RICE HALL JAMES
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***Market Review***
***First Quarter 2025***

The first quarter of 2025 did not go according to plan, as unexpected developments and policy uncertainty muddled the picture for business and investors. The circumstances deteriorated further in April.

During the period, the S&P 500 and the Russell 2000 indices declined -4.27% and -9.48%, respectively. This marked the worst performance for the Large and Small Cap benchmarks since 2022. The losses also worsened as the quarter progressed. Consistent with the deterioration, Value outperformed Growth on both ends of the market capitalization spectrum. The Nasdaq Composite was the biggest loser among the major indices retrenching -10.42% for the quarter and -8.21% in March. There were two primary drivers behind the sell-off.

First, less than one week after President Trump hailed the formation of the $500 billion Stargate project and joint venture, China-based DeepSeek released its R1 model, which shook up the artificial intelligence (AI) narrative. The high-performing model, which is built on open-source architecture and lower-cost chips, gained widespread acclaim for its computational efficiency and cost effectiveness. It also raised questions about the sustainability of the capital investment plans for the AI leaders, and the future pricing they can expect, for the same reasons. This upended investor confidence in the most important growth driver in the domestic economy.

The bigger challenge for markets, however, has been the increasing realization that the initial "Trump 2.0" priorities are very different than four years ago. While investors cheered the prospect of tax cuts and deregulation, tariff plans and massive federal government budget cuts (and overhaul) have become the lead policy position. They are also extremely controversial and disruptive to business. Gone too are the days of the President using the stock market as a barometer of success. This is evidenced by increasing discussion of a "period of transition" for the market and economy among prominent government officials.

The result of this new path forward has been steadily increasing uncertainty and consternation, which has permeated every level of the economy. The consistent trickling out of policy has made it impossible for business to understand its cost base, for consumers to feel secure about budgets and employment, and for investors to divine future business conditions. The specter of rising prices has also challenged the Federal Reserve's ability to preemptively lower interest rates without exacerbating inflation, raising the stakes further.

As sentiment has soured, the persistent hope has been that (i) final policy won't be as severe as insinuated, and (ii) the new rules will become clear, enabling business and markets to better plan and respond. Unfortunately, this is not the way things played out in early April on the President's self-ascribed "Liberation Day". Tariff rates were significantly higher and more broad-reaching than expected, and exceeded 50% (cumulative) on the high-end. There was also no assurance that the book on the subject is closed…by the U.S. or its trading partners. Stocks plummeted in response.

At this point, it seems like the U.S. is on the front-end of a self-inflicted crisis. Because of the President's tendencies, there is some belief that the assertive terms are the start of a negotiation process and the situation will improve from here. Having said this, we believe the better reason for hope amid the pessimism is the resilience of U.S. business, which helped the economy to stay afloat during the first pandemic in a century. Although it will take time for the market to differentiate between the winners and losers, the team is encouraged by the domestic footprint and focus of the majority of our Small and Micro Cap investments. More importantly, we are confident that our profitability-focused, conservative growth process will help us to weather the lingering uncertainty while we strive to capitalize on attractive valuations to position for better days ahead.

Sources: *FactSet, GICS Sector Classification*

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*The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities.*

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Index Definition Sources: *Standard & Poor's, FTSE Russell, Nasdaq*