MONTH IN REVIEW

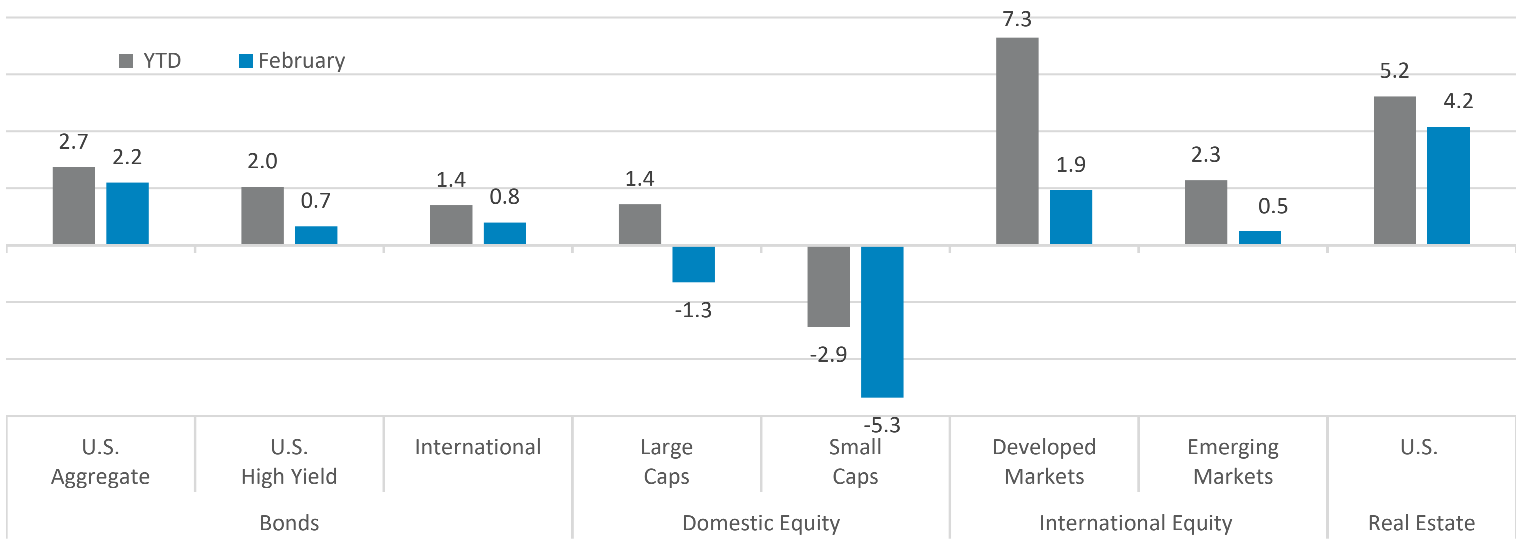
Prime Capital FINANCIAL

Quick Takes

- **Volatile Stocks.** US equity indices fell in February as investors began to reset expectations after earnings season, economic data, and policy changes by the Trump administration. The S&P 500 fell 1.4% while the Nasdaq 100 fell 2.8% in February.
- **Inflation and Interest Rates.** The 10Y treasury yield fell from 4.5% to 4.2% in February as investors sought safety. CPI and PPI inflation accelerated in January while Core PCE inflation fell slightly. Energy, food, transportation, and recreational services drove price increases. Annualized Core CPI inflation was 3.3% for the month.
- **Tariffs.** Trump announced that he would place 25% tariffs on imports from Canada and Mexico and put an additional 10% tariff on China. The tariffs were delayed by 30 days after Mexico and Canada agreed to cooperate with Trump on border security. Later in the month, Trump imposed 25% tariffs on all steel and aluminum imports into the US from all countries.
- **China's Economy.** The launch of DeepSeek's R1 AI model and considerable investment in AI by major Chinese technology companies has increased optimism around China's economy. The Chinese also retaliated against US tariffs with tariffs on US coal and liquified natural gas.

Asset Class Performance

Large caps outperformed small caps in February. US stocks underperformed international stocks, emerging and developed alike as policy uncertainty and headline risks hurt US markets harder. US bonds and real estate and international stocks and bonds rose in February while US stocks fell.



