



## 1st Quarter Review

From the start of 2024 through the end of the 1st quarter of 2025, the S&P 500 Index has established 60 new all-time highs. Perhaps it is time for a long-awaited rest. We started the quarter off well with equity indices rising. However, that all changed with the talk of tariffs being imposed by the United States on its international trading partners. It appears that the S&P 500, Dow Jones Industrial Average, and NASDAQ 100 (as well as lesser-followed indices) all peaked on February 19, 2025. The losses continued through the end of the quarter, giving negative total returns for domestic equity indices (the losses have also continued past the end of the 1st quarter as the 2025 market selloff has intensified).

For the 1st quarter 2025, the S&P 500 Index was down 4.27% and the tech-heavy NASDAQ 100 fell 8.07%. Small capitalization companies were the biggest losers with the Russell 2000 Index off 9.48% for the quarter. Large company "growth" stocks slid nearly 10%, but large company "value" stocks rose by over 2%. The big winner for the quarter was international stocks, and in particular European stocks. The MSCI EAFE Index (an index of developed international stocks) was up 6.86% while the FTSE Developed Europe Index jumped 10.28%. The Asia Pacific region was only modestly up for the quarter, with Japan down over 5%.

Other winners for the quarter were bonds and commodities. The Bloomberg Barclays U.S. Aggregate Bond Index (an index of high-quality bonds) was up 2.78% while lower quality bonds advanced by just 1.0%. The 10-year U.S. Treasury Note yield fell, ending the quarter at 4.246% after falling from a year-end 2024 level of 4.573%. Additionally, the Bloomberg Commodities Index rose by 8.88%.

When will the 2025 market selloff end? Are there underlying concerns with the economy that we need to worry about? Will the Federal Reserve bail us out? Will President Trump's tariffs derail the markets longer-term? We look at these issues and others below.

### Indices Performance

Category	Representative Index	March 2025	1st Qtr 2025	12 Months	3 yr*	5 Yr*	10 Yr*
Mature US Large Companies	DJ Industrial Average	-4.06	-0.87	7.40	8.75	16.20	11.43
Broad US Large Companies	S&P 500 Index	-5.63	-4.27	8.25	9.06	18.59	12.50
US Small Cap Companies	Russell 2000 Index	-6.81	-9.48	-4.01	0.52	13.27	6.30
US Mid Cap Companies	Russell Mid Cap Index	-4.63	-3.40	2.59	4.62	16.28	8.82
Largest 100 NASDAQ Companies	NASDAQ 100 Index	-7.61	-8.07	6.44	10.04	20.76	17.24
Large "Value" Stocks	Russell 1000 Value Index	-2.78	2.14	7.18	6.64	16.15	8.79
Large "Growth" Stocks	Russell 1000 Growth Index	-8.42	-9.97	7.76	10.10	20.09	15.12
Large Cap Stocks	Russell 1000 Index	-5.79	-4.49	7.82	8.65	18.47	12.18
Developed International	MSCI EAFE Index	-0.40	6.86	4.88	6.05	11.77	5.40
Emerging Markets	FTSE All Emerging Markets	0.99	2.17	12.13	2.88	9.36	4.33
Broad US Bonds	Bloomberg Barclays US Aggregate Bond	0.04	2.78	4.88	0.52	-0.40	1.46
High Yield Bonds	Bloomberg Barclays US Corporate High Yld	-1.02	1.00	7.69	4.98	7.29	5.01
Commodities	Bloomberg Commodity	3.93	8.88	12.28	-0.77	14.51	2.77
Total US Market (all cap stocks)	Russell 3000 Index	-5.83	-4.72	7.22	8.22	18.18	11.80
Real Estate Investment Trusts	Wilshire US REIT Index	-3.55	1.01	10.23	-0.84	11.15	5.33
Cash	US T-Bill 90 Day	0.34	1.04	4.71	4.34	2.62	1.86
Dev. International Europe	FTSE Developed Europe	-0.29	10.28	7.20	7.32	13.21	5.73
Dev. International Asia Pacific	FTSE Developed Asia Pacific	-0.31	0.91	-2.47	2.05	8.68	4.63
Japan	Nikkei 225 Index (Yen)	-2.76	-5.49	-9.33	2.93	7.96	5.68

\* 3 year, 5 year and 10 year returns are annualized.

