Market Commentary

March 31, 2025

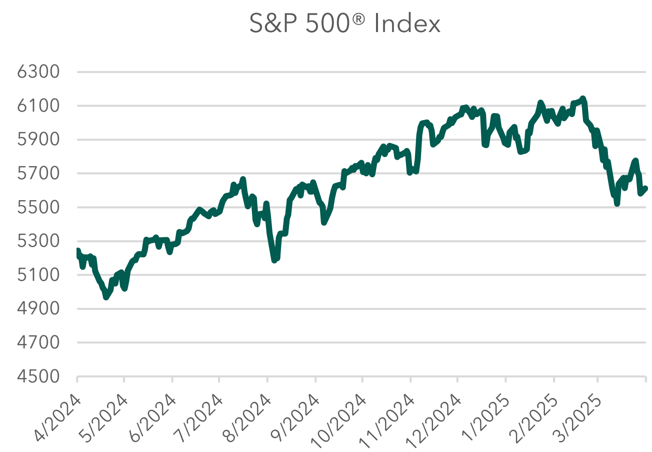
U.S. Equities Market

Uncertainty versus Opportunity

The market's first quarter performance was volatile and varied with the S&P 500® Index finishing down over 4%. Underperformance was mainly due to Technology and Communication Services stocks as the Artificial Intelligence (AI) trade unwound. Defensive sectors such as Health Care, Utilities and Consumer Staples, however, finished higher as investors became more risk-averse and sought safety in dividends. Financials and Energy stocks also moved higher as interest rates and the U.S. dollar fell. Growth underperformed Value as stock selection mattered more than momentum, which was a marked change from the past few years.

The main topic in markets has gone from interest rates to tariffs with the new Trump administration the focal point of news flow – trade wars, deportation, DOGE and dramatic changes in international affairs. The narrative changes daily and markets are reacting accordingly. Though much more has been said than done, consumer confidence has fallen, the housing market is basically frozen, and retail sales are decelerating as inflation expectations are rising. The so-called "soft" data is weak, yet the economic "hard" data is solid – though less so than just a few months ago. Employment remains robust even though the unemployment rate is moving higher. In other words, the current situation is clear as mud. Even the Federal Reserve seems to have little confidence as to what to think, so they are sitting pat until something happens. So, what to do?

Most people dislike uncertainty, but long-term investors view market volatility as an opportunity. We find ourselves at that moment now. Our last commentary mentioned Prince's "Party like it's 1999" mindset, full of exuberance and carefree thought despite storm clouds on the horizon. The markets have been whipsawed by politics and fear. The "Magnificent Seven" have been anything but… yet opportunity exists. As a multi-asset investment firm, we continue to look for opportunities in uncertain markets. Within fixed income markets, in 2024, we advised to "lock in it" with respect to higher, real yields. Within equity markets we have advised discipline and have been moving to resilient balance sheets and more exposure to dividend growth stocks. Timing, and markets, are uncertain – but they are a reminder that our firm's overriding investment philosophy is long-term, truly active and delivering on risk. Therefore, we remain steadfast to our investment philosophy and discipline.



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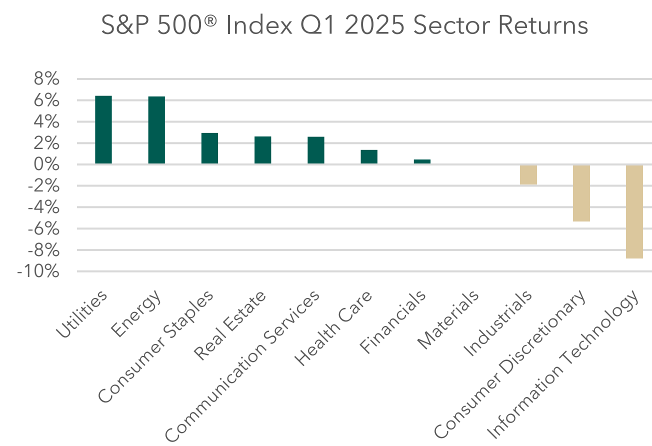

