

# Monthly Download

## March 2025

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### Summary

**Negative equity market performance continued** in March amid intensifying tariff threats, uncertainty around US tariff policy implementation, higher than expected inflation readings, and weaker US consumer sentiment data. Trade war developments again dominated headlines, and markets anxiously anticipated more detail on reciprocal tariffs scheduled for April 2<sup>nd</sup>. Foreign markets continued their positive momentum as investors are now expecting large fiscal stimulus packages from both the European Union and China that should help lift the economic growth outlook for both regions.

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### Market Overview

- ◆ **Equity markets** fell as investors grew more concerned about the economic outlook and potential price increases from the Trump's administration's reciprocal tariff plans. Magnificent 7 stocks had their worst monthly performance during the 2.5-year rally since ChatGPT was initially launched in 4q22, dropping 10.5% and bringing losses to 15% year to date, contributing to the underperformance of US stocks relative to global markets. Positive momentum continued for China and Europe during the month.
  - US Large Cap stocks (S&P 500) fell 5.6% for the month as mega cap technology stocks stumbled. The S&P 500 index underperformed the equal-weight index as sectors including Information Technology and Consumer Discretionary and Communications in the cap-weighted index were the worst performing sectors. Eight of the 11 sectors posted negative performance and only Energy and Utilities generated positive returns. The Index now sits at a loss of 4.3% for 2025.
  - US Small Cap stocks (Russell 2000) delivered negative returns of 6.8% as higher rates weighed more on small cap companies. Technology, Consumer Discretionary, and Telecom were the largest detracting sectors during the month. Year to date returns now stand at -9.5%.
  - Non-US stocks (MSCI EAFE Net) were down 0.3% in March, outperforming U.S. markets, driven by the outperformance of European equities. European Aerospace and Defense stocks and Financials were the top performing sectors. Defense stocks surged 11% as Eurozone nations committed to large fiscal stimulus targets designed to achieve military independence. Year to date returns remain up 7.0%.
  - Emerging Markets (MSCI Emerging Markets Net) added 0.7% during the month led by China and India. The Chinese government unlocked further fiscal stimulus measures in March to support consumption and cushion the impact of an escalating trade war. India's equity markets rallied in March after a five-month losing streak that led to the return of foreign inflows and investors buying the dip. Emerging markets are now up 3.0% in 2025.
- ◆ **Interest rates** fell more significantly on the front end of the treasury curve, with the 2-Year US Treasury Yield declining close to 10bps while the 10-Year US Treasury yield declined just 2bps ending the month at 4.21%. The bigger decrease in 2-Year rates reflects the market's anticipation of rate cuts by the Federal Reserve given the weakening sentiment. The Federal Reserve kept rates unchanged in their March policy meeting and cut their growth forecast for 2025.

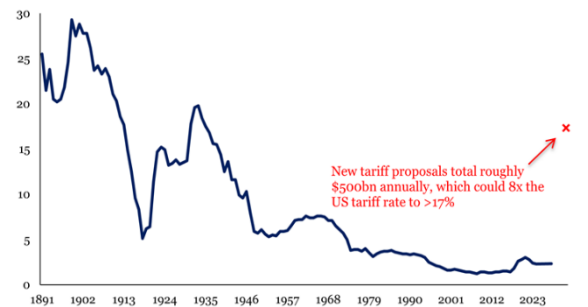
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- High Grade Taxable bonds (Bloomberg US Aggregate) returned 0.0% as concerns grew regarding US growth risks combined with higher than expected inflation numbers. Year to date gains remained at 2.8%.
  - Municipal bonds (Bloomberg 1-10 Year Muni Bond) declined 0.7% in March. Municipals underperformed taxable bonds, as the broader risk-off sentiment drove interest rates lower and municipal bond spreads wider. Year to date gains for municipal bonds are now 0.8%.
  - Investment Grade bonds spreads widened to levels last seen in September 2024 and High Yield spreads widened even further, weighed down by the prospect of a slowdown in economic growth that could come from escalating tariff wars. Investment Grade bonds (Bloomberg Corporate Investment Grade) and High Yield bonds (Bloomberg Corporate High Yield) returned -0.3 % and -1.0% in March, respectively. Year to date returns for Investment Grade and High Yield bonds are now up 2.3% and 1.0%, respectively.
- ◆ **Commodities** (Bloomberg Commodity Index) rose 3.9% during the month with precious metals leading the pack as risk off sentiment and higher inflation risk drove investor flows to Gold. The yellow metal reached new highs and rallied 10% in March. Oil prices also climbed over 3% on concerns that supply could decline if President Trump imposes tariffs on Russia or escalates tensions with Iran.

