The Nexus Report

First Quarter, 2025

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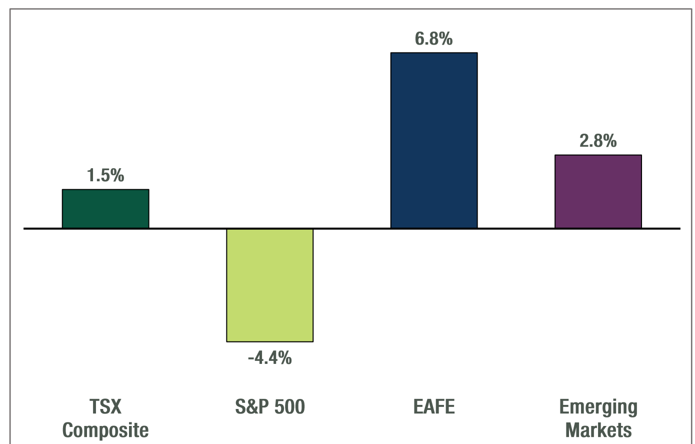
Investment Outlook

Cracks in the Foundation

Following two wonderful years in financial markets, investors entered 2025 with a growing sense of apprehension. It is quite rare to have three strong years for investment returns in a row. Nonetheless, stock markets continued to climb higher in January and February based on the belief that newly re-inaugurated President Trump's promises of lower taxes and lighter regulation would provide a strong boost to U.S. economic growth and to corporate profits. In March, however, cracks began to form in the foundation of investor confidence as tariffs became the President's focus and other pro-growth promises took a back seat. Stocks began to decline, with U.S. markets leading the way lower.

An observation we made early in the quarter was that the U.S. stock market was particularly vulnerable to a correction based on the stretched valuations of many of its leading stocks. Indeed, once the dust settled on a messy quarter, the S&P 500 had declined by 4.4%. The so-called Magnificent 7[1], which we have discussed frequently in the last two years, were down over 15% as a group and were responsible for the entirety of the S&P decline. The other 493 stocks in that index actually contributed a small *positive* return. In Canada, other dynamics were at work. The TSX Composite gained 1.5% over the first quarter, but more than all of the gain was a result of soaring gold stocks. The rest of the Canadian market declined modestly. Some investors perceive gold as a safe haven in times of uncertainty, and uncertainty spiked during the quarter.

Remarkably, and surprisingly to many, European stocks had a strong gain during the quarter. After years of lacklustre economic growth, the outlook in Europe became markedly better. Largely on account of the worry that the U.S. is abandoning Ukraine in its war against Russia, European countries declared new determination to take charge of their own security. The commitment to significant new defence spending will act as a strong stimulus to European economic growth. This has investors excited. As well, in Trump's early actions on tariffs, Europe did not seem to be his principal focus.



Total Returns – 3 Months ended March 31, 2025 (C$)

Normally, our comments on market returns are entirely focused on what happened in the previous quarter. To be silent on the market dynamics in early April, however, is to ignore the elephant in the room. On Wednesday, April 2, after the market closed, President Trump announced the long-awaited plan for "reciprocal tariffs".[2] Trump called it "Liberation Day". Many

NOTE: Unless indicated otherwise, all Nexus returns are compound annual average, time-weighted, total rates measured in Canadian dollars and calculated after deducting such direct and indirect costs as applicable withholding taxes, trading commissions, custody fees and other fund/account expenses, but without deducting Nexus's management fees (which are charged to client accounts and vary by client). Returns for market indices and benchmarks are presented on the same basis, but without any such deductions. Stock-specific returns are price-only returns, and for U.S. listed stocks are in U.S. dollars. Past performance is not indicative of future results. For more information about benchmarks, please refer to https://tinyurl.com/NexusOnBenchmarks.

[1] The Magnificent 7 include Alphabet, Amazon, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

[2] There was nothing vaguely "reciprocal" about the tariffs, but that is a topic for a separate essay.

market observers preferred titles like “Liquidation Day” or “Obliteration Day”. Suffice it to say that the proposed tariff plan was far worse than most investor expectations. Markets around the world plunged the day after the announcement, wiping out $6.6 trillion of value from the stock market, the largest single day of value destruction in history.[3] Declines continued in the days that followed. One week later, on April 9th, Trump ordered a pause on some of the tariffs. Markets soared on the hope that someone with common sense got to the President’s ear. Time will tell whether the rebound endures.

