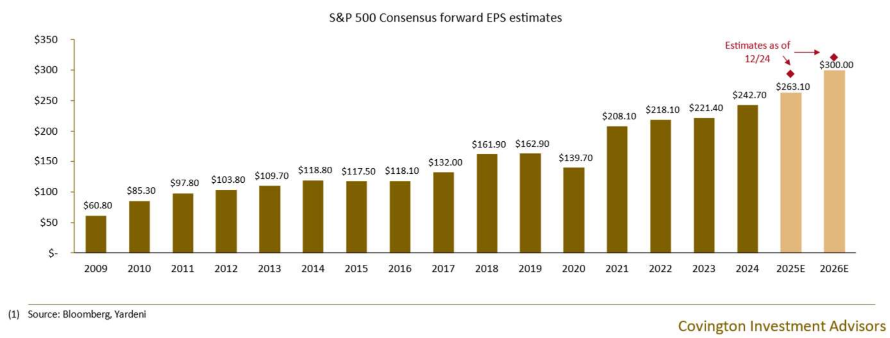
COVINGTON INVESTMENT ADVISORS, INC.
Q1 2025 QUARTERLY NEWSLETTER

2024 was a year of defying expectations. So far 2025 has been a period of recalibrating those expectations. Economic growth for the fourth quarter of 2024 came in strong with US Real GDP Growth of 2.4%. However, markets are forward looking, and a combination of uncertainty and cyclical factors have caused consensus estimates for FY 2025 GDP to be revised down from 2.5% to around 1%. This is still positive, but downward revisions have caused volatility in markets.

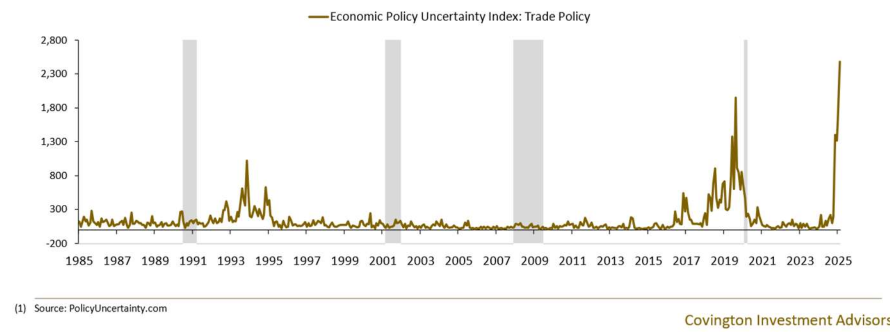
Exhibit 1: S&P 500 EPS estimates are still positive for 2025, but further downward revisions are likely



The labor market remains resilient as job growth has stabilized. However, the slight rise in the unemployment rate and downward revisions in previous months suggest a potential moderation in the pace of growth.

Inflation has continued to remain sticky with CPI rebounding from its trough of 2.4% in September 2024 to 2.8% as of March 2025. Policy uncertainty causes risks in both directions on prices but on balance we think risks are skewed towards slightly weaker growth and higher inflation for 2025. All these factors put the Federal Reserve in a precarious situation where the US entered 2025 with above-trend growth, stocks at all-time highs, a solid labor market, and above-target inflation.

Exhibit 2: Changes in trade policy has increased economic uncertainty



For 2025 we also have a new presidential administration that has made trade policy and government efficiency a priority. Tariffs can be used to boost the size of the US manufacturing sector but can also have adverse effects of elevated uncertainty and a negative impact on corporate earnings due to higher production costs. Ultimately, the impact of tariffs on economic growth will come down to level and duration, along with the accompanying fiscal adjustments. All of these can change as tariffs can be implemented/lifted relatively easily.

Fiscal and government efficiency are another policy priority of the new administration. Similarly to tariffs, quantifying the impact of policy outcomes is difficult but consensus expected federal layoffs are 300k - enough to possibly affect headline data but not enough to spring widespread labor market weakness on its own.

So, in review, the current data shows a solid economy. But the forward risks to economic growth cannot be ignored. Signs of weakening capex expectations and capital markets activity are already beginning to show. Downward revisions to economic growth expectations are likely to continue.

Now let's review the market performance for the first quarter of 2025.

