Quarterly Market Review
First Quarter 2025

First Business Bank.

Executive Summary

Preliminary data indicates a likely deceleration in first-quarter 2025 economic growth, attributed to policy-driven uncertainty from Washington's trade and immigration reforms. This uncertainty has amplified hesitation in spending, investment, and hiring across consumer, business, and investor sectors, suggesting potentially weak or negative growth.

The U.S. economy expanded by an annualized 2.4% in Q4 2024, slightly slower than the previous two quarters. Real gross domestic product (GDP) increased by 2.8% for the 2024 calendar year. In the final quarter, gains in consumption and residential investment offset weakness in business investment and inventory accumulation.

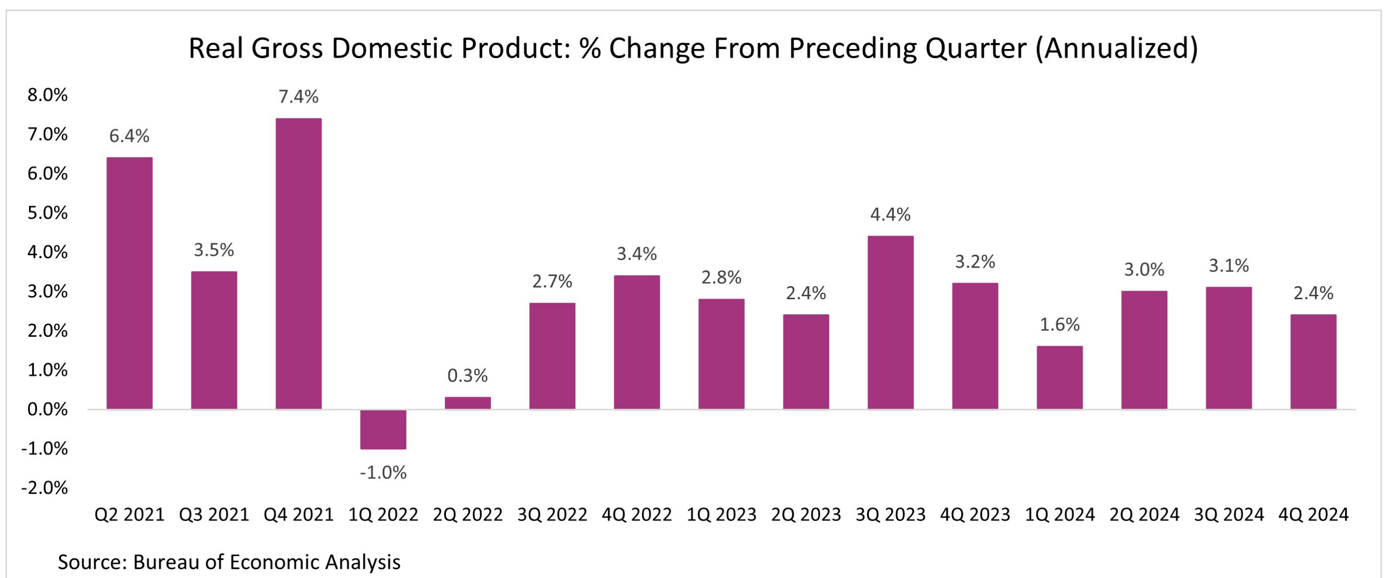
Inflation, as measured by the Consumer Price Index (CPI), decreased to 2.8% in February from an annualized rate of 3.2% a year earlier. Core CPI, which excludes volatile categories like food and energy, also decreased from 3.9% to 3.3% over the same period. Unemployment was slightly higher at 4.1%.

In March, the Federal Reserve held rates steady at a target rate of 4.25% to 4.5% as the committee assessed the potential for higher inflation and slower growth due to the impact of tariffs on global trade. Current expectations are that the Federal Reserve will cut rates three times in 2025 to end the year at a target rate of 3.5% to 3.75%.

Uncertainty surrounding tariffs and slowing global growth weighed on equities and dragged stocks lower in the quarter. The S&P 500 dipped into correction territory in March after hitting a record in February, finishing the quarter down 4.3%. The risk-off trade in the quarter benefited investment grade bonds, with the Bloomberg US Aggregate index gaining 2.8%.

