WEALTH MANAGEMENT 360
FARMERS TRUST COMPANY

MARKET UPDATE & OUTLOOK | Q2 2025

COMPANY PROFILE

Farmers Trust Company is licensed by the Ohio Division of Financial Institutions as a bank, authorized to conduct trust business and exercise full fiduciary powers. Our efforts are focused on the administration and management of trust assets. As an independent trust company, Farmers Trust Company offers several investment management options.

We are committed to providing the highest level of service in the areas of investment management, estate settlement, living trusts, testamentary trusts, charitable trusts, charitable endowments and employee benefit plans. Tax and estate planning services are available to our clients as well.

Farmers Trust Company has the unique ability to integrate investment, trust and estate management at a local level. Our clients appreciate the fact that their financial affairs are handled personally and confidentially. They also value our ability to work closely with their attorneys, accountants and insurance professionals to achieve a comprehensive financial strategy.

MARKET RECAP

The first quarter of the calendar year highlighted the value of the most important rule of sound investing: portfolio diversification. While the U.S. equity market was down for the quarter overall, the U.S. Bond market and International equities provided a cushion as they performed relatively well. Given the rising level of uncertainty in the US economy, portfolio diversification should be an enduring theme this year. Similarly, we witnessed several important market rotation trends in the quarter that could also have staying power, including the resurgence of defensive sectors, the outperformance of value stocks, and relative strength in International stocks.

The U.S. Equity market had a slow start to the year as investors continued to grapple with expensive stock valuations amid a foggy economic outlook. The S&P 500 Index declined 4.3% in the first quarter. This was the weakest quarter for U.S. equities since Q3 of 2022 when the market was down almost 5%. The weakness in the equity market was primarily confined to the Technology (-12.7%) and the Consumer Discretionary (-13.8%) sectors. Investors shunned those two sectors in favor of the seven others that had positive performance in the quarter, including Energy (10.2%), Health Care (6.5%), and Consumer Staples (5.2%). Sector rotation was also accompanied by rotation into value stocks. The S&P 500 Value Index was up 0.3% for the quarter while the S&P 500 Growth Index was down 8.5%. Weakness was also pronounced in the small capitalization stocks with the Russell 2000 Index finishing the quarter down 9.5%.

International equities provided a refuge of sorts for investors on the back of a weaker U.S. dollar and a preference for cheaper valuations. The MSCI EAFE Index of developed international markets was up 7.0% for the quarter, and the MSCI Emerging Markets Index was up 3.0%. European equities were particularly strong, as the Eurozone STOXX 50 Index was up 12.5% for the quarter. The same could not be said of the Japan's Nikkei Index, which was down 5.6%. In aggregate, the MSCI World ex-US Index was up 6.4% during the first three month of 2025.

Commodities held their own in Q1, with Energy and Metals both up and Agriculture flat. The GSCI Commodity Index was up 4.89% for the quarter. Oil prices were flat while Copper (25%) and Gold (18%) shined brightly.

The bond market was a valuable ballast to the equity market during Q1 as bond yields went down during the quarter (prices rose). The yield on the 2-yr U.S. Treasury note went from 4.24% at the start of the quarter to 3.88% at the end of it. Similar declines occurred across the yield curve. As a result, the Bloomberg Global Aggregate Bond Index was up 2.6% for the quarter. High Yield Corporate bonds were up 1%.

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MARKET SCORECARD as of 3/31/2025	TOTAL RETURN IN USD	
	Q1	2025 TR
DOW JONES IND AVG	-0.9%	-0.9%
S&P 500	-4.3%	-4.3%
NASDAQ	-10.3%	-10.3%
MSCI EAFE EQUITY (GROSS)	7.0%	7.0%
RUSSELL 2000 INDEX	-9.5%	-9.5%
MSCI EMERGING MARKET EQUITY (GROSS)	3.0%	3.0%
BLOOMBERG GLOBAL AGG BOND INDEX	2.6%	2.6%
BLOOMBERG INTERM. TREASURY	2.5%	2.5%
BLOOMBERG INTERM. GOVT/CREDIT	2.4%	2.4%
BLOOMBERG 5 YEAR MUNI INDEX	0.9%	0.9%
BLOOMBERG HIGH YIELD CORP INDEX	1.0%	1.0%
ishares S&P GSCI COMMODITY TR INDEX	4.9%	4.9%

Note: All returns include invested cash flows expressed in U.S. dollar terms.

KEY POINTS

- Investors were quick to sour on President Trump's economic plan: government spending cuts and tariffs on imported goods. Neither of the two is likely to have positive implications for economic growth this year.
- Backward looking employment trends look fine, but the implications of the proposed economic policies could have a negative effect on labor markets. Given the amount of leverage in the economy and in financial markets, a credit cycle downturn is a distinct possibility.
- Our focus remains on playing defense in this market. We favor Health Care, Utilities, and Consumer Staples sectors over Technology and Consumer Discretionary. We also find better relative value in International and Small-Cap equities.
- Bonds should continue to provide diversification benefits to investors' portfolios, but yields may drift higher given long-term inflationary pressures. Commodities are a good hedge against the possibility of a stagflationary scenario.

GLOBAL MACROECONOMIC REVIEW & OUTLOOK

The US economy finds itself in a delicate position as we enter the second quarter. The magnitude of the twin deficits that the U.S. economy currently has is simply unprecedented. These two, the Federal budget deficit and the US trade deficit, form a toxic mix to the future economic outlook. The Trump administration is correct to deal with those deficits right away. However, the repercussions of such actions are likely to be negative for the outlook for risk assets in the short-to-medium term. The equity markets have only started to come to terms with such a proposition, as their performance in the month of March indicated. All of the losses in the U.S. Equity market during Q1 came in the last month of the quarter. Those losses have accelerated into early April as the extent of Trump's trade policies became clearer, and investors started to estimate how it could affect corporate profits.