## Economic Commentary

**President Trump's reciprocal tariff deadline** cast a shadow over markets throughout March. The plan was announced on April 2<sup>nd</sup> after US markets closed and included 10% universal base tariffs, 25% tariffs on all automobile imports, and varied reciprocal tax rates across 60 nations with China as high as 34%<sup>1</sup> and the European Union at 20%. Canada and Mexico, the other two largest U.S. trading counterparties were not listed in the reciprocal tariffs. The overall April 2<sup>nd</sup> tariff package was generally described by analysts as their worst-case scenario and surprised markets to the downside versus expectations. While President Trump described the reciprocal tariffs as "50% of what they charge us" the calculation of foreign tariffs included non-monetary factors, value-add taxes (VATs), and currency manipulation, increasing the number the 50% reciprocal tariff was based upon. European Union (EU) tariffs according to the World Trade Organization (WTO) are below 3% on a trade-weighted basis, but the EU's VAT structure and currency led to a 39% calculation in the President's reciprocal tariff announcement, resulting in a 20% tariff (they rounded up) that was far higher than the market expected for the EU. The administration also provided a shorter timeline for tariff implementation, reducing market expectations that the reciprocal tariffs were a tool for negotiation prior to implementation. Auto tariffs were immediate and other measures were scheduled to begin between April 5<sup>th</sup> and 9<sup>th</sup>. Based on analysis done by Strategas, the April 2<sup>nd</sup> policy announcement and the existing tariffs already implemented since February will generate the equivalent tax revenue of around 2% of GDP, about \$500-600b. Strategas described this number as double the largest tax increase in US history. The rough math on the new tariff policy translates to an increase on average US imports from 2-3% to closer to 20%.



Average US Import Tariff Rate  
Source: Strategas

Markets responded to the April 2<sup>nd</sup> announcement with a substantial sell-off and market decline on April 3<sup>rd</sup>. The S&P 500 Index dropped 4.8%, US 10-Year Treasury Yields fell 14bps, the market's fear index of expectations on forward volatility for the S&P 500 Index (known as the VIX) increased from 21 to 30, and the US Dollar Index declined by 1.8%.

<sup>1</sup> China's 34% reciprocal tariff will be in addition to a previously levied 20% tariff on Chinese imports to the US.

We entered 2025 with optimism around S&P 500 earnings growth and the benefits of tax extensions and deregulation along with a more accommodative Federal Reserve. Business and consumer confidence had skyrocketed after the November election given expectations on the positives of Trump economic policies and the script from his 1<sup>st</sup> term. There is little to be positive about assuming the tariffs are implemented as laid out on April 2<sup>nd</sup>. At minimum, the sudden hike in tariffs on US imports will dramatically impact earnings for many US companies, increase prices for US consumers, and therefore lead to a reduction in economic activity which could include recession. Business and consumer confidence will plunge even further than levels that were already showing declines from Trump's tariff threats in February and March. Even if one agrees with the administration's message about the benefits of bringing production and manufacturing jobs back to the US, those benefits will take multiple years to bear fruit, while the pain will be more immediate. Possible offsets to the tariff impact could include Republicans in Congress prioritizing pro-growth measures like tax rates and deregulation or the Fed being more aggressive on reducing interest rates.

The tariff policy as it currently stands creates a free-for-all of negotiations for companies, industries, and countries to all line up and make their case for exemptions. This likely creates the type of negotiating frenzy that President Trump seems to enjoy and an environment in which he believes he thrives. It also serves to consolidate power even further in the executive branch. All of the recent tariffs are being implemented under the President's perceived authority from the International Emergency Economic Powers Act of 1977 (IEEPA). IEEPA was put in place to give the President authority in the event of national emergency ("unusual and extraordinary threat to national security, foreign policy, or economy of the United States") to impose regulations on international commerce. We would not be surprised to see courts weigh in on whether the current environment and broad nature of the reciprocal tariff policy meets the standard of IEEPA's intent. In addition, Congress, which is supposed to regulate international commerce in normal times, may look to assert more control on tariff policy<sup>2</sup>, although it is less likely in a Republican-controlled legislature.