All periods ending March 31, 2025.

All returns include the reinvestment of dividends.

Source: Morningstar Direct.

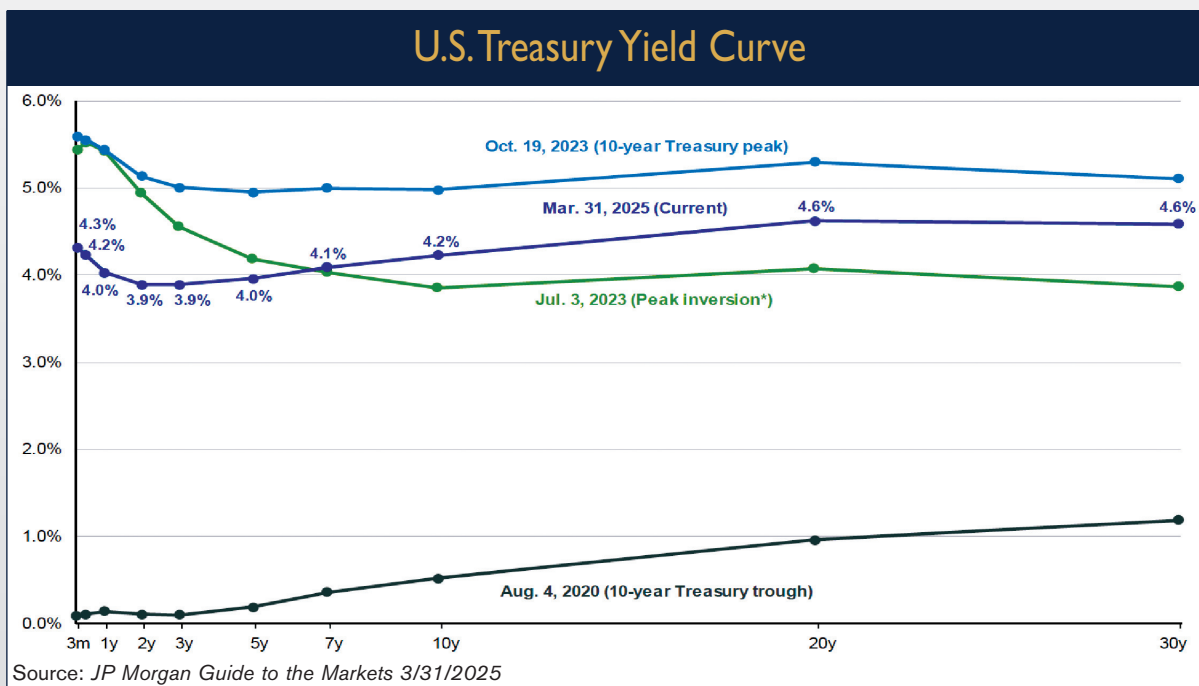
## The Federal Reserve and Interest Rates

At the March 2025 meeting of the Federal Open Market Committee (FOMC), interest rates were left unchanged in a range of 4.25% to 4.50%. This policy pronouncement was not a surprise, although we may have gotten more clarity on the number of rate cuts to be expected this year.

At the meeting, the FOMC released its Summary of Economic Projections (which it does four times per year) in which it tells us its forecast for interest rates, economic growth, unemployment, and inflation. In its report, it projected that we will see two interest rate cuts in 2025. It reduced its expectation for economic growth with the growth in Gross Domestic Product (GDP) to be between 1.6% to 1.9% from a prior range of 2.0% to 2.3%. As a result of the lowered growth forecast, it is now expected that the unemployment rate will move higher this year than previously estimated, to be between 4.4% to 4.5% from the current level of 4.2%. As for inflation, the FOMC projects that the Personal Consumption Expenditure (PCE) will be higher than previously forecast at between 2.7% and 2.8% for this year, from the previous 2.5% to 2.6%.

