



Quarterly Recap – March 31st, 2025

The first quarter essentially erased the U.S. stock market gains and bond market losses we saw post-election. This reversal was particularly pronounced in the so-called “Magnificent 7” giant tech stocks. In addition, we saw a modest slowing down of the economy while also seeing resistance to further progress on inflation. This has started to put the Federal Reserve in a tighter spot where they will have to choose between their dual mandate of price stability and full employment. For the last several years getting inflation down was also beneficial for the jobs market. That no longer seems to be the case.

For most of our careers we have noted that political noise is generally overwhelmed by the economic signal. On April 2nd Donald Trump announced a reversal of at least 45 years of trade policy, even invoking the 1800’s as the economy he was trying to replicate. It will take time to understand the far-reaching implications of this policy shift. Massive tariffs were announced in early April which sent markets reeling. However, a last minute decree paused the most egregious tariffs for ninety days to negotiate. 10% tariffs will stay in place on most trading partners, as well as a 125% tariff on China, who has refused to engage in negotiations. Whether this was always the plan or not, markets celebrated the announcement and clarity.

The administration has noted that their economic policy has four main thrusts. 1. Tariffs 2. Spending cuts 3. Less regulation 4. Tax cuts. So far, we have only seen an opening salvo on 1 & 2, and essentially nothing on 3 & 4. Many of these policy choices have costs and benefits, some of which will likely offset each other. For instance, government spending cuts (even ones you agree with) can cause a short-term slowing of economic activity. That can be offset by tax cuts, but of course, then you don’t get a reduction in the deficit. In another offset, 1 & 4 are inflationary, while 2 and 3 tend to be deflationary. Markets would love to see a comprehensive strategy so that investors can properly weigh the costs versus the benefits. Until that time, the uncertainty could lead to lower economic growth as consumers, business owners, and CEOs await further information before making decisions.

So, what do we know and what can we do? We know that stocks are trading at elevated valuations compared to historical norms. We know that yields on income investments, after an incredibly low 2008-2022 period, have returned to something more normal. These datapoints lead us to overweight income investments throughout our balanced models (2-7). We also believe this is a time to make sure investors are not taking undue risk, don’t have too much leverage, and have access to the liquidity they will need.

Of course the situation is changing quickly and we know that some part of this newsletter will be stale by the time it hits your inboxes. Over the next weeks & months we plan to be in more regular contact with updates about the economy and markets.

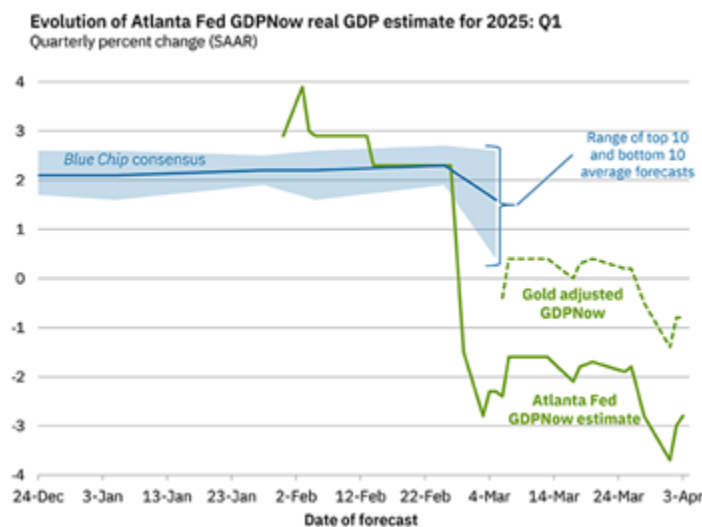
INDEX RETURNSⁱ	1st Qtr	2024	2023
MSCI All Country World	-0.9%	19.2%	24.4%
S&P 500	-4.8%	25.0%	26.3%
Dow Jones Industrial	-1.9%	15.0%	16.2%
Russell 2000	-9.0%	11.5%	16.9%
EAFE	9.3%	4.4%	19.0%
MSCI Emerging Markets	4.8%	8.0%	10.2%
BC Aggregate Bond Index	2.5%	1.3%	5.5%

