



In recent days, the U.S. stock market has experienced a steep decline and significant price volatility, with the broad market S&P 500 index falling over 10%. We want to share context, offer our perspective, and provide guidance during this period of volatility.

Recognizing a High Valuation Starting Point

- Recent stock market gains contributed to elevated valuations as the domestic blue-chip company S&P 500 index increased well over 20% in both 2023 and 2024. Strong consecutive year performance at this rate has only happened eight times in the last 75 years.
- These back-to-back gains placed stock valuations at historically high levels to begin 2025.
- As the excitement around AI and its potential to facilitate massive innovation related infrastructure buildout gained considerable momentum, prices rose faster than underlying corporate earnings.
- This valuation "perch" left the market vulnerable to downside catalysts, such as President Trump's recently announced aggressive tariff policy.

Understanding Animal Spirits

Animal spirits is a term popularized by a famous economist near 100 years ago which refers to the human emotion behind economic decision-making.

- Investopedia suggests "Animal spirits represent the emotions of confidence, hope, fear, and pessimism that can affect financial decision-making, which in turn can fuel or hamper economic growth. If spirits are low, then confidence levels will be low, which will drive down a promising market—even if the market or economy fundamentals are strong. Likewise, if spirits are high, confidence among participants in the economy will be high, and market prices will soar."
- Clearly the stock market has exhibited a rapid onset of low spirits.
- In times of uncertainty, investor behavior in action can allow fear to override logic. In other words, a prior commitment to a certain risk tolerance may give way by concluding "it is different this time."
- According to State Street Global Advisors on April 3, 2025, over the last 100+ years, there have been 25 instances where the S&P 500 had a >10% pullback from all-time highs. Subsequent market performance looks like this:

	Fwd 3-months return (after 10% Drawdown)	Fwd 6-months return (after 10% Drawdown)	Fwd 1-year return (after 10% Drawdown)	Fwd 2-year return (after 10% Drawdown)
Avg Return (all periods)	2.8	5.4	5.2	14.0
Avg Return (when Up)	9.5	14.8	17.1	24.5
Avg Return (when Down)	(7.3)	(8.6)	(16.1)	(28.1)

Source: FactSet, S&P, State Street Global Advisors. Data is from Jan-1928 until Mar-2025.

