

Market Commentary

Q1 2025



- U.S. equity markets declined in the first quarter, weighed down by rising concerns over broad-based tariffs, decelerating growth, and renewed inflation risks
- The Federal Reserve held rates steady at its March meeting, signaling a cautious stance and emphasizing it is not in a hurry to begin cutting, despite market pricing to the contrary.
- Gold extended its outperformance as investors sought defensive positioning amid rising volatility, while cryptocurrencies and high-growth tech—including AI-related names—faced sharp selloffs

Market Total Returns

	Month %	QTD %	YTD %	1 Year %	3 Year %	5 Year %	10 Year %
S&P 500 TR USD	-5.63	-4.27	-4.27	8.25	9.06	18.59	12.50
DJ Industrial Average TR USD	-4.06	-0.87	-0.87	7.40	8.75	16.20	11.43
NASDAQ Composite TR USD	-8.14	-10.26	-10.26	6.37	7.61	18.48	14.52
Russell 2000 TR USD	-6.81	-9.48	-9.48	-4.01	0.52	13.27	6.30
MSCI EAFE NR USD	-0.40	6.86	6.86	4.88	6.05	11.77	5.40
MSCI EM NR USD	0.63	2.93	2.93	8.09	1.44	7.94	3.71
Bloomberg US Agg Bond TR USD	0.04	2.78	2.78	4.88	0.52	-0.40	1.46

Source: Morningstar Direct

U.S. Equities Retreat on Tariff and Growth Concerns

U.S. equity markets entered the first quarter of 2025 with strong momentum, notching fresh all-time highs in February. However, early-year optimism—fueled by expectations of pro-growth policies, reduced regulation, and lower taxes from a new administration, alongside hopes for a soft landing orchestrated by the Fed—quickly gave way to mounting concerns over tariffs, trade policy shifts, and signs of government contraction. By mid-March, that optimism had unraveled, with stagflation fears resurfacing as investors recalibrated expectations.

Major equity indices officially entered correction territory as the S&P 500 fell more than 10% from its February 19th high through March 13th. Although the full scope of tariffs was not disclosed until early April, rising inflation expectations and deteriorating consumer sentiment weighed on risk assets throughout the quarter. The looming impact of broad-based tariffs injected uncertainty into the earnings and inflation outlook for 2025 and 2026.

Nowhere was the selloff more acute than among the “Magnificent Seven” mega-cap tech names, which collectively declined by an average of 16% in Q1. The group—previously the engine of 2023–2024 market gains—suffered as AI-related enthusiasm failed to translate into near-term profitability. Disappointment over lackluster earnings growth, coupled with news that Chinese AI firms had developed comparable models using less sophisticated and less costly chips, contributed to the pullback and raised questions about the sustainability of current valuations.

Yet, despite the pressure on large-cap tech, market breadth improved meaningfully during the quarter. Investors broadened exposure beyond the narrow leadership of the past two years, a trend underscored by the S&P 500 Equal Weight Index outperforming its cap-weighted counterpart by 3.5%, the largest margin of outperformance in 16 quarters. In fact, the S&P 500 excluding the Magnificent Seven posted a modest gain [of 0.4% for the quarter](#), highlighting just how concentrated the late-2024 rally had been. The sharp reversal in these names was the principal driver behind the S&P 500’s mid-single-digit decline.

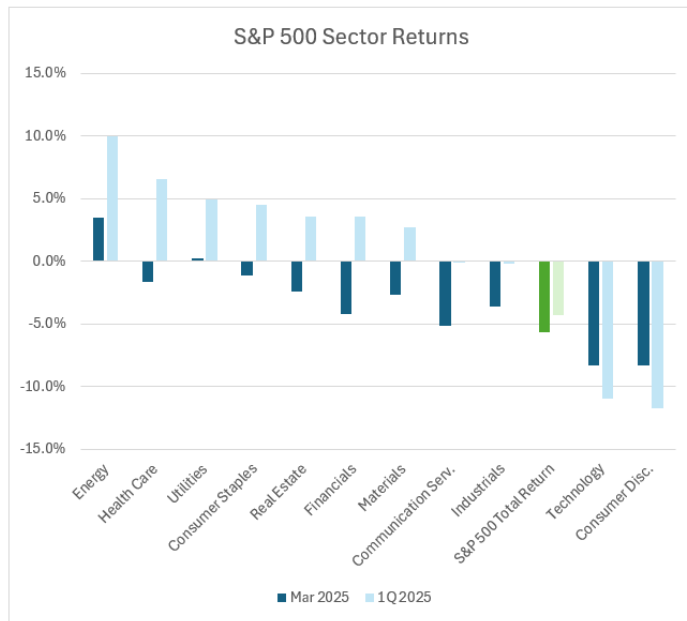
	March 2025			1Q 2025		
	Value	Core	Growth	Value	Core	Growth
Large Cap	-2.8%	-5.8%	-8.4%	2.1%	-4.5%	-10.0%
Mid Cap	-3.7%	-4.6%	-7.4%	-2.1%	-3.4%	-7.1%
Small Cap	-6.0%	-6.8%	-7.6%	-7.7%	-9.5%	-11.1%

