Market Insight Quarterly

First Quarter 2025

News & Views from LPL Research

The economic forecasts set forth in the presentation may not develop as predicted. Please note: all return figures are as of March 31, 2025, unless otherwise stated. This information is not intended as authoritative guidance or tax or legal advice. You should consult with your attorney or tax advisor for guidance on your specific situation.

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Q1 2025 at a Glance

Sector	Q1 2025
Gross Domestic Product*	1.1%
S&P 500 Index	-4.3%
Bloomberg U.S. Aggregate Bond Index	2.8%
Bloomberg Commodity Index	8.9%

Source: LPL Research, Bloomberg, FactSet, 03/31/2025

* Bloomberg consensus as of 03/31/2025

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodities Index are total returns from 12/31/2024 - 03/31/2025 (Q1)

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Past performance is not indicative of future results.

Equity Momentum Faded on Growth Concerns

A lower risk appetite from investors washed over markets in the first quarter, sending the S&P 500 4.3% lower, including dividends, marking the worst quarter for the index since the third quarter of 2022. The tech-heavy Nasdaq faced the worst selling, shedding 10.3% as technology names struggled, while the Dow Jones Industrial Average fared the best with only a 0.9% loss. The Magnificent Seven (Mag Seven) names that have powered U.S. equity market gains were a notable laggard, acting as a headwind for major averages as the group collectively dipped into bear market territory. The Russell 3000, a popular gauge for total stock market performance, ended 4.7% in negative territory.

Despite a bright start to 2025 and fresh record highs for the equity benchmark S&P 500, the index tumbled over the latter half of the quarter amid widespread selling in March. Tariff uncertainty and some softer-than-expected economic data sparked growth concerns and disinflation worries that rippled through markets, leading investors to lock in profits and take risk off the table. Cracks in the artificial intelligence (AI) secular growth and U.S. exceptionalism themes also contributed to the sharp sell-off in the latter half of the quarter.

Meanwhile, corporate earnings remained resilient, delivering another quarter of strong results. Earnings per share (EPS) growth for the S&P 500 in the fourth quarter arrived at 18.3% (the highest reported growth since the fourth quarter of 2021) with 76% of companies topping earnings estimates, pushing the string of quarterly earnings growth up to six. However, big tech earnings takeaways were mixed.

Headlines out of Washington dominated market focus. After the inauguration of Donald Trump as the 47th President of the U.S., the administration unleashed a barrage of executive orders before following through on his campaign promise of fresh tariffs. Elsewhere on the geopolitical front, the U.S. attempted to broker a ceasefire deal in Ukraine before Russian President Vladimir Putin rejected the offer.

Small Cap Stocks Faced Widespread Selling

Small cap stocks bore the brunt of last quarter's selling, underperforming their large cap peers by 5%. The Russell 2000 small cap index tumbled 9.5%, including dividends, while the Russell 1000 large cap index slipped 4.5% over the last three months on a total return basis. Small caps sold off nearly across all sectors, with the defensive utilities sector delivering a solid return and consumer staples moving a few points higher, comprising the short list of positive quarterly sector returns. Technology and consumer discretionary names fared the worst. Looking forward, large caps continue to display superior earnings power and may outperform as the economy cools in 2025.

Value Names Cruised Past Growth

Growth names wavered last quarter, succumbing to downside pressure concentrated on index heavyweights. Cracks in the AI theme emerged in January after Chinese AI startup DeepSeek released a low-cost model that performed on par with its larger, more costly American rivals. Further, growing skepticism around the massive amount of AI spending weighed on theme related names. As a result, investors rotated to more defense, value-centered pockets of the market, powering the value asset class to relative outperformance. The Russell 1000 Value Index added 2.1%, led by consumer staples and communication services companies, while the Russell 1000 Growth Index declined 10%.

Mixed earnings takeaways from Mag Seven names also contributed to the risk-off tone toward growth stocks. Among highlights, both Microsoft (MSFT) and Google parent company Alphabet (GOOG/L) experienced a slowdown in cloud units during the fourth quarter, while Amazon (AMZN) delivered disappointing operating income despite surpassing Walmart (WMT) in sales.

International and Emerging Markets Rally in a Strong First Quarter

International and emerging markets (EM) presented strong momentum in the first quarter of the new year, outperforming U.S. stocks. The MSCI EAFE Index for developed international markets rallied 7% and the MSCI EM Index advanced 3.0%, outperforming the S&P 500's 4.3% decline.

