Q1 Market Review

Stress Test

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U.S. stock markets declined in the first quarter of 2025, making it the worst quarterly performance since 2022. The downturn was largely attributed to escalating trade tensions under President Donald Trump's administration - including the announcement of widespread tariffs on imports - which sparked fears of a global trade war and potential stagflation. The S&P 500 finished the first quarter, -4.4% total return, while the Nasdaq Composite fell -10.5%, and the Dow Jones Industrial Average declined -1.3%. Technology stocks, particularly the "Magnificent Seven," suffered notable losses, with companies like Nvidia and Tesla experiencing outsized declines. Defensive sectors such as healthcare, consumer staples, and utilities outperformed as investors sought safe-haven investments amid the uncertainty. Despite price volatility, earnings for the S&P 500 remained positive, with an estimated increase of 7.3% year-over-year for Q1 2025, marking the seventh consecutive quarter of growth. As we enter the second quarter, we expect continued volatility due to the administration’s aggressive trade policies, inflationary pressures, and the potential for an economic slowdown. Factors which will impact our investment decisions in the second quarter include the state of the U.S. economy and unemployment rates, inflation and interest rates, U.S. consumer sentiment, the broadening of the U.S. stock market performance drivers, and corporate earnings projections.

INVESTMENT COMMITTEE

Thomas Famigletti
Company Founder &
Vice Chairman

Douglas Famigletti, CFA
Managing Partner &
Portfolio Manager

Michael Jamison
Managing Partner &
Portfolio Manager

John Carey
Managing Director &
Portfolio Manager

Carl Morganstein
Managing Director &
Portfolio Manager

Thomas Loizeaux
Managing Director &
Relationship Manager

Brian Famigletti
Managing Director &
Head of Marketing

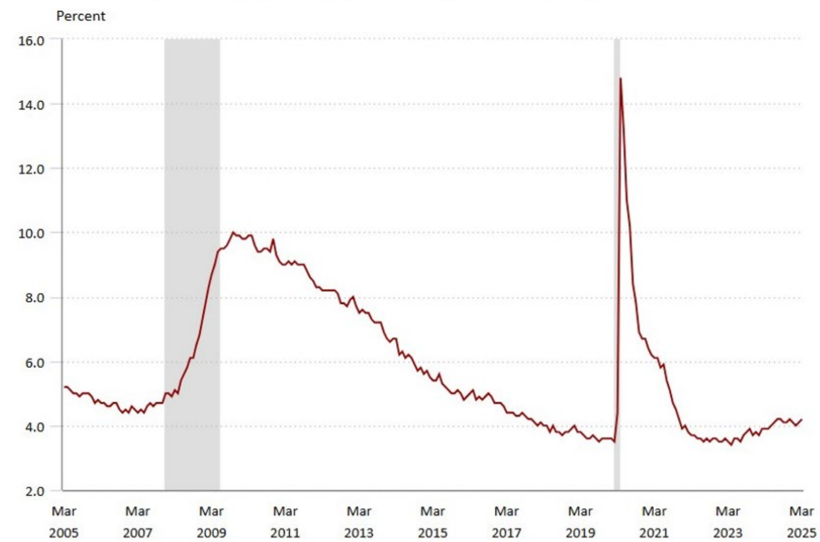
Joseph LoBue, CIPM
Head Trader

The Economy

Preliminary data from the Bureau of Economic Analysis (BEA) suggests that the U.S. economy contracted at an annualized rate of 2.2% in Q1 2025, the largest contraction we've experienced since the COVID-19 pandemic. At the same time, the U.S. Bureau of Labor Statistics reported that the economy added approximately 152,000 jobs per month, a modest slowdown from the 173,000 monthly average in Q4 2024. Unemployment continued to remain stable, averaging 4.1% throughout the quarter (*Figure 1*). Despite general economic stability, there are several factors which may introduce headwinds. According to Reuters, Federal workforce reductions across various agencies have raised concern regarding the outlook of public sector employment. Banks have noted increased risk regarding consumer spending as prices of consumer goods and household debt levels rise. Economic uncertainties related to the new tariffs have increased the possibility of recession in the next year. As a result, we are taking a cautious outlook towards the U.S. economy for the remainder of the year until we begin to see increased signs of stability.

