ADP STRATEGIC PLAN SERVICES, LLC

Market Commentary & Outlook

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Market Commentary

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During the first three months of 2025, market volatility increased as investors prepared for the impact of changing trade relations and a new federal government policy agenda. While monetary policy decisions, directed by the U.S. Federal Reserve's Federal Open Market Committee (FOMC), have been closely watched by investors in recent years, in 2025, investors are keeping a closer eye on how fiscal policy (federal government spending and tax decisions) may impact the economy and capital markets.

A reduction in the size of government and government spending cuts combined with greater enforcement of immigration regulations and increased efforts to protect certain U.S. manufacturing businesses from foreign competition have the potential to disrupt the status quo. For example, there may be uncertainty related to tariffs for both investors and consumers alike. A tariff is a fee that is charged to companies that import goods from outside the United States. Increasing or adding tariffs on imported goods raises their cost, which is often passed on to their customers. Therefore, consumers and investors may question what the impacts of higher tariffs will mean. My colleague, Neil Fentress, addresses tariffs in greater detail on the following page.

Consumers and investors seek stability and a clear path to the future. Consequently, investment markets faltered to start the year given the uncertain global trade environment and rapidly changing federal government policy priorities. In contrast to the 25% returns generated by the S&P 500 Index during each of the last two calendar years, the U.S. stock market has started off the year in negative territory. The increase in market volatility so far in 2025 may signal a shift to tamer U.S. stock market returns that echo long-term historical averages.

After hitting three new market highs during the first quarter, the S&P 500 Index (a broad U.S. stock market index that primarily measures the returns of large U.S. companies) briefly experienced a market correction (a decline of 10% from a recent market peak) before moving modestly higher while finishing with a loss of 4.27% in Q1 2025.[1] At the same time, the NASDAQ Composite Index dropped 10.42%, and the Dow Jones Industrial Average fell 1.3% in Q1 2025.[2]

Companies in the energy, healthcare, and consumer staples sectors tended to perform better this quarter while information technology and consumer discretionary sector stocks, on average, performed the worst.[3]

The Russell 2000 Small Cap Index declined about 9.5% in Q1 2025. While foreign stocks, as measured by the MSCI EAFE Index, advanced about 6.86%, and emerging market stocks, as measured by the MSCI Emerging Markets Index, rose about 2.93% in Q1 2025.

The yield on the ten-year U.S. Treasury note dropped from about 4.57% to about 4.20% during the first quarter, while bond prices increased, with the Bloomberg Aggregate Bond Index rising about 2.75% in Q1 2025.

The U.S. inflation rate has continued to challenge the Federal Reserve's policymakers as it has not yet moved down to their 2.0% inflation target. The Personal Consumption Expenditures (PCE) and core PCE indices are the Federal Reserve's preferred price gauges. The February 2025 readings for these two inflation measures reported price increases of 2.5% and 2.8%, respectively.[4] Both numbers exceed the Fed's 2.0% inflation target and may keep it from lowering the federal funds rate in the near term.

Consequently, while the FOMC met twice this quarter (in January and March), at neither meeting did the Committee move to lower the federal funds rate, acknowledging that they wanted to pause after having reduced the federal funds rate by 1.0% during the last three meetings in 2024.

Lastly, another challenge for the Fed is the increasing inflation expectations consumers are expressing. The March 2025 University of Michigan's surveys of consumer inflation expectations reported an expected 5.0% inflation rate for the next 12 months and a 4.1% inflation rate for the next five years; both numbers were the highest since November 2022 and February 1993, respectively.[5]

As we reflect on recent market performance, what should be remembered by retirement plan sponsors and participants alike is that your plan is an investment for the long term. Short-term market fluctuations should not play a major role in your decision-making process. Many plan participants are investing for a 30+ year period and should keep their priorities on having a diversified investment mix of low cost, risk appropriate investments as their top goal. An appropriate mix of properly allocated asset classes and time in the market have historically played a much more impactful role in their long-term retirement investing success than trying to predict short-term market volatility.

Are tariffs concerning? Maybe, but they aren't anything new.

Neil Fentress
Sr. Director, Institutional Investment Consulting*

Tariffs have played a significant role in both creating revenue for the federal government and protecting domestic industries and jobs since our nation's creation. The United States didn't move away from widespread tariff use until after World War II, when the government started encouraging a policy geared more toward worldwide free trade. The World Trade Organization also has played a major role in the decreased use of tariffs for U.S. imports, but in recent years multiple administrations have reengaged the use of tariffs on China and other nations to protect domestic industries and for environmental policy purposes.