As a result of the Fed's actions on interest rates, we expect short-term borrowing costs to fall; the prime rate should fall, and yields on U.S. Treasury bills and short-term certificates of deposit should drop. As for longer-term interest rates, these rates tend to be more market-driven than Fed-driven. However, the Fed can affect the longer-term interest rates through its various quantitative easing and quantitative tightening programs. It is currently undergoing a quantitative tightening program whereby it is redeeming up to \$25 billion of U.S. Treasuries per month. At the last FOMC meeting, it said it would begin to reduce that to just \$5 billion of redemptions per month. The redeeming of Treasuries can cause longer-term interest rates to rise. By reducing the level of redemptions per month, it may have the effect of lessening the upward pressure on longer-term interest rates. We have believed that the U.S. Treasury Note yield, currently at 4.246% on March 31, 2025, should not exceed 5% in 2025 and likely will not rise much above its current level for the remainder of the year. We see that the yield will possibly drop as low as 3.5% at some point this year.

The equity markets generally welcome lower short and long-term interest rates, and such lower rates could be a potential tailwind for stocks after the tariff dust settles.

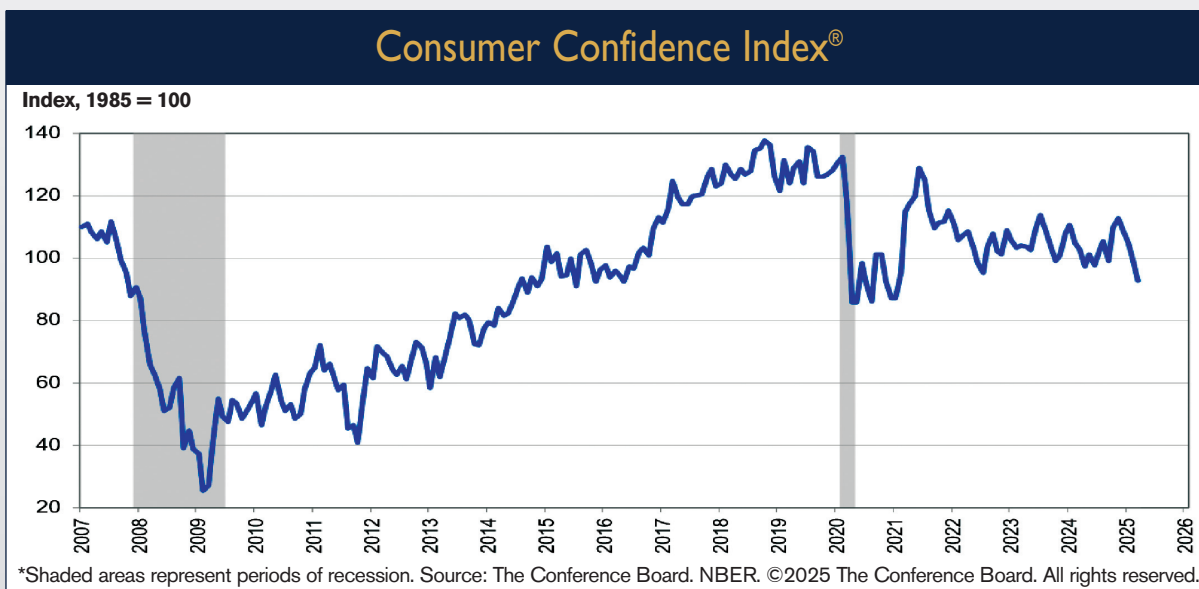
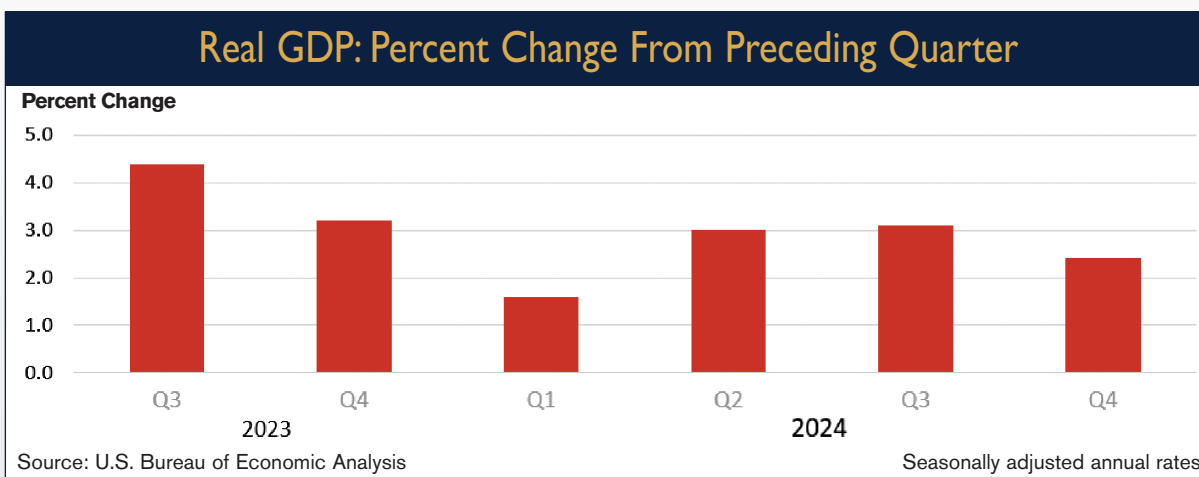