Tariff Trauma

As 2025 began, the economic outlook in both Canada and the U.S. seemed positive. After a slow patch of growth in the summer and fall, Canadian economic growth picked up late in 2024 and into early 2025. In the U.S., many thought President Trump’s pro-growth policies would usher in a new age of prosperity. Most investors ignored the chatter on tariffs, believing that Trump would back off as soon as the market declined – just as he did in his first term.

As the quarter progressed, the President’s focus on tariffs became more determined and more worrisome. Tariffs on Canada and Mexico were introduced, then deferred, on the claim of threats to U.S. national security from fentanyl and migrants. Then tariffs on all steel and aluminum imports were introduced. Then autos. But the “grand reveal” was scheduled for April 2. This progression caused consumers, businesses, and investors to become increasingly alarmed. In late March, the University of Michigan Confidence Survey had some shocking revelations. Long-term inflation expectations soared to the highest level since 1992. Two-thirds of American households expect unemployment to rise in the coming year – the highest level since the Global Financial Crisis in 2009. The Conference Board Confidence Survey revealed a similar discouraging state of affairs – “consumer expectations for the future” fell to the worst level in 12 years, a level that is well below that which portends a recession. As Federal Reserve Bank of Richmond President, Thomas Barkin, said: the fog of policy uncertainty is so dense it is “zero visibility, pull over and turn on your hazards kind of fog.”[4]

The worrisome economic data in the U.S. was mostly “soft” data, such as measures of sentiment and expectations for the future. The “hard” data of what consumers were spending and businesses were investing continued to hold up through the quarter. March’s employment report, for example, revealed better-than-expected hiring in the U.S. Nonetheless, most investors fear that the tariff fiasco will lead to the hard data weakening noticeably in the months to come.

The Canadian economy also slowed during the quarter. Our economy lost 33,000 jobs in March, the worst employment report in three years. The unemployment rate rose from 6.6% to 6.7%. Importantly, job losses came from a reduction in hiring. Layoffs have not yet spiked higher than normal rates.[5] In early April, the Bank of Canada’s quarterly Business Outlook Survey similarly depicted growing caution. There was a sharp increase in the number of businesses expecting recession in the next year, and there were reduced intentions for investment and hiring. Both these economic indicators were based on data collected before the full brunt of tariffs had hit the Canadian economy. Greater weakness likely lies ahead.

Of course, the biggest economic news came on April 2. As mentioned above, investors were shocked by the scope and extent of planned tariffs. The average tariff rate in the U.S. jumped to well over 20% across imports, higher than the Smoot-Hawley tariffs in 1930 that deepened the Great Depression. As well-known economist, Ed Yardeni, commented: “It is a pity to see the administration take a perfectly good economy and hit it with a wrecking ball.”[6] While Trump changed his mind on April 9 and suspended many of the tariffs, we think a lot of damage has been done. An executive order signed in the morning may be reversed in the afternoon. What business owner would commit to a major capital investment when the rules of the game may change from hour-to-hour?

Market Outlook

We find ourselves in a disturbing situation where short-term stock market moves are driven by the social media posts of one man. It is an investment environment unlike any in the history of our firm. It is possible that there is a bad outcome, with economic growth significantly compromised in the U.S. and around the world. Stock prices could decline further from here and stay there for an extended period. However, we think that is a low probability scenario. The April 9 reversal on tariffs is fairly good evidence that the U.S. administration is unwilling to suffer much pain to achieve its purported (but entirely contradictory) goals.

Nexus’s investment philosophy is designed to account for the fact that there will be periods of disruption. We seek to buy high quality companies with valuations that incorporate a margin of safety. We are not immune from market turmoil in moments like the present, but our portfolios ought to be more resilient than market averages. They proved to be that way in the first quarter. Each client’s asset mix incorporates the knowledge that periods of market disruption are part of the life of an investor. Cash and bonds temper the volatility. In time, skies will clear and portfolio returns will continue their march higher.

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[3] *The Wall Street Journal*, April 5, 2025.

[4] Quoted in *The Globe and Mail*, March 29, 2025.

