanent would add $37 trillion to the debt over the next 30 years (likely sending Treasury yields soaring).

Good Start to Year in China, But More Stimulus Needed to Sustain Momentum

As shown in Exhibit 9, for 2025, policymakers have again set their sights on economic growth of "around +5.0 percent," versus our forecast for +4.5 percent. While the economy got off to a good start in the first two months of the year, growth momentum will likely slow in the second quarter due to the (1) fading benefits from last year's stimulus, (2) reversal in exports following a pull forward in demand, and (3) negative impact from broad-based U.S. tariff hikes. Without added (timely) policy support, the economy may continue slowing into the year's second half. Although recent communications signaled more easing in the coming quarters, a "wait and see" mindset persists. The State Council's 30-point action plan to support consumption is a step in the right direction, but it is light on details and lacks fresh stimulus measures. New initiatives, possibly rolled out later this year, could include a fertility subsidy and an expansion of the trade-in program. Still, the structural rebalancing toward consumption will be gradual (Exhibit 10).

Exhibit 7: Fiscal Impact of Trump's Tax Priorities

2026 to 2035

Policy	Low Est.	High Est.
Extend the Tax Cuts & Jobs Act	$3.9 trillion	$4.8 trillion
Provide SALT Relief	$200 billion	$1.2 trillion
Cut Taxes on Tips	$100 billion	$550 billion
Cut Taxes on Overtime Pay	$250 billion	$3.0 trillion
Cut Taxes on Social Security	$550 billion	$1.5 trillion
Cut Taxes for Domestic Prod.	$100 billion	$200 billion
Close Carried Interest Loophole	-$100 billion	#
Total	$5.0 trillion	$11.2 trillion

 # Less than $25 billion of savings

Source: Committee for a Responsible Federal Budget, 2/6/25

Exhibit 8: Policy Effects on Consumer Spending

Taxes	Effect (%)	Probability	Prob.-Wtd. Effect (%)
No Taxes on Tips	0.28	50%	0.14
No Taxes on Overtime	0.64	50%	0.32
No Taxes on Social Security	0.60	25%	0.15
Deduct Auto Loan Interest	0.05	50%	0.03
SALT Repeal	0.60	20%	0.12
TCJA Extension	0.00	100%	0.00
Taxes Total	2.16		0.75
Tariffs	-1.84		-0.73
Immigration	-0.54		-0.51
DOGE	-0.28		-0.19
All Items	-0.50		-0.68

Source: Rubinson Research, 3/17/25

Exhibit 9: China's Economic Targets for 2025

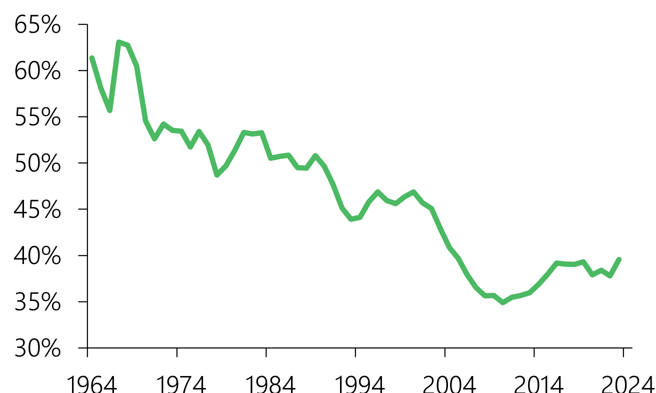
	2025 Target	2024 Target	2024 Reported
GDP Growth, Y/Y%	≈5.0	≈5.0	5.0
CPI Inflation, Y/Y%	≈2.0	≈3.0	0.2
Fiscal Deficit Ratio, % of GDP*	4.0	3.0	3.0 (4.8)
Local Government Special Bond (LGSB) Quota, RMB tn	4.4	3.9	4.0
Central Government Special Bond (CGSB) Quota, RMB tn	1.8	1.0	1.0
Implied Total Government Bond Net Issuance Quota, % of GDP	8.4	6.6	6.7
Surveyed Unemployment Rate, %	≈5.5	≈5.5	5.1

**Numbers outside and inside the bracket refer to the official and effective on-budget fiscal deficit ratios, respectively*

Source: Goldman Sachs, 3/27/25

Exhibit 10: China's Private Consumption

Percent of Nominal GDP



Source: CEIC, 3/31/25

Easing of Germany's Debt Brake Will Give Economy a Shot in the Arm

Once Europe's growth engine, Germany's economy struggled to find its footing post-pandemic, with real GDP stagnating over the past two years. Yet, the new governing coalition's agreement to loosen the government borrowing limits imposed by the 2009 balanced budget amendment, also known as the debt brake, should give the economy a shot in the arm. The plan (1) exempts defense spending above 1 percent of GDP from debt brake limits, (2) establishes a €500 billion off-budget infrastructure fund, and (3) lifts deficit limits for federal states to 0.35 percent from zero. Higher government spending could increase real GDP growth by around 20 basis points in 2025 and 40-60 basis points in 2026 and 2027, which could bring real GDP growth to +0.2 percent in 2025 and +1.5 to +2.0 percent in 2026 and 2027 (there is some risk to 2025 based on the timing of stimulus and how the tariff situation shakes out). Against anemic productivity growth and a shrinking working-age population, the government must implement significant structural reforms to prevent the economy from backsliding to sub-one percent growth in 2028.

