

April 7, 2025

Dear O'Brien Client,

Dendrology – the science and study of woody plants – teaches us that trees in forests would grow indefinitely if left to their own devices to gather as much sunlight as possible. Ultimately, what limits their growth is gravity – which makes it too difficult for them to continue pulling water from roots to canopy. Perhaps the same can be said for the world's largest corporate trees during 1Q.

After driving double-digit stock returns for five of the past six years, the stock prices of the world's largest companies underperformed last quarter. While the overall global stock market fell a modest 1%, the 10 largest companies in the index contributed a negative 3.5% return to that performance. In other words, the rest of the market rose roughly 2.5%.

There were two underlying themes that led to that gap in performance: 1) a shift toward less-stimulative fiscal policy in the U.S. while other parts of the world (Germany and China) moved toward more fiscal stimulus, and 2) investors re-evaluating the potential financial rewards from the significant investments being made by the Magnificent Seven¹ companies in artificial intelligence (AI) in light of the competition from DeepSeek advancements in China.

Both themes benefitted international stocks over domestic stocks, resulting in international stocks outperforming by their largest quarterly amount since the summer of 2009.

| | 1Q 2025 | 2024 | 3 Years | 5 Years | | 1Q 2025 | 2024 | 3 Years | 5 Years |
|----------------------------------|-------------|-------------|-------------|--------------|------------------------|--------------|--------------|-------------|--------------|
| Gold | 18.2% | 26.6% | 16.3% | 13.2% | Real Estate Stocks | 2.8% | 4.9% | -1.7% | 9.5% |
| Commodities | 8.9% | 5.4% | -0.8% | 14.5% | Investment Grade Bonds | 2.4% | 2.0% | 1.1% | 1.3% |
| Non-U.S. Developed Market Stocks | 6.9% | 3.8% | 6.1% | 11.8% | High Yield Bonds | 0.9% | 8.2% | 4.8% | 7.2% |
| Non-U.S. Stocks | 5.2% | 5.5% | 4.5% | 10.9% | Municipal Bonds | -0.2% | 1.1% | 1.5% | 1.1% |
| Mortgage-Backed Bonds | 3.1% | 1.2% | 0.6% | -0.7% | Global Stocks | -1.3% | 17.5% | 6.9% | 15.2% |
| Emerging Market Stocks | 2.9% | 7.5% | 1.4% | 7.9% | U.S. Mid Cap Stocks | -3.4% | 15.3% | 4.6% | 16.3% |
| Treasuries | 2.9% | 0.6% | 0.0% | -1.7% | U.S. Large Cap Stocks | -4.3% | 25.0% | 9.1% | 18.6% |
| U.S. Aggregate Bond Index | 2.8% | 1.3% | 0.5% | -0.4% | U.S. Small Cap Stocks | -9.5% | 11.5% | 0.5% | 13.3% |

Past performance is no guarantee of future returns. You cannot invest in an index. 3-year & 5-year returns are annualized.

Source: Morningstar Direct, O'Brien Wealth Partners, as of 3/31/25.

Our recent commentaries have focused on the potential impact of tariffs on the outlook for economies and markets in the short run. Those commentaries are available on the [blog page](#) of our website (please click the link to view them if you would like to revisit them).

In this letter we will focus instead on the extent to which recent announcements are impacting our longer-term views on investing.

Over longer periods of time economic fundamentals are largely driven by two factors – how many workers are in an economy and how productive are they. We have a good idea what the former will

¹ Apple, Alphabet, Amazon, Microsoft, Meta Platforms, Nvidia, and Tesla.

look like because that population already exists today. The latter is less predictable but tends to be more impactful where investments in education and technology are greater. When we combine both factors, we have concluded that global growth is likely to be slower in the future.

Against that slower growth backdrop there are relative winners and losers. For example, while demographic trends are weakening for most major economies on a relative basis, the outlook for the U.S. is brighter than other developed markets or China. In a similar vein, U.S. companies reinvest in their businesses much more than their international competitors, which should help them continue to better capture the benefits of emerging technologies – such as AI.

Finally, U.S. financial markets are more liquid than international markets and our property rights/rule of law have been amongst the strongest in the world. All these factors have led us to a long-held belief that the U.S. will ultimately continue to outperform into the foreseeable future.

Every political administration can influence these dynamics with their policy platforms, and some do so more meaningfully than others. The past few months have seen significant shifts in immigration and trade policy, and the next few will likely bring shifts in regulatory policy and taxation.