Source: Bloomberg, as of February 4, 2025. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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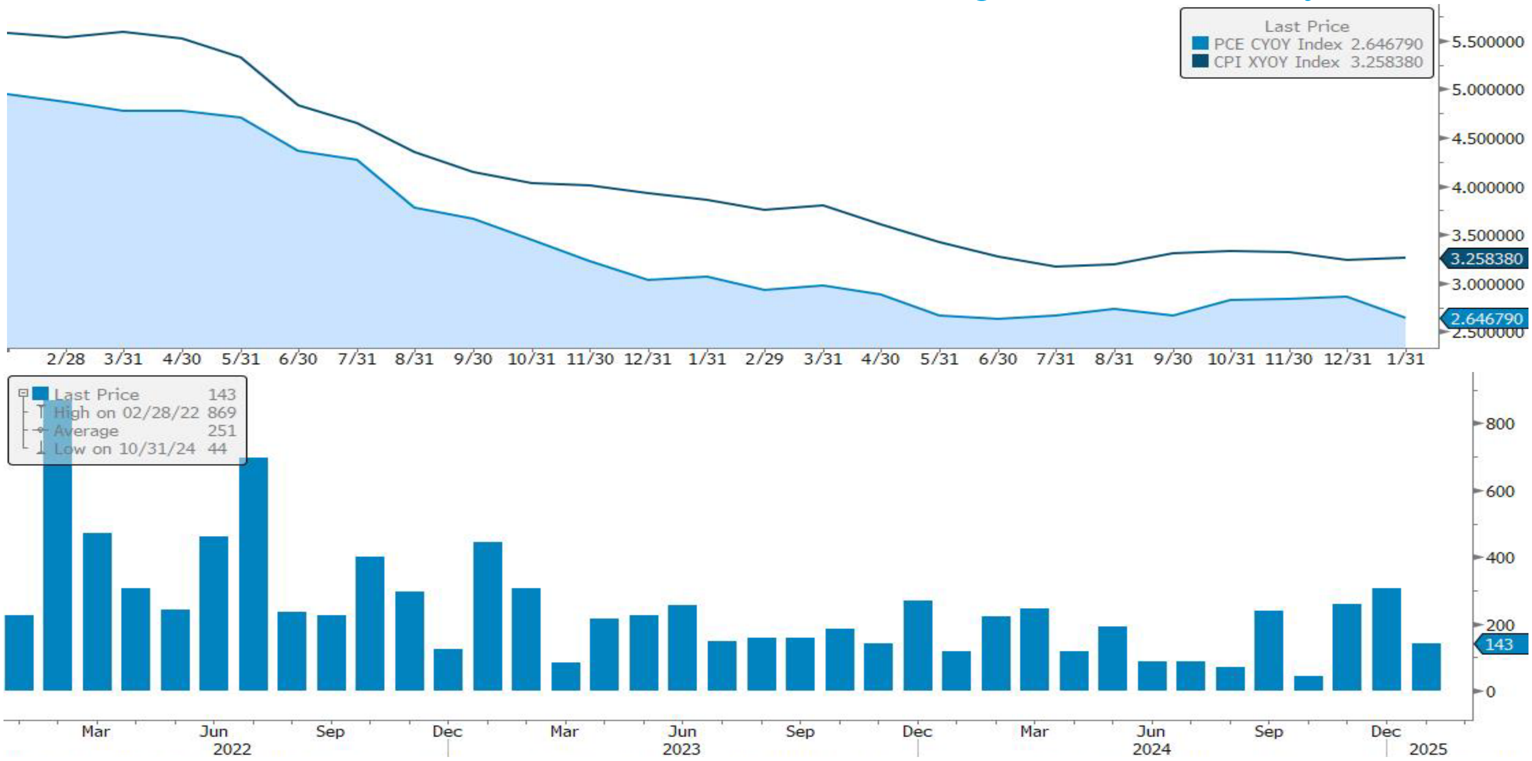
February 2025

