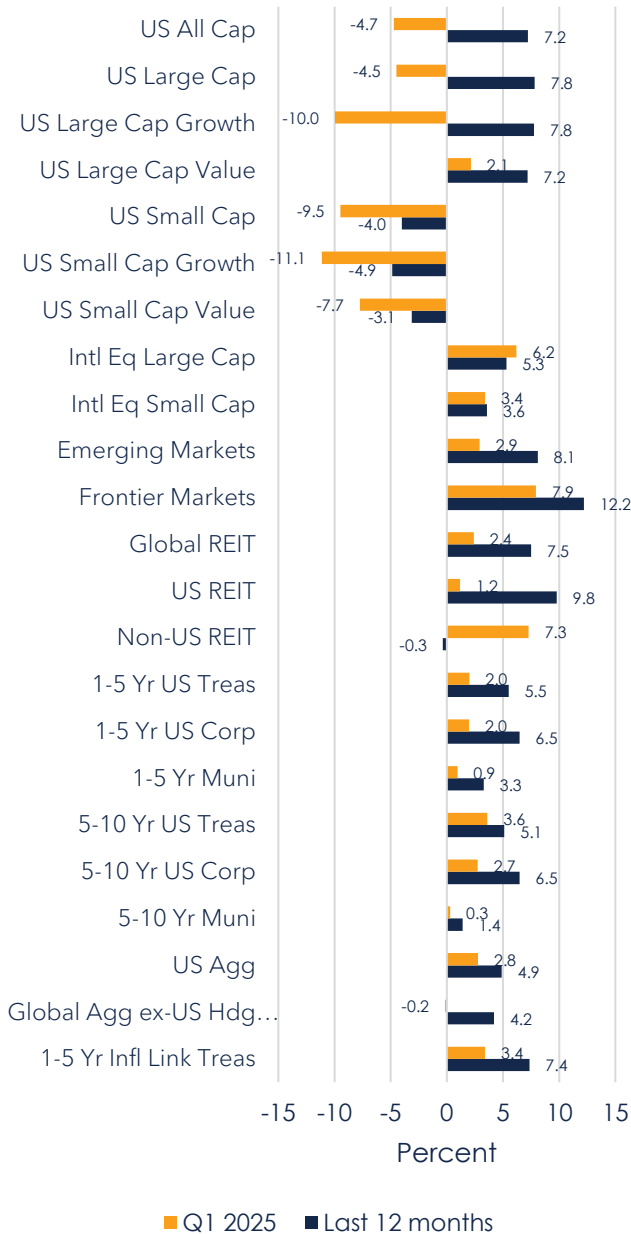


Quarterly Investment Commentary – Q1 2025

PERIODIC RETURNS



Source: Morningstar; Russell, MSCI, Dow Jones, Bloomberg, ICE BoA ML benchmarks shown; past performance is not indicative of future results

KEEPING A BALANCED APPROACH

Summary:

- U.S. stocks were down for the quarter, falling -4.7% (Russell 3000).
- Developed International stocks provided welcomed growth by increasing 6.2% during the quarter (MSCI World ex USA).
- Fed takes a cautious approach to future rate cuts as projections for inflation, growth, and employment are uncertain.

Glass half-full:

- ✓ Global diversification boosted returns for U.S. Investors in Q1.
- ✓ Germany is dramatically increasing defense spending while the UK is spending on housing and infrastructure.
- ✓ Recent macroeconomic data suggests the U.S. labor market remains solid.
- ✓ Inflation declined to 2.8% in its latest reading from February 2025.

Glass half-empty:

- ? Uncertainty as it relates to tariffs and impact of global trade wars.
- ? U.S. Consumer sentiment and confidence have declined.
- ? Growing skepticism around the timing and feasibility of future Fed rate reductions
- ? U.S. stock markets are off to a sluggish start in Q1, heavily impacted by the Mag 7.

Q1 2025 by the numbers

- **4.25% - 4.50%** remains the Federal Reserve’s policy range as inflation has held steady and the labor market has shown no signs of imminent collapse. Combined with potential inflation, the Fed seems to be in a wait and see mode, with no further reductions imminent.
- **65.2** is the latest reading for the consumer confidence expectations index, which measures U.S. consumer expectations for business, income and jobs. This is the lowest level in 12 years and well below the threshold of 80, a recessionary indicator.
- **10.9%** is the amount that international large cap stocks (MSCI EAFE) outperformed US large cap stocks (R1000) YTD, highlighting a current benefit of being globally diversified.
- **-0.3%** is the YTD return of a portfolio comprised of 60% MSCI ACWI and 40% Bloomberg Global Aggregate (hedged USD). In other words, despite the headlines for US stocks, a globally balanced portfolio comprised of both stocks and bonds is relatively flat YTD.