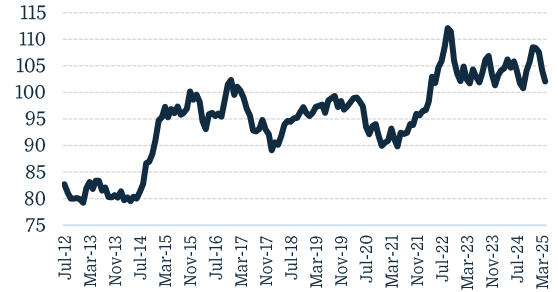
Business owners of capital good companies looking to sell their products in the US without domestic production will now have to decide between adjusting their supply chains back to the US through long-term capital investments, passing along price increases to US consumers, dealing with shareholders on shrinking financial margins, or waiting out the administration to see if the new policy changes based on blowback or after a future election. That does not sound like a robust environment for economic activity in the near-term. We would humbly suggest that the Trump administration consider a review of the trade policies from their 1<sup>st</sup> term. There is one major economy that has significant tariffs on US products entering their markets, actively manipulates their currency relative to the US dollar, subsidizes input costs for their companies that compete globally, requires joint ventures with local companies to enter their market, and actively captures intellectual property from foreign companies. That country is China, and while they are being hit hard with an additional 34% tariff on top of the existing 20% tariff increase from earlier in 2025, there will likely be a significant amount of collateral damage to other countries that appear to be more friendly and aligned with US interests. One could reasonably argue that the new US tariff policies actually help China's position with the rest of the world in the absence of US leadership for trade deals and introduction of Chinese products and technology.

Assuming the administration does not follow our advice above to focus on China (which is likely) and holds firm in the face of the economic and market volatility (less likely, but they are talking tough for now) there are implications for US investors to navigate this upending of global trade policy. The implication for overall risk-taking is always the most difficult assessment. The starting point is the outlook for risk assets is diminished in terms of upside and the risks have increased, yet markets have already priced in just over a 12% decline from market highs earlier in 2025. Foreign governments initially appear likely to retaliate to this round of US tariffs with their own tariff increases or other economic policies towards the US to attempt to create leverage in any negotiation. The US and Trump's team seem likely they would then retaliate to the retaliation and the back and forth would not be constructive for markets. US

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<sup>2</sup> *Senators Grassley and Cantwell introduced a bill on April 3<sup>rd</sup> in the Senate that any tariffs through Presidential decree would expire after 60 days without Congressional approval.*

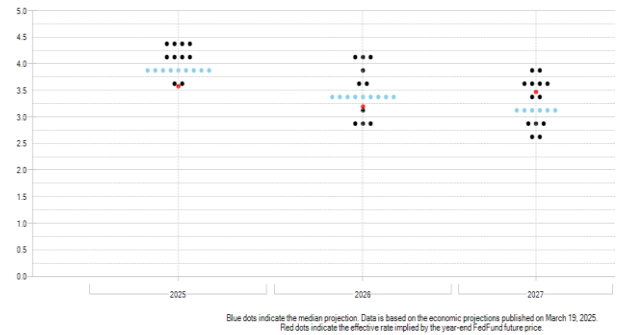
investors should pay attention to their likely concentration in US assets. The dominance of the US dollar and US markets has driven many US investors to abandon foreign markets or maintain foreign equity weightings well below the roughly 35% that foreign companies represent of the global equity market. The US dollar index has declined over 7% from its recent post-election high but remains well above levels from the prior decade. US tariff policies may discourage foreign capital from US markets, and if the Fed is more likely to cut interest rates to support the tariff-impacted economy, US Dollar performance is highly correlated with changes in the Fed Funds rate. While we do not believe the dollar's reserve status is in question, a weaker dollar fits with the current administration's goal of increasing US manufacturing and is worth considering.