U.S. Economy Loses Steam In Q4 2024

GDP increased at an annual rate of 2.4% in the fourth quarter, down from 3.1% in the previous period. This growth was primarily driven by increases in consumer and government spending, partially offset by a decrease in fixed investment. Consumer spending contributed 2.7% to GDP, with strong increases in goods and services. Durable goods spiked by 12.5% over the previous period as consumers anticipated proposed tariffs. Motor vehicle production added 0.46% to GDP. The last negative quarter in personal consumption was the second quarter of 2020, the peak of the pandemic shutdown.



Fixed investment, which includes spending on equipment, structures, and intellectual property, fell by 1.1% compared to the previous quarter, reducing GDP growth by 0.4%. Business investment in equipment fell by 8.7% after two consecutive strong quarters. Private inventories were negative, indicating that businesses sold more than they produced in the quarter, reducing GDP by 0.84%. Government spending rose by 3.1% over the previous period, adding 0.52% to GDP.

Federal Reserve Holds Rates Steady Amid Economic Uncertainty

The Federal Open Market Committee (FOMC) voted to keep the federal funds rate at a target range of 4.25%-4.50% at its March meeting as it assessed the impact of significant policy changes by the Trump administration on the economic outlook. The official statement indicated a shift in sentiment, noting increased uncertainty. The committee also modified its statement language that suggested that risks to its employment and inflation goals were "roughly in balance," indicating members may now be more sensitive to slowing growth than increased price pressures.

Policymakers initially projected gradual 2025 rate cuts for a "soft landing." However, new tariff projections suggest potential price increases and reduced investment, impacting growth. While a majority (11 of 19) still foresee at least two 2025 rate cuts, this is down from December 15. Market expectations, via the CME FedWatch tool, currently indicate three 25-basis-points cuts in 2025.

The Federal Reserve extended its wait-and-see approach on interest rates while revising its forecasts for inflation and lowering its outlook for growth and employment this year. Specifically, economic growth expectations were downgraded from 2.1% to 1.7% for 2025 and adjusted slightly lower for 2026 and 2027. Updates to the Summary of Economic Projections (SEP) signal the rising near-term risk of stagflation, characterized by the simultaneous occurrence of stagnant economic growth, high unemployment, and high inflation. This complicates the Fed's ability to cut rates this year to prevent a slowdown.

During the press conference, Chairman Powell acknowledged the uncertainty in Washington and noted that tariffs—those implemented and proposed—are expected to contribute to upward pressure on near-term inflation. However, he took some solace in the fact that longer-run inflation expectations have remained well anchored. For their part, investors appeared heartened that Chairman Powell did not signal a more aggressive stance toward potential tariff-related increases in inflation.

U.S. Tariffs Set To Impact Global Trade And Local Economies

The administration is escalating tariff discussions, with several tariffs scheduled to take effect on April 2, including a 25% levy on imported vehicles. The president has also announced plans for reciprocal duties aimed at countries that impose tariffs on U.S. imports. Trump said the levies will target all countries rather than a small group with trade imbalances with the U.S., and most countries have announced their intention to retaliate. Exceptions are occasionally granted but may or may not be permanent. Many speculate that threats of tariffs are a potential bargaining chip and that U.S. tariff hikes leave room for negotiations. That said, some of those tariff threats are likely to materialize in the coming weeks. The rapid speed makes it difficult for businesses to strategize and for investors to digest. The timeline and scope for many of these actions remain uncertain, making the potential economic ramifications difficult to estimate.

Tariffs can significantly impact investment portfolios by introducing volatility and uncertainty into the market. When tariffs are imposed, they often lead to higher costs for imported goods, which can increase prices for consumers and businesses alike. This inflationary pressure can reduce consumer spending and corporate profits, potentially leading to lower stock prices and decreased investment returns. Additionally, tariffs can strain international trade relationships, causing disruptions in supply chains and affecting global economic growth.