The Tariff Story Continues

- White House tariff policies have been fluid and widespread to start the year.
- The stance from the Trump administration has been that tariffs are meant to level the global trade deficit the U.S. has with its trading partners.

The first quarter of 2025 has been rife with attention-grabbing headlines, which most have been related to the evolving White House trade policies.

A tariff can be defined as a tax on imported goods to make them more expensive. Tariffs, in theory, can be implemented to protect domestic industries, influence another country on a particular policy or issue (which may not even be related to trade), or generate revenue. Keep in mind that tariffs are paid by the domestic companies importing the goods, not the foreign companies exporting them, and those costs are most often passed on to the consumer.

As of the end of Q1, there were multiple tariffs enacted and proposed and included several country and product specific tariffs as well as broader blanket policies. It is important to note all the information discussed here relating to tariffs is prior to April 2, or what President Trump referred to as Liberation Day when he imposed sweeping tariffs on imported goods from all nations.

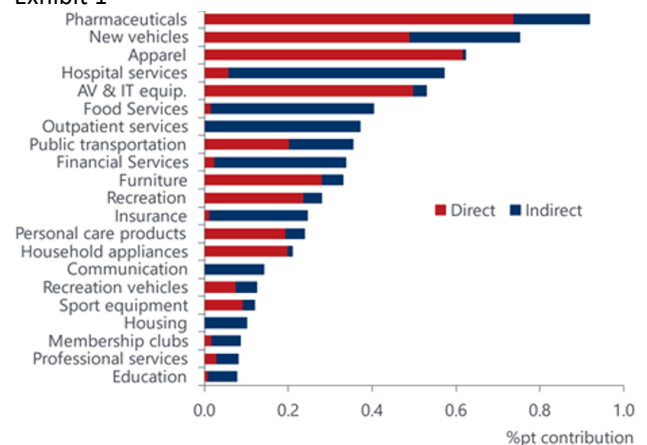
White House policies regarding tariffs have proven to be fluid so far during the second Trump administration. It is not only the tariffs that can cause issues but the uncertainty of the on-again-off-again nature of these policies that causes issues for businesses and has introduced the possibility of slower growth in the future. We have seen words like “erratic,” “whipsaw,” and “unpredictable” to describe the wave of tariff policies so far this year and we know markets do not care for these terms. Ultimately, the outcome of these tariffs will depend on their duration and magnitude.

The inflation story

Even with the large amount of uncertainty surrounding tariffs, many economists anticipate an increase in the prices consumers will pay for the affected goods and therefore could put upward pressure on inflation as a result.

Exhibit 1 displays how this dynamic might play out. Here we display the percentage contribution of products in a number of different spending categories to the Fed’s preferred measure of inflation, the Core Personal Expenditures Index (Core PCE). The chart also differentiates between direct and indirect imports, which describe the share of each product type that are wholly imported from abroad and those whose components are partially imported from abroad.

Exhibit 1



Source: Oxford Economics/Haver Analytics

This chart suggests that consumers will begin to pay more for categories like pharmaceuticals, new vehicles, and clothes because of their heavy reliance on direct importing. As long as consumers keep spending, this could make combatting inflation a challenge. A study published in February 2025 by the Boston Fed suggested that a 25% tariff on Canada and Mexico with a 10% tariff on China could add between 0.5% to 0.8% to core PCE.

Because these tariff policies are still quite new, we haven't yet seen an upward spike in inflation. However, inflation has proven to be sticky as of late, which gives further credence to Fed Chairman Jerome Powell's guidance that the last mile of lowering inflation from 3% to 2% would be an ongoing battle. Given perspective from what's already been discussed around the potential effects of tariffs earlier in this commentary, the Fed's battle against inflation has now become even more challenging.

In order for the Fed to resume lowering interest rates, we would likely need to see a material downgrade in economic growth and/or the labor market, both of which have remained resilient up until now. The latest reading for core PCE was 2.8% in February 2025.

Back To The 70s?

The Fed implemented three 0.25% rate reductions in each of their last meetings of 2024 but have since left short-term rates unchanged to begin 2025. After the conclusion of their March 2025 meeting, Fed Chairman Powell said that the U.S. economy and labor market have remained strong and that the Fed is well positioned to maintain a wait-and-see stance with regard to movements in future inflation readings, giving a specific nod to the potential short-term impact of tariff policies. And while a certain level of poise is often well received by markets, one can't help but notice how the Fed's current battle with inflation looks compared to another notable inflationary shock in the U.S.