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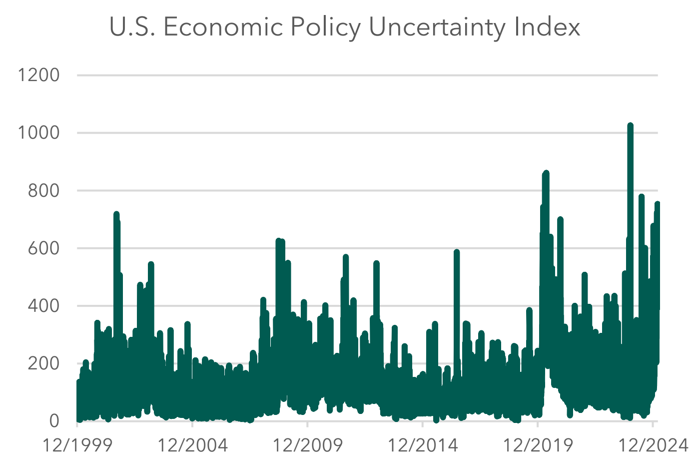

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Market Commentary

March 31, 2025

U.S. Taxable Fixed Income Market

Bonds Being Bonds

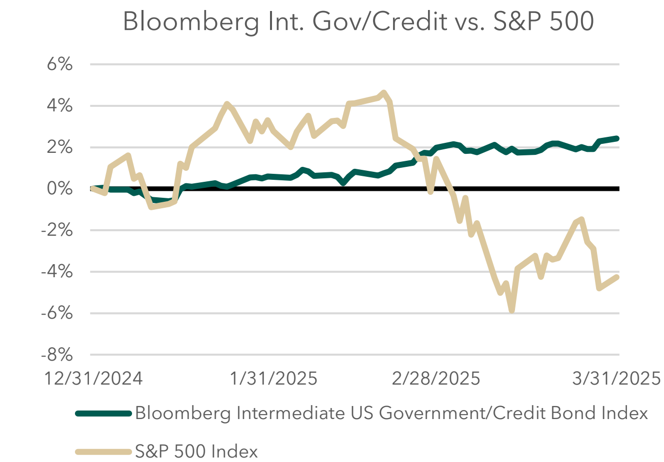
In the first quarter of 2025, bonds acted like bonds. They provided a positive return that helped to offset the more negative return of stocks. They were bought as investors sought security and relief from the uncertainty and unpredictability of future earnings and economic policy. They were purchased even though inflation expectations crept higher, credit spreads widened and at the margin the Fed seemed less willing to cut rates than at the beginning of the year. This buying led to the Bloomberg Intermediate U.S. Government/Credit Bond Index returning 2.4% in the first quarter. Bonds providing a positive return under such conditions is somewhat surprising, but as noted above, bonds provide a ballast to portfolios amid uncertainty , and uncertainty is high. In fact, Baker, Bloom and Davis's U.S. Economic Policy Uncertainty Index is back near COVID levels.

While economic policy uncertainty is elevated, credit markets are still functioning, and credit spreads remain subdued, even expensive, relative to historical levels. As you can see from the second chart, high yield credit spreads tend to rise to a median level of 781 basis points during recessionary periods. Currently, spreads are 347 basis points, not even half of the level that would be indicative of a recession. At the end of January, high yield spreads were the 11th tightest going back 376 months to the middle of 1994. All of this is to say that lenders are not yet reflecting a concern about a widespread outbreak of defaults or a recession. If the moves wider remain orderly, and the labor market remains healthy, these lenders have a good chance of being right.

While it is true that the labor market has cooled somewhat since the middle of 2023, the unemployment rate remains near 4%, the number of jobs relative to unemployed people remains above 1, and construction payrolls continue to climb. According to the Conference Board Consumer Confidence Survey, fewer people found jobs hard to get in March compared to February, a sign of some marginal improvement in labor market conditions and potentially of seasonal factors making their way into the survey. The labor market is crucial to the economy and warrants close monitoring, but the fact that most consumers still have a job is probably why they feel relatively good about their current situation.

As active fixed income investors, we seek opportunities to allocate capital to areas with attractive risk/reward characteristics. Said another way, we look to pick up yield and capture returns for investors through security selection and allocation within our portfolios. In today's market, we see an opportunity for this in BBB-rated bonds. As the third chart indicates, current interest coverage (the number of times earnings covers interest expense) of A-rated paper is much lower than it has been historically, especially relative to its BBB-rated counterparts. In our view, overweighting portfolios to this space provides investors with enhanced yields relative to higher-rated bonds without taking on materially more risk.

In times of increased uncertainty, we believe that careful research, security selection, and active management positions us to add value. Recent rate and macroeconomic volatility appear to have opened the door for us to do just that.



