Wespath

Investment Services Driven by Your Mission

A Message from Chief Investment Officer
Johara Farhadieh

Welcome! Thank you for your interest in Wespath's[1] quarterly letter for institutional investors. It's been a busy start to 2025—both here at Wespath and throughout global financial markets.

Abroad, investors showed fresh optimism around the prospects for major markets like Germany and China. In the U.S., investors have contended with a pullback in stocks, particularly in the Magnificent 7 companies that have captured so much attention in recent years.

At Wespath, we've been hard at work seeking to ensure our funds remain well-suited to support the missions of our nonprofit clients into the future. A notable emphasis this quarter was the efforts of our Client Asset Allocation Committee—the team within Wespath that helps develop custom client portfolios based on the unique needs and objectives of the organizations we serve.

You'll hear more about this Committee—and all the latest market headlines—in this quarter's letter. We also share more on recent tariff news, including the back-and-forth tariff discussions witnessed in Q1. This theme intensified significantly this week following the Trump administration's April 2 announcements of tariffs on virtually all U.S. trade partners.

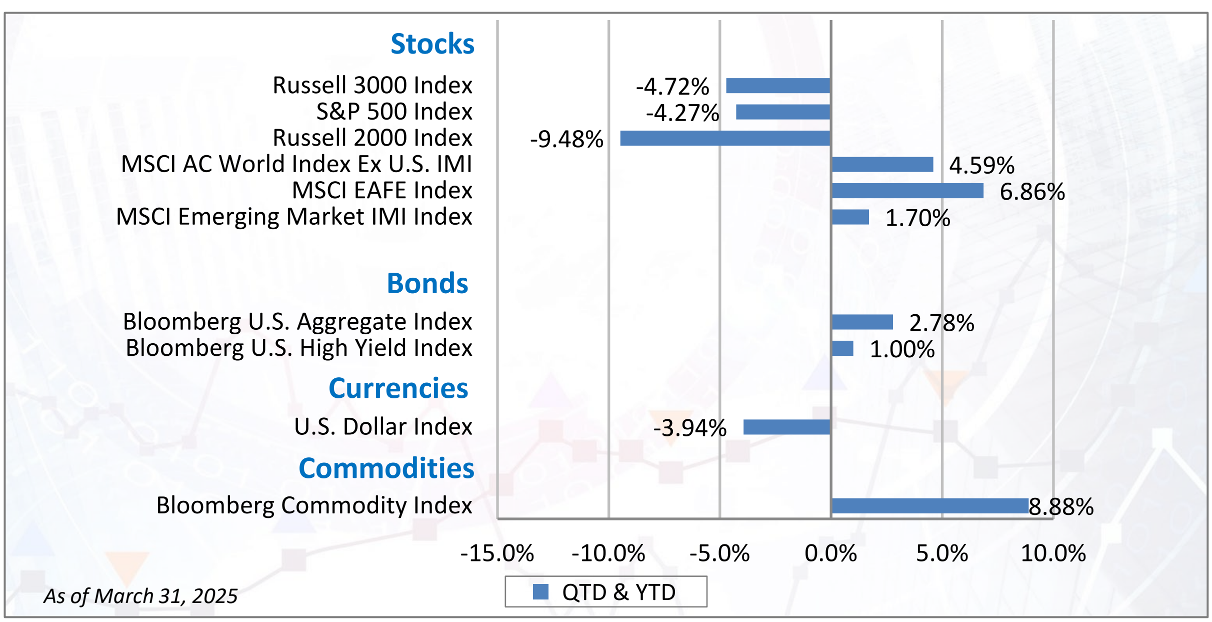
This news has underscored that we're in a unique, rapidly changing environment—a reality our team will continue to reflect and share insights on as the dust settles and we get a clearer picture of the impacts on markets and the economy. As we describe below, market pullbacks are normal. And even in these times of uncertainty, it's sticking to our philosophy and process that's truly important. I continue to have conviction that our approach, which emphasizes diversification, thoughtful rebalancing and a long-term mindset, will support our investors through periods like we are experiencing now.

I hope you enjoy this quarter's letter!

[1] *This letter is intended for institutional investor audiences. Wespath Benefits and Investments ("Wespath") is a general agency of The United Methodist Church, a 501(c)(3) tax-exempt organization. Wespath administers benefit plans and together with its subsidiaries, UMC Benefit Board, Inc. ("UMCBB") and Wespath Institutional Investments, LLC ("WII"), invests (or provides back-office services for) assets on behalf of benefit plan participants and beneficiaries, plan sponsors and other institutions controlled by, associated with or related to The United Methodist Church. The P Series funds are managed by UMCBB, and the I Series funds are managed by WII. As part of the Wespath organization, the WII and UMCBB utilize certain shared personnel, including investment professionals. The shared personnel relationship is governed by the terms of a Dual Employee Agreement entered into by and among Wespath, WII and UMCBB.*