Markets & Macroeconomics

Inflation Pressures, Lower Job Growth will Challenge Fed

Core CPI and Core PCE Inflation and Change in Nonfarm Payrolls



Source: Bloomberg, BLS, Bureau of Economic Analysis

New economic data for January indicated higher price inflation and slower job growth than in December, which was a large contributor to investor angst in the stock market during the month. Headline CPI and Core CPI inflation came in ahead of expectations at 3.0% and 3.3% respectively. Headline PPI and Core PPI inflation came in even further ahead of expectations at 3.5% and 3.6% respectively. These data seem to indicate continued challenges with further reduction of inflation back to the Federal Reserve's 2% long-term target. PCE inflation came in more in line with expectations for the month with Core PCE inflation coming in at 2.6% and the headline figure coming in at 2.5%. On the consumer spending side of things, retail sales fell sharply in January by 0.9% from December's level, far more than expected. Retail sales excluding car sales also fell by 0.4% versus expected growth of 0.3%. Personal incomes rose 0.9% during the month of January, ahead of expectations, but personal spending fell more than expected dropping 0.2% during the month. Consumer sentiment indicators for February were below expectations as well. In the housing market, new and existing home sales both fell more than expected in January as stubbornly high mortgage rates and real estate prices hurt demand. In addition to inflationary pressures remaining elevated and consumer spending slowing in some areas, job growth slowed in January to 143K versus December's revised addition of 307K jobs. Despite the lower rate of job growth, unemployment fell and labor force participation rose on the month as unemployment fell in January to 4.0% from 4.1% and the labor force participation rate rose slightly from 62.5% to 62.6%. Wages rose significantly ahead of expectations in January with average hourly earnings increasing 4.1% from a year earlier compared to the forecasted 3.8%. Some trouble could be ahead for labor demand, however, as initial jobless claims came in above forecasted in the last two weeks of the month. The FOMC announces its next rate decision on March 19. Investors are currently expecting a 91% probability of no rate cut in March implying that the Federal Funds target rate will remain at 4.25%-4.50%.

Bottom Line: Inflation remaining elevated and policy uncertainty around immigration and tariffs continue to be barriers to interest rate cuts by the Fed. Uncertainty amid slower job growth, deteriorating consumer sentiment, and falling retail sales in January and February will make the Fed's job even more challenging going forward as it tries to balance inflation reduction with a healthy labor market.

