



WALKER, HIGGINS & ASSOCIATES

WEALTH MANAGEMENT, LLC

Second Quarter 2025 Review and Outlook

Data Points

Stock Market Data @ 3.31.25

DOW Jones Industrial (DIA)	8.57%	3-year average annual return ⁱ
S&P500 Index (SPY)	8.98%	3-year average annual return
NASDAQ Composite (ONEQ)	7.86%	3-year average annual return ⁱⁱ
S&P Small Cap (IJR)	0.65%	3-year average annual return ⁱⁱⁱ
MSCI EAFE (EFA)	6.65%	3-year average annual return ^{iv}
U.S. Market Valuation	20.15	S&P 500 Forward P/E Ratio ^v
	16.93	S&P 500 Forward P/E Ratio 30-YR average ^{vi}

Interest Rates, Bonds, Federal Reserve Data @ 3.31.25

U.S. Aggregate Bond (AGG)	0.52%	3-year average annual return ^{vii}
3 Month U.S. Treasury Bill Yield		4.32% ^{viii}
10 Year U.S. Treasury Bond Yield		4.23% ^{ix}
U.S. Federal Reserve Effective Federal Funds Rate		4.25-4.50% ^x

2025 Quarter 1 Review

As we mentioned in our January writing, an increased level of market volatility seemed natural and inevitable. By the beginning of 2025, the U.S. stock market had gone a while without any meaningful pullback and valuations were elevated. Coupling stretched valuations with political change provided the necessary formula for the current correction we are experiencing as all the U.S. stock market averages are down in the first quarter. As we creep into April, the realization of tariffs and possibility of a trade war is at the forefront of the news and the market decline is accelerating.

First, we would remind you that corrections are normal. Since 1928, corrections occur about every 1.1 years.^{xi} Corrections often enable markets to “blow off” steam, which can be helpful in preventing major collapses. Furthermore, corrections can make market valuations more attractive. Finally, stock market return potential after corrections, historically has been strong. Jeffrey Buchbinder with LPL Financial writes, “Historically (since 1980), after corrections, the S&P 500 has been higher by an average of 13.1% three months later, with gains 92% of the time”.^{xii}

Second, before the April 2 tariff day, the U.S. stock markets have only recently touched the technical definition of a correction as the S&P500, and the NASDAQ have both been down a bit over 10%. As of this writing and after tariff day, the S&P500 index is 15% down from its high and the NASDAQ is 21% down from the high.

The central question that we feel needs the most focus, is this a normal correction within the confines of how it typically plays out, or is it the start of a recession and a true bear market?

U.S. Federal Government Spending & Debt

Before we jump into tariffs, we need to lay some groundwork. We have written about the size of the Federal government's debt in numerous quarterly newsletters over the years. So, it is nothing new to say that the size and growing nature of the amount of spending and debt is a substantial long-term concern. There are many ways to express the size of the debt: \$36 trillion^{xiii}; 121.8% of GDP^{xiv}; interest on debt equals 3.5% of GDP^{xv}. Whatever way you want to slice it, the Federal government's debt is large, rapidly growing, dangerous and unsustainable. Very simply, the debt is high because we spent too much over a long period of time—last year, the annual budget deficit was \$1.8 trillion.

There are many problems created by high government spending and debt. First, the higher the government spending, the more it limits private investment as there can only be so much money in circulation. This has been a big problem in Europe over the last 25 years—excess spending (coupled with high taxes and excessive regulations) has led to chronically low GDP growth rates.

When you print money excessively, it almost always results in inflation. Further, the U.S. government issues bonds to finance that debt and, obviously, has to pay interest on the bonds. Last year, the U.S. government paid \$1.2 trillion in interest.^{xvi} As debt matures and is refinanced, if it's excessively large, it has to do so at higher rates of interest to attract investors. Higher rates on U.S. treasuries lead to other rates like mortgage rates being higher.

High rates of government spending and debt limit the growth of the private sector and lead to higher inflation and higher interest rates. None of that sounds good. It is our belief that this cycle must be corrected if the U.S. is to remain the preeminent economy and country in the World.