Tariffs are taxes imposed on goods imported from foreign nations. The entity that imports the foreign goods into the country pays the tax to the government. That normally results in the cost of those taxes, or some part of those taxes being passed along to the consumer who purchases those goods. Keep in mind, that does not mean that all prices will necessarily increase because in some instances competing goods are produced domestically and therefore can avoid the tariff and price increases. Tariffs are used as both economic and political tools. Generally, the U.S. has charged far lower tariffs on imported goods than many other developed nations.

The recent tariff announcements have caused some short-term volatility and uncertainty in the stock market. The long-term impact, or if there will be a long-term impact, is unknown. The exact impact of most historical tariffs is debated by economists. Economic purists will argue that any sort of tax or tariff will create inefficiencies in the market. What is less understood by most, is that there are already artificial inefficiencies in the U.S. economic system, particularly on imports. Economic tools like trade restrictions, trade agreements, embargoes, foreign tax credit agreements and other government programs already exist and impact consumer prices and import competitiveness. The long-term implications of tariffs are open to debate and a valid argument can be made for both negative and positive impacts.

Rest assured that your plan's investment manager, ADP Strategic Plan Services, will continue to monitor market events and are in constant contact with the investment managers selected to invest plan assets to ensure that we are offering a cost competitive and diversified portfolio of investments with varying risk and return characteristics. We believe our long-term approach will continue to serve your participants well and help them achieve their retirement goals.

The Last Word

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As Neil and Kevin address in the previous two articles, there is a good amount of uncertainty surrounding the U.S. economy and consequently U.S. equity and fixed income markets. With uncertainty comes volatility, and we are seeing this play out in the form of significant swings in asset prices on a monthly, weekly, and even daily basis. One thing that our clients can be certain of is that our Investment Committee is monitoring the markets closely and evaluating the impact of any volatility on the strategies that are a part of our investment lineups. While doing so, we are also ensuring that we continue to take a long-term view when it comes to the task of making any investment decisions that impact our clients and their participants.

One major tenet of the ADP Strategic Plan Services Investment Committee philosophy is that we place an emphasis on downside protection. While investment risks can't be completely eliminated, we value asset managers with sound investment processes who do not overreach with respect to the amount of risk they are willing to take to achieve higher returns. As such, the funds we select tend to be relatively resilient in turbulent or declining markets as we have seen in the first quarter of 2025. With that said, we will continue to be in frequent contact with asset managers to discuss not only their performance, but also their positioning and outlook during this period of heightened economic and market uncertainty.

As a plan sponsor, you have entrusted us with the task of monitoring and maintaining the investment lineup that you provide to your valued employees, and this is a task that we do not take lightly. We make all decisions with the best interests of participants in mind. As noted in the first article, it is important to maintain a long-term view when it comes to retirement savings. We hope that knowing we are monitoring short-term developments and the impact on the investments offered in your retirement plan lineup allows you to rest easier in these turbulent times.

As always, we thank you for your continued trust and business with ADP Strategic Plan Services.

1 S&P Dow Jones Indices

2 S&P, NASDAQ post big quarterly percentage drops on Trump tariff turmoil By David French

3 S&P Dow Jones Indices

4 Moderate US consumer spending, increasing prices raise specter of stagflation By Lucia Mutikani

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Data provided by Morningstar, Inc.

S&P 500 Index: The index measures the performance of 500 widely held stocks in US equity market. Standard and Poor's chooses member companies for the index based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies. Since mid 1989, this composition has been more flexible and the number of issues in each sector has varied. It is market capitalization-weighted.

NASDAQ Index: The index measures the performance of all domestic and international based common type stocks listed on the NASDAQ Stock Market. It includes common stocks, ordinary shares, ADRs, shares of beneficial interest or limited partnership interests and tracking stocks. The index is market capitalization-weighted.

The MSCI EAFE Index is an equity index which captures large and mid cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 694 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Developed Markets countries in the MSCI EAFE Index include: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,206 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, fixed rate agency MBS, ABS and CMBS (agency and non-agency). Provided the necessary inclusion rules are met, US Aggregate-eligible securities also contribute to the multi-currency Global Aggregate Index and the US Universal Index. The US Aggregate Index was created in 1986, with history backfilled to January 1, 1976.

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