The Client Letter

2025.Q1 PERFORMANCE

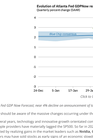
1st Quarter Recap - "Changing Winds"

As of March 26, 2025

The SP500 is looking to have a solid first quarter but the bulk of the gains have provided positive returns as the 10 year benchmark treasury yield has fallen from 4.6% to 4.3%, producing capital gain and interest income.

Client portfolios generally had a better than their benchmarks as we reduced equity exposure and shifted into more defensive holdings.

The year started with optimism that economic growth would continue, and earnings would remain robust. The SP500 let all time highs in late February, then quickly declined 10%. The combination of new tariffs and **Department of Government Efficiency (DOGE)** driven budget cuts upended investors and their economic expectations, causing **Gross Domestic Product (GDP)** estimates to plummet.



Atlanta Fed GDP Now Forecast, near -4% decline on announcement of tariffs.

Clients should be aware of the market volatility that could be the result of equity markets, rotating from winners to losers.

For several years, technology and innovation growth oriented companies have been top performers, with traditional consumer, industrial, and staple providers have materially lagged the SP500. So far in 2025, the leadership has reversed. Initially investors may have been motivated by rotating gains in the market leaders such as **Nvidia, Constellation Energy,** and **Arista Networks.** As the quarter progressed, investors started and continued to sell the market leaders and rotate into laggards. Clients should note that 1st quarter, our top holdings have materially changed from the beginning of the year as we have rotated into laggards.

Economic Outlook: "Uncertain"

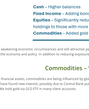
The economy grew 2.3% on an annualized rate in the 4th quarter of 2024, in line with the long-term trend of GDP over the past 30 years. Looking forward, the outlook is uncertain. The Trump Administration is rapidly attempting to re-shape the U.S. economic from a global consumption based model to a domestic production based model. Tariffs are being implemented to force companies to move their offshore manufacturing and supply chains to the US will more than offset the impact of tariffs on increase in prices, increase profits and add new jobs to operations.

At the end of 2024 Q4, the U.S. has pursued a globalization of business whereby countries could sell products which have a competitive advantage to others lacking in resources. This has allowed the United States, with 60% of GDP from consumer spending, to purchase a wider variety of products at lower prices than if they were produced locally.

The Trump Administration is pursuing three current tactics:

1. Tariffs
2. Immigration controls
3. Budget Cuts

Tariffs are generally a bad policy for the economy in the long term. While tariffs are a good defense against foreign countries with a surplus economic advantage, they are a terrible economic policy when used against friends, allies, and countries with a trade deficit with the United States. President Donald Trump's "reciprocal" tariffs, Foreign Competition has led to superior quality products as well. President Ronald Reagan's 1981 sales utilities highlighted the long-term negative implications of tariffs which are more impactful than short-term pain. The link to his address is **Ronald Reagan on Tariffs.** President Reagan concentrate on lowering tariffs on goods that didn't appear to the average middle class worker, such as agricultural labor. It big to immediate. TL will provide a snapshot of the importance of farm workers. Tries bad we could not find an easy way to provide work for this population.



To sum up Trump's policies being implemented to slow economic growth is anticipated to be lower, and inflation is expected to be higher than previously projected. Yet to come are tax and regulatory policies. It will be difficult to expect material tax cuts given the current budget deficit and the need to fund the military. Regulatory changes to reduce burdens and increase competition will be a major experiment from the Biden Administration who backed an unbelievably large amount of new rules.

Asset Allocation – "Bonds Chance to Lead"

Since the fourth quarter of 2024, equity exposure has been decreased materially. Last year, equity sales could have been characterized as "selling into strength" as we took advantage of strong equity markets to reduce exposure to equities. Since the inauguration of the Trump Administration, especially tariffs, has driven the SP500 index lower, beginning in February with a 10% drop over 3 weeks.

Asset Allocation Changes since beginning of the Year

Cash – Higher balances
Fixed Income – Adding bonds and extending bond ladders
Equities – Reduce exposure to equities and shifting
Equities – Shifting with more defensive characteristics
Commodities – Added gold as a hedge

Given the weakening economic circumstances and still attractive yields, the bond market may be the best asset category until there is more clarity on the economy and policy. In addition to reducing exposure to equities, we have allocated 3% – 5% of most client portfolios to gold.

