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Investment Insights Monthly

From the Desk of Jack Kraft, CFA, Investment Strategist May 2025

Turning the Corner?

The old adage, "Sell in May and go away," would have backfired this year, as the S&P 500 staged a sharp rebound from its April lows. Equity markets have rallied as investors reassess recession risks and trade dynamics. At the time of this writing, the S&P 500 returned to positive territory after a 19% drawdown last month—a rapid move that has left investors wondering, “Have we turned the corner?” According to Bespoke Investment Group, this marks the fastest recovery since 1982.

It's a timely reminder that market pullbacks are a normal part of long-term investing as sentiment can quickly shift from negative to positive. In fact, the S&P 500 experiences a 10% decline in about half of all calendar years. The chart below reinforces why staying invested matters: missing just a few of the market’s best days can significantly derail long-term retirement plans.

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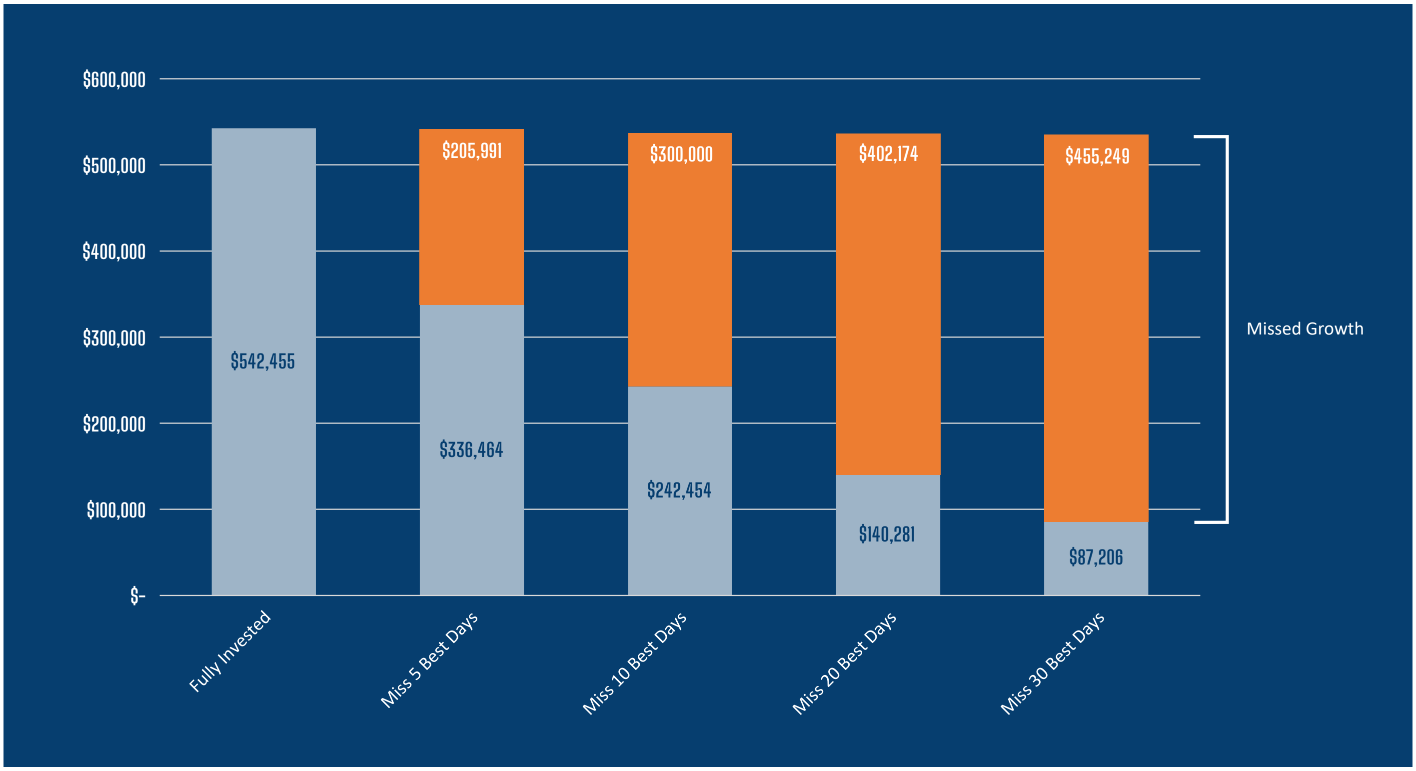
Impact of Missing the Best Days in the Market since 1980



As of April 30, 2025
Source: Morningstar Direct

To understand how the market returned to positive territory so quickly, it's helpful to look at what history tells us about bear markets (defined as a decline of 20% or more from recent highs). Bear markets typically fall into three categories: structural, cyclical and event-driven.

