Fort Washington
Investment Advisors, Inc.

A member of Western & Southern Financial Group

MONTHLY MARKET PULSE — MARCH 2025

HIGHLIGHTS

- **Market Leadership:** For the past two years, the stock market has been fueled by the AI trade. In 2025, however, value stocks are outperforming growth, signaling a potential shift in market leadership.
- **Tariffs:** Both enacted and proposed tariffs are shaping consumer and corporate sentiment due to uncertain impacts on growth and inflation.
- **Heightened Uncertainty:** In today's environment of elevated uncertainty, pragmatic portfolio construction and thorough risk management will be key drivers of future returns.

MONTHLY SPOTLIGHT:

Investing Through Elevated Uncertainty

Author: Daniel Carter, CFA

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MACRO INSIGHTS

Confidence Falters, Volatility Rises

Stocks fell in February, with the S&P 500 declining 1.4%, led lower by technology stocks and the "Magnificent 7" trade. Notably, Tesla (-27.6%) and Google (-16.5%) posted steep losses. The CBOE Volatility Index (VIX) surged above 20 near month-end for the first time this year. The Nasdaq dropped 4%, marking its worst month since April 2024. Market weakness was driven by softer economic data, stubborn inflation, uncertainty surrounding the Trump administration's tariff policies, and lingering concerns over AI spending durability. This month's *Spotlight* below examines persistently high valuations despite these risks.

Federal Reserve (Fed) Chair Powell's Senate testimony reiterated that recent inflation data suggests the Fed "has more work to do" to control rising prices. This, combined with weaker economic indicators, shook investor confidence, particularly as the economic impact of new trade policies (supposedly going into effect in the coming days) has yet to be felt. The mega-cap tech trade, particularly those more notably tied to AI, was weak on the month. While cloud service providers maintained capex guidance in line with expectations, Microsoft CEO Satya Nadella's recent comments on a potential overbuild in AI infrastructure further dampened sentiment following the prior month's shockwaves from DeepSeek.

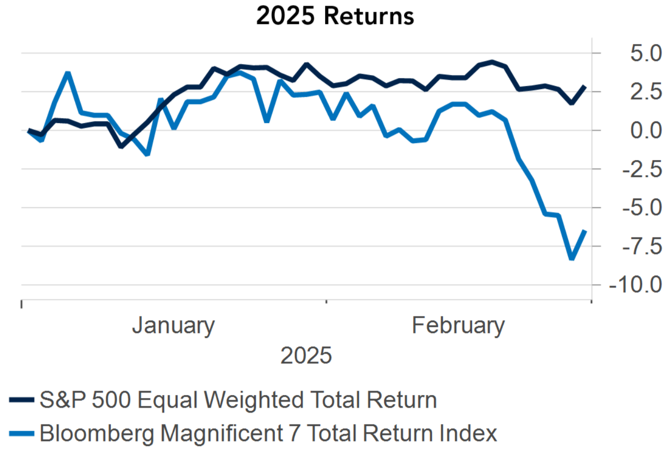
Bond markets reflected a risk-off shift, with the 10-year Treasury yield falling over 30 basis points to 4.2% by month-end, down from a mid-January high of 4.8%. Early February employment data revealed weaker job growth but higher-than-expected wage gains, a combination that signals slower economic growth with persistent inflation risks. Looking ahead, markets have increased expectations for Fed rate cuts, now pricing in 60 basis points of additional cuts this year as economic concerns outweigh inflation fears.

Despite economic uncertainty, corporate profits remained strong. With the Q4 earnings season nearly complete, revenue growth beat expectations by 1%, while earnings outperformed by 7%, exceeding the prior two quarters. Many data points continue to highlight resilience in the U.S. consumer, though Walmart's disappointing guidance highlighted a shift toward essential purchases over discretionary spending, raising questions about consumer durability.

The "Magnificent 7" mega-cap stocks have been a key driver of market gains over the past two years, contributing roughly half of the S&P 500's returns. While the S&P 500 remains up 1.4% year-to-date, international markets have outperformed, largely due to the U.S. market's heavy tech concentration. We will continue to closely monitor developments relating to the implementation of tariffs as well as unfolding economic data to assess the trajectory for corporate profits and the Fed.

Magnificent 7 vs. Equal Weighted S&P 500

Outside of the Mag 7, S&P 500 stocks are largely up this year.



Source: Fort Washington and Bloomberg.

Chris Shipley
Senior Vice President, Co-Chief Investment Officer
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WHAT TO WATCH

Inflation data continues to drive Fed expectations, impacting yields and interest rate-sensitive equities. Consumer sentiment declined in recent reports. As a result, investors will monitor that data for a potential change from the current trend.