Commodities – "Going for the Gold"

Much like financial assets, commodities are being influenced by global tariffs and trading policies. Gold has been hitting record highs as investors have found new interest, possibly due to Central Bank purchases, or confidence in the US banking system has been damaged recently. We hold gold via SGOL ETF in many client accounts.

Given the risk of a weakening economy, recently we have focused on buying bonds with at least an A (Standard & Poor's) credit rating. Buying lower grade bonds with higher yields is not worth the stress. Below is the chart of the spread between high yield bond yields less the U.S. Treasury yield. The high yield spread rose as the risk of default increases.

Equities – Rough Seas Likely, Hoping for Calm

With the SP500 close to breaking even year to date, the large cap, technical and mastcap arguments make it feel like a significant bear market. Economic data is mixed, but leading indicators point to a slowdown in economic growth. Inflation is still above the Fed's 2% target and has been stubborn to eliminate with cuts to Federal expenditures, assets seem sold off further, global markets may have been aggressive sellers too. Small has outpaced those with the biggest gains over the past several years. Many of the leading technology companies were some of the biggest losers, despite sales and earnings still growing.

At present, most portfolios are positioned defensively with large exposure to healthcare, financials, and utilities. Last year, the artificial intelligence-tech ecosystem, including technology providers, users and utility providers accounted for a large portion of client gains. While we have reduced our exposure, we still quickly allocate funds back.

The characteristics of companies we invest in remain focused on a few key factors:

1. Leading industry positions with strong competitive advantages
2. Growth in sales and earnings
3. Strong balance sheets
4. Good corporate citizenship
5. Positive earnings revisions

In the short term, companies with rising sales earnings estimates published by analysts have positive stock returns. We monitor earning revisions via analysts of Strong Fundamental Core holdings showing the greatest earning revisions over the last 3 months include:

The equity market represented by SP500 has produced above average returns for several years. However, many of the factors associated with strong equity markets are no longer in place. The Bloomberg Intelligence Equity Research Team watches 11 market factors. Six months ago, the checklist was green 8 yellow. Now greens are almost all gone and replaced with red as shown below.

In addition to the factors listed on the chart, investors confidence in the future is often measured by the price to earnings ratio or "P/E". Often used as a measure of value, it is a psychological indicator of confidence. Should these factors be threatened, investor confidence could be negatively impacted. Currently, the forward P/E ratio is 19.9 versus the 10 year average of 18.5 and the 5 year of 19.5. Although the P/E ratio is not at lofty levels, it does represent investor group that fears return of their principle may not be adding to the quality of growth. The chart below highlights the potential longer-term investment return under a new more restrictive administration government. Should the SP500 return to the historical PE ratio of 18.5, the index would be about 20% lower.

The key issues in why a lower P/E is possible include:

1. Shift from a highly profitable service economy to less profitable service and manufacturing economy
2. Political shifts to a more authoritarian and socialist system
3. Offsetting factors could include lower tax rates and regulatory burden

Our portfolios have been overweight utilities stocks in it international markets. China has been the best performing market year to date. The Trump Administration has placed a 10% tariff on all Chinese goods. Although the Trump Administration is threatening Closely to Europe European defense stocks have started on a new spurting full and increase European investment in defense.

Comments on Top Core Holdings

Johnson & Johnson (JNJ) JNJ is the top holding in many portfolios due to defensive characteristics. First, with an AAA credit rating and 3% dividend yield, JNJ is a very financially secure company. As a result, stock performs well during bear market environments. The company is also moving growth expectations at 8% with a well-diversified drug portfolio and strong pipeline.

Progressive Insurance (PGR) PGR is one strong no profit from Annual Report. Focus on insuring homes, autos, boats, and small businesses. With competitors having to raise prices and flood prone areas, PGR has reduced competition and the opportunity to earn attractive returns.

JPMorgan Chase (JPM) JPMorgan Chase is a cornerstone of the global financial system. The company has consistently demonstrated robust growth in earnings and sales. With a very strong core profit from diversified revenue streams, JPMorgan Chase is well positioned regardless of the macro environment.

