



## 1<sup>st</sup> Quarter North American Market Commentary – 2025

### Key Take-aways:

- U.S. March Headline CPI slowed by 50 basis points from December, reaching a Y/Y increase of 2.39%. Meanwhile, Core CPI decreased to 2.79% from December's 3.24% Y/Y. Despite this moderation, inflation continues to exceed the FED's target of 2% consistently. FED's credibility remains under scrutiny.
- The U.S. economy is estimated to have grown at an annualized rate of 2.4% in Q4 2024, down from 3.1% in Q3 2024. Meanwhile, the official unemployment rate increased to 4.3%, compared to 4.1% at the start of 2025 and a historical average of 5.7%. Although the unemployment rate remains relatively low, the upward trend indicates a gradual softening in labor market conditions.
- The FED has maintained interest rates steady across two consecutive FOMC meetings. The next FOMC decision on interest rates is scheduled for May 7. Meanwhile, the Bank of Canada continued cutting rates an additional 75 basis points in Q1 2025.
- As of March 31<sup>st</sup>, the S&P 500 was down 4.59% YTD. In the first week of April, the index plunged an additional 9.1%, driven by market repricing following President Trump's April 2<sup>nd</sup> tariff announcements. Cross-asset volatility, spanning currencies, fixed income, high yield, and treasuries, has shown some instability.

### Positioning:

- The CBOE Volatility Index (VIX) has more than doubled to 47, its highest level since the 2020 pandemic related shutdowns. The VIX began 2025 at 11 and the historical average is 19.5. Finding order in the markets and economy hasn't been easy.
- In Q1 2025, GDP growth for both the U.S. and Canada remains subdued due to ongoing uncertainties surrounding global trade. A deeper-than-anticipated economic slowdown appears increasingly likely. Paradoxically, this sharper contraction may pave the way for a stronger rebound later in the year.
- Tariffs typically have a short-term inflationary effect. The widening spread between U.S. 10YR and 2YR yields suggests potential further economic slowing and may indicate anticipated easing by the FED.
- Markets continue to be preoccupied with concerns over tariffs, reported CPI figures, labor market health, and the implications for the FED's potential rate-cutting cycle. A global trade war combined with fiscal tightening does not bode well for short-term economic growth. Initially, we anticipate a modest slowdown before expecting growth and inflation to start accelerating. In this environment, prioritizing smaller position sizes and robust risk management, focusing on investable volatility, is crucial.



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In the U.S., the March Headline CPI was reported at 2.39% year-over-year, down from 3.48% previously and 50 basis points lower than in December 2024. The primary factor behind this deceleration in March was core services excluding shelter, particularly transportation. Categories such as airfare, hotels, and car rentals showed deflationary trends, indicating that consumers are reducing their spending on discretionary services. Additionally, the shelter sector continued to cool, with rent growth slowing by 25 basis points. Energy also contributed to the decline, with year-over-year inflation decreasing by 3.25%. Recall, Headline CPI measures the total change in the cost of all goods and services purchased by households. This includes all categories, such as food, energy, housing, apparel, transportation, medical care, recreation, education, and other goods and services. In contrast, reported Core CPI excludes food and energy prices and includes all other categories, such as housing, apparel, transportation (excluding fuel), medical care, recreation, education, and other goods and services. Core CPI is often used by policymakers, like central banks, to gauge underlying inflation trends and to make decisions about monetary policy. It is considered, by them, to be an appropriate measure for setting interest rates because it is less affected by transitory price shocks, such as weather conditions and geopolitical events. We argue that their choice of CPI measure makes the extent of price increases

and currency debasement less obvious. The Core CPI was reported at 2.79% year-over-year, down from 3.80% previously. Tariffs typically have a short-term inflationary effect. Combining the delayed impact of tariffs with the easing base effects expected in the second half of 2025, inflationary pressures are likely to increase within core goods throughout the year. Despite various conflicting factors, we anticipate that these dynamics will initially lead to disinflation through at least April, before setting the stage for a potential reacceleration of inflation in May and June.

