Bitterroot
CAPITAL ADVISORS

CAPITAL MARKETS REVIEW

2025
Quarter 1

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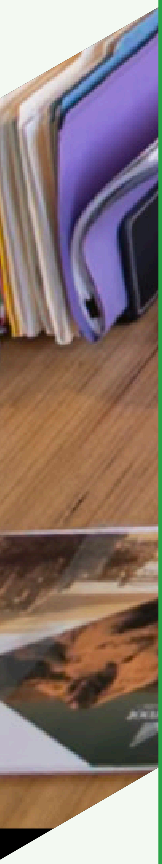
Table of Contents

All public market data are as of April 15, 2025 unless indicated otherwise.



Executive Summary

- Macroeconomic Backdrop Entering 2025
- US Tariff Policy (Liberation Day Announcement)
- Equity Markets
- Government Bonds & Investment Grade Credit
- High-Yield Bonds & Leveraged Loans
- Hedge Funds
- Private Equity
- Private Credit
- Private Real Estate

Macroeconomic Backdrop Entering 2025

Entering 2025, the global economy seemed on solid footing led by very strong fundamentals in the US, stabilization and rebound in Europe, further stimulus coupled with greater pro-business policy implementation in China, and continued progress towards disinflation globally.

Analysts were optimistic about S&P 500 earnings growth, with earnings projected to grow 13% over 2024 levels. US investors were optimistic regarding President Trump's election, focusing on his pro-business policies with regards to less regulation and potentially lower tax rates. Importantly, US investors seemed to view Trump's tariff threats as negotiation posturing rather than ideologically driven.

Underlying these benign conditions, however, are trends in the global economy that have existed for decades and in some cases, have accelerated in recent years.

These include:

- Globalization which has led to the US share of global GDP declining from 40% in the 1960s to about 25% today as China and other emerging markets gained economic strength.
- High US consumption, supported by relatively low US personal savings rates, leading to increased demand for imports.
- Persistent shift in the US towards a services-based economy and away from manufacturing, leading to significant share loss for manufacturing jobs and rising income and wealth inequality.
- A decoupling between the S&P 500, which increasingly consists of asset-light, high-margin, and strong cash flow generating companies, and the real economy ("Main Street"), with large gains in the S&P 500 further exacerbating US inequality.
- High and rising government deficits (current deficit of 6% of GDP is unprecedented during expansionary times), helping propel the US economy.
- Enhanced status of the US as a safe haven status globally given its relatively stable governmental policies, free market orientation, and military strength (actual and implied protection afforded to other countries), and relatedly, the USD's position as the global reserve currency with foreign countries investing excess savings into US financial assets.

The two most important: (1) US fiscal deficits (and resulting US public debt load), and (2) US trade deficits and China trade surpluses. It is not clear that these two imbalances interrelate, although there may be some linkage.

Furthermore, we can debate whether these imbalances can continue at current levels or even widen in the future without having negative effects on equity markets.

However, it is clear that these deficits increase the risk of geopolitical or monetary shocks that may be extremely disruptive and difficult to manage.

The Trump administration seems intent on swiftly addressing global imbalances on its own terms, especially with regards to global trade. President Trump views tariffs as the primary tool to lower persistent US trade deficit for goods.

He believes that he can strike deals with countries that will achieve the following:

- Increase US tariff revenues from imported goods. This revenue increase can offset other populist policies such as individual tax cuts.
- Increase US exports as Trump believes the combination of other countries' tariffs, regulations, and currency markets have impeded US manufacturers from exporting their fair share of goods.
- Incentivize reshoring of US manufacturing.

US Tariff Policy (Liberation Day Announcement)

During Q1, tariff-related uncertainty had already started to rear its head. President Trump announced tariffs on certain Canadian and Mexican goods (in an on-again, off-again fashion) as penalties for those countries' lack of effectiveness in border control and combatting fentanyl smuggling, implemented a 25% tariff on all aluminum and steel imports, and increased tariffs on China to 20% effective rates. Equity markets generally absorbed these announcements with the MSCI ACWI Index down 1.3% during Q1.

However, on April 2, 2025, President Trump announced the "Liberation Day" trade initiative—a sweeping and highly consequential shift in U.S. trade policy. The initiative introduced a minimum 10% tariff on all imported goods from every country, alongside a series of country-specific tariffs tied to the level of US trade deficit and targeting over 60 nations with rates as high as 50%.

These actions represent the most aggressive U.S. tariff regime since the 1940s. If fully enacted, the effective average tariff rate on all US imports would climb to 25.3% from 2.7% entering the year.

Tariffs proposed included:

- A universal baseline tariff of 10% on all imports
- A further 34% tariff on Chinese imports (bringing the effective rate on Chinese imports to 54%, effective April 9th)
- Tariffs ranging from 10%-50% for many countries with Southeast Asian countries hit especially hard (46% rate for Vietnam, 32% for Taiwan, 26% for India, and 25% for South Korea)
- Continuation of prior actions including a 25% tariff on many Canadian and Mexican imports (April 2), a 25% tariff on steel and aluminum imports (March 12), and a 25% tariff on finished autos and certain car parts.

- Further tariffs aimed at specific sectors such as pharmaceuticals, copper, and semiconductors may be forthcoming.

The Liberation Day tariffs were originally framed as reciprocal in nature. However, the magnitude of the tariffs was significantly higher than that justified by implementing purely reciprocal tariffs. Rather, it became clear that the Trump administration's focus is aimed at reducing US trade deficits in goods and reshaping the global economic order.

The administration views trade deficit reduction as a key lever to bring back manufacturing jobs to the US and tariffs as the tool to do so while increasing revenues that can be utilized to fund tax cuts.

Globally, countries' response to these tariffs have varied significantly.

- Over the past week through April 11th, the US and China have significantly escalated the trade war. The US has raised the effective tariff on Chinese imports to 145% while China has raised their tariffs on US imports to 125%. Neither side has initiated negotiations, thus far.

- The EU prefers to negotiate but has prepared countermeasures including raising tariff rates on US goods and services.

- Most other countries are engaging in negotiations including Japan, Korea, India, Vietnam and several others.

This seismic change in US trade policy has created considerable economic uncertainty and has raised the potential for a global recession if trade deals are not struck quickly.

Equity and credit markets plunged in the four trading days post the Liberation Day announcement, and even the Treasury market exhibited unusual behavior, with long-term bond yields sharply spiking from April 8th through 11th after initially falling, as expected, for several days due to growth concerns.

- Under immense pressure from business leaders and the bond market, Trump announced a 90-day pause in reciprocal tariffs for all countries except China beyond the universal 10% rate less than a day after they took effect. Countries will likely negotiate the outlines of trade deals with the US over the next 90 days.

- Trump further temporarily exempted companies importing certain electronics (phones, computers, chips), including imports from China.

- With the current tariffs on China coupled with the 10% base tariff rate on other countries, the US effective tariff rate is roughly 20%.

While equity markets sharply rallied by more than 10% from their April 7th intra-day lows, the S&P 500 still remains 5.4% below April 2nd pre Liberation Day levels.

Equity Markets

Global equities, as measured by the ACWI Index in USD, declined 1.3% in Q1 and 5.6% YTD through April 11th . In Q1, US large-cap stocks (-4.4%) underperformed international developed (+6.9%) and emerging market (+2.9%) equities.

US market weakness was driven by pullbacks in the AI trade as investors responded negatively to significant planned capex increases for several technology behemoths coupled with fears regarding cheaper AI models being developed in China (DeepSeek). Uncertainty regarding potential US tariff policy, coupled with a chaotic implementation of federal workforce downsizing, also contributed to US equity market weakness. International developed markets strength was driven by Europe's (primarily Germany) pivot towards significant planned fiscal spending increases to bolster defense and infrastructure needs.