- **Structural:** Most severe and arises from imbalances or vulnerabilities within the financial system itself, such as asset bubbles or excessive leverage among banks or consumers.
- **Cyclical:** Reflects the regular ebb and flow of the economy, typically following higher interest rates and periods of expansion in output and corporate earnings.
- **Event-Driven:** Triggered by unforeseen external shocks—like natural disasters, health emergencies and changes in policy—that disrupt market stability.

Bear markets are not created equal, with the key difference being the speed of the decline and the pace of the recovery. The April drawdown was a result of "Liberation Day " when President Trump announced higher-than-expected reciprocal tariffs, sparking the S&P 500 to fall 20% from all-times highs. This type of shock places the selloff in the *event-driven* category. The good news is that event-driven bear markets tend to recover the fastest, historically lasting an average of just eight months. The risk, however, is that they can evolve into more prolonged *cyclical* or *structural* downturns if underlying conditions worsen.

Let's recap how sentiment has quickly shifted from recession fears to stock market optimism. Although we are not out of the woods yet, recession odds have started to ease as the Trump administration has shown willingness to de-escalate the trade war. The first major development earlier this month was a preliminary deal between the United States and the United Kingdom that set a framework for what potential deals could look like with other countries. The main takeaways include a 10% baseline tariff on U.K. imports, with additional agreements around steel, automobiles and agricultural products. This was followed by a reduction in U.S.-China import taxes for 90 days—bringing U.S. tariffs on Chinese goods from 145% to 30%, and Chinese duties on U.S. imports from 125% to 10%. Markets cheered the progress as U.S. policymakers have a short window to make deals in order to avoid supply disruptions and a reduction in economic growth.

Few deals have been finalized, but the absence of negative news on worsening trade relations, coupled with the positive developments listed above, was the catalyst the market needed to get back into positive territory for the year. Looking forward, here are some additional positive catalysts that have the opportunity to support the rally in U.S. equities during the second half of the year:

- Progress on trade deals with other major U.S. trade partners, such as the European Union, Mexico and Canada.
- An agreement on drug-related issues related to fentanyl, which could remove the emergency tariffs on Canada/Mexico (25%) and further reduce the tariffs on China (20%).
- Expectations for the U.S. Federal Reserve (Fed) to cut the federal funds rate towards the end of year.

It is easy to point to good news as the market rallies, but there are still elevated risks the market is choosing to ignore. Trade deals have not been finalized, and any setback would be a negative shock and could reignite recession concerns. Furthermore, the increase in the effective tariff rate will be inflationary as those prices will likely be passed on to consumers. This puts the Fed in a tough spot to weigh rising prices and slowing economic growth. Look for any deterioration in economic data to be a setback, such as weak job growth, decline in consumer spending or increase in the Consumer Price Index. Lastly, continued upward momentum in the 10-year Treasury yield along with a ballooning U.S. deficit is another potential headwind being ignored by investors.

Now that the stock market is back to positive territory for the year, it's a good time to reassess portfolio positioning. Were you comfortable with the decline in your portfolio during April lows? If not, leaning into defensive or value-oriented stocks that have more durable earnings during slowdowns may be a good option. Also, geographical diversification in equities remains a top idea as leadership rotates across regions and should benefit from a weaker U.S. dollar. Additionally, high-quality bonds play an important role in a portfolio, including equity market risk mitigation, income and liquidity.

