OCTAVIA
WEALTH ADVISORS

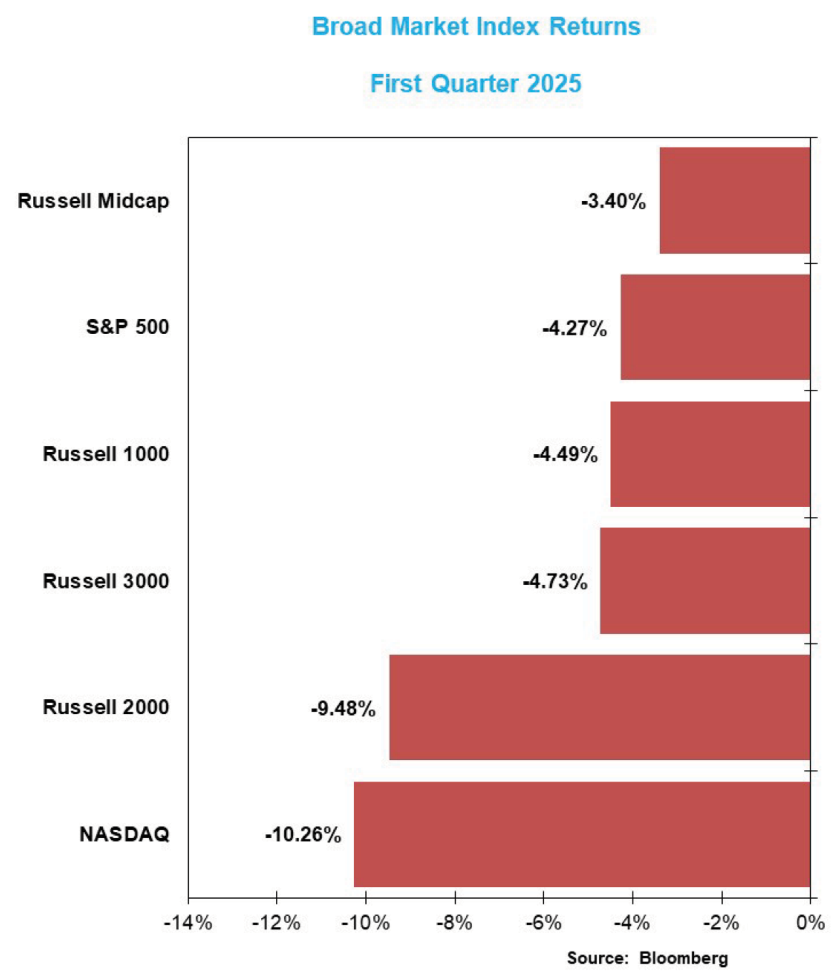
Economic and Market Overview

First Quarter 2025

Building a Lifelong Partnership

The Economy

Entering the new year, markets carried weak performance from December into the first quarter, and softened further in March as the new Presidential administration's tariff priorities came into greater clarity. Throughout the first quarter, incoming economic data remained relatively strong in spite of rising uncertainty. Real gross domestic product (GDP) grew strongly in the fourth quarter of 2024, and the labor market continued to expand into the new year while inflation was roughly stable at moderately elevated levels. The Federal Open Market Committee (FOMC) met twice during the quarter, choosing both times to leave interest rates unchanged due to labor market and inflation dynamics.



