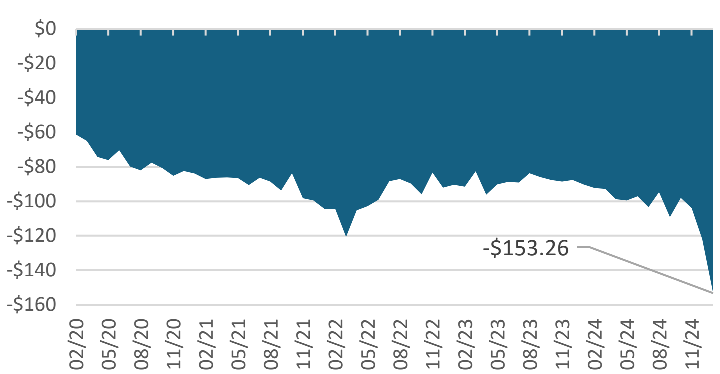
INSIGHTS & OBSERVATIONS

ECONOMIC, PUBLIC POLICY, AND FED DEVELOPMENTS

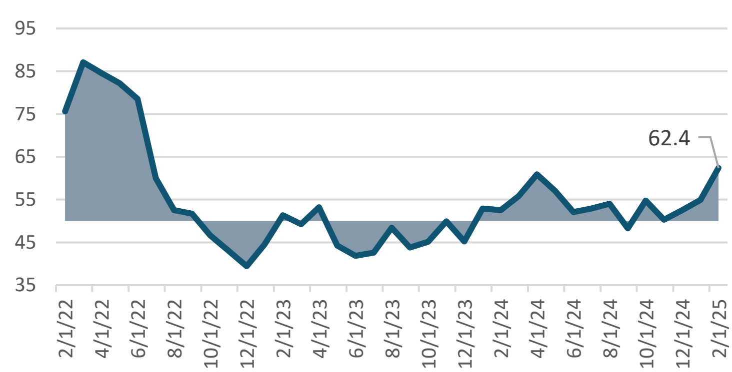
- While at the start of February, it was possible to tune out Washington and focus on fundamentals, by the beginning of March, that was no longer the case. There are a number of developing trends here we see as meaningful to investors.
- The first is that it's increasingly clear DOGE is targeting a massive reduction in federal employment. The scale is still unclear, but between the voluntary severance package and the potential termination of probationary period employees, the upper end of plausible estimates now comfortably exceeds half a million workers. **While it can be debated if a leaner government might better serve Americans, it is undeniable that half a million Americans losing their jobs in short order would be a risk to growth**. A common rubric is that every federal job reduction yields two contractor reductions; the actual impact could be an order of magnitude larger.
- The "Sahm Rule," that layoffs causing a 0.5% increase in unemployment lead to a recession, became a popular topic of discussion in late 2024. With a current US labor force of 170.7 million, 0.5% represents about 850,000 workers; **this is a benchmark to keep in mind as the size and legal basis of federal job reductions comes into focus**. Cuts approaching this level will significantly increase the likelihood of recession.
- Likewise, even after tariffs of 25% on Canada and Mexico and 20% on China went into effect on March 3rd, there is still great uncertainty around how tariff policy will evolve. Tariffs are complex and, depending on multiple factors, can either be inflationary and raise prices, or instead be price neutral and depress demand. During a period of fear of widespread layoffs, we would argue the latter is more likely. **While this would bode well for the Fed's crusade against inflation, it would do so for the wrong reasons: by depressing demand at a time when growth is weakening.** This is an outcome the Fed hopes to avoid.
- Importantly, the degree of uncertainty around tariff policy and federal layoffs *themselves* has become a growth risk. **It may matter less how many federal workers are laid off than how many federal workers change their spending habits for fear they might be, or the degree the threat of further trade barriers weighs on current market activity**. We are already seeing evidence of this in economic releases.
- The S&P US Services PMI unexpectedly dropped into contraction for the first time since January 2023, rattling markets and pulling longer yields down. Meanwhile, while the headline ISM Manufacturing remained slightly in expansion, employment and new orders both contracted, and the prices paid subcomponent surged to levels not seen since 2022. One factor likely explaining prices was that the largest US merchandise trade deficit on record occurred in January, broadly attributed to tariff front-running. **In an uncertain environment, businesses appear to be positioning for tariffs and demand weakness just in case**.
- We expected a hot January CPI and got one, with headline inflation rising +0.5%. PCE was more restrained, if too hot, and as at the start of 2024, our thesis was that seasonal factors would pull inflation up. **Still, this will likely keep the Fed on hold until early summer.**
- Meanwhile, two Congressional developments are worth watching in March: first, the House and Senate both passed legislation to begin the reconciliation process needed to extend the Tax Cuts and Jobs Act. Razor thin majorities and technical differences in policy cost calculations may complicate negotiations, however. Second, the government is now funded under a continuing resolution that expires on March 15th; this has yet to generate much attention, but a shutdown would likely be welcomed by DOGE and is a very real risk. **Moody's is the last credit agency to rate the US "Aaa," though with a negative watch; an extended shutdown may prompt a downgrade**.

