



Rapid Recalibration

Q2 2025 Market Outlook



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“Even the finest sword plunged into salt water will eventually rust.”- Sun Tzu

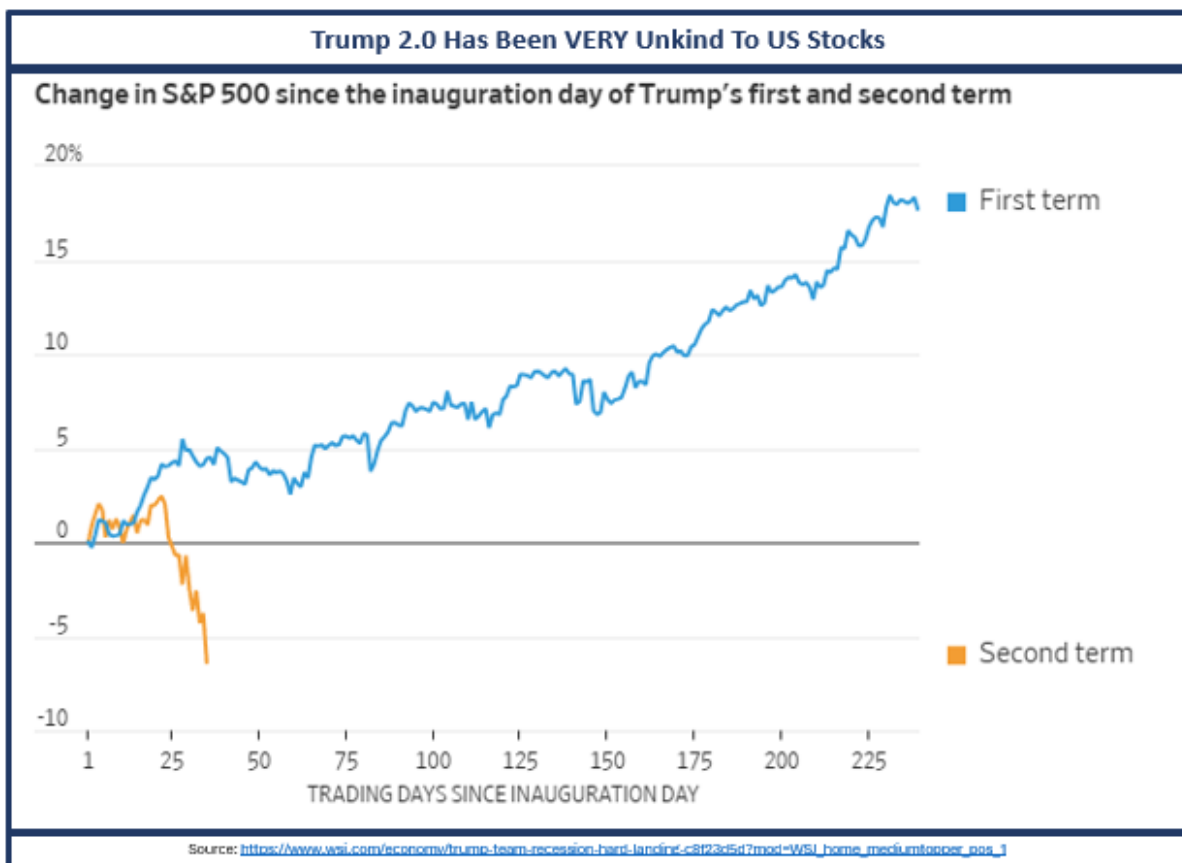
We entered the year cautiously bullish and flagged a policy error as a big potential risk to derail the market bull run – and boy, did that play out in Q1. While tax cuts, spending, or any sense of what the budget will look like is stuck in Congress, the market has been subjected to a large-scale game of chicken over tariff and trade which has raised the anxiety level significantly. Potential shifting alliances may pivot the US away from Europe and more towards Asia and Russia which could disrupt trade further if Europe pivots away from US trade in retaliation. The quick market sentiment change has caused the Magnificent 7 to pull an Icarus, flying too high and falling sharply down to earth. As we are preparing to enter Q2, all we can advise is to be comfortable being uncomfortable this year.