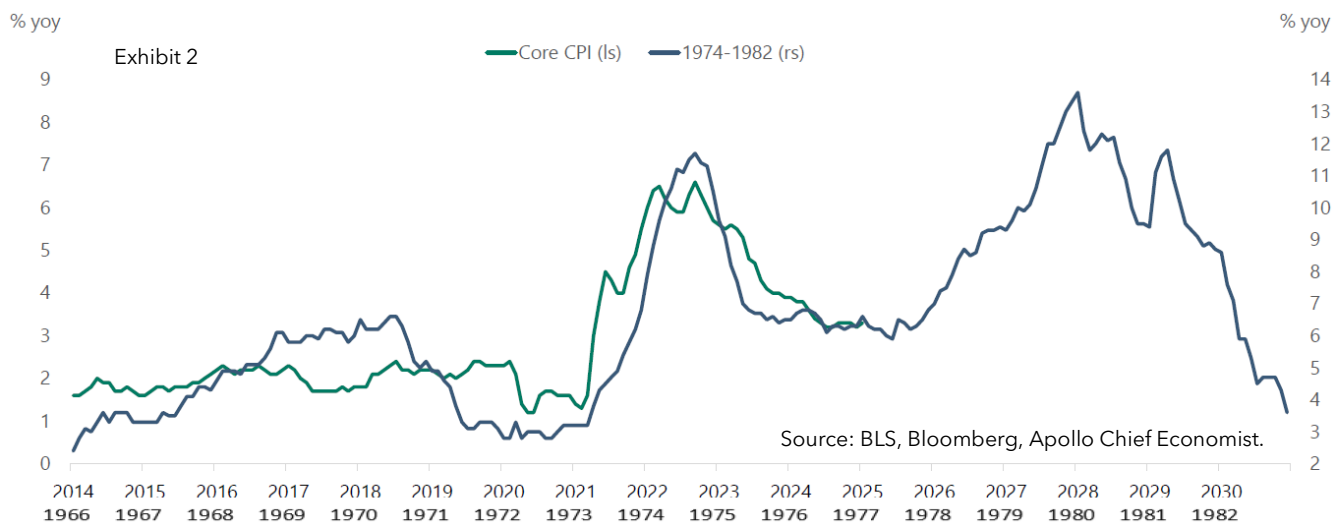
Exhibit 2 plots out what the path of inflation has been from 2014 until now (green line) and what transpired beginning in the early 1970s: the "Great Inflation." This series of events gave way to an era of stagnant economic growth and high inflation. Even though these two time

periods look eerily similar as to the actual path of inflation, their underlying causes are not quite the same. The first was caused by a multitude of factors including an oil supply shock, the removal of the Gold Standard, and expansionary monetary and fiscal policies. Today's environment is much different, but the stakes are just as important. If inflation were to reaccelerate as it did in the late 1970s and the unemployment rate were to take off, the Fed would find itself in a very difficult position.

Between a Rock and a Hard Place

Speaking of the Fed being in a difficult position, well, that's where it might find itself as it assesses the current environment. Ideally, the Fed would like to lower rates due to good news, such as inflation coming to rest in a sustainable manner at its target level of two percent. However, the Fed can also lower rates due to bad news, like challenging economic conditions akin to the Covid shock or the Great Recession. If tariffs prove to be inflationary, the Fed would prefer to raise interest rates, but if economic growth and/or labor markets begin to dramatically weaken, the Fed would like to reduce interest rates. Because maintaining stable prices (i.e. low inflation) and low unemployment rates are each a mandate of the Fed, it's difficult to know which one they would focus on if they had to choose focusing on one over the other.

It's also useful to remind ourselves that the future is inherently unknown and that predictions are just a guess at what might unfold. To reiterate what Chair Powell has stated previously, the risks of inflation and the labor market are fairly well balanced, and that the Fed believes it's in a good position to act if and when the time comes.



U.S. Equity

- US stocks were mostly negative for Q1 with the exception of large cap value stocks (+2.1%).
- Uncertainty around tariffs and trade wars continued to weigh on U.S. stocks across the market cap and valuation spectrum. Large cap growth stocks fell -10% during the quarter.
- During the last 12 months, large cap stocks across the valuation spectrum all returned over 7% while small cap stocks fell between -3% and -5%.

