PATHSTONE
THE FAMILY OFFICE℠

Monthly Market Insights

MARCH 2025

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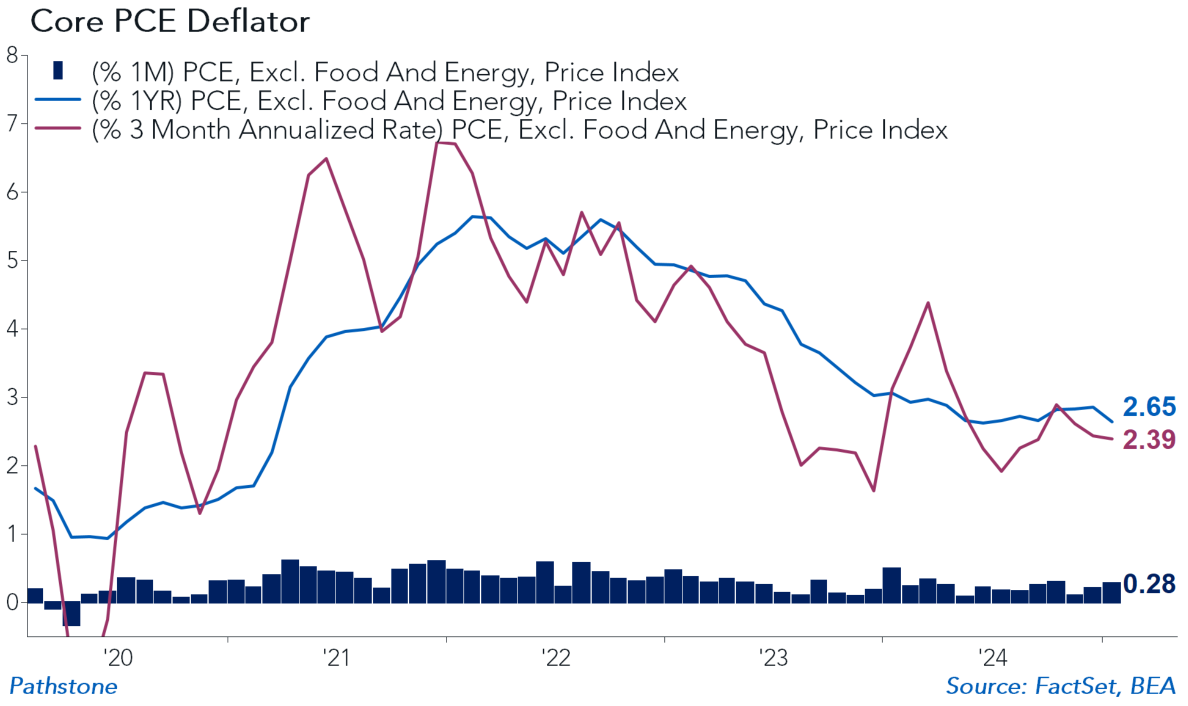
PCE REPORT REFLECTS MORE MODERATE INFLATION THAN CPI REPORT IN JANUARY

While the January CPI inflation print was hotter than expected, the Core PCE Price Deflator (which is the Fed's preferred inflation gauge) came in essentially right in line with expectations. The month-over-month number was under 0.3% and the year-over-year number was well under 3%. Importantly, we like to look at the 3-month annualized rate for any shifts in trends rather than just focusing a single monthly data point. **While the January print was in line with expectations at slightly higher than the prior two months, the 3-month annualized trend continues to run below 2.5%, a welcome sign on the inflation front. However, we do still see some signs of "sticky" inflation in underlying data and thus expect inflation to remain a bit hot, but manageable.**



The Fed's stated inflation target is 2%, but we believe they will tolerate mid-2's for a time, albeit making rate cuts less likely.

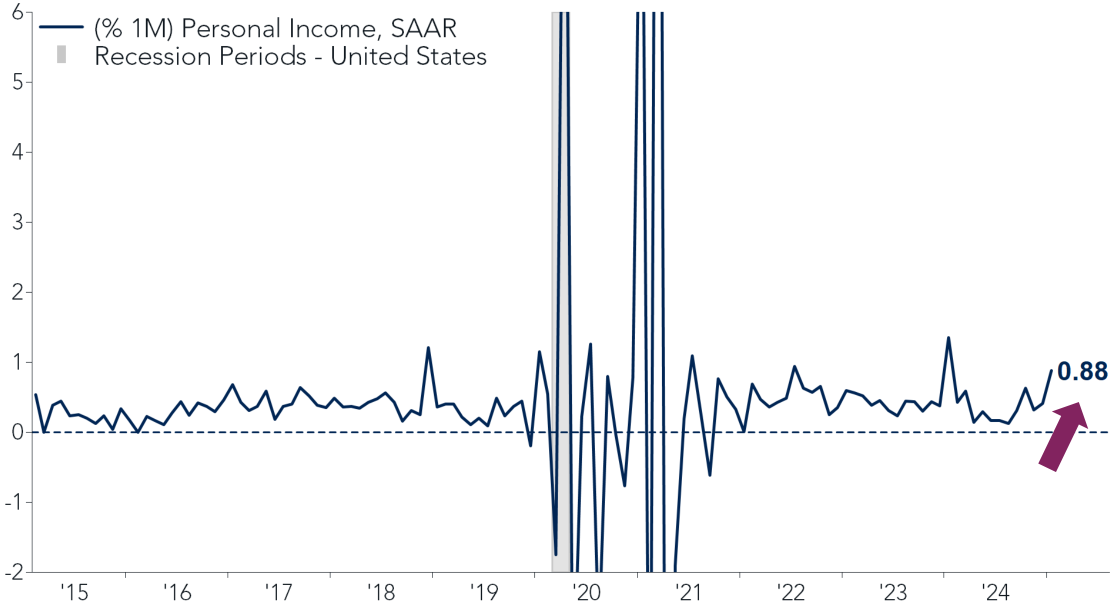
Futures suggest the next Fed rate cut to be in June, with 1-2 rate cuts following in 2H25.

