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Sage Advice

1Q25 Market Review & Outlook

April 2025

Quarter in Review

Global markets began the year on what appeared to be solid footing, given resilient economic data in Q4 and a high level of optimism surrounding the new administration and its business-friendly attitude. Things soured rapidly by mid-February, however, on rising policy uncertainty, job cuts, and tariff announcements, with hints of steeper actions coming. Sentiment and soft data shifted lower and inflation expectations in the near-term rose rapidly. The market reaction was a US centric correction in the back half of the quarter. The S&P 500 declined 4.5%, notching its worst quarter since 3Q22 and correcting 10% from its mid-February peak. Core US bond markets provided an offset, with the Aggregate Bond Index gaining 2.8%, as rates fell 20 bps to 40 bps across the curve. Attribution for Q1 was notable for the divergence between US and non-US markets. Both broad developed markets (EAFE +9%) and emerging markets (+3%) were positive, outperforming US equities by wide margins. Commodities were also a standout with broad-based commodities up +5%, benefiting from higher energy prices and a large gain in gold (+19%). Within fixed income, quality and duration outperformed, but falling rates overall offset modest spread widening, and all major sectors had positive performance. Higher-quality spread sectors (IG credit +2% to +3%, Agency MBS +3%) had moderate gains and outperformed lower-quality markets (HY +1.2% and preferred stocks -1.2%).

The Q1 risk-off environment was just an appetizer, as Liberation Day tariff announcements fueled further declines and a much broader global correction. Key dynamics so far into the second quarter (as of April 17) include a broader risk-off backdrop, but with the US still feeling the most pain (S&P -10%, non-US +4%). Tech and consumer discretionary are still laggards (-17%), but energy has seen a big reversal (-15% so far in April). In fixed income, liquidity concerns and more severe spread widening have prevented further gains (Aggregate Bond Index +2.2%), while steeper dollar declines have boosted non-dollar assets (non-dollar government and credit +8%).

Macro Outlook & Positioning

The uptick in activity and optimism during the fourth quarter and early first quarter has become a distant memory in the second quarter. Signs of consumer fatigue, sticky inflation, and aggressive government job cuts were already beginning to erode sentiment and prompt lower consensus growth forecasts by mid-first quarter; however, post-Liberation Day, investors must now recalibrate for significantly higher tariffs and the possibility of a drawn-out global trade war. Implications include a shallow recession in the back half of this year, further downward earnings revisions, inflationary pressure, and continued volatility in not only risk assets but in rates and currencies as well.

Uncertain tariff levels and an unpredictable administration make a quick resolution unlikely, and the longer the standoff, the greater the negative feedback loop will impact sentiment and growth. This puts the Fed in an impossible position. We expect the Fed to remain patient given expected tariff-driven inflation, but to ease later in the year as growth stalls. While we don't see near-term easing, the Fed has said that it stands ready to provide support in a liquidity crisis. The Treasury and administration are also highly incentivized to prevent a disorderly sell-off in rates and to provide regulatory relief aimed at giving banks more room to purchase Treasuries. This outlook leaves our yield forecast similar to the beginning of the year: modestly lower with curve steepening as the back-end declines more slowly given inflation and deficit concerns.

From an asset allocation perspective, the magnitude of uncertainty and increased downside economic risk suggest favoring yield-oriented investments over risk assets to insulate against volatility; and duration, to hedge economic risk and provide a benefit vs. cash given steeper curves. Equities have repriced lower, but multiples remain historically high and nowhere near recessionary levels, implying downside potential and flows continuing to be more supportive of fixed income. Positioning within fixed income strategies is yield focused with lower portfolio-level risk and a modestly long duration posture. We remain cautiously positioned in credit with a substantial allocation to MBS, and we have dry powder to take advantage of spread widening opportunities. Within multi-asset and equity strategies, we have focused on increasing diversification, including outside the US, and we remain tilted toward higher-quality market segments with favorable valuations versus the broad markets.

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Fixed Income Overview

Extreme rate volatility and inconsistent trade policy messaging have caused periods of disorderly selling in bond markets and confusion about what are considered safe-haven assets. Since rate volatility is not going away in the short-term, we believe positioning for the medium-term is important. We expect to avoid a severe liquidity crisis, but not a recession, which will keep demand firm for safe assets, bias rates lower overall, and support core fixed income returns. Inflation and shrinking foreign demand for Treasuries will keep pressure on long-end yields; however, we expect the Fed to view tariff-driven inflation as temporary, and that they will still look to ease later in the year. For core fixed income, key structural support remains in the form of attractive all-in yields, which provide a strong base for returns, and favorable relative value vs. other assets. Core investment grade yields near 5% offer a cushion to rate volatility, and when compared to low historical equity earnings yield, still provide fixed income its best relative value in 15-plus years. Our game plan into 2025 was to lean into yield carry and drive returns through relative value opportunities and security selection, while keeping overall portfolio risk low. Positioning tilts included a modestly long duration tilt versus indices, a cautious posture in our credit allocation, and a substantial allocation in agency MBS. This philosophy worked well during the first quarter, and we carry these core themes into the second quarter. We also expect emerging opportunities to deploy dry powder in the more volatile spread environment. Within our core credit allocations, we continue to prioritize sectors with short-term tailwinds and minimal exposure to policy-related risks. Specifically, we favor large banks that are well-positioned to navigate uncertainty, regulated utilities benefiting from AI-driven power demand, and air lessors experiencing unique demand dynamics due to ongoing challenges at OEMs. Within core plus strategies we carry modest and well-diversified exposure in non-core sectors given macro headwinds but attractive yields.

Equity Overview

Volatility and peak-to-trough declines have stung equity market participants. The pain of a mid-single-digits repricing in US markets post-Liberation Day could be considered mild, however, given the level of uncertainty and growing odds of a recession. Valuations, especially in the US, remain well above longer-term averages and far above recession levels. Tariff negotiations aren't moving fast enough to prevent further economic damage, and while technical bounces may happen, we don't see sustainable upside until later in the year as negations become clearer, the Fed is closer to cutting rates, and positive policy initiatives, like deregulation and tax cuts, are sharing headlines. Our baseline themes into 2025 included being more mindful of valuations and concentration risk to insulate against volatility. This included staying focused on quality and stable cash flows and adding value exposure during the first quarter. Our other factor tilt is high free-cash-flow sectors, such as healthcare, which offer a better hedge in economic weakness; and energy, which has attractive valuations. To lower average portfolio valuation vs. broad markets and increase diversification, we also carry a small allocation to small caps. Regionally, we were favoring the US but pivoted mid-quarter on tariff concerns and rising US recession risks.