Market Review

Exhibit 3: Major indices performance table

Index	2024	Q1 2025
Stock Indices		
S&P 500 Total Return Index	25.02%	-4.27%
Dow Jones Industrial Average	14.99%	-0.87%
Nasdaq Composite	29.57%	-10.26%
Russell 2000 Index (Small Cap's)	11.54%	-9.48%
Bonds		
Bloomberg Barclays US Aggregate Bond TR	1.25%	2.78%
Bloomberg Barclays Municipal Bond TR	1.05%	-0.22%
ICE BofA US High Yield Index	8.22%	0.94%
Gold		
S&P GSCI Gold Spot Price Index	27.47%	19.28%
Real Estate Investment Trusts (REITS)		
FTSE NAREIT REIT Composite Index	4.75%	2.90%
International Indices		
MSCI EAFE Index	1.15%	6.15%
MSCI Emerging Markets Index	5.05%	2.41%

(1) Data provided by Envestnet Tamarac through data providers Refinitiv. Total Return includes the effects of dividends. Past performance is no guarantee of future results

Covington Investment Advisors

Equities

After a stellar run of positive performance, US large cap equities, as represented by the S&P 500, stumbled in the first quarter, falling -4.27% - the worst quarter going back to the third quarter of 2022. Changing policy, lowered growth expectations, and elevated equity valuations put pressure on large cap US stocks in the first quarter.

Large cap technology stocks, which have propelled equity markets higher for the last cycle, were instead a drag on the major stock indexes. The tech heavy NASDAQ Composite fell -10.26% in the first quarter of 2025. Expectations for artificial intelligence rollout continue to be the driving factor of technology equities.

US small cap stocks continued their underperformance falling -9.48% in the first quarter as represented by the Russell 2000 Index. Low valuations were not enough to outweigh high leverage and lower earnings quality. Smaller companies also tend to be more sensitive to economic uncertainty than large peers which spiked in the first quarter (*see exhibit 2*).

Looking abroad, the first quarter of 2025 has been a mean-reverting period for international stocks that had a strong performance after several years of lagging domestic peers. Developed international equities, as represented by the MSCI EAFE Index, returned 6.15% in Q1 2025. Emerging markets were not as strong as their developed international counterparts but still had positive returns of 2.41% for the first quarter of 2025.

Gold continued its strong momentum from 2024 during the first quarter as investors piled into the precious metal for its perceived safety amid market volatility. The S&P GSCI Gold Spot Price index rose 19.28% in Q1 2025.

Fixed Income

Fixed income had relatively stable performance in 2025 as interest rates fell. The Bloomberg US Aggregate and Municipal bond indexes had returns of 2.78% and -0.22% for the first quarter, respectively. High yield bonds, which are issuers with lower credit quality, had a slightly positive return of 0.94%, as measured by the ICE BofA High Yield Index.

Tariffs and growth scares will put conflicting pressure on interest rates as growth is expected to fall but prices could increase. Investors might flock to bonds as a safe haven if uncertainty continues.

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Summary

In summary, the first quarter of 2025 has been an adjustment period. Adjustment to new policies, new growth rates, and new technology adoption. Trade policy will be front and center as it presents the most severe change.

The consensus coming into the year was the broad tariff rate would be around 10% across the board on imports. Following President Trump's "Liberation Day" announcement the average effective tariff rate will be roughly 22% with some countries having a significantly higher rate. The impact on US GDP, inflation, sentiment, and chances of a recession will depend on the duration of restrictions and possible retaliation by other countries. Broad estimates are for a -1.5% impact on GDP, and +1.5% impact on inflation. Longer term the tariffs may be deflationary if growth underwhelms.

There are positive catalysts to look forward to. In the second half of 2025 we are expected to have a new tax package passed to ideally offset the impact of higher tariffs. Deregulation will also be necessary to pair with tariffs if manufacturing is to be reshored. Nevertheless, now that there is a clearer tariff picture, upcoming economic data releases, including GDP growth, employment figures, and consumer confidence indices, will provide insights into the health of the global economy.

The benefits of fixed income in portfolios are being felt for the first time in years. As economic growth weakens, credit quality will be paramount. Lengthening duration over recent years has also been favorable as interest rates have fallen. Going forward we want to maintain our levels of duration and rebalance to fixed income allocations as necessary.

Periods of volatility also demonstrate why having a long-term view and owning high quality assets are paramount. Furthermore, it underscores why our financial planning processes we have prepared for you are valuable. We again emphasize that having 6-12 months of operating cash in an emergency fund, sticking to budgets, and owning cash-flowing assets with low leverage will help carry investors through periods of volatility and uncertainty in markets.

Enclosed is your performance report for your account as of March 31st, 2025. Please contact us if you have any questions on your quarterly performance report or if there are any changes to your financial picture.

Sincerely,

Pat

Patrick R. Wallace