Source: Commentary data via CME Group.
Past performance is no guarantee of future returns. As with any investment, there is the risk of loss.

PCE REPORT ALSO REFLECTS UNUSUAL DICHOTOMY OF INCOMES UP, BUT CONSUMPTION DOWN

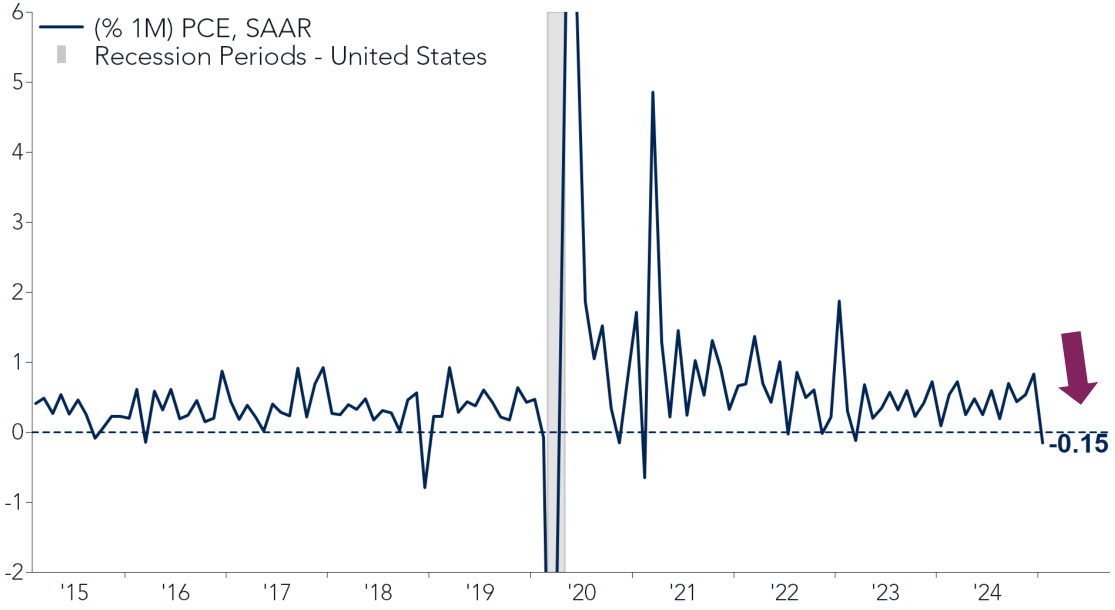
"Headline volatility" looks to be causing consumers to pull back. Despite Personal Income data ahead of expectations and at a strong 0.9% level, Personal Consumption Expenditures (PCE) reflected a pullback in consumption. This pullback was slightly worse than the already revised lower expectation given the very soft retail sales data showing retail sales declined -0.9% in January. As we will show on following slides, **much of the pullback in consumers looks to be driven more by uncertainty hampering sentiment rather than an outright deterioration in consumers' financial health today, at least as measured in aggregate terms.**

Personal Income



Pathstone *Source: FactSet, BEA*

Perconal Consumption Expenditure (PCE)