While the ultimate impact of the new immigration policy is unclear, the U.S. already lacks workers, and that problem is poised to worsen over time. What is unknown is the extent to which the shortage of workers could be mitigated by technology.

In a similar vein, trade and foreign investment policies are increasingly being driven by geopolitical goals. It is too soon to know how these dynamics will play out over the longer term, but they are likely to create new opportunities (perhaps better diversification) and risks (perhaps higher inflation) for investors compared to previous decades.

To that extent, developments in industries where these dynamics have been taking place for decades may provide some guidance for what may happen in the future.

In 2022², Congress published a report on the domestic steel manufacturing industry – an industry that has long been caught in the push-and-pull between globalization and national security concerns. This study concluded that while U.S. steel mill employment fell 49% between 1990 and 2021, increased use of new arc furnace technology drove a surge in productivity that more than offset the decline in production from a smaller workforce. Moreover, this dynamic occurred during a period of heavily restricted foreign trade. As of 2022, there were over 300 antidumping and other duties in force on foreign producers, which accounted for 47% of all U.S. duties.

This is an example where, despite a decline in labor and a period of restrictive trade policies, technology significantly boosted productivity to make up for the labor shortage. In essence, fewer workers and

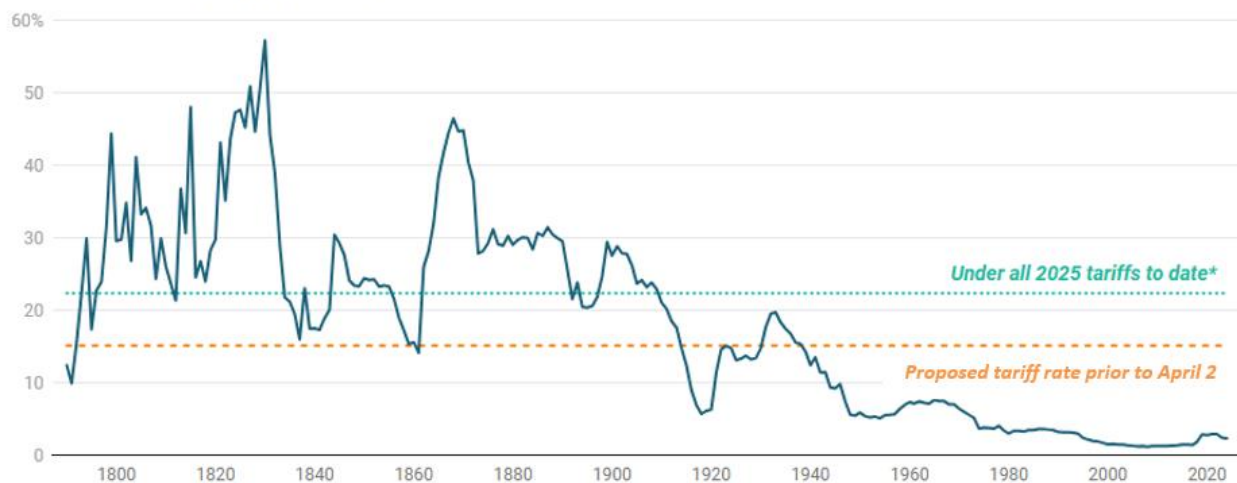
² U.S. Congress, H.R. 4521; P.L. 117-58 (2022). *Domestic Steel Manufacturing: Overview and Prospects*. <https://www.congress.gov/crs-product/R47107#:~:text=The%20average%20annual%20wage%20in%20steel%20product,produce%20one%20ton%20of%20steel%20in%202020.>

fewer opportunities to trade can hone opportunities to produce more efficiently. Companies making investments in productivity advancements today are better positioned to capture their benefits in the future.

While some recent policy announcements challenge the outlook for these long-term drivers, others could well provide a boost to productivity potential. And over longer time horizons, we have seen that change has been a constant. Policies that are in place under one administration could well change when a new administration arrives.

Turning from the long-term outlook to the more immediate term, we are now in a post- “Liberation Day” world and have more clarity on what that may mean for economies and markets. As it currently stands, the average tariff rate will soon rise to roughly 25% on imported goods (the green dotted line in the chart below) versus roughly 3% entering the year (the solid blue line). According to Yale Budget Labs³, for the average household this means their costs will soon rise by \$3,800 – assuming spending patterns do not change.

Customs duty revenue as a percent of goods imports



* Through April 2.