Currency movements also materially contributed to Q1 returns in USD terms. Emerging market strength was primarily driven by China's embrace of material stimulus targeted at increasing domestic consumption coupled with a pivot towards pro-business policies after several years of regulatory crackdowns.

Since Q1 end, equity markets initially tumbled following President Trump's April 2nd "Liberation Day" tariff and trade policy announcement, although they have rallied substantially following his abrupt turn around and implementation of a 90-day pause on most reciprocal tariffs except for those facing China.

Global stocks have declined 4.4% since quarter-end, with all major regions down by similar levels. The S&P 500 declined by almost 10% in two trading days alone! Following Trump's 90-day tariff pause, global markets rallied substantially with one-day gains of 5%-10%.

Volatility has reached extreme levels not seen since the GFC. YTD, the ACWI Index is down 5.6%, with the S&P 500 down 8.6%, international developed equities up 2.4%, and emerging markets down 2.2%. The USD weakened by 5%-10% vs. major currencies since the end of February, which has augmented international equities' returns in USD.

Government Bonds & Investment Credit

U.S. government and investment-grade corporate bonds appreciated in Q1 as bond yields declined sharply, reflecting rising concerns regarding slowing economic growth driven by slowing consumer spending and potential employment weakness, especially across the Federal government and contractor landscape. The Barclays US Aggregate Index appreciated 2.9% during Q1, with US Treasuries up 2.9% and corporate investment grade bonds up 2.3%.

US Treasuries have behaved strangely since the Liberation Day announcement. Initially, long-term (10-year and 30-year) maturities swiftly declined 20bps-30bps, which was expected, given higher recession probabilities. However, over the next four trading days, these bond yields climbed by a staggering 70bps!

- Possible explanations include hedge fund unwinding of levered basis trades (trades involving futures vs. cash bonds arbitrage trades), as well as possible foreign investor (possibly China) selling. The latter appears less likely as foreign investor demand for Treasuries at recent auctions remains robust.

- The Fed is closely watching bond market liquidity and other conditions and has indicated willingness to step in should conditions deteriorate.

- Given the self-inflicted tariff turmoil facing the US, investors are questioning whether the US will continue to hold its safe-haven status globally.

YTD, the Barclays AGG remains up 1.1% with US Treasuries up 1.6% and corporate IG bonds down 0.2%. IG bonds declined since the quarter end as spreads widened by 20bps.

High-Yield Bonds & Leveraged Loans

US high-yield bonds were up 1.0% in Q1 as the benefit from high coupon yields and declining base rates was partially offset by widening credit spreads.

Leveraged loans were up 0.5% as high coupon rates were offset by spread widening.

Since Q1 end, high-yield bonds and leveraged loans have declined 2.4% and 1.4% respectively as spreads have risen quickly (but remain well below levels seen during recessions) driven by concerns of US economic slowdown post the Liberation Day tariff policy announcement. Reflecting these declines, riskier credit is down about 0.9% to 1.4% YTD.

Hedge Funds

Hedge funds were up 0.5% in Q1, with mixed performance across strategies. Event-driven (+1.0%) and convertible arbitrage strategies (+0.7%) performed best, while macro / trend following (-0.8%) and credit (-0.6%) strategies performed worst.

Private Equity

Preliminary data indicates that private equity returns rose 1.0% in Q4 and were up 7.0% in 2024 (latest data due to lagged reporting). Returns in 2024 lagged public equities, largely due to lower exposure to AI and tech sectors. Additionally, PE managers have been reluctant to mark up asset valuations during a period of still low exit activity.

US PE new deal activity rebounded strongly in Q1 to $250bln (up from $185bln in Q4 2024). Entry valuations have remained stable in the low-to-mid 12x EBITDA range (above 2023 trough levels and below the 14x 2021 peaks) while leverage has remained in the low-5x Debt / EBITDA range or roughly 45% of deal value. Rising economic uncertainty, especially with regard to tariffs, may temporarily constrain deal activity in future quarters. With $1 trillion in dry powder, PE firms are well positioned to capitalize on opportunities presented by potential market dislocations.

US PE exit activity continued to improve during Q1. At $187bln, exit activity was 45% higher than during Q4 2024 (although this was boosted by the $58bln Venture Global LNG IPO, and flat excluding that transaction). However, exit deal count remains low, with only higher-quality portfolio companies exiting in this environment.

US PE company inventory has swelled to 12,379 companies during Q1, which represents a 7-8-year inventory at the observed pace of exits in 2024. Improvement in exit activity must be sustained for the recovery to broaden to lower quality assets.

Private Credit

Private Credit (measured by the Cliffwater Direct Lending Index) was up 2.8% during Q4 2024 and 11.3% in CY 2024 (lagged reporting). Q1 Returns are likely to resemble Q4 2024 returns. Unlevered yields approximate 10% at base rates of 4.3%. Although current credit quality remains solid, the percentage of loans in non-accrual is increasing, indicating potential defaults or markdowns in legacy portfolios.

Additionally, the percentage of income comprising paid-in-kind (PIK) as opposed to cash is also increasing. Competition is intensifying among private credit lenders, but conditions remain reasonably favorable in the lower middle market, where spread compression has been less severe.

Private Real Estate

The private real estate market continued to experience a slight rebound in Q4, with the NCREIF index up 0.4% (the second consecutive positive quarterly performance). Signs of stabilization are emerging, as cap rates level off and transaction volumes increase.

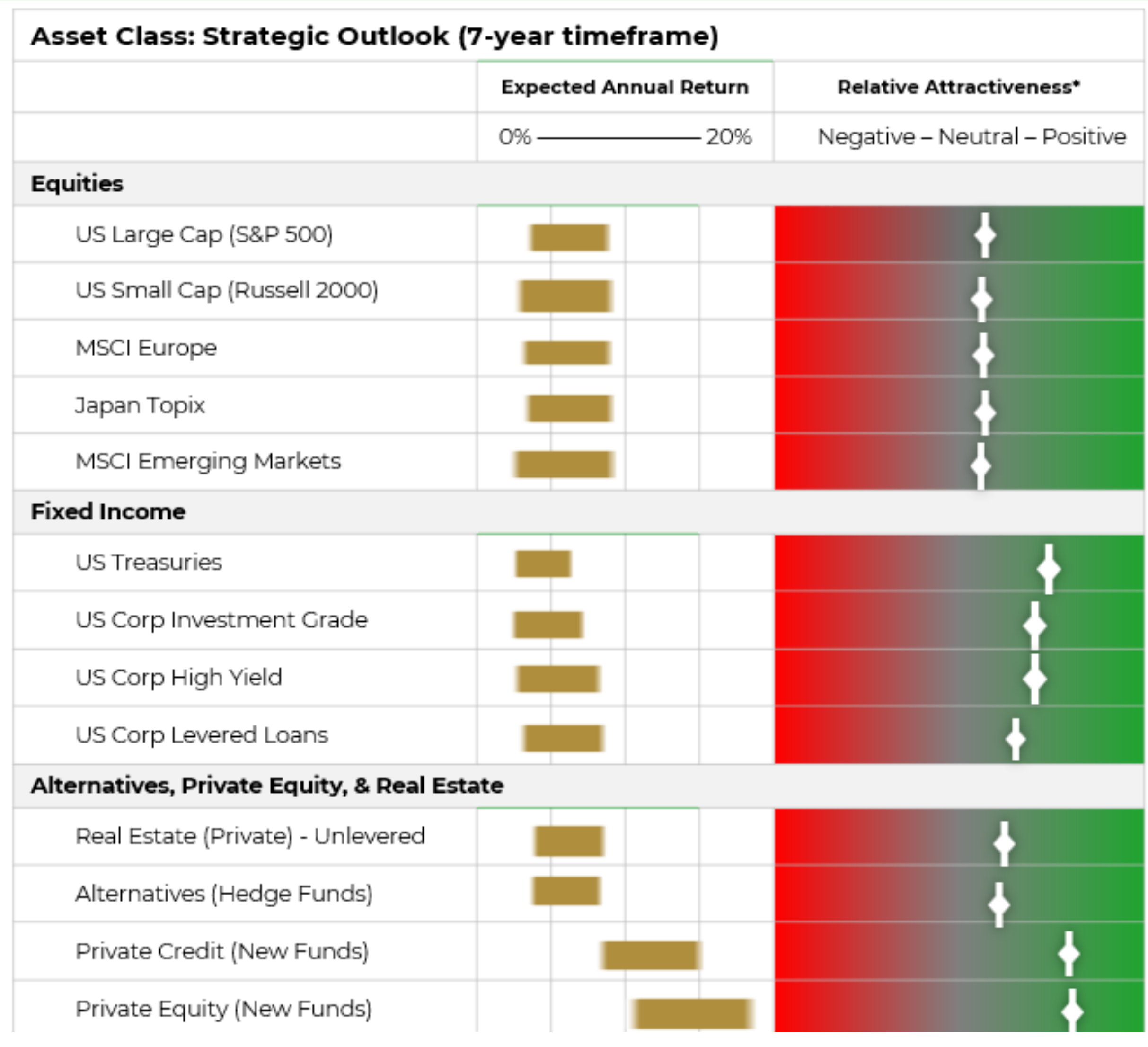
Operating fundamentals vary by property type: industrial and multi-family rents are flat despite strong demand due to still high supply additions, while offices continue to be pressured with historically high vacancy rates.