- The next Consumer Price Index (CPI) reading will be available on March 12th, and Personal Consumption Expenditures (PCE), the Fed's preferred inflation gauge, will be available on March 28th. Investors will focus on the details, specifically housing and other services.
- The University of Michigan's Consumer Sentiment will be available on March 14th, and Conference Board sentiment on March 25th.
- March 19th is the FOMC's next meeting, where investors will await their rate decision and summary of economic projections. Currently, investors don't expect any change in fed funds.

MONTHLY SPOTLIGHT

DANIEL CARTER, CFA
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Investing Through Elevated Uncertainty

Investing has always involved uncertainty, but today's landscape presents an elevated level of ambiguity across multiple fronts. From shifting economic policies to technological disruptions and elevated market valuations, investors must navigate a complex environment that demands a careful understanding of risks. Despite these heightened uncertainties, equity and fixed income markets reflect a strong risk appetite, raising important questions about sustainability and prudent portfolio positioning.

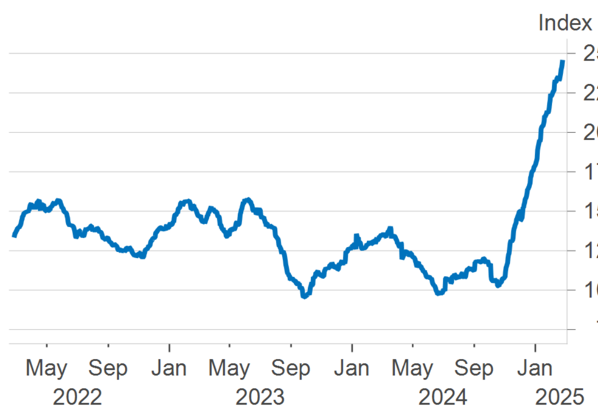
One major source of uncertainty is the evolving policy landscape, both domestically and globally. Rapid shifts in tax policies, trade agreements, and regulatory frameworks create volatility for corporate decision-making and unsettle consumer confidence. Geopolitical tensions, particularly between the world's largest economies, further complicate long-term planning by disrupting supply chains and introducing variability for input prices. At the same time, central banks face the delicate task of normalizing monetary policy after a period of restrictive measures.

Beyond macroeconomic concerns, the rapid evolution of Artificial Intelligence (AI) introduces another layer of complexity. While AI-driven investments have fueled market leadership over the past two years, the timing and impact on productivity are still unclear. Investors are tasked with weighing both the opportunities AI presents for economic gains and the potential disruptions it could create across industries.

Despite these challenges, markets have largely embraced a risk-on sentiment. Credit spreads remain historically tight, and the S&P 500 has surged 50%+ over the past two years, resulting in rich valuations across both asset classes. Investment-grade corporate spreads have only been this expensive 10% of the time since the early 1990s, and high-yield spreads are hovering near record lows. While valuations can stay elevated for extended periods, history suggests that risk-adjusted returns can be constrained when asset prices approach these levels.

In today's backdrop of mounting uncertainties and potential risks, we believe now is a critical time for prudent portfolio management. Investors should focus on maintaining diversification as well as re-evaluate portfolio allocations to ensure alignment with risk tolerances and long-term goals. Investor success in this environment will depend on understanding over- and underweight exposures, both intentional and unintentional, and how those are influenced by a variety of risks.

Economic Policy Uncertainty (3m MA)



U.S. Credit Spreads

Percentiles Relative to History	
BBB Rated Industrials	10%
BB Rated Corporates	5%
B Rated Corporates	3%

Source: Fort Washington, Bloomberg, and Economic Policy Uncertainty. Corporate spread data begins in 1994.

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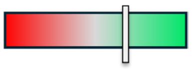
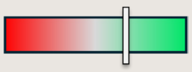
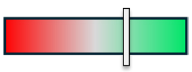
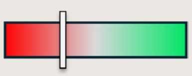
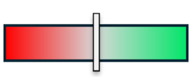
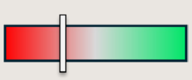
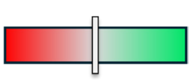
CURRENT OUTLOOK