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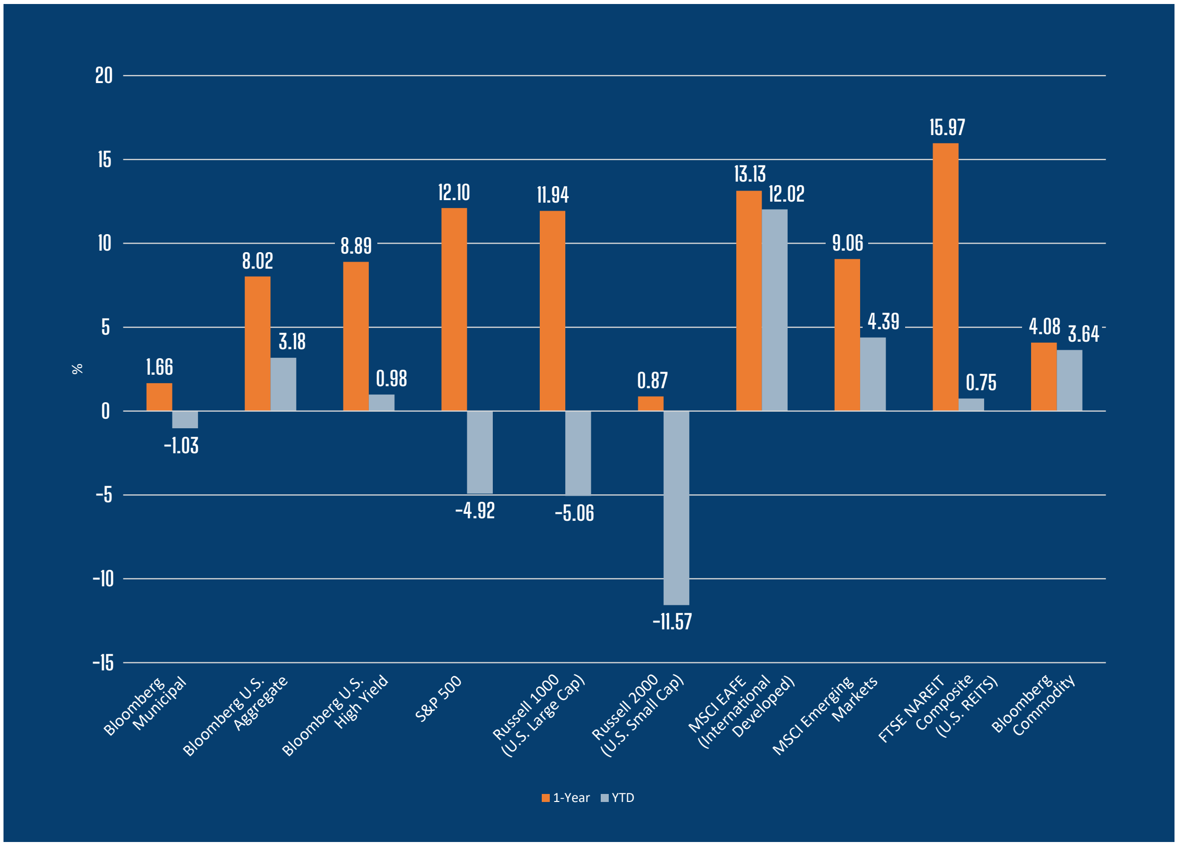
Asset Class Returns

Comparing Recent 1-Year and Year-to-Date Total Returns



As of April 30, 2025
Source: Conway Investment Research

Fixed Income

- Treasury and other sovereign debt yields trended lower in April, leading to gains in core fixed income.
- Munis continued to suffer losses due to technical headwinds like higher issuance.
- Credit spreads were volatile throughout April, ultimately leading to modest losses in high yield, loans and emerging-market (EM) debt.
- Bonds outside the United States benefited from the sharp decline in the U.S. dollar.

Equities

- U.S. equities faced extreme volatility and weakness after "Liberation Day," but most losses were recouped during the last two weeks of April.
- Growth ended up beating value across all market capitalizations, and small caps lagged large caps.
- Despite a lot of noise and anxiety in financial markets this year, it is important to note that the S&P 500 is only down 4.9% year to date.
- Developed markets outside the United States posted solid gains in April fueled by defense stocks and financials.
- Unlike what occurred in the United States, small caps beat large caps within Europe, Australasia and the Far East (EAFE) markets. Growth managed to outperform value in April.
- EM equities underperformed last month due to weakness in China.
- The U.S. dollar weakness added 466 basis points (bps) to EAFE returns and 152 bps to EM returns.