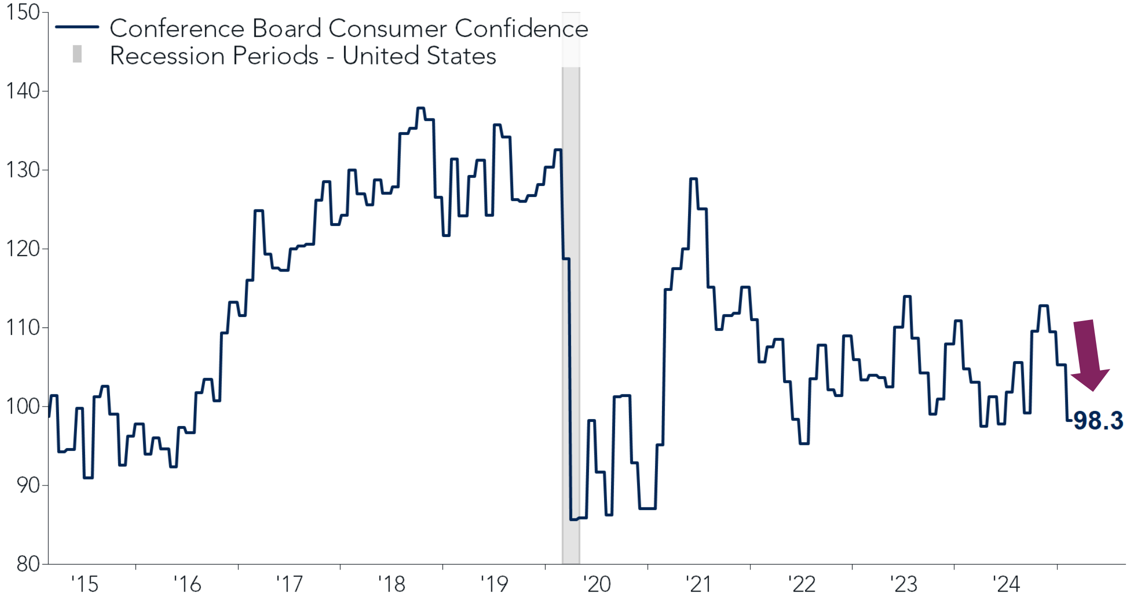


Pathstone *Source: FactSet, BEA*

DECLINING CONSUMER SENTIMENT ("SOFT" DATA) LOOKS TO BE A DRIVER OF CONSUMER SPENDING

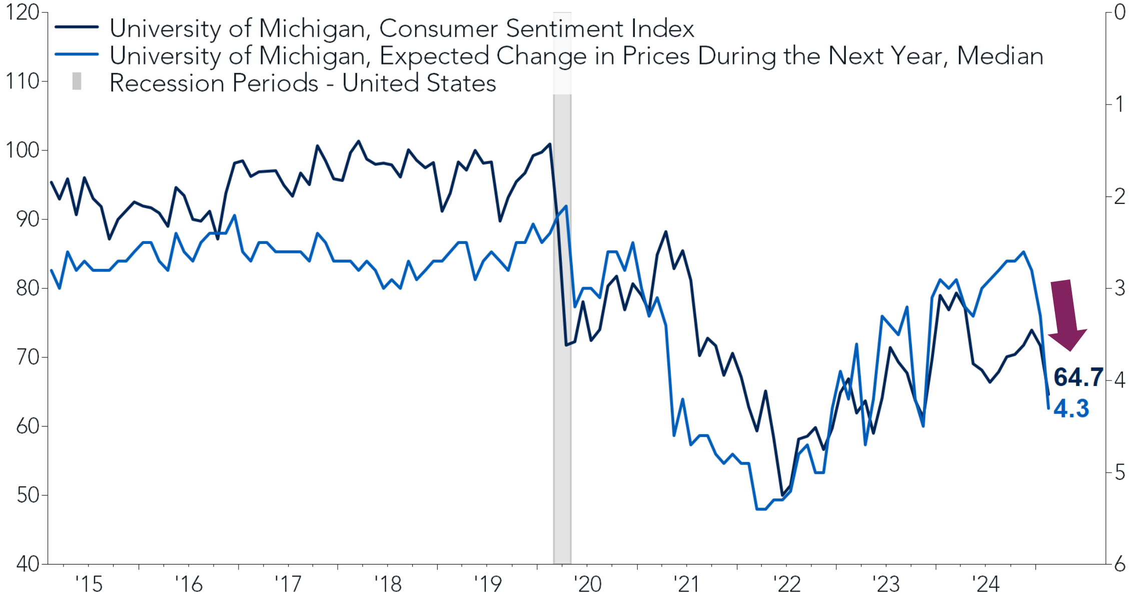
Given elevated valuations, lofty earnings expectations, increasing inflation fears, increasing growth concerns, and overall uncertainty around policy issues, consumer confident has declined. Both the Conference Board and University of Michigan data reflecting softening sentiment, with **the Michigan data highlighting that consumer sentiment looks to be materially impacted by consumers fears that inflation could be spiking again, and we know how much consumers loathe inflation**. The recent PCE inflation data may help to calm some nerves, but until we see more policy certainty, especially around tariffs and any potential risks to upside inflation, it may be unlikely to see sentiment shift back up materially.

Consumer Confidence



Pathstone *Source: FactSet, Conference Board*

Consumer Sentiment Declining As Inflation Expectations Increasing



Pathstone *Source: FactSet, University of Michigan*

Footnote: Conference Board Consumer Confidence Survey reflects how consumers feel about their expected financial situation. University of Michigan Surveys of Consumers reflects how consumers feel about the economy, personal finances, business conditions, and buying conditions.
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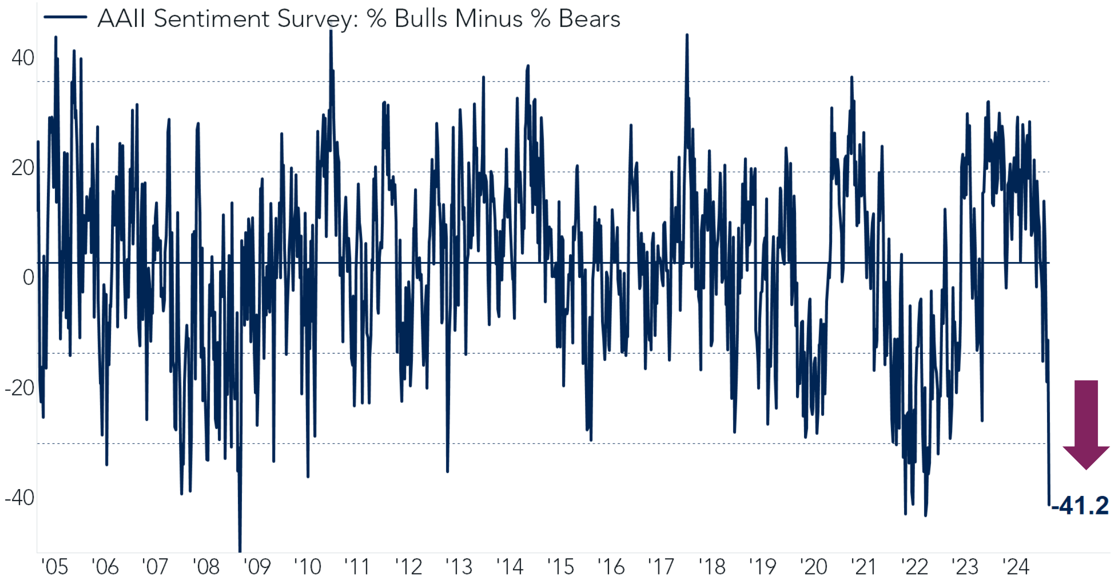
AAII INVESTOR SENTIMENT ("SOFT" DATA) LOW, BUT EQUITY ALLOCATIONS ("HARD" DATA) REMAIN HIGH

