WEBINAR

May 2025 Market Update Webinar

A Deep Dive into CNR's Economic and Investment Outlook

May 29, 2025

Since hitting an intra-day low on April 7, the S&P 500 surged over 16%, marking one of the fastest equity rebounds in recent years. This quick reversal prompted questions about the sustainability of growth: Was the rally purely relief-driven, or indicative of a deeper shift?

Economic Forecasts

- June changes reflect the possibility of “peak tariff” policy and a stabilization of tariffs near 10% effective.

- GDP growth is expected to remain positive, but it may be weighed down by policy decisions.
- Corporate profits may swing within a wide range, but Q1 results are positive.
- Some inflation pressure will be present based on the administration’s policy.
- The Fed may cut rates 1-2 times later this year, which may be a tailwind for stocks.
- Structural pressure will likely keep 10-year Treasury yields over 4%.

City National Rochdale Forecasts		2024	Current 2025e
Real Annual GDP Growth		2.5%	1.0% to 1.75%
Corporate Profit Growth		9.6%	7.0% to 10.0%
Headline CPI Year End		2.9%	3.25% to 3.50%
Interest Rates	Federal Funds Rate	4.25% to 4.50%	3.75% to 4.25%
	Treasury Note, 10-Yr.	4.57%	4.0% to 4.5%

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country’s borders in a specific time period.

e: estimate.

The consumer price index (CPI) measures the monthly change in prices paid by U.S. consumers.

Sources: Bloomberg, FactSet, proprietary opinions based on CNR Research, as of May 2025. Information is subject to change and is not a guarantee of future results.

Relief Rally Risks

Luke cautioned that this “relief rally” may overshoot. Markets appear more attuned to “good news” and dismissive of bad, introducing risks of overvaluation unless underlying fundamentals reaffirm the move.

Economic Landscape: Strong Core, Fragile Shell

Q1 GDP – Surface Weakness, Underlying Strength

Initial Q1 GDP showed a modest -0.3% decline, the first contraction since 2022. However, this was largely driven by a temporary spike in imports as firms front-ran tariffs. Real final sales to private domestic purchasers rose by roughly 3%, indicating resilient consumer and business activity.

Interpretation: Core demand is intact; headline GDP weakness reflects short-term policy impacts, not recession dynamics.

Labor Market – Holding Firm

April's non-farm payrolls added ~252,000 jobs, with stable unemployment and rising participation — a robust labor market backdrop. However, federal hiring reductions (~200,000 jobs) are being monitored for possible regional knock-on effects.

Tariff Shock and Trade Policy Realignment

Major Global Shift

April's "Liberation Day" tariff policy marked a break with globalization: 25% tariffs on Canada/Mexico, 20% on China, and threats of additional tariffs elsewhere. Though many escalations were pulled back, China's remains at ~145%, with a 10% reciprocal tariff floor.

Growth and Inflation Drag

CNR estimates a 0.1% GDP drag per 10% China tariff, plus another 0.2-0.3% from Canada/Mexico tariffs. Cumulatively, growth forecasts for 2025 have been lowered from 2-2.5% to 0.75-1.25%, with earnings trimmed and inflation forecasts raised.

Supply Chain and Sentiment Impact

Tariffs are not abstract; they elevate input costs, shake supply chains, and strain consumer sentiment. Surveys reveal rising inflation expectations and cautious consumer behavior. Fed Chair commentary signals legal and political risks around magnetic tariff tools.

Monetary Policy: The Stagflation Dilemma

Persistent Price Pressures

Though the latest CPI/PPI eased modestly, core inflation remains elevated. Given that imports make up ~10% of CPI, a 1% effective tariff hike adds about 0.1% to inflation — real, but manageable.

Fed's Tightrope

With inflation near 2.9% and employment strong, the Fed faces a stagflation risk: If it fights inflation with hiking, growth may stall; if it eases to support growth, inflation may persist. Traders have priced in nearly 100 bps of cuts by year-end, but Luke stresses the Fed is adopting a wait-and-see approach.

Market Volatility: Not a Crisis, But a Reset

Volatility of Policy Origin

Unlike crises rooted in leverage or institutional fragility, this storm originates from policy shifts. April's record swings reflect the market digesting new norms — without systemic collapse.