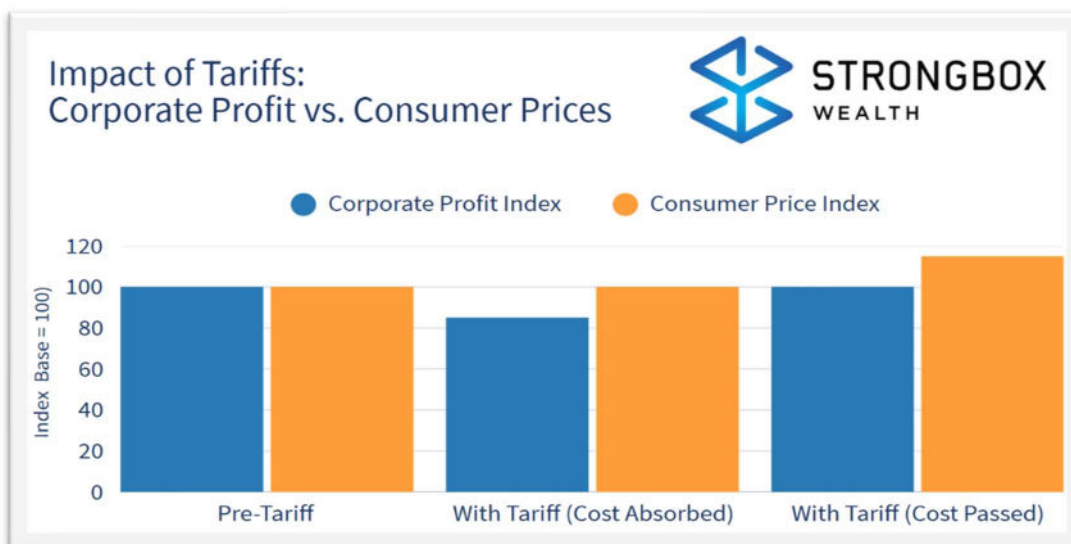


- State Street goes on to say “The main take-away is that on average, the index has positive returns over all subsequent periods. For periods that had subsequent positive returns, the 10% pullback ends up being fully reversed on average, even after just 3 months.”
- Over the past 30 years, markets have faced several sharp and unsettling declines around unprecedented moments, such as the Dot-com bust (2000), 9/11 (2001), the global financial crisis (2007), and the COVID-19 pandemic (2020). Though each event sparked intense fear and uncertainty, the stock market ultimately recovered and went on to reach new highs.

Tariffs and Market Impact

A tariff is a tax or duty placed on imported goods. It is paid by the importer—not by the foreign producer or the exporting country.

- **The importer must choose to either:**
 - Absorb the cost, reducing profits and pressuring stock prices.
 - Pass the cost on to consumers, raising prices and fueling inflation.
- **This chart illustrates the two primary economic outcomes of tariffs:**



- **Recent Developments:**
 - The Trump administration has introduced broad-based tariffs affecting the majority of U.S. trading partners worldwide.
 - Markets are reacting sharply to the potential long-term consequences of these policies and the uncertainty they create.
 - What is the rationale behind the administration’s tariff policy?
 - The first possible goal is to strengthen the U.S. negotiating position by making tariffs more burdensome for trade partners than for the U.S., potentially giving the administration leverage to lower global trade barriers.
 - Another possible objective is to generate revenue. While higher tariffs might help reduce the burgeoning federal deficit, economic costs could outweigh the additional tax income.



- A third intention may be to encourage reshoring of manufacturing jobs by making U.S. production more cost-effective than importing. However, this would likely raise domestic costs significantly and take years to materialize.

Favorable Economic Conditions vs. Tariff Impact

Several economic factors tend to create a fertile environment for market stability, resilience, and economic growth. The introduction of tariffs can weaken these conditions and introduce uncertainty—something markets react to swiftly.