TREASURY RATESⁱⁱ	3/31/25
Fed Funds	4.38%
3 Month	4.20%
2 Year	3.89%
5 Year	3.95%
10 Year	4.21%
20 Year	4.61%
30 Year	4.58%

Economic Developments

Last year ended on an optimistic note. The domestic economy had been growing for several years and unemployment was low. Inflation was higher than desired, but not meaningfully so. Markets waited anxiously for Inauguration Day and the start of a second term under President Trump. He'd campaigned on multiple business-friendly issues and the stock market and the economy had generally done well under his first term. (Of course excluding the disaster that was 2020.)

The first few weeks of the new administration had a torrid pace, as executive orders reshaped the federal government. President Trump had four years of relentless conflict in his first term, then the next four years to assess his perceived failures. To say the least, he came in prepared to enact his agenda. Trump has always had a distinct brash style, both in politics and his private life. But this has been kicked into overdrive as he seems to have adopted Silicon Valley's mantra of "Move Fast and Break Things," a sentiment perhaps borrowed from his ally Elon Musk. The two primary ways we have seen this implemented are with the Department of Government Efficiency (DOGE) and tariff policy. DOGE has yet to yield much in terms of the promised results, but we are reserving judgment for now. We believe trade tariffs, on the other hand, represent a big and immediate change to the status quo and threaten to tip the global economy into recession.



The GDPNow model is reacting to a variety of data points which point to concerns about the economy and tariffs. The "gold adjustment" accounts for the recent influx of gold imports which isn't really related to economic strength.ⁱⁱⁱ

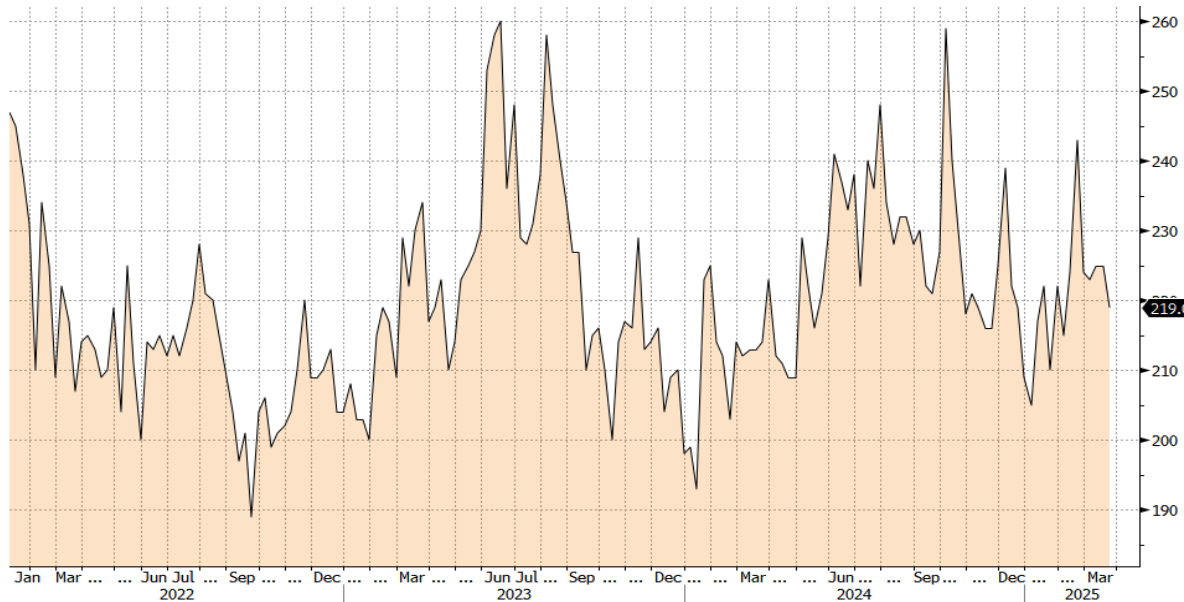
produced domestically. GDPNow wasn't built to model this sort of one-off activity, so we aren't treating its current estimate with a great deal of seriousness. We're rather highlighting the incredible amount of trade that is taking place in advance of the tariffs.^{iv}