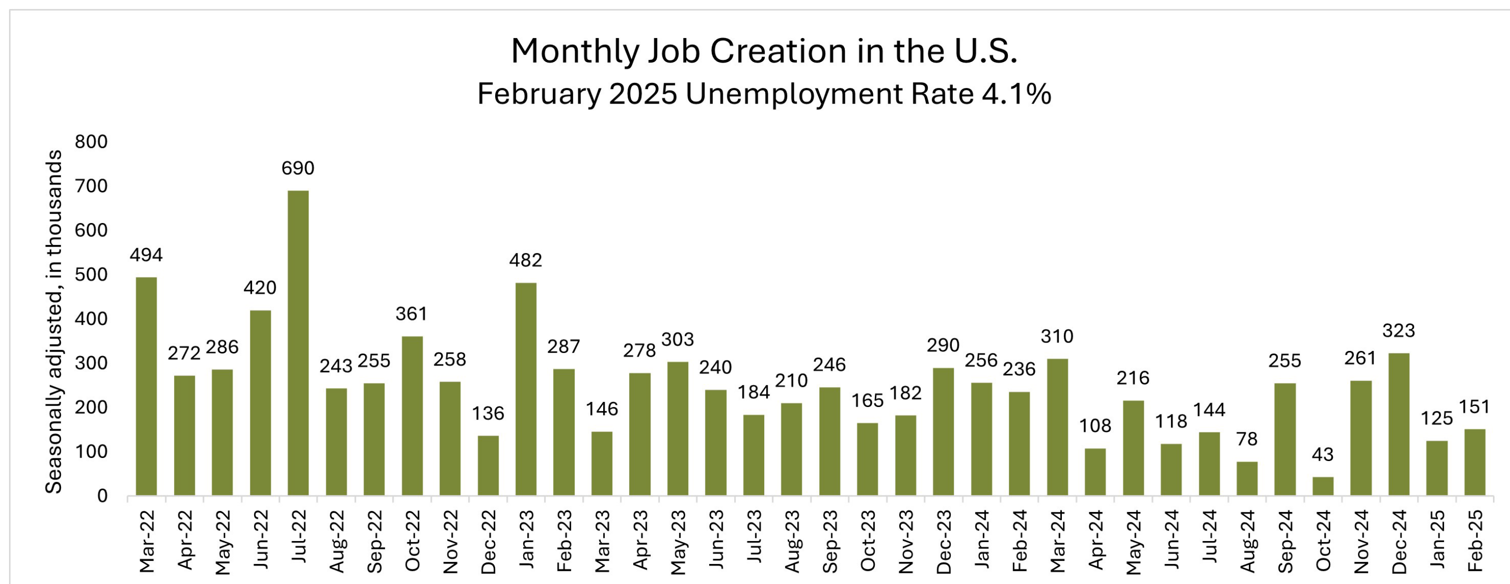
Tariffs are not an insignificant issue for our home markets. In 2024, Wisconsin's exports accounted for approximately 6.5% of its GDP, with the total value of exports reaching almost $28 billion. Canada is a key trading partner, receiving nearly 29% of Wisconsin's total exports, followed by Mexico, China, and Germany. The most significant export products are industrial and industrial machinery, medical and scientific instruments, and auto parts.

Missouri exported $19.4 billion worth of goods in 2024. The state's largest export categories are transportation equipment, chemicals, machinery, food products, and computer and electrical products. Missouri's top export destinations include Canada, Mexico, Japan, Germany, and China. Kansas achieved a

record-high export value of $14.1 billion in 2024. The state's top exports include aircraft parts, beef, maize, and soybeans. Major export destinations for Kansas are Mexico, Canada, Japan, China, and Germany.

Labor Market Holds Firm

Total nonfarm payroll employment rose by 151,000 in February, with the unemployment rate remaining relatively stable at 4.1%. Employment trended up in health care, financial activities, transportation and warehousing, and social assistance, while federal government employment declined. According to the Bureau of Labor Statistics (BLS) Establishment Survey, private payrolls increased by 2,132,000 in the last twelve months ending February 2025. During the same period, the unemployment rate has increased 0.2%, with 590,000 more people seeking employment than a year ago. The number of people employed part time for economic reasons increased by 460,000 to 4.9 million in February. Additionally, the number of people not in the labor force who currently want a job increased by 414,000 to 5.9 million in February.



The number of job openings has declined to 7.7 million as of January, down by 728,000 over the year. The January job separation numbers do not yet reflect the reduction in the federal workforce. According to the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey (JOLTS), the total number of job separations in January were little changed at 5.3 million. Of that number, 3.3 million workers quit, and layoffs and discharges accounted for 1.6 million, both figures remaining stable. Other separations, including retirement, death, and disability, were stable at 350,000. A reduction of the federal workforce, discussed below, will have an impact on national employment statistics. Many federal workers may be quickly absorbed into the private workforce, but at a minimum, the JOLTS survey is likely to indicate an uptick in layoffs and discharges.

CBO Forecasts Rising Deficits And Debt Amid Tax Cuts, Tariffs, And Workforce Reductions

The Congressional Budget Office (CBO) released its latest estimates for the federal budget earlier this year. These projections indicate that the budget deficit for fiscal 2025, ending on September 30, will be $1.9 trillion, or 6.2% of GDP. By fiscal 2034, the deficit is projected to rise to $2.6 trillion annually. Over the same period, U.S. debt held by the public climbs from $30.1 trillion (99.9% of GDP) to $49.6 trillion (117.1% of GDP). These projections are based on an assumed economic growth rate of 1.9%.