Strategic Asset Allocation (7-years)

- Macroeconomic and Market Factors
- Equity Market Outlook
- Fixed Income Outlook
- Credit Market Outlook
- Alternative Investment Outlook
- Portfolio Positioning

STRATEGIC ASSET ALLOCATION

Our 7-year forecasts consider several factors that will shape the mid-term investment landcape.



Note *: The attractiveness of each asset class (as depicted by the positioning of the sliders) is based upon risk-adjusted returns when considering expected returns, volatility, and liquidity. Thus, US Treasuries with mid-single digit returns are shown as quite attractive given a low-risk profile whereas public equities are only rated modestly attractive despite their higher expected return as equities have much greater volatility.

Macroeconomic & Market Factors

Interest Rates Outlook
We anticipate that interest rates will decline from current levels over the forecast period, but they are unlikely to return to the ultra-low levels experienced from 2009 to 2021.

Corporate Profit Margins
Margins (especially in the US) will be affected by opposing forces. Increased onshoring, reduced labor flexibility, and tariffs may exert downward pressure, while AI adoption could significantly boost productivity and expand profit margins, particularly in the U.S.

Geopolitical Risks
Heightened geopolitical uncertainty stemming from the U.S.-China relationship, conflicts in the Middle East, and the potential for other military tensions will likely influence market volatility and investment strategies. Traditional alliances may also fray as the Trump administration appears set on changing the global order both economically and with regard to defense.

Equity Market Outlook

Expected Returns
Following the recent market declines, valuations have retreated since the beginning of the year. However, earnings uncertainty has also increased.
Weighing these factors, we now forecast 6.5%-8.0% nominal pre-tax annual returns over the next seven years. Given the potential for a prolonged seismic shift in global trade policies, along with shifts in geopolitical dynamics, we caution that the risk of lower-than-forecast returns is heightened.

U.S. vs. International Markets
We have historically favored US stocks for several reasons including higher exposure to technological innovation, greater labor flexibility, a more shareholder-oriented corporate culture, and limited governmental Involvement. While many of these factors still hold true, U.S. trade policy appears to be changing materially, with the "new world order" ramifications still unknown. We still anticipate US outperformance over the next several years but expect the magnitude of this outperformance to be lower.

Growth vs. Value Stocks
Quality and growth stocks are expected to continue outperforming value stocks, though at a slower pace compared to the past seven years. For U.S. equities, earnings growth and dividends are likely to be the primary drivers of returns, rather than multiple expansion.

Potential Wildcards
The adoption pace of generative AI could significantly impact U.S. tech sectors, potentially leading to above-trend revenue

growth and margin expansion. Conversely, should AI capex spend decline from extremely robust current levels or revenue monetization from AI prove lower than expected, several US large-cap technology stocks may experience muted stock performance.

Given their high concentration in the index, S&P 500 performance may be heavily influenced by the performance of a select number of stocks. Additionally, the ultimate level of US tariffs and any retaliatory actions or negotiated agreements remains to be seen.

Fixed Income Outlook

Attractive Base Yields

“Safe” fixed income remains appealing (especially in light of slowing economic growth and heightened uncertainty), with base yields across the curve ranging from 4.0% to 4.4% for maturities between 2 and 10 years. U.S. 10-Year Treasuries currently yield 4.4%, significantly higher than the 3.6% lows seen in September, but lower than the 4.7% levels observed in early February.

We expect yields to stay within a 3.5% to 5.0% range in the near term, with a potential retrenchment from current levels appearing more likely than a sustained surge above 5.0%.

Expected Returns

We project close to mid-single digit returns for U.S. government debt and investment-grade bonds over the 7-year horizon.

Credit Market Outlook

Riskier Credit Assets

High-yield bonds are yielding 8.5%, while leveraged loans offer 9.1% yields. Expected returns for these assets are in the range of 6.5%-7.5%, factoring in elevated default risks. The high base yields make these options appealing for generating current income.

Spread Considerations

High-yield spreads have widened significantly over the past few weeks. At 420 bps, spreads are slightly above historical averages, but below recessionary levels (600-800 bps). If a recession occurs, spreads may widen, negatively impacting near-term prices, but high starting yields should cushion total returns.

Comparative Attractiveness

With widening spreads and higher total yields, riskier credit is becoming more attractive relative to Treasuries over the 7-year horizon. However, we caution that the near-term outlook for corporate earnings is highly uncertain, and spreads could widen further.

Alternative Investment Outlook

Private Market Strategies
We expect private equity and private credit to deliver higher returns compared to public markets over a multi-year period.

Private equity secondaries, specialty finance, and asset-backed credit remain appealing areas for new investments given their potential for superior returns and diversification benefits.

Portfolio Positioning

We are incorporating these views into our portfolio positioning by:

Extending Duration
Adding Treasury bonds with intermediate maturities (5-10 years), especially with 5-10 year U.S. Treasury yields ranging between 4.0% to 4.4%.

Focusing on Private Investments
Continuing to allocate to new private investment strategies, with a particular emphasis on private equity secondaries and private credit, which offer compelling risk-adjusted return potential in the current environment.

Actionable Investment Opportunities

- US Government Bonds
- Private Equity
- Private Credit

US Government Bonds

US Treasury bond yields are still attractive with 5-year and 10-year Treasury bonds yielding between 4.0% and 4.4% respectively as of April 11, 2025.

At these levels, bonds provide attractive coupons if held to maturity and provide potential for capital appreciation should bond yields decline due to recessionary conditions or faster than expected declines in inflation.

Private Equity

The secondary market for private equity remains robust, with strong activity in both LP-led transactions and GP-led deals. As buyer and seller expectations converge, the quality of LP portfolios and GP continuation vehicles offered via secondaries continue to improve, making this an appealing segment for discerning investors.

LP-Led Secondaries

Volume has surged as exit activity remains low and several PE fund vintages from 2007-2011 approach maturity walls. Despite the exit environment forecasted to improve in 2025, this trend is expected to continue as the overall secondary market transaction volume represents only 2% of private equity NAV.