Is Trump serious about the tariffs? On April 2nd we got the answer as so-called "Liberation Day" stuck a shocking number of "retaliatory" tariffs on international trading partners, both allies and adversaries. The calculations make us scratch our heads, as the President appears to be conflating trade deficits with oppositional tariffs, which leads to stunningly high retaliatory tariffs. However, he suspended them for ninety days on the day they went into effect, though he kept a blanket 10% tariff and massive 125% tariffs on China, who had continuously escalated their response, rather than negotiating. It's still early to assess the longevity of these

The tariff talk has at times been amusing and at other times infuriating. Even several weeks into his term it remained to be seen whether it was just "tough talk" or a real risk and new friction for global economies. As the situation evolved, uncertainty climbed. The Atlanta Federal Reserve's GDPNow model estimates GDP based on incoming economic data. A shocking trade imbalance data point sent the estimate into freefall, showing that businesses were stockpiling inventory in advance of any tariffs. A large trade imbalance in a steady-state situation would be a negative indicator for GDP; an economy that's importing lots of goods is replacing goods that would have otherwise been

measures, their effectiveness in generating revenue and/or leveling trade “fairness,” or their global economic effect. It’s also not clear what the overall purpose is – To generate revenue? To extract concessions? To reset global trade? But it does show that President Trump was serious when he threatened to impose dramatically more onerous tariff policy, regardless of the short-term pain it might cause. It also shows that they have been a negotiating tool, though at considerable expense to domestic sentiment. It remains to be seen what can be negotiated with each country. In the meantime, the 10% tariff and threat of additional tariffs will have a cooling effect on the economies of some countries. The United States account for 75% of Canada’s exports, for example. That global economic weakness will also have an effect domestically. Tariff uncertainty recently caused many economists to dramatically raise their recession probabilities for the year – over 50% in many cases. As we update this newsletter, just after the pause announcement, it remains to be seen whether the specter of recession dissipates. Despite the pause on most country-specific tariffs, the average tariff rate will still increase to 23% from 2%.

A divergence has appeared in the current uncertain environment. “Soft Data” – which measures opinions and sentiment – has gotten significantly worse, while “Hard Data” – data which measures actual economic activity – has remained steady. It wouldn’t surprise us if economic data begins to worsen. But it’s still early to pronounce that the economy has meaningfully deteriorated. Just like in 2022, when sentiment was poor and uncertainty was high, the general labor market continues to be healthy – an important hopeful indicator.



Despite the economic angst, initial jobless claims have not risen like you might expect.^v

A well-known historical heuristic is that a great nation ceases to be great when its interest expense exceeds its defense spending. Since WWII, the US has been the world’s largest spender on defense, but with higher interest rates and a large persistent federal deficit, this is now flashing warning signs about the sustainability of the situation. Trump has been serious about reducing defense spending,

“The crucial threshold is the point where debt service exceeds defense spending, after which the centripetal forces of the aggregate debt burden tend to pull apart the geopolitical grip of a great power, leaving it vulnerable to military challenge.”

-Historian Niall Ferguson

holding primarily Europe but also Canada to account for their failure to invest in their militaries. They're taking him seriously – Germany passed legislation which enabled hundreds of billions of spending over the next few years. In anticipation of higher spending, European-based defense contractors have seen their stock prices surge. The German yield compared to the United States' yield have narrowed dramatically as the US seeks to shrink its deficit while Germany has voted to enable deficit spending for national defense.^{vi}

While we closely track economic data, we must acknowledge that in the current environment looking at “trends” in the data may be a misleading or fraught exercise. There's simply a lot of changes on many different fronts, the effects of which are impossible to guess.