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April 30, 2025	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.35%	0.35%	1.40%	4.94%	4.44%	2.68%	1.89%
Bloomberg Municipal	-0.81%	-0.81%	-1.03%	1.66%	2.21%	1.17%	2.10%
Bloomberg US Govt/Credit Intermediate	0.76%	0.76%	2.39%	6.76%	3.54%	1.59%	1.80%
Bloomberg U.S. Aggregate	0.39%	0.39%	3.18%	8.02%	1.95%	-0.67%	1.54%
Bloomberg U.S. High Yield	-0.02%	-0.02%	0.98%	8.69%	6.25%	6.35%	4.88%
Bloomberg Global Aggregate	2.94%	2.94%	5.65%	8.82%	1.21%	-1.20%	0.79%
U.S. Equity Indices							
DJ Industrial Average	-3.08%	-3.08%	-3.92%	9.48%	9.41%	13.05%	11.04%
S&P 500	-0.68%	-0.68%	-4.92%	12.10%	12.18%	15.61%	12.32%
NASDAQ Composite (Price)	0.85%	0.85%	-9.65%	11.42%	12.25%	14.44%	13.44%
Russell 1000	-0.60%	-0.60%	-5.06%	11.94%	11.87%	15.42%	12.03%
Russell 1000 Growth	1.77%	1.77%	-8.37%	14.53%	15.60%	17.23%	15.27%
Russell 1000 Value	-3.05%	-3.05%	-0.98%	8.55%	7.61%	13.00%	8.36%
Russell Mid Cap	-1.03%	-1.03%	-4.40%	7.33%	7.08%	12.96%	8.81%
Russell 2500	-2.06%	-2.06%	-9.41%	1.70%	4.12%	11.37%	7.43%
Russell 2000	-2.31%	-2.31%	-11.57%	0.87%	3.27%	9.88%	6.32%
Russell 2000 Growth	-0.64%	-0.64%	-11.68%	2.42%	5.05%	7.60%	6.39%
Russell 2000 Value	-4.02%	-4.02%	-11.45%	-0.68%	1.38%	11.74%	5.87%
Non-U.S. Equity Indices							
MSCI World	0.94%	0.94%	-0.77%	12.64%	11.60%	14.48%	9.91%
MSCI ACWI	0.98%	0.98%	-0.25%	12.34%	10.80%	13.59%	9.18%
MSCI ACWI Ex-U.S.	3.69%	3.69%	9.25%	12.52%	8.60%	10.63%	5.34%
MSCI EAFE	4.69%	4.69%	12.02%	13.13%	10.64%	11.92%	5.96%
MSCI EAFE Growth	5.22%	5.22%	7.54%	6.93%	7.36%	8.42%	5.97%
MSCI EAFE Value	4.21%	4.21%	16.47%	19.48%	13.90%	15.25%	5.69%
MSCI Europe	4.54%	4.54%	15.65%	14.39%	11.75%	13.50%	6.32%
MSCI Japan	5.23%	5.23%	5.76%	8.67%	10.84%	9.17%	5.80%
MSCI AC Asia	2.32%	2.32%	3.75%	10.31%	6.64%	7.07%	4.66%
MSCI EAFE Small Cap	5.88%	5.88%	9.92%	12.98%	5.78%	9.45%	5.89%
MSCI ACWI Ex-U.S. Small Cap	4.75%	4.75%	5.55%	8.77%	5.37%	10.81%	5.63%
MSCI Emerging Markets	1.34%	1.34%	4.39%	9.60%	4.33%	6.78%	3.48%
MSCI EM Asia	0.78%	0.78%	2.21%	10.20%	4.38%	6.21%	4.18%
MSCI China	-4.25%	-4.25%	10.18%	26.46%	3.68%	-0.48%	0.68%
MSCI EM Eastern Europe	5.81%	5.81%	35.74%	29.36%	25.04%	-11.69%	-4.84%
MSCI EM Latin America	6.97%	6.97%	20.69%	-3.75%	5.61%	12.48%	2.68%
MSCI EM Small Cap	2.75%	2.75%	-2.81%	-0.85%	4.89%	13.89%	4.55%
MSCI Frontier Markets	-1.15%	-1.15%	6.78%	14.84%	2.77%	8.68%	3.21%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	-0.11%	-0.11%	-0.12%	5.79%	5.21%	4.04%	2.67%
Real Assets Indices							
FTSE NAREIT Composite	-2.09%	-2.09%	0.75%	15.97%	-1.04%	7.37%	5.83%
Alerian MLP	-8.84%	-8.84%	2.63%	13.50%	21.24%	26.98%	3.87%
Bloomberg Commodity	-4.81%	-4.81%	3.64%	4.08%	-3.70%	13.74%	1.70%
S&P Global Infrastructure	3.72%	3.72%	8.49%	23.89%	8.59%	12.61%	6.41%
Other							
CBOE Market Volitility (VIX)	10.86%	10.86%	42.36%	57.83%	-9.57%	-6.27%	5.43%

Source: Morningstar

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