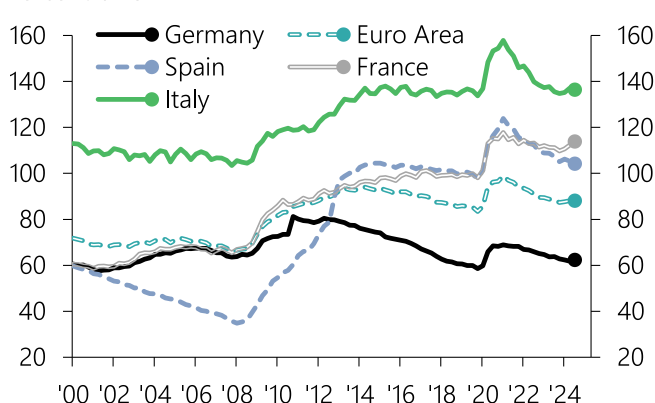
Euro Area Faces Another Year of Low Growth, But Better Prospects for 2026

Rising Russian aggression and the impact of "America First" policies have intensified Europe's drive to strengthen its energy self-reliance and military readiness, possibly leading to a sizable increase in domestic investment over the next decade. European Union members spent about €326 billion (1.9 percent of GDP) on defense in 2024, a 65 percent rise since 2020. According to the European Council, defense spending is expected to climb another €100 billion by 2027. However, most other European countries do not have the fiscal space to follow Germany's lead on deficit spending in the near term. Germany's government debt-to-GDP ratio is 62 percent compared with Italy's 137 percent, France's 110 percent, and Spain's 105 percent (Exhibit 11). Therefore, the Euro Area's overall fiscal impulse may be a slight economic drag in 2025 and neutral in 2026. Adjusting for better German prospects and potential tariff impacts, Euro Area real GDP is poised to expand by +0.25 to +0.75 percent in 2025, with better growth in 2026.

Bank of Japan's Balancing Act Getting Tougher as Tightening Cycle Progresses

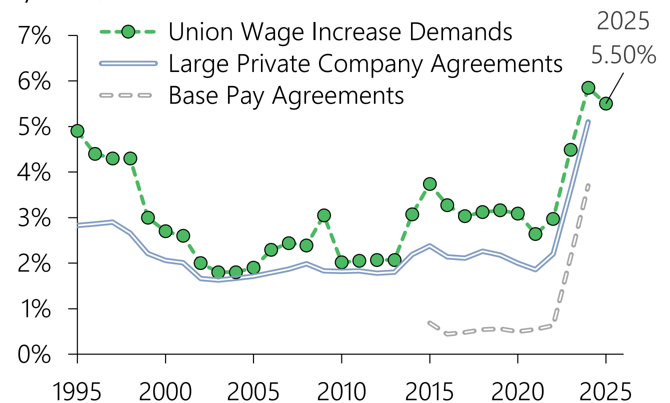
The Bank of Japan (BoJ), seeking to defeat deflation, has fostered an environment where labor shortages create persistent upward pressure on wages and prices. Ongoing annual labor union negotiations, a barometer for national wages, point to a third consecutive year of above-trend pay increases (Exhibit 12). A still-stimulative +0.50 percent policy rate and the recent rise in food prices that pushed headline CPI to +3.6 percent in February argue the BoJ should tighten further. However, hiking rates too quickly risk backsliding, as a firm handoff from higher wage growth to sustained consumption growth remains elusive. Consumer confidence has receded amid higher prices, and spending stalled in January. Moreover, tariff uncertainty is an added headwind for an already challenged manufacturing sector and risks dulling a strengthening domestic investment cycle. Although inbound tourism remains a tailwind and tariff risks may prove benign, we expect modest +0.5 to +1.0 percent real GDP growth in 2025.

Exhibit 11: Europe General Government Debt
Percent of GDP



Source: Bank for International Settlements, 9/30/24

Exhibit 12: Japan Wage Demands & Agreements
Y/Y Percent

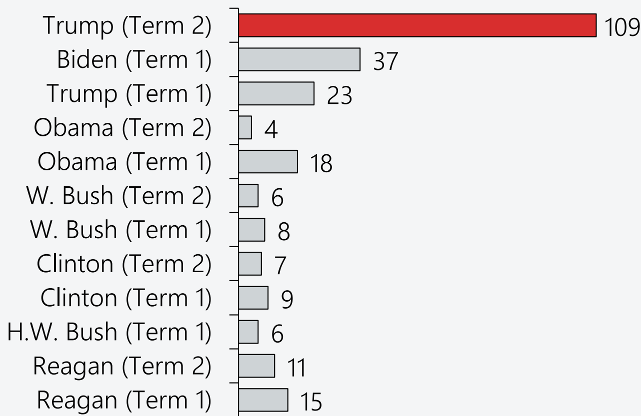


Source: Piper Sandler, 3/31/25

United States: Other Notable Data Points

Executive Orders Contributing to Uncertainty

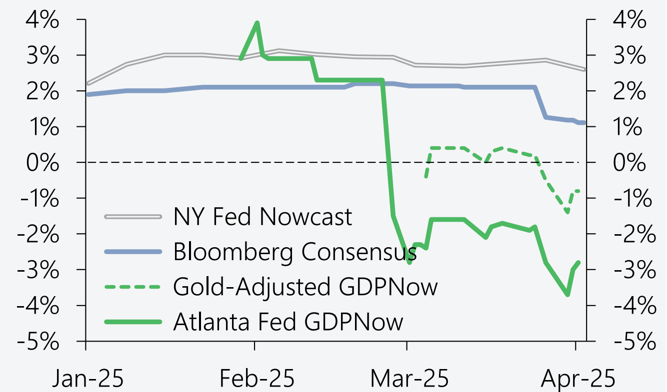
Number of Executive Orders in First 10 Weeks of Term



Source: Federal Register, 4/3/25

Possible Negative 1Q Growth as Imports Surged

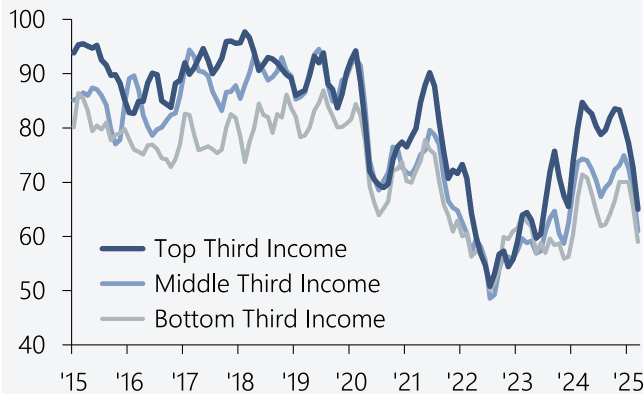
First Quarter 2025 U.S. GDP Growth Estimates
Q/Q SAAR, Percent



