Market Commentary – The Bumpy Path to More Trade Policy Clarity

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Market Thoughts

The tariff negotiations and the market reaction are generally playing out just as I suspected coming into the new year. I was a little surprised that Trump decided to negotiate tariffs with all the US's major trading partners at once, and that decision really rattled the markets. However, the 90-day pause on the "Liberation Day" tariffs has slightly eased some investors' fears. I do believe that volatility will remain elevated as news leaks out on the back and forth of trade negotiations, but we may be close to a bottom of the S&P 500's fall unless trade talks completely break down between one or more of US's major trading partners. I remain optimistic as corporate profits remain healthy as do the labor markets and the US consumer. However, we need to get past this cloud of trade policy uncertainty as it's holding back businesses from capital expenditures and hiring plans and may also dampen consumer spending. I believe we are on our way to clarity, but if I'm wrong and this uncertainty still exists 2 – 3 months from now, I will start employing more defensive strategies in our model portfolios.

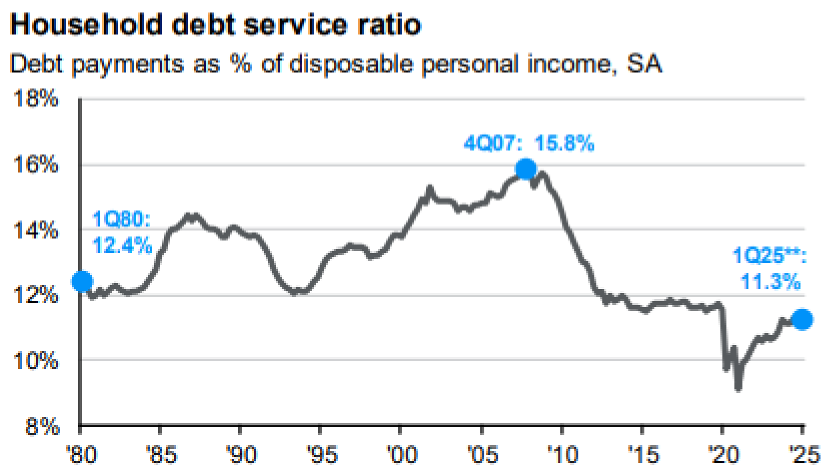
I view Trump's comment that "now is a good time to buy stocks" is further evidence that Trump considers the stock market performance is an important piece of his legacy. While Trump previously said he is not concerned about the stock market and is willing to accept a recession, I never believed that and I considered those comments as part of his high-stakes tariff negotiations. If the US economy fell into a recession due to high tariffs and businesses / consumers pulling back from spending, Trump risks losing majority control of the House and the Senate in 1 ½ years at the mid-term elections, and he clearly wants to avoid that scenario. The "Trump Put" was on display with the 90-day pause of "Liberation Day" tariff rates. Since Trump took office, the S&P 500 index is down roughly 10%, the index's worst performance in the first 94 days of any presidential term on record, according to Dow Jones Market Data. Trump wants to correct this trend quickly.

Economic Overview

The contentious relationship between Trump and Powell is nothing new, but Trump's comments on potentially attempting to remove Powell also rattled the markets. Trump has backtracked from those comments. We continue to see many similarities between Trump's 1st and 2nd terms where Trump makes bold public statements and if it causes a negative reaction to the stock market, Trump eases off those stances. I believe the Fed's independence is absolutely critical to the integrity of our economy and status as a safe haven for investments.

I'm getting a little concerned about the Fed holding rates too high for too long. There's plenty of evidence that the disinflationary trend is still in place and the economy is weakening, but Powell's tone still sounds hawkish. The money supply growth is below average trends (less than 4% over the last year vs a 30 year average in the range of 5.5% – 6%) and initial and continued jobless claims are slowly creeping higher. The latest inflation report was below expectations. While egg prices and instant coffee prices remain high, those increases are due to the bird flu and droughts affecting coffee beans. Higher rates will not bring down those items. Shelter inflation is the other most stubborn component of inflation (4% annually as of March 2025), but the housing shortage problem is the major cause behind those higher prices. Some members of the Fed may be reluctant to cut rates with the trade policy uncertain, but tariff inflation will most likely be transitory in nature. Tariffs may increase the price of particular items, but that means consumers have less money to buy other goods, so demand will fall, which will most likely leave overall inflation flat. It seems that Fed Governor Christopher Waller holds this view, but I'm concerned that he may be in the minority. I look forward to Powell's next press conference after the Fed meeting on May 7.

Consumer spending is slowing, but not slumping. We saw a positive surprise in retail sales for March as it rebounded from January and February. The bounce back can be attributed to several factors including cold weather in January, large amount of illness in Jan and Feb, and a rise in demand from consumers ahead of possible tariffs. The story of the US consumer remains a bifurcated one. Home equity in the US has skyrocketed 80% since 2020 (from $19.5 trillion to $35 trillion), nearly double the increase in wealth from stocks and bonds as of the end of 2024. However, this wealth effect benefitted the higher end consumer who is more likely to be a homeowner and have exposure in the stock markets. The household debt service ratio (debt payments as a percentage of disposable personal income) has slightly risen since COVID to 11.3%, but it is far from the levels right before the Great Financial Crisis (15.8% in Q407). Wage growth is also exceeding the current inflation rates, which help increase consumer's purchasing power.



