Liberation Day

April 3, 2025

"In truth the prison, unto which we doom

Ourselves, no prison is: and hence for me,

In sundry moods, 'twas pastime to be bound

Within the Sonnet's scanty plot of ground;

Pleased if some Souls (for such there needs must be)

Who have felt the weight of too much liberty,

Should find brief solace there, as I have found"

-William Wordsworth, Nuns Fret Not at Their Convent's Narrow Room, 1807

Liberation Day has arrived for the United States. Unlike in most other countries where it is celebrated in reflection of the end of a past war or the dawn of a new revolution, Liberation Day in the U.S. as it has come to be known is the declaration of promised tariffs to free the country from the import of foreign goods. As we have seen since the prospect of tariffs were first reintroduced to the American public, gallons of ink have and will continue to be spilled dissecting the minutiae of how the various tariffs might impact every corner of the economy and financial markets. I look forward to my future evenings and overnights filled with such reading. But when it comes to evaluating the implications of what has culminated in Liberation Day from the current administration, I continue to prefer to paint the economic and financial market picture with broad brush strokes. For it is general, and not the specific, where the true answer of what we may ultimately and reasonably expect most likely resides.

Doom. Let's get right to it. The current administration final revealed their much ballyhooed and long anticipated tariffs on Wednesday. Put simply, they were much bolder and far reaching than generally expected. The already beleaguered U.S. stock market recoiled on the news, plunging by more than -4% at the start of the trading day on Thursday and setting a new peak-to-trough low of -12% dating back to the February 19 highs on the S&P 500 Index.

The U.S. Stock Market Decline Remains Orderly To Date

The relentlessness of the headline stealing news flow on a day-to-day basis from the current administration has been head spinning. But nearly all of us do not manage our investment portfolios on a day-to-day basis, as we instead dedicate ourselves to a long-term plan to achieve our financial goals. So what, if anything, should we take away from this latest news bombardment emerging from Liberation Day.

Solace. With no shortage of unsettling headlines for you to continue to read, my focus in these remaining pages is to focus on the constructive. And for that, I will be relying not on conjecture and perception, but instead will remain focused on what the hard data is telling us today. Has the probability of an economic recession risen in the U.S. between now and the end of the year in the wake of Liberation Day? Sure, but this assume the tariffs that were just announced actually stick (or if they are even implemented at all). I'll leave speculation for another day. Today, it's best to stick to the facts.

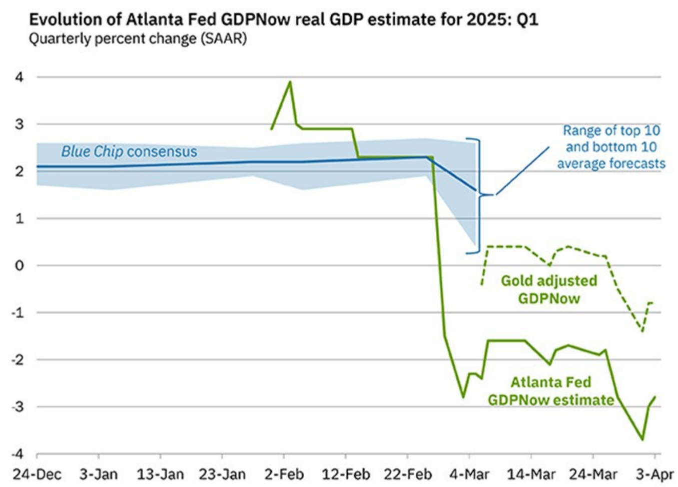
Yes, the U.S. stock market as measured by the S&P 500 is down once again today. But not all of the stocks in the market that makes up the S&P 500 are down. The previous highfliers that are most directly exposed to what may come with tariffs? Yeah, they've been on the receiving end of the monkey hammer as would be expected. Energy? Down -6% so far today. Industrials? Down -4 but off the lows. Consumer Discretionary? Down -5% but well off the lows. Tech? Oof - Down nearly -6% and falling still. In short, the usual cyclical subjects that are not only sensitive to the idea of an economic recession but also do business all around the world are down bigly so far today (yes, I still view tech as a cyclical sector despite the notions in recent years that it has become this invincible third category that will never go down – heard that one back in 2000 too – didn't buy it then, don't buy it now).

But what about some of the other sectors? Is it all bad today? Consumer Staples? Up more than +1% and continuing to streak to the upside since March 26. Health Care? Marginally higher through mid-day and holding its ground and trading meaningfully higher from where it opened yesterday. Utilities including those that are going to power the AI revolution? Also marginally higher through the mid-day and continuing to streak higher since March 25.