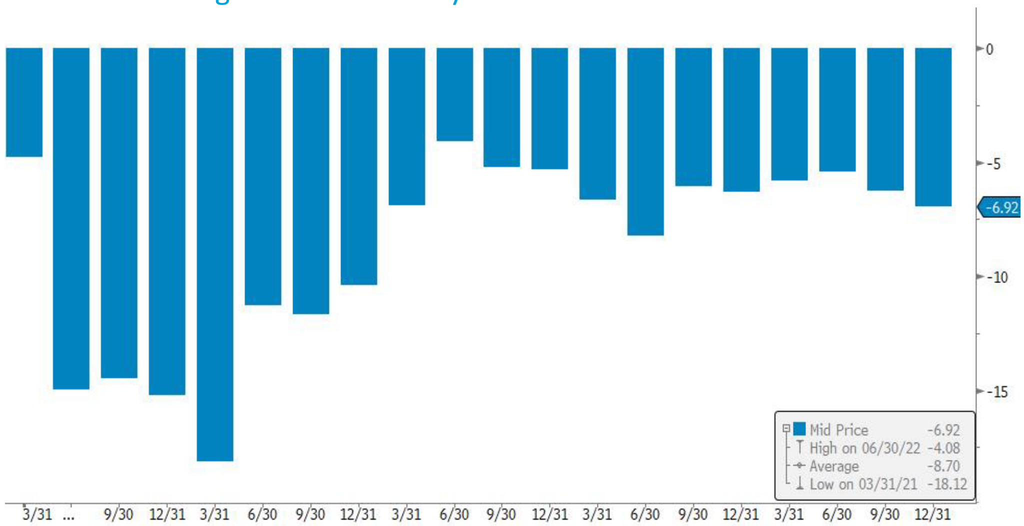
February 2025

What’s Ahead

The Budget, DOGE, and the Economy

US Budget Balance as a % of GDP

The Federal Budget Deficit is nearly 7% of GDP

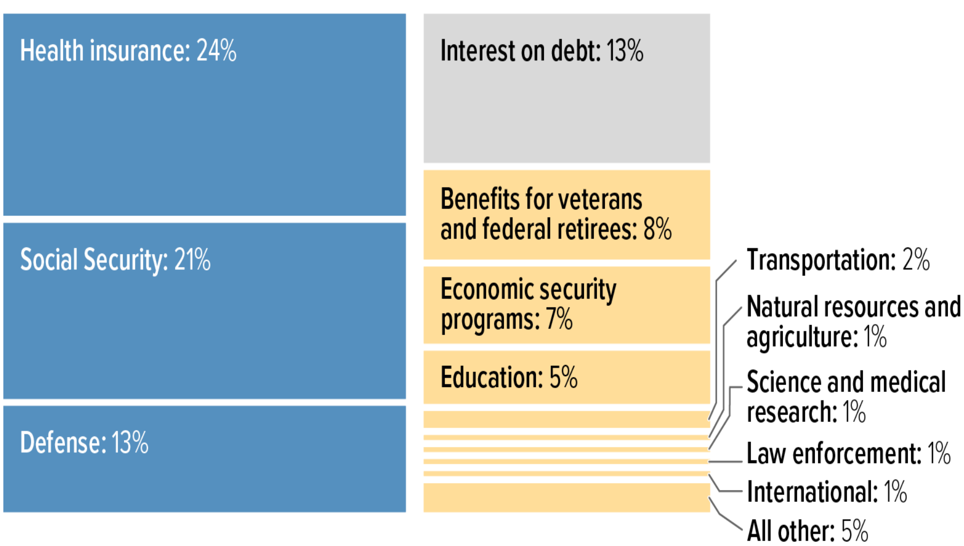


Source: US Census Bureau, Bloomberg

One of the main priorities of President Trump has been to reduce Federal government spending and reduce the budget deficit. With Trump as president and the GOP controlling both the House and Senate, Republicans have an opportunity to do just that. The problem is that the Republicans’ House majority is thin with the current balance being 218-215, just three seats in the GOP’s favor. Additionally, Republicans in Congress are divided on the degree on which to reduce federal spending and the degree to which the Trump Tax Cuts enacted in the 2017 Tax Cuts and Jobs Act should be extended or made permanent. In the first week of February, House Republicans had worked toward a budget deal which attempted to balance the interests of Republican representatives in higher-tax states like New York who wanted to increase the state-and-local-tax (SALT) deduction, a move fiercely opposed by more fiscally conservative Republicans. Days later, Republicans had released a budget plan that would involve a minimum of $1.5Tr in spending cuts over a decade and a maximum of $4.5Tr in tax cuts over the same period as well as an increase in the federal debt limit by $4Tr. The proposal also called for $300B in new spending, likely on defense and immigration enforcement. The $1.5Tr spending cut minimum was below the $2-2.5Tr that the most conservative house members wanted and the $4.5Tr tax cut maximum was below the $5.5Tr needed to extend the 2017 tax cuts permanently. In terms of what federal spending would be cut, $880B of the spending cuts would come from cuts to Medicaid, the health insurance program for low-income people. On the 21st, the Senate managed to pass a Budget resolution which involved $342B in spending on defense and border security over 4 years and spending cuts of the same amount. Much of the budget math, however, depends on higher economic growth from tax cuts, reduced regulation, and higher fossil fuel production. The Republicans are also banking on the newly created Department of Government Efficiency (DOGE) to find more sources of potential spending cuts and room for reducing the federal government’s headcount. Savings from DOGE, run by Tesla CEO Elon Musk, are difficult to pin down given the wide range of numbers from various sources, but the department has laid off tens of thousands of federal workers with many more likely to follow. Despite this, it is unclear that DOGE will be able to materially impact the federal budget deficit.

Federal Government Spending Breakdown FY 2024

Most US Federal Spending goes to Medicare and Medicaid, Social Security, Interest on the Debt, and Defense Spending



Source: Center on Budget and Policy Priorities

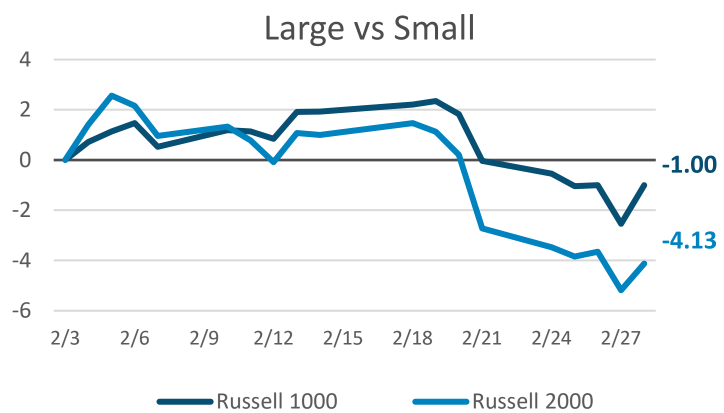
<u>Bottom Line</u>: GOP budget proposals are trying to balance deficit reduction with tax cuts with a great deal of division within the party about how much spending to cut and to what degree to extend the 2017 tax cuts.

