Thoughts from the Holy City – May 2025

"Ask yourself who you would want to spend the last day of your life with and then meet with them as often as you can."

"Generally speaking, investing in yourself is the best thing you can do. Anything that improves your own talents; nobody can tax it or take it away from you. They can run up huge deficits and the dollar can become worth far less. You can have all kinds of things happen. But if you've got talent yourself, and you've maximized your talent, you've got a tremendous asset that can return 10-fold."

~ Warren Buffett

Dear Valued Clients and Friends,

If I told you that last month we saw the S&P 500 drop by 0.8% many would do a double take. Of course that is the totality for the month, but intra month the S&P 500 dropped by 19% from its record close of 6,144.15 on February 19th. April 2025 brought a lot of uncertainty and market volatility, but not so many feelings of liberation. This is coming off the month of March in which we experienced the fastest 10% correction for the S&P 500 on record.

It is quite timely that Warren Buffett, the legendary investor, the "Oracle of Omaha," announced his retirement after six decades at the helm of Berkshire Hathaway. He is undoubtedly one of the best investors of all time. Sure, there are others who have had better track records than Buffett, but none have done so with such consistency and longevity. He has blessed us with volumes of wisdom over the course of his career, and much of that wisdom should be revisited now.

April 2025 marked a period of heightened volatility across global financial markets, driven largely by escalating trade tensions, softer economic data, and shifting investor psychology. A combination of macroeconomic headwinds—including a surprise GDP contraction, slowing job creation, and rising global uncertainty—created an environment where both rational analysis and behavioral biases heavily influenced asset prices and economic expectations. ***In short, it was a roller coaster of a ride.***

Equity Markets: A Tale of Two Halves

The month began with a substantial sell-off following President Trump's April 2nd Liberation Day announcement of sweeping new tariffs on a broad set of imported goods. The market response was immediate: the S&P 500, which was already down 4.5% for the year, dropped 11% in three days, and the Dow Jones Industrial Average fell over 4,600 points, reflecting investor anxiety around the potential for a renewed global trade war.

And then, the big reversal happened mid-month as the administration delayed most tariffs (excluding those targeting China) for 90 days. Simultaneously, a strong corporate earnings season reassured investors. As a result, markets recovered a portion of their early losses with the S&P 500 ending down 0.8%, the Dow Jones down 3.2%, and the Nasdaq Composite managing a 0.9% gain, supported by resilience in technology stocks. The volatility illustrates the fragility of sentiment and the market's current sensitivity to policy signals.

Bond & Currency Market Turbulence

The Bond market and currency market, more specifically the US dollar, also roiled after the Liberation Day announcement. Yields on bonds spiked (pushing prices down) as fears that China was going to retaliate by dumping the large amounts of government debt they hold surfaced. There were also other rumors as to what was contributing to the bond market volatility, but it was ultimately several contributing factors including concerns over inflation and fiscal policy, foreign investors reducing exposure to U.S. debt, and the Federal Reserve's stance amidst political pressure. After all was said and done, the bond market closed April essentially flat.

The dollar also dropped as capital was "allegedly" fleeing the United States. There were concerns/rumors that the dollar was going to be replaced as the reserve currency. As with the stock market it is important to put this into perspective. This is not unprecedented. The dollar also experienced a similar 10% drop in 2009 and 8% to 9% drops in 2003, 2004, 2010, 2022. ***In every case the dollar ended up bouncing afterward. Patience…***

The dollar has been strengthening over the past five years and even with its most recent decline it remains at a historically elevated level. Brian Wesbury from First Trust so aptly put it in one of his recent pieces, ***"The U.S. is not strong because the dollar is the reserve currency; the dollar is the reserve currency because the U.S. is strong."***

Global Ripple Effects

Retaliatory actions from major trading partners—most notably China's imposition of a 34% tariff on select U.S. exports—further exacerbated market fears and raised the specter of a full-blown trade conflict. Equity markets in Europe and Asia mirrored the U.S. sell-off in early April, and currency markets reflected increased demand for safe-haven assets, including the U.S. dollar and gold. This global tension added another layer of complexity to monetary policy decisions and capital allocation, particularly for multinational firms with supply chain exposure.

