Quarterly Market Outlook

April 2025

The Good Ol' Days

Starting in the 1980s, a confluence of macro forces fueled disinflation and growth in the U.S. and globally: the Soviet Union collapsed, opening the Eastern Bloc markets, freeing up resources previously spent on defense (the "peace dividend") and bringing hundreds of millions of workers online; China opened up and joined the WTO, another huge boost to global labor supply and manufacturing capacity; baby boomers entered the workforce – a demographic tailwind favoring production and demand; U.S. immigration soared after hitting a low in 1970; and the tech revolution drove productivity and globalization. Meanwhile, energy efficiency and rising non-OPEC production, including the U.S. shale boom and growth in renewables, increased supply and kept prices in check.

These trends largely played out against a backdrop of relatively disciplined fiscal and monetary policy, deregulation, financialization, falling tax and interest rates, relative geopolitical stability, and low starting valuations (e.g., the S&P 500 traded at a P/E ratio of 7 in 1980). As the supply and productivity of labor, commodities and capital increased, production rose and prices and borrowing costs fell, creating a virtuous cycle of investment and growth. The U.S. also benefited from the dollar's dominant role as the global trade and reserve currency, with the rest of the world (particularly China) reinvesting their dollars back into U.S. assets.[1]

Pulling Out All the Stops

After the Global Financial Crisis, vulnerabilities began to emerge. The Fed held rates near zero and bought assets ("quantitative easing") to manage the post-2008 deleveraging, leading markets to recover while the real economy lagged behind ("secular stagnation"). When Covid hit, the U.S. and others flooded the system with liquidity and fiscal support, more than offsetting the downturn and spurring demand in the face of supply constraints. Inflation peaked at 9% in the U.S. before tighter policy reined it in. The widely anticipated recession never materialized, as rising incomes and excess savings continued to fuel the expansion, underpinned by strong corporate and household balance sheets, record immigration, and massive fiscal stimulus (e.g., CHIPS Act, Inflation Reduction Act). Today, the U.S. economy is more dependent than ever on record deficit spending (over 6% of GDP) and the world's willingness to finance it.[2]

Enter Trump 2.0: Macro Meets MAGA

This fragile era of U.S. exceptionalism now faces disruptive policy shifts. In just over two months, the Trump administration has: (a) pressured Ukraine to accept a ceasefire with Russia by scaling back support; (b) withdrawn from climate agreements and rolled back environmental regulations; (c) enacted broad federal budget and payroll cuts with plans to slash the deficit (from >6% to ~3%); (d) tightened immigration enforcement; and, perhaps most significantly, (e) imposed sweeping tariffs on over 180 countries, including 25% on Mexican and Canadian imports, 25% on steel, aluminum and auto imports globally, and "reciprocal tariffs" totaling rates of 10%-50%+ on dozens of countries, including 54% on China, 46% on Vietnam, and 20% on the E.U. These moves raise questions about the durability of the current expansion and the longer-term reliability of the U.S. as a trading partner, ally, and leader of the world order.[3]

Q1 2025: Markets React

Market volatility in Q1 was largely a response to these policy shifts – especially tariffs – and concerns that inflation may be rebounding. Despite the headlines, however, most markets rallied in Q1, including international developed equities (+9%), emerging markets (+5%), the U.S. Bond Aggregate (+3%), commodities (+8%), and gold (surging 18% after a 27% rise in 2024). U.S. equities were the outlier, falling 4% after briefly entering correction territory (-10%). Reversing the prevailing trend in recent years, Europe outperformed, buoyed by relatively cheaper valuations, U.S. policy uncertainty, and a large German fiscal package of up to €1 trillion in defense and infrastructure spending. Meanwhile, gold benefited from dollar weakness, ongoing central-bank purchases, and concerns about tariffs, debt and inflation.[4]

Following Trump's "Liberation Day" tariff announcements, equities and the dollar sold off and Treasuries rallied, reflecting an increasing likelihood of a U.S. recession. [5]

Risks to Growth and Price Stability

Recent developments pose significant risks to both growth and price stability. Tariffs raise the costs of inputs and finished goods, curb demand from abroad, and introduce uncertainty, dampening investment and hiring. In addition, federal budget cuts and layoffs are a near-term headwind that may add to labor market softness and weigh on demand. At the same time, with unprecedented tariffs looming and core inflation back up (now rising at a 3.6% annualized rate), the Fed's ability to cut rates is limited, despite signaling plans for two more cuts this year. Households will continue to grapple with rising expenses and poor housing affordability, and businesses will have to continue re-adjusting to higher refinancing costs as existing debts mature.[6]

Consumer spending is driven by incomes, borrowing costs and perceived wealth. Post-Covid, rising incomes and asset values fueled demand. Now, with the labor market weakening and financing costs still high, spending looks increasingly dependent on financial assets. Even a modest market selloff could therefore weigh on demand, which can in turn pressure earnings and potentially drive stocks and employment lower. As real consumption and sentiment weaken, the risks of a self-reinforcing contraction may be mounting.[7]

Finally, with ongoing wars in Ukraine and the Middle East, China threatening Taiwan, and the U.S. taking action against the Houthis, geopolitical risks remain high.[8]

The End of U.S. Exceptionalism?