For now, we see the bull market as wounded but not dead. AI and tech are sharp correcting within a long term up market, and the economy seems to be bending but not breaking. However, this comes with a strong caveat that if the labor market breaks, we could tip into a recession, and it could kill off the bull market. For the first time in years, European equity markets are trouncing US markets as we flounder for direction. Small caps continue to be crushed and large growth, specifically technology and consumer discretionary, look to be rolling over sharply. As we head into Q2, questions remain if this is a pause/speed bump or the start of a breakdown.

Recession is now being openly talked about and strategists across the street are downgrading US equity growth expectations. CEO sentiment, which had just hit an all-time high in Q4, is starting to downshift. This is key as there is a high correlation between quarter-over-quarter change in management sentiment and S&P 500 performance. Post-election Q4 sentiment and earnings calls commentary was extremely upbeat about lower regulation, business friendly policy, and lower taxes. However, as Q1 has unfolded, commentary in February and March has shifted to concern, tariffs questions, uncertainty, and a more cautious tone. Even if a recession is avoided, the pullback in spending and expansion due to uncertainty will still leave an economic scar.

Trump 2.0 Has Been Different

Trump 2.0 has been less party and more pain than investors were anticipating on Election Day. Gone are all the post-election returns and euphoria. Wall Street is now grappling with a Trump administration that seems less concerned with helping Wall Street and more concerned with leveling global trade. Both President Trump and Treasury Secretary Scott Bessent alluded to allowing pain in the markets to sacrifice for long term gains. In early March, Bessent did a long interview with CNBC and stated, “The market and the economy have just become hooked. We’ve become addicted to this government spending, and there’s going to be a detox period.” He also acknowledged that the economy is starting to roll a bit, which he considered a “natural adjustment.”



More concerning to stocks was his statement, “Wall Street’s done great, Wall Street can continue to do fine, but we have to focus on small businesses and the consumers. So, we are going to rebalance the economy.” Bessett’s comments echoed President Trump’s that there could be “a little disturbance” from tariffs. A healthy Main Street (meaning a strong consumer and a strengthening lower and middle class) is still good for Wall Street, but it’s raising eyebrows that this administration may allow more pain and downside in the stock market than in President Trump’s first term. There was an expectation of a “Trump Put,” meaning there would be a floor that the administration would not want markets to fall below and would adjust policy to ensure growth. But if there is a (needed) effort to cut spending and deficits, reduce the trade deficit, and wean the US off of government expansion, it could certainly be a longer and more painful adjustment period than investors were anticipating. The message right now is: no pain, no gain, so suck it up buttercup.

Tariffs and DOGE: a Risk to Growth

The Trump administration is also taking a hardline approach to global trade and leaning into tariffs to rebalance the flow of goods and services. This is one of the hardest areas to extrapolate since it seems to change on a daily basis, but for now, the administration seems highly likely to keep at least some tariffs on a broad segment of countries and goods. Standoffs abound with tension continuing to ratchet higher with the expectation of reciprocal tariffs in April. Mexico is taking the easy road – working with the Trump administration and publicly being supportive and non-combative. But Canada is focusing more on saying “no” and meaning no. Companies are struggling to adjust; for instance, the newly announced steel and aluminum tariffs covers not only raw materials but also consumer products such as aluminum baseball bats, cookware, and metal furniture. The breadth of tariffs this time around far exceeds President Trump’s first term and likely has a much broader economic effect as the administration wants to ween US consumers off of cheap foreign goods.

Tariff Summary as of 3/11/2025 (VERY Subject to Change)					
Trump Tariffs So Far					
Effective Date*	Target Countries	Tariff Rate	Goods Targeted	Bloomberg Economics Forecast	Retaliation?
2/4/25	China	10%	All	Hike nearly as large as Trade War I, impact manageable	Restrained
3/4/25	China	Another 10%	All	Hike close to twice Trade War I, risks more than 50% drop in China exports to US	Undetermined
3/4/25	Canada, Mexico	25%, but 10% for Canadian energy	Most	Risks 1% hit to US GDP, severe shock to Mexico and Canada	Pledged
3/12/25	Major exporters	25%	Steel, aluminum	Marginal impact on US. Canada exposed	Pledged
4/2/25	European Union	25%	All	Risks 70% cut in EU exports to the US - hitting 1.5% of EU GDP	Threatened
4/2/25	Major exporters	25%	Cars, chips, pharma	Awaiting details	Undetermined
4/2/25	All	Unspecified recipricols vs VAT, other barriers	Undetermined	Matching VAT and non tariff measures would be a major shock	Undetermined
11/22/25	Major exporters	Unspecified	Copper	Marginal impact on US. Chile, Canada most exposed	Undetermined
12/31/25	EU, UK, Canada	Unspecified vs digital taxes	Undetermined	Awaiting details	Undetermined

