



*Pinnacle Consulting Group*

## **PCG 2025 First Quarter Letter**

### **Stumbling out of the Starting Gate**

Heading into 2025, after back-to-back years of strong gains, the S&P 500 stock market index expectations were high with a new administration taking office and an economy that was the envy of the rest of the world. This enthusiasm rose higher in the early part of 2025 with the stock market reaching all-time highs by mid-February. Unfortunately, it was around this time that a combination of events came together to stall out the positive market momentum.

First, the release of the AI-driven chat software application DeepSeek by a Chinese software firm shocked Silicon Valley. The app which was deemed competitive with our own ChatGPT was reputedly developed for a fraction of the cost. This cast a major cloud over the entire technology sector as it brought into question the plans to invest billions and billions into US data centers.

Next, the market began to realize that the Administration was serious about implementing tariffs on our major trading partners Mexico, Canada and China as a means to implement policy objectives (reducing illegal Fentanyl & immigration) as well as level the trading playing field. Uncertainty about exactly when and how large these tariffs would be, and how many other countries would ultimately be included, and their implementation timeframe began to weigh on consumer and business confidence.

And lastly, the economic data based on consumer or business surveys began to show weakening forward expectations. Combined with slightly softer hard data on retail sales, inflation data that was slightly high, and a mediocre jobs report people began raising their risks of either a recession or stagflation later in the year.

So, what REALLY happened to change the positive start to such a sour outlook? In our opinion, it was a combination of all these factors. Tariff policy has been a little unclear so far, and some specifics will most certainly help both business leaders and market participants. And while there's been some weaker-than-expected economic data this quarter, we suspect this is partially attributable to one-off events like the LA Fires and the harsh winter weather across much of the nation. Combine this with a flight from the big cap tech market leaders driven by doubts over the Artificial Intelligence story, and by late March markets were in correction territory with the indexes down over 10% from their February highs.

Earnings for Q4 2024 came in much better than expected, with year-over-year growth of 17.1% for the S&P 500 versus expectations of 9.5% heading into the reporting season. Corporate guidance was a mixed bag, especially as the quarter progressed. As the tariff related noise level rose, CEOs increasingly cited the difficulty in providing accurate estimates for the coming quarters.

Interest rates, which were a major concern at the start of the year, have actually dropped recently with the 10-year Treasury rate falling well below 4.5%. And although the Federal Reserve has opted to hold the overnight rate steady for now, Chairman Powell made it clear in their last post-meeting press conference that there's room for further rate cuts should the economy show signs of faltering.

### **One Thing's for Certain**

While we would not pretend to have more insight than anyone else into exactly how the Tariff Saga will ultimately unfold, one thing that do feel confident in saying is that in the coming months most – if not all – of this “uncertainty” will be behind us. Our best guess is that we will go through a period of preliminary tariffs, followed by retaliatory tariffs, negotiations and ultimately compromise. It's important to remember that the Administration's primary tariff goal is to promote domestic production, not throw us into a recession.

GDP will likely show decelerating growth in Q1 and Q2 as we expect that both consumers and corporate business leaders pare back their spending while waiting to see how the situation unfolds. However, given the underlying strength of the job market we don't see consumer spending falling to recessionary levels. Unemployment data may trend upwards as government job cuts start to show in the monthly data but should remain at historically low levels. Interest rates could trend higher, as the inflationary aspects of tariffs may keep inflation stubbornly above the Federal Reserve's 2% target, but should stay within a historically low range.

Equity markets will likely remain volatile in the near term, with the upcoming Q1 earnings season featuring plenty of “uncertainty” comments from corporate management. But as we move into the summer, the focus hopefully will shift from tariffs to tax cuts, helping to bolster both sentiment and equity markets. Earnings expectations have come down from low double-digits to high single-digit growth for 2025, but that is still indicative of a positive market full-year return.

Unlike the last two years, where market gains have been concentrated in a handful of large cap technology companies, we expect gains to be more evenly distributed in 2025. We favor Financials and Industrial companies that will benefit from a favorable regulatory environment and onshoring initiatives. And although we have trimmed back our exposure to the technology sector, we still believe in the secular benefits of Artificial Intelligence over the coming years. We also have increased our allocation to International Equities, as recent political/structural changes have improved the prospects for European and Asian corporations.

In our Fixed Income, we still prefer to avoid exposure to potentially higher long-term interest rates, sticking with shorter maturity bond funds. And given the historically low level of incremental yield provided by Bank Loan funds, and the potential downside should recession fears rise, we have moved out of those markets. Although recession is not our base case, it's always important to balance the ratio of risk and return.

Of course, as always, we are mindful that conditions can change rapidly, perhaps even now more than ever. However, it's always important to focus on your long-term objectives and resist the urge to overreact to day-to-day events. That's why we focus on maintaining diversified portfolios meant to hold up under a variety of scenarios.

It's my great pleasure to serve you and your loved ones in helping you attain your financial goals.

**Best regards,**

A handwritten signature in black ink that reads "Donald E. Garcia". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Donald E. Garcia

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