The fiscal 2025 budget resolution passed by the House in late February authorizes up to $4.5 trillion in tax cuts, primarily by extending the 2017 tax cuts set to expire at the end of this year. To reduce government spending, President Trump, and the Department of Government Efficiency (DOGE), led by Elon Musk as a "special government employee," have targeted the federal workforce, laying off thousands of employees. DOGE, which is expected to grow to two hundred workers, has promised to reduce the size of the government by $1 trillion by the start of the 2025-2026 fiscal year beginning on Oct. 1. Additionally, there have been cutbacks and pauses in a wide range of federal grants and spending. President Trump has estimated that

proposed tariffs, at their most extreme, will generate $600 billion a year in revenue.

Implications Of Federal Workforce Reductions

The federal government is the nation's largest employer with just over three million people, 1.9% of total nonfarm employees, on federal government payrolls as of February. The 1.3 million active-duty military personnel are not counted as federal government employees. Among those three million federal workers, more than 600,000 work for the U.S. Postal Service, an agency that operates independently of the federal government. In addition, there are some 3.7 million federal contractors who are not counted as federal employees. In fiscal year 2024, "personnel compensation and benefits" accounted for 8.6% of government spending, according to data from the U. S Treasury Department.

Apart from the roughly 75,000 federal workers who accepted the initial buyout offer from the new administration and numerous layoffs at individual departments, media reports suggest the administration plans to cut roughly 45,000 IRS jobs, 55,000 Department of Defense civilian positions, 10,000 at Health and Human Services, and 80,000 Veterans Affairs jobs. The full impact of the staff reductions is difficult to measure as several of the actions have been countered in the courts.

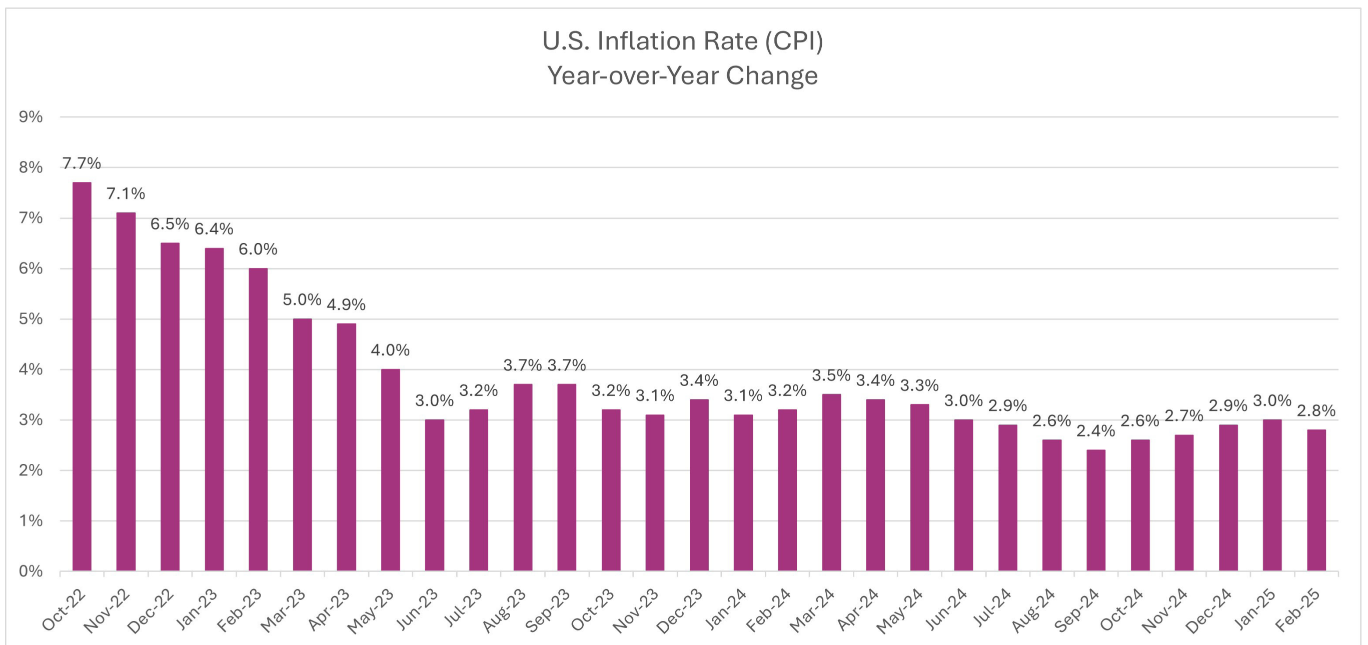
Implications of Government Staffing Reductions