US Merchandise Trade Deficit Widens to Record Low on Tariff Front-Running ($ billions)



Source: US Census Bureau

ISM Manufacturing Prices Paid Hit 3-Year High (Index Value)



Source: Institute for Supply Management

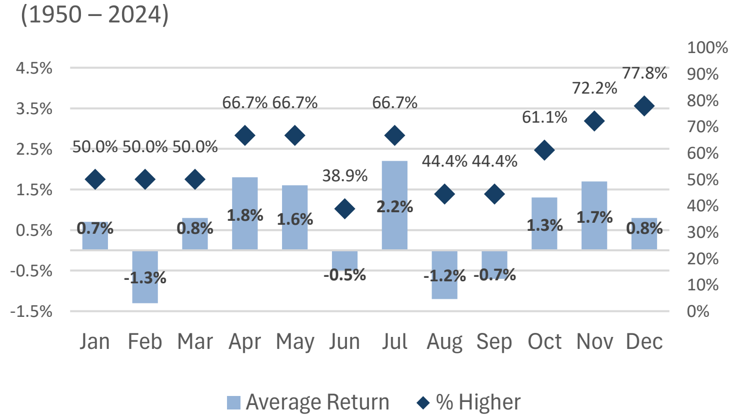
Sources: St. Louis Fed, Institute of Supply Management, Standard & Poor's, Moody's, and Bureau of Labor Statistics