Source: Bloomberg, Atlanta Fed, NY Fed, 4/4/25

Expectations Plunged Across Income Groups

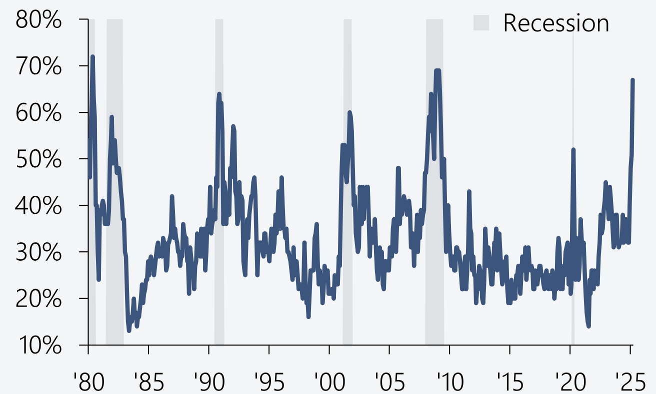
Index of Consumer Expectations
1966=100



Source: University of Michigan, 3/28/25

Consumers Increasingly Worried About Jobs

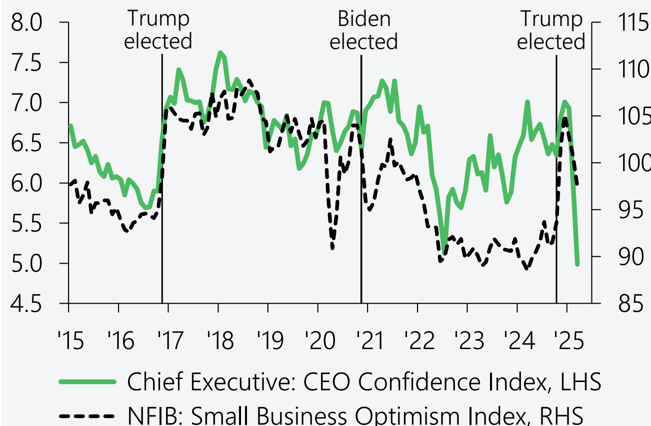
Share of U.S. Consumers Expecting Higher Unemployment During the Next Year



Source: University of Michigan, 3/28/25

U.S. CEO Confidence Dropped to 13-Year Low

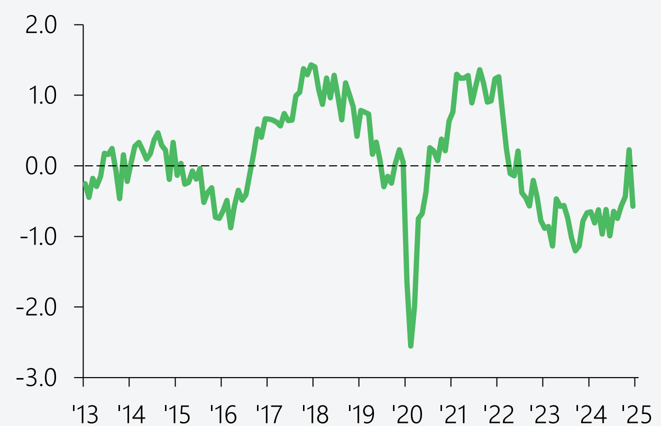
U.S. Business Confidence



Source: Chief Executive Magazine, NFIB, 4/8/25

Uptick in Corporate Capex Plans Put on Hold

Federal Reserve Composite Capex Plans Index

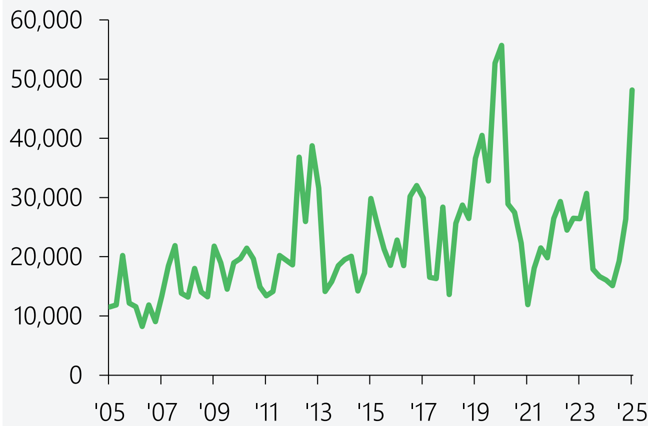


Source: Regional Federal Reserve Banks

International: Other Notable Data Points

Uncertainty Has Rocketed Across the World

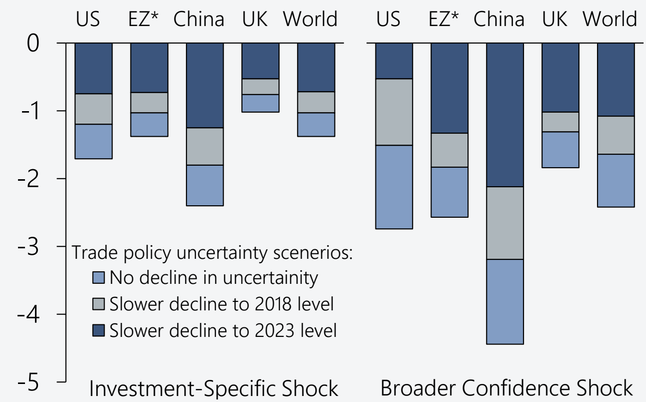
World Uncertainty Index



Source: Ahir, Bloom, & Furceri, 3/31/25

High Uncertainty Damaging Growth Prospects

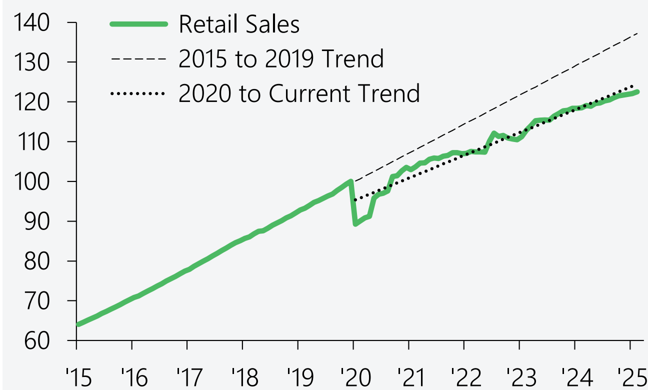
GDP Impact of Trade Policy Uncertainty
% Difference from Baseline Forecast in 2028



