

The Capital Markets

After two consecutive years of strong, double-digit market gains, investors entered 2025 with elevated expectations, encouraged by the prospect of pro-growth policies under the new Trump administration. These conditions initially appeared favorable for continued market momentum, fueling optimism around sustained economic expansion. However, as highlighted in last quarter's newsletter, heightened investor sentiment and elevated valuations can leave markets vulnerable when outcomes fall short of expectations.

Despite an initial post-election rally, optimism surrounding a prolonged "Trump bump" quickly faded in the first quarter. Uncertainty around policy direction and renewed concerns about economic growth soon took precedence, leading to a sharp market reversal. Within just 16 days, the S&P 500 declined by 10%, underscoring the rapid shifts that can occur in investor sentiment. By the end of the quarter, the index had fallen below pre-election levels, effectively unwinding much of the enthusiasm that had fueled the earlier rally.

Following the President's "Liberation Day" announcement on April 2, the market may take some time to regain its footing. As of this writing, we are closely monitoring potential responses from global trade partners to the latest tariff developments. While the international trade landscape appears to be shifting, we remain cautiously optimistic that a full-scale trade war can be avoided.

Navigating risk and uncertainty is a fundamental aspect of equity investing, but the current environment presents an unusually high degree of unpredictability. We anticipate continued market volatility in the months ahead as investors seek greater clarity around both economic conditions and policy direction.

As always, we are committed to maintaining a disciplined investment approach, grounded in rigorous analysis and long-term perspective. Our focus remains on objectively assessing key data points and adapting thoughtfully to the evolving environment—regardless of political developments.

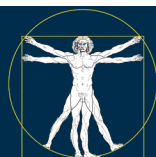
Newsletter Highlights:

The allure of high-performing stocks in recent years led some investors to question long-term strategies but the sharp market correction in Q1 reinforced the value of diversification.

Tech pullback & sector rotation as tech giants experienced a 20% decline from their peak, highlighting the risks of concentration.

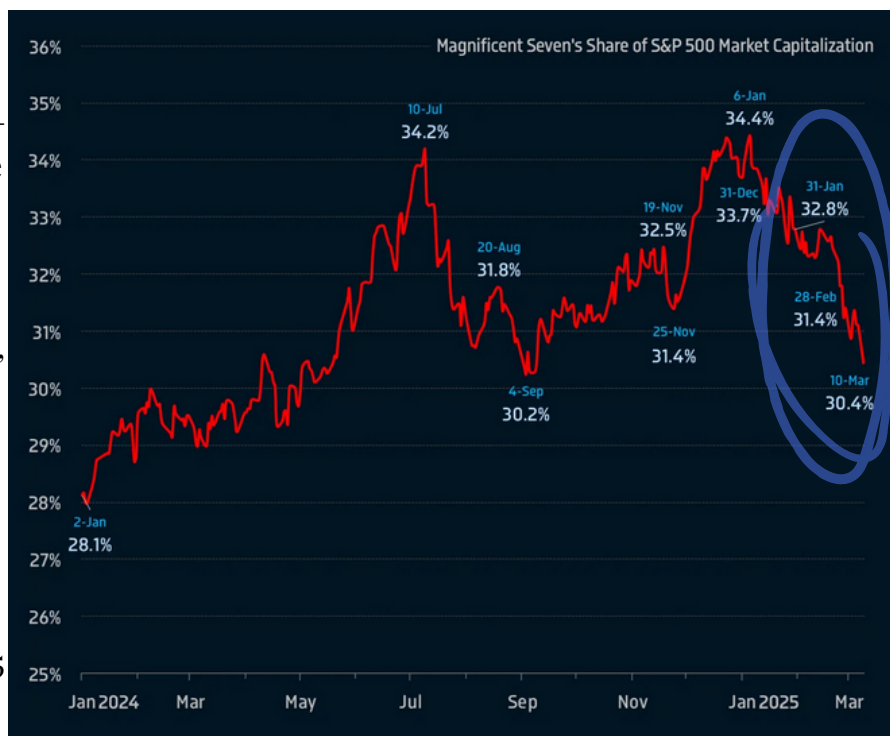
International markets gain ground as non-U.S. equities outperformed domestic markets by the widest margin since the 1980's

A lack of clear direction from the new administration has led to hesitation among businesses



Diversification is Back

It's often said that few things are more difficult than watching your neighbor get rich—and for many investors, the past few years have put that sentiment to the test. A handful of high-profile stocks delivered outsized returns, dominating headlines and capturing the attention of the market. As these names soared, it became increasingly tempting for some investors to abandon diversified portfolios in pursuit of quick gains. The resulting sense of FOMO (fear of missing out) led many to question the effectiveness of their long-term investment strategy. However, one of the most important lessons from the first quarter of 2025 was a reaffirmation of the value of diversification.