DOGE's goal in reducing the size of the federal government is to reduce spending quickly. But if DOGE succeeds in dramatically decreasing government spending, it could have short-term economic growth consequences. Mass layoffs tend to have more localized impacts, so areas with denser populations of federal workers could experience more disruption. A Pew Research Center analysis of 2024 federal data shows that while D.C, Maryland, and Virginia first come to mind as a hotbed of government workers, together they comprise only about one-fifth of the federal workforce. Outside the beltway, the biggest states have the heftiest number of federal workers: California (147,500 workers) and Texas (130,000 workers). But concentration is what matters when it comes to localized impact. In D.C., Maryland, and Virginia combined, federal workers comprise 5.84% of the region's total workforce. Outside the D.C. area, the only states with greater than 2.49% concentration are Alaska and New Mexico.

The indirect impacts of the workforce are what worry the typical person the most. Delivery of services including Social Security, Medicaid, Medicare, tax refunds, student loans, veterans' benefits, or the governments' ability to respond in a crisis, could be jeopardized by diminished federal staffing levels.

Key Inflation Rate Dips In February

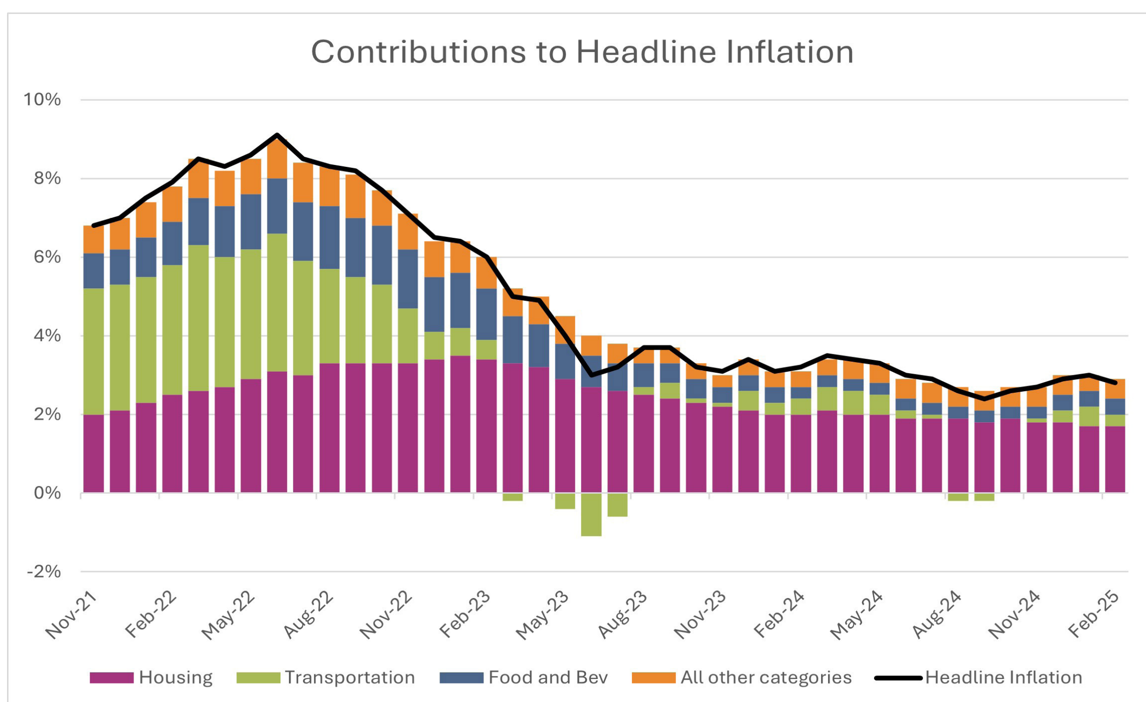
Consumer prices dipped slightly lower as of February, rising 2.8% on an annualized basis. Shelter remained the most significant driver of inflation, accounting for about three-fifths of the overall inflation rate. Housing price increases contributed 1.7% to the 2.8% overall inflation rate. Food and beverages also saw price



increases, adding 0.37%. The headline inflation rate peaks around mid-2022 and gradually decreases towards February 2025.