In March 2025, Canada's Headline CPI rose 2.1% year-over-year, while economic growth remained subdued, with Q4 2024 GDP at 0.8%, falling short of forecasts, and Q1 2025 showing similar sluggishness. The unemployment rate climbed to 7.0% in February 2025. On March 12, the Bank of Canada reduced its benchmark interest rate by 25 basis points for the second time this year, lowering it to 3.0%. This widening interest rate gap has favored the U.S. dollar, leading to a 5.8% depreciation of the Canadian dollar against the U.S. dollar during the quarter. Concerns over potential U.S. tariffs on Canadian exports under President Trump's administration, coupled with domestic policy uncertainty, have further clouded the economic outlook. Currency valuation continues to be influenced by fiscal discipline, monetary policy, and economic fundamentals such as productivity and GDP growth—areas where Canada faces



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persistent challenges. Weak leadership, sluggish productivity, and significant deficits remain key issues weighing on the economy. Until these structural problems are addressed, the outlook for the Canadian dollar remains weak.

Inflation is often attributed to expansive monetary policies and the printing of money. Since 1999, the U.S. money supply has grown at an annual rate of 6.26%. The extent of currency debasement globally since 1999 is remarkable. While the U.S. has seen a 78% debasement of the dollar, averaging 6.26% annually since 1999, it is not the most extreme case. Canada has experienced an even greater erosion, with an 81.5% reduction in purchasing power and a 7.1% annual increase in its money supply since 1999. Theoretically, if governments were not prioritizing short-term political gains over long-term fiscal responsibility, we might not be facing the challenge of historically high inflation levels. Governments worldwide are collectively devaluing fiat currencies, thereby diminishing their purchasing power. Given that this trend is likely to continue, with nations persisting in printing money and devaluing their currencies, it is unsurprising that individuals and corporations are increasingly seeking refuge in assets like gold, bitcoin, and real estate.

Cumulative inflation reflects the total percentage increase in prices over a period, accounting for compounding effects. In the U.S., cumulative inflation since 1999 now

approximates 89.45%. This means that today's prices are 1.8945 times as high as average prices since 1999. In Canada, cumulative inflation since 1999 is 74.26%. This means that today's prices are 1.7426 times as high as average prices since 1999. Inflation is a regressive tax, impacting households regardless of income, yet doing so with varying degrees of relative magnitude, is gradual and cumulative. As such, disinflation from record-high price levels offers little relief. Costs are not deflating; they are simply inflating less. Inflation for each person is individualized and cumulative. Real inflation simply means the destruction of the purchasing power of the currency. Inflation remains a huge concern in the real world. Consumers are not focused on what Wall Street is focused on which is the rate of change from M/M, Q/Q, Y/Y or the different categories. They are focused on the level of inflation on 'needs' and 'wants' and how things are drastically more expensive. The level of arrogance out of the FED, Washinton, Ottawa and the Bank of Canada is at all time highs (rising money supply and ridiculous deficit spending leads to persistent inflation prints). The point is underlying inflation has remained elevated and the cumulative decline in purchasing power of US and CDN dollars remains a major concern for consumers and investors.

Looking ahead, the prospects for U.S. inflation to return to the FED's 2% annual target appear uncertain. The FED may face



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challenges due to its lack of discipline, as inflation could reaccelerate, driven by tariff impacts and money supply growth. Higher tariffs are likely to push inflation upward as companies pass increased costs onto consumers, while trade disruptions could exacerbate persistent inflation through reduced production efficiency and higher intermediate goods costs. Although governments and central banks often attribute inflationary pressures to external factors like tariffs, informed market participants recognize that long-term inflation stems from expansive monetary policies and excessive money printing. Policymakers have yet to fully acknowledge their role in fueling inflation through fiscal and monetary decisions. In this environment, focusing on cumulative inflation trends, GDP performance, and monetary policy remains critical for guiding investment strategies and adjusting portfolio positions. Data consistently suggests that inflation will continue to deviate from the FED's 2% target, prompting the bond market to price in a lower likelihood of future rate cuts. Federal Reserve Chair Jerome Powell has signaled caution in making immediate policy changes due to economic uncertainties, particularly those stemming from tariffs. While tariffs may temporarily inflate prices and slow growth, the FED is taking a measured approach until the full economic impact becomes clear.