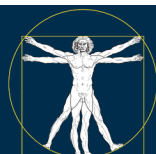
Source: Voronoi

As investors worked to navigate a wave of headline-driven uncertainty, high-growth technology stocks—long regarded as market leaders—experienced a notable pullback. Shares of the so-called “Magnificent 7” (Apple, Microsoft, Amazon, Meta, Nvidia, Alphabet, and Tesla) declined by 20% from their recent highs, offering a clear reminder that market leadership can shift rapidly. In contrast, traditionally defensive sectors such as Energy, Health Care, and Consumer Staples delivered strong performance, as investors rotated into areas that had been largely underappreciated in recent years.

International equities outperformed their U.S. counterparts by the widest quarterly margin since the late 1980s, supported by stronger-than-expected economic data and favorable policy developments across Europe and China. While it may be too early to declare a definitive shift in market leadership, the recent outperformance of foreign markets—following years of U.S. dominance—has prompted a renewed conversation around the notion of U.S. exceptionalism.

Meanwhile, fixed income markets delivered solid results during the first quarter, as investors sought safety amid equity market volatility. Declining U.S. Treasury yields contributed to positive performance across government bonds and other fixed-income sectors. This relative strength in bonds highlighted the continued importance of diversification—demonstrating how a balanced allocation to both equities and fixed income can help cushion portfolios during periods of heightened market stress.

Looking back, the first quarter of 2025 served as a timely reminder of the importance of balance, discipline, and perspective in navigating dynamic markets. While headline-driven volatility and sector rotations can challenge investor confidence, maintaining a diversified portfolio remains one of the most effective strategies for weathering uncertainty and capturing long-term opportunities.



Signs of Economic Weakness

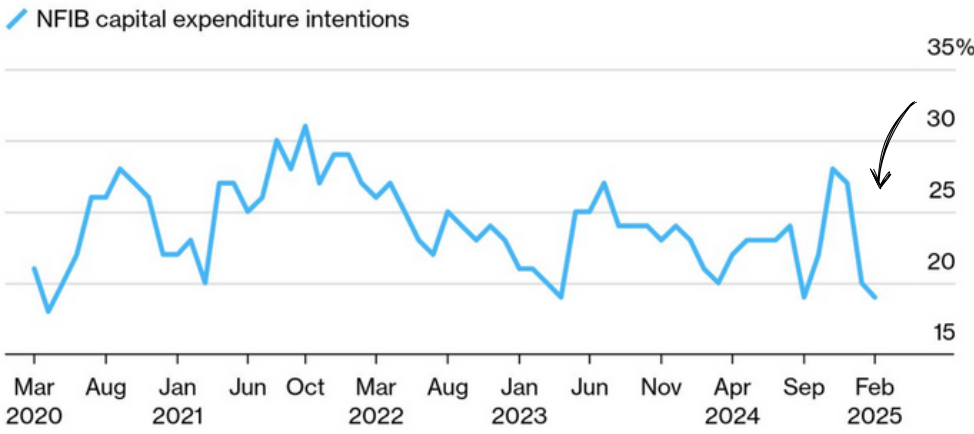
Three months into the new administration, investors had hoped for greater clarity regarding the economic outlook. Instead, the absence of concrete policy details—combined with frequent and abrupt shifts in direction—has led to ongoing uncertainty, prompting investors to continuously reassess their expectations. This lack of clarity is weighing on business sentiment, with many companies adopting a wait-and-see approach, delaying major investments and spending decisions. Much of this hesitation stems from concerns about potential changes in trade policy, which could significantly impact long-term planning and profitability.

The uncertainty is also extending to consumers. Recent data from the University of Michigan shows a growing sense of caution among households, with many scaling back their spending. This shift in consumer behavior is adding to broader concerns about the economy’s underlying strength. At the same time, fears of an escalating global trade conflict have driven household inflation expectations to their highest levels in more than three decades—further complicating an already fragile economic environment.