The stacked bar chart shows the components of year-over-year percent change of the Consumer Price Index (CPI) from November 2021 to February 2025. The chart includes contributions from housing, transportation, food and beverages, and all other categories, which together add up to the headline inflation rate marked by a black line. Housing has consistently been a significant contributor to the overall inflation rate, while transportation shows periods of both positive and negative contributions. Transportation, including vehicle prices, insurance, and fuel was another significant factor.

also soft, with ex-auto retail sales falling by 0.6% in January and only bouncing back by 0.3% in February. Consumer confidence, as measured by both the Conference Board and the University of Michigan, fell in January and February. The Michigan index plunged to its lowest level since November 2022 in March. The Conference Board Consumer Confidence Expectations Index dropped to its lowest level in twelve years. Consumers' expectations worsened for personal finances, business conditions, unemployment, and inflation. Notably, two-thirds of consumers expect unemployment to rise in the year ahead, the highest reading since 2009. The decline in sentiment spans all age groups, education levels, races, and political affiliations.



Commentary from consumer companies during the recent earnings season also suggest that consumers are spending more cautiously. However, the drivers of consumer spending remain relatively strong for now. The economy added a respectable number of jobs in February, and real wages have risen on a year-over-year basis for 22 straight months. Despite a negative start to 2025, stock prices have risen sharply over the past two-and-a-half years, bolstering spending on luxury goods and services. Real consumer spending has grown in every quarter since the pandemic. However, if consumers spending slows later this spring due to government workforce layoffs and higher prices from tariffs, GDP growth could decline or decelerate.

The Core Personal Consumption Expenditure index, the Federal Reserve's preferred gauge of inflation, rose by 2.8% annually through February, slightly hotter than was expected. The month-over-month increase in February was 0.4%, the largest monthly increase since January 2024.

Consumers Spending More Cautiously

After growing at nearly a 4% pace in the second half of 2024, real consumer spending is now tracking less than a 1% gain for the first quarter of 2025. A significant factor has been a decline in light vehicle sales, which fell to an annualized rate of 15.7 million units in January and February, compared to 16.5 million units in the fourth quarter. Other areas of consumer spending are

U.S. Business Activity Remains Mixed

The S&P Global U.S. Composite Purchasing Managers' Index (PMI) increased to 53.5 in March, up from February's 10-month low, signaling the strongest growth in private sector activity in the last three months. A strong upturn in the service sector offset a renewed drop in manufacturing output. Service sector

output rebounded strongly in March after hitting a 15-month low in February. The service sector gains are likely attributed to a recovery of business activity lost to weather-related disruptions in January and February. However, exports remained a weak spot, declining for the third straight month.

Manufacturing output declined after February's sharpest increase in nearly three years, with factories reporting fewer instances of output being boosted by the front-running of tariffs and new orders growth nearly stalling. Input price inflation surged to a near two-year high, especially in manufacturing, though competition limited the pass-through to selling prices. Business expectations for the year ahead dropped to their second lowest since October 2022, reflecting growing caution.

Housing Market Remains Constrained

The U.S. housing market showed mixed signals early in 2024. January saw declines in existing home sales, new home sales, and housing starts. For the full year 2024, housing starts totaled 1.37 million units, the lowest annual pace since 2019. However, February experienced a significant rebound, with housing starts, which measures new residential construction, unexpectedly jumping 11.2% from January to a seasonally adjusted annual rate of 1.5 million units. This surge followed an 11.5% drop in January, which was largely attributed to severe winter weather disruptions.

Sales of existing homes rose in February, reflecting an increase in shopping activity and in the number of homes for sale since the start of the year. Sales of new single-family homes rose 1.8% to a seasonally adjusted annual rate of 676,000 in February 2025, partially recovering from a revised 6.9% drop in January. Existing home sales increased by 4.2% in February to a seasonally adjusted annualized rate of 4.26 million homes. For perspective, annualized home sales in January 2021 were 6.6 million. The total inventory of single-family homes and condominiums for sale is 1.24 million, equivalent to 3.5 months of supply at the current sales pace.

Despite persistent affordability challenges, a segment of buyers and sellers, having acclimated to prevailing mortgage rates, are resuming activity. Nevertheless, overall market activity remains subdued for the third consecutive year, constrained by diminished affordability. Prospective buyers are deterred by elevated home prices, heightened mortgage rates, and escalating costs associated with home insurance and property taxes. Furthermore, homeowners retaining historically low mortgage rates are disincentivized from selling, thereby limiting housing inventory and contributing to upward pressure on prices.

