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Doll's Deliberations®

Weekly Investment Commentary

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Summary

Stocks fell again last week (S&P 500 -0.95%), (NASDAQ -3.45%), (DJIA 1.01%). Equal-weighted averages outperformed again and 10-year Treasury yields fell to 4.25% (after being at 4.8% in mid-January). Trump 2.0 policy uncertainty remained a key focus. Best sectors were financials (2.82%) and real estate (2.20%); worst sectors were technology (-4.01%) and communication services (-2.54%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	1.01	3.32
S&P 500	-0.95	1.44
NASDAQ	-3.45	-2.31
Russell 1000	-2.50	-0.19
Russell 1000 Growth	-2.56	-1.69
Russell 1000 Value	0.89	5.05
Russell 2000	-2.53	-3.94

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	-2.54	2.26
Consumer discretionary	-2.10	-5.38
Consumer staples	1.27	7.85
Energy	0.16	6.13
Financials	2.82	8.06
Heathcare	1.74	8.38
Industrials	1.17	3.52
Information technology	-4.01	-4.19
Materials	0.81	5.58
Real estate	2.20	6.14
Utilities	-1.31	4.67

Key takeaways

1. The U.S. economy could be in a lose-lose scenario for equities: Growth slowing below trend will increase unemployment, but re-accelerating growth would be inflationary.
2. The February Conference Board Consumer Confidence Index missed estimates for the third month in a row as expectations worsened and further labor market loosening was evident.
3. Roughly $500 billion of liquidity is entering the financial system in Q1, which is working as a financial cushion to the policy uncertainty lowering bond yields and the dollar.
4. We continue to see policy headline risk remaining elevated over the near term as the White House adjusts policy decisions in real time. As tariff policy continues to be highly fluid and uncertain, we see continued whipsaw rotations and potential for further downside to risk assets.
5. Canada and Mexico export 20% and 30% of their GDPs to the U.S., respectively. They stand to suffer the most from the impending tariffs. Trump's threatened 25% tariffs may cut nearly -8% off Mexico's GDP, and roughly -5% off Canada's.
6. Reasons for stock market caution include weakening internals (e.g., number of stocks above various moving averages, deteriorating A/D line), aggressive ETF flows, cyclicals deteriorating vs. defensives, and economic reports weakening. The debate is on as to whether the growth scare is real or not.
7. European equities have outperformed the U.S. so far in 2025. Europe's valuation improvement reflects growth sentiment data that indicate that Europe is past peak pessimism, without much evidence yet of economic/earnings improvement.
8. Through last Thursday, the average Magnificent Seven stock is down 8%, while the S&P 500 is flat. Capex increases are now eating into the margins of mega-cap tech stocks and beginning to hurt their strong free cash flow attraction.
9. The U.S. House of Representatives narrowly passed a FY2025 budget resolution that aims to provide U.S. $4 trillion in tax cuts and U.S. $2 trillion in spending cuts over the 2026-35 period.
10. President Trump's polls have fallen in the past two weeks. He will eventually realize the country likes incremental change, not mass layoffs.

Tariff headwinds and a growth scare rock risk assets

Global financial markets have hit a rough patch as the cumulative impact of President Trump's trade and related economic threats are fueling concerns that he will diverge from the pro-growth script that he initially followed during his first term. Then, the positive economic elements arrived first, primarily tax cuts, before the negative actions followed, i.e., a brief trade war. These negative actions caused a downturn in global trade and slowed the U.S. economy and corporate profits. A meaningful risk-off phase occurred in 2018, although the cyclically positive backdrop survived, and risk asset prices subsequently revived. To be fair, President Trump is still constantly shifting his narrative, making it difficult to anticipate the likely economic outcome. The small silver lining for equities is that the prior rise in U.S. Treasury yields has recently reversed, as investors are hedging against a negative economic outcome (coupled with the impact of the liquidity bazooka).

It would be dangerous for risk assets if bond yields were rising at the same time as growth fears were intensifying. This potential remains possible as long as the inflation backdrop remains concerning. For sure, investors are becoming more concerned about the growth downside than any inflation upside.

It is premature to assume that Trump will risk a significant outcome slowdown and a lasting risk-off phase, even though the probability of these outcomes has increased. The U.S. economy has had a good tailwind, which is unlikely to be easily undermined, but needs to be watched carefully.

The most likely path ahead is that Trump will move forward and apply some tariffs, albeit selectively, but will eventually reduce the hit after negotiations. This still implies that there is the likelihood of continued risk-off behavior (and possibly several such episodes), although we are betting that such setbacks will not be sufficient to derail the positive cyclical corporate profit backdrop, but the valuation threat remains.

It is somewhat encouraging that recent investment flows have not all been one-sidedly anti-equities, despite the difficulty in the U.S. market. Some non-U.S. markets have enjoyed solid gains. The excitement over U.S. exceptionalism in the later part of 2024 has given way to rolling over in the U.S. dollar and underperformance of U.S. equities, especially many of the former high-flying stocks. The process of fiscal reflation in the euro area will be slow, but additional spending is coming in some form that will support both faster growth and put upward pressure on German and regional bond yields (and possibly the euro).

U.S. price levels continue to move higher at a rate above the Fed's 2.0% target. There is little chance for lower inflation outside a recession. The combination of tariffs and an ongoing economic expansion will sustain the inflationary trend. As a result, measures of consumer inflation expectations have recently surged.

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	-1.96	2.05
MSCI ACWI EX U.S.	-0.71	6.63
MSCI EAFE	-0.02	8.15
MSCI EM	-1.97	4.77

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	0.85	2.34
Bloomberg U.S. Corp High Yield	0.37	2.02
Bloomberg U.S. Gov/Credit	0.83	2.25
Bloomberg U.S. T-Bill 1-3 Month	0.05	0.66

Alternatives (Index total return %)	Last week	Year-to-date
Real estate (FTSE NAREIT)	1.67	4.65
Commodities (DJ)	-3.74	4.76
Global listed private equity (Red Rocks)	-2.03	2.27
Currencies (DB Currency Future Harvest)	0.57	-0.75

Conclusion

The U.S. equity market today can be summarized as one that has high valuations at a time of already high earnings as well as high growth expectations. Consequently, there is little room to absorb any bad news. The risk of some economic damage from threatened trade actions is growing. Somewhat of an offset is the recent decline in Treasury yields.

Source: Bloomberg as of Feb. 28, 2025

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