GP-Led Continuation Vehicles

The market for GP-led transactions continues to expand, particularly for transactions involving high-quality assets. The supply-demand dynamic is also favorable with significantly greater demand from GPs to effect transactions vs. LP demand for investment (LP's can be choosier in terms of deals).

Private Credit

Private credit offers compelling potential returns, ranging from low double-digits to mid-teens, through a variety of specialty finance and structured credit solutions

Specialty Finance

There is increasing interest in niche opportunities such as consumer credit card portfolio purchases, forward flow agreements (i.e., "lending to lenders"), and bank credit risk transfers. These transactions provide attractive yields as banks seek to reduce regulatory capital charges.

Flexible Junior Capital

Demand is rising for flexible junior capital, which involves structuring payment terms with a mix of cash and PIK interest. These solutions offer mid-teens IRRs and can negotiate stronger financial and maintenance covenants, providing additional downside protection.

Asset-Backed Credit Solutions

There is a growing appetite for asset-backed lending, where companies pledge high-quality collateral such as receivables, inventory, and certain fixed assets to secure liquidity. This trend reflects a shift towards collateralized lending in a more cautious credit environment.

NAV Financing and Liquidity Solutions for PE Firms

There is increasing demand for NAV financing and other bespoke lending solutions tailored to private equity firms seeking to generate liquidity from their portfolios. These financing options can unlock capital without necessitating an asset sale.

Macroeconomic Conditions

- United States
- Canada
- Europe
- China

United States

The seismic shift in US trade policy and tariff application has significantly clouded the outlook for US economic growth.

The U.S. economy entered 2025 with robust momentum, but indicators have signaled emerging weaknesses driven by increased policy uncertainty. Following strong GDP growth of 3.1% in Q4 2024, preliminary estimates indicate substantial moderation in growth during Q1, influenced by recently imposed tariffs, fluctuating consumer confidence, and reductions in federal spending.

Consumer spending has continued to show resilience, particularly among higher-income households. However, discretionary spending and confidence measures have started to reflect caution, largely due to concerns over potential job losses, particularly within the public sector and related contracting industries. The extensive federal workforce reductions initiated earlier this year have not yet fully appeared in official employment data but are anticipated to negatively impact forthcoming labor market reports. Recent tariff uncertainty has further dented consumer confidence with surveys now showing consumer confidence having plummeted to levels last seen in June 2022. It is important to note that survey data has not proven to be an accurate barometer for future consumer spending, however. Businesses are increasingly delaying investment decisions until more clarity around tariffs emerges.

The labor market remains fundamentally sound, though signs of strain are increasingly evident. Unemployment continues to hover near 4.2%, but forthcoming data revisions might indicate greater deterioration. Wage growth has slowed, stabilizing at approximately 3.8% annually, while job openings have begun trending downward. Additionally, layoffs within federal employment and associated sectors may further stress labor market conditions into Q2.

Inflation continues its gradual downward trend after heightened service sector prices observed in late 2024. The Federal Reserve's preferred inflation indicator (Core PCE) has moderated recently, with forward-looking metrics suggesting ongoing deceleration. Nonetheless, inflation remains above target levels, and implementing recent tariffs introduces additional inflationary risks due to higher input costs.

Markets are now anticipating four interest rate cuts from the Federal Reserve beginning mid-year. However, the exact timing and extent of these cuts will depend heavily on labor market developments, inflation dynamics, and broader fiscal and trade policy impacts. While a soft landing scenario remains plausible, rising uncertainties related to consumer confidence and downward revisions in corporate earnings projections have notably increased downside risks.

Canada

The Canadian economy is projected to experience slower growth in 2025, primarily due to concerns about trade policy and the impact of tariffs.

Canada's economy showed signs of strain in Q1 2025, with growth slowing more than previously anticipated due to rising trade tensions and domestic policy uncertainty. Real GDP is now projected to expand at an annualized pace of just 0.7%, reflecting the adverse effects of newly imposed U.S. tariffs and retaliatory measures by Canada, which have weighed on trade and industrial output.

Goods-producing sectors, particularly natural resources and manufacturing, were significantly impacted by these trade disruptions, leading to softer output. Consumer spending has weakened, particularly among highly indebted households facing elevated debt servicing costs and diminished confidence. The housing affordability squeeze continues in major metropolitan areas, further straining household finances.

The unemployment rate edged up to 6.6% in January, temporarily offset by the addition of 76,000 jobs. However, business sentiment has deteriorated, with firms scaling back investment and hiring plans in response to increased uncertainty. Labor market conditions are beginning to show stress, and wage growth has slowed from earlier peaks.

In response to softening growth and moderating inflation, the Bank of Canada cut its policy rate by 25 basis points to 3% in January, initiating a gradual easing cycle expected to continue through 2025. While inflation has moved closer to the central bank's 2% target, the outlook remains clouded by the uncertain effects of ongoing trade disputes and their potential drag on growth.

Looking forward, Canada's economic trajectory will depend heavily on the resolution of external trade tensions and the effectiveness of policy measures aimed at supporting domestic demand.

Europe

Europe's economy closed Q1 on a positive note but enters Q2 facing heightened uncertainty.

Europe's recovery gained traction in Q1 2025, though momentum remains uneven. Eurozone GDP is projected to grow by 0.4%–0.6% YOY, extending the modest rebound from late 2024. However, rising global trade tensions—particularly the impact of recent U.S. tariffs—are increasingly clouding the outlook.

Fiscal policy has become more supportive, with Germany and others committing to large-scale defense and infrastructure investments. These efforts have helped mitigate some risks, though persistent trade uncertainty continues to weigh on confidence.

Consumer demand is improving, supported by falling inflation and strong labor markets. Inflation declined to 2.3% in February, nearing the ECB's target, though tariff-related price pressures pose a near-term risk.

Business investment remains cautious due to trade concerns and political uncertainty in France and Italy. Corporate sentiment has moderated, with several sectors scaling back capital expenditures. Service sectors continue to expand, with PMIs in positive territory. Manufacturing remains soft but shows signs of stabilizing.

The ECB cut rates by 25 basis points in Q1 to 2.5%, signaling a dovish stance, with additional cuts likely if growth remains subdued.

While fiscal support and easing inflation aid the near-term recovery, long-term challenges such as aging demographics and weak productivity persist. The region's near-term outlook will heavily depend on the evolution of global trade and policy responses.

China

China's economic continues to muddle along with mixed indicators.

China's economic growth has been better than expected the last two quarters, driven by stimulus expectations and a shift toward more pro-growth policy. Q1 Real GDP growth of 5.4% exceeded expectations, driven by robust factory activity and strong consumption. Encouragingly, retail sales increased by 5.9% YOY, supported by robust bank lending growth. Earlier in March (prior to the trade war escalation), the government reaffirmed its full-year 2025 growth target of 5%, underpinned by fiscal easing and renewed monetary accommodation.

However, the external environment has become more challenging due to newly implemented U.S. tariffs, including a whopping 145% levy on Chinese goods (although certain electronic goods such as smartphones, computers, and servers are exempted). If maintained, these tariffs are expected to reduce China's GDP growth by 1%-1.5% in 2025 in the absence of significant incremental stimulus. In response, Chinese policymakers are preparing significant fiscal and monetary measures, including potential interest rate cuts and increased deficit spending, aimed at sustaining domestic demand and market stability.

Domestic consumption remains weak, especially among middle-income households, as job insecurity and deflationary pressures continue to weigh on sentiment. The property sector also remains a drag, with home prices in major cities falling further despite government stabilization efforts. Confidence in the real estate market remains subdued, limiting a broader recovery in household spending and private investment.

