Quarterly Market Update for Q2 2025: Volatility, Tariffs, and Consumers

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The famous investor Peter Lynch once wrote that "far more money has been lost by investors trying to anticipate corrections, than lost in the corrections themselves.” The topic of stock market corrections, defined as declines of 10% or more from all-time highs, rose to the forefront in the first quarter as major market indices stumbled. However, as Lynch’s quote suggests, taking a longer perspective reveals that despite recent swings, the stock market has still made significant gains over the past few years. Amid ongoing market and economic uncertainty, it’s important for long-term investors to not lose sight of this fact.

Continued turbulence in financial markets is the result of tariffs on major trading partners and the possibility of reciprocal tariffs against many others. While there are concerns that a trade war could slow global economic growth, much of the market’s recent moves are simply due to uncertainty around what, when, and how these tariffs will be implemented. The possibility of higher prices for everyday goods and services has also raised concerns among consumers, feeding worries about inflation and slower spending.

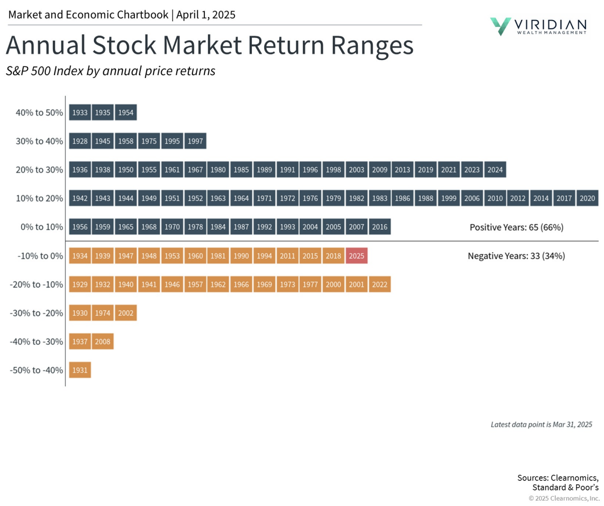
In general, the stock market dislikes uncertainty since it makes it difficult to assess risk and determine asset prices. The wide range of possible outcomes only makes this more challenging, and is why markets experienced daily swings in the first quarter.

However, proper investing and financial planning is not about picking a single asset class or reacting to daily headlines. Instead, holding an appropriate portfolio that can withstand all phases of the market cycle is the best way to achieve financial goals. This approach has benefited from the many other asset classes that have supported balanced portfolios this year, including bonds, international stocks, and alternative assets such as commodities. This will be important to remember in the coming months as uncertainty continues.

Key Market and Economic Drivers

- The S&P 500 declined 4.6% in the first quarter of the year, the Nasdaq 10.4%, and the Dow Jones Industrial Average 1.3%.
- The Bloomberg U.S. Aggregate Bond index gained 2.8%. The 10-year Treasury yield ended the quarter at 4.2% after reaching as high as 4.8% in January.
- Developed market international stocks (MSCI EAFE) gained 6.1% and emerging market stocks (MSCI EM) increased 2.4% in the quarter.
- Gold rallied to a new record level of $3,122 per ounce, while Bitcoin declined to $82,421. The U.S. Dollar Index fell to 104.21.
- In the economy, headline inflation (Consumer Price Index) rose 2.8% year-over-year in March, while the Core measure, which excludes food and energy, rose 3.1%.
- The University of Michigan Consumer Sentiment index fell to 57, the lowest level since 2022. Consumers expect inflation of 5% over the next year.
- The Federal Reserve kept rates unchanged within a range of 4.25 to 4.5% in March, but slowed the pace at which assets will roll off its balance sheet.

Major stock market indices stumbled in Q1



The stock market experienced its first negative quarter since the third quarter of 2023. The chart above shows that the year-to-date return for the S&P 500 is in negative territory at this early point in the year. However, it also shows that this is quite normal for the stock market. Historically about two-thirds of years are positive while one-third are negative. Despite these down years, the stock market has grown steadily over history, across decades and market cycles.

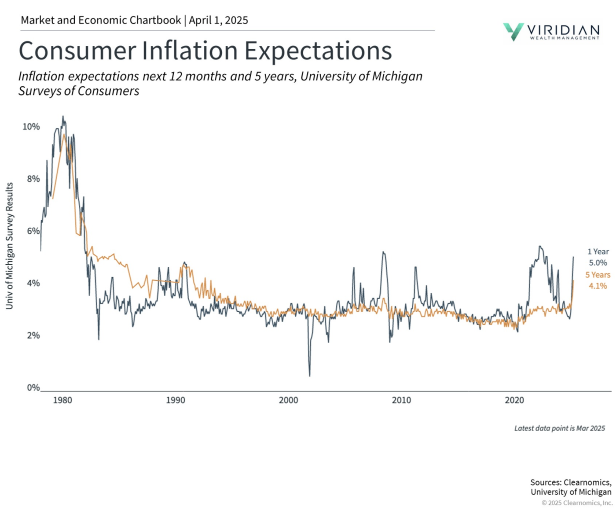
As the second quarter begins, there is still a great deal of uncertainty. Where the market goes from here will likely depend on how corporate earnings and the economy perform, especially once there is greater clarity. This is largely because markets have been driven by large technology companies with lofty growth expectations, and because valuation ratios have been elevated.

