PRIVATE CAPITAL MANAGEMENT

Q1 2025 Commentary

April 2025

"In the midst of movement and chaos, keep stillness inside of you."

– Deepak Chopra

Q1 Market Recap

U.S. equity markets faced a challenging first quarter. Large U.S. stocks ended the quarter down 4.3%, while small cap stocks declined by 9.5%. Consumer staples and utilities held up well as momentum shifted away from large cap growth stocks into more defensive companies. Foreign and emerging market stocks provided much needed diversification and delivered positive 6.9% and 2.9% returns, respectively, for the quarter. Driven by falling interest rates and narrow credit spreads, fixed income had a strong start to the year with longer dated bonds outperforming. Investment grade, intermediate-term bonds gained 2.8% for the quarter while municipals were flat. Despite increasing equity volatility, high yield bonds returned 1% for the quarter.

The U.S. economy finished the year on a positive note. Finalized GDP data confirmed the U.S. economy grew 2.4% while consumer spending continues to trend higher. Unemployment remains near cycle lows, although we are anticipating federal employee layoffs will drive this number higher in the short term.

Asset Class	Benchmark	Q1 2025	Since Election Day	12 Months
U.S. Large Cap Stocks	S&P 500 TR USD	-4.3	-2.4	8.3
U.S. Small & Micro Cap	Russell 2000 TR USD	-9.5	-10.5	-4.0
Intl Dev Stocks	MSCI EAFE NR USD	6.9	3.1	4.9
Emerging Mkt Stocks	MSCI EM NR USD	2.9	-2.6	8.1
Global Stocks	MSCI ACWI NR USD	-1.3	-1.4	7.2
U.S. Municipal Bonds	Bloomberg Municipal TR USD	-0.2	-0.3	1.2
U.S. Taxable Bonds	BBgBarc US Agg Bond TR USD	2.8	2.0	4.9
U.S. High Yield Bonds	BBgBarc US Corporate High Yield TR USD	1.0	1.6	7.7
Intl Dev Bonds	S&P International Sov Ex-US Bond TR USD	2.6	-1.4	-0.2
U.S. REITs	MSCI US REIT NR USD	0.8	-4.1	9.0
Broad Commodity Futures	Bloomberg Commodity TR USD	8.9	9.3	12.3
Energy Partnerships	Alerian MLP TR USD	12.6	17.1	23.0
Gold	DJ Cmmdty Gold TR USD	18.2	13.3	39.4

Morningstar Data as of 3/31/2025

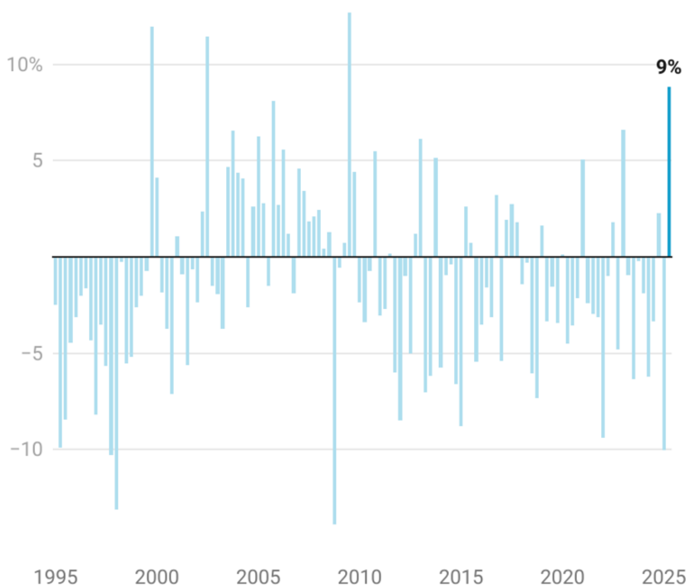
Investor sentiment shifted sharply negative towards the end of the quarter. During the campaign, President Trump's agenda called for deregulation, lower interest rates, and protectionist trade policies that were intended to catalyze another leg higher in economic growth for the U.S. Fast forward to today. Policy uncertainty is at COVID level highs, U.S. equity markets are in correction territory, and tariff wars are looking more like mutually assured destruction versus détente. Thinking clearly about your investment portfolio and financial plan is harder, but also more important than ever right now. In this commentary, we will recap notable observations from the previous quarter and discuss how you can use today's market volatility to your advantage.