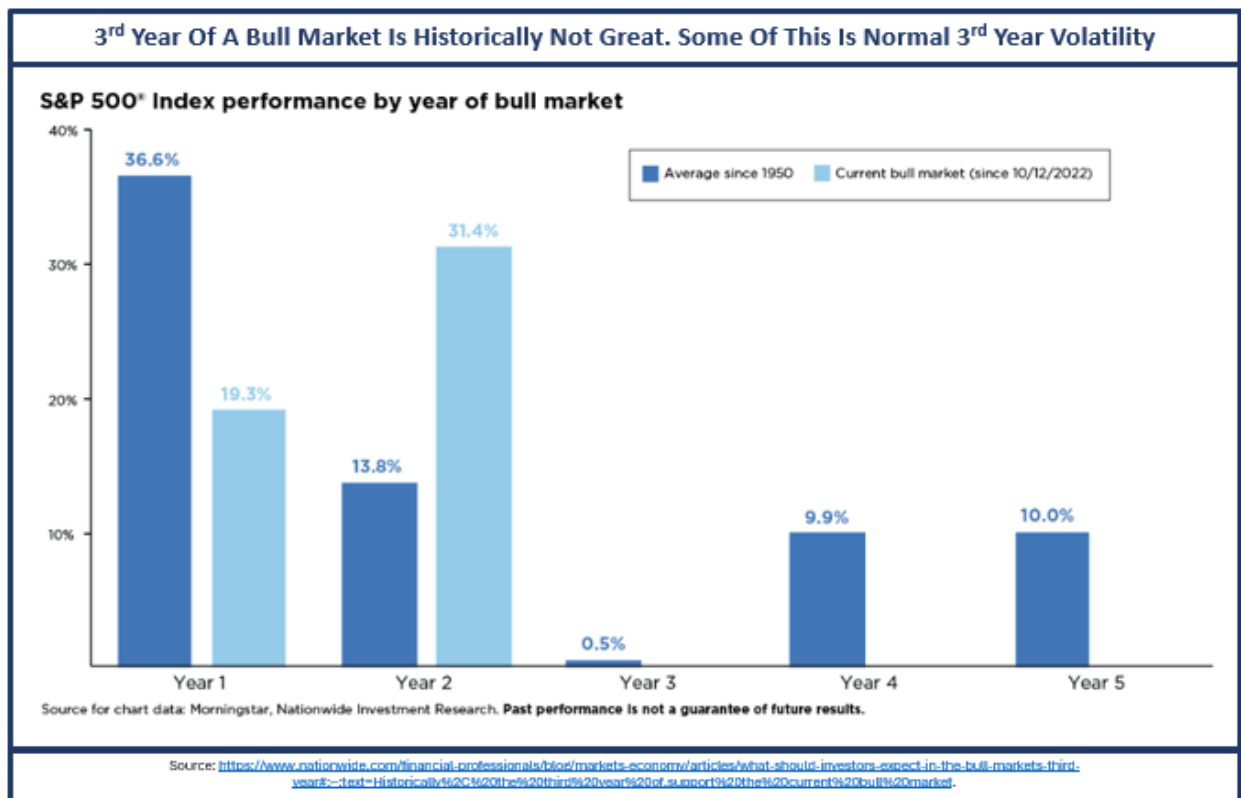
Source: Bloomberg
 Note: Future dates subject to change; for tariffs targeting digital taxes, date hasn't yet been set yet.

Source: <https://www.bloomberg.com/news/features/2024-12-01/trump-trade-war-explaining-tariff-scenarios?sref=aNaDWQJ5>