Topic	View	MoM Change	Commentary
Macroeconomic Views			
Economic Growth		–	▸ U.S. economic data remains solid, **led by robust consumer spending**, especially higher income earners. ▸ Wage growth, low savings rates, and a significant rise in net worth (homes and investments) are supporting growth. ▸ Recent tariffs, both executed and proposed tariffs, with some of our largest trading partners (Mexico, Canada, and China) **present risks to inflation and growth**. ▸ Uncertainty remains elevated due to changing trade policy and geopolitical tension.
Inflation		–	▸ **Inflation remains on a path toward 2%**, which is expected to continue as service inflation cools. ▸ FOMC members have articulated **needing further progress on inflation** to resume lowering rates. ▸ Market expectations for near-term inflation have increased following stronger-than-expected economic data and tariffs; however, longer-run inflation forecasts remain largely grounded. ▸ Inflation is being driven by shelter and other non-discretionary services, while goods inflation is near zero.
Monetary Policy		–	▸ The Fed cut rates by 100 basis points in 2024 but paused in January. Investors **expect a continued pause at the March meeting**. Strong economic growth and tariff concerns have resulted in volatile expectations for rate cuts in 2025. ▸ Investors anticipate about 60 basis points of cuts in 2025, implying a **terminal rate of around 3.6**.
Fiscal Policy		–	▸ Flexibility within fiscal policy continues to diminish as federal debt levels swell and **higher interest costs** consume a larger portion of government outlays. ▸ Deficits are expected to remain elevated under the Trump administration amid current policy proposals. ▸ Both Chambers of Congress passed their budget proposals, which shows positive progression for the reconciliation process. Moving forward, the focus will be on the **extent of spending cuts**.
Market Valuations			
Rates		↓	▸ Yields moved lower in February, which was largely driven by lower real yields, as opposed to lower inflation expectations. ▸ We anticipate the **magnitude of expected rate cuts will continue shifting** with new economic data and developments around executive branch policies, presenting opportunities for tactical adjustments. ▸ Long rates are within our expected fair value range following the recent rally.
Credit		–	▸ Credit spreads remain below historical averages, supported by continued U.S. growth. ▸ We believe **current fixed income valuations are expensive**, and credit spreads represent little upside. ▸ Investment-grade spreads (10yr BBB Industrials) ended November at their 14th percentile and high yield (single B corporates) at their 4th percentile since the 1990s.
Equity		–	▸ Uncertainty over market leadership (Magnificent 7) has increased this year as value stocks have outperformed growth. ▸ **Valuations remain stretched** after the S&P 500 advanced almost 55% over the past 2 years. ▸ Market breadth has improved since mid-2024, but small-cap stocks need stronger fundamentals to continue that momentum. ▸ Three notable themes from Q4 earnings calls include the impact of tariffs, the strength of the U.S. Dollar, and the impact of AI on businesses.

MARKET DATA & PERFORMANCE | AS OF 02/28/2025

U.S. Snapshot	Current	6 Months Prior	1 Year Prior
Core Inflation (YoY%)	2.6	2.7	2.9
Unemployment Rate	4.0	4.2	3.9
Real GDP (YoY%)	2.5	3.0	3.2
Retail Sales (YoY%)	4.2	2.0	2.1
30-Year Mortgage Rate	6.8	6.8	6.7
10-Year Treasury	4.2	3.9	4.3
US Corporate IG Yield	5.1	4.9	5.4
US Corporate HY Yield	7.2	7.3	7.9

TOTAL RETURNS

Asset Class	MTD	QTD	YTD	1 Year	3 Years*	5 Years*
Equity						
Russell 3000 Index	-1.9%	1.2%	1.2%	17.5%	11.6%	16.1%
S&P 500 Index	-1.3%	1.4%	1.4%	18.4%	12.6%	16.9%
S&P Midcap 400 Index	-4.3%	-0.7%	-0.7%	8.7%	6.9%	13.0%
Russell 2000 Index	-5.3%	-2.9%	-2.9%	6.7%	3.3%	9.4%
MSCI World Index	-0.7%	2.8%	2.8%	16.1%	10.7%	14.5%
MSCI World Excluding US	1.8%	6.8%	6.8%	10.1%	6.9%	9.5%
Fixed Income						
Bloomberg US Aggregate	2.2%	2.7%	2.7%	5.8%	-0.4%	-0.5%
US Corporate Investment Grade	2.0%	2.6%	2.6%	6.4%	0.4%	0.0%
US Corporate High Yield	0.7%	2.0%	2.0%	10.1%	4.9%	4.9%
Emerging Market Debt	1.5%	2.9%	2.9%	10.8%	3.2%	0.6%
US Treasury (7-10 year)	2.8%	3.3%	3.3%	4.5%	-2.3%	-1.8%
Cash	0.3%	0.7%	0.7%	5.2%	4.2%	2.6%

Source: Fort Washington and Bloomberg. *Returns longer than 1 year are annualized. Past performance is not indicative of future results.

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