European equities drew market attention after the broader region outperformed U.S. companies early in the quarter. The region received another boost during the back half of the quarter after Germany unveiled a "whatever it takes" approach to defense and infrastructure spending, powering gains. On the other side of the coin, Japanese equities struggled as bond yields continued to rise amid rate hike speculation. In EM, tech names in greater China led gains on AI enthusiasm. Plus, wage increases, increased debt issuance, and support for consumer goods, real estate, and the banking system among other stimulus highlights aided sentiment in EM's largest country. A weaker dollar and peace talks around the war in Ukraine also helped lift international benchmarks past domestic averages.

Bonds Gained Ground on Haven Buying

Core bond prices gained 2.8% last quarter, as proxied by the Bloomberg U.S. Aggregate Index. Treasury yields initially moved higher through mid-January until policy and trade uncertainty washed over capital markets, sending Treasury prices higher (yields lower). As growth and trade jitters pushed investors to de-risk, Treasury yields pulled back as investors moved to haven assets. The policy sensitive two-year yield and the 10-year yield closed the quarter 0.4% lower, with the two-year yield falling back below 4% for the first time since last fall. The Treasury yield curve continued to steepen with short-term yields falling.

High-yield corporate bonds, the most credit sensitive sector of the bond market, underperformed the broader corporate credit market last quarter. Based on the Bloomberg High-Yield Index, the sector gained 1% while the more interest rate sensitive and higher quality Bloomberg Corporate Bond Index added 2.3%. Nonetheless, all domestic bond sectors printed positive results with other outperformers, including Treasury inflation-protected securities (TIPS), mortgage-backed securities (MBS), and municipal bonds.

Gold Delivers Its Best Quarter in Nearly 40 Years

The Bloomberg Commodities Index also delivered a solid gain, adding 8.9% during the first quarter. West Texas Intermediate (WTI) crude prices edged below the quarter-to-date flat line, printing a 0.3% decline. After erasing early-year gains on the back of falling inventories, crude traders grappled with the downside of upcoming production increases by OPEC+ and support from U.S. sanctions on Iranian oil and shipping.

After wrapping up its best year since 2010, gold extended recent gains with a 19% gain, marking the best quarter for the yellow metal since the third quarter of 1986. Gold found support from haven buying, a mass influx of physical gold pouring into the U.S., and looser monetary policy in Europe and Canada. Silver and copper also delivered strong quarterly gains, while the dollar weakened against its peers, ending 3.9% lower. Soft commodities extended their fourth quarter advance, while grains moved lower again last quarter.

All commodities performance is based on Bloomberg commodity indexes.

A Look Ahead

Economy. The economic landscape remains dynamic and complex, marked by both opportunities and potential risks. Looking ahead, investors should consider the following:

- **Lingering Economic Fog.** While inflation has moderated, it remains historically elevated, putting pressure on certain segments of the population, while arguably benefitting others. This bifurcated nature will continue to pose challenges for monetary policymakers.
- **Economy Will Slow but Most Likely Avoid Recession.** While the U.S. economy is quite resilient, we expect first quarter growth to approach zero. Lower real consumer spending in January and February increased this risk, but some consumers and businesses potentially pulled demand forward into March, anticipating tariffs.
- **Inflation Hiccups and Challenging Rate Narratives.** Some inflationary pressures may naturally re-emerge with the latest batch of U.S. tariffs, putting the Fed in a tricky spot as economic growth slows and they take a wait-and-see approach.
- **So Goes Employment, So Will Go the Economy.** The labor market held steady through the first quarter, lacking signals of a recession, although we expect the unemployment rate to continue ticking higher in the coming quarters. Anything more than gradual could indicate the economy is entering a more pronounced slowdown.