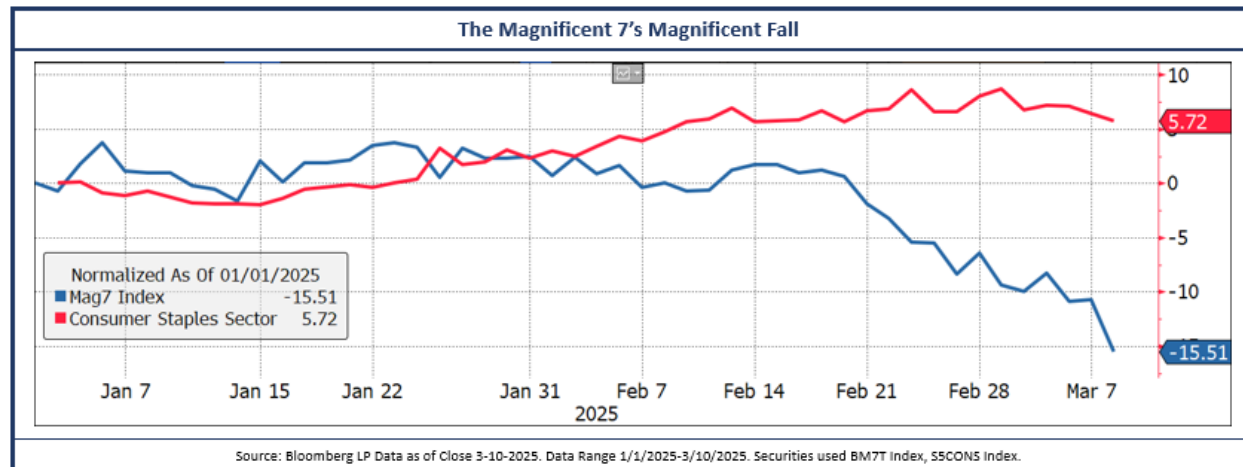
On the other side of the economic spectrum, DOGE and Elon Musk have been bringing the wild west to public sector spending and employment. And while Musk still can't figure out how to wear a cowboy hat correctly (he often accidentally puts it on backwards), he is bringing a gunslinger mentality to a historically slow-moving bureaucracy. DOGE has been reined in slightly in recent days, as his chainsaw approach to cuts is proving unpopular, and the administration now seems to be moving back to a scalpel approach. The effects of DOGE have yet to fully work their way into the economy, with the bulk of the layoffs likely to show up in March data after 62,000 federal workers across 17 agencies lost their jobs in February. This does not include the 75,000 workers who took the buyout offer, who are still technically employed through 9/30/25. The labor market will likely struggle to absorb these numbers, which may pressure the Fed if unemployment jumps at the same time we are seeing sticky inflation.

3rd Year of Bull Markets are Hard

The bull market has hit Year 3, which is often turbulent and lower performing than the first 2 years. The easy money has been made, and while we have the overhang from changing tariff policy and uncertainty, some of the market turbulence is a normal year 3 experience. Remember, last year in 2024 we did not have an actual correction (a market pullback greater than -10%) which is abnormal. The low volatility and minimal drops in 2024 was not a normal occurrence and the largest pullback of the S&P 500 was -8%. Many investors may have become complacent that US stocks can continue to defy gravity, which was unlikely. For the first time in years, Europe, Japan and the Rest-Of-The-World are vastly outperforming US stocks as US stocks have hit a tariff and uncertainty wall.



The Magnificent 7 have also been a huge problem this year for investors. This vaunted group (NVDA, META, MSFT, AMZN, AAPL, GOOGL, & TSLA) drove 70%+ of the stock market returns in 2023-2024, but are now underperforming the broad market by a significant amount. These stocks are now in a decisive breakdown, as they have also fallen through their 200 day-moving average as well as uptrend lines from the bottom of the bear market in 2022.