Global Growth At A Below-Trend Rate

Eurozone real GDP grew 0.1% in the fourth quarter of 2024. Momentum remains weak: consumption is barely growing, industry is still mired in recession, and the job market is showing signs of slackening. Rate cuts of 1.75% from the European Central Bank are anticipated by mid-summer. Coupled with the prospect of American tariffs, consumer caution could offset the benefit of easier monetary conditions.

The U.K. barely avoided a technical recession in the fourth quarter, with real GDP growing 0.1%. Government consumption and inventories provided just enough to overcome stagnation in household consumption and a decline in business investment. Given the risks of large spending cuts and rising external uncertainties, Britain is expected to be stuck in a low-growth rut. The Bank of England (BoE) cut its policy rate by 25 basis points to 4.5% in February. The BoE is expected to cut by another 75 basis points this year, bringing the target rate to 3.75% by the end of 2025.

Though reported fourth quarter 2024 output allowed China to officially hit its "around 5%" growth target,

Key Rates

	12/31/2023	12/31/2024	03/31/2025
2-yr U.S. Treasury	4.25%	4.25%	3.90%
10-yr U.S. Treasury	3.88%	4.58%	4.21%
30-yr Fixed Mortgage (Freddie Mac)	6.61%	6.85%	6.65%
Fed Funds Target Rate (upper)	5.50%	4.50%	4.50%
U.S. Dollar Index	101.38	108.48	104.18
Crude Oil Futures	$71.65	$71.72	$71.40
Gold	$2,072	$2,641	$3,157
Unemployment Rate	3.70%	4.20%	4.10%*

*As of February 2025 | Source: *The Wall Street Journal*

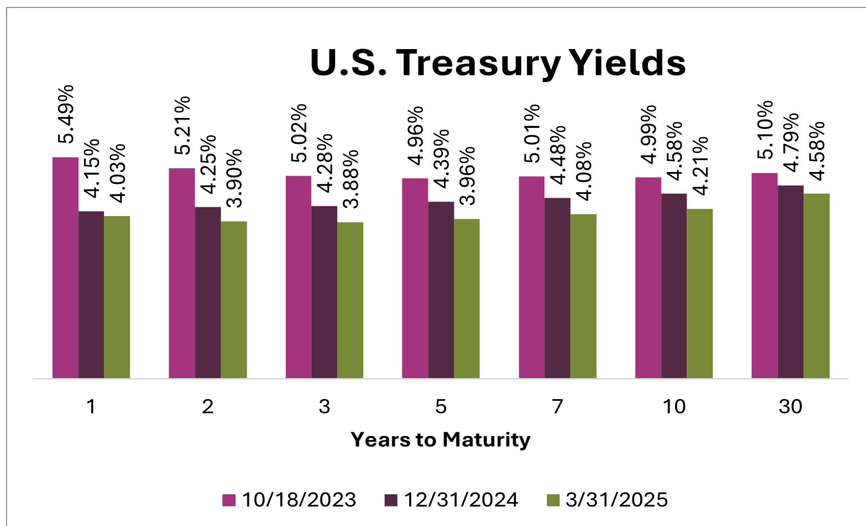
momentum is likely to fade after the first quarter of 2025. The real estate market is already starting to lose steam after a stimulus-fueled bump. Local governments are hurting under debt burdens. The economy is highly vulnerable to U.S. trade policies, owing to the size of the bilateral trade deficit and the strategic nature of the nations' competition.

Market Commentary – Are Investors Tariff-fied?

The equity market entered 2025 on a high, driven by optimism around AI innovation from mega-cap tech and the prospects of pro-business policies in Washington. The 26.3% return in 2023, followed by a 25% return in 2024, marked the S&P 500 index's best consecutive annual returns since 1997 and 1998. Markets soared to fresh highs by mid-February, then the risk dynamic shifted. Policy uncertainty triggered a rapid 10% correction, the seventh fastest since 1929. The index closed the quarter down 4.3%, nearly 9% below the record level reached in February. To date, large cap stocks have fared better than small cap stocks, which are generally more susceptible to economic downturns. Value sectors have held up better with large cap value up 2% in the first quarter versus a decline of 10% for large cap growth. The best performing sectors are energy (10%), health care (6.5%), consumer staples (4.4%), and financials (3.4%). Consumer discretionary and technology are both off by around 13%.