The proposed tariff rates are likely a ceiling, with several countries expected to enter bilateral negotiations. On April 9, President Trump announced a 90-day pause on reciprocal tariffs for most countries except China, which saw its tariff rate rise from 104% to 125%. Additional exemptions on April 12 for products like smartphones, computers, semiconductors, and solar panels provided relief for major tech companies. These moves indicate that market volatility and bond market pressures may have influenced the administration's decisions. The revised plan now includes a 10% baseline tariff on all imports, a 25% tariff on foreign auto imports, 25% on steel and aluminum and elevated tariffs on Chinese goods.

While these developments offer some de-risking opportunities and could lead to favorable trade deals over the next 90 days or longer if extensions continue, the threat of a global trade war remains a significant concern for risk assets and the bond market. A worst-case scenario would involve stalled negotiations and a return to aggressive tactics by President Trump, likely triggering a deeper recession comparable to the economic downturn during COVID-19 lockdowns. Such an outcome would necessitate historic monetary and fiscal interventions. This is not the time to hold a strong bias in either direction, particularly given the inconsistent news flow about tariffs.



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In the short term, the administration's fluctuating tariff policies have created substantial market turbulence. Beyond realigning global trade, the administration appears to be leveraging potential tariff revenues to justify a larger tax cut plan ahead of the midterm elections. Looking further ahead to 2026, extending Trump-era tax cuts could offset some economic drag. Ultimately, President Trump aims to secure these tax cuts before the midterms as part of his broader economic strategy.

Markets should be recognized for their complexity, dynamism, and unpredictability, with volatility fluctuating and often behaving unexpectedly over time. Risk is ever-present, even when it is not immediately visible. The sharp market drawdown on April 3<sup>rd</sup> exemplified the instability of a market, dominated by the 'Magnificent 7' concentration risk and increasingly influenced by mechanical processes. While President Trump's tariffs exceeded expectations and played a fundamental role in the decline, the S&P 500 was already in a structurally unstable regime. This instability was exacerbated as mechanical and non-discretionary funds were forced to deleverage during the selloff. Dealers were caught in a negative gamma structure, creating an environment where option dealers had to hedge their delta exposure in the same direction as market movements—buying futures as markets rose and selling futures as they fell. These mechanical hedging flows amplified asset price

movements, driving volatility higher regardless of fundamental or discretionary factors. The CBOE Volatility Index (VIX) surged to 47, its highest level since the 2020 pandemic related shutdowns. It is essential to remember that volatility is bi-directional; sharp declines can be followed by equally sharp rallies as market makers chase momentum in either direction. Despite narrative-driven headlines and fundamental risks, non-discretionary flows have been a significant driver of price instability, leading to larger and more unpredictable intraday swings than fundamentals alone would justify.

Looking ahead, systematic selling pressures may be nearing exhaustion, and sustained volatility would be necessary for these funds to maintain their current selling pace. These non-discretionary flows are driven by algorithms managing risk without regard for sentiment or fundamentals. More than half of the market is influenced by computer algorithms involved in market-making, index replication, or risk management, often independent of changes in fundamentals, news, or prices. While dealer positioning contributes to higher volatility, it does not guarantee its occurrence. This environment remains structurally unstable, and with potential catalysts over the next 90 days—given tariff delays excluding China—it may be prudent to limit excessive risk-taking.

On the other hand, if market volatility subsides, mechanical and non-discretionary



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funds will be compelled to significantly increase their equity exposure, creating a supportive environment for equities. These strategies operate on strict rules, unaffected by trade wars, news, or fundamentals. If realized volatility declines, these funds will automatically purchase equities. While a reduction in volatility presents a favorable setup from a systematic perspective, the increasingly unpredictable political landscape introduces additional risks that are difficult to quantify.

Macroeconomic factors, particularly negotiations around President Trump's tariffs, pose significant risks to equity markets. Immediate threats include spiking inflation, retaliatory tariffs, potential FED rate hikes, and a global recession leading to equity losses. Unless clarity on tariffs emerges, immediate FED rate cuts are unlikely unless the labor market deteriorates significantly. Another threat is the erosion of confidence in U.S. leadership decision-making, especially with major trading partners. A trade war with China could escalate into a financial conflict. Both the U.S. and China have maximized their tariff capabilities, and any delay in counter-tariffs could calm global markets if negotiations are prioritized.

