

The Legacy Group, Inc.

Dear Legacy Clients,

Thank you for your continued partnership and trust, and welcome to our quarterly economic and investment update. In this letter, we will be detailing our thoughts on the current investment landscape, reflecting on the first quarter of 2025, and providing our general economic/investment outlook going forward.

During the first quarter of 2025, global equity markets returned to a state of heightened volatility and price declines amidst fears of the increased risk for economic slowdown, due to the Trump Administration's tariff policy announcements. On April 2nd, President Donald Trump announced universal 10% tariffs on all U.S. imports, and much higher tariff rates ranging from 20-49% on many of the country's biggest trading partners. These high tariff rates took the investing world by surprise, as most investors thought the announcement of "reciprocal" tariffs would translate to tariffs set at a rate equal to whatever the opposing country sets on us. Instead, the administration based the tariff calculation on trade balances and "non-tariff barriers." Up until now, we and many others mainly viewed tariffs as a short-term inflationary risk, but these higher tariff rates carry risks of slowing down the global economy, as much higher costs of production either hurt companies' profit margins, or are passed along to the end consumer. JPMorgan's asset management team states that the 10% tariffs are likely to remain in place as a revenue collection source, while the remaining higher tariffs are likely to be used as a means of negotiating better trade deals with trading partners, and therefore could be reduced or removed in the short term. This is the optimal outcome that investors are certainly hoping for, and it may very well be the case given that on April 9th, Donald Trump announced a 90-day pause on most of the larger tariffs for the exact purpose of allowing time to negotiate better trade deals. The only caveat is that tariffs on China were not reduced, as both the U.S. and China have responded to these events by increasing retaliatory tariffs against one another even further. Treasury Secretary Scott Bessent made the point that China has more to lose in this trade war than we do, since we export one fifth to them of what they export to us. Regardless, Trump has not ruled out the possibility of negotiating a deal with them either.

The next factor to consider in this investment environment is how the Federal Reserve (the "Fed") responds to this new tariff-focused narrative. Just as we mentioned last quarter, the Fed is still looking to reduce interest rates down to a lower level this year. As a reminder, the Fed hikes rates higher when they want to slow inflation, and they cut rates lower when they want to support the economy, although the rate cuts expected to happen this year are more about "recalibration" than economic support. They hiked rates up to 5% two years ago to combat inflation levels that were much higher than they are today, and if they leave rates high for too long, it could unnecessarily hurt economic growth. If the aforementioned tariff policies do in fact slow down the economy though, they could be incentivized to cut rates even further to help the economy. But this is a tricky situation for them, because if tariffs create long-term inflationary pressures, they will not want to cut rates too far, as it will risk adding fuel to the inflationary fire. During his press conference on March 19th, Fed Chair Jerome Powell stated that the Fed sees tariff-related inflation as likely to be a one-time price increase rather than a long-term inflationary pressure, in which case they would not need to address it. However,

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on April 4th after Trump's tariff announcement, Jerome Powell reiterated that they will want to be patient with the speed at which they cut interest rates to ensure that this is the case.

With respect to current inflation, the annual PCE inflation rate ("PCE" inflation is the Fed's preferred measurement of inflation) is 2.8% as of February. This is higher than the 2.4% number we reported last quarter, but still much lower than the highs of 7.1% in 2022, and still close to the Fed's 2% target. Additionally, the more widely used consumer price index measurement of inflation released more recent data through March, which showed prices actually declining on the month, putting the annual rate of this inflation index at 2.4%. Over the short term, these annual inflation rates may tick slightly higher due to tariff-related inflation, but one-time price increases by definition cannot continuously affect the annual rate any more than one time. We reiterate our view that inflation should continue to cool over time, as a large portion of current inflation is being driven by higher shelter prices and auto insurance. We believe that continued price pressure in these areas is likely not sustainable. On top of this, we see continued progress in declining wage inflation in both the most recent measurement of average hourly earnings, as well as the Federal Reserve Bank of Atlanta's wage growth tracker.