## The U.S. Economy: Will We Fall into a Recession?

In the 4th quarter of 2024, real Gross Domestic Product grew at an annual rate of 2.4%. In the 3rd quarter, GDP grew at an annual rate of 3.1%. The GDP growth in the 4th quarter was largely a result of an increase in consumer and government spending. In early March, the Atlanta Fed announced the results of its “GDP Now” model, which is predicting that GDP will decline by an annual rate of 2.4% in the 1st quarter of 2025. Two quarters of negative GDP growth are often used by economists to declare a recession. Should the forecast for the 1st quarter GDP growth materialize, it will certainly cause concern for investors who will then fear that the economy is slipping into a recession.

Many current statistics indicate we may be nearing a recession. The Conference Board's Consumer Confidence Index declined in March to a 12-year low, reflecting a negative outlook for the economy by consumers. If consumer confidence is lessening, will consumers tighten their belts and stop spending?

The Conference Board's Leading Economic Index (LEI) dropped by 0.3% in February. The Index has fallen by 1.0% for the six months ending in February. It fell by 2.1% in the previous six months from February 2024 to August 2024. Five out of 10 of the LEI components fell in February. The Institute for Supply Management's (ISM) Manufacturing Purchasing Managers Index (PMI) showed a reading of 50.3 in February. It fell to 49.0 in March. A reading below 50.0 is considered recessionary.



## ISM Manufacturing and Services PMIs



On the positive side of the ledger, there are some non-recessionary statistics. The ISM's Services PMI for February was an impressive 53.5, showing the eighth consecutive month of expansion. In March, the ISM Services PMI fell to 50.8 but still stayed above the recessionary level of 50.0. In addition, employment is still growing. Despite all the high-profile job losses in the Federal Government, the job market is still expanding. The Bureau of Labor Statistics showed that the economy grew by 228,000 in March 2025.

As for inflation, some prices are coming down. But overall, inflation is still increasing, but at a slower rate than it had been. The current inflation situation can be seen as a net positive for the economy.

When we look at the economic data and present situation of the economy, we believe there is a 50% probability that the U.S. economy slips into a recession. This is a much higher probability than we have had over the past few years. But overall, the risk of recession has increased.

## Making Sense of the Tariffs

Malvern Capital Management advocates for free trade, but we also believe in fair trade. Trade has made the world more prosperous and brought wealth to many nations that would otherwise be poor. Some countries are better at producing certain goods than others, whether it is because of an abundance of certain natural resources, cheaper labor, better education, their geographical location, or some other factors. The United States has a relatively open economy. Before Trump's "liberation day", April 2, 2025, the United States had some of the lowest average tariffs amongst all nations around the globe. The United States puts up fewer barriers to its trade partners than most other countries.