Key Takeaways from Q1

- **GDP:** U.S. GDP growth for the first quarter is estimated at -2.8%, per the Atlanta Fed's GDPNow forecast. This represents a dramatic decline from a forecast of +3.9% as recently as February 3—a negative adjustment not seen since early 2022.
- **Inflation:** U.S. Consumer Price Index (CPI) inflation fell to 2.8% year over year in February, down from 3.0% in January. Measured by the Personal Consumption Expenditures (PCE) Index, inflation was also 2.8%, slightly higher than expected.
- **Jobs:** U.S. unemployment for February was 4.1%, up from 4.0% in January. While this is just 0.2% higher than 12 months ago, expectations are for a continued cooling of the labor market.
- **The Fed:** The U.S. Federal Reserve (Fed) kept rates unchanged at 4.25% – 4.5% in March but warned of a softer U.S. economy amid uncertainty on policy. The markets are pricing in a 4% Fed funds rate for the end of 2025.
- **Stocks:** The S&P 500 fell 4.3% for the quarter, the worst performance in nearly three years, while the tech-heavy Nasdaq fell 10.3%. In international stock markets, the MSCI ACWI ex-U.S. IMI gained 4.6% and the MSCI Emerging Markets IMI gained 1.7% in Q1.
- **Bonds:** The sharp downward revision in GDP growth expectations drove the 10-year Treasury yield down 36 basis points to 4.21%, reflecting growing concerns about economic weakness.



Discipline During Downturns

The markets have reminded us once again that the path to long-term returns is rarely smooth. From mid-February to mid-March, we have witnessed a correction, with the Magnificent 7 technology stocks declining by approximately 15% and the broader S&P 500 pulling back around 10% from its peak.

Downturns naturally create discomfort, and our inner emotions tell us to "do something." But the drawdown in Q1 was actually well within historical norms. Since 1928, corrections of 10% have occurred about once per year on average, and this is now the 24th year since 1980 with at least one correction during the year.[1] What we experienced in Q1 was an example of the market functioning as it typically does.

This current correction follows an impressive two-year run where the S&P 500 delivered consecutive annual returns exceeding 20%. It's worth remembering that markets can indeed fall substantially; twice since 2000, equities have lost approximately half their value, and as recently as 2022, we saw a nearly 20% decline.

We are also witnessing a notable rotation in market leadership. The Magnificent 7 stocks that previously dominated performance have stumbled, while international markets (particularly Europe) and value-oriented sectors have shown relative strength. This suggests a shift from the concentrated growth story to a more balanced global economic narrative.

These periodic corrections, while uncomfortable, represent the path investors often take to achieve long-term returns. It's maintaining composure during the downside periods that separates successful long-term investors from those who get whipsawed by short-term volatility.

Remember: investing is ultimately about maintaining a clear perspective through market cycles. We continue to focus on optimizing risk-adjusted returns through diversification and disciplined rebalancing, recognizing that drawdowns are normal and always uncomfortable. However, markets have consistently recovered, often leading to new opportunities for growth and prosperity.

[1] https://www.carsongroup.com/insights/blog/houston-we-have-a-correction-now-what/

Trump Administration Trade & Policies

Throughout the quarter, the markets contended with concerns surrounding the Trump administration's trade policies. Additional tariff plans announced on April 2 only heightened those concerns.

The administration believes tariffs can increase federal revenues, inspire American companies to produce more goods domestically, and provide the U.S. more leverage in international negotiations. Others are concerned tariffs will exacerbate inflation, push the U.S. into a recession, and lead to more diplomatic disputes and the formation of more regional alliances that could weaken America's global influence. Also, the implementation and subsequent pause of tariffs on Canada and Mexico in Q1 created persistent volatility as investors struggled to determine whether these represented tactical negotiation tools or signals of a more fundamental economic restructuring. This uncertainty extended beyond trade to potential changes in immigration policy, budget frameworks, regulatory environments and international relations (also read: **5 Potential Impacts of Tariffs and Trade Policy**).

Additionally, the emerging Trump economic policy appears to be pursuing a delicate balancing act between addressing long-term fiscal concerns and maintaining economic growth. This strategy involves fiscal tightening through spending cuts and government reorganization (i.e., the "DOGE" initiative), which could create economic headwinds as government employees and contractors face uncertainty. However, the administration is also optimistic that cooling inflation and lower bond yields will create space for Fed rate cuts to offset the fiscal drag. This suggests a strategy of accepting near-term market volatility in exchange for what the administration hopes will be a more sustainable economic foundation for the remainder of the presidential term. The potential impacts of the uncertain tariff environment described above remain a sizeable question mark on whether such a controlled landing can be achieved.