Source: Oxford Economics, 3/28/25

China Retail Sales Remain Well Below Trend

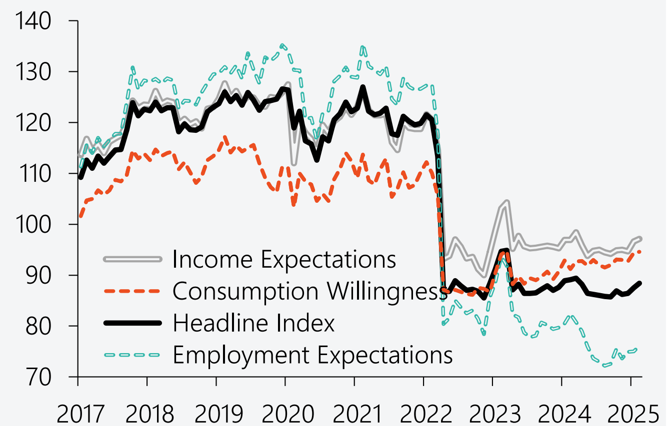
China Retail Sales of Consumer Goods
Seasonally-Adjusted, Rebased Index, 12/31/2019 = 100



Source: CEIC, 3/31/25

China Consumption Willingness Slowly Rising

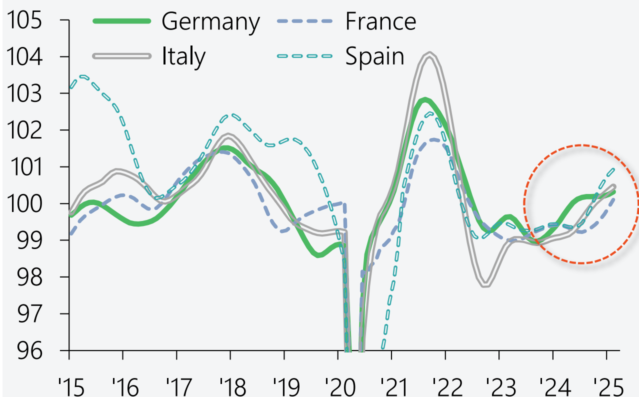
China Consumer Confidence Index



Source: National Bureau of Statistics, 3/31/25

Europe's Leading Indicators Have Been Rising

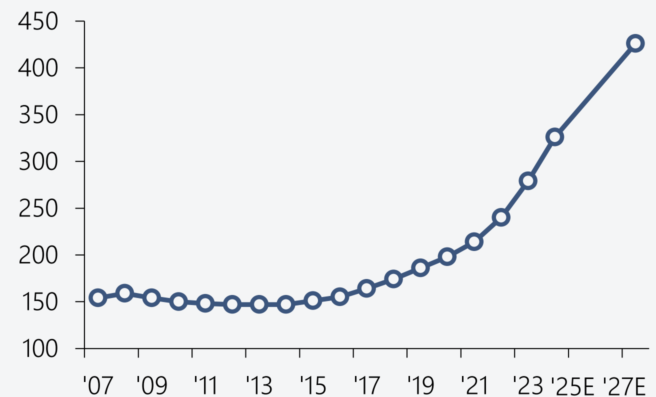
Composite Leading Indicators
Amplitude Adjusted, Long-Term Average = 100



Source: OECD, 3/31/25

Europe Defense Spending Will Continue to Climb

European Union Member States' Defense Spending
Billions of Euros



Source: European Council, 3/31/25

Fixed Income: Environment and Strategy

Fed Retains Wait-And-See Approach and Dovish Bias Amid Soaring Uncertainty

Higher tariffs, which will slow economic growth and raise prices, could put the Federal Reserve (Fed) in a pickle. Yet, much to investors' relief, the key takeaway from the March Federal Open Market Committee (FOMC) meeting is that policy remains firmly biased toward easing despite the somewhat hawkish economic projections. Reflecting the one-time impact of tariffs to some degree, the FOMC cut its 2025 real GDP growth forecast by 40 basis points to +1.7 percent and raised its PCE inflation forecast by 20 basis points to +2.7 percent. It made only minimal changes to 2026 and 2027 and kept its long-run projections intact. Still, nearly all participants cited that risks to GDP are to the downside and that risks to inflation are to the upside. While the FOMC left rates unchanged (in line with expectations), it plans to slow the monthly runoff in Treasuries on its balance sheet to $5 billion from $25 billion, the effect of which is equivalent to about a 25-basis point rate cut. Also, as the FOMC sees tariffs as having a transitory impact on inflation, it continues to pencil in two 25-basis point rate cuts in 2025 and two in 2026.

High Uncertainty Raises Probability of a Monetary Policy Mistake

Heading into 2025, the Fed was on track to achieve the elusive soft landing, and it still may be. But, the probability of a policy mistake has risen. In the post-FOMC-meeting press conference, Chair Powell downplayed the University of Michigan survey data that show consumers' year-ahead and long-run inflation expectations rocketing to +4.9 and +3.9 percent, respectively, on tariff concerns. He has a good reason for doing so. So-called "soft data" (i.e., opinion surveys) can be volatile and is not always a good leading indicator. Still, if inflation expectations remain elevated, there is a risk it may become self-fulfilling. Oxford Economics forecasts that the tariffs will cause core PCE inflation to blip to the low-4 percent range before receding to sub-2 percent in 2026 – though the outlook is highly uncertain against shifting executive actions. We do not see 1970s-type stagflation, but the echoes from that period ring loudly through the halls of Fed buildings, which may cause some central bankers to second-guess policy easing. Even so, we think they may have no choice but to continue easing if job losses rise and spending slows.

Bond Spreads Widened on Lower Yields, Not on Credit Concerns

Treasury yields dropped 20-30 basis points across the curve during 2025's first quarter, with most of the move occurring in mid-to-late February. Rising concerns over a slowing economy and softening consumer behavior prompted investors to reassess risk and rate expectations, driving bond yields modestly lower and spreads wider. Spread widening is a familiar market dynamic, often occurring when investors prioritize absolute yield levels over relative spread valuations. As yields fell, spreads adjusted to maintain the yield thresholds buyers required. This pattern underscores the importance of viewing spread movements in context. In this case, widening spreads are more a function of demand dynamics than an indication of a material deterioration in credit fundamentals or intensifying default risks. We continue to emphasize sectors offering compelling relative value, especially in high-quality assets where spreads have widened despite strong underlying fundamentals. We expect spreads to peak in the latter half of 2025, at which point we will begin adding to our corporate credit exposure.