However, many observers believe that the United States has been mistreated by other countries when it comes to trade. Before Trump's second term, the U.S. imposed few tariffs, which included the tariffs he put in place during his first term in office. President Trump seeks reciprocity on the trade front. That is, his administration says he does not want to impose tariffs that go over and above tariffs the respective trade partner already imposes (although that is not the interpretation of the liberation day announcement). His goal is to bring about free trade and close the annual trade deficits with other countries.

In contrast to what Trump believes, many economists believe that tariffs cause the price of goods to increase and that consumers will end up paying the increased price of goods. As a result of the tariffs, economists believe that tariffs are inflationary. Tariffs may be a contributor to inflation, but it is our opinion that any increase due to tariffs will be transitory. The Federal Reserve also agreed that any inflation from tariffs will be transitory at its March 2025 meeting, but Fed Chairman Jerome Powell has since changed that stance, saying the tariffs' inflation will be more "persistent."

We believe inflation comes from “too much money chasing too few goods.” Money is created by both excessive government spending and the Federal Reserve’s increase of the money supply. Tariffs do not increase the money supply. Thus, any price increases from tariffs should be temporary. It is our opinion that if there is not more money in the system, the laws of supply and demand will ultimately prevail and affect the quantity of goods sold and at what price they are sold. Prices will gravitate to that level the market will bear.

Ultimately, we want to see prices fall, not just increase at a slower rate. Trump’s attempt to shrink the size of government so that government spending declines, along with the tighter monetary policy of the Fed, may help bring prices down. At least that is what many economists believe.

## Corporate Earnings

A year ago (3/31/2024), S&P Global projected full-year 2025 earnings on the S&P 500 Index at \$273.79. One year later (3/31/2025), it projects full-year 2025 earnings on the S&P 500 Index of \$266.39. S&P Global has reduced its earnings estimate by 2.7% since last year. Earnings for the full year 2024 have also been revised downward throughout 2024. In December 2023, S&P Global projected full-year 2024 earnings of \$242.44 per share. S&P Global now (3/31/25) projects full-year 2024 earnings of \$233.36 per share. This adjustment represents a reduction of 3.8% over last year. Earnings estimates are going in the wrong direction.

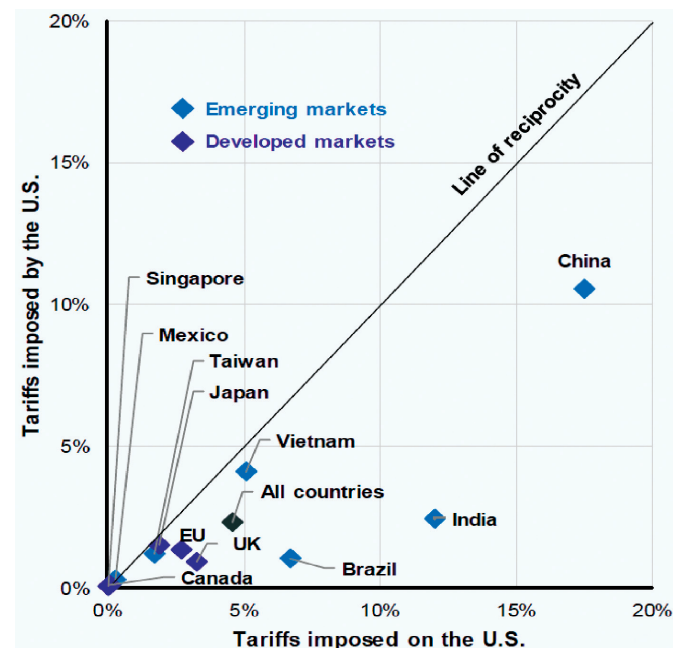
Revenue numbers for the S&P 500 Index companies have been steadily growing each quarter. In March 2024,

sales were \$471.95 per share, and in December 2024, sales were \$508.59 per share. However, the anticipation by analysts is that sales will begin to slow or decline in the upcoming quarters.

An encouraging sign is that operating margins are strong, representing companies’ efficiency at turning sales into profits. The operating margin on the S&P 500 Index estimated for December 2024 is 12.04%. The average operating margin since the 1st quarter of 1993 is 8.49%. Part of the reason for the operating efficiency may be explained by the falling tax rates on corporate earnings. In the 2017 Tax Cuts and Jobs Act, which became law, President Trump reduced corporate income tax rates from 35% to 21%, significantly reducing the tax burden on corporations. The tax savings go right to the bottom line of a corporation. Trump now wants to further reduce corporate tax rates from 21% to 15%. Corporate earnings are a key driver of stock prices.