Chart: The Budget Lab • Source: Historical Statistics of the United States Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis. • Created with [Datawrapper](#)

At the aggregate level, the increase in tariffs works out to around a \$650 billion new tax on U.S. business and consumer spending. This is the equivalent of over 2% of U.S. gross domestic product (GDP).

The magnitude of the proposed tariffs and the corresponding impact to GDP increase the risk of recession should they not be revised. However, it appears these rates are not where the administration would ultimately like them to be and negotiations will be forthcoming. There are also likely more policy shifts coming this year that would be more supportive of the economy and markets – deregulatory

³ <https://budgetlab.yale.edu/research/where-we-stand-fiscal-economic-and-distributional-effects-all-us-tariffs-enacted-2025-through-april>

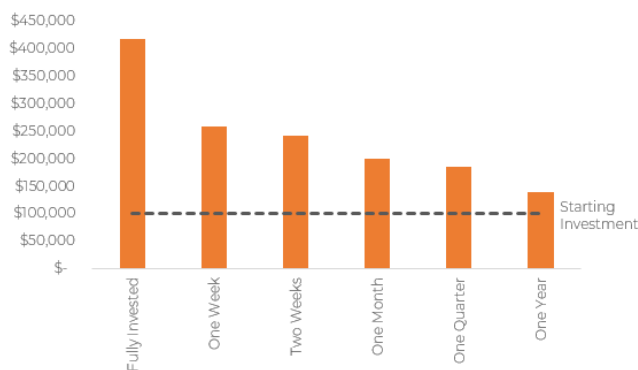
policies and tax cut extensions. All of these factors will have a meaningful impact on the risk of recession as we enter 2Q.

If a recession does occur due to these policy changes, it is likely to be more modest and briefer than recent recessions we have experienced because it is not being driven by any sort of bubble in the economy or financial markets. Historically, the lack of bubbles tends to correlate with more modest and brief downturns.

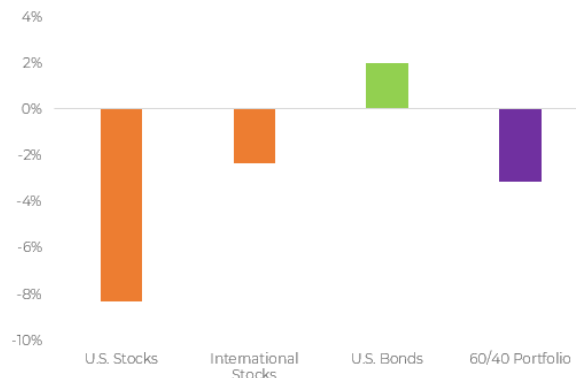
For investors, during periods of volatility and uncertainty diversification is the safest investment strategy.

Time in the market matters more than timing the market. Over the past 25 years, investors who exited the market the day after -2% move or worse would have consistently underperformed those who remained invested – regardless of how quick they returned to markets. During periods of negative returns, diversification across and within asset markets can help reduce the overall impact on portfolio performance.

Effect of Exiting the S&P 500 After a -2% Day Or Worse & Staying Out for Period Shown



Market Performance Between S&P 500 Peak on Feb 19, 2025 and Mar 31, 2025



Past performance is no guarantee of future returns. You cannot invest in an index. LEFT: Over the past 25 years, the effect of exiting the market the day after a -2% market move or worse and staying out for each period shown. Based on an initial \$100,000 investment using the S&P 500 returns. Source: Kitces.com, Clearnomics, O'Brien Wealth Partners, as of 3/21/25. RIGHT: U.S. Stocks: S&P 500, International Stocks: MSCI All-Country World ex U.S., U.S. Bonds: Bloomberg US Aggregate Bond Index. Source: Morningstar Direct, O'Brien Wealth Partners as of 3/31/25.

As U.S. growth has slowed the past few years, we have made a conscious and steady effort to increase the defensiveness of your portfolios. In stocks, this has meant shifting assets from riskier markets, such as small caps and emerging markets, to U.S. blue chip stocks – which historically hold up better during economic downturns. In a similar vein, we have shifted assets in bond portfolios away from riskier high yield credit markets toward treasuries. Alternative positions are also defensively oriented entering 2Q.

We cannot prevent losses if a recession occurs, but we have been actively trying to prepare for whenever the next one finally arrives. There will always be another recession, and the process of clearing out imbalances that occurs during them creates attractive opportunities for investors once the economy emerges.

If there are any changes in your personal or financial situation that might impact your investment objectives, or if you have any questions and would like to talk, please contact your Advisor.

Your O'Brien Team

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