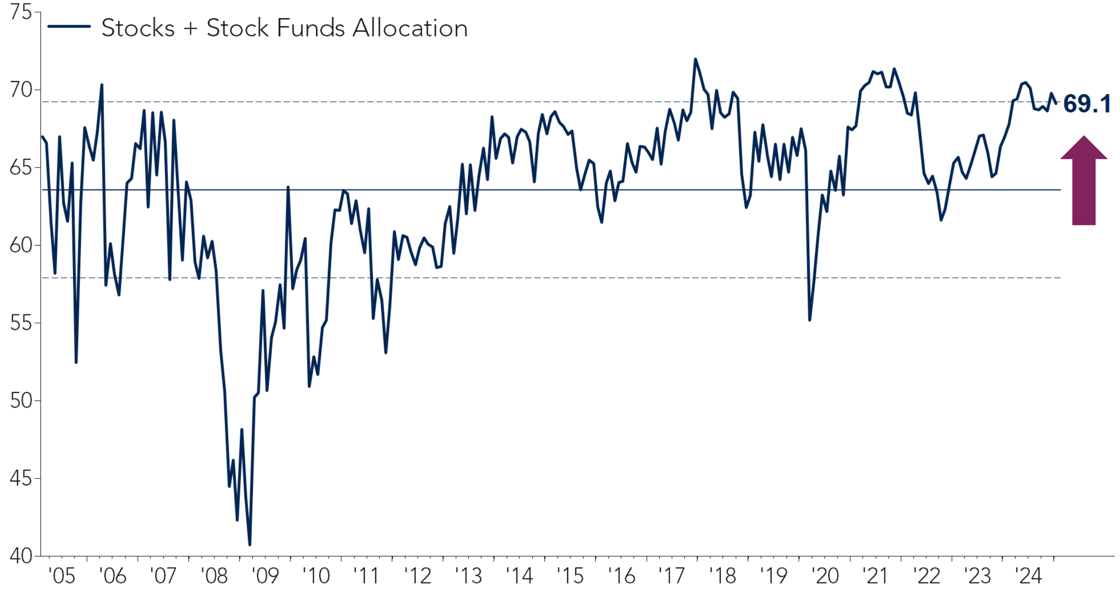
AAII bullishness fell to 19.4%, while bearishness rose to 60.6%. **There have only been three other instances where bulls were under 20% and bears were over 60%. Each were preceded by a corrections of over -10%, but were followed by strong upside returns over the subsequent 6- and 12-months.** Today's shift in sentiment has followed a much smaller pullback in equity markets, so this **extreme bearishness sits as a bit of an anomaly when also considering that AAII survey data shows equity allocations nearing 70%, above the historic average of 63%. This expresses a dichotomy between the "soft" sentiment data and "hard" allocation data.** That said, historically high equity allocations have been a tailwind bolstering overall consumer balance sheets. While strong balance sheets lead us to believe some consumer risks are mitigated, an equity selloff could also have an outsized impact versus history.

AAII Bulls Minus Bears



Pathstone Source: FactSet, American Association of Individual Investors

AAII Equity Allocation



Pathstone Source: FactSet, AAII

Source: Commentary data via SentimenTrader
Footnote: AAII is the American Association of Individual Investors.
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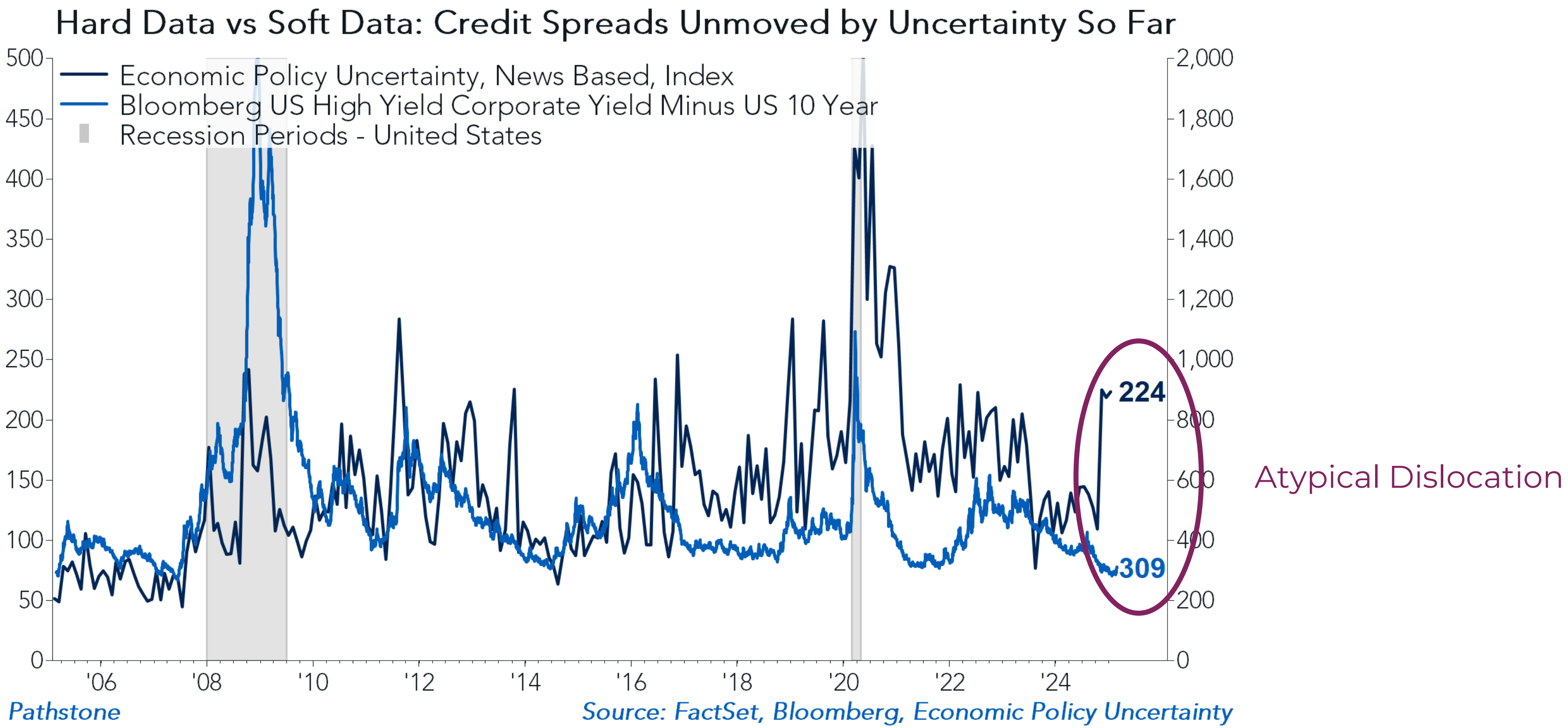
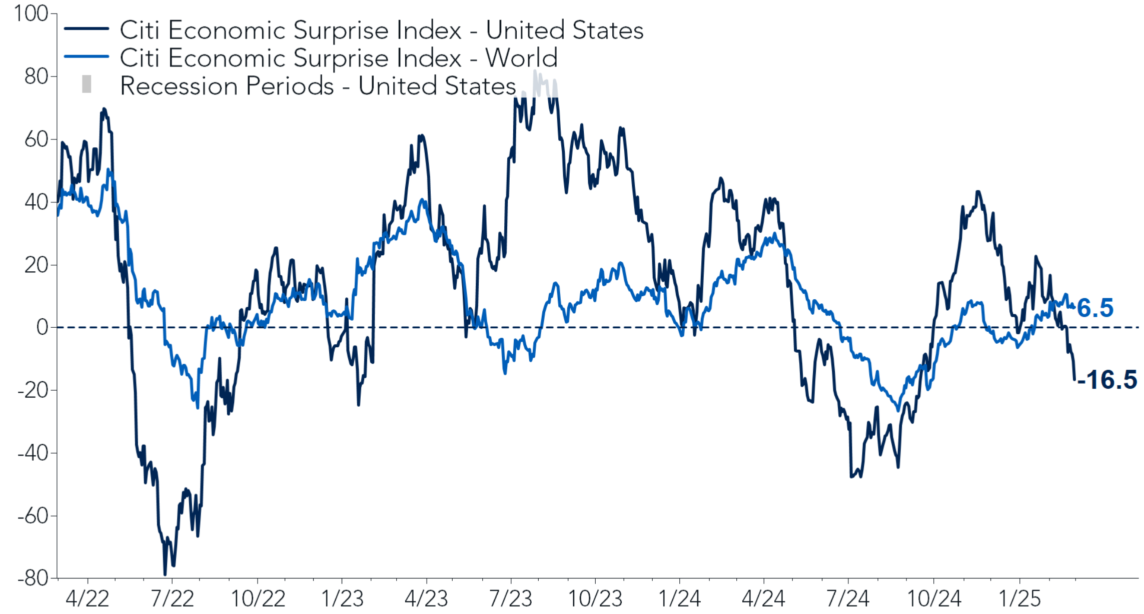
POLICY UNCERTAINTY ("SOFT" DATA) HIGH, WHILE CREDIT SPREADS ("HARD" DATA) REMAIN TIGHT