EQUITY NEWS AND NOTES

A LOOK AT THE MARKETS

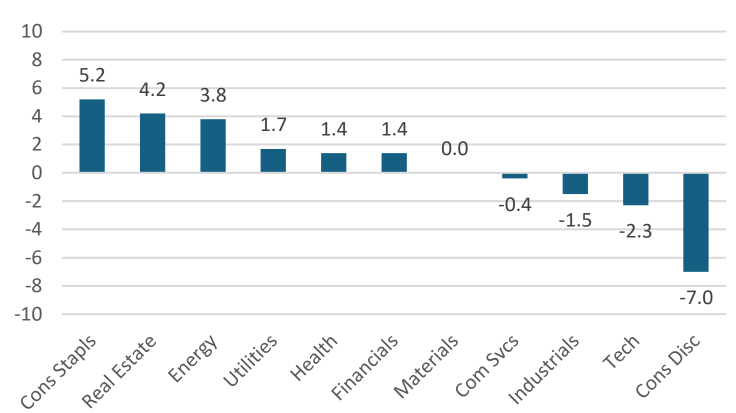
- **Stocks declined in February as several bearish developments caused investors to take a more cautious, risk-off tone.** The S&P 500 finished with -1.4% monthly performance but managed to hang on to a YTD return of +1.2%. The same cannot be said for Nasdaq (-4.0%) and Russell 2000 (-5.5%), both of which underperformed to slip into the red YTD. Sector performance was mixed, with six out of eleven finishing higher, led by defensive Consumer Staples (+5.6%) and Real Estate (+4.1%). The growthier Consumer Discretionary sector trailed (-9.4%) on notable weakness from its two largest components, Tesla (-27.6%) and Amazon (-10.8%).
- February's risk-off sentiment was driven by growing fears of an economic slowdown, as recent data has fallen short of expectations. **Retail sales, housing, and consumer confidence and sentiment readings have all lagged, in part due to elevated policy uncertainty**, particularly surrounding tariffs. Investors had perhaps been too willing to discount the threat of 25% tariffs on Mexico and Canada, and market weakness accelerated in early March as these tariffs were confirmed and global trading partners announced or readied retaliatory levies. Given the fluidity of this situation, questions regarding the extent of retaliation, reciprocity, or tariff escalation remain unanswered, and until greater clarity concerning growth and inflationary implications materializes, policy turbulence will be a headwind for risk assets.
- **Even with elevated volatility (VIX over 20), we would still classify recent market action as more of a rotation than an all-out reversal.** Weakness in certain crowded trades such as momentum, high beta, and the "Mag 7" have masked strength in other pockets of the market. It is notable that the equal-weighted S&P 500 outperformed the more popular market-cap weighted index by 84bps in February and is +2.8% YTD. The "average stock" is doing well with nine of eleven S&P sectors higher through February, with weakness confined to Technology and Consumer Discretionary. By contrast, the "Mag 7" mega cap tech names that led the market higher in 2023 and 2024 have fallen -6.5% through 2/28.
- Market rotation is also evident when looking at style, geography, and asset class distinctions. February was the worst performance month since June 2022 for high beta (SPHB) names relative to low beta (SPLV). Large Growth stocks trail Large Value by 6.5% YTD after outpacing their style counterparts by an unusually wide margin (>20%) in 2024. The MSCI All-Country World Index ex-US finished February with YTD performance of +6% after long lagging US equities. Ultimately, **the direction of the economy will likely determine if this rotation is merely a short-term reversal or a lasting trend.**
- For investors in balanced accounts, a positive aspect of recent volatility has been the sharp decline in bond yields. The bellwether 10-Year UST yield has dropped by over 60bps from its mid-January high, and bonds have now been outperforming stocks since the November election. The market has grown increasingly dovish on what the future path of monetary policy looks like, with 3+ cuts now being priced in by year-end. At this point, **the stock market is more sensitive to economic growth than the level of yields, reinforcing the role bonds have historically played as a buffer against volatility**
- Beyond today's volatility, we see some bullish points worth referencing. Corporate earnings growth was the highest it has been in years last quarter, and **S&P 500 aggregate earnings are currently expected to grow by double digits in 2025.** Corporate credit spreads remain well behaved, and liquidity has been ample as Treasury spends down their general account and the Fed hints at ending more restrictive quantitative tightening. During Trump 1.0's trade war, the stock market was soothed by corporate tax cuts, and we expect to see similar policies (tax cut extension, deregulation) pushed forward as a means of offsetting a tariff induced growth drag. A risk to keep an eye on lies in the extent to which policy uncertainty harms consumer sentiment and constrains business spending.

S&P 500 Monthly Performance in Post-Election Years (1950 – 2024)



