Birch Hill
INVESTMENT ADVISORS

Market View

April 2025

UNCERTAINTY IN WASHINGTON DRIVES VOLATILITY

In the first quarter of 2025, fluctuating policies on trade and tariffs increased economic uncertainty and market volatility. US equities retreated, with the S&P 500 Index posting a return of -4.3%. Investors shifted their focus toward defensive sectors. Healthcare, consumer staples, and utilities outperformed while cyclical sectors like consumer discretionary and technology lagged. Likewise, small-cap stocks struggled, as reflected in the Russell 2000 Index's -9.5% drop.

On the global stage, international markets outperformed their US counterparts in the first quarter of 2025. Increased defense spending in Europe and heightened expectations for stimulus in China bolstered global equities. European capital flows to the US apparently reversed course. As a result, the MSCI EAFE Index returned +8.1%, and the MSCI Emerging Markets Index registered a gain of +4.5%.

FEDERAL RESERVE HOLDS RATES STEADY DESPITE MIXED SIGNALS

At its March meeting, the Federal Reserve opted to hold short-term interest rates steady amid mixed economic signals. The Consumer Price Index eased from 3.0% in January to 2.8% in February, moving closer to the Fed's 2% target. Although inflation has moderated from its 2022 peak, it remains a key focus as policymakers balance the twin imperatives of employment and price stability. Employment remained robust—another positive signal. In contrast, soft indicators, such as consumer confidence surveys, turned negative, with some differences by political affiliation and/or income level. In parallel, the yield on the 10-year US Treasury note shifted from a January high of 4.79% to 4.23% at quarter-end.

CORRECTIONS—MILDER, MORE FREQUENT THAN BEAR MARKETS

In mid-March, after two years of robust performance, several major US indices slipped into correction—defined as a decline of 10% or more from recent highs. The Nasdaq Composite fell over 12% from its peak while the S&P 500 dropped more than 10% from February highs. The last similar pullback occurred in October 2023. Such corrections, averaging around 14% on an intra-year basis, are not unusual. Although corrections can be unsettling, the S&P ended the quarter down only -4.3%.

Market Indicators		3/31/2025
TOTAL RETURN		
US Stock Markets	12 Mos	1st Qtr 2025
S&P 500 Index	8.2%	-4.3%
S&P 500 Equal Weight Index	4.1%	-0.6%
DJ Industrial Avg.	7.4%	-0.9%
S&P 400 Mid Cap	-2.7%	-6.1%
Russell 2000 Small Cap	-4.0%	-9.5%
Int'l Stock Markets		
ETF Returns in US$		
EAFE Index (Europe, Australia, Asia, Far East)	5.6%	8.1%
Japan (MSCI Index)	-1.7%	2.2%
China (FTSE 50)	51.6%	17.7%
Emerging Mkts Index	8.9%	4.5%
US Fixed Income Yields	12/31/2024	3/31/2025
6 Mo US T-Bill	4.24%	4.23%
2 Yr US T-Note	4.25%	3.89%
10 Yr US T-Note	4.58%	4.23%

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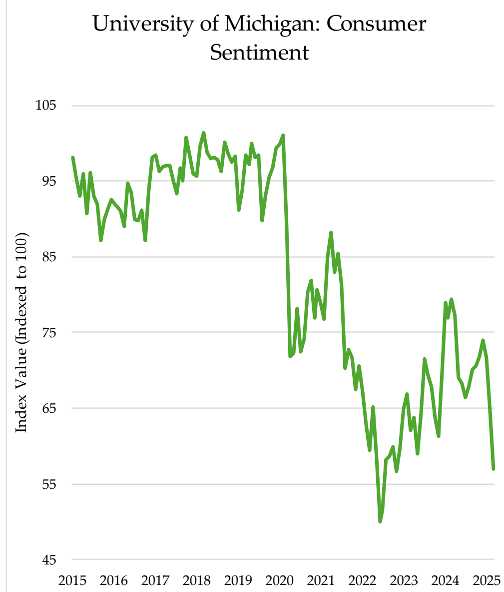
It is important to distinguish corrections from bear markets, which are characterized by prolonged declines of 20% or more. The most recent bear market, triggered in 2022 by economic instability and inflation concerns, eventually gave way to stabilization in late 2022 and 2023 as moderating inflation and policy adjustments restored confidence.

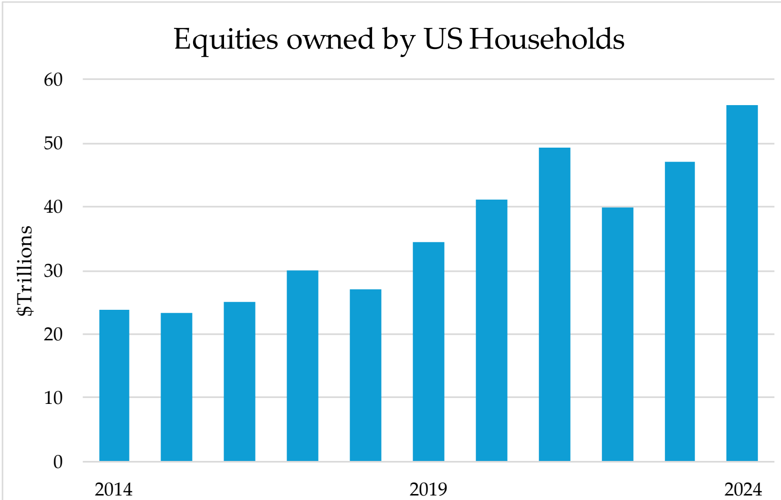


Sources: University of Michigan, FRED

In 2023 and 2024, the "Magnificent 7" stocks—Apple, Microsoft, Amazon, Alphabet (Google), Nvidia, Meta (Facebook) and Tesla—were the major drivers of market performance. As a group, the Magnificent 7 are particularly well-positioned to benefit from the implementation of Artificial Intelligence (AI). This year, as corporate investments in AI and the timing of profits generated by those investments have come into focus, investors have begun to reassess the Magnificent 7's lofty valuations. During the first quarter, the Magnificent 7 experienced an average decline of -15.7%, contributing to the market sell-off.

WEAKER SENTIMENT COULD DAMPEN SPENDING AND STOCKS

The economic outlook in the US has softened. Fourth quarter 2024 GDP growth remained solid at 2.4% but slowed from 3.1% in the preceding quarter. First quarter 2025 growth likely slowed further. Uncertainty over tariffs and potential trade conflicts continues to complicate planning for both businesses and consumers. Consumer sentiment has faltered (see graph), falling 11% to a two-and-a-half-year low—a trend that could dampen household spending.



Note: Data as of beginning of 4Q each year.
Source: Board of Governors of the Federal Reserve System.

Market volatility and falling consumer sentiment are raising concerns that the "wealth effect," in which robust stock market performance increases consumer spending, is beginning to show signs of strain. By the close of 2024, household net worth had reached record highs; however, with a substantial portion of that wealth tied to financial markets (see graph), any decline in stock prices could negatively affect spending. This shift could transform a long-standing tailwind into a headwind.

INVESTING THROUGH UNCERTAINTY

Investors, having grown accustomed to the calm markets of 2023 and 2024, now face a more volatile environment. Macro-level uncertainties, largely as a result of frequently changing government policies, could temporarily dampen economic activity. Well-run companies will persevere and eventually adjust their business activities to take advantage of future economic expansion. In light of these uncertainties, maintaining an adequate cash reserve while holding a long-term position in high-quality equities appears to be a prudent strategy for navigating the challenges ahead in 2025.

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