# Market Commentary – Back Where We Started

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If you like volatility, you got it. The market swings so far this year have been remarkable. "Liberation Day" caused a massive sell-off in US equities as the large initial tariffs announced by the White House caused many investors' fears of a recession to spike. US equities started their climb back up on April 9 after news of a 90-day tariff pause on all countries except China. The market rally pushed even higher last week when the US and China slashed their massive recent tariffs for 90 days to allow more time to negotiate a trade agreement. The S&P 500 finished Wednesday back in positive territory for the year after it barely avoided a bear market during the April sell-off. What a ride!

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. The stock market is the one entity that Trump almost always listens and responds to. However, we are not out of the woods yet.

While the "Liberation Day" tariff levels have substantially dropped, we still have 10% tariffs for most countries and 30% tariffs for China. The market celebrated the tariff pauses but, we still have a cloud of uncertainty hovering over the markets and the economy as there's still questions as far as what the final trade policies will be for various countries. The other big questions are the impacts these tariffs will have on inflation, corporate profit margins, and consumer / business spending. We are starting to collect data on the impact of these tariffs, so let's review what we learned last week.

## Inflation

Last week we had two inflation readings with the Consumer Price Index ("CPI") and the Producer Price Index ("PPI") monthly reports. CPI rose a seasonally adjusted 0.2% for the month, putting the 12-month inflation rate at 2.3%, its lowest since February 2021. There wasn't overwhelming evidence that tariffs had a noticeable impact on the CPI in April but that was expected because the lags between changes in the effective tariff rate and when it is passed onto the consumer. The areas where tariffs likely boosted prices in April were in furniture/bedding, appliances and to a lesser extent toys. New vehicle prices were unchanged between March and April while used prices fell.

The more interesting inflation report was PPI, which declined 0.5% month-over-month in April. At a headline level, this reading seemed like great news as the decline was the largest since April 2020 when the index declined 1.2%. However, looking at the details that led to the decline in April was some less optimistic news - at least in regard to inflation. The bulk of the decline was driven by a 1.7% drop in trade services. This component measures the margins received by wholesalers and retailers, which suggests tariffs are beginning to hit their margins and that they are, at least for now, accepting some margin erosion rather than fully passing along the price increase. Outside of trade services, the other driver to the decline in April was portfolio management fees, which are directly linked to the performance in equity markets. Equity markets abruptly dropped after "Liberation Day" but have since more than reversed the decline after break-through talks between US and China trade representatives. As such, portfolio management fees will flip from a drag to a boost on prices in May.

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## Retail Sales

Retail sales growth slowed in April, edging up by 0.1%. April's data follows a large increase in March when sales spiked to its highest level in two years as consumers front-loaded many goods before tariffs were set to be implemented. Most economists had expected a flat month in retail sales as March's front-loading increase was expected to reverse in the following months.

While retail sales slowed down for the month, there was some good news within the report. There was a decent 1.2% increase in spending at bars and restaurants, a sign that the collapse in consumer confidence in recent months has yet to take a toll on consumers' discretionary spending. Economists view dining out as a key indicator of household finances. Most households remained financially sound, thanks to a resilient labor market characterized by low layoffs. The other development that may help support consumer spending going forward was the bounce back in the stock markets. The "wealth effect" describes the tendency for individuals to spend more when they feel wealthier. Rising stock markets and homeowners' equity values have positive impacts on the wealth effect, and, in turn, consumer spending.

## Wrapping It All Up

It's still too early to determine the impact these tariffs will have on inflation, corporate profits, and consumer spending. S&P 500 companies' profit margins are currently above their 5-year averages, so some companies are able to absorb some of the tariff costs….at least initially. How long these companies will be willing to absorb these tariffs is another story. Last week we heard earning reports from several large retailers, such as Walmart, who said they plan to raise prices this month and early this summer. These retailers are formulating strategies as far as which goods to price higher so they can remain relatively competitive on pricing while keeping an eye on profitability.

One of the biggest risks in the markets is the trade policy uncertainty as it's holding back businesses from capital expenditures and hiring plans and may also dampen consumer spending. It remains to be seen how much these negotiations will impact our trading deficits with certain countries. The US would like to see China turn from a mercantilist exporter into a consumer to create a more balanced trade. However, China has been attempting to increase consumer spending for years and has little progress to show. The same can be said for other heavy exporting countries such as Germany. No consumer spends like the US consumer.

Overall, I remain optimistic as corporate profits remain healthy as do the labor markets and the US consumer. However, as this trade policy uncertainty persists, investors should place more emphasis the Quality factor by focusing on companies with strong balance sheets and a track record of strong cash flows and earnings. The market may have come roaring back, but we still do not know the final outcome of these trade negotiations. Expect volatility to remain elevated and stay diversified!