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Investment Letter by Erik Ridgley, CFA - 1st Quarter 2025
CEO & Chief Investment Officer of Salem Partners Wealth Management May 31, 2025

- The U.S. economy went from outperforming expectations in January to recession warnings on April 2nd because markets viewed the unrealistically high "reciprocal" tariff rates as policy errors, which were then reversed on April 9th (with the 90-day pause) in response to selloffs in stock markets, Treasuries, and the dollar. This sequence of events created a V-shaped bottom in global equities markets, not unlike past episodes when the Fed committed policy errors and then (thankfully) reversed them in response to market selloffs signaling threats to financial stability.
- Foreign developed equities were up +16.9% and US large cap equities were up +1.1% year-to-date as of May 31, after +25.0% total returns in 2024.
- Consensus forecasts of 2025 U.S. GDP growth rates were cut to 1.4% from 2.1% due to tariffs. We forecast a 35% probability of recession in 2025 (up from 15% in January).
- S&P 500 earnings growth rates consensus forecasts are +8.6% in 2025 (down from +12.5% in January) in 2025, and +13.6% in 2026.
- The Fed rate-cutting cycle is getting complicated with 2.3% CPI inflation set to rise due to tariffs. Fed chair Powell said he would be willing to cut Fed Funds Rates if needed, but 4.2% unemployment rates remain low, and consumer spending continues to grow.
- Tax-exempt investment grade municipal bonds offer very attractive after-tax yields with the highest interest rates in 17 years for government bonds.

Asset Class Benchmark Returns – 2024 and 1st Quarter 2025 (1Q25)

2024:	+25.02%	1Q25:	-4.27%	U.S. Large Cap Equities: S&P 500 Index
2024:	+17.49%	1Q25:	-1.32%	Global Equities: MSCI All Country World Index (ACWI)
2024:	+3.82%	1Q25:	+6.86%	Foreign Developed Equities: MSCI EAFE Index (EAFE)
2024:	+10.91%	1Q25:	-0.88%	60/40 Allocation: 60% ACWI / 40% Muni Bond
2024:	+11.54%	1Q25:	-9.48%	U.S. Small Cap Equities: Russell 2000 Index
2024:	+7.50%	1Q25:	+2.93%	Emerging Markets Equities: MSCI Emerging Markets Index
2024:	+8.44%	1Q25:	+0.94%	Real Estate: S&P U.S. REIT Index
2024:	+8.19%	1Q25:	+1.00%	Junk Bonds: U.S. Aggregate Corporate High Yield Index
2024:	+1.25%	1Q25:	+2.78%	U.S. Fixed Income: U.S. Aggregate Bond Index (AGG)
2024:	+1.05%	1Q25:	-0.22%	Municipal Bonds: Bloomberg Barclays Muni Bond Index
2024:	+5.32%	1Q25:	+1.04%	Cash: U.S. T-Bills (1-3 Months) Bloomberg Index

Who Pays the Tariffs?

Imports were 11% of U.S. GDP in 2024. Tariffs are a sales tax on imports, paid to our government by importers including Walmart, Amazon, and millions of small businesses in America. Importers can react to higher tariffs by passing on higher prices to consumers, requesting lower prices from suppliers, accepting lower profit margins, cutting costs elsewhere, or some combination of all of the above. In addition, economics textbooks say tariffs should cause the dollar to appreciate, which would offset some of the costs of the tariffs paid by importers. Price increases to end consumers will vary by product.

What Caused the V-shaped Market Bottom?

The U.S. economy went from outperforming expectations in January to "recession watch" on April 2nd. Markets viewed the unrealistically high April 2nd "reciprocal" tariff rates as policy errors which were reversed on April 9th with the 90-day pause in response to selloffs in stock markets, Treasuries, and the dollar. This sequence of events created a V-shaped bottom in equities markets, like past episodes when the Fed committed policy errors and then reversed them in response to market selloffs signaling threats to financial stability (e.g. 4th quarter of 2018). Policy errors should always be reversed.

Market Bottoms Can Be V-shaped, VV-shaped, or VVV-shaped

Over the last 50 years, V-shaped market bottoms were more than twice as common as VV-shaped bottoms, and VVV-shaped bottoms occurred only a couple of times. Market pundits frequently write about the possibilities for U-shaped or L-shaped bottoms, but they usually fail to mention that they've never actually occurred. Each market bottom has its own unique story, but the most important insight is that U.S. stock markets have always recovered from downturns and then moved on to higher levels.