The economic backdrop has deteriorated as well, with [GDPNow from the Atlanta Federal Reserve](#) having plunged into negative territory for the first quarter, as shown below. GDPNow is not an official forecast by the Atlanta Fed; rather, as a *nowcast*, it's a running estimate of real gross domestic product (GDP) growth based on available economic data for the current measured quarter.

Adding to these concerns is the recent slowdown in wage growth, which has begun to moderate after several years of steady gains. While cooling wage pressures may ease inflationary concerns, they also raise questions about the resilience of consumer demand. Slower income growth, particularly when coupled with elevated cost-of-living expectations, may limit household spending power and dampen overall economic momentum in the months ahead.

US Small Business Capital Expenditure Plans Plummet



Source: National Federation of Independent Business

Source: Bloomberg

Wage Growth Tracker



Source: Current Population Survey, Bureau of Labor Statistics and author's calculations

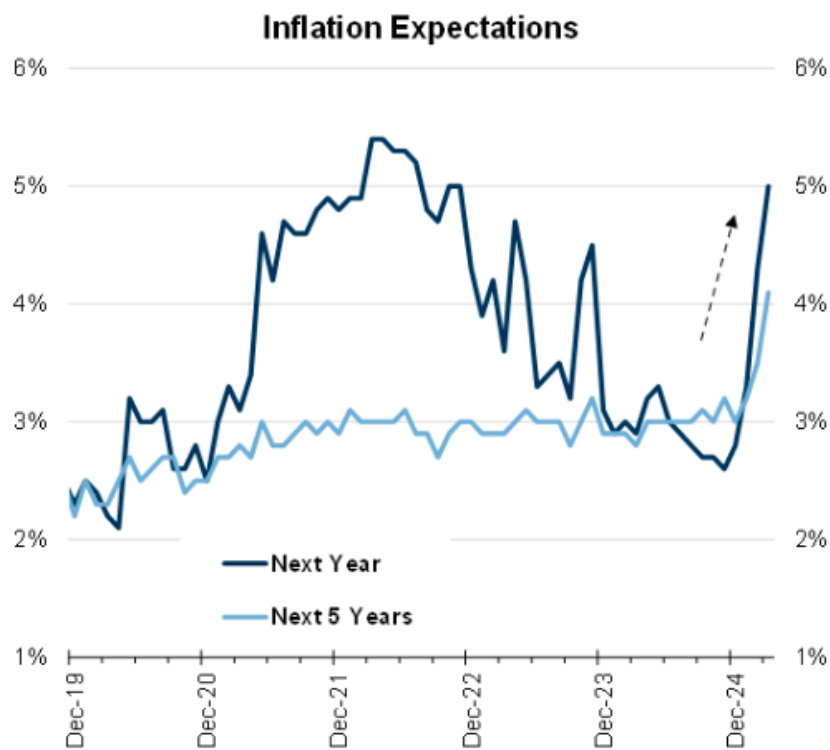
Source: Federal Bank of Atlanta

A Difficult Position for the Federal Reserve

One of the most prominent themes emerging from the first quarter was uncertainty—a word Federal Reserve Chairman Jerome Powell used no fewer than 16 times during his one-hour press conference following the March FOMC meeting (a count we may well rival by the end of this newsletter). In a policy landscape marked by a wide range of potential outcomes, the Fed continues to face an increasingly complex balancing act.

While meaningful progress has been made in the effort to restore price stability, inflationary pressures remain persistent. These could intensify further as the nation's effective tariff rate climbs to its highest level in nearly a century, potentially adding upward pressure on prices. However, it's also possible that these inflationary trends may prove temporary. A significant economic slowdown could reduce demand for goods and services, exerting downward pressure on prices and reshaping the inflation outlook.

Against this backdrop, concerns about a potential recession are growing—particularly as the threat of a trade war looms over an already fragile economy. The Federal Reserve now finds itself in a particularly delicate position: managing inflation without further constraining economic growth. Holding off on rate cuts could add stress to businesses and consumers alike, while moving too early could risk a resurgence of inflation and erode the Fed's hard-won credibility. With both inflation and growth in a precarious state, the path forward offers few easy choices.