Markets dislike uncertainty, and it makes running a business difficult. Hopefully in the next few weeks, or at least within the ninety-day window, a clearer picture will emerge.



German ten-year yields (black) have risen while US ten-year yields (orange) have fallen due to budget changes. These two rates are typically highly correlated.^{vii}

Preserve – Interest Rate Commentary

If there's one positive about the unfolding political drama, we think it's that it's taken some focus off of the Federal Reserve. It's also difficult to forecast monetary policy with so much uncertainty surrounding economic policy. During their most recent meeting the Fed kept interest rates where they are at 4.5%, 1% lower than the highs from last year. The Dot Plot, which shows expectations for future interest rate policy, forecasted two more cuts before the end of the year, which was largely inline with market expectations at the time. As the outlook has become less certain, more interest rate cuts have become the market's expectation, with three or more now expected before the year end. Powell currently seems comfortable with current interest rate levels, though President Trump would like him to take action now.

Inflation has been the major factor informing Fed policy for four years. High inflation required jolting interest rates higher and keeping them there for several years. While inflation has fallen out of the headlines recently, it's still complicating Fed policy. Though inflation has relaxed considerably, it has recently started moving slightly higher, and tariffs could have an inflationary impact as well. With growth slowing, any notable inflation could lead to an uncomfortable "stagflationary" environment. Powell got some laughs a few quarters ago, saying that he didn't "see the 'stag' or the 'flation.'" But the current environment continues to trend mildly in that direction. The most recent CPI data point was arguably one of the most encouraging that we've seen in a long time. But investors are discounting its pre-tariff importance as they now look to future inflation caused by tariffs.

Powell has tried to allay concerns about inflation. He recently stated that consumer

expectations for 5-10 years out from here have moderated to historical averages. That may be true, but if it takes another few years to return to a normal inflation environment, that's nearly ten years of above-target inflation. In a facepalm-worthy moment, Powell also resurrected the word "transitory" to describe inflation. The Federal Reserve hopes that inflation will return to their target. There's very little indication that's the path from here, and the Fed is handcuffed in their ability to change policy right now to be more restrictive.

It's telling that with so much uncertainty, the Fed still did not lower rates in March. During the meeting they lowered their GDP outlook, described heightened uncertainty, and saw equity markets struggling. If that's not enough to lower rates, what do they need? The recent uncertainty and volatility has made it likely that the Fed will lower rates soon, despite sticky inflation. It's possible that we will see a similar outcome as in September of 2024 – when the Fed lowered rates, the rest of the yield curve moved higher. This reflected fear that inflation had not yet been completely beaten. As we came closer to the initiation of tariffs, two-year yields fell and ten-year yields rose. They're currently more than .4% apart, the widest since the Fed started raising interest rates in 2022.^{viii} A steeper yield curve (ten-year yielding higher than two-year yield) is good in a normal environment. But in this case a falling two-year yield is showing a likelihood of the Fed cutting rates due to a flagging economic environment. And a rising ten-year yield could be attributed to persistent inflation fears, divestment by foreign countries, fear of interest rate volatility, or forced liquidation from leveraged investments. Treasuries are typically a safe haven asset. It's peculiar and frustrating that they're not following that playbook in early April.

It's arguable that the rate volatility, especially for long interest rates, is what caused Trump to take a softer stance on tariffs. The volatility and rise in rates were reminiscent of the darkest days of Covid and could put enormous stress on unknown parts of the economy. Back in March of 2020 the Federal Reserve lowered interest rates drastically in an emergency meeting. If

"It can be the case that it's appropriate sometimes to look through inflation if it's going to go away quickly without action by us, if it's transitory. And that can be the case in the case of tariff inflation."