On the one hand, the Trump administration has tasked the Department of Government Efficiency (DOGE) with finding potential savings in federal government spending. That is the right thing to do in terms of providing a sustainable path for the federal budget over the long-term. However, the cuts in government spending that are likely to occur from such an initiative ($300bil so far), specifically job losses across various departments, will certainly have a negative impact on the US employment trends in the short run. When we consider that in the last two years of the Biden administration that government has been responsible for most of the job creation, a reversal in that trend is bound to affect the economy negatively. What is troubling is that despite all of the DOGE cuts, the fiscal 2025 budget deficit is already $710bil, which is $200bil more than in the same period last year. With the budget deficit at 6.5% of GDP and government debt at $36T, that implies that deeper cuts and additional sacrifice will be needed to get the government finances in order. Our concern is that a spillover of such belt-tightening could start a downturn in the credit cycle, negatively affecting the consumer's debt-service capacity and increasing corporate borrowing costs.

As the other leg of its economic plan, the Trump administration has introduced tariffs on imports. Tariffs, which are surcharges on products that are not produced in the United States but are consumed here, could provide additional revenues to the Treasury while also addressing the $1.2T trade deficit that the U.S. has with its trading partners. On the surface, the tariffs look like a potential solution to the twin deficit problem. However, their true nature is that they are a tax on consumption that will be borne mostly by U.S. consumers. Foreign producers will likely increase their prices to offset the impact of tariffs on their profits. Consumers will then have to pay more for imported products or switch their consumption towards non-tariffed substitutes, which are not currently their preferred choice. The aim of this policy is to re-energize the U.S. manufacturing base, but the reality is more complicated. Consumers are likely to pay more and get less for their hard-earned dollars. Similarly, a lot of "foreign" producers are not really foreign but rather U.S. companies that manufacture overseas. Their profits are likely to be negatively affected, which will mean less resources for reinvestment, whether in the U.S. or abroad. The bottom line is that tariffs are not likely to be a panacea for U.S. economic woes. The Trump administration will have to be more aggressive with its other policies, especially regarding taxation, in order to create additional incentives for manufacturing to return home.

INVESTMENT OUTLOOK

We continue to be cautious in terms of our expectations for the economy and risk assets. While we recognize that the new administration is properly focused on addressing the twin deficit problem, we are concerned that the fallout from their efforts may result in a deeper than expected pullback for the economy. This is likely to have negative repercussions on the profitability of the U.S. companies, exposing an already expensive market to potential downside earnings risks. The presence of a high degree of leverage in the financial markets, as well as on consumer and government balance sheets, only exacerbates those risks.

The rebalancing of the U.S. economy towards more domestic manufacturing is being proposed at a delicate time for risk assets. Historically-high equity valuations leave little room for economic weakness that could result from potential pullbacks in consumer spending or corporate hiring. While employment trends have held up thus far in 2025, indicators of future hiring trends have begun to inflect lower. Companies are likely to cut spending, including hiring, as a result of increased uncertainty surrounding U.S. economic prospects. This could hit consumers on both ends of their pocketbooks: in the form of lower incomes and higher prices.

Given these risks, we continue to be underweight US equities relative to International equities. International equities are far more reasonably valued relative to their own history as well as relative to U.S. equities. Within the US equity market we are overweight defensive sectors, including Health Care and Utilities, and underweight the Technology and Consumer Discretionary sectors. Small caps remain a conundrum of sorts because they offer more attractive valuations than large caps, but they are more directly exposed to any potential weakness in the economy. Nevertheless, we see relatively good prospects for small and mid-cap equities for long-term investors as the second wave of economic reforms, including the changes in tax policy, acts as a positive catalyst for the market later this year. In terms of fixed income, we see some modest value in bonds given their relative valuation to U.S. equities. However, we continue to have concerns about the long-term outlook for the bond term premium in light of stubborn inflationary expectations, which leave bond yields exposed to upside risks. Commodities remain our preferred asset class to allocate to as a hedge against potential stagflationary risks.

INVESTMENT TEAM

Meet the team!

David A. Dastoli, President – CFA, CFP®
dastolid@farmerstrustco.com | 330.740.1231

John D. Stewart, SVP & Chief Investment Officer – CFA
stewartj@farmerstrustco.com | 330.740.1208

Igor Golalic, VP – CFA
golalici@farmerstrustco.com | 724.867.2019

Thomas S. Rumbaugh, VP
rumbaught@farmerstrustco.com | 330.765.0583

Dale Standley, VP
standleyd@farmerstrustco.com | 330.740.1207

Mark Wilhelm, VP
wilhelmm@farmerstrustco.com | 330.702.7215

Joe Waterman, AVP
watermanj@farmerstrustco.com | 330.609.8328

YOUNGSTOWN: 42 McClurg Rd., Youngstown, OH 44512 | 330.743.7000
HOWLAND: 1625 Niles-Cortland Rd. NE, Warren, OH 44484 | 330.609.5057
HUDSON: 75 S. Main St., Hudson, OH 44236 | 330.282.4158
CANTON: 4518 Fulton Dr. NW, Suite 100, Canton, OH 44718 | 330.526.7305
WOOSTER: 305 West Liberty St., Wooster, OH 44691 | 330.439.4495
ASPINWALL: 319 Freeport Rd., Aspinwall, PA 152155 | 844.781.3623