As noted, **policy uncertainty appears to be one of the, if not the, biggest factors driving negative sentiment**. Similar to the "hard" data of equity allocations remaining elevated, **we see credit spreads also remaining tight, suggesting credit investors remain more confident about economic and company fundamentals amidst this uncertainty**.



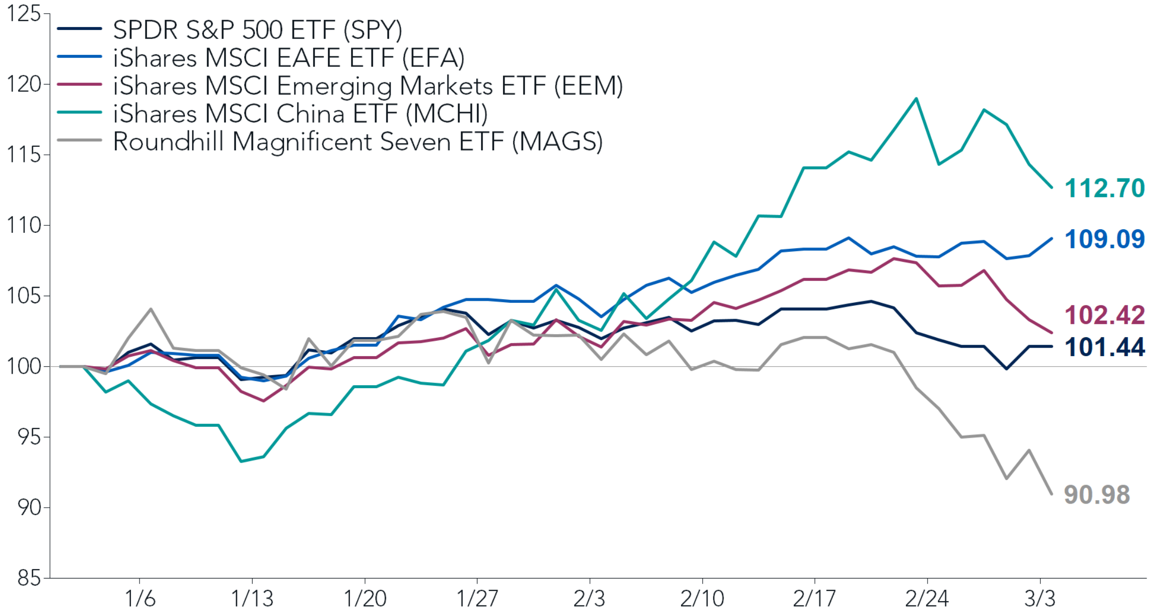
The Citi Economic Surprise index is in decline, reflecting softer than expected US economic data. **The recent string of softness has been a near-term headwind in the US. Contrast that with the rest of the world, where the economic data has been better than expected (or less bad than feared in many cases), and it's not a big surprise we have seen non-US equities outperform.** China, which has seen tech optimism resume after the DeepSeek news and recent news of Alibaba investing $53 billion into AI over the next three years, has been a leader. Broader Developed Non-US and Emerging Market indices have outperformed the S&P 500, while the "Mag 7" have declined nearly 9% year-to-date, reflecting the rotation trade playing out to start the year.