Markets Did Not Expect the Higher "Reciprocal" Tariffs

Markets sold off when the higher "reciprocal" tariffs were announced because they would lead to slower GDP growth, higher inflation, and more uncertainty. Fortunately, markets can learn to live with tariffs if they don't go too far. For example, all card-carrying economists have been trained that tariffs are always a bad idea, but highly respected Kenneth Rogoff (former chief economist of the International Monetary Fund and current Harvard professor of economics) recently said, "if Trump had just come in and put on 10% tariffs, it's a dirty little secret among economists that it wouldn't be a big deal."

What's Next for Tariffs?

Markets seem to be anticipating that tariffs will settle at 10% baseline rates for most countries, with certain national security-related industries such as aluminum, steel, and semiconductors subject to higher 25% tariffs. China is a special case because it is facing 30% baseline rates and their negotiations will likely drag on for years.

During the first Trump administration, tariffs negotiations with China started in early 2018 and they went back and forth for two years until the "Phase One" trade deal was signed on January 15th, 2020. China never lived up to their obligations under the Phase One trade deal. China's past behavior indicates that enforcing compliance with the terms of any trade deal will require constant and never-ending negotiations over accusations of non-compliance, disputes over conflicting interpretations of basic facts, etc. The Chinese Communist Party (CCP) strategy is to "run out the clock" until the next U.S. President is elected.

What About "Non-Tariff Trade Barriers"?

Long lists of credible examples of CCP driven hurdles intentionally placed in front of foreign firms trying to compete with Chinese firms anywhere on the planet have been compiled and published by U.S. Trade Representative staff. Economics textbooks say that currency exchange rates should adjust to even out the impacts from the resulting trade imbalances, but this has not happened. China's regulatory environment is marked by inconsistent implementation of rules across provinces and opaque administrative procedures, particularly for permits, licensing, and product registrations. Foreign firms often face demands to transfer technology or make concessions in exchange for market access. Strict cross-border data transfer requirements and local storage mandates prevent U.S. social media companies from operating in China. China imposes inspection delays, permit cancellations, and other regulatory barriers. State-owned enterprises (SOEs) and "national champions" receive subsidies and regulatory support. Provincial governments often hold stakes in local companies, further incentivizing protectionist policies. Widespread intellectual property infringement remains a challenge. Forced labor in Xinjiang, weak environmental protections, and Hong Kong's national security laws have prompted supply chain audits and reputational risks for firms operating in these regions.

Why Have International Stocks Outperformed US Stocks in 2025?

Germany and China are the most important economies in foreign developed and emerging markets, respectively, and they both announced big fiscal stimulus programs in 1Q25. These government spending programs are in line with what analysts and economists have been recommending, and politicians finally summonsed the courage to move them forward. International growth rates of corporate earnings per share have woefully lagged those in the U.S. If international growth rates are anticipated to increase relative to those in the U.S., then this will divert a portion of global investment flows from U.S. to foreign markets, all else being equal. This can be a healthy development if it occurs gradually.

The extension of the 2017 Tax Cuts and Jobs Act (TCJA) via the 2025 budget reconciliation process has reduced expected increases to the federal deficit relative to proposals from the 2024 election campaign. Said another way, even though federal deficits will continue to grow, pushback from Congress means they won't grow as much as markets were expecting them to grow back in November. Stock market returns often respond to big fiscal impulses and changes in expectations matter.

Why Has the Dollar Weakened in 2025?

Foreign exchange rates are primarily determined by commercial trade flows. U.S. exporters are more competitive with foreign firms when the U.S. dollar is weaker and key White House advisors have publicly acknowledged this. In November, the current Chair of the Council of Economic Advisors trial ballooned various controversial measures (i.e., Mar-A-Lago Accord) that could lead to a weaker dollar in a paper titled, "A User's Guide to Restructuring the Global Trading System." Section 899 of the House version of the "big, beautiful bill" would impose higher tax rates on foreign investors from countries with tax policies the U.S. considers discriminatory. It is not a given that all these measures will be implemented, but these proposals, together with tariffs on allies and pauses of U.S. support for Ukraine, will be emotionally charged talking points ahead of many investment committee meetings in the boardrooms of global asset allocators in Europe and Asia.

Will the U.S. Dollar Remain the Primary Global Reserve Currency?