**US Dollar Index**  
Source: Yahoo! Finance

There is some speculation that the Trump administration may prefer an early recession to clear the decks for stronger growth later in Trump's presidential term while lowering interest rates to help certain segments of the economy. We believe a tariff-induced recession would be an unforced error. The US's current fiscal position makes supporting economic growth in a downturn more challenging and predictable recessions are not a term economists utilize. It is now clear that the administration intends to prioritize its trade agenda versus the economic policies that were viewed positively by the market the first go around. Investors are on notice that risk levels and US dollar exposure should be actively monitored.

**The Federal Reserve** kept the benchmark rate unchanged in its March Federal Open Market Committee (FOMC) meeting and the median expectations of FOMC members still show two rate cuts in 2025, same as projections that were published in January. However, instead of one member, four members now penciled in zero rate cuts in 2025 compared to the last economic projection, striking a more subtly hawkish tone as the FOMC reduced its US GDP forecast by 0.4% to 1.7% while increasing core inflation expectations by 0.3% to rise to 2.8% annually, reflecting the impact that tariffs could have on inflation and economic growth. Investors' focus has shifted from achieving a so called "soft-landing" to how the Federal Reserve can achieve its dual mandate if faced with a possible stagflation scenario based on their reduced growth forecast and increased



**FOMC Participants' Assessment of Appropriate Monetary Policy: "Dot-Plot"**  
Source: CME Fedwatch.

inflation expectations. Based on sell side analysts, S&P 500 earnings are still expected to grow at 11.4% over the next twelve months, a slower pace than 2024 but not a sign of imminent recession. However, analyst earnings estimates do not yet include how tariffs would be worked into consumer spending and corporate earnings. So far soft data such as consumer confidence and inflation expectations are showing more negative readings, but hard economic data such as consumer spending and labor market remains stable. Whether this recent market decline is a short-term correction on valuations or the early sign of recession and earnings decline remains to be seen. Tariff negotiations and how the tariff policy impact will be felt across the economy will create more volatility and make the Federal Reserve's job even more difficult than usual.

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**European defense stocks soared** supported by a slew of concrete actions by the EU aimed at boosting defense spending over the next decade. The Select Stoxx Europe Aerospace & Defense ETF (Ticker: EUAD) rose over 8% in March and is up 38% in 2025 on anticipated spending as the EU rushes to achieve defense independence as a result of US policy towards Ukraine. The EU endorsed a plan to free up hundreds of billions of euros to add to their defense budgets in early March. Germany, Europe’s largest economy saw its parliament remove the country’s constitutional debt brake on defense spending. The debt brake is a mechanism to limit government borrowing which Germany adopted post Global Financial Crisis to avoid the instability that excess debt had brought on neighboring European nations. As a result, Germany has the lowest Debt to GDP ratio amongst the Eurozone nations at 66%. The rigid debt brake has been blamed for

Germany’s underinvestment in infrastructure and technology over the last decade. The law change could mark a decisive turning point for Germany and the EU when it comes to defense independence. Despite the enthusiasm reflected in the stock prices, the road to fulfilling that goal is not as clear. There is obvious preference to source supplies only from European suppliers. Europe currently imports 78% of its defense equipment from outside of the EU, with 63% from the U.S. alone. Out of the top 10 western defense companies ranked by revenue, seven are U.S. companies. After decades of underinvestment in the sector, European suppliers alone will not be able to meet the demand for rearmament. It will take careful collaboration with the U.S. to achieve the rebuilding of its defense capabilities. Given the current climate of protectionism, it is uncertain how cooperative the U.S. government will be despite a goal both governments may share. Increasing defense spending in Europe is not unanimous. There are already disagreements amongst EU nations regarding the defense spending plan with Spain and Italy wanting to opt out. It remains to be seen how effective political support will translate into real action and progress despite the initial excitement in the stock prices to date.

Country	Company	Revenue (\$bn)	Percentage of Revenue from Defense
US	Lockheed Martin	63.6	96%
US	RTX	39.6	59%
US	Northrop Grumman	32.4	89%
US	Boeing	30.8	46%
US	General Dynamics	30.4	77%
UK	BAE Systems	25.2	96%
US	L3 Harris	13.9	82%
Italy	Leonardo	12.9	83%
France	Airbus	12.0	20%
US	HII	10.6	100%

**Top 10 Western Defense Companies by Revenue**  
Source: Visualcapitalist.com.

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