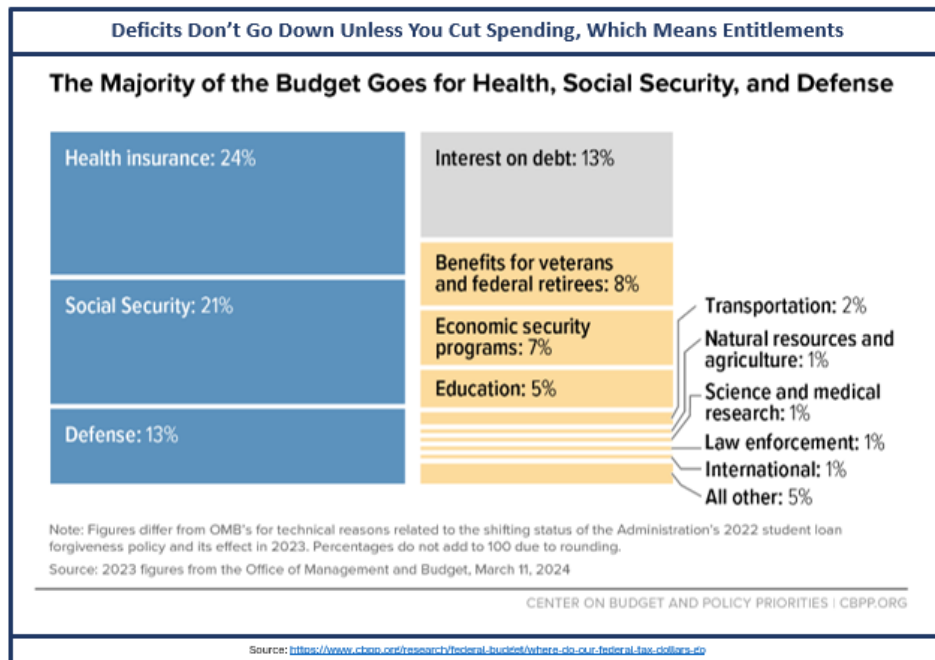


Some of this was a necessary and painful adjustment needed to bring valuations back down to earth. You can't trade at sky high multiples forever. The question "Is tech dead?" is one of the main questions that may determine if this pullback is a correction within a bull trend, or a complete meltdown a la 2000's tech bubble popping. For now, we feel there is a market leadership rotation towards defensive sectors such as health, staples, and utilities while tech is being punished for its high valuations. DIG (Dividends-International-Gold) may well be where investors want to position in 2025 as there could be further recalibration and leadership rotation. However, we do not feel that AI is dead and the billions and billions in profit made by the Mag7 are likely secure and growing (outside of TSLA which has its own unique headwinds currently). What has fundamentally changed for AMZN or META? Honestly, not a whole lot. Both will continue to dominate their respective sectors and have the scale, balance sheets, and cash flow to adapt and overcome any economic headwinds and policy changes. AMZN has averaged over 11% sales growth during the last 2 years and we find it unlikely that it suddenly sees falling sales in 2025. Yes, its growth rate may be challenged, but it likely still grows profits this year. For now, it seems that we are in a highly sentiment driven selloff for 6 of the 7, with TSLA the only one we flag at risk of falling revenues because of global backlash due to Musk's role in the current administration.

One other area we flag as a risk in 2025 is taxes. Tax policy risks not being as stimulative for the economy as it was in 2016. In Trump's first administration, these cuts were actual CUTS, not an extension of existing policy. So, tax rates fell, which spurred investment. In 2025, we are looking at EXTENSIONS of existing policy – keeping things status quo – with a few potential tweaks or additions but nothing considered a major tailwind to the economy. This means even when Congress gets around to passing tax policy, it's not the shot in the arm it was last time, it's more keeping the boat from getting rocked.

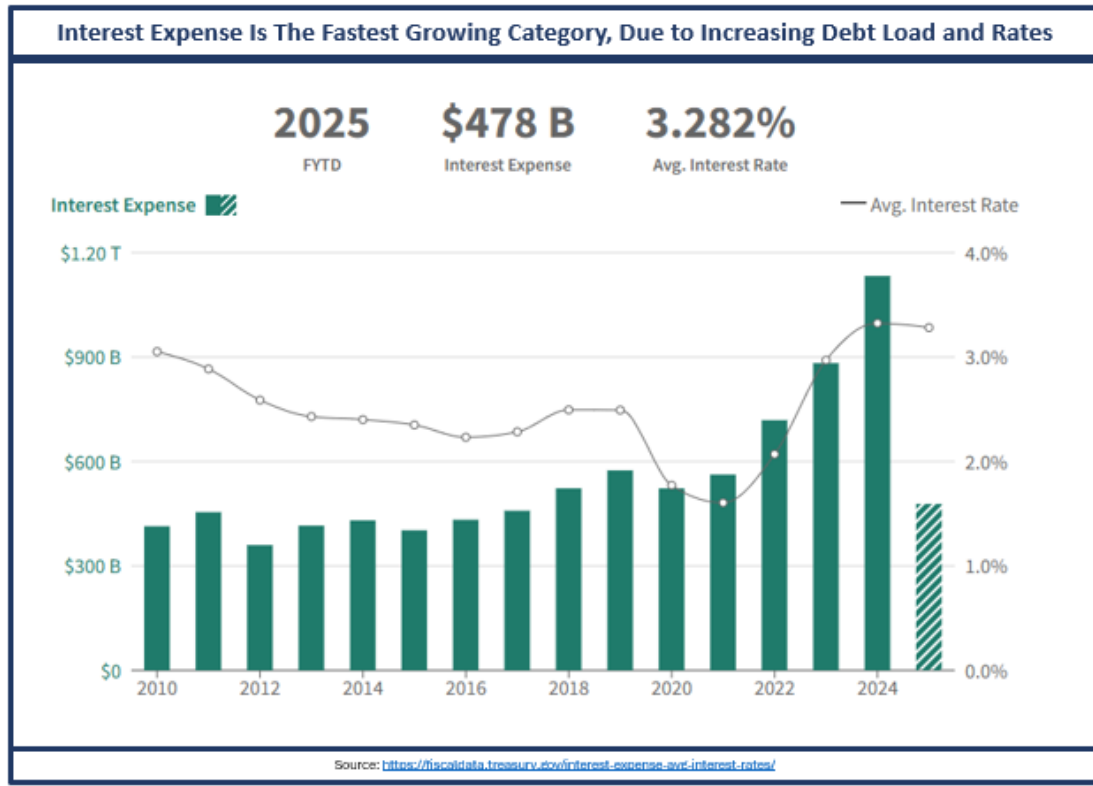
How Much Economic Pain Will the Trump Administration Tolerate?