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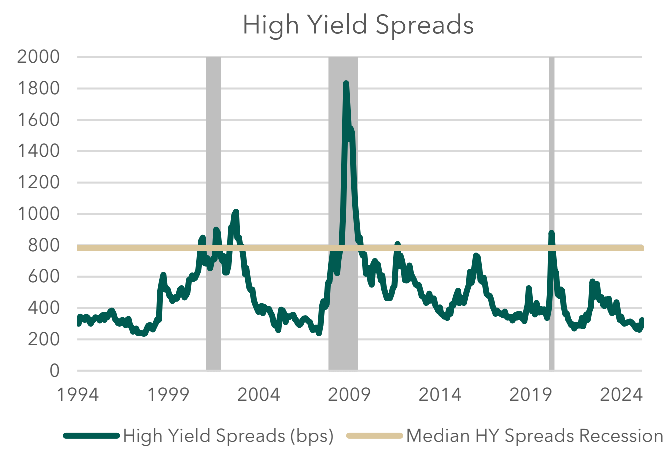

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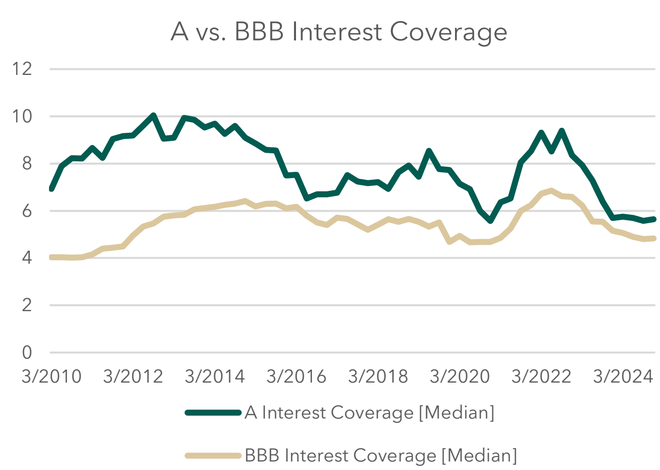

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Market Commentary

March 31, 2025

U.S. Municipal Fixed Income Market

Undoing the Trump Put

As the Trump administration took over the White House in January, changes started coming in fast and furious. Sometimes, changes implemented immediately were then reversed quickly; other times, they were postponed a while longer. All of this seemed to unsettle the markets.

On a year-to-date basis, U.S. Treasury market interest rates are lower. However, municipal bond supply increased substantially in March and municipal interest rates are now higher and the yield curve is significantly steeper. From 15-year maturities and longer, the difference in yields between similar maturity Treasuries are 60-70 basis points. Municipals are now “cheap!”

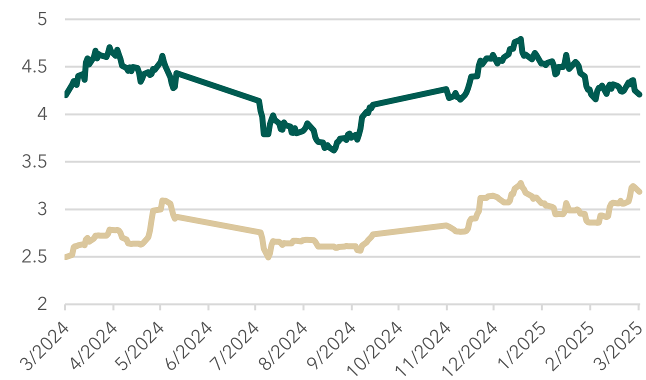
The reason for this dramatic change for municipal bond yields is two-fold: larger new issuance, up 25% versus the first quarter of 2024, at the highest level this century, and uncertainty surrounding this administration’s discussion of eliminating the federal tax-exemption on interest earned from municipal bonds. While the industry does not believe that there will be a whole-sale elimination, many sectors, such as private activity bonds (PABs) which may include affordable housing, higher education, hospitals, highways, bridges, and airports, could be targeted. This is meaningful because several of these issuers are also facing direct cuts to federal funding. For example, there is a discussion of cutting Medicaid reimbursements to hospitals, who are also PAB bond issuers. So, there is a double impact to these entities which could drain the ability for the hospital to continue operations or necessitate an increase in prices. This could certainly hurt the general population and those with more medical needs. The amount of “tax savings” is far less valuable to our communities compared to caring for loved ones in need of hospital services.

We are working diligently to not react to the noisy headlines, complete our credit surveillance and invest in holdings that are liquid, have good structure and may be minimally impacted by these external threats. Credit and tax considerations are paramount in this rapidly changing arena.