-Federal Reserve Chairman Jerome Powell on March 19th, needing a thesaurus so he can stop reminding us of the "transitory" inflation of 2021-2022

"I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everybody."

-Political consultant James Carville

the Fed were to lower interest rates in that fashion right now, it would have probably made the long interest rates get even crazier from fear of inflation, similar to when the UK market hyperventilated for similar reasons a few years ago.

Earn – Bond Market Commentary

The bond market had a mixed quarter. The primary bond benchmark – the “Bloomberg US Aggregate Index” – is primarily driven by interest rates rather than credit. As interest rates fell through the quarter, this index was up 2.5%. Areas with more credit risk, however, fared slightly worse. The tailwind from falling interest rates was offset by increasing concern about



Spreads for corporate high yield bonds had become extremely narrow. Recent uncertainty has caused them to rise to a more normal level.^x

credit risk. High yield bonds, for example, returned just 1%.^{ix}

While it was not anything particularly special, the performance was notable in that bonds acted as a hedge for stocks. This is the rationale behind the idea of the “60/40 portfolio” – when stocks are challenged, interest rates fall and investors seek the safety of bond

markets. During a period of significant uncertainty, a quarterly return in the single digits without as much volatility is a welcome option.

Last quarter we highlighted “spreads” for corporate bonds. This is the amount of extra interest that an investor receives for taking credit risk instead of the safety of a government bond. These spreads had given us pause, as they were historically narrow. While we didn’t see much risk of a default cycle (before tariff talk), it didn’t seem like investors were getting compensated adequately for that risk. Spreads expanded in the first quarter, though they are still somewhat narrow.

Infrastructure continued to be a bright spot. Pipelines and utilities can basically ignore the risk of tariffs, though they would be impacted by fears of a recession. Falling interest rates are also beneficial, as it reduces the cost of their borrowing and makes their dividends look better in comparison.

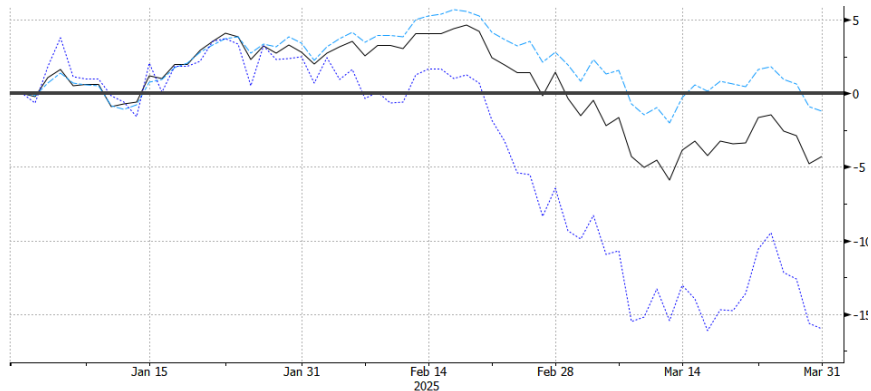
Bond closed-end funds (CEFs) broadly did well during the quarter. They entered the year relatively expensive (prices close to net asset value). With the increasing uncertainty and volatility, these bond funds have become a source of funds as investors are looking for assets to sell to raise cash. This is normal in emotional times and can lead to opportunities to buy funds at a discount.

Flexible Income Portfolio

The Flexible Income Portfolio (FIP) had another slightly positive quarter, roughly in line with its benchmark. (Though it's worth remembering for all performance commentary that portfolios that arrived at Verismo Financial during different times in the quarter will see a different performance number on the statement. Combined performance between Morgan Stanley and Wells Fargo Advisors Financial Network should be similar). Most of the portfolio experienced low single-digit gains. Our recent moves to increase duration worked in our favor, as did the elevated exposure to infrastructure. Preferred stock was another bright spot. Banks (the primary issuers of preferred stock) are another sector which are uniquely unaffected by tariff uncertainty.

