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Dear Valued Investor,

As spring approaches and the weather warms, the U.S. economy has begun to cool. After a sizzling recovery from the pandemic, followed by a period of surprisingly solid and steady growth on the back of resilient consumer spending, the economy finally seems poised to downshift to its pre-pandemic trend near 2% growth. Recent confidence surveys suggest consumers may pull back some and jobs are a bit tougher to get. But consumers remain in good shape financially overall — particularly upper-income folks who drive most of the spending. In fact, the top 10% of income earners are now responsible for about half of all spending.

Slower growth may be good for stocks because it helps ease some of the inflation pressure and can pave the way for more Federal Reserve (Fed) rate cuts. We're talking about a slight cooldown, not a collapse. Reaccelerating inflation is probably a bigger risk than recession, even after weak economic data last month. We'll take our chances with a gradual slowdown from last year's unsustainable pace near 3% growth.

Slower growth and easing inflation pressure will keep Fed rate cuts in play and prevent big up moves in interest rates that could weigh on stock and bond returns. With bond yields down this year but still attractive, 2025 is shaping up to be a good year for fixed income investors. Although stocks are off to a slow start on tariff concerns, cooling inflation and stable yields are key ingredients for the bull case.

Another key ingredient for the bull case for stocks is strong earnings. Corporate America delivered in the fourth quarter, as S&P 500 companies grew earnings per share by over 18% year over year. Although strategists' expectations for double-digit earnings growth in 2025 may be too high, especially if tariffs stick and prompt more retaliation, the earnings outlook is good enough to support stock gains.

This year has brought new stock market leadership. The average "Magnificent Seven" stock — the largest seven technology companies — has fallen about 9% so far this year, while the average S&P 500 stock is up slightly. As some doubt the staying power of the artificial intelligence-fueled rally in the big tech stocks, others are finding opportunities rotating to other areas — the normal evolution of a maturing bull market.

Tariffs remain a near-term threat. Although exceptions, reductions, delays, or complete reversals may come, some tariffs will stick. Retaliation by trading partners will likely weigh on U.S. economic growth. Prices on some items will rise, as foreign producers and currency adjustments can only absorb so much, making the Fed's job tougher. Expect some impact on importers' profits in certain industries, such as autos, food and beverages, and certain segments of retail. But don't expect tariffs to derail corporate America's AI-driven earnings gains.

Expect a positive year for stocks on the back of steady growth in corporate profits, but likely with more bumps along the way as the economy slows and policy uncertainty remains elevated.

As always, please reach out to your financial advisor with questions.

Sincerely,

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