On the policy front, Beijing has maintained a more business-friendly tone, particularly in the technology and internet sectors. Regulatory headwinds have eased, and capital markets have responded positively, with Chinese equities up sharply YTD. The People's Bank of China has signaled a shift toward a more accommodative monetary stance, indicating a readiness to use interest rate and reserve requirement tools to ensure ample liquidity.

While headline growth is improving, structural challenges—including high local government debt, demographic headwinds, and a tepid labor market—continue to constrain China's long-term growth potential.

Short-Term View: Key Issues & Scenarios

- US Trade Policy & Tariffs
- Inflation Trajectory and Fed Policy
- Economic Growth
- Corporate Earnings
- AI Adoption
- China Stimulus and Trade Policy
- Geopolitical Risks

- Scenario A: Pessimistic Case
- Scenario B: Base Case
- Scenario C: Optimistic Case

Short-term View: Key Issues

Below, we visit vital issues affecting markets over the next 12-18 months.

Issue #1: US Trade Policy & Tariffs

Policy uncertainty has increased significantly and reflects the Trump administration's intent to reshape the global economic landscape, particularly concerning trade deficits.

Most economists believe that these tariffs will reduce global economic growth and serve as a consumption tax in the US. Economists are forecasting a 0.5%-1.0% hit to global GDP resulting from the tariffs. At the same time, they are predicting rising inflation, especially in the US.

The reshoring of US manufacturing seems unlikely given a) the length of time for new factories to be built in the US and b) the significant differences in labor wage rates between the US and many other countries. Given the complexity of tightly integrated global supply chains, it is simply impossible for US companies to quickly move production back to the US.

Substantial uncertainty remains with regard to tariff implementation and foreign countries' responses. Post the Liberation Day announcement, global stock markets tanked. The S&P declined by almost 15% from April 3rd through the intraday low on April 7th.

After Trump announced a 90-day pause mid-day April 9th, the S&P furiously rallied more than 10% over the next few days.

Investors are increasingly concerned about slowing growth, inflationary pressures from rising input costs, and widespread supply chain disruption. With trade conditions evolving rapidly and retaliatory measures unknown, these policies pose a meaningful threat to global economic stability and risk amplifying downside pressure in the months ahead. Analysts are likely to further cut forecasts for corporate earnings, although forecasting earnings is highly challenging until clarity emerges regarding ultimate tariff rates. In the short-term, President Trump's actions have damaged the US' credibility across the globe. It remains far too early to predict longer-term consequences and potential ramifications on global appetite for US assets.

Issue #2: Inflation Trajectory & Fed Policy

Most economists anticipate that Trump's tariffs will result in a slowdown in economic growth and increased inflation.

Recent inflation data has shown uneven progress towards the 2% goal. Core PCE (fed's preferred inflation gauge) has remained at 2.8% YOY and recent monthly data has been bumpy. According to some surveys, consumer inflation expectations for both the next one year and the next five years have ticked up materially. However, bond market expectations of 5-to-10-year inflation levels have eased and are down 20bps since February.

Trump's tariffs are likely to lead to a combination of slower growth and rising inflation. Most economists are currently forecasting an increase in inflation of 50bps-100bps by YE 2025.

The Fed's job is increasingly difficult in terms of prioritizing economic growth and employment or tackling inflation. Bond market participants currently expect the Fed to cut four times by YE 2025, higher than the two cuts expected prior to the Liberation Day trade announcement.

Outside of the US, inflation continues to recede in Europe, Canada, and many other developed markets. Growth remains much slower in those economies than in the US.

As such, it is likely that rates in Europe and Canada decline at a faster pace and to lower ultimate levels than in the US. However, tariff policy remains a wildcard with regard to its impact on interest rate policy.

Issue #3: Economic Growth

Economic growth is likely to slow materially over the next one to two quarters, and the risk of recession has increased substantially due to US trade policy.

The U.S. economy entered 2025 on solid footing, supported by strong consumer spending, resilient labor markets, and healthy corporate balance sheets. However, downside risks increased meaningfully as the year has progressed. The combination of sweeping tariff measures and large-scale federal workforce reductions has eroded consumer and business confidence, with sentiment surveys weakening across the board.

While inflation had moderated significantly by late 2024—evident in minimal month-over-month increases in core CPI and a core PCE reading approaching the Fed's 2% target—recent developments are beginning to reverse that trend. The introduction of broad-based tariffs on key imported goods such as steel, aluminum, and consumer products may introduce inflationary pressures, creating the risk of a renewed squeeze on real household incomes.

Lower- and middle-income households remain especially vulnerable, already burdened by higher costs and limited wage growth. Although higher-income consumers have provided a buffer to overall spending trends, this support may wane if job losses increase or financial market volatility deepens. The recent wave of federal layoffs, coupled with weakening demand indicators, has amplified concerns that the economy may shift from a soft-landing scenario toward a more material slowdown or recession in the latter half of 2025.

Globally, growth is likely to be lower as well. While the European Union has promised significant fiscal spending increases for defense and infrastructure needs, implementation will take time. Additionally, China is likely to further increase consumption driven stimulus measures as export growth becomes challenged. While these measures may offset some weakness, most international economies are dependent on exporting to the US (the largest consumer market). With US demand likely lower, these countries may face economic challenges.

Issue #4: Corporate Earnings

Forecasting near-term corporate earnings is extremely challenging with the present uncertainty regarding tariffs.

Coming into the year, analysts were forecasting 13% S&P 500 earnings growth for 2025 as US economic fundamentals remained strong and international fundamentals were beginning to improve. Importantly, earnings growth was projected to broaden across sectors, beyond the Magnificent Seven and related stocks.

With consumer and business uncertainty rising throughout Q1, analysts had already reduced S&P 500 YOY earnings growth to 10% from 13% earlier in the year. Post the Liberation Day announcement and Q1 earnings season, earnings growth forecasts are likely to be reduced. However, it is simply not feasible to have confidence behind earnings estimates until there is more clarity with regards to tariff policy, both in terms of the ultimate level of tariffs and the timing associated with implementation.

Looking at prior recessions, earnings have generally declined by 10% to 15% (they declined 32% during the GFC). Applying that range suggests that S&P earnings trough at 210 to 220 per share. As they are forward-looking, markets tend to rally well before earnings troughs are reached.

Historically, markets have tended to bottom at 20x trough earnings, which suggests a bottom of 4,200 to 4500, 15%-21% percent lower than current levels.

However, a more likely base case is that the Trump administration reaches agreements with most countries over the next 90 days and makes progress towards a deal with China over the next 6 months. The effective tariff rate might settle in the 10%-12% range, although the ultimate effect may be lower due to product exemptions. While there may be some earnings disruptions over the remainder of 2025, companies and markets will adjust, with investor focus shifting towards 2026 and 2027 earnings. Under this scenario, we would not anticipate large (>15%) market declines.

Issue #5: AI Adoption

AI drove the strong S&P 500 performance in 2023 and 2024. While demand appears strong heading into 2025, it is difficult to predict the level of spending and demand in future years, with tariffs adding to uncertainty.

Thus far in 2025, the Mag 7 are down 16.8% and have significantly underperformed the S&P 500 (-8.5%) and the MSCI ACWI Index (-5.6%). While spending on AI-related semiconductors and data center capex is poised to ramp significantly in 2025 (many hyperscalers such as Amazon, Alphabet, Meta, and Microsoft have increased planned capex in 2025 by 40%-80%), investors are increasingly questioning whether these expenditures will pay off in terms of materially improved revenue and margin growth. The DeepSeek announcement (from China), which purported to have achieved significant large model computational capabilities at fractions of the cost spent by US hyperscalers, exacerbated these concerns.