Netflix (NFLX) Netflix has become synonymous with movie streaming from home, dominating the market based on most metrics. Last year, Netflix added 19 million of subscribers, bringing the total number of members to over 300 million, for about comparison. This growth was driven by their high quality content, supported by a diverse workforce creating shows and movies that appeal to members worldwide. As a subscription based business, Netflix has very favorable cash flows, and is one of the main platforms for entertainment. They are likely recession proof.

Apple (AAPL) Apple continues to lead the tech industry with its innovative products. The company's growth is driven by its strong brand loyalty and ecosystem of devices and services. Apple is leaning into Artificial Intelligence with its own "Apple Intelligence" integrated into new devices. With cash on hand and a revenue mix of subscriptions and purchases, Apple is positioned for reliable growth.

Amazon (AMZN) Amazon has two main businesses. Amazon Web Services (AWS) serving cloud customers, and their better known retail platform. AWS has been supercharged by developments in Artificial Intelligence and huge spending from customers. The retail platform continues to grow sales and earnings. Recently, the company has been spending more customers Amazon has high revenue diversification, serving some of the largest retail customers as well as small companies.

Duke Energy (DUK) Duke Energy is a traditional regulated electric utility with good potential due to its geographic location near data centers and potential growth in nuclear power. Duke Energy has been in business for more than a hundred years and has been very stable. During the current risk, adverse investors' appetite. Duke has limited tariff risk and a 3.5% dividend yield.

Garmin (GRMN) Garmin is the leader in the global market, although it's main home is dominated by investment analysts. The company has the separate businesses that serve Global Positioning System (GPS) technology. Revenues are recurring and wearables are consumer focused. With a very strong balance sheet, Garmin is well positioned to continue to grow revenues and earnings. Wearable is each of its businesses. Garmin's stock has held up better than the overall equity market this year and should be a good growth company worth holding through a potentially tough environment although the company is exposed to tariff risks.

Microsoft (MSFT) We have recently increased the holding in MSFT due to its defensive attributes. First, its AAA credit rating suggests the ability to withstand a long economic decline. Second, over 95% of Microsoft's revenues are recurring subscription based. Third, Microsoft's Azure cloud service is a leader in Artificial Intelligence and is being used by many of its Microsoft Enterprise applications (Excel, Word, PowerPoint, etc.) with Copilot has been a valuable addition, although at $30/month additional cost.

2024 IRA Contribution Deadlines & Limits:

We would like to remind clients that the deadline to contribute to Traditional and Roth IRAs for the 2024 tax year is **April 15th, 2025.**

However, certain clients may qualify for an extension to May 15th, 2025 (please see the chart below). Below is the maximum amount you can contribute:

- **Under** 50 $7,000
- **50 or Older**: $8,000 (including a $1,000 catch-up contribution)

Please reach out to us if you would like assistance contributing to your account, confirming your contributions for 2024, or we wondering if you qualify for the May 1st extension.

BEWARE OF EMAIL FRAUD

As we are at the peak of tax season, we urge clients to be mindful that this is the time of year where identity theft and cybersecurity attacks are rampant. Email fraud is on the rise, and we recommend clients follow these best practices:

1. **Be cautious with links in emails**: Avoid clicking on unexpected links and scanning QR codes in emails, or text messages. When in doubt, call the company directly and type into the website.
2. **Closely review the sender's email address**: Often, a fake email will look very similar to the legitimate email. See example below:
   - Legitimate email address: **name@company.com**
   - Fake Email: **name@mail.docu.com**
3. **Verify "urgent" or "past due" requests for payment**: An email requesting you make payment to a new account is a red flag. Businesses rarely change their accounts. *Do not respond to this email and call the business directly to confirm.*

The security of your financial information remains a top priority at Andrew Hill Investment Advisors, Inc. Please let us know if you have any questions regarding your 2024 tax documents and/or security.

OUR TEAM

Andrew "Andy" R. Hill, CFA
President and Co-Founder

Jennifer B. Figueiredo, CFA
Managing Director Co-Founder

Elicha D. Moore
Client Concierge Representative

Sean Wilkins
Associate Portfolio Manager

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