We continue to see our modestly longer duration target of 5 years as offering a favorable risk-return profile for the strategy. This enables portfolios to take advantage of the more positively sloped 12- to 18-year portion of the yield curve, while providing the ballast offered by shorter maturity holdings.

The total return performance for the month of March basically eliminated the positive returns from January and February. We find these higher yields particularly attractive now, especially compared to Treasury options. While it may take time for the dust to settle, these yields levels compensate for current inflation rates and are high enough to be enticing from a relatively stable asset class.

10-Year AAA Muni Yield vs
10-Year U.S. Treasury Yield



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10-Year AAA Muni Yield as a % of 10-Year
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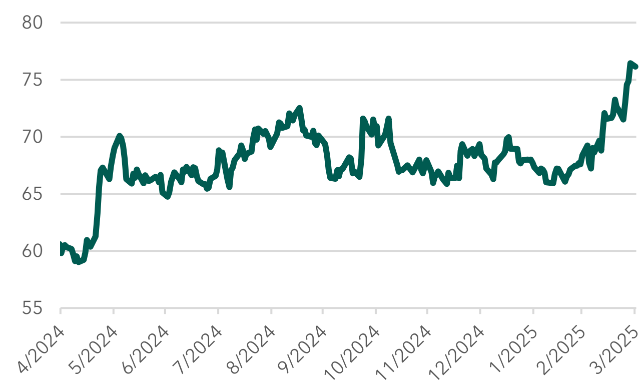

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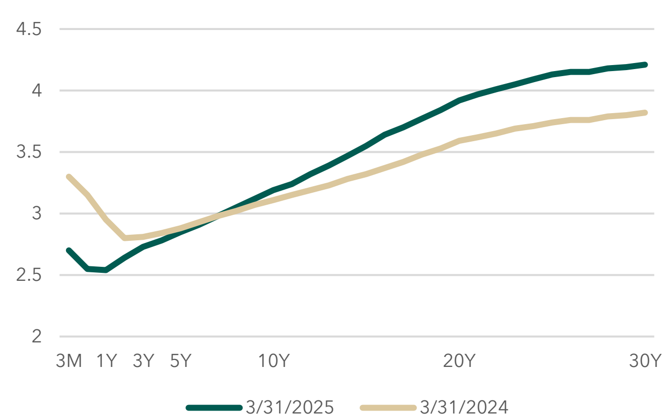
AAA Muni Yield Curve



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Market Commentary

March 31, 2025

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International Equities Market

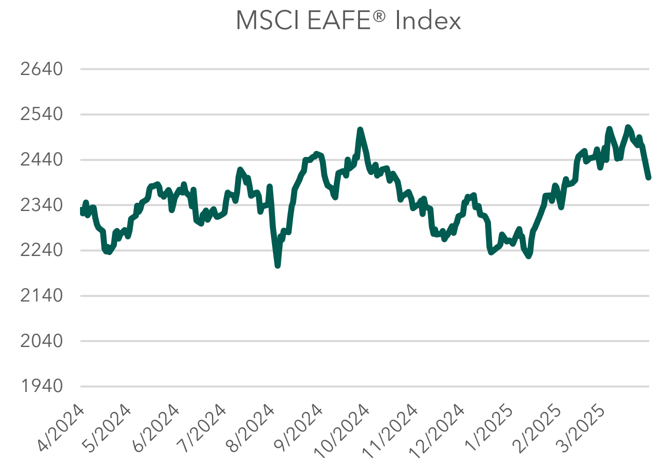
Expect the Unexpected

International equities outperformed domestic equities during the first quarter of 2025. Part of the outperformance was due to a weak dollar, down 2.7%, but when analyzed on a currency-neutral basis, international equities still outperformed. International developed markets were led by the MSCI EAFE® Index up 6.9%. Emerging market performance was also positive, with the MSCI Emerging Markets® Index finishing up 2.9%. In contrast, the Russell 3000® Index, our proxy for domestic equities, ended the quarter down 4.7%.

The outperformance of international equities was surprising, as consensus assumed tariffs would negatively affect foreign companies more, given the U.S.'s negative trade balance. Over time, this view may still prove to be true. Another explanation could be valuation. At the beginning of this quarter, domestic equity valuations were high on both a relative and absolute basis. A healthy U.S. economy helped explain part of this disparity on a relative basis, but the decline on an absolute basis may be recognition of the heightened uncertainty associated with current U.S. trade policy. Lower multiples are typically associated with increased volatility and market uncertainty.