Upcoming earnings reports will be closely watched for signs of sustained demand, cost pressures, and shifts in competition.

Issue #6: China Stimulus & Trade Policy

China has enacted significant fiscal stimulus aimed at stimulating domestic consumption and has also adopted a pro-business sentiment after several years of ramping up regulatory actions. However, increasing trade uncertainties will hamper efforts to achieve its 5% growth target for 2025.

China's Q1 GDP growth of 5.2% surpassed expectations. Importantly, the government has intensified consumption-driven fiscal stimulus and adopted a more pro-business tone.

However, China will need to enhance stimulus further to offset potentially severe headwinds from increased US tariffs. Furthermore, the stance that China takes regarding bilateral trade negotiations with the US has widespread implications for the duration of the US-China trade war.

Issue #7: Geopolitical Risks

Militarily, the situation remains relatively unchanged in the Middle East and in Ukraine, although prospects for resolution remain. However, conflicts surrounding trade and tariffs have intensified significantly between the US and the world.

The conflict in Gaza has resumed following a brief ceasefire. The recent regime change in Syria represents a future unknown. The Trump administration is escalating pressure on Iran to submit to a nuclear deal.

The Russia-Ukraine war is stuck in a stalemate. However, under Trump, a resolution appears more likely than it did under the Biden administration.

Thus far, oil prices have declined due to global growth fears. However, a sustained increase in oil prices arising from geopolitical disruption could reignite inflation and raise the risk of a global recession.

As discussed previously, changes in global trade policy and tariffs are the largest wildcards over the next few years. It is too early to ascertain whether the US' global standing is materially altered and whether a new economic order unfolds.

Short-term View: Scenarios

Given the considerable macro uncertainty surrounding tariffs, we discuss a range of scenarios below:

Scenario A: Pessimistic Case

This scenario assumes higher levels of tariffs result in a recession beginning in H2 2025.

In this case, we assume that tariff negotiations take longer to reach agreement and that ultimate tariff levels are higher. Furthermore, we assume that the incremental effect from the Republican tax bill is relatively muted. Economic activity will likely weaken substantially in H2 2025, and unemployment will begin to rise swiftly.

Inflation is likely to increase 50-100bps, while the Fed remains cautious (cutting rates gradually but remaining behind the curve). Analysts begin to slash EPS expectations for 2025 and 2026. Investors price in S&P 500 earnings declines of 10%-15% vs. peak levels (resultant range of $210 to $220 per share) and the S&P 500 troughs in the low-to-mid 4,000 range later this year or early next year.

Scenario B: Base Case

This scenario assumes substantial tariff clarity emerges over the next few months and a US / China trade deal is reached over the next six months. However, higher tariffs lead to reduction in 2026 earnings estimates.

In this case, we assume while effective tariff rates increase to the low double-digit range, tariff clarity emerges over the next few months as deals are struck with multiple countries. We also assume positive news flow with regards to US / China deal talks, with an ultimate agreement struck over the next six months.

While economic growth slows, the US avoids a recession. Inflation increases 50bps-75bps, but the Fed leans towards supporting the economy and cuts rates three times – a total of 75bps-100bps over the remainder of 2025.

Analyst forecasts for S&P 2026 earnings are reduced by 5%-10% from $305 to $275 - $290. As positive news emerges, the market focuses on 2026 and 2027 earnings potential and the S&P ends the year between 5,400 to 5,800, before rallying to the low 6,000-6,300 level by late 2026.

Scenario C: Optimistic Case

This scenario assumes that successful negotiations lead to ultimate tariff rates well lower than currently anticipated. Furthermore, this scenario assumes positive impact from the Republican tax bill for individuals and possibly corporations as well.

This scenario assumes that increasingly positive news flow regarding successful bilateral tariff negotiations with several countries including Japan, South Korea, India, Vietnam, and others will materialize over the next 1-2 months. Furthermore, China and the US reach a deal faster than expected with the ultimate tariff rate around 30%. We also assume the Republican tax bill produces incremental benefits for individuals (perhaps tax exemptions on certain types of income) and corporations (perhaps greater deductions in terms of capex).

While we anticipate transitory economic weakness, businesses and consumers adjust, and the economy returns to more normal growth in 2026 and beyond. We anticipate that analysts would cut 2025 S&P 500 EPS forecasts to $255-$260 from $269 today and 2026 estimates to $280-$290 from $302 today.

As normalcy resumes, investors will focus on 2027 earnings potential of $310-$325 and the S&P 500 could trade at 6,200-6,700 by late 2026.

Given the extreme level of policy uncertainty today, it is simply not possible to place probabilities with regards to any of the scenarios unfolding.

The potential for a global recession increases the longer the trade war lasts. However, for investors with a long-term horizon, we would begin adding to US equities if the S&P 500 declines to the low $5,000 level, with more aggressive additions upon further weakness towards $4,500.

Asset Class Reviews

- Equity Markets
- Fixed Income
- Hedge Funds
- Commercial Real Estate
- Private Equity
- Private Credit
- Venture Capital

Equity Markets

Performance

Equity Indices - Performance	YTD 4/11/25	Mar-25 Qtr	Annualized Returns (as of 4/11/25) 1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	-8.6%	-4.4%	4.1%	7.9%	15.2%	11.9%
US Small Cap (Russell 2000)	-16.3%	-9.5%	-7.7%	-0.6%	9.8%	4.1%
MSCI EAFE	2.4%	6.9%	2.7%	5.4%	10.1%	4.4%
MSCI Emerging Markets	-2.2%	2.9%	1.5%	0.6%	5.9%	0.8%
MSCI ACWI	-5.6%	-1.3%	3.6%	6.3%	12.8%	8.3%
S&P 500 - Equal Weight	-7.1%	-0.7%	-0.2%	2.8%	13.4%	8.7%
MSCI ACWI - Equal Weight	-2.0%	2.1%	2.3%	0.6%	7.4%	2.6%
<u>US Style Factors</u>						
MSCI US Quality	-6.5%	-3.0%	3.5%	11.1%	15.7%	14.0%
Russell 1000 Growth	-12.6%	-10.0%	4.3%	10.6%	17.5%	15.3%
Russell 1000 Value	-4.5%	2.0%	2.4%	3.7%	11.8%	7.4%