Stocks. A rotation away from the big tech names that led the market higher in 2024 weighed on stocks last quarter. As the calendar turns to April, trade and economic growth concerns linger after also acting has a headwind over the first three months of 2025. Looking ahead, investors should consider the following:

- **Varied Upside Potential.** Higher costs for companies importing foreign goods in a slow-growth, moderate revenue environment is a formula for lower earnings and higher prices, which is not a great combination for stocks. Potential upside could come from incrementally better headlines, lower rates, productivity gains, or confirmation of additional market friendly policies.
- **Avoiding Recession Is Key.** The stock market has historically delivered single digit returns in the 12 months following an initial Fed rate cut. When a recession is avoided, the median gain has been closer to 11%, and the market will be looking for implications of U.S. tariffs in future data releases.
- **Potential Risks.** While not the base case, a much slower-than-expected economy, coupled with ongoing clouds around interest rate policy, could make for a serious headwind. Plus, resurgent inflationary pressures in response to new policies or geopolitical tensions could further undermine the positive narrative for stocks.
- **Recent Volatility Weighs.** Following recent tariff announcements, S&P 500 earnings per share (EPS) estimates across Wall Street will likely soon come down materially. It's impossible to know the duration or outcomes of tariff negotiations, but the latest developments did bring some clarity.

Bonds. The bond market clearly remains in flux after a volatile 2024. But as markets enter the second quarter of 2025, bond markets are dealing with the competing narrative of slowing growth and higher inflation. Looking ahead:

- **A Range-Bound Yield Environment.** Ten-year yields are expected to remain in a range of 3.75% to 4.25% in 2025. The risks for yields are roughly equal, with potential upside from fiscal deficits and Treasury supply, and downside risks from a more aggressive-than-anticipated Fed rate-cutting cycle.
- **Stay Focused on Quality.** The ongoing tug-of-war between slowing growth and higher inflation will likely continue to add volatility to markets. If conditions do deteriorate and the economy slows meaningfully or even contracts, investors will likely continue to benefit from an allocation to high-quality fixed income investments.
- **Balance Yield and Risk.** Considering the uncertainty surrounding future interest rate movements, benchmark level exposure to bonds and a neutral degree of sensitivity to interest rates is preferred. Intermediate term maturities of five years or less are favored in the current environment.

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U.S. Treasuries may be considered "safe haven" investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

First Quarter Performance Overview

Mega-cap Technology Hit Hard as Defensive Sectors Lead in Q1

S&P 500 sector performance, ranked by first quarter returns*

Sector	Q1 2025
Energy	10.2%
Healthcare	6.5%
Consumer Staples	5.2%
Utilities	4.9%
Real Estate	3.6%
Financials	3.5%
Materials	2.8%
Industrials	-0.2%
S&P 500	-4.3%
Communication Services	-6.2%
Technology	-12.7%
Consumer Discretionary	-13.8%

International and Value Stocks Enjoy Solid Q1 Returns

Domestic and international asset class performance, ranked by first quarter returns*

Asset Class	Q1 2025
Large Foreign	7.0%
Emerging Markets	3.0%
Large Value	2.1%
Mid Value	-2.1%
S&P 500	-4.3%
Russell 3000	-4.7%
Mid Growth	-7.1%
Small Value	-7.7%
Large Growth	-10.0%
Small Growth	-11.1%

Strong First Quarter for High-Quality Fixed Income

Bond market performance, ranked by first quarter returns*

Sector	Q1 2025
TIPS	4.2%
MBS	3.1%
U.S. Treasuries	2.9%
Bloomberg U.S. Agg	2.8%
EM Debt	2.3%
Foreign Bonds (Unhedged)	2.3%
Investment-Grade Corporates	2.3%
High-Yield Corporates	1.0%
High-Yield Munis	0.8%
Bank Loans	0.4%
Munis	-0.2%
Foreign Bonds (Hedged)	-0.6%
Preferred Stocks	-0.6%

**Sources: LPL Research, FactSet, as of 03/31/2025

All data as of 03/31/2025

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The sectors are represented by the 11 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg U.S. MBS Index; Investment-Grade Corporate – Bloomberg U.S. Corporate Bond Index; Municipal – Bloomberg Municipal Bond Index; Municipal High-Yield – Bloomberg Municipal High Yield Index; TIPS – Bloomberg Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg U.S. High Yield Loan Index; High-Yield – Bloomberg U.S. Corporate High Yield Index; Emerging Market Debt – Bloomberg Emerging Markets USD Aggregate Total Return Index Unhedged; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Important Disclosures

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and are usually expressed annually as a percentage based on the investment's cost its current market value or its face value.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

Small cap is a term used to classify companies with a relatively small market capitalization. The definition of small cap can vary, but it is generally a company with a market capitalization of between $300 million and $2 billion. The prices of small cap stocks are generally more volatile than large cap stocks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg Global Aggregate Index measures the performance of global investment grade debt. The index includes treasury, corporate, and securitized fixed-rate bonds. Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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