

2025 First Quarter Investment Report

After two years of stellar returns, the U.S. stock market dropped in the first quarter, posting its worst performance since the third quarter of 2022. The main concern igniting investor queasiness was uncertainty over tariffs and their potential impact on consumer spending in the U.S. Most notably, as U.S. stocks declined starting in mid-February, international stocks popped on investor enthusiasm for increased infrastructure and defense spending, particularly in Europe. As a result, many American investors with balanced, diversified portfolios are surprised to see that their overall rate of return was largely flat for the first quarter despite poor U.S. stock returns.

Here is a summary of investment returns across the main categories in our portfolios:

	Quarterly Benchmarks (%)				
	QTD	1 Year	3 Year	5 Year	10 Year
Domestic Equities					
Russell 3000	-4.72	7.22	8.22	18.18	11.80
S&P 500	-4.27	8.25	9.06	18.59	12.50
International Equities					
MSCI EAFE	6.86	4.88	6.05	11.77	5.40
Emerging Equities					
MSCI Emerging Markets	2.93	8.09	1.44	7.94	3.71
Domestic Fixed Income					
Barclays US Aggregate Bond	2.78	4.88	0.52	-0.40	1.46
International Fixed Income					
Barclays Global Aggregate Ex USD	2.53	1.46	-3.47	-2.35	-0.18
Global Real Estate					
S&P Global REIT	1.66	6.61	-2.25	9.01	3.87
Tangibles & Commodities					
S&P GSCI Enhanced Commodity	4.61	2.71	1.64	21.28	3.99

The trend of consistent U.S. stock outperformance over international stocks sharply reversed in the first quarter. The differential in returns between these two categories was 11.58% in the first quarter, which was the largest difference between these two categories in favor of international stocks since the mid-2000s. Stock markets in Latin America and Europe in particular were up double digits over this period.

One factor driving this trend is increased investment by foreign governments in their own economies in the wake of U.S. tariffs. Germany, in particular, recently passed a \$1 trillion infrastructure and defense spending bill designed to stimulate the German economy and boost European defense capabilities. Investors have not seen investments of this scale in foreign economies in recent years, and these investments are spurring excitement in the renewed growth potential of international stocks.

Another factor driving international stock outperformance in the first quarter was currency fluctuation. In the fourth quarter of 2024, the U.S. dollar strengthened significantly against foreign currencies, however, this trend reversed in the first quarter, with the U.S. Dollar Index falling about 5% compared to a basket of foreign currencies. This fall in the U.S. dollar was a boost to international stocks.

U.S. bond returns of 2.78% was a very solid start to the year. Bond returns were boosted by a drop in longer-term interest rates as the 10-year Treasury Bill decreased from 4.57% to begin the quarter to 4.16% by quarter-end. Looking at the entire bond market, the yield curve, which measures bond yields across various maturity lengths, has started to steepen. This means that investors are now being compensated for investing in longer-term bonds and that short-term cash alternatives, such as CDs, savings accounts, and money market funds, have lost the significant yield advantage that they have had over traditional intermediate-term bonds over the past few years. While many investors have enjoyed strong returns on cash in recent years, the steepening of the yield curve is a healthy dynamic for the fixed income markets.

One theme emerging from these various crosscurrents in the first quarter is that portfolio diversification still works. Investors who abandoned balanced models and chased returns in the high-flying technology sector, which has been a huge winner over the past two years, are now facing the consequences of such investment concentration. Even within the U.S. stock market, diversification has boosted returns with high dividend and value-style stocks holding up over the selloff. The Magnificent 7 group of large technology companies was down over 15% in the first quarter while the value side of the U.S. stock market, which includes more traditional manufacturing and banking companies, was up over 2% for the quarter.

Most recently, President Trump announced additional tariffs on April 2nd only to reverse course one week later and pause most of the newest tariffs except for those placed on China. This has led to significant volatility in global stock markets, with the S&P 500 Index experiencing multiple trading days down by over 4% as well as a recovery day up over 9%. Volatility of this level has not been seen since the onset

of the pandemic in March of 2020. What is unique about this market action is how directly it has been the result of the president's policy direction. In particular, the Trump Administration's latest discourse has focused on the U.S.'s trade deficits with other countries. Trade imbalances do not get resolved overnight, so it is unclear what long-term tariff rates will be and what the ultimate impact will be on the U.S. economy.

These latest headlines will likely not be the end of tariff-related market volatility. Markets will continue to be forward-looking and price in the latest tariff news as it is announced, but as we have seen those announcements can come suddenly and shape the markets quickly. During times like these, it is paramount to maintain a long-term investment strategy and avoid overreacting to short-term news, which we will continue to do as stewards of your investment savings. Over the long term, markets will recover and make new highs as they always have in the past.

This is not to say that tuning out media headlines and waiting for the latest announcements on tariff policy is easy. We are all humans, and we are all tempted to let emotions rule financial decision making. When this happens, our best guide is to remember that a plan has already been put in place ahead of time in preparation for such a scenario as this. That plan is your asset allocation, and it is the unbiased, unemotional bedrock that we use to guide you through times of market volatility and maintain focus on the long-term.

In the meantime, if you have questions about your portfolio or our strategy or if you would like to discuss the markets in more detail, please do not hesitate to reach out to your Harbor Group team.

Sincerely,

Your Harbor Group Team