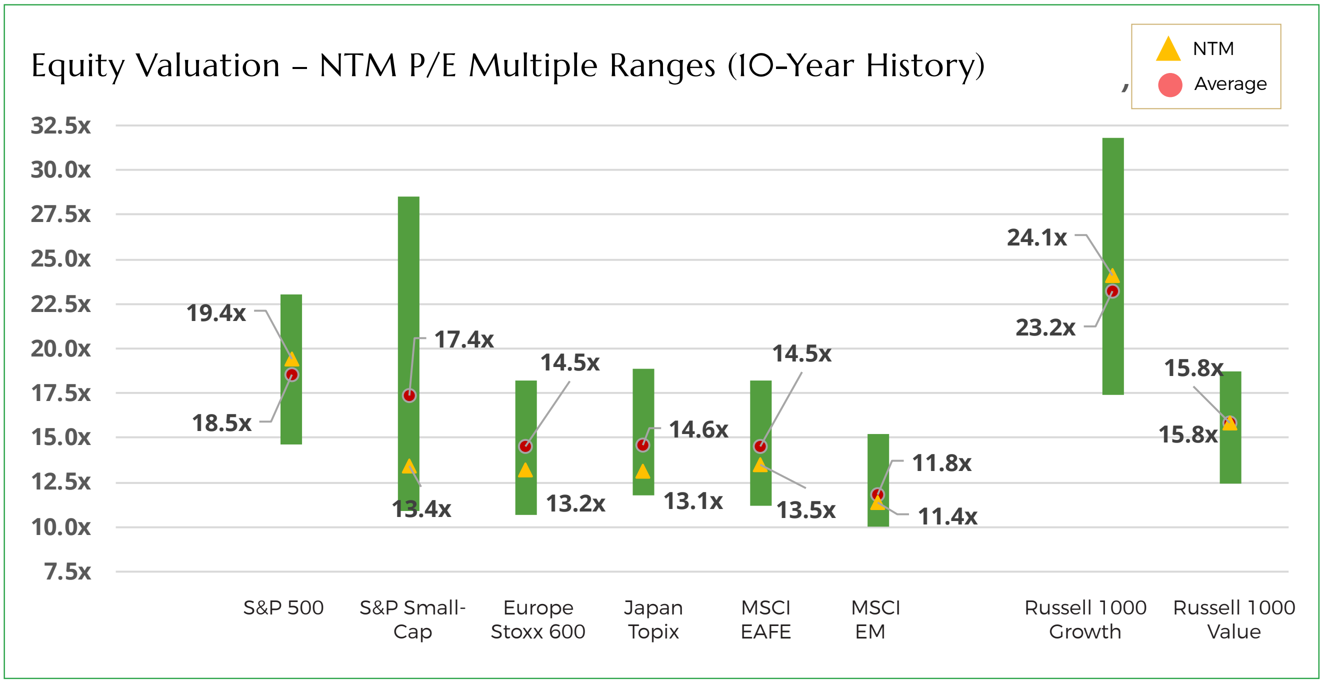
Performance Observations

- In Q1, international developed (+6.9%) and emerging markets (+2.9%) equities significantly outperformed US equities.
- Q1 US equity weakness was driven by a) partial unwinding of AI trade (especially for Magnificent Seven companies), b) a pullback from elevated valuations and lofty expectations, and c) uncertainty regarding inconsistent application of tariffs to Canada and Mexico coupled with hatchet-like DOGE reductions to the federal government workforce.
- International developed stocks' outperformance was driven by positive investor sentiment associated with European countries' (led by Germany) stated plans to materially increase fiscal spending for defense and infrastructure needs. Emerging market outperformance driven by China's commitment to materially increase stimulus targeted towards domestic consumption coupled with adopting a more pro-business policy outlook.
- US growth stocks underperformed given high exposure to technology and communications services sectors (-6.2% and -12.7%) and Magnificent Seven (-14.5%). US Value stocks outperformed given greater exposure to defensive sectors such as consumer staples healthcare (+6.5% and +4.3%).

YTD Performance Observations

- Post Trump's April 2nd tariff announcement, all regions and sectors have declined and correlations have tightened.

Valuation



Key Observations

- Following global equity market declines, valuations across regions are lower and, in some cases, attractive. However, earnings uncertainty is much higher.
- The S&P 500 is now trading at 19.4x forward EPS (slightly higher than its 10-year average and more expensive than its historical 17.0x), down from its 22.6x peak in February. Growth stocks (Russell 1000 Growth Index) valuations have retreated considerably to 24x forward EPS from 28x earlier this year.
- Clearly, earnings uncertainty is much higher given the shifting policy dynamics.
- International developed equities are now trading below historical averages.
- Historically, given a greater exposure to cyclical companies with higher levels of exports, international developed company earnings have been more influenced by global macroeconomic developments than S&P 500 earnings.
- Since the uncertainty today is driven by US tariffs, historical patterns may be less relevant.

Outlook

Over the near-term, it is impossible to forecast corporate earnings until clarity surrounding tariffs emerges. We expect that analysts will reduce earnings estimates for 2025 and to a lesser degree for 2026. Given the many moving parts for 2025 and the lag effect of tariffs' impact on earnings, investors will focus on establishing a baseline for 2026 earnings.

As long-term investors, we advocate the following:

- Selectively adding to US quality and growth stocks (especially in the technology and communication services sectors) if US equity market declines continue.
- Adding opportunistically to international developed stocks upon further weakness.

Fixed Income Markets

Performance

Fixed Income Indices – Characteristics and Performance in USD

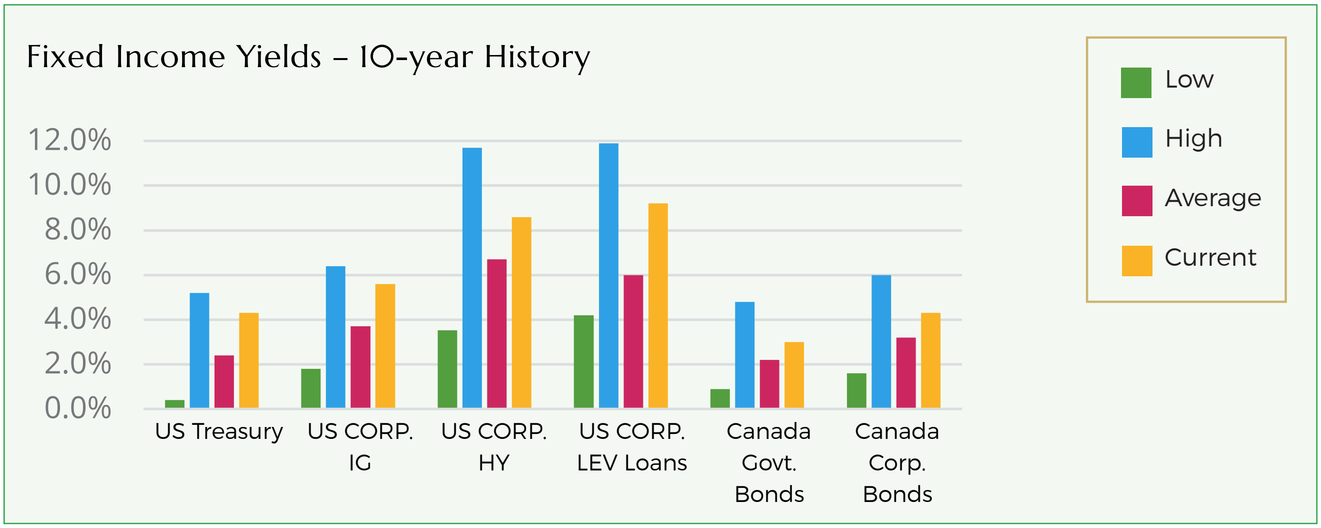
	% Ret YTD 4/11/25	% Ret Mar-25 Qtr.	Annualized % Returns As of 4/11/2025 1Y	3Y	5Y	7Y	Duration (yrs)
US Treasury	1.6%	2.9%	5.3%	0.3%	-1.9%	1.0%	5.8
US Corp. IG	-0.2%	2.3%	4.4%	1.4%	0.5%	2.1%	6.8
US Corp HY	-1.4%	1.0%	6.1%	4.9%	6.1%	4.5%	3.3
US Corp Lev. Loans	-0.9%	0.5%	5.2%	6.5%	7.9%	5.1%	NA
Barclays US Aggregate	1.1%	2.8%	5.3%	0.8%	-0.9%	1.3%	6.0
Barclays Canada Agg. *	-0.3%	1.9%	6.9%	2.4%	0.3%	1.7%	7.2

