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Turmoil and Silver Linings: First Quarter Market Review and Outlook

April 15, 2025

Key Takeaways

- In early 2025, the broad U.S. stock market took investors on a wild ride, climbing to record levels before falling into correction territory. Policy uncertainty was largely to blame.
- Companies that led the market higher in recent years were hit hardest, including stocks that had come to be known as the Magnificent 7. A number of asset classes and sectors remained resilient.
- The U.S. economy remained on solid footing, but a longer stretch of elevated uncertainty could take a toll.

After nearly two years of gains, the broad U.S. equities market stumbled in the first quarter. Policy uncertainty soured investors on the economic outlook and, in particular, the prospects for companies that have led the market higher in recent years.

As difficult as it was, the quarter served as a reminder that **volatility**, while unsettling, is a normal part of investing. The quarter was also a reminder that during tumultuous times, diversification can be an investor's best friend.

In this week's Markets in a Minute, we explore what triggered the sell-off and which asset classes fared relatively well. We also touch on the outlook for trade policy and a few other issues that are top of mind for investors.

Risks Converge

Heading into the new year, some of our biggest concerns were policy risk, the lofty valuations of **market-leading companies** (including the tech-focused Magnificent 7 stocks) and a high level of market concentration. The combination of these risks made for a volatile mix in the first quarter, when mounting policy uncertainty sparked a sell-off that hit the market's most richly valued companies especially hard.

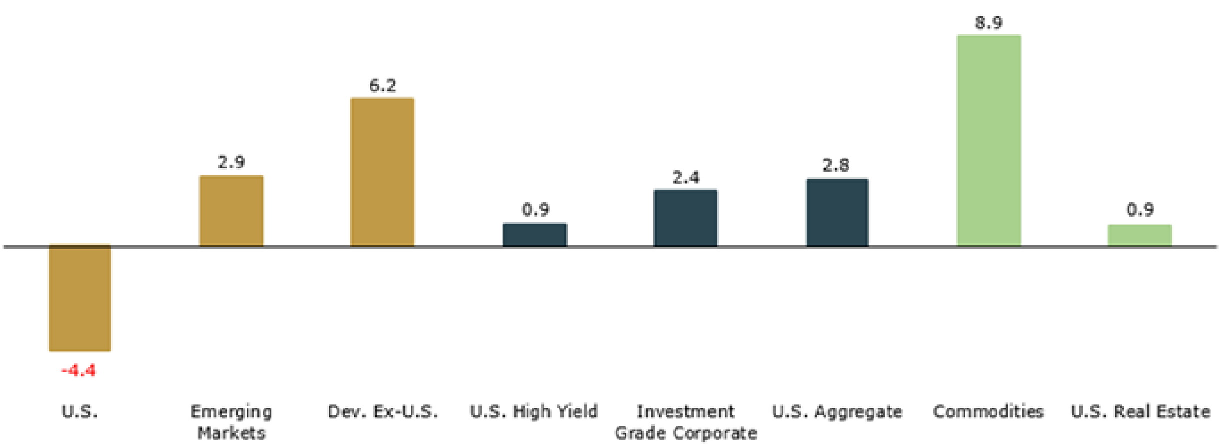
Highly valued stocks tend to be more sensitive to market-moving news because their prices reflect robust investor expectations for earnings growth, among other factors. And, in fact, share prices of the Mag 7 declined by a whopping 16% in the first quarter, about four times the decline for the overall market, as measured by the S&P 500 index.

Pockets of Strength

During the turbulent quarter, a number of asset classes fared pretty well, helping to inoculate those investors with diversified portfolios from the weakness in the market's biggest names. A few highlights:

- International stocks staged a **dramatic comeback** after lagging their U.S. counterparts for years.
- Bonds, which have had a lackluster two years, started to get their mojo back, once again demonstrating that they can help to **cushion portfolios** during stock-market declines. The classic 60/40 portfolio – one with a 60% allocation to the broad U.S. equities market and a 40% allocation to the broad U.S. bond market – would have declined in value by just 1.5% in the first quarter.
- Gold, which has performed well over the past year, continued to shine, buoyed by an expected increase in inflation, higher government borrowing and rising geopolitical risk. (Watch **this episode** of Money with Murphy for our take on the merits of gold as an asset class.)