Fortunately, earnings-per-share growth for the S&P 500 has remained strong, with current consensus expectations suggesting that earnings could grow as much as 12% in the coming year. While these Wall Street forecasts should always be taken with a grain of salt, they suggest that many stock market fundamentals are still strong.

For investors, bonds play an important role in these market conditions by offsetting the pullback in stocks. Bond prices tend to rise when interest rates fall since existing bonds with higher yields become more valuable. Thus, when the market struggles due to growth concerns, this often pushes down interest rates, which then support bonds and balanced portfolios.

In fact, many types of bonds have performed well this year including TIPS, mortgage-backed securities, Treasurys, and corporate bonds. This is a reversal of the past few years when high inflation and rising interest rates created the most challenging bond environment since the mid-1990s. This is also a reminder that a key principle of successful investing is holding a diversified portfolio that is aligned with long-term financial goals.

Tariffs have raised concerns among consumers



Trade policy weighed heavily on investors' minds in the first quarter. According to the AAII Investor Sentiment Survey, individual investors became the most bearish they have been since 2022. Investors are still waiting for clarity on the size, scope and duration of tariffs, and several countries sought to negotiate mutually-acceptable terms ahead of the April 2 deadline for retaliatory tariffs.

The inflation outlook added to the uncertainty in the quarter. Key measures of inflation, including the Consumer Price Index and the Personal Consumption Expenditures Index, moderated during the first quarter of the year, but remained stubbornly above the Fed's target of 2%. Some economists worry that tariffs will raise prices on imported goods, which will raise the prices of goods and services more broadly.

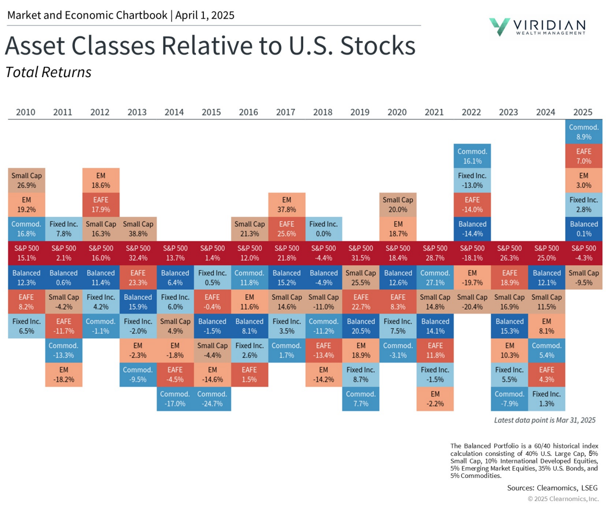
All of these factors weighed on consumer sentiment which continued to slide to historically low levels. In March, the University of Michigan Surveys of Consumers showed that consumers expect long-term inflation to be 4.1%, its highest level in three decades, in anticipation of higher prices due to tariffs. The one-year expectation of 5.0% is a sharp acceleration from last year when inflation continued to improve.

Given the inflation experience of the past few years, it's not surprising that households are worried about higher prices. Counterintuitively, actual consumer spending remains relatively healthy. The robust job market, with unemployment still only 4.1%, has supported consumer income statements. Wages also continue to rise (even after accounting for inflation), leading to more financial stability even in the face of higher debt loads. While this isn't true for all households across the country, these figures suggest that many are still in healthy financial shape.

Given limited visibility into trade policy outcomes, the Fed downgraded its outlook for the economy in 2025. Their March Summary of Economic Projections contains a forecast of just 1.7% GDP growth for the year, below 2% for the first time since 2022. They also expect more stubborn inflation, even while the job market remains strong.

Still, the Fed is not cutting rates despite weaker numbers since they view tariff effects as "transitory," meaning they are one-off events that could fade over time. For example, tariffs on washing machines in 2018 highlight how, after an initial increase, prices stabilized. That period also underscores the fact that tariffs were used by the first Trump administration as a negotiating tactic to achieve longer-term trade deals.

Other asset classes have performed well this year



Bonds weren't the only asset class to have a positive return in the first quarter. International markets also performed well with both developed market and emerging market stocks experiencing gains. International investing has been challenging the past several years due to both the outperformance of U.S. stocks as well as global economic and geopolitical challenges. The weakening U.S. dollar also helped to boost international stock returns, as the value of those assets in their local currencies increased.

This highlights the importance of investing across different asset classes, regions, and sectors, both in good and difficult markets. While a balanced portfolio is never the best performer, and may not always outperform the S&P 500, it creates a much smoother ride. This allows investors to focus not on short-term market moves, but on staying on track to achieve their long-term goals. When done well, ideally with the guidance of a trusted advisor, it also has the benefit of allowing investors to sleep well at night.

The bottom line? Market uncertainty is never comfortable, but short-term swings are a normal part of investing. The first quarter serves as a reminder of the importance of holding a balanced portfolio to achieve long-term financial goals.

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