Trading volumes spiked; credit spreads widened — but the system held. This signals an environment of recalibration rather than panic.

Strategic Volatility

Periods like this are part of systemic realignments, not breakdowns. They reset prices and introduce new volatility regimes, often creating valuation dislocations ripe for active investors.

Earnings and Sector Dynamics

Q1 Earnings Overview

Q1 marked seven consecutive quarters of earnings growth. For the S&P 500:

- +12.8% YoY earnings growth
- +4.8% revenue growth
- ~76% beat actual earnings estimates; ~62% beat revenue estimates

Leaders: Healthcare, Communication Services, IT. Lagging: Energy, due to low oil prices. Companies are pulling guidance due to trade uncertainty.

Sector Shifts

April also triggered a reevaluation of AI valuations, especially as Chinese AI entrants begin to challenge U.S. players. A broader theme of sector rotation emerged, favoring defensives (e.g., staples, utilities) while technology and industrials faced pressure.

Equity and Fixed Income Implications

Equity Outlook

- Valuation pressure: P/E multiples rebounded in relief rally, but real terms remain under pressure.
- Outlook: Strategy remains cautious. Markets have priced much of the tariff risk, but reversal or further escalation could rapidly shift sentiment.

Fixed Income Opportunity

- Treasuries: 10-year yields reached ~4.2% after a flight-to-quality rally in Q1, absorbing market volatility.

- Investment-grade corporates: Spread widened meaningfully (up to ~94 bps), with yields crossing ~5.15% on corporates and ~3.85% on municipals, presenting selective long-term value.
- High-Yield and Bank Loans: Yield-to-worst for high-yield remains attractive (~7%+), with credit fundamentals stable. Diversification remains key to manage event risk.

Tactical and Strategic Considerations

Strategic Positioning

- Stay disciplined: Avoid emotional asset shifts during policy-driven volatility.
- Diversify: Across equities, bonds, alternatives, and within fixed income (IG, HY, municipals).
- Capture dislocations: Tactical positioning where credit yields and valuations misprice risk.

Tactical Flexibility

- Maintain liquidity: For volatility-driven opportunities.
- Hedging optionality: Use momentum and valuation signals, but don't overreact to headlines.
- Active credit management: IG and muni spreads offer entry points; high-yield BB and loan sectors warrant due diligence but appear structurally sound.

Monitor Key Triggers

- Tariff adjustments: Any rollback would swing markets bullishly; escalation adds downside pressure.
- Fed decisions: Rate path dependent on inflation and growth interplay.
- Economic data: Pay attention to GDP revisions, labor trends, consumer sentiment and spending patterns.

Final Takeaways for Financially Savvy Investors

1. Market behavior reflects policy, not panic: April's volatility is functional recalibration, not crisis.
2. Control what matters: Asset allocation, diversification, disciplined process over market timing.
3. Prepare for inflation friction: Tariffs add modest inflation; the Fed will prioritize data over rhetoric.
4. Look past headline GDP: Core demand remains healthy; front-loaded imports temporarily depress growth.
5. Credit income advantage: Investment-grade and high-yield provide structurally sound yield amid volatility.

6. Volatility breeds opportunity: Dislocations are fertile ground for active, risk-measured investors.

Summary

City National Rochdale's May 2025 update boils down to a central thesis: We've entered a phase of purposeful realignment, driven by policy imperatives — chiefly tariffs and trade. Markets are digesting this through heightened volatility, but underneath, macro fundamentals (domestic demand, labor, earnings) remain resilient. Discipline, not daring, is the recommended posture:

- Stay allocated
- Focus on fundamentals
- Monitor policy developments
- Exploit value in fixed income

Volatility isn't noise to be tuned out; it's information. And as Luke makes clear: Thoughtful navigation trumps prediction.

Review Your Portfolio with Your Financial Advisor Today

City National Rochdale encourages you to review your investment portfolio with your advisor. Contact our financial professionals today to get help with your wealth planning needs.

Index Definitions

The Standard & Poor's 500 Index (S&P 500) is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity and industry group representation to represent U.S. equity performance.

Definitions

A consumer price index (CPI) measures changes in the price level of a market basket of consumer goods and services purchased by households. The CPI is a statistical estimate constructed using the prices of a sample of representative items whose prices are collected periodically.

Gross Domestic Product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.

Important Information

uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such statements.

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