Highlights and Perspectives

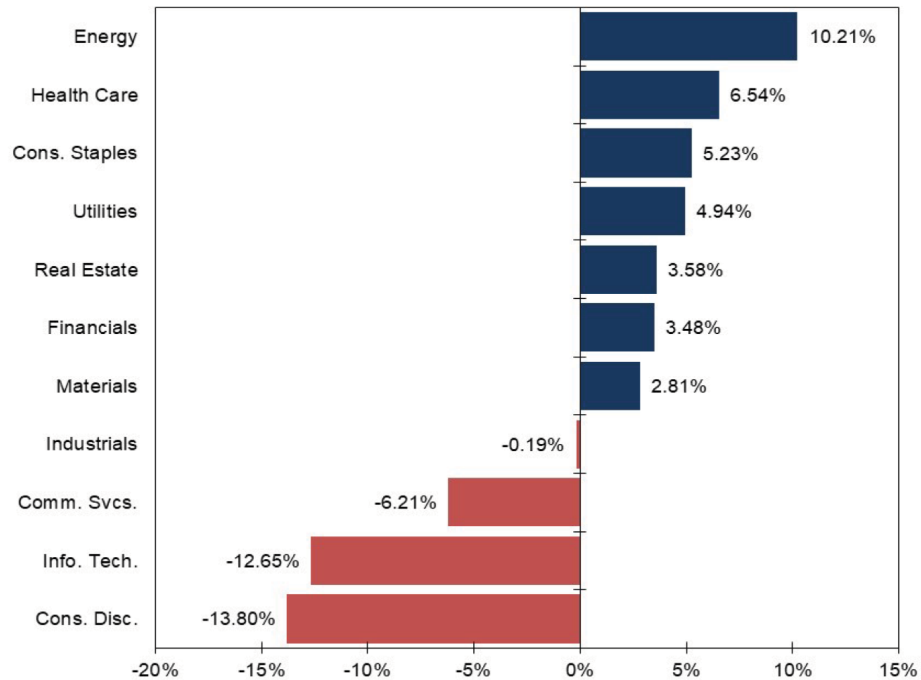
GROSS DOMESTIC PRODUCT (GDP)

According to its most recent data, the Bureau of Economic Analysis estimated that U.S. real GDP expanded at a 2.4% annual rate in the fourth quarter of 2024, slowing from 3.1% in the quarter prior but remaining reasonably strong. Consumer spending remained the primary growth driver, expanding at a 4% annual rate. Government spending was also a strong contributor, while private investment softened. Trade was a modestly positive contributor as imports slowed from the prior quarter. Corporate profits rose 5.4% (not annualized) during the quarter after falling by 0.4% in the prior period. Inflation figures were similar to the prior quarter and remain somewhat elevated despite trending lower over time.

Looking forward, however, GDP growth is expected to have slowed in the first quarter of 2025, with several forecasts pointing to a potential contraction. Multiple forces likely worked against growth in the quarter, including more cautious consumer and business spending in a more uncertain environment, as well as a massive surge in imports as companies attempted to stock inventories ahead of President Trump's tariffs. Imports are subtracted from the GDP calculation, offsetting dollars spent to consume the imported products. The first estimate of first quarter GDP growth will be released at the end of April.

U.S Equity Market Returns by Major Sector

(GICS Sectors in S&P 500, First Quarter 1Q25)



Source: Bloomberg

HOUSING

Housing market activity increased modestly in recent months but remains at historically low levels due to high mortgage rates holding down affordability. Sales of existing homes rose 4.2% in February to an annualized rate of 4.3 million units, about 1.2% below last year's already-low levels. Further, full-year 2024 numbers showed 4.06 million homes sold, the lowest for a calendar year since 1995. The inventory of existing homes available for sale continues to move higher, rising to 3.5 months in February. Existing home prices were up 3.7% year-over-year. Looking ahead, mortgage rates remain elevated and homebuilder confidence has fallen amid an uncertain macroeconomic environment. The NAHB Housing Market Index, a measure of homebuilder activity, ended the quarter at 39, down slightly from the prior month and well below the baseline level of 50 that indicates neutral sentiment.

EMPLOYMENT

Labor market reports have shown mixed signals in recent months, with the overall picture remaining strong enough to facilitate economic growth. The Bureau of Labor Statistics estimated that non-farm payrolls expanded by a strong 228,000 in March, well ahead of expectations. Payrolls averaged 152,000 monthly additions in the first quarter, slowing from 209,000 in the last three months of 2024. The labor force participation rate rose to 62.5% in March, while the unemployment rate nudged up to 4.2% as a result of more people entering the workforce. Average hourly earnings grew 0.3% in March and 3.8% over the past year, modestly ahead of inflation.

INFLATION

Inflation rates were little changed throughout the first quarter as high insurance costs and rebounding energy prices kept upward pressure on inflation indices. The Consumer Price Index (CPI) showed a 2.8% year-over-year increase in prices in February, barely improved from 2.9% in December and up from its recent low at 2.4% in September 2024. Inflation has oscillated but has mostly remained between 2.5% and 3% for almost a year. Core CPI, which removes food and energy prices due to their greater volatility, fell to 3.1% in February from 3.3% in January, but has remained similarly rangebound, sitting between 3.1% and 3.3% since last summer.