Amidst the heightened volatility and uncertainty, it is no secret that stock performance saw meaningful declines on the quarter. U.S. large cap growth and technology stocks had been leading the way in outperformance last year, but saw more significant declines this year. This is because these stocks trade at much higher price-to-earnings multiples, which makes them more susceptible to downside risk. Should tariff-related volatility persist, further downside in this sector is likely to continue, as data coming from Franklin Templeton indicates that many of the "magnificent 7" companies (Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA, Tesla) derive a substantially larger portion of their revenues from outside of the United States. Turning now to foreign equities, these stocks actually held up better than U.S. stocks on the quarter, as negative economic sentiment weighed more on the U.S. than it did internationally. We reiterate our view that economic headwinds to international equities are already well discounted in the price of those stocks, meaning that even a small amount of positive news can have a strong positive impact. Bonds held up well on the quarter as interest rates fell due to fears of an economic slowdown, and gold soared to new all-time highs with returns of 20+ percent. We mention all of this to once again emphasize the importance of staying diversified in this environment, as bonds, international stocks, and commodities have all helped buffer balanced portfolios against further losses.

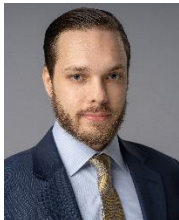
As it pertains to our economic and recessionary outlook, the risk of recession has undoubtedly increased assuming these tariffs stay in place, though future changes to tariff policy are fundamentally impossible to predict. One of the main indicators of slowdown has been a recent drop in consumer sentiment driven by tariff-related uncertainty. Consumer sentiment surveys are commonly referred to as "soft data," and despite consumer sentiment being lower since the pandemic, it has not had any negative impact on real-time consumer activity. In the first quarter, the Federal Reserve Bank of Atlanta estimated that the economy actually contracted, with GDP at an annualized pace of -2.4%. However, a large portion of this contraction came from a huge surge in gold imports, likely as a result of companies trying to get ahead of tariff announcements. Stripping this figure from GDP, we get a "gold-adjusted" GDP number of -0.3% annualized for the first quarter. Going forward, we continue to emphasize that consumer spending makes up 68% of GDP, and high-net worth individuals who can likely handle higher prices from tariffs make up half of total consumption in the U.S. and should continue to support the economy. In addition, we are still seeing data that indicates our labor market is very strong on all fronts, despite government labor cuts from the Department of Government Efficiency, and despite recent

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deportations. The most recent employment report showed an increase of 228,000 new workers in March, much higher than the Dow Jones estimate of 140,000. We expect the private sector to be able to absorb the vast majority of D.O.G.E.-related layoffs over the coming months. Our unemployment rate ticked up from 4.1% to 4.2% for the right reasons: an increase in the labor force participation rate. Additionally, we still have 7.57 million job openings as of March, and we reiterate that elevated job openings should help buffer against rapid increases in unemployment.

Regarding our own portfolios, we maintain that our current allocations are working as intended. During times of heightened uncertainty, we believe the best thing to do is not overreact. Last quarter, we stated that we may experience volatility in the early days of this new administration, as much depends on which policies will be prioritized in the early phases. This has turned out to be true so far, but we still believe that the administration has intentions on focusing on pro-growth policies in the future, namely tax cuts and deregulation. With tariff policy, the most important thing to remember is that any positive revision to tariff rates could be announced at any moment, at which point we believe stocks should likely rally higher as they did on April 9th. With the upcoming 90 days of trade negotiations taking place, we believe the likelihood for positive trade deal announcements has increased. Our economy remains on strong fundamental footing, insulated by the strength of our consumer and labor market, and the Federal Reserve still has the ability to cut interest rates and support it if necessary. Most importantly though, diversified portfolios are working in this environment, and we believe the stock market will ultimately look through these current headlines and to the future, as it always does. We hope that you find these updates helpful, and please do not hesitate to reach out if you have any questions.

Sincerely,



Austin Smith, Analyst for The Legacy Group, Inc.

Craig Lestner

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Resources used:

<https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20250319.pdf>

<https://www.atlantafed.org/chcs/wage-growth-tracker>

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<https://www.franklintempleton.com/insights/anatomy-of-a-recession>

DataTrek Research: DataTrek Morning Briefing

- March 19, 2025: “Powell Presser, New SEP, US Vs. China Big Tech”
- April 3, 2025: “STT: Questions, Answered”