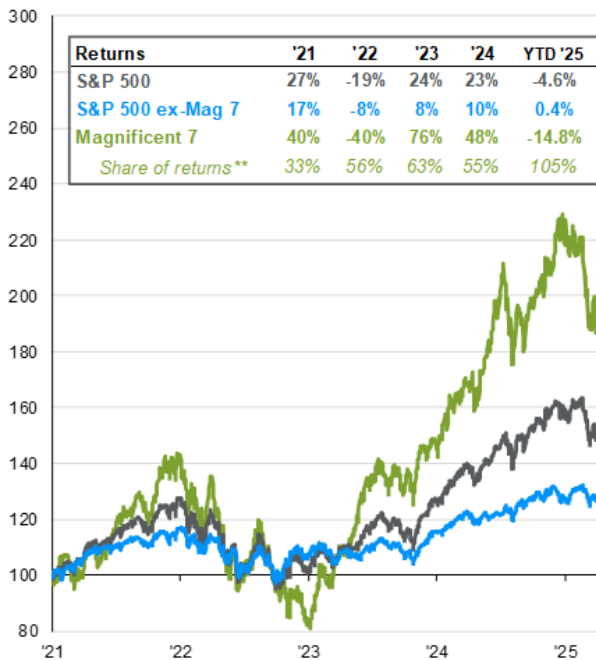
In Exhibit 3 we show the returns of the Magnificent 7 stocks, which represented approximately 30% of the S&P 500 at the end of Q1.

You don't have to look further back than 2023 and 2024 to see periods where these stocks skyrocketed overall, but more recently, they've begun their descent back toward Earth. This has weighted on U.S. stock markets this quarter, but if you look at the other 493 stocks in the S&P 500, they've actually had a positive overall return to start the year.

Exhibit 3

Performance of "Magnificent 7" stocks in S&P 500*

Indexed to 100 on 1/1/2021, price return



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. *Magnificent 7 includes AAPL, AMZN, GOOG, GOOGL, META, MSFT, NVDA and TSLA. Earnings estimates for 2025 are forecasts based on consensus analyst expectations. **Share of returns represent how much each group contributed to the overall return. Guide to the Markets – U.S. Data are as of March 31, 2025.

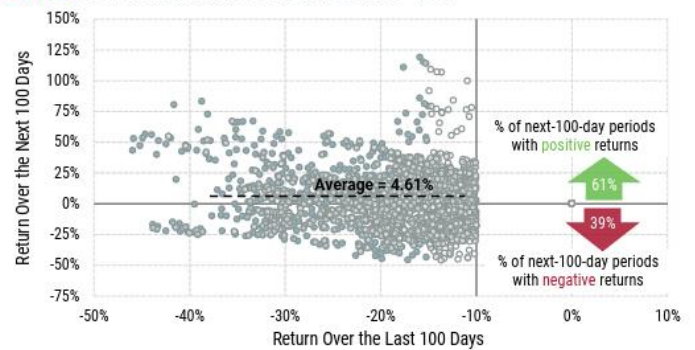
Market Volatility and Future Returns

How will the Magnificent 7 and their 493+ counterparts do for the remainder of 2025? Like you, we wish we knew, as would the many market prognosticators. But what we do know is the importance of sticking to a long-term plan through periods of market volatility.

And speaking of dramatic market moves, investors must be willing to withstand upticks in market volatility as the price they pay for achieving needed long-term returns. At times, volatility can cause some to take seek safety in lower-risk investments, but at the cost of giving up potential upside returns. Exhibit 4 details what history shows us about future market returns after periods of downturns.

Exhibit 4

Panel B | U.S. Stock Market: Periods with Declines >10%



Source: Avantis Investors, data from 7/1/1926 – 2/28/2025. US stocks sourced from the Center of Research in Security Prices (CRSP) include all firms incorporated in the US and listed on the NYSE, AMEX, or Nasdaq. Past performance is no guarantee of future results.