Yes. The dollar has been the primary global reserve currency since the end of World War II and is the most widely used currency for international trade and commodities transactions. The International Monetary Fund recognizes eight major reserve currencies, of which the U.S. dollar is the most commonly held, making up 58% of official global foreign exchange reserves, followed by the euro at 20%, the Japanese yen at 6%, the British pound sterling at 5%, the Canadian dollar at 3%, the Chinese renmimbi at 2%, the Australian dollar at 2%, and the Swiss franc at less than ½%.

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Updated Estimates for Valuations, Earnings, Revenues, Margins, GDP Growth, Interest Rates

Price/earnings (P/E) multiples are 21.9 for S&P 500 large cap, 15.8 for S&P 400 mid cap, 14.8 for S&P 600 small cap, 15.4 for foreign developed, and 12.7 for emerging markets, where E is EPS estimates for next four quarters, per Bloomberg consensus. The quarterly average since 3/31/1990 for U.S. large cap P/E multiples is 17.0 times next four quarters estimated earnings. Thus, U.S. large cap equity valuations are 29% above average. S&P 600 small cap equity P/E multiples are cheaper than their historical averages. Foreign developed and emerging markets P/E multiples are in line with their historical averages.

Consensus estimates for S&P 500 EPS growth are +9.7% in 2024 (actual), +8.6% (down from +12.5% in January) in 2025 (estimate), and +13.6% (up from +13.2% three months ago) in 2026, per I/B/E/S data by LSEG DataStream. Year-over-year quarterly EPS actuals were +6.6% in 1Q24, +11.3% in 2Q24, +8.2% in 3Q24, +13.7% (up from +8.2% est. in January) in 4Q24 (act.), and forecasts are +11.6% (up from +10.6% in Jan.) in 1Q25 (est.), +3.6% (down from +10.8% in Jan.) in 2Q25, +6.4% in 3Q25, and +7.0% (down from +15.2% in Jan.) in 4Q25.

Consensus estimates for S&P 500 revenues per share are forecasted to grow +4.6% in 2024 (act.), +5.5% in 2025 (est.), and +5.8% in 2026. Consensus estimates for net profit margins are 13.1% in 2024, 13.1% in 2025, and 14.0% in 2026, per I/B/E/S data by LSEG DataStream.

Wall Street's full year consensus forecast for U.S. real GDP is +2.8% in 2024, +1.4% (down from +2.1% in Jan.) in 2025, and +1.5% in 2026, and the quarterly consensus forecasts (QoQ%, SAAR) are +1.6% in 1Q24, +3.0% in 2Q24, +3.1% in 3Q24, +2.4% in 4Q24 (act.), -0.2% (down from +1.9% in Jan) in 1Q25 (act.), +1.4% (down from +2.0% in Jan.) in 2Q25, +0.8% (down from +2.0% in Jan.) in 3Q25, and +1.3% (down from +2.0% in Jan.) in 4Q25, per Bloomberg <ECFC>. Average U.S. real GDP growth has been 2.3% over the past ten years. Throughout 2023 and 2024, we thought U.S. real GDP quarterly reports would come in stronger than consensus forecasts, but 2025 will be much more likely to underperform.

The European Union and Japan are both forecasted per Bloomberg <ECFC> to accelerate growth in 2025. Europe's economy is forecasted to grow +0.5% in 2023, and +1.0% in 2024 (act.), +1.3% in 2025 (est.), and +1.6% in 2026, vs. its trend rate of +1.0% real GDP growth. Japan's economy is forecasted to grow +0.2% (up from -0.2% in Jan.) in 2024 (act.), +0.8% in 2025, and +0.8% in 2026, vs. its trend rate of +0.5% real GDP growth. China is forecasted per Bloomberg <ECFC> to decelerate growth in 2025. China's real GDP is forecasted to grow +5.0% in 2024, +4.5% in 2025, and +4.1% in 2026.

The Treasury yield curve is currently pricing in Fed Funds Rates to be cut from 4.50% currently to 4.25% in September and again to 4.00% in December, and 10-year Treasury yields to rise to 4.62% one year from now, per Bloomberg <FWCM>. The yield curve is also priced for 10-year Treasury yields to gradually increase to 5.40% during the next 5 years. The Treasury yield curve represents the "real money" pricing of many trillions of dollars of U.S. Treasury securities across maturities from 7 days to 30 years, based on bond investors' expectations for the future, which is why it commands the respect of equity investors and the Fed. Of course, the yield curve always reserves the right to change its mind.