Taxable Fixed Income Strategy

Our outlook for 2025 returns remains centered on attractive interest income levels. The yield curve will likely steepen further as the Federal Reserve cuts rates. Thus, we have maintained portfolio durations slightly longer than the benchmark, predominantly in the three-to-six-year segment of the yield curve. As we wait for the Federal Reserve to resume its rate-cutting cycle later this year, we anticipate a significant income advantage relative to benchmarks across the strategies we manage to be the primary driver of outperformance. We continue to find value in non-agency asset-backed securities (where appropriate) due to their high quality, significant credit support, and strong underlying borrower characteristics. We have been able to source bonds at significantly wider spreads in this sector relative to agency MBS and corporate credit; we expect this sector to outperform corporates as the economy slows. We have maintained an up-in-quality bias within credit-sensitive strategies and expect to move down in quality when the eventual materialization of an economic slowdown pushes credit spreads wider.

Tax-Exempt Yield Curve Steepens Sharply

Tax-exempt bond yields moved independently of Treasury bond yields in the first quarter, with the tax-exempt yield curve steepening significantly. Short-term high-grade tax-exempt yields decreased, although by a lesser margin than short-term Treasury yields. Intermediate tax-exempt yields were relatively stable, generally changing by less than ten basis points. Conversely, long-term tax-exempt bond yields increased by almost 40 basis points. Yield ratios, which are tax-exempt bond yields as a percentage of comparable maturity Treasury bond yields, increased across the curve. For the most part, tax-exempt credit spreads tightened during the quarter. Overall, the Bloomberg Municipal Bond Index had a total return of -0.22% during the quarter. Shorter-term bonds generally outperformed longer-term bonds, and lower-quality bonds outperformed higher-quality bonds. Most of the revenue bond sectors experienced negative returns for the quarter, although housing bonds tended to fare better than most, primarily due to spread tightening.

Ability to Absorb Supply Wanes when Fund Flows Reverse

Municipal bond issuance was historically high during the first quarter, totaling over $118 billion, compared to nearly $104 billion in the first quarter of 2024. We did not have the typical post-holiday January reprieve in bond issuance, and supply remained consistently high throughout the quarter. Taxable issuance, still a relatively small proportion of total municipal bond issuance, increased to $6.9 billion in the first quarter from $5.9 billion in the first quarter of 2024. Tax-exempt fund flows were strong for most of January and February but weakened in March. Once fund flows began to weaken, long-term muni yields began to increase sharply. Interestingly, high-yield fund flows remained strong throughout the quarter, likely contributing to this quarter's spread tightening. Trading volume increased slightly in the first quarter compared to the fourth quarter of last year. Moreover, trading volume sequentially increased during each month of the first quarter.

Tax-Exempt Fixed Income Outlook

While the Fed has been on hold, policy and economic factors have driven changes in Treasury rates and taxable bond rates. Tax-exempt municipal investors face the added complication of potential tax reform impacts this year. Municipal bond strategists, issuers, and investors are concerned that the municipal bond tax exemption may face risk as Congress debates paying for the extension of the Tax Cut and Jobs Act. The range of impacts on the municipal bond tax exemption being discussed varies from a full repeal to more targeted changes. While we believe a complete repeal of the municipal bond tax exemption is unlikely, some sectors or investors could be negatively impacted. Volatility in the municipal bond market is likely to remain higher than normal until we have more clarity on the provisions of the tax bill that emerges from Congressional negotiations. Regardless, income levels, particularly for longer-term tax-exempt investments, have become quite attractive and will drive longer-term returns.

Tax-Exempt Fixed Income Strategy

Consistent with our investment philosophy, we remain focused on income as the primary driver of return. Most revenue bond sectors continue to possess an attractive yield advantage over general obligation bonds. Our purchases continue to emphasize housing bonds, although transportation bonds, notably airport revenue bonds, have become an increasingly significant proportion of our purchases in many strategies. We also continue to use bonds with short or current-call provisions to construct the short-end of our barbell, where portfolios can garner a high level of income and reduced price volatility in exchange for the potential of a bond redemption. Such bonds have become somewhat easier to source with the increase in long-term yields and trading activity. While the long end of our barbell approach to managing duration has not been beneficial in the first quarter, we believe the increase in long-term tax-exempt yields bodes well for future returns. Overall, portfolios are positioned to benefit from their income advantage and are generally expected to have modestly longer durations than benchmarks going forward.

Fixed Income: Other Notable Data Points

FOMC's Long-Term Projections Unchanged

FOMC Summary of Economic Projections, March 2025

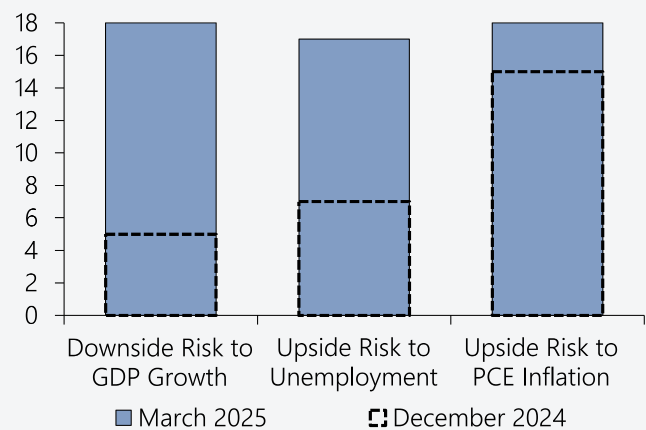
Percent

	Median			
	2025	2026	2027	Longer-Run
Change in Real GDP	1.7	1.8	1.8	1.8
December Projection	2.1	2.0	1.9	1.8
Unemployment Rate	4.4	4.3	4.3	4.2
December Projection	4.3	4.3	4.3	4.2
PCE Inflation	2.7	2.2	2.0	2.0
December Projection	2.5	2.1	2.0	2.0
Core PCE Inflation	2.6	2.3	2.0	
December Projection	2.5	2.2	2.0	
Federal Funds Rate	**3.9**	**3.4**	**3.1**	**3.0**
December Projection	3.9	3.4	3.1	3.0