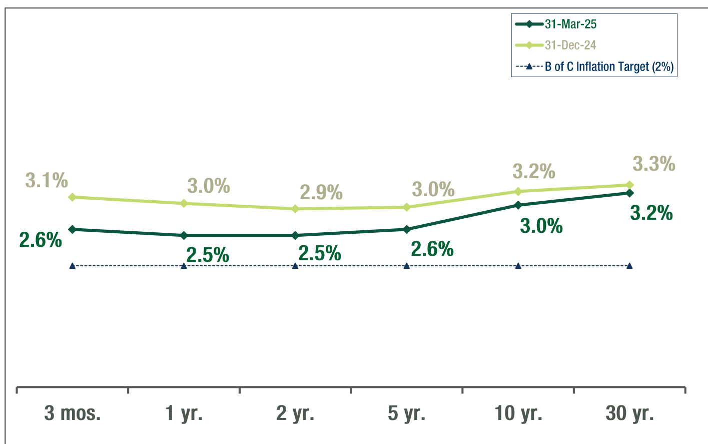
[5] *The Globe and Mail*, April 5, 2025.

[6] *Barron's*, April 5, 2025.

Asset Class Review

Fixed Income

The first quarter of 2025 delivered strong fixed income returns for Canadian bond investors. The FTSE TMX Universe Bond Index increased 2.0% and Nexus's bond portfolio performed slightly better, generating a return of 2.4% for the quarter. For the 12-month period ending March 31, 2025, the Index gained an impressive 7.7%. Nexus's bond portfolio outperformed with an 8.9% gain. The Nexus Income Fund, which includes up to 20% in income-oriented equities, returned 2.4% in the first quarter, and 10.4% over the 12 months ending March 31, 2025.



Government of Canada Yield Curve

Early in the quarter, economic data indicated that the Canadian economy was gaining momentum following a period of weakness, with signs of improvement in both economic growth and the labour market. Then, in early February, trade policy developments began to dominate headlines and influence markets. This started with the announcement – and subsequent deferral – of "fentanyl-related" tariffs by the U.S. on Canada and Mexico. China received the same threat, but unlike Canada and Mexico, the tariffs were implemented a month later. From there, additional tariffs were announced, and by the end of the quarter, the U.S. had either proposed or enacted tariffs on global imports of steel, aluminum, autos and parts, as well as the fentanyl-related measures targeting Canada, Mexico, and China. These actions prompted varying degrees of retaliation from the affected countries.

Following the initial tariff announcement on February 1st, uncertainty quickly became the prevailing theme in fixed income markets. The potential for a broader trade war overshadowed existing economic data, shifting the focus to larger, unresolved questions: What comes next? And how long might it last? In the absence of greater clarity, uncertainty effectively outweighed the relevance of incoming data.

In the first quarter of 2025, the Bank of Canada implemented two interest rate cuts – one in January and another in March – continuing the trend of lower overnight rates. Canada's overnight rate peaked at 5.0% in the first half of 2024 and has since declined steadily to its current level of 2.75%. The divergence between Canadian and U.S. overnight rates is now wide by historic standards. While Canada has continued to lower rates, the U.S. overnight rate has remained at 4.50% so far in 2025. While the Canadian overnight rate was cut twice (0.50% in total) in the first quarter, longer dated yields did not decline by nearly as much, adding to the differential between shorter- and longer-dated yields. This is a move that we have been expecting for some time, and one that we believe could continue in the coming months. See the chart for the changes in the yield curve.

We note that following the end of the first quarter, and the "Liberation Day" announcement from Trump discussed earlier, yields have risen further. This is notable because, in periods of uncertainty and unease, yields typically decline while bond prices rise. However, expectations of higher global inflation have pushed longer-dated yields higher, as investors begin to price in that risk. In the U.S., concerns around rising debt levels persist and are understandably intensifying amid growing global tensions. To illustrate the extent of inflation concerns, a monthly consumer sentiment survey by the University of Michigan reported that 1-year inflation expectations reached 6.7% in April[7] – a 40-year high. The survey hasn't recorded a reading above 6% since 1981 and has only rarely exceeded 5% during that period.

During the quarter, we opportunistically sold some corporate bonds which had performed well and left little room for outperformance. For example, we sold most of our Limited Recourse Capital Notes – among the best-performing bonds in the market – in favour of higher-quality alternatives. We also sold many bonds maturing in under two years to capture higher yields on slightly longer-dated securities. Overall, these trades did not materially alter the portfolio, and our duration remains significantly shorter than the Index.

[7] Note that this portion of the Nexus report makes reference to the April University of Michigan sentiment survey. These results were not yet available at the time of the completion of the Investment Outlook section of the report.