## Tariffs Between the U.S. and Its Trade Partners

2023, average weighted tariff rate on goods imports



Source: JP Morgan Guide to the Markets 3/31/2025

## S&P 500 Tax Rate

	QUATERLY	12-MONTH
<b>Avg fr 1993</b>	<b>29.41%</b>	<b>30.29%</b>
<b>Jun-24</b>	20.51%	18.22%
<b>Mar-24</b>	20.15%	17.72%
<b>Dec-23</b>	13.97%	17.74%
<b>Sep-23</b>	17.70%	19.35%
<b>Jun-23</b>	18.81%	19.82%
<b>Mar-23</b>	20.20%	20.15%
<b>Dec-22</b>	20.90%	19.66%
<b>Sep-22</b>	19.50%	18.46%
<b>Jun-22</b>	20.05%	17.83%
<b>Mar-22</b>	18.35%	17.54%
<b>Dec-21</b>	16.33%	17.56%
<b>Sep-21</b>	16.97%	17.62%
<b>Jun-21</b>	18.65%	17.80%

Source: S&P Global, 3/31/2025.

## Major Indices Reach Correction Territory

A stock market correction is defined as a decline in the indices of at least 10% but less than 20%. A decline of over 20% is defined as a “bear market.” In our last quarterly commentary in January of 2025, we predicted that we would see a market correction likely in the early part of 2025. All three major U.S. indices (the S&P 500, NASDAQ, and Dow Jones Industrial Average) peaked on February 19, 2025. As of the end of the 1st quarter 2025, the S&P 500 Index was down 8.7%, the NASDAQ was down 13%, and the Dow Jones Industrial Average was down just 5.9%. At the end of the quarter, only the NASDAQ was officially in correction territory. Since the end of the quarter, the indices have all reached correction territory and are flirting with bear market readings (as of press time).

Higher than historical average valuations (as measured by the P/E ratio and other statistics) led us to believe that an adjustment to prices needed to occur. The catalyst for this correction has been the uncertainty regarding tariffs, but a correction was in order. We believe that had it not been the tariffs, there would have been some other reason or catalyst for a correction.

We expect that the correction will run its course and we will see a rebound in the indices later this year. As we will discuss, valuations are becoming much more reasonable. We are very pleased with our clients’ portfolio resilience during this troubling and difficult time in the markets. Proper diversification amongst various asset classes allows portfolios to weather the storm quite well.

## Market Valuation

For the quarter ending December 31, 2024, the “trailing” Price-to-Earnings (P/E) ratio on the S&P 500 Index was 25.21 times. The “forward” P/E ratio was 21.68 times. At the end of the quarter, we wrote that “the market seems a little stretched”. With the current market correction, the value of the S&P 500 Index has fallen. Based on estimated earnings per share of \$238.10 for the 1st quarter of 2025 and a closing price of 5611.85, the trailing P/E ratio has fallen to 23.57 times. The forward P/E ratio is now 20.25 times. To put these readings into perspective, the 30-year historical trailing P/E ratio (the average of the last 30 quarter-ending P/E ratios) is 20.07 times. The 30-year average forward P/E ratio is 16.91 (as calculated by JP Morgan). Even though the market value has fallen, both P/E ratio readings suggest a market that is still a little over-valued.

A variation of the P/E ratio is the Cyclically Adjusted Price Earnings (CAPE) ratio, which considers the effects of inflation in its calculation. The current CAPE ratio is 34.39 times with a 30-year average of 28.16 times (on 3/31/2025). The current CAPE ratio also suggests the market is expensive. Other measures also point to an expensive market. The Price-to-Book (P/B) ratio is currently 4.21 times with a 30-year average of 3.21 times. Also, the dividend yield for the next 12 months on the S&P 500 Index is 1.70% with a 30-year average of 2.06%.

