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The 1st quarter was an incredibly tumultuous period for stock markets. After two years of relatively smooth sailing and blockbuster returns for stocks (US technology stocks, in particular), aggressive rounds of tariffs launched by the new administration served as a rude awakening for markets and were the main driver behind much of the recent volatility. Despite the overall disappointing performance during the quarter, the year actually got off to a decent start in January as markets continued their post-election rally. The S&P 500 had moved up to a new all-time high by mid-February, at which point the index was up over +4% in the first 6 weeks of the new year on a total return basis. However, widespread tariff worries then began to weigh on markets in the second part of the quarter. Investors became increasingly concerned that tariffs would mean higher inflation, which snowballed existing fears, given inflation had still been lingering above comfortable targets across the world's major economies. At the same time, there were growing concerns about the outlook for growth in the US and even mounting speculation about a recession. The S&P finished February with a monthly loss of -1.3% before it fell -5.6% in March, marking its worst monthly performance since 2022ⁱ.

Before tariff concerns really started to kick in, one of the most important non-tariff developments of the 1st quarter came from an AI startup company called DeepSeek. The Chinese startup unveiled its new AI model as a more efficient and cheaper alternative, which started to raise serious questions as to the sustainability of the lofty valuations of the big tech companies here in the US (as we've written about quite extensively in recent quarters). The technology-heavy Nasdaq Composite index fell sharply the day of the DeepSeek announcement, which impacted other AI companies in the process. Although there was a bit of a recovery after the initial selloff occurred, it raised doubts for the rest of the quarter about the narrative of US tech dominance that had powered the US stock market's advance for the last couple of years. Market losses were particularly concentrated among tech stocks during the 1st quarter, with the "Magnificent 7" (the group of the largest US tech companies at the center of the AI boom consisting of Amazon, Google, Microsoft, Apple, Meta, Nvidia, and Tesla, and otherwise referred to as the "Mag 7") ending the quarter down -16%, and shedding -20.7% since their December peakⁱⁱ.

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All three major benchmarks for US stocks closed the quarter with negative performance. The indexes with the highest concentration in technology companies were impacted the hardest, with the S&P 500 and Nasdaq down -4.3% and -10.3%, respectively, for the full quarter. These losses marked the worst quarters for the indexes since 2022ⁱⁱⁱ. The drops were much steeper, however, from the peak set in mid-February, exceeding -10% and officially entering “correction” territory. The Dow Jones Industrial Average (i.e., “the Dow”) was down just -0.9% during the quarter, as it has the least amount of exposure to tech^{iv}.

But it wasn't all bad news across the global equity markets. European and Chinese stock markets saw a significant outperformance relative to domestic markets. In fact, the 1st quarter marked the biggest quarterly performance gap between European stocks and the S&P in more than a decade. Developed-economy stocks (as measured by the MSCI EAFE index) rose +6.9% during the quarter while the still-developing-economy stocks (as measured by the MSCI Emerging Markets Index) also rose +2.9% during the quarter^v. This performance differential marks the biggest the underperformance of the US vs the rest of the world in 23 years^{vi}. Perhaps the drawn-out disparity between domestic and overseas markets that we've written about is finally starting to reverse.

Bond markets remained mostly positive during the 1st quarter as US stocks sold off and investors sought safety in fixed income. That was a sharp contrast with the 4th quarter, when stocks were soaring as bonds struggled. The Bloomberg US Aggregate index, the benchmark for taxable bonds, posted a gain of +2.8% during the quarter. The interest rate on the US Treasury 10-year bond dropped to 4.23% at the end of the quarter after peaking at 4.79% in early January^{vii}. Bond prices move in the opposite direction of interest rates.

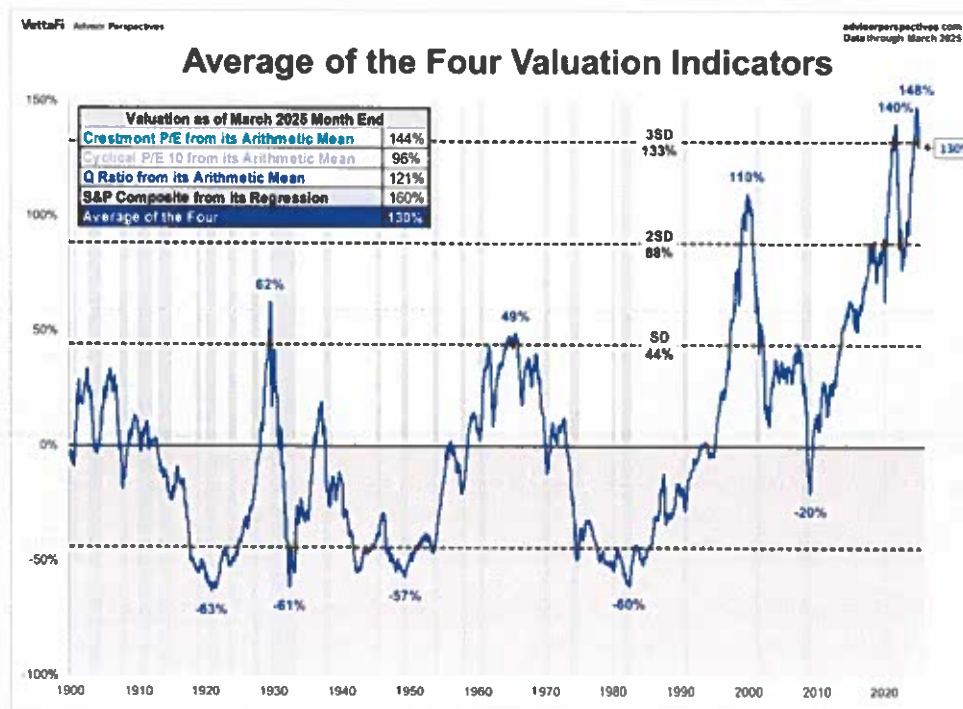
A neglected “elephant in the bond room” situation concerns the nearly \$10 trillion that the US government will need to borrow over the next 12 months to refinance maturing debt and fund our deficit spending. Who is going to lend us that much? Some of our historical lenders like China, Japan, and the Middle East are recently more reluctant to lend us money, and instead looking to reduce their US dollar exposure. So it seems that either A) we have to entice lenders with a higher interest rate (not good for our bond and mortgage markets) or B) have our US Treasury electronically print more dollars out of thin air (i.e., quantitative easing) to buy the new bond debt necessary. This would have a direct impact of reducing the value of the existing dollars already in circulation. All this certainly creates imminent challenges for our US bond market.