Source: Federal Reserve, 3/19/25

High Tariff Uncertainty Raising Economic Risks

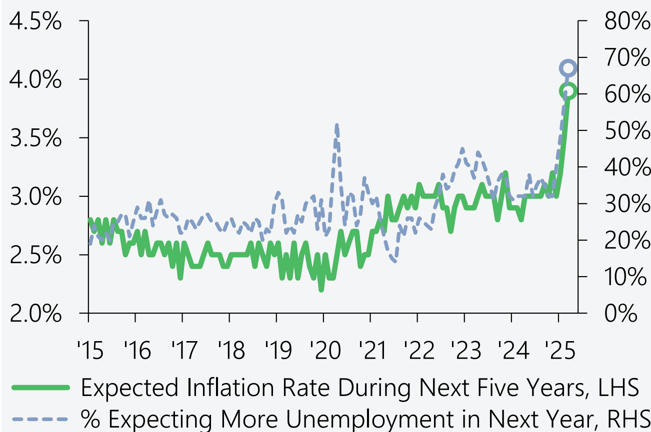
Number of FOMC Participants Reporting . . .



Source: Federal Reserve, 3/19/25

Consumers' Inflation Expectations Up on Tariffs

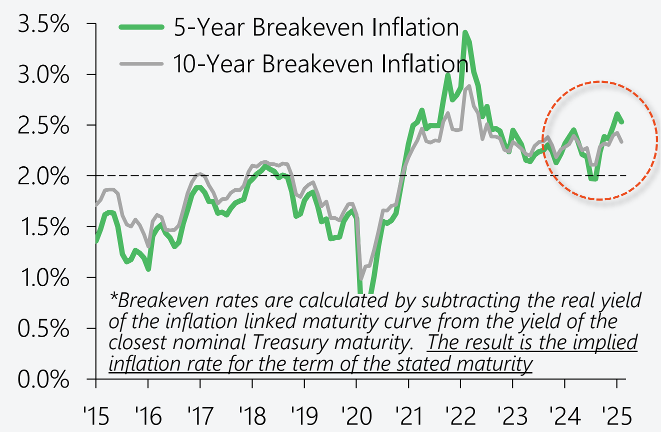
University of Michigan Survey of Consumers



Source: University of Michigan, 3/28/25

Markets' Inflation Expectations More Benign

Breakeven Inflation Rates*



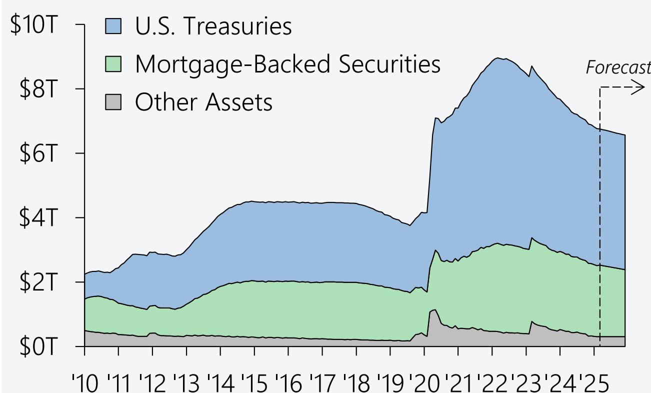
*Breakeven rates are calculated by subtracting the real yield of the inflation linked maturity curve from the yield of the closest nominal Treasury maturity. The result is the implied inflation rate for the term of the stated maturity

Source: Federal Reserve, 3/31/25

Slowing Asset Runoff Supports Lower Yields

U.S. Federal Reserve Assets

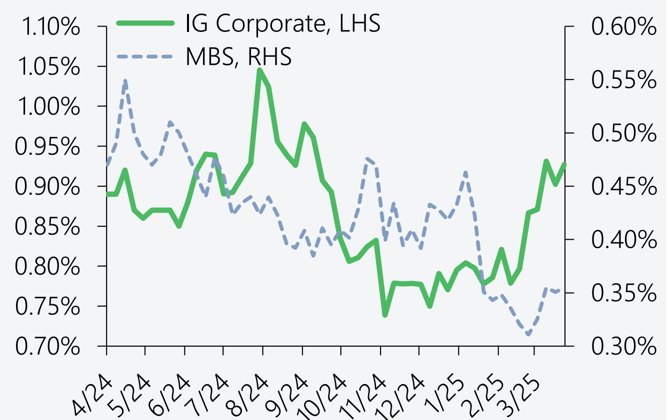
$ Trillion



Source: Federal Reserve, Sit Investment Associates, 3/31/25

Declining Bond Yields Driving Spreads Wider

Bloomberg U.S. Aggregate Option-Adjusted Spreads



Source: Bloomberg, 3/31/25

Global Equities: Environment and Strategy

From Trump Bump to Trump Slump in U.S.; Investors Rotated to Non-U.S. Stocks

The S&P 500 Index ended the March 2025 quarter -8.7 percent below its February 19 all-time high and is down -4.6 percent year to date as the shine came off the artificial intelligence trade and as concerns that tariffs could upend the economy grew. The Magnificent Seven stocks took the brunt of the selling pressure, plunging -14.8 percent year to date on a market cap-weighted basis (with most of the losses coming after February 19). Excluding those stocks, the S&P 500 Index would have been basically flat year to date (Exhibit 13). However, the percentage of S&P 500 constituents producing a trailing one-month negative return grew to 69 in March from 51 in February and 29 in January. Conversely, the softening U.S. outlook and mounting stimulus in Europe and China spurred a rotation into international stocks, which, when combined with the depreciating U.S. dollar, led to a +5.4 year-to-date return for the MSCI All-Country World (ex. USA) Index. As for key nation-specific MSCI indices, Spain returned +22.5 percent in the first three months of 2025, Italy +17.4, Germany +15.6 percent, and China +15.1 percent.