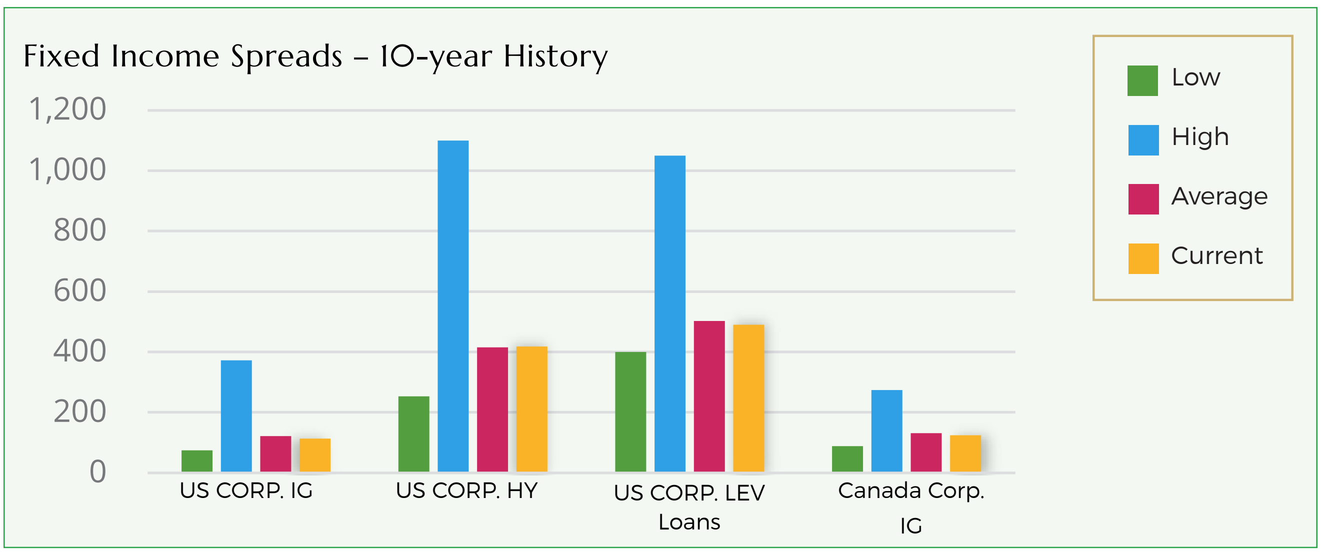
** Barclays Canada Aggregate Index returns in CAD*

Key Observations

- During Q1, safe fixed income (government bonds and corporate investment grade bonds) performed well as bond yields declined by 30bps to 40bps across the curve. Riskier credit (high yield bonds and leveraged loans) delivered positive performance but high coupon income was somewhat offset by modestly widening credit spreads.
- After the April 2nd Liberation Day announcement, credit spreads across investment grade bonds, high yield bonds, and leveraged loans widened sharply, leading to mark-to-market losses YTD in high-yield and leveraged loans.

Valuation





Key Observations

- Absolute yields are still attractive for safe fixed income with Treasuries generally yielding over 4% across most maturities and investment grade bonds yielding 5.4%. Yields are also attractive for high-yield bonds and leveraged loans. However, leveraged loan yields will likely come down as we project 100bps+ of Fed base rate cuts over the next 18 months.
- Credit spreads have widened sharply since April 2nd, after being very tight earlier in the year (HY spreads are now at 420bps vs. 270bps in mid-February). However, HY spreads could certainly widen to 600bps or more should recessionary conditions emerge.

Hedge Funds

Hedge funds were up 0.5% in Q1, with mixed performance across strategies. Event-driven (+1.0%) and convertible arbitrage strategies (+0.7%) performed best, while macro / trend following (-0.8%) and credit (-0.6%) strategies performed worst.

It bears watching how levered strategies with exposure to underlying fixed income securities perform over the next few months given the significant volatility arising in the US Treasuries market.

Commercial Real Estate

The NCREIF Index for commercial real estate increased by 0.4% in Q4 2024, marking the second consecutive quarter of positive performance. According to Green Street, prices for a weighted index of commercial real estate was relatively stable in Q1 and have appreciated by 5% over the past year. While commercial real estate seems to have stabilized broadly, it is unclear how potential economic slowdowns might impact certain sectors. On the one hand, operating fundamentals are likely to weaken for some sub-sectors. On the other hand, if interest rates decline, cap rates may decrease as well.

Data from the RCA Commercial Property Index highlights variation across different property sectors:

Industrial and retail properties appreciated by 5% YOY through February 28, 2025, while apartments and office properties declined 1.5%-3.0% YOY.

Operating fundamentals across property types show divergence:

Office: Vacancy rates ended 2024 at 21.0%, an increase of 160bps YOY. However, the rate of vacancy increases is slowing.

Apartments: Demand remains strong, with high absorption, but an increase in new supply is limiting rent growth.

Industrial: Vacancy rates rose to 6.5% in 2024, up from a post-pandemic low of 3.7%, but still below pre-pandemic averages. The pace of vacancy growth slowed in H2 2024, and vacancy rates may peak in 2025. However, the industrial sector is most influenced by economic conditions and may exhibit weakness if a recession develops.

Private Credit

Private Credit (measured by the Cliffwater Direct Lending Index) increased by 2.8% during Q4 2024 and 11.3% in CY 2024 (lagged reporting).

Q1 returns are expected to align with Q4 2024 returns. Unlevered yields approximate 10% at base rates of 4.3%. Although current credit quality remains solid, the percentage of loans in non-accrual is rising, indicating potential defaults or markdowns in legacy portfolios. Additionally, the percentage of income comprising paid-in-kind (PIK) rather than cash income is also increasing. Competition is intensifying among private credit lenders. At the larger end of the market, spreads have compressed by 150bps compared to mid-2023 levels. Spread compression was less severe among lower-middle-market and middle-market borrowers (75bps-125bps).

Private Equity

Preliminary data indicates that private equity returns rose 1.0% in Q4 and were up 7.5% in 2024 (latest data due to lagged reporting). PE deal activity and exits continued to improve in Q1.

Returns in 2024 lagged large cap public equities, largely due to lower exposure to AI and tech sectors. Additionally, PE managers have been reluctant to mark up asset valuations during a period of still low exit activity.

US PE new deal activity rebounded strongly in Q1 to $250bln (up from $185bln in Q4 2024). Entry valuations have remained stable in the low-to-mid 12x EBITDA range (above 2023 trough levels and below the 14x 2021 peaks) while leverage has remained in the low 5x Debt / EBITDA range or roughly 45% of deal value. Rising economic uncertainty especially with regards to tariffs may temporarily constrain deal activity in future quarters.   With $1 trillion in dry powder, PE firms are well positioned to capitalize on opportunities presented by potential market dislocations.

US PE exit activity continued to improve during Q1. At $187bln, exit activity was 45% higher than during Q4 2024 (although this was flattered by the $58bln Venture Global LNG IPO). However, exit deal count remains low with only higher-quality portfolio companies completing sale transactions in this environment.

Middle-market PE increased its share of PE deals to 61% in 2024 from 52% in 2021. Middle-market exits were up 15% YOY in 2024, with sequentially improving YOY growth trends throughout the year. While M&A bankers have alluded to a significantly higher pipeline of potential portfolio company exits, the 16% YTD decline in public small cap equity returns bears watching as middle market portfolio companies are more comparable to US small cap equities as opposed to large cap equities.

Venture Capital

Venture capital (VC) performance appears to have bottomed but remains uneven. According to Pitchbook, US VC delivered 1.2% returns in Q4 (preliminary returns) and low-to-mid SD returns for CY 2024.

US VC deal activity at $92bln increased 110% YOY and 15% sequentially during Q1. However, deal count actually declined by 25%. AI deal activity increased to $65bln vs. $14bln YOY, with AI deals representing 71% of VC deal value (34% of deal count) in Q1 2025 vs. 35% of VC deal value (27% of deal count) in Q1 2024.

Exit activity continued to improve, both in terms of deal value and deal count. Q1 exit value of $56bln was 40% higher YOY and sequentially. Recent public market volatility may hamper future exit activity, however.

Signs of valuation froth are emerging with regards to AI venture deals. Outside of the AI sector, investor terms for new deals have become more favorable compared to the 2020-2021 period.

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