Figure 1

U.S. Civilian Unemployment Rate (seasonally adjusted)



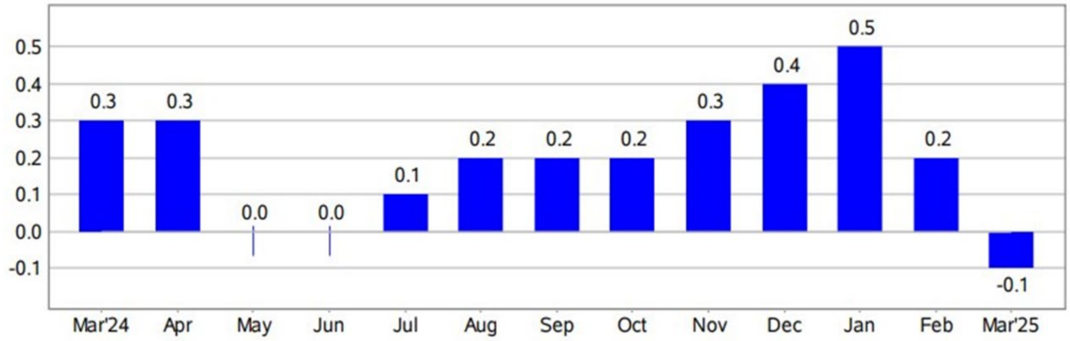
Source: U.S. Bureau of Labor Statistics

Inflation and Interest Rates

The United States is currently experiencing moderate inflation and stable interest rates, with increased political pressure on the Federal Reserve. For the 12 months ending in March 2025, the annual inflation rate in the U.S. was 2.4%. Core inflation, which excludes food and energy, stood at 2.8% year-over-year, marking the smallest 12-month increase since March 2021. Preliminary data for April indicates a slight uptick in inflation, with the year-over-year Consumer Price Index *(Figure 2)* estimated at 2.38% and core CPI at 2.76%. The Federal Reserve has maintained the Federal Funds Rate at 4.25%–4.50% since January 2025. The Fed has emphasized a "wait and assess" approach – until there is clear visibility into the economic impact of Trump's policies – before making rate adjustments. Recent tariffs, such as those imposed on Chinese imports, have raised concerns about potential stagflation (a combination of stagnant growth and persistent inflation). Fed officials, including Chicago Fed President,

Figure 2

One-month percent change in CPI for All Urban Consumers (seasonally adjust 3/24-3/25)



Source: U.S. Department of Labor

Austan Goolsbee, have warned that political interference with the Fed's independence could lead to higher inflation and unemployment. The Fed's next policy meeting is scheduled for early May, where officials will examine the current economic conditions and determine the appropriate course of action for interest rates.

The Consumer

The U.S. consumer landscape can be characterized as tentative. Overall spending has fallen, and several indicators point to a negative shift in behavior amid the uncertainty. The University of Michigan recently published its preliminary consumer sentiment numbers for March. Per *Figure 3*, sentiment has declined by 10.5% since February 2025 and 27% since March 2024. Additionally, economic conditions, consumer expectations, personal finances, economic outlook and buying conditions have all fallen month-over-month and year-over-year. The decline reflects widespread pessimism across demographics, fueled by fears of rising inflation and unemployment amid escalating trade tensions. While spending continues, it is more strategic, with a focus on value and necessity. Retailers and policymakers will need to monitor these trends closely, as consumer behavior will play a critical role in shaping economic trajectory in the coming months.