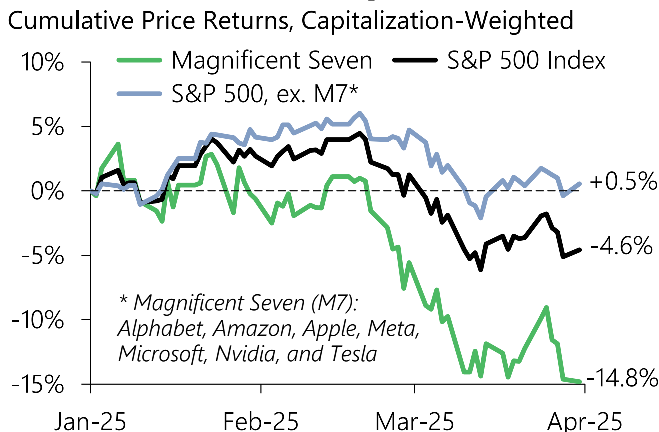
Confidence in Trump and Fed Puts Contained Market Losses in March Quarter

The year-to-date outperformance in international stocks follows a consistent 15-year period in which domestic stocks outperformed massively (as shown on the front page). Still, as we noted last quarter, investor sentiment on U.S. equities was euphoric heading into 2025, and markets would likely be more volatile after two successive years of robust gains for the S&P 500 Index. According to the NAAIM Exposure Index, U.S. active portfolio managers reduced risk exposure to historically average levels by the end of March, likely indicative of a wait-and-see approach. On the other hand, the investment advisors' bull-to-bear ratio has plummeted to lows not seen since 2022 (Exhibit 14). They must have forgotten to tell their clients because retail investors were buying on the dip. In March, about $19 billion flowed into U.S. equity mutual funds and ETFs, bringing the cumulative total since 2021 to nearly $1.3 trillion. As for the general market tone heading into April, investors appeared to be banking on the "Trump put," the "Fed put," or a combination thereof to bail out the economy (and the markets) if it got into trouble.

Trump Unmoved by Post-Liberation Day Market Rout – Has "Trump Put" Expired?

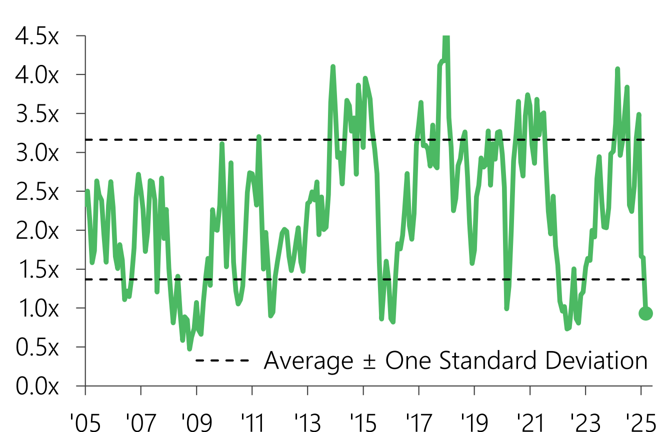
As President Trump used it as a barometer of his success, the stock market helped temper some of his more aggressive economic policies during his first term. Thus, many investors, including ourselves, expected that his second-term policies would not be nearly as severe as his campaign rhetoric and that the stock market would again have a moderating effect. In a recent Evercore ISI investor survey, 65 percent of respondents believe the S&P 500 "strike price" on a "Trump put" is at 4,700 or above, while 15 percent said it is below 4,700, and 20 percent said no "Trump put" exists. A price of 4,700 for the S&P 500 would be a -23 percent drop from its February 19 peak, putting it into bear market territory. Incidentally, 82 percent of survey respondents just

Exhibit 13: S&P 500 First Quarter 2025 Returns
Cumulative Price Returns, Capitalization-Weighted



Source: FactSet, 3/31/25

Exhibit 14: Advisors' Bull-to-Bear Ratio



Source: Investors Intelligence, 3/31/25

two weeks ago thought the "strike price" was 5,200 or higher. The President continues to dig his heels in on tariffs, but the early April market rout could incentivize him to seek quick wins. Still, March quarter earnings reports will likely do little to soothe investors, as companies will probably guide cautiously given the high uncertainty. On the other hand, investors will begin looking to 2026 and beyond for upside opportunities once earnings are adjusted downward.

Global Equity Strategy

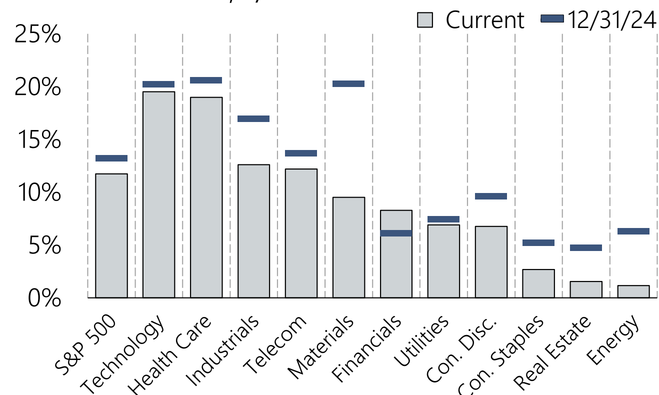
We expect the combination of slower economic growth and uncertainty surrounding tariffs to weigh on corporate earnings in the near term (Exhibit 15). While a mild recession is possible, we anticipate that potential deregulation, monetary easing, and tax cuts will cushion the impact once current uncertainties ease. Equity market volatility will likely persist but offers valuable opportunities to "upgrade" portfolios to optimize risk-return profiles. As short-term gains may be limited, a longer-term view is essential, given that few companies will be unaffected by the broader economic trends. However, we are confident that focusing on company fundamentals and secular growth drivers will reward patient investors. A quality-focused investment style that emphasizes consistent earnings, strong balance sheets, cash flow generation, and dividend growth, remains a key defense during times of market and economic turmoil.

Sector diversification continues to be a central element of our investment strategy, but we see the most attractive long-term opportunities in technology, finance, and healthcare. Despite the recent slowdown in technology earnings growth, companies well-positioned in secular growth areas, such as artificial intelligence, cloud adoption, and cybersecurity, will continue to generate superior earnings growth over the long term. Financials should benefit from a more favorable regulatory landscape and a potential rebound in loan growth and capital markets activity. Also, investors are "paid to wait," as these firms provide attractive capital returns through dividends and share buybacks. Finally, we are investing in innovative healthcare companies supported by strong demographic trends and lower economic sensitivity. Given the potential headwinds of drug pricing pressures on large pharmaceutical firms, we prioritize investments in medical devices, health services, and select biotech companies.