We have been reducing credit exposure in the portfolio, both coming into the quarter and during the quarter. While we aren't concerned with imminent defaults, we acknowledge the heightened uncertainty in the current climate. The risk-to-reward tradeoff doesn't seem balanced.

We have also reduced our holdings of CEFs to the lowest point in many years. They weren't ridiculously expensive like they were in 2021, but they were more expensive than we think they should be given the level of volatility. With the general reduced correlation with stocks and reduction in volatile holdings like CEFs, once interest rates stabilize the FIP portfolio should be less volatile than equity markets while still producing annual income in the high single-digits. While prices have moved lower and are currently volatile, the level of income that the portfolio is generating has stayed consistent.



Global markets (blue) hardly moved during the quarter. The Magnificent 7 (purple) acted as a drag on the performance of the S&P 500 (black).^{xi}

Grow – Stock Market Commentary

Global stock markets rose to start the quarter, with the S&P 500 making new all-time highs in mid-February. As tariff discussions came into focus, markets became more volatile and fell to levels from last September. Markets ended the quarter with modest overall declines, though nearly 10% from the highs. The day after President Trump's tariff announcement markets fell further in one of the most volatile sessions since 2020. Much of this damage reversed when the tariffs were delayed a week later.

We were cautious coming into the quarter, acknowledging valuations which were historically expensive. Valuations are now more reasonable, but we now question whether earnings expectations need to be revisited.

International markets mostly outperformed domestic markets. The strength in the US Dollar from last year largely reversed. International stocks were also quite cheap. It was also driven by weakness in the "Magnificent 7," after years of AI-driven strength. They were collectively 16% lower during the quarter.

Markets fell abruptly to end the quarter as tariff headlines hit on a daily basis. This was exacerbated by a “growth scare” as economic data points were showing incremental weakness. This had some commentators talking about the “end of American Exceptionalism,” which seemed hyperbolic. President Trump has historically used the stock market as a measure of success. During his first term he routinely touted the excellent stock market performance. Yet

during this term he seems to have a disregard for the stock market, even stating that “I’m not even looking at the stock market” while markets were manic. We wondered when the stock market decline would get his attention and potentially

“HASSETT: TRUMP IS CONSIDERING A 90-DAY PAUSE IN TARIFFS FOR ALL COUNTRIES EXCEPT CHINA”

-Fake news spread knowingly or unknowingly by multiple users on X (formerly Twitter) on April 7th gave markets whiplash. Two days later it was real news and sent markets flying higher.

cause him to change course – a so-called “Trump Put”. (A Put is an option that allows you to sell at a specified price level if you’d like to.) For example, in late 2018 we saw negative stock market reactions cause the Federal Reserve to change unpopular policy. A tweet about pausing tariffs on April 7th sent the market flying higher. On April 9th it became official policy leading to the best day in the market since March 2020. It’s not clear that the stock market drove his decision, but President Trump did foreshadow his announcement to pause tariffs, tweeting that morning that “THIS IS A GREAT TIME TO BUY!!! DJT”.^{xii}

The “Magnificent 7” were due to have a disappointing quarter eventually. But the main driver of their poor performance is actually worrisome for the investment narrative. A rival in Artificial Intelligence (AI) from China named “Deepseek” debuted its impressive competing product. Even worse, the AI model was rumored to have been developed with significantly less money and with less powerful semiconductors. The details are unclear, but also not necessarily important. The important takeaway is that the AI race is more competitive than we thought. Domestic technology companies have made enormous investments in intellectual property and infrastructure in order to power their AI models. Their current valuations are predicated on the future profitability of AI. If AI can be developed much cheaper, it’s not clear whether those investments are necessary or whether the margins on the eventual AI product will be as large as they hoped. Earnings for new technology have typically grown at an average rate of 7-8%. It’s unclear why that would necessarily be different this time.