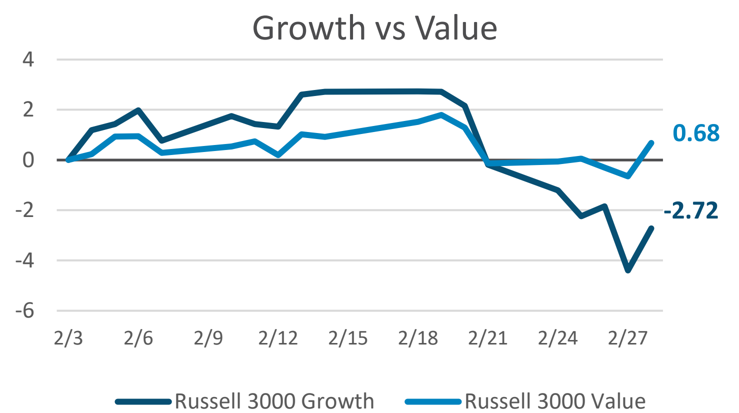
February 2025

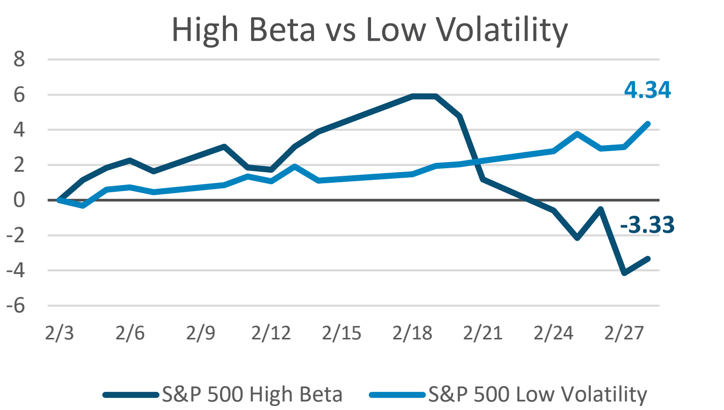
Equity Themes

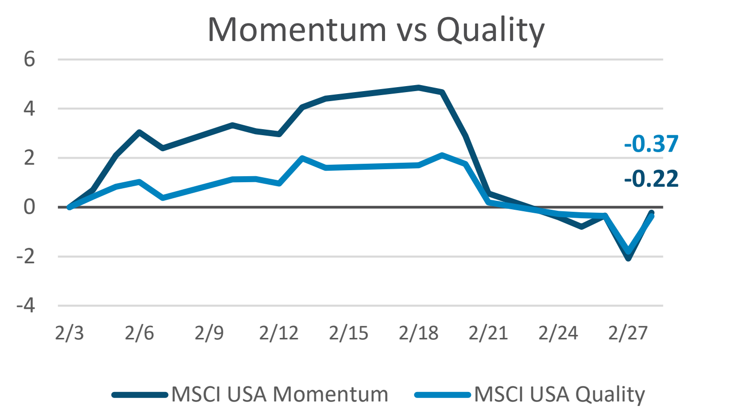
What Worked, What Didn’t

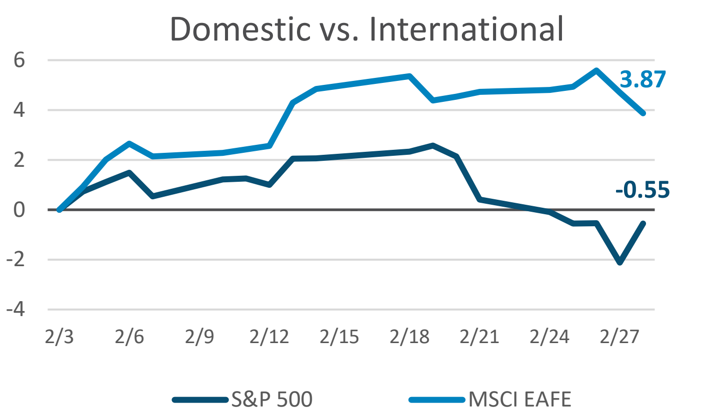
- **Large Outperformed Small while Value Outperformed Growth.** Market participants moved more into large-cap value stocks in February than small-cap or growth as investors continued to look for more defensive investments amid policy uncertainty.
- **Low Vol and Momentum Outperform.** Low Vol significantly outperformed High Beta in February. Momentum outperformed Quality in February, but only narrowly.
- **International Over Domestic, Developed Over Emerging.** International equities outperformed domestic stocks again in February. Developed markets outperformed Emerging Markets by 155bps during the month.