The yield curve is upward sloping, with 10-year Treasury yields higher than 2-year Treasury yields by 50 basis points (bps), which signals future economic growth. The yield curve was inverted (downward sloping) from July 2022 until September 2024, with a nadir of 106 bps inverted on June 30th, 2023. Yield curve inversions have historically been reliable leading indicators of future economic downturns, but not the past few years, due to pandemic-related distortions. Inverted yield curves have (in the past) dis-incentivized banks from lending to corporate borrowers, but rapidly growing private credit funds have partially replaced commercial banks as key sources of capital to private businesses.

High yield bond spreads (over 10-year Treasuries) tightened to 306 bps by May 30th after widening to 448 bps on April 7th from 292 bps at year end, per Bloomberg <CSI BARC>, implying that credit markets are pricing in slower growth but not a recession.

Our Forecast: 35% Probability of Recession vs. 50% "Soft-ish Landing" vs. 15% "No Landing"

We have increased our estimate to 35% (up from 15% in Jan.) probability of a recession (i.e., "hard landing"), a 50% probability of a "growth recession" (i.e. soft-ish landing, per Fed Chair Powell) which is defined as two or more quarters of 0.0% to +1.0% real GDP growth (QoQ% SAAR) and a material increase in unemployment rates, and a 15% probability of no recession (i.e., "soft landing" or "no landing" with no increase in unemployment rates). The wild cards will be consumers' spending behavior and CEOs' decisions on hiring vs. layoffs, which might be significantly impacted by tariffs and uncertainty. For the first time in decades, the Fed does not seem to be holding all the cards.

Economists spent 2023 and 2024 debating whether the Fed could defeat inflation without throwing the U.S. into a "hard landing" recession. The bearish case was that "long and variable lags" of tight monetary policy take time to work through the economy, and that everything we were seeing was consistent with the late-cycle phase of the business cycle. The bullish case was bolstered by low unemployment rates and war-time levels of fiscal spending (i.e., $1.8 trillion federal deficit, American Rescue Plan Act, Chips and Science Act, Inflation Reduction Act, and Infrastructure Investment and Jobs Act).

The Fed's Updated Economic Projections for Inflation and Fed Funds Rates Cuts in 2025

The FOMC March quarterly "dot plot" summary of economic projections signaled the Fed will cut the Fed Funds Rate to 4.00% by December 2025, and then to 3.50% by December 2026, and then to 3.25% by December 2027. The rule of thumb is that Fed Funds Rates should be 1% higher than inflation rates to force inflation down. The Fed is now forecasting core personal consumption expenditures (Core PCE) inflation rate, its preferred measure of inflation, which excludes energy and food, of 2.8% by December 2025 (and Fed Funds Rate of 4.00%), and then 2.2% by December 2026 (and Fed Funds Rate of 3.50%), and then 2.0% by December 2027 (and Fed Funds Rate of 3.25%), and 2.0% by December 2027 (and Fed Funds Rate of 3.1%). Investors mostly agree with the Fed i.e., fed funds futures pricing implies the Fed Funds Rate will be 4.00% by Dec 2025, and 3.50% by Dec 2026, per Bloomberg <WIRP>. The Fed is also forecasting stable U.S. real GDP growth of 1.8% and low unemployment rates of 4.3% for 2025-2027.

Review of 1st Quarter of 2025: Concerns Over Tariffs

The S&P 500 index of stocks fell -4.27% including dividends in the 1st quarter of 2025, to 5,612 from 5,882. 10-year Treasury yields declined to 4.21% from 4.57%, while Fed Funds Rates of 4.50% were unchanged. West Texas Intermediate (WTI) crude oil prices per barrel eased to $71.48 from $71.72 at year end. The U.S. Dollar currency index weakened to 104.21 from 108.44. U.S. unemployment rate rose to 4.2% from 4.1%. The Fed's 5-yr/5-yr forward inflation expectation rate fell to 2.15% from 2.30%, per Bloomberg <T5YIFR Index>.