Stepping back, risks to U.S. hegemony are also rising. For decades, the economy has been powered by disinflationary demographic and immigration trends, free-market trade policies, tech supremacy, and international support for U.S. assets and the dollar. Today, the population is aging, the border is closing, tariffs are burdening trade, deficits are at records, and allies and adversaries alike are seeking to reduce their reliance on the U.S.[9]

Diversification Matters More than Ever

As the secular U.S. bull market enters its 16th year, portfolios are more concentrated than ever in U.S. equities, which are in turn highly concentrated in megacap tech. This comes at a time when international ownership of U.S. equities is at a peak, valuations are still stretched (with U.S. stocks at a forward P/E of 20 vs. 14 for international stocks), and many of the tailwinds that fueled the rally – including disinflation, accommodative monetary and fiscal policy, tax cuts, and low starting valuations and deficits – are either fading or operating in reverse. The next decade may look very different from the recent past. [10]

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We believe that today's cyclical and secular backdrop is a clarion call for diversification. In our view, investors may benefit from having exposure to international and emerging markets, not just the S&P 500; allocating to fixed income and commodities (including gold, TIPS and other inflation-hedge assets), not just equities; investing with skilled, lowly correlated active managers; and committing to select private-market alternatives, where the best managers can potentially add value through sourcing, underwriting, and operational improvements in less efficient markets.

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Notes

All data as of 3/31/2025.

[1] U.S. Immigrant Population and Share over Time, 185.. | migrationpolicy.org; What Happened to the Peace Dividend? - Finance & Development - March 1997 - Benedict Clements, Sanjeev Gupta, and Jerald Schiff; How the graying of America is reshaping the workforce and economy - Washington Post; 3 charts to help you understand the American shale boom | World Economic Forum; S&P 500 PE Ratio – Multpl; The Dollar: The World's Reserve Currency | Council on Foreign Relations.

[2] Immigration is driving the nation's modest post-pandemic population growth, new census data shows; Amid a resilient economy, many Americans aren't ready for a "rainy day" | Federal Reserve Bank of Minneapolis; CBO sees US deficits rising over 30 years, economic growth slowing | Reuters.

[3] Bessent's 3-3-3 Economic Growth Plan and the 5-4-3 Threat – WSJ; Full List of DOGE Spending Cuts, Findings as Trump Marks One Month Into Second Presidency – Newsweek; Trump's tariffs: the full list | Tariffs | The Guardian; Goods imported from China now face a 54% tariff rate — and possibly higher.

[4] Source: Bloomberg (SPX Index, NDDUEAFE Index, NDUEEGF Index, LBUSTRUU Index, BCOMTR Index, XAU Curncy); The potential large-scale implications of the German fiscal stimulus.

[5] Source: Bloomberg (SPX Index, NDDUEAFE Index, NDUEEGF Index, USGG10YR Index, DXY Curncy); Apollo's Zelter Sees Recession Risk, Stagflation on Tariffs – Bloomberg; Trump tariffs raise U.S. recession and stagflation risks - TheStreet.

[6] Source: Bloomberg (CPI XYOY Index), based on 3-month moving average rate, annualized; Fed rate decision March 2025: Fed holds interest rates steady; Americans' credit card debt reaches new record high: New York Federal Reserve - ABC News.

[7] Bridgewater Daily Observations (March 30, 2025).

[8] China's Military Exercises Around Taiwan Enter Second Day - The New York Times; US moves B-2 stealth bombers to Indian Ocean island in massive show of force to Houthis, Iran | CNN.

[9] How the graying of America is reshaping the workforce and economy - Washington Post; Securing Our Borders – The White House; The 'competition going on for supremacy' between China and the U.S. may create benefits, says International Chamber of Commerce secretary general | Fortune; Menaced by Trump, Canada Prepares to Join E.U. Military Industry Efforts - The New York Times; U.S. budget deficit surged in February, passing $1 trillion for year-to-date record.

[10] Source: Bloomberg (SPX Index – BE051, MXWDU Index – BE051).

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