FEDERAL RESERVE POLICY

The FOMC met twice during the first quarter and voted to hold the target range for the federal funds rate steady at both meetings, citing continued resiliency of the U.S. economy and stalled downward progress on inflation. Both decisions were widely anticipated by markets.

In its latest Summary of Economic Projections (SEP), issued after its March assembly, the FOMC increased its expected year-end level for inflation to 2.7% from 2.5%, acknowledging the continued stickiness of price increases. The committee also raised year-end unemployment expectations to 4.4% from 4.3%, and lowered GDP growth expectations to 1.7% from 2.1%. Fed members clearly foresee a more stagnant economic picture ahead, characterized by slower growth and sticky, but not exceptionally high, inflation. According to the SEP, the committee still expects to lower interest rates twice in 2025.

INTEREST RATES

Fixed Fixed income securities broadly realized positive returns during the first quarter as yields shifted lower. Several factors are expected to create a complex picture for bond yields for the remainder of the year, including stubborn inflation, new policies from the Trump administration, trade wars, fiscal deficits and potential spending cuts, the federal debt ceiling, and more.

The yield curve remained in its upward-sloping shape but flattened slightly as yields on intermediate and long maturities declined 10 to 50 basis points while the short end of the curve was relatively flat. The yield on 10-year Treasury notes ended the quarter at 4.21%, down from 4.57% at the end of the year. 10-year yields declined materially in January and February, then were roughly flat throughout March.

As a result of declining yields and mostly steady credit spreads, total returns on fixed income securities were largely positive. The Bloomberg U.S. Aggregate Bond Index, which covers a broad swath of high-quality bonds, returned 2.8% in the quarter. Longer duration bonds benefited from falling long-term yields, as the Bloomberg 10-20 Year Treasury Index returned 4.8% compared to just 1.6% for its 1-3 Year counterpart. The Bloomberg High Yield index returned 1.0%. Non-U.S. Bonds, as measured by the Bloomberg Global Aggregate ex-U.S. index, advanced 2.5%. Municipal bonds underperformed other segments of the market, falling 0.2%