*Index returns are reflective of the Russell 1000, Russell 2000, and Russell Mid Cap

Source: Morningstar Direct

The final weeks of the quarter revealed a clear rotation out of high-growth names and into large-cap value peers. From a factor perspective, strategies emphasizing low volatility, enhanced value, and low volatility/high dividend meaningfully outperformed, returning 7.3%, 5.8%, and 5.0%, respectively. Notably, low volatility posted its largest outperformance versus the S&P 500 Index—an 11.5% spread—[since the index’s inception in 2011](#). This shift illustrates the market’s pivot toward quality and downside protection in the face of macro uncertainty.

At the sector level, returns were broadly positive, with Energy, Health Care, Utilities, and Consumer Staples leading. Stable oil prices and renewed investor interest in commodities lifted the Energy sector, while traditionally defensive areas benefited from increased demand for income and stability. Investors gravitated toward sectors less sensitive to cyclical slowdowns amid rising geopolitical and inflationary risks.



Source: Morningstar Direct

Fixed Income Faces Turbulence Amid Fed Caution and Political Uncertainty

Fixed income markets delivered solid returns in Q1, with the top-performing segments being longer-duration Treasuries and mortgage-backed securities. The Bloomberg U.S. Treasury 20+ Year Index led with a 4.6% return, followed by the 5–7 Year Treasury Index at 3.4% and the MBS sector at 3.0%, as markets began to price in an earlier and more aggressive rate-cutting cycle in response to rising recession risks.

Select Fixed Income Returns	Mar. %	1Q 25 %
Bloomberg US Treasury 20+ Yr TR USD	-1.25	4.59
Bloomberg Treasury 5-7 Yr TR USD	0.57	3.40
Bloomberg US MBS TR USD	-0.02	3.06
ICE BofA US Corporate TR USD	-0.28	2.36
Bloomberg US Treasury Bill 1-3 M TR USD	0.34	1.04
Bloomberg US Corporate High Yield TR USD	-1.02	1.00
S&P UBS Leveraged Loan USD	-0.26	0.61
Bloomberg Municipal TR USD	-1.69	-0.22
Bloomberg US Convertible Comp TR USD	-2.65	-1.29
Bloomberg US Agg Bond TR USD	0.04	2.78

Source: Morningstar Direct

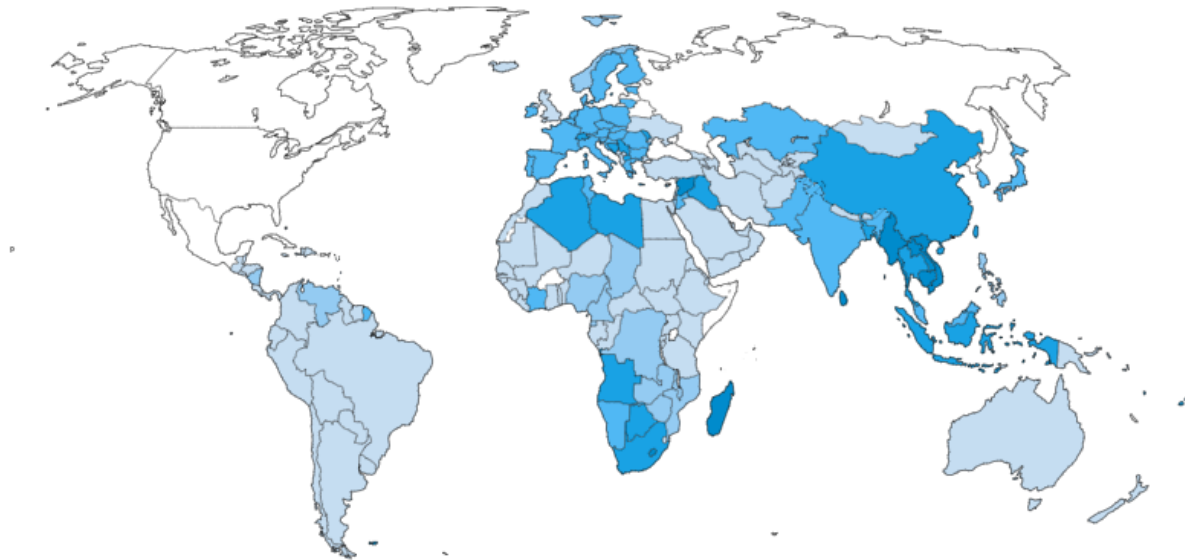
The Federal Reserve held interest rates steady at both of its meetings during the quarter, as policymakers faced an increasingly complex outlook. Early in the year, the expectation was for gradual disinflation and a possible soft landing. But that narrative was quickly challenged by the administration’s protectionist policy agenda. Even before the tariff levels were announced, markets grew wary of the inflationary impulse from tighter immigration and broad-based trade restrictions—prompting the FOMC to pause further rate cuts despite slowing momentum in economic growth.