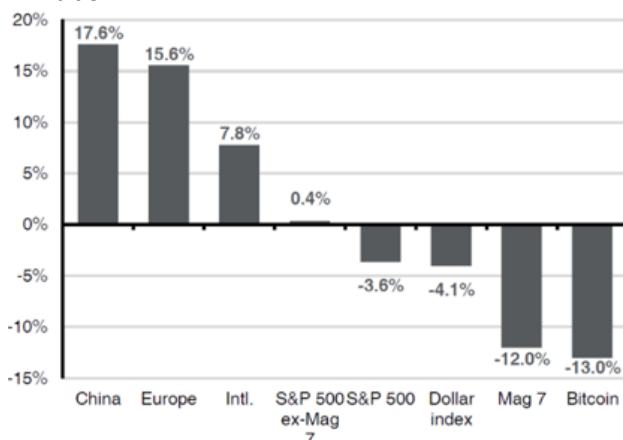
Investors often read the sentence “past performance is no guarantee of future results” all the time in investment literature. In fact, you will find the same in the disclaimer of the exhibit. But too often investors don't follow this mantra. For example, in good markets, investors expect the good times to continue, and in bad markets, investors are hunkering down for an impending apocalypse. Using nearly a century data, this chart aims to provide context for how returns over the next 100 days stack up after a prior 100-day period where markets were down -10% or more. What we see is that a majority of the time (61% of all qualifying periods) markets went on to have positive returns over the next 100-day period. It may not always be sunny and smooth sailing, but it's not necessarily all dark clouds either.

Non-U.S. Equity

- Developed and emerging non-US stock market returns were all positive for Q1 and for most market segments during the last 12 months.
- International developed large-cap stocks outperformed U.S. large-cap stocks by 10.9% over Q1.
- This stark contrast to U.S. market performance introduces the idea that policy uncertainty may be weighing on U.S. exceptionalism.

The first quarter of 2025 has been an eventful three-month period, but one of its narratives that has perhaps been buried beneath the surface of tariff talk is that of international stocks. As noted in the previous bullet points, international developed and emerging markets stocks have all outperformed the U.S. market so far this year. International large-cap value stocks, which posted the only double-digit performance for any asset class this quarter, has outperformed U.S. large-cap growth companies by more than +20% so far this year. That's certainly a welcomed development for global diversification diehards (like us). What's caused this recent turnaround? A small but significant portion of these international stock returns comes from a depreciating U.S. dollar, but perhaps much more has come from heightened policy and macroeconomic uncertainty that has befallen the U.S. market recently. Exhibit 5 details the YTD performance differential through just prior to the end of Q1.

Exhibit 5



Source: Bloomberg, FactSet, J.P. Morgan Asset Management. Index Returns, USD, year-to-date as of 3/21/25

While this is less than a drop in the bucket compared to the market's long history, and we have no way of knowing how long this trend might continue. The benefits of diversification tend to show up at the strangest times.

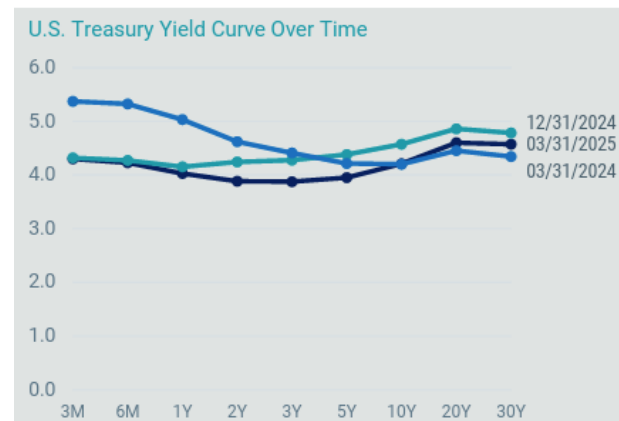
Global REITs (Real Estate Investment Trusts)

- Global REITs, as represented by the Dow Jones Global Select REIT, rose by 2.4% over the quarter and by 7.5% over the last 12 months.
- In the US, REITs rose 1.2% during the quarter and by 9.8% during the last 12 months.

Global Fixed Income

- U.S. bond returns were mostly positive for the quarter as well as the last 12 months
- Global bonds were slightly negative for the quarter falling -0.2% but have risen 4.2% during the last 12 months

Exhibit 6



Source: Bloomberg, Avantis. Data as of 3/31/2025

Focusing on Exhibit 6, we can see that short-term rates relative to year-end remain the same with longer yields falling, supporting the outperformance of longer maturity bonds over shorter maturity bonds. Yields across most of the curve dropped this quarter as investors sought safety from stock market risk.

Municipal bonds were mostly positive for the quarter with the exception being on the longer segment of the muni curve. This highlights how municipal bonds and treasuries behave differently as different factors affect each bond type. Rates on the longer end of the muni curve rose. Munis have also been negatively impacted by widening credit spreads, seasonal weakness, and heavy issuance, each of which impacted the return of longer term munis.

Overall, we continue to view our bond allocations as a method of reducing overall portfolio risk (as measured by standard deviation), given that stocks are expected to have much higher volatility. Our portfolio's focus will continue to be on high quality bonds with an emphasis on short to intermediate duration government and corporate bonds, where default risk has historically been relatively low.

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