Both real and *nominal* U.S. economic activity decelerated in the 1st quarter due to the uncertainty over tariffs and the lagged cumulative weight of 4.25% of net Fed Funds Rate hikes over 36 months. The U.S. economy real GDP (QoQ% SAAR) estimates are -0.2% in 1Q25 (est.), +2.4% in 4Q24 (act.), +3.1% in 3Q24, +3.0% in 2Q24, +1.6% in 1Q24, +3.2% in 4Q23, +4.9% in 3Q23, +2.1% in 2Q23, +2.1% in 1Q23, +2.6% in 4Q22, +3.2% in 3Q22, -0.6% in 2Q22, -1.6% in 1Q22. 1H22 would have been called a recession except there weren't any net job losses.

But earnings, revenues, and expenses are all reported in *nominal* terms, not real terms. The U.S. economy ***nominal* GDP** (QoQ% SAAR) was +2.5% in 1Q25 (est.), +5.1% in 4Q24 (act.), +5.7% in 3Q24 (act.), +6.2% in 2Q24, +4.9% in 1Q24, +6.4% in 4Q23, +8.4% in 3Q23, +6.1% in 2Q23, +8.0% in 1Q23, +9.7% in 4Q22, +11.5% in 3Q22, +8.1% in 2Q22, and +6.4% in 1Q22 (Note: the relevant formula is "*nominal* GDP = real GDP + CPI Inflation Rate").

The Fed's preferred measure of inflation, **Core PCE** (YoY%), estimates are +2.8% in 2Q25 (est.), +2.8% in 1Q25 (act.), +2.8% in 4Q24, +2.7% in 3Q24, +2.7% in 2Q24, +3.0% in 1Q24, +3.2% in 4Q23, +3.8% in 3Q23, +4.6% in 2Q23, +4.8% in 1Q23, +5.1% in 4Q22, +5.0% in 3Q22, and +5.0% in 2Q22. The Fed's target rate is +2.0%.

U.S. headline CPI inflation (YoY%) estimates are +2.6% in 2Q25 (est.), +2.7% in 1Q25 (act.), +2.7% in 4Q24, +2.6% in 3Q24, +3.2% in 2Q24, +3.3% in 1Q24, +3.2% in 4Q23, +3.5% in 3Q23, +4.0% in 2Q23, +5.8% in 1Q23, +7.1% in 4Q22, +8.3% in 3Q22, +8.7% in 2Q22, and +8.0% in 1Q22. The Fed's target rate is +2.0%.

Taxes Are Your Biggest Investment Expense Item

For wealthy investors, taxes often represent the most significant expense item, overshadowing other costs like management fees or transaction charges. This stems from the various forms of taxes they encounter, including capital gains tax, income tax on dividends and interest, and estate taxes. Capital gains taxes can be substantial due to the large profits generated from investments. Additionally, high-income brackets face progressive tax rates, leading to a higher percentage of their earnings being taxed. Strategic tax planning and the utilization of tax-efficient investment vehicles and portfolio management methodologies become crucial for wealthy investors to mitigate their overall tax burden and optimize their net returns.

Estate Tax Law Changes in 2026 Will Cause Some Wealthier and Older Individuals to Revise Plans

We at Salem Partners Wealth Management try to make sure that we are planning well ahead of any potential tax or regulatory changes in order that our clients can be ready for new environments. One such significant change on the horizon is a reduction in the amount of money that individuals can give away during their lifetimes, or pass along upon death, free of estate or gift tax. This amount could get cut in half starting on January 1, 2026. We encourage clients to start understanding whether they may want to address these changes in their current estate plan in anticipation of this change in the laws.

In 2025, individuals will be able to pass along an estimated $14.4 million free from estate or gift tax during their lifetime or as part of their estate. In 2026, that amount could be cut in half. That means a couple which today could pass along $28.8 million to their children or grandchildren tax free can only pass along half of that tax free in 2026. The most obvious clients who may want to think about doing something to take advantage of current laws would be those who are older (70+) and with an estate valued comfortably over the limit in 2026 ($7.2 million for an individual and $14.4 million for a couple) and a clear beneficiary.

Clients that check the net worth box but are younger may also want to consider strategies that take advantage of the laws but leave access to the capital in the hands of the donor during the donor's lifetime.

As always, we are happy to discuss considerations regarding your estate plan at your convenience. We understand that the implications of these and other estate plan issues are complex and want to support you to the greatest extent possible. We also want to make sure that our clients who do want to address the potential changes can do so before the high demand for planning that is likely to occur in late 2025.