Citi Economic Suprise Index



Pathstone Source: FactSet, Citi

Year-To-Date Total Returns (Indexed to 100)



Pathstone Source: FactSet

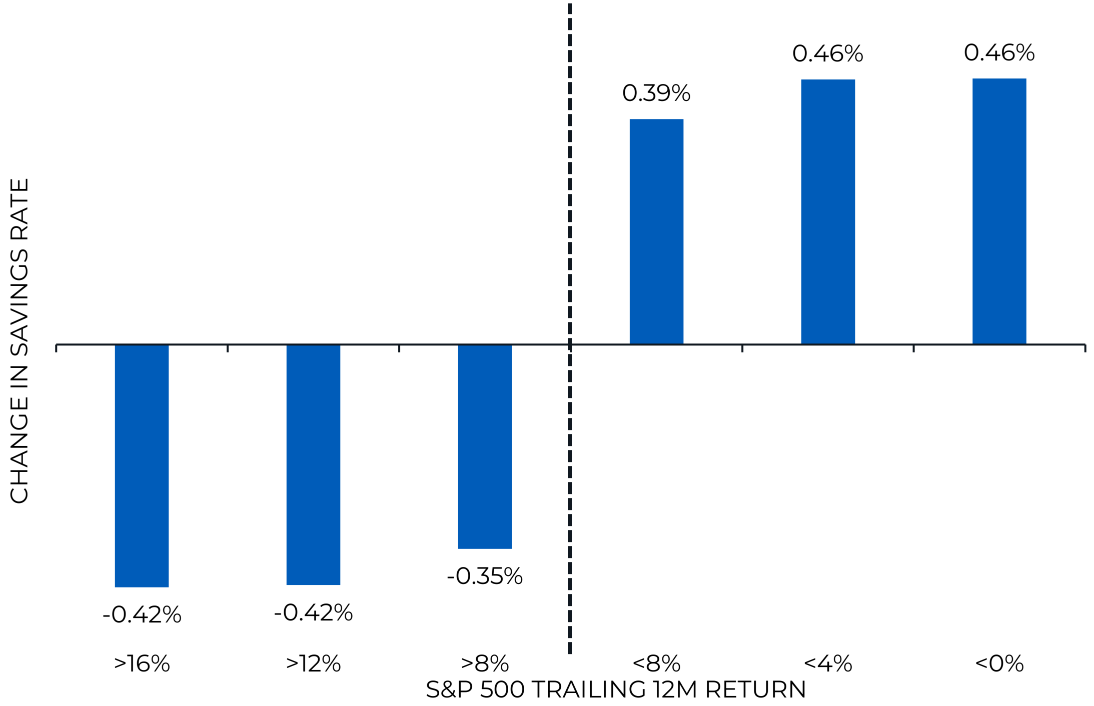
Footnote: Citi Economic Surprise Index represents the sum of the difference between official economic results and forecasts.
Past performance is no guarantee of future returns. As with any investment, there is the risk of loss.

DIP IN MARKET PERFORMANCE (OR SENTIMENT?) OFTEN LEADS TO REDUCTION IN CONSUMER SPENDING

This is a chart we showed in our January outlook as one area to watch for potential headwinds on consumer spending. Any hiccups in equity or economic fundamentals could provoke market declines, but declining sentiment could also be a driving factor in consumers pulling back, as we believe we are currently seeing. Thus, **a further re-rating lower in equity prices could come with knock on effects beyond just lower values of equities. If equities sell off, we see an increase in savings rates and a further reduction in spending**. Consumer spending is roughly 70% of the US economy, so further pullbacks could be a drag on growth.

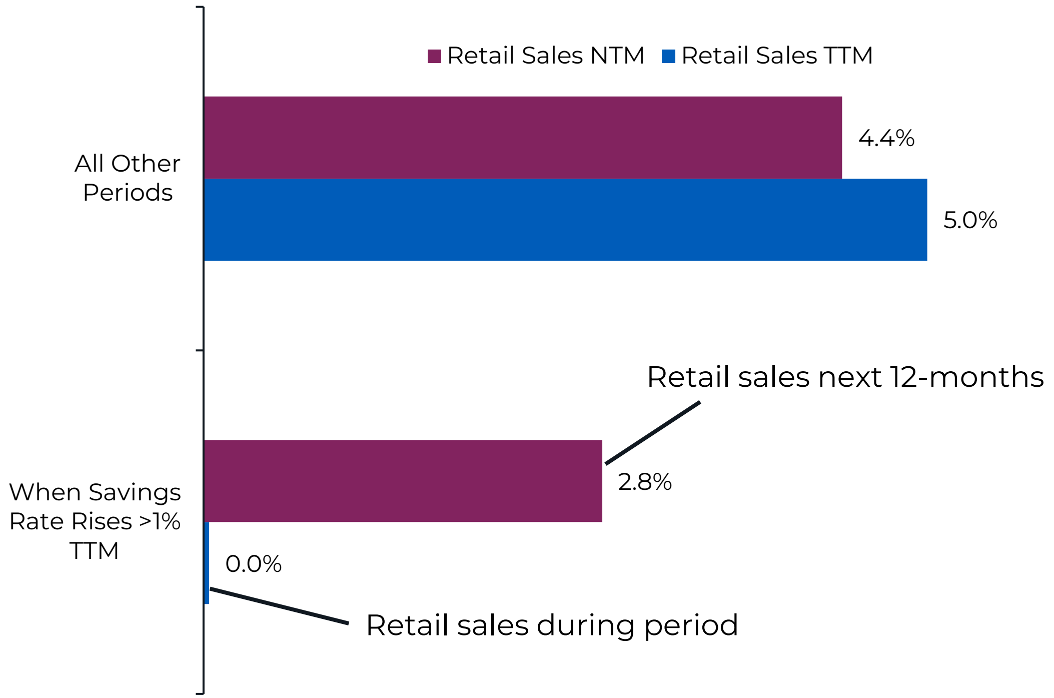
Declining Market Often Leads to a Rise in Savings