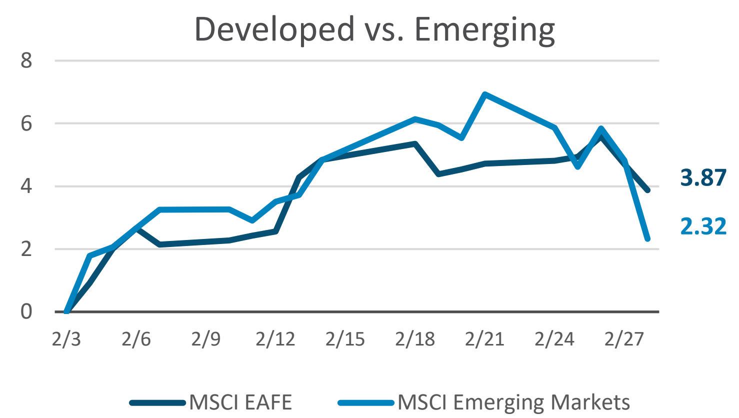












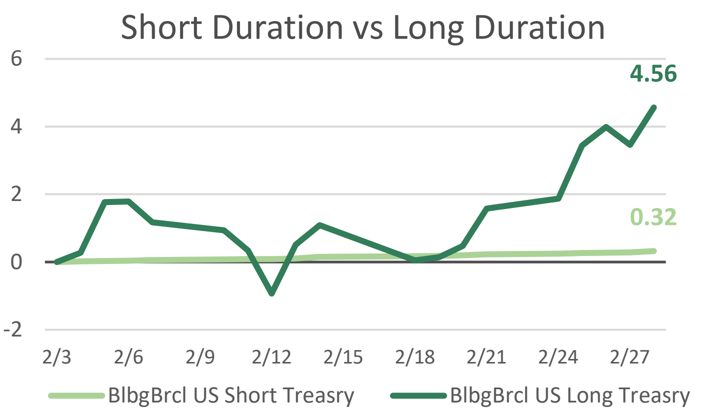
Source: Bloomberg.