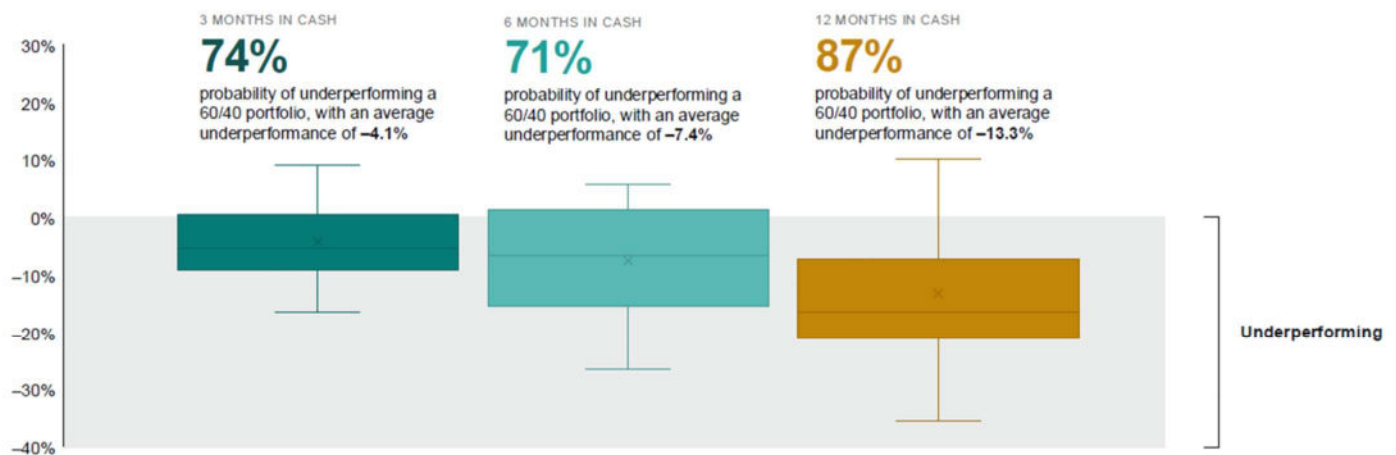
Factor	Supportive Economic Conditions	Tariff Impact
Corporate Earnings	Strong, consistent earnings growth supports rising stock prices. Predictable business environments fuel investment and expansion.	Tariffs can compress profit margins, especially when companies absorb added costs. Over time, lower earnings lead to falling stock prices, as there is a long-term correlation between earnings and valuation.
Inflation	Stable inflation preserves consumer purchasing power and promotes spending and investment.	Tariffs raise the cost of imported goods. When importers pass those costs on to consumers, prices rise—risking an inflation spike.
Interest Rates	Lower and stable interest rates keep borrowing affordable, supporting home buying, business growth, and credit markets.	If tariffs drive inflation higher, central banks may raise interest rates or delay planned rate cuts. Higher rates increase the cost of borrowing across the economy.
Consumer Sentiment and Spending	The U.S. economy is about 70% consumer-driven. Confidence fuels steady consumption, which supports business revenues and employment.	Rising prices and uncertainty weigh on consumer confidence. As spending declines, the risk of recession rises.
Uncertainty: The Wildcard	Stability breeds confidence and long-term capital investment.	Policy-driven uncertainty disrupts expectations, causes fear, and can lead to reactionary behavior—amplifying market volatility.



Keeping Perspective in the Face of Uncertainty

In periods of market volatility, it's important to stay grounded and resist the urge to make reactive changes. History shows that major portfolio shifts during turbulent times often lead to poor outcomes. While market swings can be uncomfortable, they are a natural part of the long-term investment journey—what we often call the “cost of admission” for building long-term wealth.

Moving to cash in a panic rarely pays off



Source: Vanguard total return calculations, as of December 31, 2024.

Notes: Equities in the 60% equity/40% fixed income portfolio are represented by the Russell 3000 Index and fixed income is represented by the Bloomberg U.S. Aggregate Bond Index. Cash is represented by the FTSE 3-Month Treasury Bill Index. Monthly data are from January 1960 through December 2024. Equity losses of more than 10% over three months trigger the move from a 60/40 portfolio to all cash in the illustration.

Fear can be unsettling and may nudge investors toward emotionally driven decisions. However, staying the course has historically proven to be the most effective approach. It's also important to remember that your portfolio was designed with your unique long-term goals and time horizon in mind—stock market declines are not only expected but built into your overall financial plan.