The Fed model looks at the effect of interest rates on the value of the market. When the Fed Model shows that the earnings yield on stocks is less than the 10-year U.S. Treasury Note yield, stocks are overvalued. Likewise, if the earnings yield on stocks is higher than the 10-year U.S. Treasury Note yield, stocks are undervalued. Currently, the earnings yield on the S&P 500 Index is 4.24% and the yield on the 10-year U.S. Treasury note is 4.246%, virtually the same. Thus, this would suggest a market that is fairly valued.

On balance, the valuation measures are mostly pointing toward a market that is still expensive.

## Looking Beyond the United States

While the United States markets declined in the 1st quarter and most notably since February 19th, international stocks, particularly Europe, advanced. Although the MSCI EAFE Index is up 6.86% year to date, the FTSE Developed Europe Index has jumped by 10.28% (as of 3/31/2025).

The international economies are growing, corporate earnings are expanding, governments are spending money, and Trump’s tariffs have all been contributing to rising foreign stock prices. European economies are outperforming the economies of the United States. This is largely due to stimulus programs in Europe. Europe is easing some regulations in response to tariffs. Germany may spend billions of Euros on defense and

infrastructure because of the U.S. pulling back on aid to Ukraine. Certain stocks in the aerospace and defense sectors have risen over 40% this year (Charles Schwab, "Making International Great Again," March 10, 2025).

Low interest rates tend to favor growth stocks, which outperformed value stocks and international stocks over the past few years. But the higher inflation and interest rates should benefit value stocks as well as international stocks. International value stocks outperformed international growth stocks in 2023 and 2024 as inflation and interest rates rose. International countries have more value exposure than growth exposure. In addition, the U.S. dollar has also been falling versus most of the 31 major currencies in the world, which also benefits international stocks. Given uncertain tariff policies and a move away from globalization by the U.S., the U.S. dollar should continue to weaken.

Valuations are currently more compelling internationally. According to JP Morgan, the forward P/E ratio of the ACWI Index ex-US (the All-Cap World Index ex U.S. stocks) is 13.4 times. The Eurozone forward P/E ratio is 13.7 times, Japan is 13.4 times, and emerging markets are 12.1 times. Above, we showed a forward P/E ratio of 21.68 times in the U.S. as of 3/31/2025.

Since the end of the quarter, international stocks have succumbed to the global market selloff. However, they are holding up much better than U.S. stocks. For the 30 days ending April 4, 2025, the MSCI EAFE Index (the broad international index) was down 6.0% while the S&P 500 Index was down 12.06%. The FTSE Developed Europe Index was down 5.75% over the same period.

## Summary

The equity markets started the year on a positive note but gave way when talks of tariffs began to heat up. The current market selloff began on February 19th. The 1st quarter was not good for the domestic equity markets, but bonds and European stocks were positive.

The Federal Reserve left the Federal Funds rate unchanged at the March 2025 FOMC meeting. It left the door open for two interest rate cuts during calendar year 2025. However, after the end of the quarter, the Fed Funds futures market predicts up to five rate cuts in 2025.

There is mixed data regarding the health of the economy. Some things point to a recession while others point to continued growth. We estimate that there is a 50% chance of a recession in the next 12 months. The recession odds are increasing due to tariff talk. Tariffs are intended to be reciprocal and not go beyond that which each respective country already has in place. We do not see the tariffs as inflationary in the long run, but they may cause prices to rise temporarily in the short run.

Earnings estimates for the full year of 2025 are \$266.39 per share. This estimate has gradually been reduced over the past year and may even be reduced further. Valuations still suggest that there may be more downside to come. We predicted a market correction in our last market commentary in January 2025. Our clients were able to hold up quite well so far during the turbulence with broad portfolio diversification.

High relative inflation and interest rates, along with a falling dollar, should benefit international stocks. Valuations internationally are compelling compared to the United States. Most investors are under-weighted in international stocks, which should help propel international stocks higher as U.S. investors reallocate toward international stocks.

As such, we are here to listen, counsel, and provide direction to all our clients.

**James L. Olsen, CFA, CFP®**  
President & Chief Investment Officer

**Michael P. Czajka**  
Chief Executive Officer

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