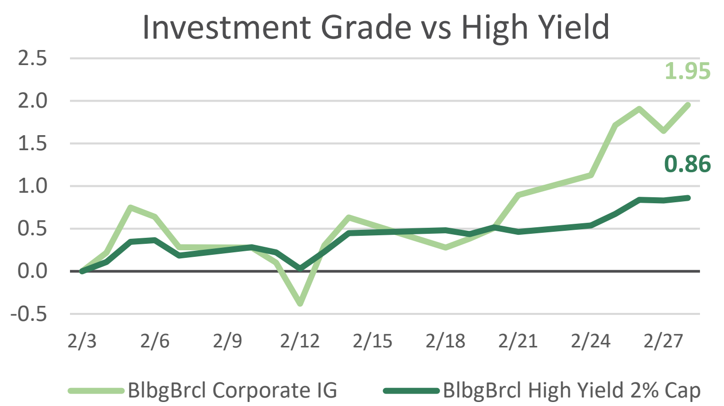
February 2025

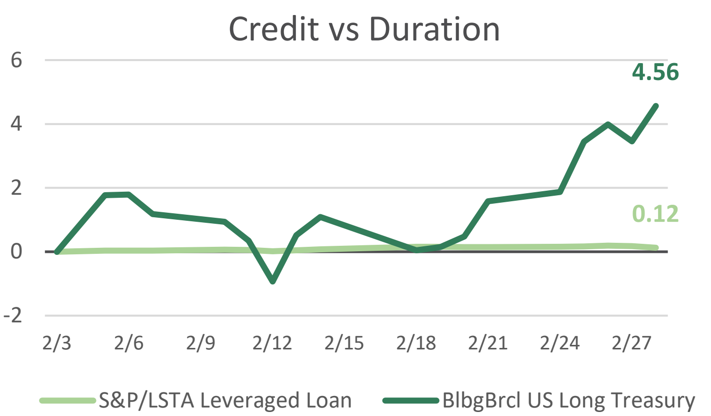
Bond Themes

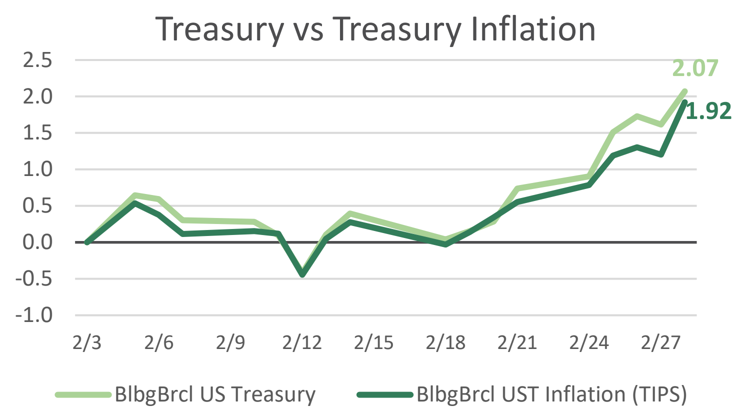
What Worked, What Didn't

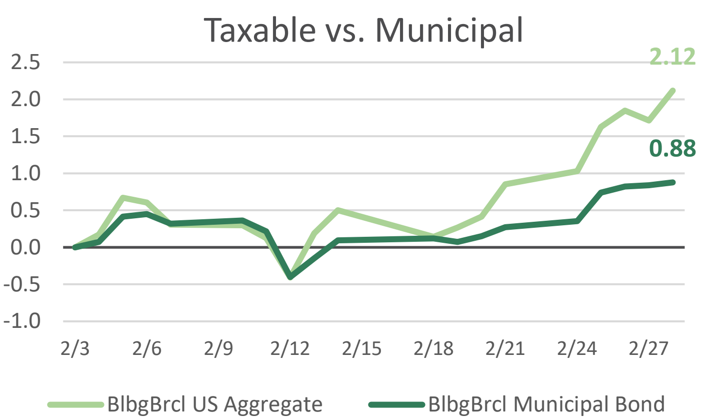
- **Long Duration and High Yield Outperform.** Long Duration Treasuries performed better in February significantly outperforming Short Duration. Investment Grade outperformed in February beating High Yield by 109 bps.
- **Duration Tops Credit while Treasuries Narrowly Beat TIPS.** In February, Duration outperformed Credit while Treasuries and TIPS were near even.
- **Taxable Beat Munis and International Outperforms Domestic.** Taxable Municipal bonds underperformed Taxable Aggregate, while U.S. bonds outperformed their International peers in February.

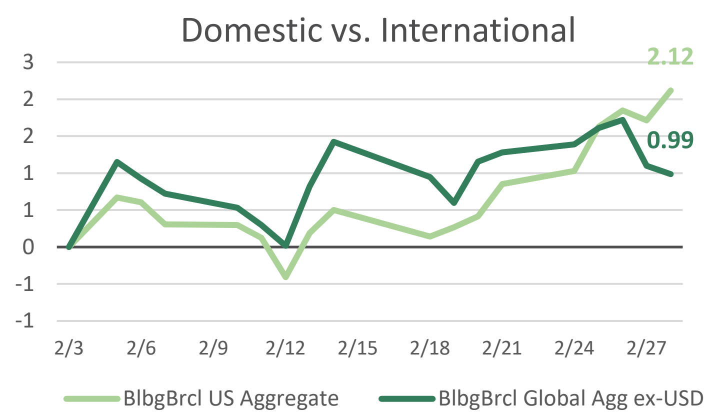












Source: Bloomberg.