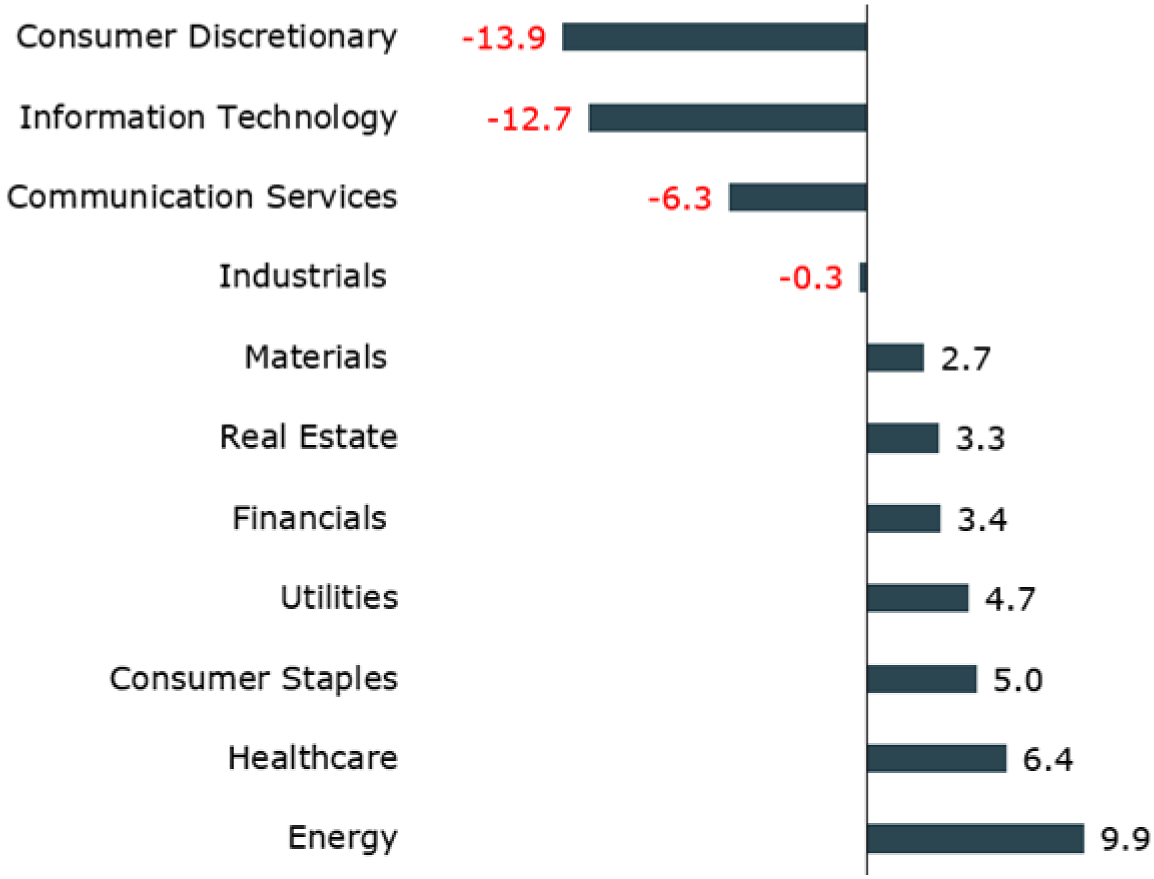
Performance by Asset Class



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Note: views are from a U.S. dollar perspective. Data labels represent total year-to-date returns. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. Source: Kestra Investment Management with data from FactSet. Index proxies: Bloomberg U.S. AGG Bond Index, ICE BofA U.S. Corporate, ICE BofA U.S. High Yield, S&P 500, MSCI EM, MSCI World ex US Index, Dow Jones U.S. Select REIT, and Bloomberg Commodity Index. Data as of March 31, 2025.

More than half of all S&P 500 sectors had positive returns for the quarter. Sectors that supply the goods and services consumers need, regardless of the economic climate, performed especially well. Healthcare and Consumer Staples, for instance, were among the best-performing sectors. Both have lagged the broad market over the past year and, based on analyst forecasts, weren't expected to outperform in 2025.

Performance by Sector, Q1 2025 (%)



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Uncertainty Reaches a Tipping Point

Uncertainty is a constant in life and investing, but there are times when it's especially difficult for investors and businesses to see around the corner. This year has been a case in point.

The market barely reacted to President Trump's initial moves on tariffs, including the levies introduced during his first term, because they were fairly targeted in scope, size and purpose. The tariffs he unveiled in January were mostly intended to address national security concerns, including the fentanyl crisis.

In March, however, the market began to falter after the Trump administration announced a broader set of tariffs **meant to level the playing field** on international trade and encourage domestic production. Then, last week, the president announced an even more far-reaching tariff package, targeting nearly every foreign country the US trades with. Since then some tariffs have been hiked (China), others haven't materialized (Mexico, Canada) and the rest have been put on pause. While the most extreme version of the tariff proposals has been taken off the table, there remains tremendous uncertainty about future policy.

The good news is that tariffs are not immutable. If the administration decides it has made a policy mistake, it can remove tariffs with the stroke of a pen. What's more, President Trump has indicated he's open to **making deals** on tariffs with individual countries, as he's done in the past. So, his latest tariffs may not persist at current levels. (For a historical perspective on tariffs, watch **this edition** of Money with Murphy.)

An Economic Cushion

Amid the turmoil over tariffs, we take some comfort in the fact that U.S. economy kicked off the year in solid shape. **Consumers** and **companies** have fairly strong balance sheets, and the labor market remains healthy, at least on the private-sector side. In March, the economy added **more jobs** than expected, and the unemployment rate ticked up to 4.2%, which is enviable from a historical perspective. And **inflation**, while still elevated, has moved closer to the Federal Reserve's 2% target.

The economic picture could change, of course. Heightened uncertainty makes consumers and companies reluctant to take risk, which typically means less spending on everything from vacations to business equipment. In recent months, consumer and business **sentiment** has taken a hit, but the reason was mostly high prices and, ironically, **real retail sales** climbed. At this point, it's safe to say that the longer high levels of uncertainty persist, the greater the potential economic consequences.

The Takeaway

In recent years, diversification may have seemed a bit old fashioned. In fact, more than a few pundits declared it dead. But the first quarter provided a powerful case for maintaining a well-diversified portfolio even when may not be the popular thing to do.

In the coming weeks and months, we're likely to see continued volatility as the market digests the impact of the president's ambitious trade gambit and other big policy initiatives. As usual, we'll be keeping a close eye on macroeconomic, geopolitical and other risks.

Invest wisely and live richly,

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