FLAGSTONE

FINANCIAL ADVISORS, INC.

MARKET REVIEW
FIRST QUARTER 2025

What Happened:
2023 and 2024 were terrific years for investors with the S&P 500 Index up over 50% over that time span. The move up was propelled largely by enthusiasm for artificial intelligence. In fact, many large technology stocks including five of the Magnificent Seven, more than doubled in price over those two years. Everyone loves a rally, but many of those high-flying stocks rose too far and too fast, making them vulnerable to a correction (drop of 10% or more). Indeed, stock prices fell as nervous investors fretted over the new administration and the many changes to economic policies and agendas. It will take a while to see how these new policies play out, but in the meantime, uncertainty rules the day and investors are uneasy. Surprisingly, despite the heightened uncertainty, the broader S&P 500 Index fell by only 4.3% in the first quarter. The tech-heavy Nasdaq Composite index, however, went into correction mode, down 10.3%. What's more, some of the Magnificent Seven stocks are down more than 20% from their all-time highs.

On the brighter side, international stocks had an impressive rebound in 2025. Returns for the first quarter were 6.9%, beating US stock returns by over 11%. Bonds also had a nice showing with year-to-date gains of 2.8%.

First Quarter 2025 Performance:

S&P 500 Index (large stocks)	(4.3%)
Russell 2000 Index (small stocks)	(9.5%)
MSCI EAFE Index (international stocks)	6.9%
Bloomberg U.S. Aggregate Bond Index (bonds)	2.8%

Prognosis:
There are several key economic indicators that give us clues about the health of the economy and the likely future direction of the markets. Our favorite barometer is corporate earnings. Consensus earnings estimates for 2025 have been lowered from 12.8% to 9.0% due to the weakening of consumer demand and the uncertain effects of tariffs. However, given that stock prices have fallen recently, current valuations are attractive enough to counter the modest decline in earnings estimates. What's more, lower interest rates and tame inflation data also support stock advancement going forward.

Another key indicator we closely monitor is investor sentiment. Currently, investors are negative to an extent not seen since October 2022. This largely explains why there is a record amount of cash, $7.1 trillion, sitting on the sidelines. People are troubled by the negative headlines of geopolitical conflicts abroad, uncertainty over tariffs, constant political discourse in Washington D.C., and fear of inflation. The wall of worry is high. The good news is that history has proven that when investor sentiment sinks this low, it has always been a good time to be invested—bearishness is bullish. Just as the market did in October 2022, it will recover strongly and swiftly. Since our clients are fully invested, we are poised to ride the market upward as prices recover. As sentiment improves, we'll also see much of the $7.1 trillion of sideline money enter the market which will further fuel the rally.

Wishing you all a wonderful spring season!

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