The Magnificent Seven, the largest companies in the S&P 500 index, accounting for almost a third of the index, tumbled nearly 16% and pulled the S&P 500 down 4.6%. Tesla has declined by 37% in 2025, dropping its market cap by almost 35%. Both Berkshire Hathaway and Broadcom now have larger market capitalizations than Tesla. The Magnificent Seven are all significantly off recent highs with the lone exception of META, which is only off -1.5% for the year to date. As a sector, technology is off 11%.

Meanwhile, global markets, despite trade tensions, have flourished on attractive valuations, a weaker



dollar, and fiscal tailwinds. European markets climbed 8%, boosted by Germany's historic €500 billion defense spending plan. Developed international, based on the MSCI Europe, Australia, and Far East Index (EAFE) is up 5% (local currency) in 2025 to date. Due to a drop in the value of the dollar, the return for U.S. investors is 6.7%.

The Treasury curve has generally made a parallel shift lower with both the nominal U.S. 2-year and 10-year Treasury yield declining 35 and 37 basis points (bps), respectively year to date. Effectively, the bond market is pricing in a greater risk of near-term stagflation, followed by a longer-term drag on economic growth. The outlook for longer-duration interest

Index Total Return	Q1 2025	Last 1 Year	Last 3 Years (annualized)	Last 5 Years (annualized)
MSCI All-Cap World Index	-1.61%	6.26%	6.24%	15.00%
S&P 500 Index	-4.27%	8.25%	9.06%	18.59%
Russell 2000	-9.48%	-4.01%	0.52%	13.27%
MSCI EAFE Index	6.86%	4.88%	6.05%	11.77%
MSCI Emerging Markets Index	2.93%	8.09%	1.44%	7.95%
Bloomberg 1-3 Year U.S. Treasury	1.62%	5.42%	2.84%	1.14%
Bloomberg U.S. Aggregate Bond	2.78%	4.88%	0.52%	-0.40%
Bloomberg Municipal Index	-0.22%	1.22%	1.53%	1.07%

Source: Morningstar Direct

rates is less clear, as they can reflect offsetting market expectations. Slower growth prospects are weighing on yields, as is the prospect of tamer inflation that

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Kansas City Metro:
11141 Overbrook Road
Leawood, KS 66211

could accompany a downturn in economic activity. However, tariffs and supply chain realignment could prove inflationary. An imbalanced reconciliation package that raises the deficit and national debt would extract a higher-risk premium from bond investors.

Navigating Volatility As A Long-Term Investor

For investors, the outlook for growth and inflation remains highly uncertain. Therefore, remaining well diversified across high-quality bonds, a globally diversified equity portfolio, and alternatives seems most appropriate. Tariffs, government layoffs, funding cuts, and immigration restrictions all could at least temporarily exert some drag on the economy. Put them all together, and they have a "perfect storm" dynamic that could cause near-term damage. In times like this, we do need to remember the investment fundamentals that have seen us through many periods of market volatility. Those are:

1. Stay invested. Market timing attempts often result in missed recovery opportunities. Historically, significant returns have followed market downturns, rewarding those who remained invested. However, even brief periods of market absence can substantially diminish overall gains. Emphasize time in the market, rather than attempting to time it.
2. Diversification serves to reduce risk and enhance portfolio stability during volatile periods. While the 2022 Federal Reserve rate hikes led to notable fixed income losses, current elevated bond yields offer both enhanced income generation and diversification benefits relative to equities.
3. Short-term market volatility should not dictate long-term investment strategies. Maintain a focus on sustained, long-term growth.

As markets continue to evolve and adapt to changing economic conditions, investors seek clarity on positioning their portfolios for the years ahead. Matthew Rice, CFA, CAIA, and First Business Bank's Chief Investment Officer, presents our Ten-Year Capital Market Assumptions for 2025-2034, providing a comprehensive roadmap for long-term investors with detailed insights into expected returns across asset classes. While short-term market movements often capture headlines, these forward-looking projections help our clients maintain perspective and make informed decisions aligned with their long-term investment goals. Access a video and a summary of our Ten-Year Capital Market Assumptions on our website.

As we navigate these dynamic market conditions, we remain committed to providing you with insightful analysis and strategic guidance. We are excited to welcome several new team members in our Private Wealth group who bring valuable expertise to our organization. Their addition strengthens our ability to support your financial goals.

Thank you for your continued trust and partnership.

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