This, we believe, is the purpose of DOGE. While it is impossible to talk about a true balanced budget without discussing reforms to entitlement programs, spending reform must start somewhere. If DOGE can reduce annual deficits by \$100s of billions, we view that as a step in the right direction. If Elon Musk, the guy who founded the most successful U.S. car company, who's company launches and reuses rockets routinely, and who pioneered free speech on social media, can't do it, we don't think it can be done.

Unfortunately, it is our view that attempts to reign in government spending will be difficult and contentious. There are powerful forces in Congress and elsewhere that want the piggy bank mentality to continue. It is likely to continue to cause uncertainty in the financial markets.

Tariffs and Trade Wars

As of this writing, April 2 has come and gone. At the announcement press conference, Trump laid out the so-called "reciprocal tariffs" and they, unfortunately, are even higher than the worst-case scenario estimate. If they are implemented, they will be the highest tariffs in over 100 years!

Trump's tariff announcement seems to have several objectives.

The first is to bring in revenue to the U.S. treasury. Remember the \$1.8 trillion budget deficit we outlined above? Maybe DOGE can close the gap by reducing government waste, fraud, and abuse. What about the rest? A tariff is nothing more than a tax on imported goods. If these tariffs stick, they will produce revenue for the U.S. government.

The second is to encourage companies to bring manufacturing back to the U.S, which could boost economic growth. Over a long period of time, the U.S. has lost its manufacturing and industrial base. Industrial production data show that manufacturing has grown in the U.S. just 4.3% in the past twenty-five years. Not 4.3% annualized, but 4.3% total! This translates to .2% annualized growth.^{xvii}

Perhaps President Trump's thinking is tariffs will encourage companies to produce goods here and, therefore, avoid the tax. Numerous large announcements have already been made that total well over \$4trillion to include \$500 billion from Oracle/SoftBank, \$150 billion from Taiwan Semi-Conductor, and \$500 billion from various Japanese interests. These large investments hopefully produce jobs and activity that will, in fact, generate growth. Not growth next week or this year, but hopefully long-term growth in the U.S.

Finally, these tariffs are meant to provide some fairness back into the global trade markets. As a general statement, it does seem that the U.S. ended up in an inferior position relative to other countries when it comes to tariffs. The U.S. simple average tariff rate across all imported goods has been low at 3.3%. Mexico imposes a tariff of 6.8% on imported U.S. goods—China is at 7.5%, the European Union is at 5%, and India is at 17%.^{xviii}

Make no mistake, as of this writing, the high nature of the announced tariffs could be game changing to the U.S. economy in the negative. We are surprised at how high these tariffs are. Should Vietnam's tariff, as an example, go from 9.4% to 46%? What if the rest of the world digs in and reciprocates those tariffs? China has already announced an additional 34% tariff against the U.S. Is this opening volley simply a place to start the negotiations and the final tariffs will be much less extreme? Or, if these high tariffs remain in place, would they trigger a sharp recession with rising inflationary pressures on the U.S. consumer and a bear market for stocks?

Unfortunately, we, along with many others, hoped for clarity after April 2nd. Instead, we received more unknowns. We think the coming weeks and months will be critical. Hopefully, if trade negotiations bear fruit and proposed tariff rates decline, the stock market will stabilize and eventually rebound.

Inflation & the FED

Adding to the uncertainty around tariffs, is the ever-present issue of persistent inflation. The FED's long-stated target of a 2% annualized inflation rate continues to be elusive. From February 2024-February 2025, CPI rose by 2.8%.^{xix}

Further, the Treasury Department will have to refinance \$7.5 Trillion in coupon securities (remember the debt?) over the next 3 years.^{xx} Unless, the Federal Reserve dramatically reduces interest rates, this refinance will occur at significantly higher rates. This will likely make interest cost to the U.S. government higher and a reduction in annual deficits much more difficult.

These issues place the Federal Reserve in a difficult position. If they keep interest rates elevated to keep inflation in check, it is likely the Federal government will pay significantly more in debt service costs. If they lower interest rates to make the refinancing more palatable, they run the risk of inflation escalating or even worse stagflation.

Current probabilities suggest that the Federal Reserve will try to cut rates 2-3 times in 2025.^{xxi} However, this is a moving target based upon tariffs, incoming economic data, pressure from Washington, D.C., stock market performance, etc. Jerome Powell has his hands full. As such, we continue to favor an approach of a significant portion of fixed income allocations being directed towards shorter duration. Frankly, if we can find yields of 5% in high quality, short duration bonds^{xxii}, we see little incentive of dramatically higher bond risks when there is so much uncertainty around stocks, tariffs and the economy.