By quarter-end, the macro backdrop had shifted further. The April rollout of sweeping tariffs—including a blanket 10% import tax and steep levies on key trading partners—intensified downside risks to U.S. GDP while threatening to reignite inflation. According to [UBS Chief US Economist Jonathan Pingle](#) the scope of the tariffs could push the U.S. into a mild recession. “Clearly such a large adjustment poses material downside risks to expansion. Our assessment would lift not only inflation into 2026, but also sees GDP fall and the unemployment rate rise...we would expect two quarters of negative GDP growth”.

US Reciprocal Tariffs

Asia and Europe are generally being hit harder

■ 10% ■ 11–19 ■ 20–29 ■ 30–39 ■ 40–50% minimum tariff



Source: White House, partial list of reciprocal tariffs announced by US President Donald Trump during his April 2 press conference

Note: Canada and Mexico are subject to previously announced tariffs

This dual-threat of slower growth and renewed inflation has left the Fed navigating a narrow path. [Chair Jerome Powell](#) acknowledged the central bank’s dilemma, stating: “We face a highly uncertain outlook with elevated risks of both higher unemployment and higher inflation.” That uncertainty has upended earlier consensus around monetary policy. [Traders are now pricing in an increased probability](#) of multiple rate cuts in 2025—with nearly 30% odds of a first cut at the May meeting, and roughly even odds for cuts at each subsequent meeting this year.

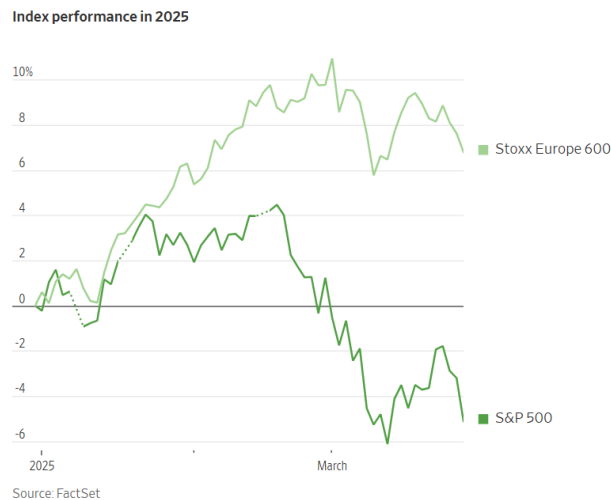
Europe Leads as Global Markets Navigate Trade and Growth Risks

International stocks largely outperformed their U.S. peers in the first quarter of 2025 amid shifting economic and policy winds. Many European and Asian indices posted solid gains, while the S&P 500 fell sharply on trade-war jitters. The chart below highlights Q1 returns across major markets, with Eurozone and Chinese equities leading gains and U.S. benchmarks lagging.

Select Developed and EM Country Returns	Mar. %	1Q 25 %
S&P Spain BMI NR USD	3.4	21.2
S&P Italy BMI NR USD	2.2	15.7
Hang Seng HIS PR HKD	0.8	15.3
S&P Germany BMI NR USD	1.7	15.1
S&P Brazil BMI NR USD	6.8	14.4
S&P China BMI NR USD	1.7	12.7
S&P Switzerland BMI NR USD	-0.5	10.7
S&P France BMI NR USD	0.1	10.2
S&P United Kingdom BMI NR USD	0.3	8.1
S&P Mexico BMI NR USD	0.9	7.3
S&P Argentina BMI TR USD	-7.5	3.2
S&P Japan BMI NR USD	0.7	1.0
S&P Canada BMI NR USD	-1.5	1.0
S&P 500 Total Return	-5.6	-4.3
MSCI ACWI Ex USA NR USD	-0.2	5.2

Source: Morningstar Direct

[The STOXX Europe 600 has outperformed the S&P 500](#) by nearly 10% through the first quarter of 2025 for its largest quarterly outperformance since 2015. In the March global fund manager survey from Bank of America, respondents showed a record rotation out of US stocks with preferences for Eurozone equities.