Figure 3

	Mar 2024	Feb 2025	Mar 2025
Index of Consumer Sentiment	79.4	64.7	57.9
Current Economic Conditions	82.5	65.7	63.5
Index of Consumer Expectations	77.4	64.0	54.2

Source: University of Michigan, 2025 Consumer Sentiment Survey

The U.S. Stock Market

In Q1 2025, the “Magnificent Seven” (Apple, Microsoft, Amazon, Alphabet, Nvidia, Meta, and Tesla) experienced significant declines, with the group collectively falling by approximately -14.6%. Tesla led the downturn with a drop of over -35%, while Nvidia and Alphabet also experienced substantial losses. This marked a stark contrast to the Magnificent Seven’s strong performance in previous quarters, where it had been the primary driver of market gains. According to S&P Global, the underperformance of these mega cap giants has led to a shift in market dynamics as the equal-weighted S&P 500 index (-.61% total return) outperformed the market-cap-weighted version (-4.4% total return). The high valuations of the seven stocks likely raised questions about their future growth potential, leading investors to seek opportunities elsewhere. Per *Figure 4*, sector performance in the first quarter was led by Energy (+9.1%), Healthcare (+6.1%), and Utilities (+4.2%). Consumer Discretionary (-12%), Technology (-11.2%), and Industrials (-.5%) were the worst performing sectors. The transition away from the concentrated leader-

Figure 4

Sector	Q1 2025 (Total Return)
Basic Materials	+2.2%
Communication Services	-0.4%
Consumer Discretionary	-12.0%
Consumer Staples	+3.9%
Energy	+9.1%
Financial Services	+3.1%
Healthcare	+6.1%
Industrials	-0.5%
Real Estate	+2.9%
Technology	-11.2%
Utilities	+4.2%

Source: S&P Global

ship of the "Magnificent Seven" towards a more diversified set of market drivers reflects changing investor sentiments and a response to various geopolitical tensions, regulatory scrutiny and valuation concerns. We hope that this trend continues well into 2025 as it creates a healthier dynamic for diversified investors.

Earnings Outlook

Ed Yardeni, President of Yardeni research, has recently adopted a more cautious outlook on S&P 500 earnings growth for the remainder of 2025 primarily due to rising stagflation risks stemming from new U.S. tariffs and a potential economic slowdown. Per *Figure 5*, he has made the following adjustments:

- Yardeni has lowered his base-case earnings estimate for the S&P 500 to $260 per share for 2025, down from a previous estimate of $275. For 2026, he reduced the estimate to $300 from $320. These adjustments reflect concerns over a potential growth recession and squeezed profit margins.
- His revised target range for the S&P 500 by the end of 2025 is 5,100 to 6,000, with the best-case scenario at 6,000. This is a downward revision from earlier, more optimistic projection.

Figure 5

S&P 500 EARNINGS FORECASTS: YRI VS ANALYSTS' CONSENSUS

Year / Quarter	a / e *	Yardeni Research - Level	y/y%	Analysts' Consensus - Level	y/y%
2023	a	221.4	1.5	221.4	1.5
Q1	a	53.1	-3.1	53.1	-3.1
Q2	a	54.3	-5.8	54.3	-5.8
Q3	a	58.4	4.3	58.4	4.3
Q4	a	57.2	7.5	57.2	7.5
2024	a	242.7	9.7	242.7	9.7
Q1	a	56.6	6.6	56.6	6.6
Q2	a	60.4	11.3	60.4	11.3
Q3	a	63.2	8.2	63.2	8.2
Q4	a	65.0	13.7	65.0	13.7
2025	e	260.0	7.1	266.0	9.6
Q1	e	63.0	11.4	60.2	6.4
Q2	e	65.0	7.6	64.5	6.8
Q3	e	62.0	-1.9	69.2	9.4
Q4	e	70.0	7.7	71.8	10.4
2026	e	300.0	15.4	304.1	14.3