Source: Bloomberg

S&P 500 Sector Returns (%): February 2024



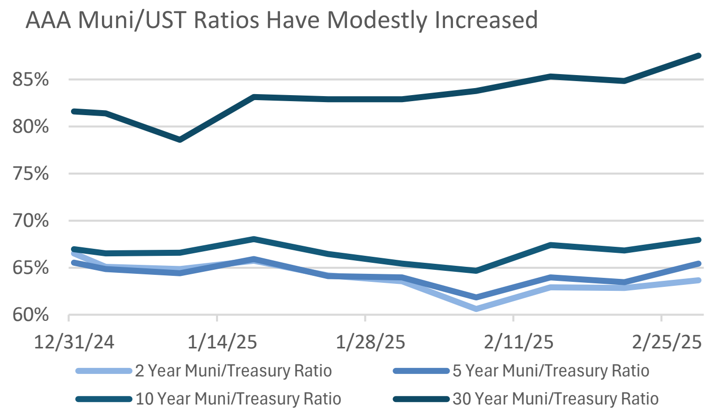
Source: Bloomberg, Factset

Source: Financial Synergies Wealth Advisors: The Blog

FROM THE TRADING DESK

MUNICIPAL MARKETS

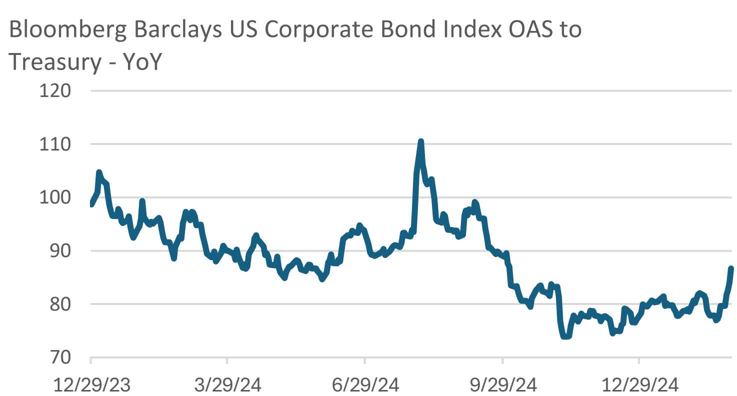
- Over the month, municipal yields were lower across the curve, with the 2-Year AAA closing at 2.54%, 13bps lower than at the beginning of the month. The 10-Year was lower by 11bps at 2.86%. The spread between 2s and 10s widened slightly to 32bps, while the differential between 2s to 30s rose by 9bps to 139bps. **While overall yields were lower, buyers should appreciate the steeper yield curve as it creates the opportunity to pick up value when adding duration.**
- Municipal values improved in February relative to USTs. On the 10-Year part of the AAA curve, municipals reached almost 68% of USTs, the relative value we have not seen in quite some time. The **2-Year, 5-Year, and 30-Year ratios also increased as municipals cheapened relative to USTs**.
- At $33.8B, February issuance exceeded the prior year by a slim 2% margin, according to the Bond Buyer. Through the end of February, YTD issuance was 8.5% above the previous year. Given that 2024 issuance was elevated throughout the year, the strength of YTD new supply is notable. **Strong levels of new tax-exempt bond offerings may be due to issuers bringing deals ahead of the threat of potential tax law changes**. While we do not believe the municipal tax-exemption will be eliminated, there may be impacted market sectors.
- Looking forward to March, reinvestment capital of $30.5B is lower than both January and February, a dynamic that may dampen demand. Additionally, towards the end of March, investors tend to sell municipals to meet April tax bills. Against this selling pressure, the Bond Buyer reports 30-day visible supply of $15B, the highest level since January 14th. **The combination of heightened supply and potentially muted demand could create an imbalance that pressures municipal prices over the near term.**



Source: MMD

CORPORATE AND TREASURY MARKETS

- **A drop in rates throughout the month of February made the new issuance backdrop attractive for issuers as overall funding cost has dropped to a YTD low.** The final week of March saw $51B of new debt hitting the market, which significantly beat market expectations of $30B and brought the MTD volume up to $161B. So far, 2025 issuance is trailing 2024 levels when compared to the same longer-term, but the Month of March is expected to bring roughly $190B. That could prove to be higher and may signal a robust market going forward due to bonds issued in COVID era of 2020 now maturing. There is approximately $135B in maturities coming due in the month of March, leaving only net issuance of $50B if estimates come to fruition. The resurgence of M&A activity funding had certainly contributed to overall volume, which has easily been absorbed by heightened demand.
- The fight to quality trade, in reaction to the large amount of economic and political uncertainty, has contributed to spreads widening to levels not seen since October 2024. Spread movement in the month of February was a roller coaster ride as spreads slid to a YTD low 77bps OAS on the Bloomberg US Corporate IG index to a YTD high 87 bps to close out the month. While this move is the largest since August 2023, the backdrop and technicals remain stable. Demand due to COVID era bonds coming due will keep demand high. **There may be some slack in the market prior to the FOMC decision in the middle of March, but post Fed, demand for bonds should be positive for spreads remaining in the current range.**
- **The front-end trough of the UST curve deepened over the course of February as longer-term bonds dipped lower, driving a Bull Flattening trend throughout the month.** Maturities inside of 1yr remained stable as maturities of 3yrs or more fell by 25 – 30bps. To open the month, the 2-10yr spread was 34 basis points, but the 33bps move lower in the 10yr yield to 4.20% was more than the move in the 2yr.
- The volume of economic indicators in addition to Fed speak in March is likely to keep the market on its toes, and it seems that the continuation of market volatility will be apparent. **We take comfort in the strength of credit fundamentals in the corporates we own and are seeking relative value across the high-grade taxable markets as conditions change.**