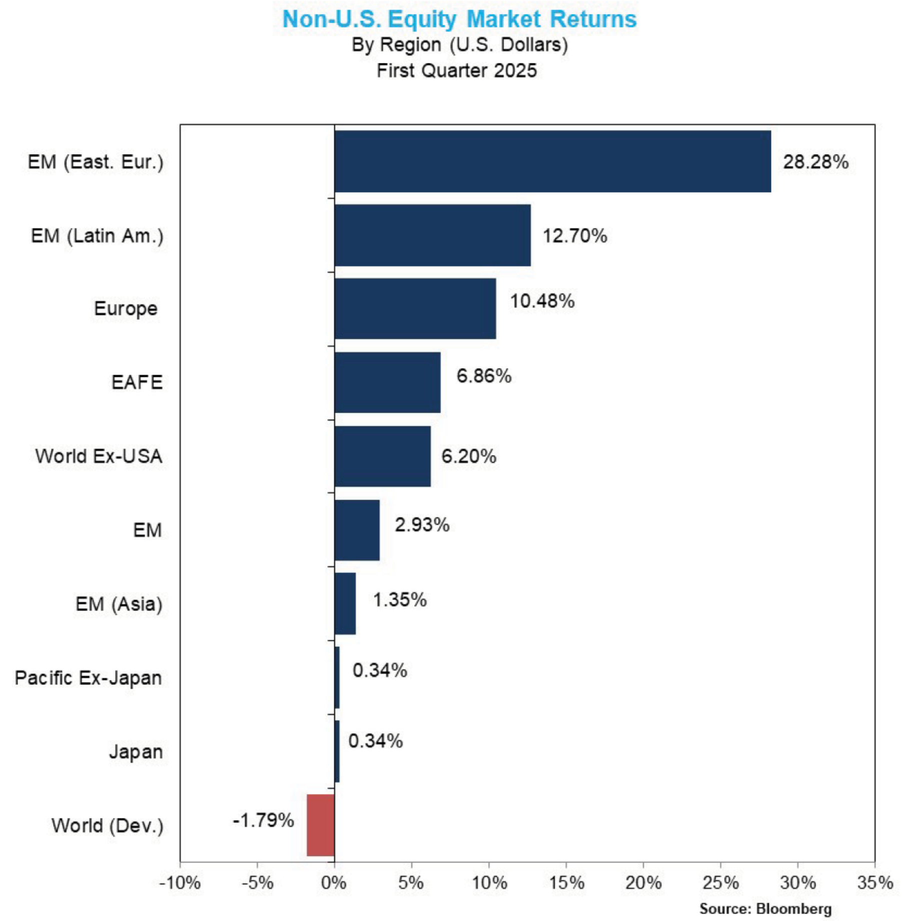
EQUITIES

Domestic stock performance was broadly negative for the quarter as weakness from the end of 2024 carried over into the new year and accelerated in March. Stock prices trended modestly higher through the first several weeks of the quarter, but began to fall once tariff discussions began in earnest in late February. The S&P 500 fell 4.3% in the quarter.

Performance among the S&P 500's eleven economic sectors varied widely, with more conservative segments generally performing better. The Energy, Healthcare, and Consumer Staples sectors were the index's best performers, rising 10.2%, 6.5%, and 5.2%, respectively. Meanwhile, the cyclical, "growthier" sectors that dominated returns throughout 2023 and 2024 were weaker in the first quarter, as Consumer Discretionary, Technology, and Communication Services fell 13.8%, 12.7%, and 6.2%, respectively.

Further subdividing the index, the quarter's negative performance can largely be attributed to the same handful of stocks that drove its stellar returns over the past two years. The so-called "Magnificent 7" of Apple, Microsoft, Alphabet, Meta Platforms, Tesla, Amazon, and NVIDIA contributed more than 100% of the index's quarterly loss. In other words, the "S&P 493" (all companies in the index other than those seven) was very modestly positive for the quarter while the big names drove the index to a 4% loss. The Magnificent 7 comprise a large portion of the Consumer Discretionary, Tech, and Communication sectors, leading to the poor performance mentioned previously.

Looking at other domestic indices, the Russell 1000 index, comprised of many of the same companies as the S&P 500, fell 4.5%. Value stocks within the Russell 1000 significantly outperformed growth for the quarter. The Russell 2000 small cap index underperformed large caps, falling 9.5%.



The tech-heavy NASDAQ Composite index fell 4.5%. Value stocks within the Russell 1000 significantly outperformed growth for the quarter. The Russell 2000 small cap index underperformed large caps, falling 9.5%. The tech-heavy NASDAQ Composite index fell 10.3%, while the Dow Jones Industrial Average lost just 0.9%.

Overseas markets broadly outperformed U.S. equities for the quarter as the MSCI ACWI ex-USA index rose 5.2%. Within that global index, the MSCI EAFE subset of developed markets jumped 6.9%, while MSCI Emerging Markets gained 2.9%. Europe and Latin America both enjoyed a strong quarter, while Asian markets were weaker but still mostly positive. The 9.7 percentage point outperformance of the MSCI ACWI ex-USA over the S&P 500 was the widest for any calendar quarter since 2009.

Outlook

After a strong year in 2024, economic momentum largely carried over into the first quarter of 2025, with employment strong and optimism high following President Trump's reelection. However, rising uncertainty placed a damper on activity throughout the quarter as both consumers and businesses tried to evaluate the unclear and constantly evolving outlook for tariffs and other trade policy changes from the new administration. Equity markets were rather calm, albeit lower, in January and February before falling in greater earnest once tariff plans became more concrete in March. Tariffs remain the biggest concern for the economic outlook, threatening both consumer spending in the form of higher prices and corporate profits in the form of narrowed margins. It is likely that market performance will remain volatile in the coming months as policies evolve.

Ultimately, we believe that the U.S. economy remains flexible, adaptive, and resilient, which has allowed it to weather economic uncertainty in the past. While tariff policies are a meaningful headwind in the coming months, long-term views of U.S. innovation and economic growth remain optimistic.