Finishing Thoughts

As you would expect, the impact of tariffs will dominate headlines for the time being. These are historic. These are dramatically more substantial than even the most pessimistic projections. However, we continue to believe in American ingenuity and the private sectors ability to adapt. These two beliefs are what provide us with long-term optimism.

We think that the structural and systemic issues in the U.S. economy didn't become problems overnight. These include loss of industrial base and manufacturing jobs, excessive government spending, interest rates being too low for too long, and an increasing regulatory burden to name a few. We think these problems can't be solved overnight either.

We also think that a substantial part of the big picture here is the need for substantial tax cuts. In order to stimulate growth and stave off a recession we hope Congress will act swiftly to pass permanent tax cuts that reduces the overall burden on U.S. taxpayers as well as lower corporate tax rates to encourage growth and investment by U.S. companies.

We will be spending a great deal of time sorting through data to see if and where it is appropriate to lower risk while trying to identify opportunities. We certainly have our work cut out for us. We continue to preach two basic ideas: diversification and patience. In periods of uncertainty, this is why we hold a vast array of holdings and asset classes. We anticipate that the cash and bond positions will do their job in mitigating the negative impact of market declines.

We anticipate that there will be an opportunity at some point to buy high quality stocks at attractive prices. We still like many of the same names we have been buying in the past. There will be a time where we have enough clarity and confidence to justify purchasing these and other high quality names. We think those types of companies will lead the market as it recovers.

Finally, as we consistently say, focus on your own goals and objectives. If you'd like to reexamine any of your goals given the present scenarios, we stand ready to discuss with you.

As always, thank you for your continued trust and confidence!

We hope that you have a blessed Spring!

ⁱ <https://www.morningstar.com/etfs/arcx/dia/performance>

ⁱⁱ <https://www.morningstar.com/etfs/xnas/oneq/performance>

ⁱⁱⁱ <https://www.morningstar.com/etfs/arcx/ijr/performance>

^{iv} <https://www.morningstar.com/etfs/arcx/efa/performance>

^v https://ycharts.com/indicators/sp_500_pe_ratio_forward_estimate

^{vi} J.P. Morgan Asset Management. "Market Insights: Guide to the Markets®". March 31, 2025.. Page 5.

^{vii} <https://www.morningstar.com/etfs/arcx/agg/performance>

^{viii} https://home.treasury.gov/resource-center/data-chart-center/interest-rates/TextView?type=daily_treasury_yield_curve&field_tdr_date_value_month=202503

^{ix} Ibid.

^x <https://www.newyorkfed.org/markets/reference-rates/effr>

^{xi} Turnquist, Adam. "Are Stocks Due for a Correction?". LPL Financial. January 23, 2025.

^{xii} Buchbinder, Jeffrey. "Daily Market Update: A Case of Staying Invested". LPL Financial. March 11, 2025.

^{xiii} <https://fred.stlouisfed.org/series/GFDEBTN>

^{xiv} <https://fred.stlouisfed.org/series/GFDEGDQ188S>

^{xv} https://fredblog.stlouisfed.org/2021/11/higher-public-debt-but-a-lower-cost-to-service-it/?utm_source=series_page&utm_medium=related_content&utm_term=related_resources&utm_campaign=fredblog

^{xvi} <https://www.investopedia.com/why-interest-payments-are-blowing-up-the-federal-budget-8712197>

^{xvii} Wesbury, Brian S., Stein, Robert, et al. "Monday Morning Outlook: Symptoms or Causes". First Trust. March 24, 2025.

^{xviii} <https://www.whitehouse.gov/fact-sheets/2025/04/fact-sheet-president-donald-j-trump-declares-national-emergency-to-increase-our-competitive-edge-protect-our-sovereignty-and-strengthen-our-national-and-economic-security/>

^{xix} <https://www.bls.gov/cpi/>

^{xx} Gillum, Lawrence. "Daily Market Update: Refinancing ZIRP". LPL Financial. February 24, 2025.

^{xxi} <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html?redirect=/trading/interest-rates/countdown-to-fomc.html>

^{xxii} <https://www.morningstar.com/etfs/arcx/mint/quote>

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly. The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.