International Equities Outperform

Foreign stocks outperformed U.S. stocks by the widest margin since 2009 likely due to a variety of factors. Foreign stocks have been trading at significant valuation discounts relative to U.S. equities. Long-awaited policy shifts in Europe and China were viewed favorably by investors. The European Central Bank further cut interest rates to boost demand while Germany announced significant fiscal expansion to boost a stagnating economy. Meanwhile, China announced a 5% growth target and announced more fiscal stimulus to support its economy ahead of an escalating trade war with the U.S. Additionally, the U.S. dollar declined relative to global currencies which can act as a tailwind for foreign equity returns. Investors grew increasingly anxious over large cap technology stock concentration, slowing economic growth, and uncertainty regarding trade policy. Considering foreign stocks are under owned in investors' portfolios, the convergence of these factors likely contributed to strong relative gains for foreign stocks in the quarter.

Foreign stocks outperformed in Q1 2025

Quarterly returns for foreign stocks versus U.S. stocks



Data shows quarterly performance of the MSCI ACWI Ex USA IMI (net) minus the S&P 500 Index. 09/30/1994 - 03/31/2025

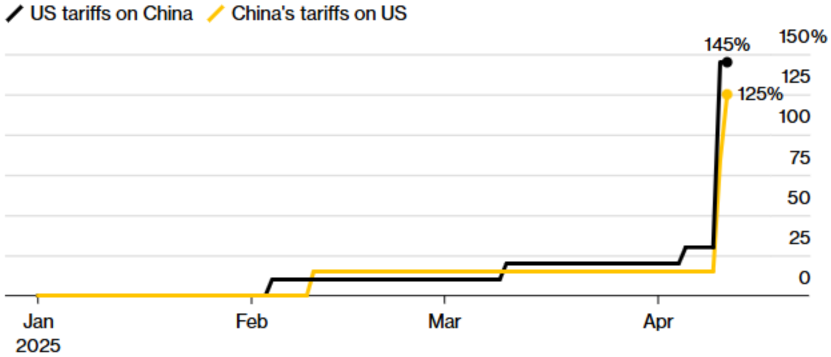
Source: Dimensional Fund Advisors • Created with Datawrapper

Trade Policy Uncertainty

Tariff uncertainty led to a surge in imports, driven by gold, last month which sent the Atlanta Fed GDP tracker into contractionary territory.[1] On April 2nd, President Trump announced tariffs on major U.S. trading partners leading to retaliation and widespread equity volatility. On April 9th, President Trump reversed course and lowered so called 'reciprocal' tariffs to the baseline 10% incremental tariff rate announced on April 2nd for 90 days for all countries except for China, Mexico, and Canada.[2] Since then, China and the U.S. have embarked on a path of tit-for-tat tariff increases. As of writing, U.S tariffs on Chinese goods stand at a trade stopping 145% while China's tariffs on U.S. goods stand at 125% (see chart to the left). On April 12th, the Trump administration announced temporary tariff exemptions on certain widely used electronics manufactured in China (think Apple products). Tensions continue to run high between both nations with the global economy stuck in the middle.

Bilateral US-China Tariffs Have Spiked

Changes in tariffs from Jan. 1, 2025



Source: Data compiled by Bloomberg
Note: Chinese tariffs on US goods before April didn't apply to all goods and were applied at 10% or 15%.