Business and Income Tax Planning Can Result in Significant Tax Savings

Business owners looking to contribute up to $300,000 per year of pre-tax money into their retirement plans should consider cash balance defined benefit pension plans. Founders launching start-ups with high growth potential can utilize qualified small business stock (QSBS) to exclude from their taxable income a portion of gain on the sale — up to $10 million or 10 times the investor's cost basis, whichever amount is greater. QSBS can be "stacked" to multiply the tax savings for a spouse, children, and multiple trusts. Private investors and limited partners can also receive the tax benefits of QSBS. Incentive stock options (ISOs) are typically offered to executives and key employees, with potential tax advantages, and non-qualified stock options (NSOs) can be granted to any employee, as well as to consultants and board members. For clients with significant wealth and liquidity, they can use private placement life insurance (PPLI) to place large sums of money in domestic entities that grow free of any taxation while maintaining access to liquidity. The US code contains various tax benefits to incentivize entrepreneurs to start and grow businesses, and we help make sure our clients don't miss out on them, so they can focus on building great businesses.

Proven and Repeatable Processes: Portfolio Rebalancing, Tax Loss Harvesting, and Tax Deferral

Portfolio rebalancing is a useful tool for long-term investors because it serves two important purposes. First and foremost, it keeps asset allocations in line with targets that have been codified in clients' investment policy statements (IPS). Second, it can be a mechanism to naturally "buy low, sell high", because it involves adding to an asset class that has decreased in price (e.g., >10%) relative to the overall portfolio, and cutting back an asset class that has increased in price relative to the overall portfolio. Good judgement, disciplined decision-making, and operational excellence are necessary to obtain the best results for every client from portfolio rebalancing.

Another proven methodology for long-term investors to take advantage of market volatility is tax loss harvesting. Unlike tax loss selling, tax loss harvesting precludes adverse impacts to investment returns, by simultaneously replacing the sold securities with very similar securities, while avoiding IRS wash sale rule violations. We actively implement tax loss harvesting throughout the year whenever material market declines create opportunities.

Tax losses provide economic value because investors can use them to offset capital gains tax, and unused tax losses can be carried forward into future years until they are fully used. The maximum federal tax rate on short-term capital gains is 40.8%, including the 3.8% net investment income tax, and for Californians the maximum combined state and federal tax rate is 54.1%. Although no one likes down markets, tax loss harvesting can effectively reduce negative returns by up to 54.1%, without sacrificing full participation in the inevitable market recovery for long-term investors.

Tax deferral strategies involve delay or avoidance of realization of capital gains through judicious planning and portfolio management. Unrealized capital gains can be permanently eliminated over time with prudent trust & estate planning, via step up in cost basis when wealth transfers from one generation to the next.

Risk Management

Asset allocations should be based on well-designed investment policy statements to enable investors to get through bear markets without selling equities, by using fixed income or cash to draw upon until stock markets have recovered, which is common sense short-term risk management. However, comprehensive risk management should also account for the long-term shortfall risk of not achieving long-term portfolio growth objectives due to sub-optimal asset allocations and portfolio construction. Along the way, contingency risks (i.e., low probability and high impact) need to be efficiently managed with various tools including adequate liquidity, appropriate insurance protection (note: we do not sell insurance), coordination with clients' trusts & estate attorneys, and proactive tax planning with clients and their CPAs.

Long-Term Investing

To paraphrase Warren Buffett, successful investors need to invest for the long-term and avoid being swayed by the fear and greed of others that can cause irrational swings in the market. We do not let the daily noise and volatility of the markets deter us from our mission to be faithful stewards of our clients' capital. As long-term investors, we and our clients have committed ourselves to adhere to well-defined investment policy statements, which have been custom-built for each individual client, to achieve their long-term investment objectives, while accepting the inevitable price fluctuations of the public markets.

As fiduciaries, we relentlessly seek out the lowest costs and best terms for our clients. As trusted advisors, long-term relationships are of primary importance to helping our clients achieve successful outcomes through personalized financial planning and disciplined implementation.

Conclusions

The U.S. economy went from outperforming expectations in January to recession warnings on April 2nd because markets viewed the unrealistically high "reciprocal" tariff rates as policy errors, which were then reversed on April 9th (with the 90-day pause) in response to selloffs in markets. This sequence of events created a V-shaped bottom in global equities markets. Foreign developed equities were up +16.9% and US large cap equities were up +1.1% year-to-date as of May 31, after +25.0% total returns in 2024.