Source: JP Morgan Asset Management, BEA. Household debt service ratio data are JP Morgan Asset Management estimates

The labor market is moderating but still very healthy as the unemployment rate is near historic lows. We saw another strong labor market report in March as well. S&P 500 profit margins are above their 5 year average (12.1% vs 11.7%) and as long as those margins remain healthy, we will most likely not see any significant pickup in layoffs.

Investment Outlook

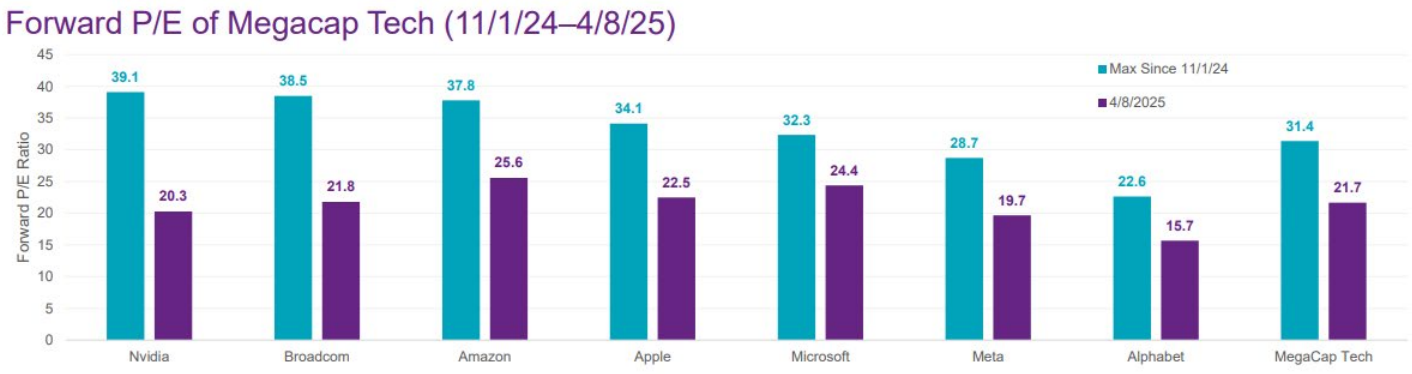
The US economy will most likely receive some tailwinds later this year through tax cuts and deregulation. Over the past few months, we have been shortening the duration of our fixed income portfolios in anticipation of interest rate volatility due to concerns regarding tariffs, inflation and an economic slowdown. Within our public equity holdings, we have increased our exposure to the Quality factor by focusing on companies with strong balance sheets and a track record of strong cash flows and earnings. While a recession is not my base case, I believe the odds of a recession are slightly higher than normal and we want to put more focus on companies that could withstand a possible economic downturn.

International equities have outperformed domestic equities this year due to lower valuations and improved international earnings. Tariff rerouting should benefit emerging markets outside of China. I will always advocate for international equity exposure, but I do believe US equities will outperform their international peers for the remainder of the year due to structural advantages in innovation and capital markets. As far as sectors that I'm most bullish on right now,

- Healthcare is projected to have the highest sector earnings growth rate in the first quarter at nearly 35% and the 2nd highest sector earnings growth rate for 2025 at 18%. Its PE ratio is roughly 16.3 right now, which is below is 5 year average of 17.1, so its valuation is attractive relative to other sectors. The aging demographics of the US and other developed countries should provide more demand for healthcare services.
- Utilities are projected to have the 3rd highest sector earnings growth rate in the first quarter. Utilities typically is one of the most highly leveraged sectors, so that sector should benefit from interest rates dropping. After a decade of anemic growth in power demand of roughly 1% to 2% annually, the AI revolution is propelling power demand growth estimates for utilities up to 6% to 8% annually over the next 10 years. This growth in power demand has the potential for improved earnings growth and durable multiple expansion for utilities.
- I still like Financials (specifically big banks) as M&A activity should pick up in 2025 as interest rates drop and Financial's profit margins should increase due to deregulation.

The three above sectors have some of the lowest revenue exposure as a percentage of foreign sales (as of 12/31/24) with Utilities the lowest, Financials the 3rd lowest, and Healthcare the 4th lowest, so these sectors should be more insulated from tariffs as compared to other sectors.

Finally, investors have a buying opportunity with Technology. The Mega Techs led the markets in 2023 and 2024, but have taken a beating so far this year. The Mag 7 is down 21.1% year-to-date (as of 4/22/25), while the "other 493" is down 3.1%. There are several reasons for this negative performance in 2025 including higher valuations, news of DeepSeek in January, and Technology has the highest revenue exposure as a percentage of foreign sales. Valuations have greatly improved since the start of the year and we are still in the very early innings of the AI revolution.



Source: Natixis Portfolio Analysis & Consulting, FactSet. Megacap Tech represents map cap weighted average multiple of Nvidia, Broadcom, Amazon, Apple, Microsoft, Meta, and Alphabet. Forward P/E represents price-to-earnings ratio based on the next 12-month earnings estimates.