[1] Atlanta Fed GDP Tracker: https://www.atlantafed.org/cqer/research/gdpnow

[2] The White House: https://www.whitehouse.gov/presidential-actions/2025/04/modifying-reciprocal-tariff-rates-to-reflect-trading-partner-retaliation-and-alignment/

Many countries have high tariffs as part of protectionist policies to support domestic industries. For a long time, U.S. trade policy has been centered on the concept of competitive advantage. In free trade, competitive advantages allow the lowest cost producers to export goods, bringing prices down and increasing global trade. This may come at a cost to domestic industries, especially in the U.S. where our cost and standards of living are significantly higher than some of our overseas trade partners. Prior to the April 2nd tariff announcement, the effective trade weighted U.S. tariff rate was only 3-4%.[3] Trade wars in the short term are detrimental to global trade volume, may reduce consumption via higher prices, and may contribute to higher market volatility.

Investors are left wondering what the Trump administration is trying to achieve here. The so-called Mar-A-Lago Accord is a conceptual economic strategy proposed by the Trump administration that aims to restructure the global financial system to reduce U.S. debt and address economic imbalances.[4] Key elements of the proposal include focusing on economic and national security, establishing an America first trade policy, boosting American manufacturing by rebalancing trade relationships, reducing trade deficits, and eliminating wasteful spending in the U.S. government. The Trump administration's tariff announcements on April 2nd are part of this high-stakes economic rebalancing to reduce government spending and increase tax revenue. As mentioned, these policies are creating significant intraday volatility in stock and bond markets which have led to portfolio losses. President Trump and Treasury Secretary Scott Bessent are clearly willing to accept-short term economic pain for what they perceive to be long-term gains.

Bear Market Investing

Global stock markets are reeling from widespread trade and economic uncertainty related to the unfolding trade war. April 3rd and 4th delivered the largest two-day U.S. stock market decline since COVID. News of 'reciprocal' tariffs being postponed on April 9th sent global equity markets skyrocketing higher. Many companies plan to suspend earnings forecasts given the heightened policy uncertainty. Frustrated and confused investors are questioning what to do next. Jack Bogle, founder of Vanguard, is famous for his long-term investing approach and quip during market volatility 'Don't just do something, stand there!'

Sticking to a diversified investment approach during times of elevated market volatility has historically benefited investors. The key is managing your emotions and making thoughtful portfolio allocation decisions. Here are some time-tested tips to maintain calm during uncertain times:

- Read market and world news from **various sources**, even if you don't align from a political perspective. It is helpful to see both sides of the argument when formulating your opinion.
- **Meet with your advisor.** We will review your long-term goals and resources allowing you to re-anchor from daily headlines to a well-crafted plan.
- **Focus on your health**. Prioritize sleep, exercise, time with loved ones, and a healthy diet. All of these will help check impulsive behavior. Importantly, these are decisions **you** can control.
- **Dollar cost averaging:** have you been sitting on excess cash for a while? Now may be an opportune time to start averaging into the stock market. Please consult with your PCM advisor or other financial professional prior to making any financial or investment decisions.
- **Roth IRA conversions and/or 2025 IRA contributions:** now may be a good time to convert IRA funds and/or make 2025 IRA contributions to invest at current stock prices. Please consult with your tax professional and PCM advisor to make sure either strategy is suitable for you.
- **Tax-loss harvesting:** we are actively monitoring client portfolios to realize losses for tax purposes while keeping them invested in similar assets. Time in the market is more important than timing the market.

[3] World Trade Organization: https://www.wto.org/english/res_e/booksp_e/world_tariff_profiles23_e.pdf
[4] Bloomberg: https://www.bloomberg.com/news/articles/2025-03-2020/-mar-a-lago-accord-chatter-is-getting-wall-street-s-attention

- **Consider dynamic spending**: one of the best techniques to enjoy a successful retirement is to adjust your spending preferences during tough times.
- **Replenish your cash reserves.** No one likes selling when markets are down but replenishing your cash reserves to fund near term expenses will alleviate anxiety around short-term market moves.

Parting Thoughts

Frustration and anxiety are common emotions during times of elevated market and economic uncertainty. Your Private Capital Management team is here to help guide you. We continue to search for attractive risk-adjusted returns while balancing risks in client portfolios. Thank you for your business and continued trust.

Sincerely,
The Private Capital Management Team

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