China might be better positioned to withstand economic pressure than the U.S. and is unlikely to back down. If exports to the U.S. continue to weaken, China may need to weaken the yuan to remain competitive with

other Asian exporters. In a constrained U.S. dollar environment, China might sell U.S. Treasuries to raise USD liquidity, introducing risks in the Treasury market. An agreement between these financial superpowers is crucial. In the interim, the FED might need to intervene with emergency Treasury purchases to stabilize the bond market. Capital markets can adjust to both positive and negative news but struggle with true uncertainty. However, if major countries negotiate favorable trade deals and commit investments to the U.S. over the next 90 days or longer, this could lead to a de-risking scenario, which would be bullish for risk assets and Treasury bonds.

Over the past few weeks, finding clarity in the markets and economy has been challenging. The core issue in the U.S. is not the trade deficit with any single country, but rather the persistent aggregate deficit accumulated over decades. This is largely due to Americans' preference for cheaper foreign goods and a low savings rate, facilitated by the continuous printing of U.S. dollars. Initially, we anticipate a modest economic deceleration before expecting growth and inflation to start accelerating. However, tariffs introduce significant uncertainty into our inflation projections, as the long-term policy direction on tariffs remains unclear. If the U.S. broadly implements double-digit tariff increases and other nations retaliate, it could lead to inflationary pressures and reduced demand. Additionally, policy uncertainty poses



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challenges for both businesses and consumers.

The ongoing U.S.-China tariff conflict is unlikely to resolve soon, given escalating tensions and tariffs. A resolution will require rational dialogue and a clear exit strategy, but the timing remains uncertain. The situation is volatile, with potential for further escalation before any de-escalation occurs. On a more positive note, many major countries are likely to negotiate favorable

trade deals and commit investments to the U.S. over the next 90 days or longer, if extensions are granted. This development could lead to a de-risking scenario, which would be bullish for risk assets and Treasury bonds. It is crucial to emphasize that a global trade war poses significant risks to both risk assets and the bond market. We are navigating unprecedented circumstances, and patience continues to be a key component of our investment strategy.

Reciprocal Tariffs		
Country	Tariffs Charged to the U.S.A. including Country's Most Favored Nation and Trade Barriers	U.S.A. Discounted Reciprocal Tariffs
China	67%	34%
European Union	39%	20%
Vietnam	90%	46%
Taiwan	64%	32%
Japan	46%	24%
India	52%	26%
South Korea	50%	25%
Thailand	72%	36%
Switzerland	61%	31%
Indonesia	64%	32%
Malaysia	47%	24%
Cambodia	97%	49%
United Kingdom	10%	10%
South Africa	60%	30%
Brazil	10%	10%
Bangladesh	74%	37%
Singapore	10%	10%
Israel	33%	17%
Philippines	34%	17%
Chile	10%	10%
Australia	10%	10%
Pakistan	58%	29%
Turkey	10%	10%
Sri Lanka	88%	44%
Colombia	10%	10%

Reciprocal Tariffs		
Country	Tariffs Charged to the U.S.A. including Country's Most Favored Nation and Trade Barriers	U.S.A. Discounted Reciprocal Tariffs
Peru	10%	10%
Nicaragua	36%	18%
Norway	30%	15%
Costa Rica	17%	10%
Jordan	40%	20%
Dominican Republic	10%	10%
United Arab Emirates	10%	10%
New Zealand	20%	10%
Argentina	10%	10%
Ecuador	12%	10%
Guatemala	10%	10%
Honduras	10%	10%
Madagascar	93%	47%
Myanmar (Burma)	88%	44%
Tunisia	55%	28%
Kazakhstan	54%	27%
Serbia	74%	37%
Egypt	10%	10%
Saudi Arabia	10%	10%
El Salvador	10%	10%
Côte d'Ivoire	41%	21%
Laos	95%	48%
Botswana	74%	37%
Trinidad and Tobago	12%	10%
Morocco	10%	10%



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*Christopher Panagopoulos, CPA, CA, CFA*

*The Portfolio Management Team*

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