KENSINGTON
Asset Management

Monthly Commentary
February 2025

About Kensington

Kensington Asset Management specializes in data-driven, quantitative investment solutions spanning across the global investment landscape. Our focus is to help provide investors with confidence through quantitative analytics, by attempting to participate in rising markets, while taking steps to help avoid exposure during times of market decline or volatility. Kensington Asset Management was founded by Bruce P. DeLaurentis, a quantitative pioneer with over 40 years of trading experience through numerous market cycles.

Investment Philosophy

Kensington believes that the best way to generate steady, above average positive returns is to employ an investment methodology that has the potential to recognize and measure consistent and repeating behavioral patterns in the financial markets. With that goal in mind, Kensington has developed clearly defined quantitative decision models that strive to minimize subjectivity in this decision-making process. The overarching goal is to capture sufficient returns in positive market conditions, while protecting capital, with rigorous mitigation during down markets.

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Market Volatility Rises Amid Trade Uncertainty

February saw heightened volatility as investors reassessed the economic impact of newly imposed trade tariffs. The **S&P 500 declined by -1.42%**, with the **Nasdaq 100 falling -2.76%** and the **Russell 2000 Small-Cap Index down -5.45%.** While the market had initially assumed tariffs were a bargaining tactic, the confirmation of their implementation triggered a swift correction.

The broader concern is the inflationary pressure tariffs create, increasing consumer prices and dampening demand. Paired with government cutbacks and immigration crackdowns, labor demand is also expected to slow. Treasury Secretary Bessent has indicated these policies are part of a broader effort to curb excessive government spending and economic over-reliance on stimulus, a “detox period” designed to tame inflation and normalize interest rates. However, markets question whether this approach will push the economy into a recession.

Despite these risks, some investors see potential offsets. Possible **corporate tax cuts, regulatory rollbacks, increased oil production, and new trade agreements** could help counterbalance headwinds. Additionally, **European markets have outperformed** in early 2025, reflecting a shift in global capital as the US steps back from international leadership.

Fixed Income: Flight to Quality in Uncertain Times

Bond markets posted strong gains in February, driven by a flight to quality amid equity weakness. The **10-year Treasury advanced 5.64%**, the **30-year gained 3.09%**, and Bloomberg US **Corporate Investment-Grade Bond Index rose 2.04%**. Bloomberg US Mortgage-backed Securities Index also performed well, climbing **2.55%**, while Bloomberg US Corporate **High-Yield Bond Index lagged at 0.67%**, reflecting investor caution toward riskier assets.

Despite the decline in yields, recession signals remain mixed. The **10-year yield** has stabilized around **4.0–4.25%**, suggesting an economy slowing but not contracting (chart below). However, a drop in the **2-year Treasury yield**, historically a precursor to Fed rate cuts, suggests growing expectations of economic weakness.

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Source: Investing.com

Credit spreads have begun widening, an early signal of potential stress in corporate debt markets. While not yet at crisis levels, the trend warrants close monitoring. If high-yield bonds continue to underperform, it could indicate deeper concerns about economic growth and corporate balance sheets.

Federal Reserve: Navigating Policy Challenges

Fed Chair **Jerome Powell** faces one of the most complex policy landscapes in recent history. The central bank remains committed to data-driven decisions, but trade disruptions and shifting consumer behavior complicate its outlook.

Labor market indicators remain relatively stable, with **non-farm payrolls meeting expectations** and **job openings showing resilience**. However, consumer sentiment has weakened. The **University of Michigan Consumer Sentiment Index fell 10% year-over-year,** while the **Conference Board's Consumer Confidence Index posted its largest monthly drop since August 2021.**

Inflation data has shown mixed signals. The **core Consumer Price Index (CPI) rose 0.2% month-over-month**, while the **core Personal Consumption Expenditures (PCE) index increased 0.3%**. Despite these modest gains, **long-term inflation expectations have surged,** with the **Conference Board survey showing a jump from 5.2% to 6.0%.** Similarly, the **University of Michigan's five-year inflation outlook hit 3.5%, its highest level since 1995.**

With these conflicting data points, the Fed is likely to hold rates steady in the near term. Market expectations currently price in rate cuts starting in mid-2025, but the central bank may wait for greater clarity on trade policy impacts and global economic conditions before making any moves.

Market Outlook: Risks and Opportunities Ahead

Looking ahead, markets remain at a crossroads. The economic impact of tariffs, labor market shifts, and consumer sentiment declines will shape the trajectory for the rest of the year. Key risks include:

- **Prolonged Trade Disruptions:** Extended tariff conflicts could weigh on corporate earnings and economic growth.
- **Rising Credit Market Stress:** Widening credit spreads and underperformance in high-yield bonds may signal deeper economic issues.
- **Fed Policy Uncertainty:** The central bank's response to evolving inflation and labor trends will be critical for market stability.

However, **potential tailwinds exist**, including:

- **Tax and Regulatory Adjustments:** New corporate tax cuts or deregulation efforts could support profitability.
- **Energy Market Stability:** Increased US oil production could help keep energy costs in check, alleviating inflationary pressures.
- **Global Market Leadership Shift:** Strength in European and emerging markets could attract capital away from US equities, altering investment flows.

Given these factors, investors should maintain a **balanced approach**, emphasizing quality assets, risk management, and flexibility in portfolio positioning. Kensington's strategies remain focused on navigating market volatility while identifying opportunities in a shifting global landscape.

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Advisory services offered through Kensington Asset Management, LLC, Barton Oaks Plaza, Bldg II, 901 S Mopac Expy – Ste 225, Austin, TX 78746.

Definitions:

Bloomberg US Corporate Investment Grade Index: An unmanaged index that covers the publicly issued US corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg US Corporate High Yield Index: An unmanaged market value-weighted index that covers the universe of fixed-rate, non-investment grade debt in the US. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on the indices' EM country definition, are excluded.

Bloomberg US Mortgage-Backed Securities (MBS) Index: An unmanaged index that tracks fixed-rate agency mortgage-backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon, and vintage.

NASDAQ 100 Index: A market index that comprises of the 100 largest, most actively traded companies listed on the Nasdaq stock exchange.

Russell 2000 Index: A market index that consists of 2,000 small-cap US companies that are part of the larger Russell 3000 Index.

S&P 500: A capitalization weighted index of 500 stocks representing all major domestic industry groups. The S&P 500 TR Index assumes the reinvestment of dividends and capital gains.

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