Trailing 12m Change in Savings Rate As A % Of Disposable Income, 1992-2024



A Rise in Savings Often Leads to Decreased Spending

Trailing 12m Change in Savings Rate As A % Of Disposable Income, 1992-2019 (Pre-Covid)



Sources: Bloomberg

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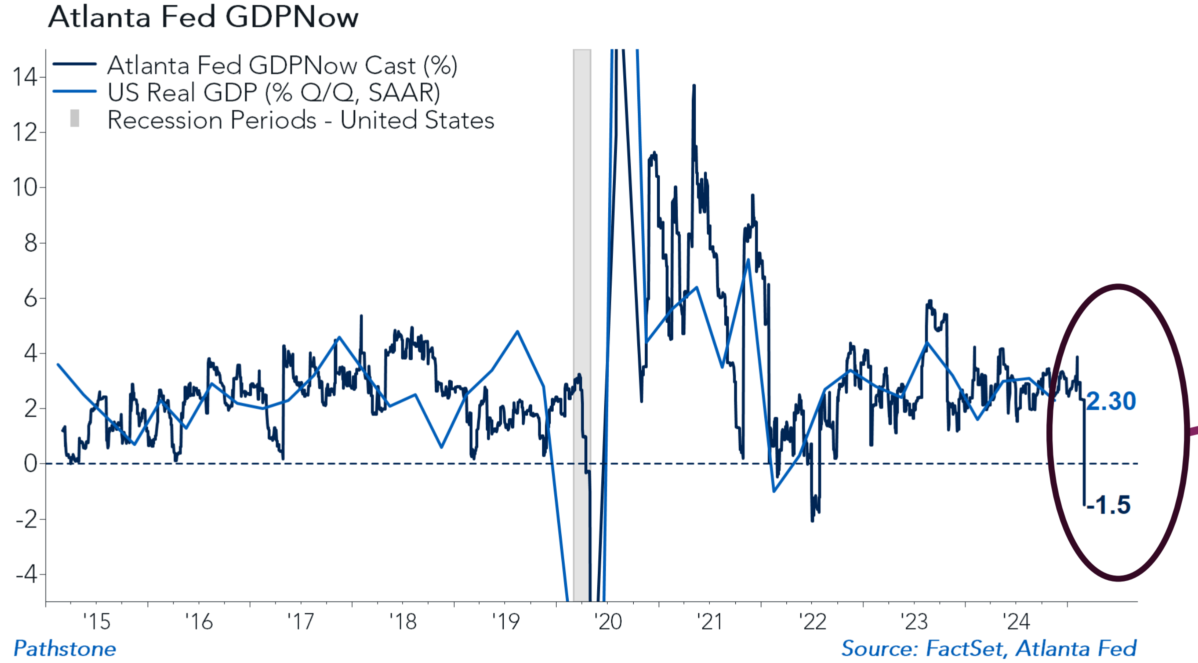
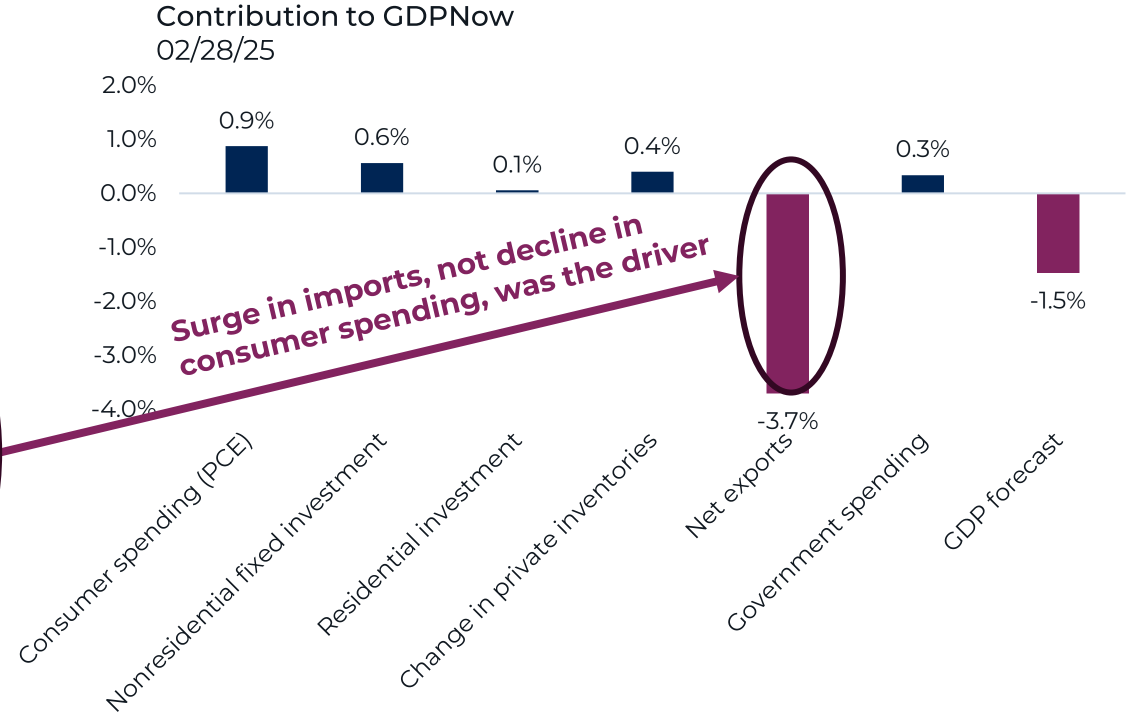
SOFTER ECONOMIC DATA HITS ATLANTA FED GDPNOW HARD, BUT MOSTLY DRIVEN BY SURGE IN IMPORTS