Outside of the traditional stock and bond asset classes, the broad Bloomberg Commodity index gained +8.9%^{viii} during the 1st quarter with the renewed inflation fears, although oil finished the quarter at about the same price as it was at the start of the year at \$71.48/bbl^{ix}. Gold bullion continued its tremendous run during the quarter (after a stellar 2024) with a quarterly increase of +19%, its largest quarterly increase since the mid-1980s^x, surging to an all-time higher of \$3,124/oz. Meanwhile, bitcoin and cryptocurrency prices plunged alongside tech and AI stocks.

If you're wondering what that hissing sound is, it could very well be the stock market bubble that we have been writing about losing its air. Some investors think stock market bubbles always "pop" or end in a crash, but history shows it can take time as they deflate lower over a longer period. Initially, the bubble-enthusiasts refuse to give up their bullish belief, as they've "learned" over the prolonged bull market that they cannot lose if they don't panic and sell. During the 2000-02 dot.com bubble's collapse, investors kept trying to buy the dips all the way down until they finally capitulated. It was similar in 2008-09 during the Great Recession. We wouldn't be surprised if this were to happen again – a trend of lower stock prices interrupted by enticing sharp bear market rallies.

As is typical, investors are still generally ignoring the warnings of the greatest and most successful investors. CEO and founder of Elliott Management, billionaire Paul Singer (one of the greatest investors of our time), recently told an interviewer: *"I think the long period of time since the last major market event has lulled people into thinking that they always will be bailed out, that there'll never be another bear market like 1974, 1987, 2007-2008 and leverage is building and building, risk taking is building..."* He went on to warn: *"The state of the stock market today is just about as risky as I have ever seen."* Another billionaire investing legend, Paul Tudor Jones, hedge fund founder of Tudor Investment Corp, went on CNBC and stated: *"We could have a 30% correction in the stock market and just be back to slightly overvalued."*^{xi} And finally, everyone's favorite billionaire Warren Buffett, has amassed a record stash of cash (\$334 billion) as part of his Berkshire Hathaway holdings from selling lots of stock in his favorite long-time positions. Buffett has successfully done this prior to other market drops. Consistent readers of our team's quarterly letters will recall we've discussed the "Buffett ratio" (total market cap/GDP, named after Warren) and the ominous picture it paints numerous times.

Our team continues to focus on the stock market's underlying valuations as a guide for future return potential and assessing downside risk. As we've frequently pointed out, valuation indicators aren't always great short-term signals of market direction, but they can help frame longer-term expectations of investment returns. Market valuation indicators help gauge whether markets are overvalued, undervalued, or fairly valued relative to historical norms. A single measurement of valuation may not always present the most complete state of the market. So instead, we take a look at an average of four popular indicators below to see if the scale has tipped back in investors' favor after the recent decline. While the chart below shows the average has indeed dropped, it still stands at 130%...an average that is still over twice its historical mean and signaling a still-overvalued market.



Source: VettaFi

Moving forward, our team remains comfortable with our cautious, but still diversified and opportunistic, approach to help navigate the challenging market environment. We remain focused on long-term growth potential, but we're as equally focused on avoiding large portfolio impairments. The warning signs still seem too obvious to us. Diversification remains a cornerstone to our investment management approach, as it can as easily serve as a risk-reduction tool as it can a return-enhancing tool.

We know volatile markets can spark a lot of emotion and concern, so please do not hesitate to reach out to us with any questions. As always, our entire team is appreciative of our relationship, and we thank you for the opportunity to be of service. We are readily available to help address any concerns that may be on your mind. Feel free to reach out to us any time.

Happy Spring,



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- i "The Best & Worst Performing Assets of The March Meltdown and Queezy Q1" by Tyler Durden, April 1, 2025
 - ii "Quarter in Review – 1Q 2025" by Morgan Stanley Global Investment Committee, March 31, 2025
 - iii "S&P, Nasdaq Post Worst Quarters since 2022" WSJ News Alert, March 31, 2025
 - iv All domestic equity index returns courtesy of Morgan Stanley Capital Markets Research
 - v All international equity index returns courtesy of Morgan Stanley Capital Markets Research
 - vi "13 Shares on Q1's Dramatic Rotation in Stocks" by Sarah Hansen of Morningstar.com, April 1, 2025
 - vii All fixed income index returns courtesy of Morgan Stanley Capital Markets Research
 - viii Commodity index returns courtesy of Morgan Stanley Capital Markets Research
 - ix JP Morgan Guide to the Markets, 2Q2025
 - x "The Best & Worst Performing Assets of The March Meltdown and Queezy Q1" by Tyler Durden, April 1, 2025
 - xi "Bubble Trouble" by Fred Hickey of The High-Tech Strategist, March 2, 2025

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A basis point is defined as one hundredth of one percent (1%), used chiefly in expressing differences of interest rates.

An investment cannot be made directly in a market index. For index and indicator definitions referenced in this report please visit the following: <https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions>

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