We are facing a period of potential severe government cuts in spending and the federal workforce, combined with tariffs possibility of reigniting inflation, all point to a period of stagflation, or at the least, slower growth. The US Federal Government is attempting to make one of the largest, and fastest, overhauls in modern history. BUT it also depends on which branch is leading the way. DOGE and its followers are advocating a chainsaw approach to cut as much as possible down to a small government. DOGE has acknowledged it will be difficult to cut entitlements; however, they continue to look for ways to reduce entitlement fraud as well as we expect rolling out of work requirements, tighter rules and harder qualifications for certain Medicaid and other benefits. Medicare and Social Security seem safe, as attempts to fundamentally change both are typically political suicide.



The recalibration of the Federal government may be a significantly painful period. We applaud efforts to rein in spending, but Congress also needs to get onboard and actually make cuts. Tax cuts without any spending cuts just add more to the deficit, which will continue to increase our interest cost and debt burden. The US budget is massive and without touching the top 5 spending categories, it's mostly window dressing. Yes, saving billions and eliminating waste is helpful, but it's like watering the garden outside a burning house. Without tackling Medicare, Medicaid, Social Security, Defense and Interest costs there is no way to bring down deficits. And if we are making significant spending cuts, the dreaded *austerity* period may loom, which Bessett alluded to in his speech. Weaning us off government spending is going to be hard.

Congress is struggling just to avoid a government shutdown and focusing on stop-gap short term spending bills, but their long-term priority would include a \$4.5T tax cut over the next decade and a \$2T in spending cut aimed at entitlements. For those of you struggling with math: $-\$2T$ in spending cuts + $+\$4.5T$ in tax cuts = $-\$2.5T$ deficit spending, which is why they also want to raise the debt ceiling \$4T. And while one can argue that tax cuts help stimulate growth (which would increase revenues being taxed at a lower rate) it's hard to see this as a fix to our debt and rising interest cost problem.