February 2025

Asset Class Performance

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Feb-03	Feb-04	Feb-05	Feb-06	Feb-07	Feb-10	Feb-11	Feb-12	Feb-13	Feb-14	Feb-18	Feb-19	Feb-20	Feb-21	Feb-24	Feb-25	Feb-26	Feb-27	Feb-28	Feb	YTD	
High	USB 0.09	EM 1.79	RE 1.51	LCG 0.58	EM -0.09	EM 1.20	IEQ 0.47	EM 0.55	LCG 1.25	EM 0.77	MCG 0.74	LCV 0.30	EM 0.92	USB 0.43	RE 0.35	RE 1.14	EM 0.99	RE 0.42	LCG 1.81	IEQ 4.18	IEQ 7.90	High
	HYB -0.13	MCG 1.44	SCG 1.23	MCG 0.53	MCG -0.17	LCG 1.02	RE 0.42	IEQ 0.37	IEQ 1.21	USB 0.37	IEQ 0.72	USB 0.14	IBD 0.84	IBD 0.10	USB 0.17	IEQ 0.91	MCG 0.61	USB -0.15	LCV 1.35	RE 4.13	RE 5.75	
	RE -0.33	SCV 1.37	SCV 1.00	IEQ 0.48	HYB -0.31	MCG 0.94	IBD 0.26	IBD 0.30	SCG 1.21	IBD 0.35	MCV 0.69	MCV 0.14	RE 0.63	HYB -0.19	HYB 0.13	USB 0.62	SCG 0.39	HYB -0.19	MCG 1.23	USB 2.14	LCV 4.99	
	MCG -0.34	LCG 1.30	IEQ 0.97	EM 0.42	USB -0.32	IEQ 0.68	LCV 0.22	LCG -0.10	SCV 1.00	60/40 0.21	EM 0.63	HYB 0.08	IEQ 0.47	EM -0.29	LCV 0.12	IBD 0.61	LCG 0.37	LCV -0.32	SCG 1.18	EM 1.89	EM 3.32	
	LCV -0.38	SCG 1.20	MCG 0.72	RE 0.24	RE -0.37	SCG 0.46	SCV 0.18	MCG -0.20	MCV 0.99	MCG 0.16	SCG 0.59	RE 0.04	USB 0.15	IEQ -0.62	MCV 0.03	60/40 0.29	USB 0.16	MCV -0.70	MCV 1.16	IBD 1.41	60/40 3.12	
	60/40 -0.51	IEQ 1.16	LCV 0.67	60/40 0.14	MCV -0.53	60/40 0.40	HYB -0.04	60/40 -0.21	MCG 0.92	LCG 0.15	LCV 0.59	LCG 0.04	HYB 0.06	60/40 -0.71	IEQ -0.06	HYB 0.25	60/40 0.15	IBD -0.83	SCV 0.83	60/40 1.17	USB 2.76	
	IBD -0.62	IBD 1.06	MCV 0.59	IBD 0.00	60/40 -0.58	SCV 0.32	60/40 -0.07	HYB -0.21	RE 0.91	IEQ 0.15	RE 0.42	EM -0.16	60/40 0.03	RE -0.73	60/40 -0.23	LCV 0.12	HYB 0.14	60/40 -0.90	RE 0.78	HYB 1.10	HYB 2.34	
	EM -0.73	60/40 0.73	60/40 0.55	LCV -0.01	LCV -0.60	LCV 0.23	USB -0.23	LCV -0.49	IBD 0.91	HYB 0.11	SCV 0.41	60/40 -0.20	MCV -0.45	LCV -1.36	IBD -0.36	SCV 0.11	IEQ 0.13	SCV -0.94	60/40 0.56	LCV 0.81	MCV 1.52	
	MCV -0.78	HYB 0.32	USB 0.53	SCV -0.04	IBD -0.63	HYB 0.20	MCV -0.23	USB -0.52	60/40 0.86	SCV -0.01	60/40 0.16	SCG -0.23	LCV -0.46	MCV -1.73	SCV -0.52	EM 0.07	IBD 0.01	IEQ -1.13	USB 0.45	MCV -1.03	IBD 1.40	
	SCG -0.98	MCV 0.26	HYB 0.26	USB -0.10	IEQ -0.95	RE 0.14	LCG -0.29	SCG -0.55	LCV 0.78	SCG -0.03	LCG -0.01	IBD -0.35	LCG -0.53	SCV -2.22	SCG -0.95	MCV 0.02	SCV -0.17	EM -1.95	HYB 0.28	SCV -2.48	MCG 0.17	
	LCG -1.04	USB 0.19	IBD 0.14	HYB -0.15	SCG -1.11	USB 0.03	EM -0.39	MCV -0.75	EM 0.64	LCV -0.09	HYB -0.09	SCV -0.51	SCV -0.84	LCG -2.27	LCG -1.02	SCG -0.82	MCV -0.24	SCG -2.06	IEQ 0.21	LCG -2.58	LCG -1.74	
	IEQ -1.17	LCV 0.16	LCG 0.05	MCV -0.16	LCG -1.16	MCV 0.02	MCG -1.12	RE -1.04	USB 0.60	MCV -0.11	USB -0.40	IEQ -1.03	SCG -0.96	MCG -3.36	MCG -1.20	LCG -1.00	LCV -0.36	MCG -2.18	IBD -0.08	MCG -5.40	SCV -1.87	
Low	SCV -1.36	RE 0.14	EM -0.25	SCG -0.56	SCV -1.17	IBD -0.18	SCG -1.29	SCV -1.24	HYB 0.45	RE -0.43	IBD -0.73	MCG -1.48	MCG -1.87	SCG -3.60	EM -1.54	MCG -1.10	RE -0.48	LCG -2.65	EM -1.37	SCG -5.85	SCG -3.83	Low

Legend

60/40 Allocation (60/40)	Large Growth (LCG)	Mid Growth (MCG)	Small Growth (SCG)	Intl Equity (IEQ)	U.S. Bonds (USB)
	Large Value (LCV)	Mid Value (MCV)	Small Value (SCV)	Emg Markets (EM)	High Yield Bond (HYB)
	Intl Bonds (IBD)	Real Estate (RE)			

Source: Sources for this market commentary derived from Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Financial. The performance of those funds in February may be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate. 080223006 - MAH