The surge in Eurozone equities during Q1 was supported by improving macroeconomic trends and fiscal tailwinds. The MSCI Europe Index jumped roughly +10% over the quarter – Europe’s strongest start to a year in decades. Economic data surprised to the upside, as manufacturing and services PMIs improved and corporate earnings outlooks stabilized. Crucially, European leaders’ commitment to boost defense spending provided a significant tailwind. At a March summit, pledges to raise military budgets (with EU/NATO defense outlays potentially rising from [~2% to 3.5% of GDP](#)) fueled a rally in defense stocks. [The aerospace & defense sector spiked +6.5%](#) in a single day after the announcement, helping lift broader indexes near record highs. Several Eurozone countries posted standout gains. S&P Germany

climbed about 15% in Q1 – one of the best performers globally – aided by reports of a new defense investment fund and strong results from major industrials.

France was a strong performer as well with a double digit return of 10% buoyed by value sectors and resilient corporate earnings. Meanwhile, [the euro currency strengthened](#) modestly (up ~1% versus the dollar in early March) as investor sentiment improved. On the policy front, Eurozone inflation stabilized around the [ECB's 2% target](#), allowing the European Central Bank to pivot to rate cuts. Trade tensions emerged as a late-quarter risk – U.S. tariff threats against EU exports (autos, luxury goods) briefly dented sentiment – but overall Eurozone equities significantly outperformed U.S. stocks in Q1.

China

China's equity performance was mixed in Q1. Mainland stocks (CSI 300) posted modest gains amid muted stimulus and lingering trade tensions, while Hong Kong's Hang Seng surged over 15% on renewed optimism in tech and AI. Beijing's GDP target of 5% and signals of further policy support helped stabilize sentiment, though escalating U.S. tariffs and currency concerns continue to weigh on the outlook.

Emerging Markets – Latin America

Latin American equities posted modest gains in Q1, with Brazil outperforming on a currency rebound and strong commodity-linked sectors, returning 14% for the S&P Brazil BMI. In contrast, Mexico lagged Brazil as U.S. tariff threats pressured the peso and dampened growth expectations, but still posted a strong quarter return with 7% on the S&P Mexico BMI.

2025 Outlook

As we turn the page on a volatile first quarter, it's critical to maintain a disciplined, long-term perspective. Q1 2025 was a reminder that after two years of unusually smooth gains, volatility, policy risk, and sector rotation have returned to the forefront. Staying diversified, focusing on quality, and keeping macro risks in context will be essential for navigating what lies ahead. Periods of uncertainty often set the stage for future opportunity—and staying grounded in fundamental principles can help investors remain resilient through market stress.

- **Diversification Matters:** One clear takeaway from Q1 was the importance of broad, balanced exposure. The sharp divergence across sectors and regions—particularly the pullback in tech and outperformance in defensives and international markets—highlighted the potential benefits of allocating across asset classes, geographies, and styles. Portfolios with exposure to both growth and value, large and small caps, and high-quality fixed income generally held up better than those concentrated in last year's winners.
- **Balance Inflation and Recession Risk:** The macro environment remains highly uncertain, with inflation risks re-emerging just as growth shows signs of slowing. Investors may want to consider balancing exposure between inflation-sensitive assets—such as equities with pricing power—and more defensive holdings like Treasuries and cash to navigate a range of possible outcomes.
- **Volatility Is Normal—and Often Constructive:** [Since 1980, there have been 15 instances where the S&P 500 declined 10% or more and still finished the year positive.](#) The average intra-year drop in those cases was 14%. Corrections are part of investing and can reset valuations, reprice risk, and create entry points for stronger long-term returns.

FOOTNOTES:

Past performance is no guarantee of future returns.

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The information here is not intended to constitute an investment recommendation or advice.

Sources:

1. Data from Morningstar. Returns over one year are annualized.

Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index.

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6330 Sprint Parkway, Suite 400, Overland Park, KS 66211