Well, That Escalated Quickly

The positive momentum from easing recession fears and declining inflation that fueled strong equity gains in 2023 and 2024 quickly unraveled in the first quarter of 2025. As the year began, markets appeared optimistic—Central Banks were expected to continue their global interest rate cutting cycle, with further reductions anticipated in both the U.S. and Canada. However, that optimism was short-lived. The reintroduction of tariffs by President Trump has disrupted markets and created uncertainty, shaking investor confidence as we moved into the early months of 2025.

Longstanding market leadership in AI and tech-related giants reversed course and led global losses in Q1. The NASDAQ index dropped 10.4%, with small-cap U.S. companies on the Russell 2000 close behind, down 9.8%. The S&P 500 fell 4.6%, marking its worst quarterly performance since Q3 of 2022. In contrast, strong gold prices helped lift the Canadian S&P/TSX Composite Index by 0.8%.

The sell-off in risk assets was met with a rally in bonds—a stark contrast to 2022, when rising inflation and low bond yields caused both stocks and bonds to fall. This time, global bonds rose 2.6%, U.S. bonds gained 2.8%, and Canadian bonds added 2.0% during the quarter.

Volatility surged after the quarter ended. On April 2nd, Trump's "Liberation Day" introduced a reset of tariff expectations to approximately 20%, levels not seen since the Great Depression. The broad and unexpected nature of these tariffs—targeting virtually every country, even the ones exclusively inhabited by penguins— sent the VIX (the U.S. stock market's "fear index") to levels rarely seen outside of crisis periods since 1990. A two-day U.S. market sell-off on April 3rd and 4th ranked as the fifth largest since World War II. Then, in a dramatic turn, markets rebounded around 10% on April 9th after Trump postponed the tariffs' implementation. Fear and greed are both very much back in style.

Political Views Aside

President Trump's flurry of executive orders during the opening months of his second term has made headlines, materially affecting immigration, the federal workforce, and trade. Each of these could prove recessionary for the world's largest economy. In February alone, the U.S. and China announced major tariff policies more than 10 times throughout the month. The unpredictable timing, scale, and duration of these decisions have created a highly uncertain environment—one that markets historically dislike.

The potential consequences of tariffs include lower economic output, higher unemployment, and one-time price increases. This raises the risk of stagflation: low growth coupled with high inflation—a challenging scenario for asset prices. Global supply chains are deeply intertwined, and many products and services involve components sourced from multiple countries. Companies are now faced with the costly and complex task of rapidly shifting their sourcing strategies.

So, why pursue these seemingly self-defeating policies? Several leading arguments tie back to reducing the U.S. trade deficit, bolstering national security, and addressing fiscal imbalances. On trade, the U.S. has run persistent deficits for over 50 years. During Trump's first term, efforts to reduce the deficit with China were undermined by the redirection of Chinese exports through countries like Vietnam and Mexico. The broad application of tariffs this time aims to counter that re-routing.

National security concerns are also central. The COVID-19 pandemic revealed the West's vulnerability due to its reliance on foreign production, particularly from China, for critical pharmaceuticals, technology, and materials. The argument is that if the U.S. doesn't re-shore key industries, it remains strategically exposed.

Finally, on the budgetary front, U.S. deficits over the last three Presidents have reached levels not seen since WWII, with the 2025 fiscal deficit expected to be about 7% of GDP. Roughly 30% of government debt is held by foreign entities—notably China and Japan. Markets are beginning to fear that unless deficits return to more sustainable levels, the U.S. may face refinancing difficulties in the near future.

Smoke Screens

While the trade war has gone global, many BWM partners believe China is the true target. For over 150 years, the U.S. has been the world's dominant economic force. That status is now being challenged. China has methodically built the world's most advanced manufacturing base, controls rare earth metals critical to modern technology, and has become the primary trading partner for many nations.

The Trump administration appears focused on reversing this momentum for strategic, economic, and military reasons. While the near-term impact may be economic discomfort, we expect the U.S. to strengthen alliances and reduce exposure to these risks. Still, some believe China's growing strength may accelerate global shifts in economic power.

In Canada, we face a generational election. Votes are expected to concentrate to the two leading parties at levels never seen before. Whomever wins, there will be important negotiations ahead with the U.S. administration. Ultimately, we do not see Canada as Trump's focus and that a bilateral or broader agreement that is positive for all parties can be reached.

Real Life Stress Test

Market corrections, including 15% pullbacks, are not uncommon—typically occurring every five years. Today, global equity markets are trading near long-term average valuations (since 1995), far more attractive than just a few months ago. As long-term investors, we're focused not on the next quarter, but on the next three, five, and ten years, and the opportunities unfolding now are exciting.

At BWM, we use leading global portfolio management software and key partnerships to model how portfolios might respond in difficult markets. In 2025, we are living through a live stress test. For nearly a year, we've been de-risking portfolios—both within asset classes and at the total portfolio level. Through the end of the first quarter, we are pleased with how our clients' portfolios have weathered the storm.

No static portfolio can perform equally well in both rising and falling markets. Adaptation is necessary as risk and opportunity shift. As we gain further clarity, we will continue adjusting exposures to protect and grow our clients' wealth. History has shown that the tide always turns.

Bessette Wealth Management
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