As for international portfolios, despite the tariff risks, we are constructive on Chinese equities, given still undemanding valuations and increasing policy support. Recent artificial intelligence breakthroughs and President Xi's meeting with private sector business leaders have helped lift investor confidence. Led by IT and internet stocks, the MSCI China Index returned +15.1 percent in the March quarter (Exhibit 16). We also have a positive stance on Indian companies due to the country's strong growth prospects. Improving rural consumption, easing monetary policy, and tax cuts for low- and middle-income households underpin prospects for real GDP growth of over +6.0 percent in fiscal 2025. Lastly, we have become more optimistic about the South Korean equity market after lawmakers voted to expand corporate boards' fiduciary duty standard to force chaebols to be more accountable to shareholders.

Exhibit 15: S&P 500 Bottom-Up EPS Estimates

Calendar Year 2025, Y/Y%



Source:

Exhibit 16: Global Equity Total Returns

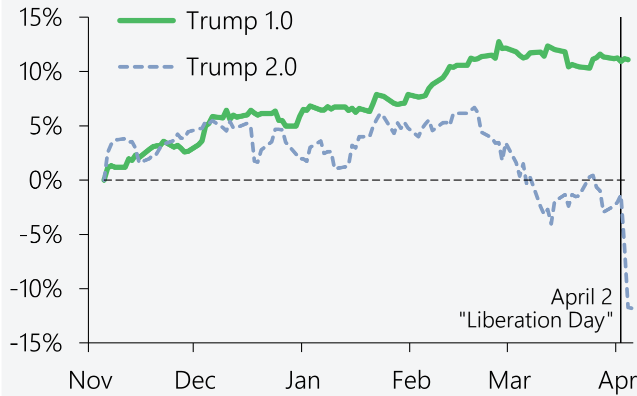
Total Returns in U.S. Dollars As of 3/31/25	1Q25	Annualized 3 Yrs.	Annualized 5 Yrs.	Annualized 10 Yrs.
MSCI China	15.1	3.7	1.6	2.7
MSCI EM L. America	12.8	-1.4	12.3	3.0
MSCI Europe	10.6	8.0	13.8	6.3
MSCI AC World (ex. U.S.)	5.4	5.0	11.5	5.5
MSCI Emerging Markets	3.0	1.9	8.4	4.1
MSCI AC Asia Pac	1.0	3.1	8.7	5.0
S&P 500®	-4.3	9.1	18.6	12.5
S&P Mid Cap 400®	-6.1	4.4	16.9	8.4
S&P Small Cap 600®	-8.9	0.7	15.1	7.5

Source: FactSet, 3/31/25

Global Equities: Other Notable Data Points

Diametrical S&P 500 Returns at Start of Terms

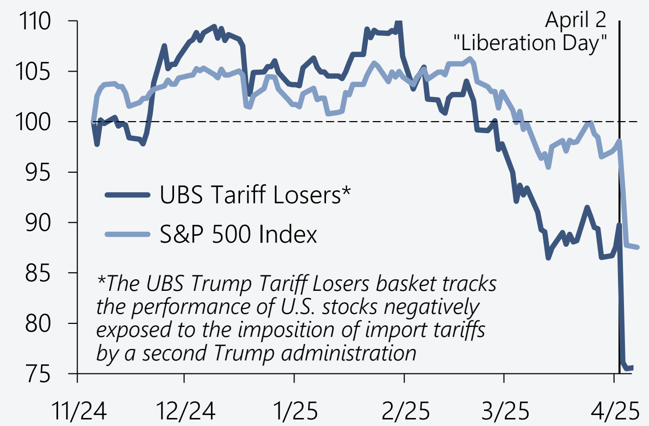
S&P 500 Index Returns During Trump Administrations
Cumulative, Election Date to April 7 the Following Year



Source: FactSet, 4/7/25

Tariff-Exposed U.S. Stocks Have Been Crushed

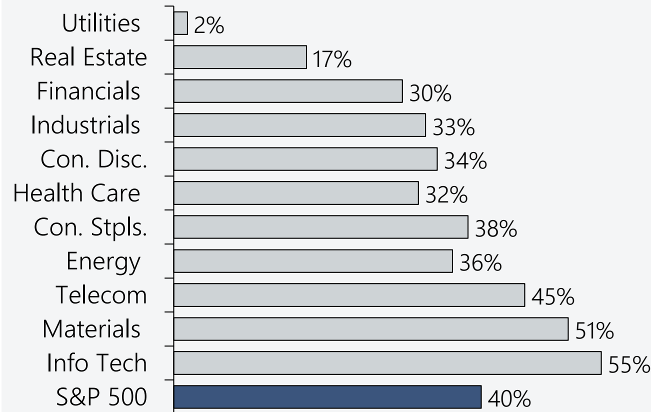
Rebased Indices as of April 7, 2025, 11/5/24= 100



Source: Bloomberg, 4/7/25

U.S. Stocks More Exposed to Trade Than GDP

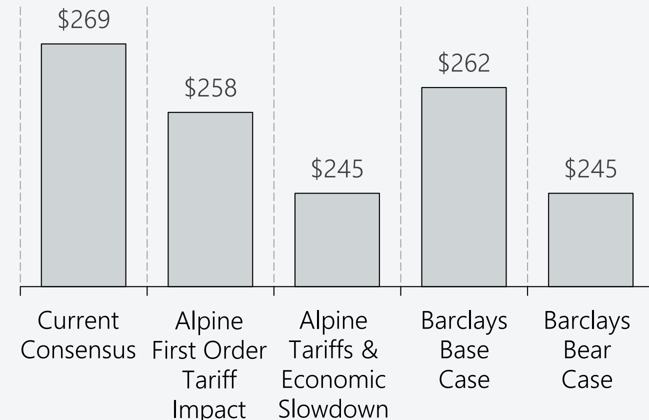
S&P 500 International Sales Exposure by GICS Sector



Source: FactSet, 3/31/25

Sellside Projects ≈9% Downside Risk to '25 EPS

S&P 500 Index 2025 Earnings Projections



Source: FactSet, Alpine Macro, Barclays, 4/6/25

ERP Will Rise; Offset By Lower Treasury Yields

U.S. Equity Risk Premium

Source: BofA Research, 3/31/25

There Is a Ton of Cash Sitting on Sidelines

U.S. Money Market Mutual Fund Assets
Trillions of U.S. Dollars

Source: Investment Company Institute, 3/31/25

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