Equities [8]

Amidst the tariff chaos, equity markets delivered mixed performance in the first quarter. In the U.S., the S&P 500 fell 4.4% in response to tariff rhetoric and the resulting uncertainty for investors. Conversely, in Canada, the TSX rose 1.5%, driven predominantly by gains in gold stocks, which are typically viewed as a safe haven during periods of economic instability. International equities performed well in the quarter, as investors sought alternatives to U.S. stocks. Despite tariff-induced turbulence and a market decline in the U.S., the Equity Fund gained 1.7% this quarter. Over the past year, it has gained 11.3%.

North American Equities

Though the tariff spectacle stole the show, there were other meaningful developments during the quarter.

The market's all-consuming enchantment with American AI companies began to wane in January. DeepSeek, a revolutionary AI technology from China, emerged with capabilities rivaling major AI companies at a fraction of the cost. This development challenged American dominance in AI, causing a sell-off in the U.S. tech sector. The tech-heavy NASDAQ faced turbulence, with NVIDIA, an AI favourite, falling 17% and losing $600 billion in market value – the largest single-day loss in U.S. history. Other AI-linked stocks also experienced sharp declines following the announcement.

For many investors, this was a stark reminder that the initial thrill of high-growth industries can be quickly replaced by a sobering clarity that all industries, no matter how exciting, eventually face competition. The principles of economics were not repealed in the first quarter of 2025.

Nexus's Canadian stocks increased by 0.7% this quarter and 10.0% over the last year. Our Energy holdings, including Suncor and ARC Resources, contributed positively to our quarterly performance. Additionally, our decision not to invest in Shopify, which experienced pressure following the tariff announcements, proved advantageous. However, this was offset by our choice not to hold gold stocks, which performed well this quarter but generally do not align with our quality criteria.

Our U.S. holdings rose 1.5% this quarter, outperforming the S&P 500's 4.4% decline, and are up 12.9% for the year. Our underweight positioning in U.S. technology stocks was particularly beneficial this quarter, as AI enthusiasm decreased and AI-linked stocks fell. In addition, our Healthcare stocks contributed to our performance, including a recovery in CVS Health and gains in Gilead Sciences, which announced better-than-expected results in the period. Overall, our U.S. holdings have shown strong resilience during this period of tariff disruptions and rapid advancements in artificial intelligence.

We purchased a new stock, Ferguson Enterprises during the quarter. Ferguson is an industrial distribution company specializing in plumbing, HVAC, and waterworks. The stock had fallen out of favour due to a cyclical industry slowdown, providing a buying opportunity. As it operates today, Ferguson is a high-quality business with strong financial characteristics, scale advantages and balanced end-market exposure. The company's prospects are promising as it pursues organic growth while also consolidating its fragmented market through strategic acquisitions of smaller, typically family-owned, businesses.

International Equity Investments

We continue to hold two externally-managed pooled funds.[9] In the quarter, EQIT (international developed market equities) rose 9.5% and EMEC (emerging market equities) gained 1.0%. These two funds are held inside our Nexus International Equity Fund, which delivered returns of 6.4% over three months and 11.4% over the twelve months ending on March 31, 2025.

International equity markets delivered positive gains in the quarter, buoyed by a rotation out of the concentrated and expensive U.S. market. Early in the quarter, the DeepSeek AI announcement prompted investors to reallocate capital away from the high-flying U.S. technology stocks towards international equities, driving gains in both international developed and emerging markets.

Europe stood out as the top-performing region. A key driver was a shift in its geopolitical posture, amid concerns that the U.S. is stepping back from its support for Ukraine in the war with Russia. European nations, especially Germany, signalled a renewed commitment to their own defence. The resulting pledge for significant fiscal spending marked a notable departure from the region's traditionally restrained budgetary stance, and investors welcomed the growth implications of this policy shift.

Meanwhile, amid a backdrop of rising trade tensions and policy uncertainty in the U.S., emerging markets found support from two key tailwinds: a weaker U.S. dollar and a decline in 10-year Treasury yields.

Looking for the Pooled Fund Reports?

Check your client statements for details on the funds held in your portfolio.

[8] The overall and geographic level return data in this section are for the Equity Fund. Equity returns within the Balanced Fund were similar. For specific performance, please refer to your own quarterly report.

[9] Both pooled funds are managed by teams from J.P. Morgan Asset Management in the U.K. and are held in our International, Equity and Balanced Funds.