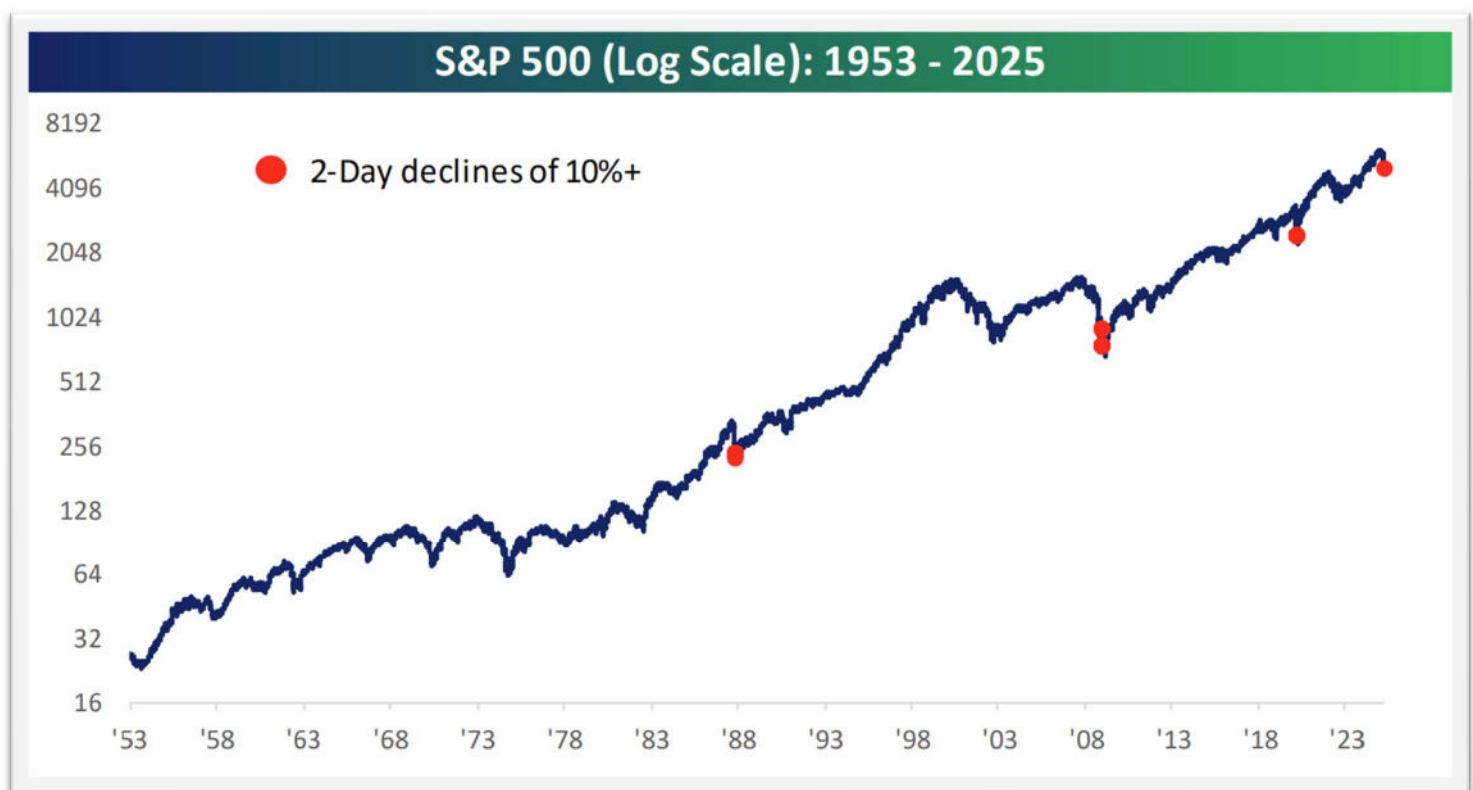
One of the most effective ways to navigate uncertainty is by maintaining adequate liquidity—ideally, at least six months of living expenses in readily accessible reserves, along with a separate emergency fund. Today's cash equivalents, such as U.S. Government Securities money market funds, offer attractive yields near 4% and can serve as a steady buffer to otherwise natural portfolio fluctuations.

We continue to believe that a disciplined strategy anchored in diversification, risk alignment, and portfolio exposure across cash equivalents, fixed income, and high-quality equities offers a resilient approach for serious long-term investors.



Final Thoughts

Periods of extreme market volatility are unsettling, but they are not uncommon. The StrongBox Wealth team remains committed to navigating these moments with clarity, discipline, and perspective. Ultimately, time has shown to be the best remedy for short-term market declines (see chart). If we are not yet aware of any material change to your current or upcoming liquidity need, please notify your Wealth Advisor. If you have questions about your portfolio, time horizon, or risk exposure, please contact the office to schedule a discussion with your Wealth Advisor. As always, we appreciate your confidence and trust in us.



Source: Bespoke

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