Source: Bloomberg

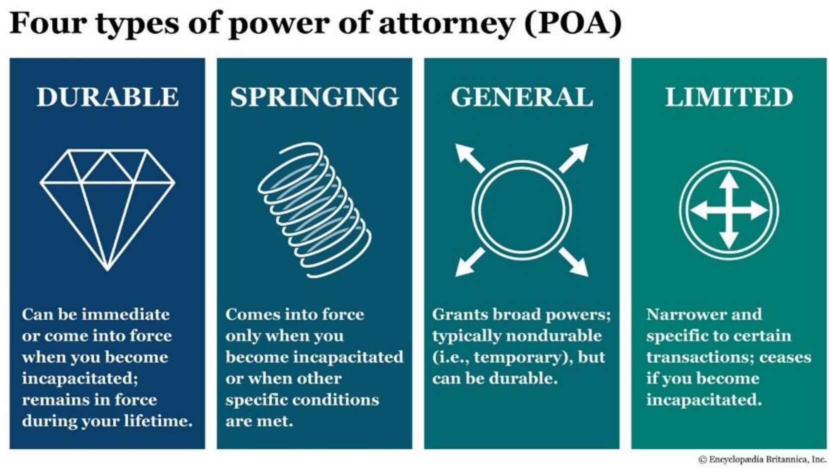
Source: MMD, Bloomberg

FINANCIAL PLANNING PERSPECTIVES

PLANNING CONSIDERATIONS SURROUNDING POWERS OF ATTORNEY

The importance of creating an estate plan is something we emphasize to clients as it can help ensure their estate, legacy, and healthcare needs are managed efficiently and according to their wishes. This package typically includes a trust, will, health care proxy, and power of attorney. The power of attorney document does not always receive the attention and focus it deserves. This legal document allows you to name a trusted individual or agent to make decisions on your behalf, a designation that can be extremely valuable and necessary for many individuals as life circumstances materialize.

There are various types of power of attorney, each of which is designed to accomplish differing objectives. **The main purpose of a power of attorney is to allow a trusted individual to act on your behalf should this be needed in the event of an emergency or other life event.** Since that emergency or event is impossible to predict, it would be most prudent to grant the trusted individual as broad authority as possible (Leimberg et al., 2021). With broad authority comes great responsibility. Below is a list of important planning considerations:



Source: Encyclopedia Britannica

1. **A power of attorney is not just for senior citizens.** Once a child reaches the age of majority, a parent can no longer sign documents or complete transactions on their behalf. This is a consideration of note, especially if a child is going out of state for college or other reasons.
2. **Once an agent is named, you should not only notify them but also create a roadmap for that individual.** That roadmap should include details concerning where accounts are held and how bills should be paid (Shenkman, CPA, MBA, JD, AEP, 2025).
3. **Be sure to understand the powers granted to your agent** and confirm that they match your objectives. Powers such as the ability to gift property or modify a revocable trust should be reviewed with an attorney or your wealth manager to make sure they are appropriate for your situation.
4. The same cadence that we advise for reviewing account titles and beneficiaries should be applied to reviewing agents named in a power of attorney document. **Are the individuals named still appropriate for your situation?**
5. **Be sure to keep power of attorney documents up to date.** A 20-year-old document may not be accepted by your bank or custodian. Updated documents should also be shared with your Wealth Manager.

Your wealth management team is here to help with these and other financial planning needs. We are happy to work with you and coordinate with other trusted advisors to ensure your needs are met. Please reach out if you are interested in discussing this subject in greater detail.

Sources:
"The Tools & Techniques of Estate Planning," Leimberg, S. R., Hood, P., & Morrow, E. P., National Underwriter Company (2021),
"Be A Catalyst For Estate Planning Action: Practical Steps Many Clients At Any Wealth Level Might Benefit From" [Webinar], Shenkman, CPA, MBA, JD, AEP, M. M. (2025, Feb. 4)

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