Economic Growth: A Disappointing First Quarter

Economic data released at the end of April revealed a contraction in the U.S. economy for the first quarter of 2025. **Real GDP declined by 0.3% (annualized)**, a surprising reversal after several quarters of moderate expansion. The primary drag came from an unprecedented trade deficit, as firms accelerated imports in Q1 ahead of anticipated tariffs, inflating imports and weakening net exports. This dynamic artificially inflated activity early in the year and masked underlying softness in consumer and business spending. In addition, consumer confidence dropped to its lowest level since mid-2020, with inflation uncertainty and labor market concerns weighing on household sentiment.

Inflation and Monetary Policy: Cautious Stability

Many pundits have expressed concerns regarding tariffs and inflation. However, inflationary pressures showed signs of easing. **The Consumer Price Index (CPI) rose at an annualized rate of 2.3%, bringing price levels closer to the Federal Reserve's long-term target.** Despite political pressure to reduce interest rates—especially from President Trump—the Federal Reserve opted to maintain the federal funds rate at 4.25% to 4.5%, citing global uncertainty and the need to preserve policy flexibility. Central bank commentary emphasized the importance of anchoring expectations, particularly in the face of volatile input costs stemming from disrupted trade flows.

Conclusion

April 2025 offered a vivid case study in the interplay between macroeconomic fundamentals, public policy, and behavioral finance. While financial markets partially recovered from their early-month lows, the underlying economic picture has become more fragile. Trade disruptions, declining consumer confidence, and slowing job growth suggest caution is warranted. Looking forward, the path of U.S. and global markets will likely hinge on geopolitical developments, the trajectory of inflation, and the Federal Reserve's ability to navigate uncertainty without undermining stability. Investors and policymakers alike must remain attuned not only to the data but to the psychological forces that influence behavior during times of stress.

Perspectives and Compound Interest

If you have read any of my past commentaries you know that I am a firm believer that the capital markets, more specifically the stock market, offer an incredible opportunity to grow one's wealth by doing very little. Asset allocation drives the volatility of the portfolio but taking a long-term view and avoiding making irrational decisions like selling out of the market when the market drops are crucial. More often than not, market pullbacks present buying opportunities for long term investors.

When the Market Drops, Does Opportunity Knock?

The stock market drops at least 10% nearly once a year on average—and sometimes more. However, historically, the steeper the drop, the stronger the rebound.

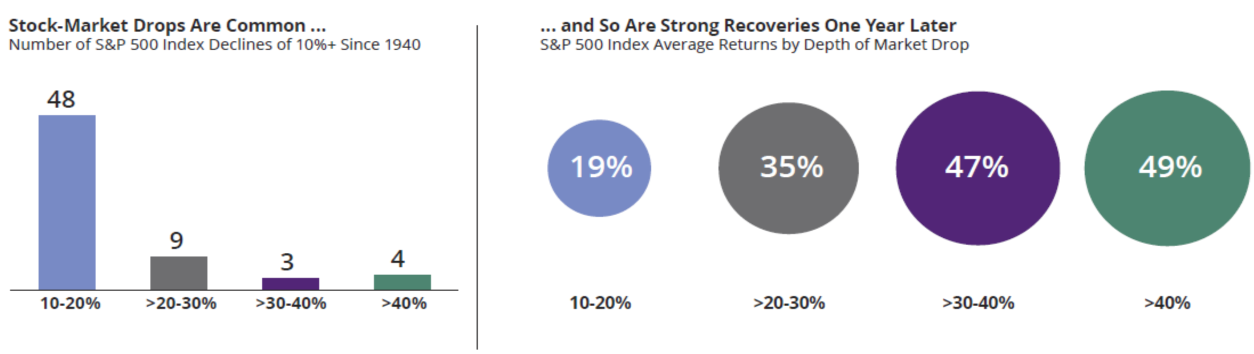

Chart Data: 1940-4/8/25. **Past performance does not guarantee future results.** Average annual returns are calculated one year from the bottom of each market drop. Data Sources: Ned Davis and Morningstar, 4/25.

Compounding is a remarkable wonder. Its magic lies in the simplicity and its ability to grow wealth over time. Compound interest is basically interest on interest. It's the financial equivalent of a snowball rolling down a hill, growing bigger and faster as it goes. ***As Buffett has often said, "My wealth has come from a combination of living in America, some lucky genes, and compound interest.*** We can't all have the success that Buffett has had, but we can certainly learn from his wisdom and practice the same principles. Prudence, risk management, and long-term views prevail.

Be Well,

Grier

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