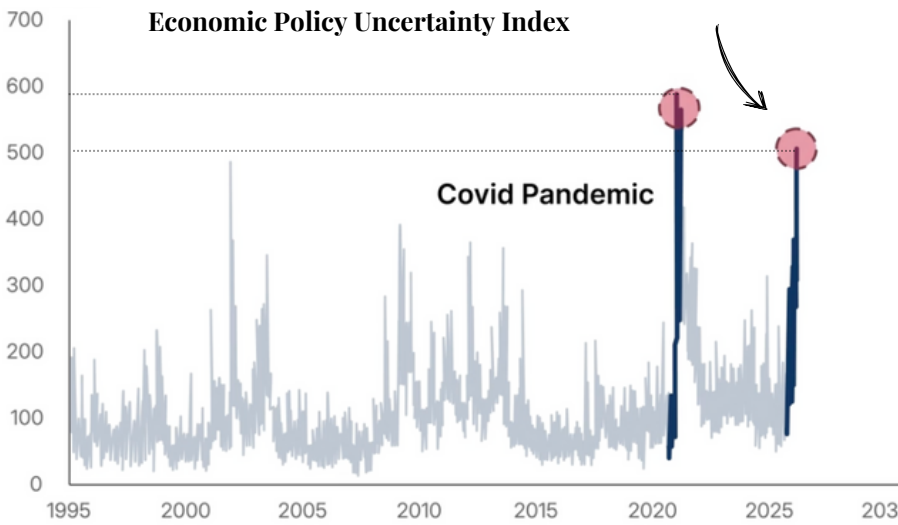
In this environment of heightened uncertainty, the path ahead for policymakers, markets, and investors is anything but straightforward. The Federal Reserve's challenge in balancing inflation control with support for economic growth underscores the complexity of the current moment. With inflationary pressures, slowing wage growth, trade tensions, and with the US consumer sentiment falling to its 2nd lowest levels in 70+ years, all converging, maintaining a disciplined, long-term perspective is more important than ever. As always, we remain focused on navigating these crosscurrents thoughtfully—grounded in data, guided by prudence.



Searching for a Catalyst

As we enter the second quarter, investors are navigating an increasingly complex and uncertain environment. Growth headwinds are mounting, and persistent policy ambiguity suggests that elevated market volatility is likely to remain a defining feature in the months ahead.

While it's important to acknowledge the downside risks, it's equally critical to remain attentive to potential catalysts for recovery. If recent tariff announcements are indeed part of a broader negotiation strategy, increased clarity on trade policy could play a significant role in restoring business confidence. Although most companies oppose tariffs, it is the lack of long-term visibility that continues to keep many firms in a holding pattern, delaying key investment decisions.



Looking beyond trade, we continue to anticipate the introduction of tax cuts later this year. However, expectations for their economic impact have been tempered, as these measures are now expected to focus more on extending existing provisions rather than implementing entirely new initiatives.

A reversion to lower inflation trends could also provide a meaningful tailwind for markets. Reduced inflation would ease the burden on consumers and potentially give the Federal Reserve greater flexibility to lower interest rates, which would help stimulate economic activity.

Lastly, stronger-than-expected corporate earnings growth would offer essential support for equity markets, reinforcing a more constructive outlook and helping to reestablish investor confidence.

Focus on What You Can Control

In times of heightened market noise and unpredictability, a strong financial plan remains one of the most effective tools for navigating uncertainty. At DaVinci Capital, our focus is on helping clients stay grounded in their long-term objectives by constructing and managing well-diversified portfolios designed to endure volatility. These will be guided by your personalized financial plan—carefully tailored to your cash flow needs, risk tolerance, and strategic asset allocation—ensuring a disciplined approach through shifting market conditions.

We remain deeply grateful for the trust you place in us. Together, we will continue to navigate the complexities of today's economic landscape, building on the progress we've made while remaining flexible and forward-looking in the face of change.



ALL INVESTMENTS CARRY CERTAIN RISK AND THERE IS NO ASSURANCE THAT AN INVESTMENT WILL PROVIDE POSITIVE PERFORMANCE OVER ANY PERIOD OF TIME. PAST PERFORMANCE IS NOT A GUARANTEE OR A RELIABLE INDICATOR OF FUTURE RESULTS.

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