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INDEX OVERVIEW

The **Dow or DJIA** (Dow Jones Industrial Average) is an unmanaged index of 30 common stocks comprising 30 actively traded blue chip stocks, primarily industrials, and assumes reinvestment of dividends. The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **S&P 500 Index** is an unmanaged index comprising 500 widely held securities considered to be representative of the stock market in general. The **DJ US Select REIT Index** is a subset of the Dow Jones Americas Select RESI and includes only REITs and REIT-like securities (The Dow Jones US Select Real Estate Securities Index (RESI) represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the US). The **Bloomberg Commodity Index** is a broadly diversified commodity price index that tracks prices of futures contracts on physical commodities on the commodity market, and is designed to minimize concentration in any one commodity or sector. The **MSCI EAFE Index** is recognized as the preeminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America: Europe, Australasia, and the Far East. The **MSCI Emerging Markets Index** is a free float-adjusted market-capitalization index that is designed to measure equity market performance in the global emerging markets. The **MSCI ACWI Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 46 country indices comprising 23 developed and 23 emerging markets country indices. The **MSCI Emerging Markets (EM) Eastern Europe Index** captures large and mid cap representation across four emerging markets (the Czech Republic, Hungary, Poland, and Russia) countries in Eastern Europe. With 52 constituents, the Index covers approximately 85% of the free float-adjusted market capitalization in each country. The **MSCI EM (Emerging Markets) Latin America Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of emerging markets in Latin America. The **MSCI ACWI Ex-US Index** is a market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of US-based companies. The **MSCI China Index** captures large and mid cap representation across China H shares, B shares, Red chips, and P chips covering about 85% of this China equity universe. The **Bloomberg Barclays Municipal Bond Index** is an unmanaged index comprising investment-grade, fixed-rate municipal securities representative of the tax-exempt bond market in general. The **Bloomberg Barclays Global Aggregate ex-US Index** is a market-capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most US-traded investment-grade bonds are represented. Municipal bonds and Treasury Inflation-Protected Securities are excluded, due to tax treatment issues. The Index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds, and a small amount of foreign bonds traded in the US. The **Bloomberg Barclays US 5-10 Year Corporate Bond Index** measures the investment return of US dollar-denominated, investment-grade, fixed-rate, taxable securities issued by industrial, utility, and financial companies, with maturities between 5 and 10 years. Treasury securities, mortgage-backed securities (MBS), foreign bonds, government agency bonds, and corporate bonds are some of the categories included in the Index. The **Bloomberg Barclays Capital US 5-7 Year Treasury Bond Index** is a market-capitalization-weighted index, and includes Treasury bonds issued by the US with a time to maturity of at least 5 years, but no more than 7 years. The **Russell 1000 Index** is a market-capitalization-weighted benchmark index made up of the 1000 largest US companies in the Russell 3000 Index (which comprises the 3000 largest US companies). The **Russell 2000 Index** is an unmanaged index considered representative of small cap stocks. The **Russell 3000 Index** is an unmanaged index considered to be representative of the US stock market, and measures the performance of the largest 3,000 US companies representing approximately 98% of the investable US equity market. The **Russell Midcap Index** is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The **Housing Market Index** (HMI) is based on a monthly survey of **NAHB** members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months, as well as the traffic of prospective buyers of new homes. The **JPMorgan Emerging Market Bond Index** (EMBI Global) tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. The **CBOE Volatility Index** (VIX) is an up-to-the-minute market estimate of expected volatility that is calculated by using real-time S&P 500 Index option bid/ask quotes. The Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected volatility of the S&P 500 Index.

DEFINITIONS

The **Federal Open Market Committee** (FOMC) is the monetary policymaking body of the Federal Reserve System. The **federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **European Central Bank** (ECB) is the central bank for Europe's single currency, the euro. The ECB's main task is to maintain the euro's purchasing power, and thus price stability, in the euro area. The euro area comprises the 19 European Union countries that have introduced the euro since 1999. The **Gross Domestic Product** (GDP) rate is a measurement of the output of goods and services produced by labor and property located in the United States. The **Bureau of Labor Statistics** (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the US government in the broad field of labor economics and statistics, and serves as a principal agency of the US Federal Statistical System. The **Bureau of Economic Analysis** (BEA) is an agency in the US Department of Commerce that provides important economic statistics, including the gross domestic product of the US. It is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the US Congress, other Federal agencies, state and local governments, business, and labor representatives. The **PCE (Personal Consumption Expenditure) Index of Prices** is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data, including US Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures, and is essentially a measure of goods and services targeted towards and consumed by individuals. Sector performance is represented by the **Global Industry Classification Standard** (GICS) sectors, developed by Standard & Poor's and MSCI Barra.

Octavia Wealth Advisors
9999 Carver Road, Suite 130
Cincinnati, OH 45242
T: 513.762.7701, F: 513.762.7741