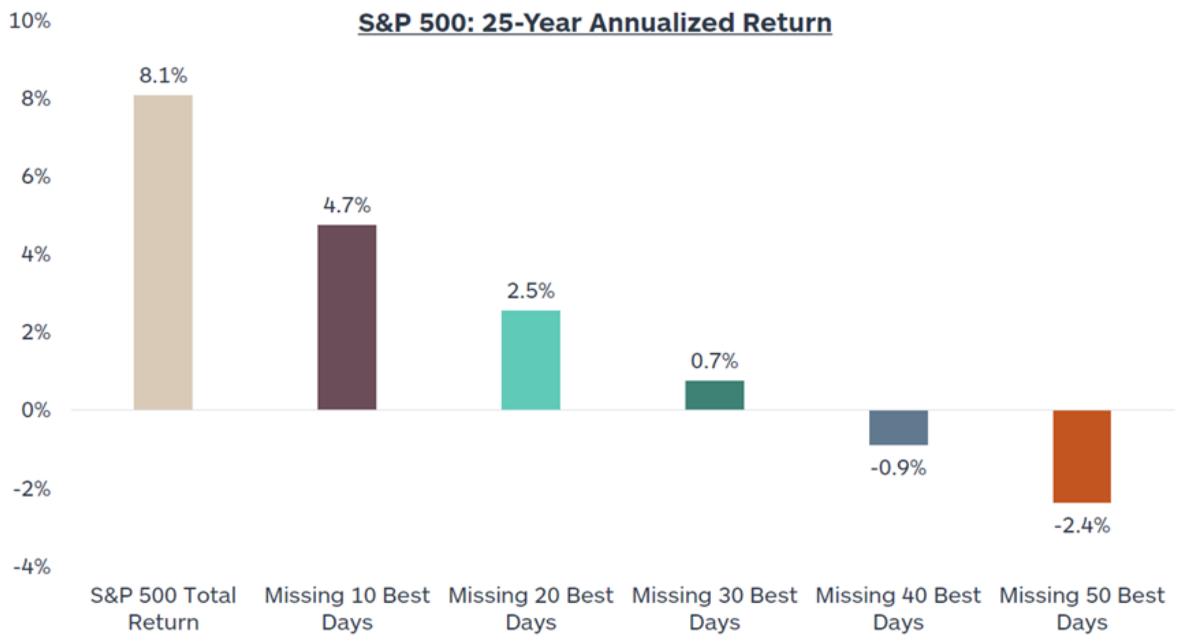
Source: Yardeni Research

Yardeni has also increased the probability of a stagflation scenario to 45%, previously up from 35%. This shift can be attributed to new tariffs, including a 25% levy on imported autos and parts, and similar duties on steel and aluminum. Despite Yardeni's near-term caution, he maintains a long-term bullish outlook, envisioning the S&P 500 reaching 10,000 by the end of the decade, driven by strong corporate earnings and productivity gains.

The Next 12 Months

We believe "Stress Test" is an appropriate way to describe the turbulence and volatility that global economies and financial markets are experiencing since Trump took office, and particularly since "Liberation Day." Although this is an uncomfortable time, it is important to remember that we have experienced dozens of events – like the current one – that have tempted investors to exit the market including the Dot com bubble, 9/11, the Financial Crisis, the European Debt Crisis, and Covid-19 to name a few. When looking back, all these events were transitory and relatively insignificant for long-term investors that stayed the course. *Figure 6 (next page)* from Cerity Partners reminds us why "time in market is more important than timing the market." Missing out on just some of the best days can have a negative impact on portfolios. Despite challenging

Figure 6



Source: Cerity Partners – date range is 3/1/2000 to 2/28/2025

market sentiment and ongoing volatility, our long-term outlook remains optimistic. Over the next 12 months, we believe that positive market factors, including extended or additional tax relief, deregulation in the United States, a broadening of sector participation, and adjustments to new tariffs, will prevail and lead markets forward. As we have done during past corrections and bear markets, we will continue to look for individual investment opportunities, particularly among high-quality stocks that were previously overvalued but can now be acquired at more attractive prices. Please reach out to us if you have any questions about the financial markets or your investments.

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