Beyond the Headlines

DeepSeek AI Breakthrough

In late January, the unexpected announcement of DeepSeek's R1 model sent shockwaves through the tech sector. This model reportedly matched OpenAI's performance while costing just $6 million to build. This revelation undermined the previously unstoppable AI infrastructure investment thesis, coming just as Microsoft and Meta had announced massive capex plans of $80 billion and $65 billion, respectively, for 2025 (also read: **How Chinese Startup DeepSeek Rocked the AI Industry—And What It Means for Wespath's Investors**).

Let's consider some historical perspective on this theme: Recall the late 1990s, when a few companies laid enormous lengths of fiberoptic cable in advance of projected internet demand growth. In hindsight, the demand growth developed much as expected over the long term—the internet was one of the most significant technological developments in human history. But as we know from some of the fallout of the Dot-Com bubble, the buildout of fiberoptic was overdone in the short term.

Many of those cables went unlit for years before demand ultimately caught up. Of course, it was too late for companies like WorldCom, Global Crossing and 360networks, each of which filed for bankruptcy. The possibility of a similar outcome in AI infrastructure is a fear for investors and Magnificent 7 companies.

To be clear, there is very little risk of Nvidia, Microsoft, Meta and their peers going bankrupt anytime soon. These are strong companies with significant moats, healthy margins and sizeable cash piles. But a little historical perspective reminds us that corporate technology development *can* outpace demand, and that risk could continue to cause volatility for the Magnificent 7, where investor expectations remain very high.

International Stocks Gain Ground on U.S.

Coming off several years of pronounced dominance by U.S. stocks, international equity markets witnessed a strong start to 2025 relative to their American counterparts. The DeepSeek story and the potential for non-Magnificent 7 competition to emerge is a relevant factor. Also of note were economic stimulus plans from both China and Germany. More specifically, China's parliament pledged to bolster its economy against rising U.S. tariffs and deflationary pressures, while Germany's new ruling party announced plans for significant infrastructure spending, greater defense spending and flexibility to allow local governments to run budget deficits. These plans sparked optimism that fiscal stimulus could inject fresh momentum in Chinese and European markets.

About Wespath's Client Asset Allocation Committee

In last quarter's letter, we highlighted Wespath's process for selecting asset managers and constructing investment funds. Today, we want to highlight the team who helps integrate those funds within customized and tailored portfolios for clients!

This work is led by our *Client Asset Allocation Committee*. Alongside our Institutional Investment Services (IIS) team, this Committee works to understand each client's return objectives, risk tolerance, the purpose of their assets, and their spending and liquidity needs. From there, the Committee:

- Uses capital market assumptions to develop strategic asset allocations that balance growth and stability while supporting diversification across asset classes
- Conducts extensive analysis to estimate expected returns, volatility and drawdowns over multiple time horizons
- Supports investment policy statement (IPS) drafting and revision to align with proposed allocations
- Diligently monitors client portfolios and IPS compliance—and seeks to be responsive and adaptive as organizations and their missions evolve

This Committee consists of the CIO, Senior Managing Director of Institutional Investment Services, Managing Director of Investment Management, Managing Director of Sustainable Investment Strategies, Director of Private Markets and Director of Investment Research, who chairs the Committee. For Wespath, constructing client asset allocations is a deeply collaborative process involving diverse perspectives to help ensure we get a complete picture of clients and their needs.

"One of the most rewarding parts of this work is getting to know the people at each organization and the mission they are working towards. I'm grateful to work alongside our IIS team and our clients—learning from them, partnering with them and supporting their missions by providing thoughtful investment strategies that support their long-term financial goals."

Raj Khan
Director of Investment Research & Chair of
Wespath's Client Asset Allocation Committee

Insights from the Wespath Team

Looking ahead

From the impact of tariffs to the state of the AI investing theme, U.S. GDP growth, the pullback in U.S. stocks and the momentum of international stocks, investors face plenty of uncertainties right now. At Wespath, we'll be keeping a close eye on the impact these and other themes may have on our funds and investors:

- **U.S. Policy Environment:** The new administration brings a fundamentally different approach to both fiscal and monetary policy. The $37 trillion national debt is in focus, and the administration's trade policy has created more questions than answers. And despite some economic cooling, lower interest rates may not arrive until inflation comes down further.

- **Domestic Markets:** In our Q4 letter, we mentioned the potential for earnings growth among non-Magnificent 7 companies, including small- and mid-cap U.S. stocks, to outpace the Magnificent 7 this year. Sharply lower U.S. GDP forecasts and uncertain policy environments create unknowns for all U.S. stocks, including the Magnificent 7 and smaller companies. But if the economy can remain resilient, a broadening of the rally beyond the Magnificent 7 to include the other 493 companies in the S&P 500—and beyond—could still be in the cards.

- **Global Rotation:** International markets present compelling opportunities. Europe, with its cheaper valuations and increased fiscal spending, and China, with the potential upside of government stimulus, highlight some of the interesting narratives outside the U.S.

As we alluded to earlier, the key to navigating this environment will be maintaining perspective while implementing thoughtful diversification throughout these—and future—periods of uncertainty.