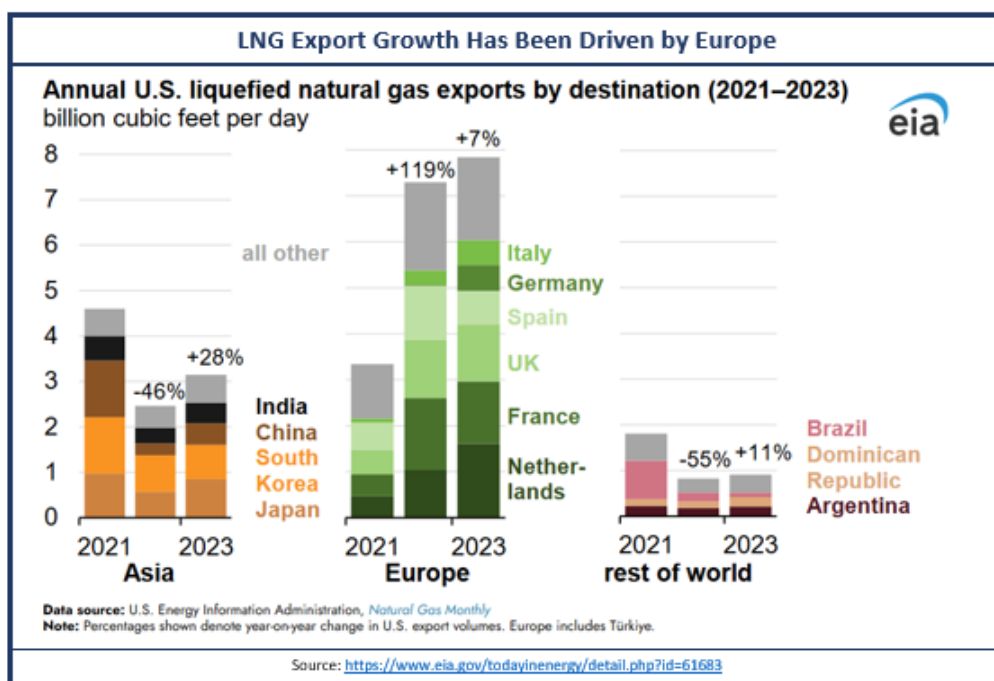


There is much debate about if private enterprise and state and local governments can step up and produce activity to support GDP growth as the US Federal government steps back. Prevailing bullish thought is that the private sector often does what the public sector wants to do but does it more efficiently and effectively. But to successfully stimulate growth, we also need to see continued reduction in bureaucracy and regulation, especially with a smaller government which could slow down certain permitting or approval processes. Stagflation is a period of high inflation combined with high unemployment, and becomes a real risk of occurring if we do not see private sector absorption of fired Federal employees. Additionally, the economy would need the private sector to thrive and grow rapidly to replace government expenditure and stimulate GDP growth. Currently, private enterprises have downshifted due to rising economic uncertainty, instead of ramping up into growth mode. For now, there seems to be a vacuum emerging as the public sector downsizes which might be painful to economic growth for the remainder of the transition period.

So, What Comes Next?

Policy has the ability to break this fragile bull market. If spending is reduced, and large federal layoffs go forward, it seems likely that we will experience a pullback in economic conditions. Already, we see the tariff uncertainty slowing investment and spending. Consumers and businesses do not know how to plan with the amount of tariff uncertainty, so we enter a wait-and-see period which slows economic activity. For now, damage has been done to sentiment and may be difficult to repair and build trust. This is frustrating to investors as much of the damage seems self-inflicted due to administration chaos and constantly changing tariff policy.

While we believe in our overweight to large cap US stocks, we do believe in broadening out and ensuring you have core Blue-Chip dividend stocks and a focus on quality and balance sheets. Playing defense right now makes sense. A rebalancing and recalibrating world may be cruel to some companies, either through tariff as a direct drag, or reputational risk if the world possibly moves against buying USA. Canada is the best example of that now, with removal of US alcohol from some stores and a sentiment shift towards boycott. Will viewers drop NFLX? Stop going to SBUX or MCD? Boycotts are often transitory, but if we shift to a less globalist and more protectionist world, some large multinationals could see an earnings hit. There is still going to be plenty of global commerce, but disruptions can drag on any earnings growth and sales growth. The world will keep drinking Cokes and buying iPhones, but maybe not at the pace they once were if the USA vs. everyone else battle continues. Concerning to us would be if we pivoted away from Europe, which is a large export market for our natural gas and LNG. In 2023, Europe accounted for 66% of all US exports of LNG, and most of the export capacity is being built on the Gulf Coast which makes Europe a prime destination. For now, US companies are seeing more headwinds from policy than business friendly tailwinds.



Sitting here in a world that feels uncertain and uncomfortable does lead us to a more defensive portfolio tilt. Bonds are having their best start to a year in recent history, and gold continues to shine as a volatility hedge. Quality, dividends, and sustainable free-cash-flow value stocks may be the place to hide as the world recalibrates what global trade is going to look like. For those with a higher risk appetite, we would recommend slowly adding to technology stocks as they have rolled over. Buying META or NVDA in the depths of the 2022 bear market was a strong decision. And, for now, the AI trade remains intact (though wounded) with the transformative technology still in the early stages of adoption and wide utilization. We are not panicking and abandoning ship yet, but we are shoring up our risk allocation and battening down the hatches for more volatility to come.