Recent geopolitical developments are also driving changes in some countries' economic policies. One example is Germany. In response to the increased uncertainty of U.S. commitments to European security, Germany passed legislation to increase its defense spending. In order to support this increase, German lawmakers approved a law that will exempt spending on defense and security from the country's strict debt rules. This vote was a historic move for the fiscally conservative country. Although the multiplier effect from defense spending is generally not as great as increases in infrastructure spending, the change in economic policy, nevertheless, is significant. Also, it appears other countries are following suit, which could have positive economic effects to GDP and earnings growth.

Although international developed markets outperformed international emerging markets, China's equity performance was particularly strong for the second quarter in a row, up almost 17%. The main driver was renewed enthusiasm for Chinese technology firms following several announcements regarding their surprising progress in artificial intelligence. More importantly though, it appears the Chinese investment environment is improving. The economy is recovering, and there appears to be a truce between the government and the private sector. It will be interesting to see if this performance continues, given the market's view the U.S. will begin to ratchet up its tariffs on Chinese exports – negatively impacting its GDP and profit growth.



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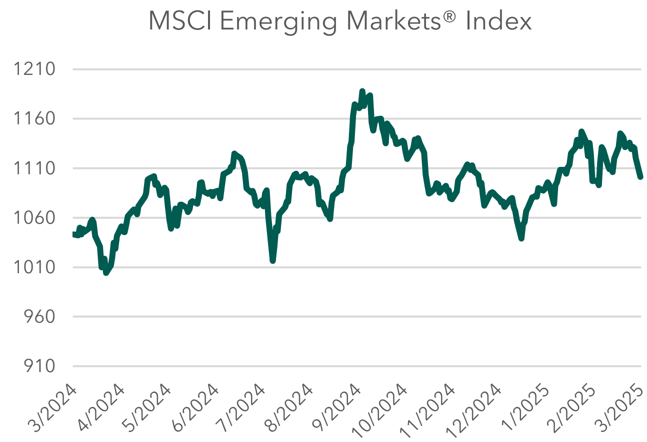

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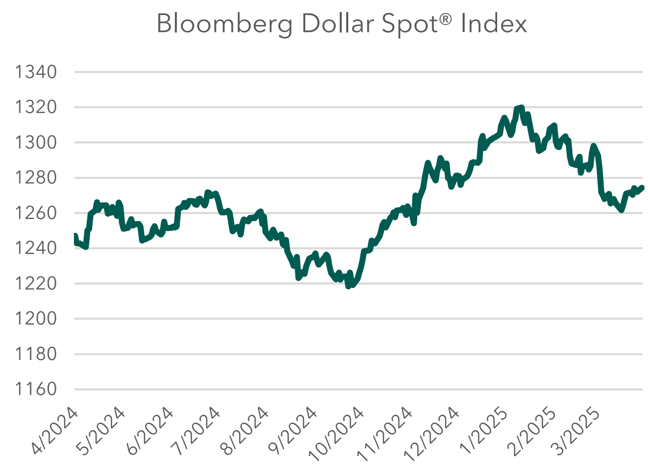

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The information on indices is presented for illustrative purposes only and is not intended to imply the potential performance of any fund or investment. Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees, or other expenses. Indices are not available for direct investment.

The S&P 500® Index is a gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The Economic Policy Uncertainty Index, developed by Baker, Bloom and Davis, aims to quantify and track the level of uncertainty surrounding economic policies, which can influence business and consumer behavior. It is constructed by counting the frequency of articles in major newspapers that contain terms related to economic policy uncertainty.

The Bloomberg Intermediate U.S. Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index with less than 10 years to maturity. The index includes investment grade, U.S. dollar-denominated, fixed-rate treasuries, government-related and corporate securities.

The MSCI EAFE® Index is broadly recognized as the pre-eminent benchmark for U.S. investors to measure international equity performance. It comprises the MSCI country indexes capturing large and mid-cap equities across developed markets in Europe, Australasia and the Far East, excluding the U.S. and Canada. Numerous exchange-traded funds are based on the MSCI EAFE® Index, and the Chicago Mercantile Exchange, NYSE Liffe U.S. and the Bclear platform of Liffe are licensed to list futures contracts on this index as well.

The MSCI Emerging Markets® Index is a free-float weighted equity index that captures large and mid-cap representation across Emerging Market countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar. It has a dynamically updated composition and represents a diverse set of currencies that are important from trade and liquidity perspectives.