A Goldman Sachs study recently found that over ten-year periods, an equal-weight portfolio outperforms a market-weight portfolio 78% of the time. (Equal-weight invests the same amount in each company while market-weight invests according to the size of each company.) That makes sense, since smaller companies have historically outperformed larger companies by a few percentage points each year. What’s more interesting is that a market-weight portfolio tends to outperform during periods with higher risk, such as the period leading up to the “Dot Com” bubble and the last few years with the AI-driven euphoria in Mega-cap Tech.^{xiii}

The scale of the AI “bubble” seizing control of the major markets is difficult to overstate. Let’s say that in 2023 you were trying to be responsible and not have outsized exposure to Big Tech and AI but you wanted only the best. So you hopped in your time machine and figured out the three best “Magnificent 7” companies for the next two years, and invested 20% across the three of them. You put the rest in the S&P 500. This portfolio would underperform by 43% over the next two years compared to just buying the Magnificent 7.^{xv} So even if you pursued your investment in AI in a selective and informed way, you would have had enormous difficulty keeping up with these stocks unless you exposed a huge portion of your portfolio to the



investment theme. Investors as a group have grappled with the risk/reward of investing in this exciting new trend while also recognizing the risks of new technology. The performance has reversed slightly over the last three months, but these stocks still trade at elevated valuations.

The strength of the US Dollar from the fourth quarter reversed sharply this year.^{xiv}

ETF Portfolio

The ETF portfolio was slightly negative for the quarter, outperforming domestic indexes and slightly trailing global indexes. The portfolio benefited from its diversification globally as well as across sectors, a welcome change to the utter dominance of mega-cap technology companies. We have increased our international exposure, expecting recent outperformance to continue. We’ve also sought exposure to tariff-insensitive sectors such as healthcare and pipelines. We maintain our skepticism about China – more so than usual – as the trade war has escalated most dramatically with them, and we worry about how either side might further retaliate.

Despite the recent bounce, it’s uncomfortable owning stocks right now. Uncertainty is very high and things are changing rapidly. It’s worth remembering that the sharpest rallies often occur in periods of great uncertainty. Some traders refer to a “Wall of Worry.” These are periods when it seems like there are all sorts of headwinds and are very frustrating to navigate. Despite the headwinds, stocks often go up – or “climb” the “Wall of Worry” – the negatives are known, and every day without another unanticipated setback is a positive. We are certainly cautious, but remind our clients that your investment plans and our PEG strategy anticipate needing to endure periods of weakness in order to participate in long-term gains. Your investment plan was created knowing that there would be periods of difficulty. The recent rebound caused by the pause in tariffs shows the importance of staying invested even when the outlook is unclear.

New Team Member Introduction – Trey Plummer

We are happy to introduce the team's newest addition, Trey Plummer! Trey is a client associate at Verismo Financial where he assists with daily operations. After attending Texas Tech University he worked for Wells Fargo Advisors helping financial teams transition their practices. After working with Verismo Financial during our transition, he joined the team full time and moved to Chicago.

Trey is originally from San Antonio. He enjoys golf and is an avid sports fan. For our golfers out there, Trey is a +2!

Trey is currently studying for his security registrations. He hopes to start working directly with clients soon – perhaps at times on their golf swing!

Best regards,



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The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The MSCI All Country World Index (ACWI) captures large and mid cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries.

The Dow Jones Industrial Average is a price-weighted index of 30 "blue-chip" industrial U.S. stocks.

The Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of 21 developed markets, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 23 emerging markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

ⁱ Bloomberg

ⁱⁱ Bloomberg

ⁱⁱⁱ Federal Reserve Bank of Atlanta

^{iv} Federal Reserve Bank of Atlanta

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^{vii} Bloomberg

^{viii} Bloomberg

^{ix} Bloomberg

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^{xi} Bloomberg

^{xii} X.com

^{xiii} Goldman Sachs Global Investor Research

^{xiv} Bloomberg

^{xv} Bloomberg