Consensus forecasts of 2025 U.S. GDP growth rates were cut to 1.4% from 2.1% due to tariffs. We forecast a 35% probability of recession in 2025 (up from 15% in January). S&P 500 earnings growth rates consensus forecasts are +8.6% in 2025 (down from +12.5% in January) in 2025, and +13.6% in 2026. The

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Fed rate-cutting cycle is getting complicated with 2.3% CPI inflation set to rise due to tariffs. Fed chair Powell said he would be willing to cut Fed Funds Rates if needed, but 4.2% unemployment rates remain low, and consumer spending continues to grow.

The biggest risks to equities investors are valuations, as U.S. large cap equity P/E multiples are 29% above their historical averages. However, U.S. small cap P/E multiples are cheaper than their historical averages. Foreign developed and emerging markets P/E multiples are in line with their historical averages. Tax-exempt investment grade municipal bonds offer very attractive after-tax income opportunities with the highest interest rates in 17 years for government bonds.

We wish all our clients and friends a joyful summer. We will keep working hard to generate superior long-term after-tax investment returns for each of our clients with personalized financial planning and customized portfolios, and we are grateful for the trust and confidence our clients have placed in us.

Please let us know if you have any questions. Thanks!

Best Regards, Erik

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- Fiduciary registered investment adviser (RIA) founded in 2004. We celebrated our 20th anniversary!
- Personalized financial planning and customized portfolios combined with institutional investment management expertise to drive superior long-term after-tax outcomes.
- Assets under management custodied at Charles Schwab ($7.8 Trillion in client assets across 34 million customer accounts) in segregated accounts under clients' names.
- Welcoming new clients with over $10 million to invest with us.

Selected to Los Angeles Business Journal's List of Leaders of Influence: Wealth Managers in 2025, 2023, 2022, 2021, 2020, 2019 (see website for disclosures)

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Disclosures

- **Past performance is not a guarantee of future results. Investments can lose money.**
- This analysis is not a guarantee, prediction, or projection of any particular result and your actual results may vary materially from those presented herein.
- Total return is the industry standard and our method of measuring investment performance in client reports. Total return is the investment income received or accrued plus the change in market value over a specified period divided by the market value at the beginning of the period.
- All total account performance returns in client reports are time-weighted total returns, displayed as net of all fees.
- Recognizing that past performance does not guarantee future results and that indices differ from actual portfolios, the data presented are based on the historical performance of their respective asset classes. When necessary, indices are used as proxies for the asset classes. The indices are not managed, not subject to fees nor transaction costs, nor available for direct investment. In certain instances, assumed rates of return or inflation are incorporated as part of the presentation. However, there is no guarantee that these assumptions will be realized in the future, and they shall not be deemed as a guarantee of future results.
- Investment returns portrayed are subject to the effect of material market or economic conditions during the specified time periods.
- Investment returns of indexes reflect the reinvestment of dividends and interest income.
- Investment returns of indexes do not reflect the effect of any fees or expenses since they do not ever pay any fees or expenses. You cannot invest directly in an index.
- Investments portrayed can generate profits, but they can also incur losses.
- Equity (stocks), fixed income (bonds), and other investments do not always gain or lose value at the same time. Historically, volatility has been reduced over time by holding multiple non-correlated asset classes in a portfolio.
- Diversification within an asset class is important because it can eliminate idiosyncratic (i.e., individual security) risk within an asset class, but it cannot eliminate systemic (i.e., market) risk of an asset class. No investment strategy or allocation can eliminate risk or guarantee investment returns.
- Although single-asset class diversification is an important tool in the toolbox of investing, relying on it alone might cause an investor to forego the benefits of other non-correlated asset classes that may help them achieve their long-term goals. Asset allocation differs from single-asset class diversification because it involves being diversified across multiple diversifying asset classes.
- Assets are broken out by market cap and style using data supplied from S&P, MSCI, Bloomberg, Morningstar, Inc. and other sources.
- This presentation does not constitute an offer to sell or a solicitation to buy any securities or an offer of any investment advisory services.
- Please see our website at www.SalemPartners.com/Wealth-Management and our Form ADV, Form ADV 2, and Form ADV 3/CRS at www.sec.gov for additional disclosures.

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The projections or other information shown in this presentation regarding the likelihood of various investment outcomes are based on publicly available information, or our opinions, and are not guarantees of future results.

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