It's important and notable that GDPNow has declined materially, given the relative accuracy it has had in tracking GDP. That said, **GDPNow is a tracker calculating only data that has been released to date, and not a direct forecast. It's not uncommon to see some volatile swings**, especially early and mid quarter when data is limited. Despite some pullback in consumption being a slight drag vs. the prior robustness, it is still positively contributing to GDP 0.9%, whereas shifts in net exports was the biggest detractor. **Net exports are exports minus imports, and we saw a huge surge in goods imports (jumping almost 12% to $325 billion in January vs. December) ahead of potential tariffs, resulting in a big net exports decline. This pull forward of goods imports mechanically lowers GDP, but net exports aren't necessarily a good predictor of future GDP and could be partially offset by rising inventories.**





Source: Right – Atlanta Fed, Commentary data via Census Bureau.
Footnote: Atlanta Fed GDPNow provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis.
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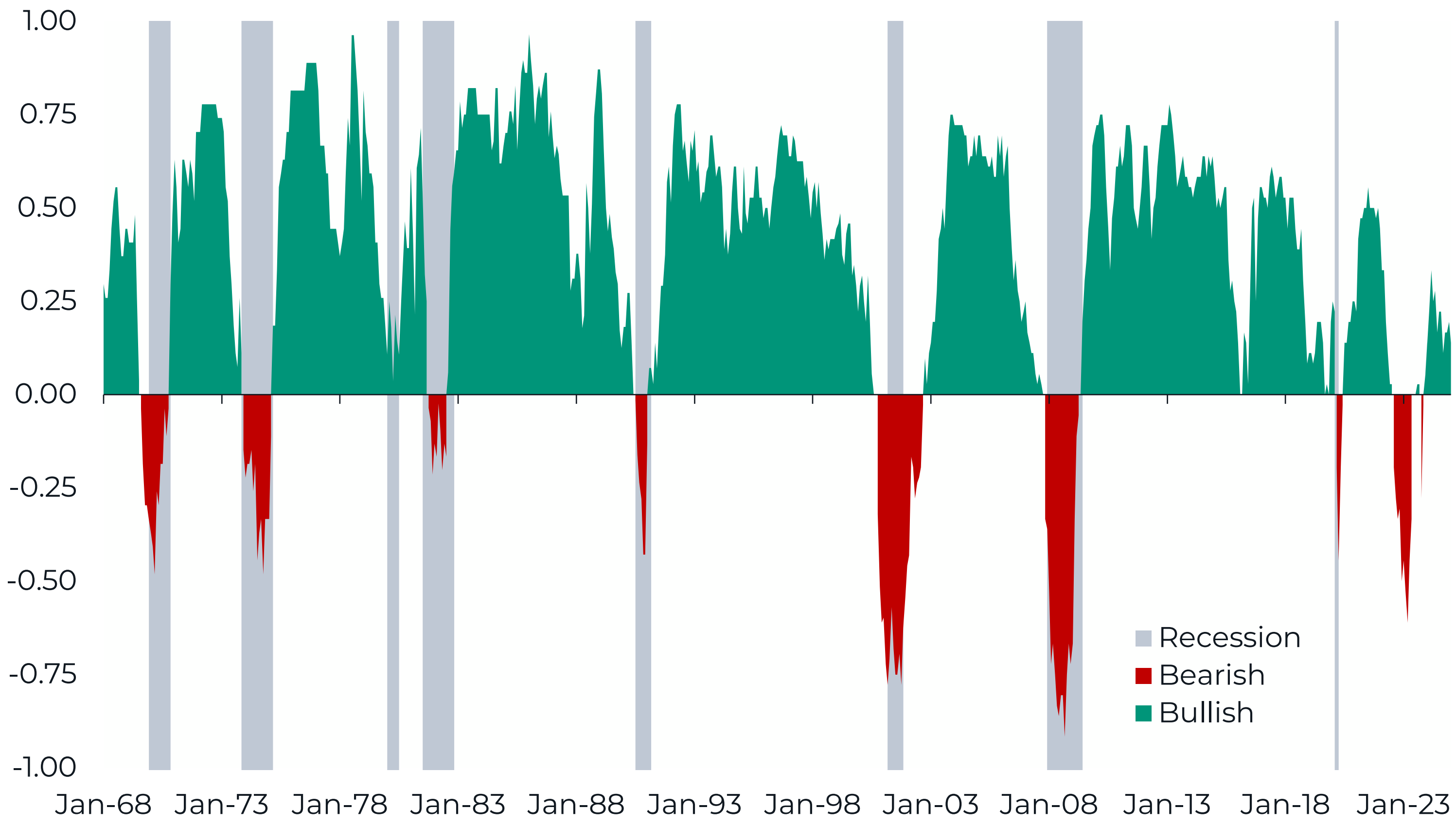
Pathstone's Market Cycle Dashboard has a bullish reading of +0.14%.

CHART INTERPRETATION:

- Reading > 0 = Bullish Cycle
- Reading < 0 = Bearish Cycle
- Gray Bars = Recession

In summary, Q1 economic growth will likely soften, but the surge in imports makes it look worse than it really is, while consumer fundamentals remain relatively healthy and should ultimately provide support for continued growth. This suggests we look like we are in a more "mid-cycle" environment than "late-cycle", meaning recession risk remains low. **Unfortunately, "headline volatility" is likely to remain a near-term headwind, and could lead to some spillover effects if/as we see corporate sentiment slow investment or hiring. Policy clarity is desperately desired by markets as a result.**



Source: Pathstone, data via Bloomberg, as of 1/31/2025.
Footnote: Pathstone's Market Cycle Dashboard – While the source of the market data is Bloomberg, Pathstone is responsible for the categorization and "Reading" score noted herein. This Reading score is based on 36 various factors which are given a score of 1 (bullish), -1 (bearish), or 0 (neutral) based on Pathstone's calculation. The average of these values is taken to get scores for each segment (Economic/Credit/Valuation/Momentum/Sentiment) and the overall score.
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