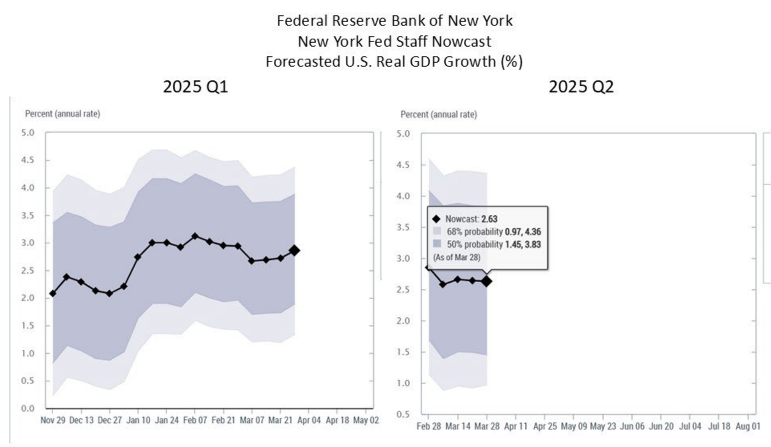
Putting this all together, is this a market in turmoil in the wake of the tariff announcements? Or is this a market that is in orderly rotation in the wake of a phenomenal tech run after so many years that needed a good reason to take a breather to regress valuations to the mean? This Chief Market Strategist remains in the latter camp.

Sundry moods. OK. But what about the rising risk of an economic recession? We absolutely need to continue to monitor for this risk. But according to the economic projection models from both the Atlanta Fed GDPNow and the New York Fed Nowcast, the U.S. economy continues to hum along at a solid growth rate. Could this change by the second half of the year? Absolutely. But changing your investment course because people think something might happen (soft data) is very different than changing your investment course because conditions are signaling that something is actually going to happen (hard data).

Economic Growth Expectations For 2025 Q1



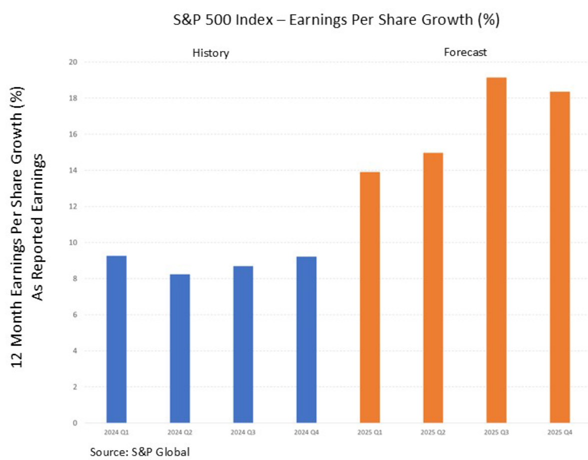
Economic Growth Expectations For 2025 Q1 & 2025 Q2



Federal Reserve Bank of New York, New York Fed Staff Nowcast
https://www.newyorkfed.org/research/policy/nowcast.

Let's take this one step further. Consider the aggregate corporate earnings forecasts from the 500 companies that make up the S&P 500 (503 stocks in the index, but 500 companies). The following is the latest projection for earnings growth for the companies that make up the S&P 500 from S&P Global dated Monday, March 31 at the start of this week. Despite all of the headlines and uncertainty and handwringing and speculation about what will ultimately come to pass with tariffs or anything else for that matter from a fixed investment and capital budgeting perspective, U.S. corporations are collectively still forecasting mid- to high teens earnings growth through the remainder of 2025.

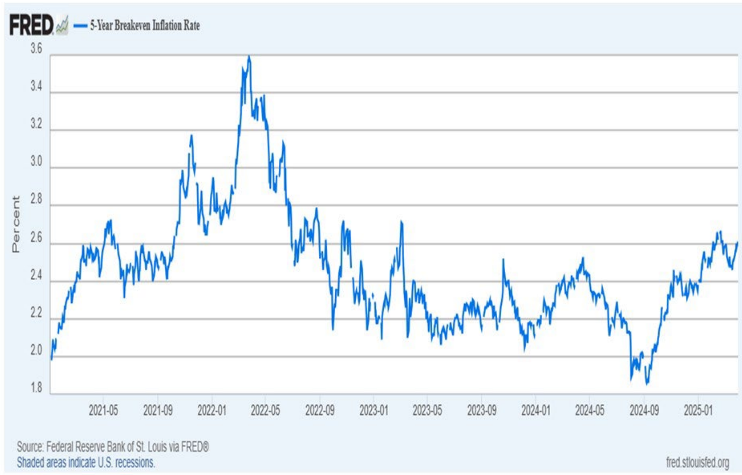
Corporate Earnings Forecast Remains Strong



Now it must be noted that the data and forecasts can change. New economic releases come out on a daily basis, and we are about to start into first quarter earnings season next week where companies will be updating their outlooks for the remainder of the year. But from where we stand today, the hard economic and corporate earnings data remains sound.

But what about inflation? I've been proclaiming repeatedly after all since the summer of 2023 that the number one downside risk for capital markets is a renewed rise in inflation. And tariffs are directly and inherently inflationary (despite the pretzel twisting logic suggesting otherwise I've been hearing from some economists lately). Won't the implementation of tariffs lead to a renewed outbreak in inflation? Perhaps, but only time will tell. In the meantime, I remain focused on what the market is actually pricing in for inflation expectations over the next five years. Just prior to Liberation Day, 5-year average breakeven inflation expectations remained firmly entrenched in the 2.5% to 2.7%, which is arguably right in the 2% to 3% sweet spot in support of strong and sustainable economic growth.

Inflation Expectations Remain Under Control



So where did the breakeven inflation rate that closed at 2.51% on Wednesday before the tariff announcements go once the news hit the headlines? 2.60%, or a whopping 9 basis points higher and still below the near 2.70% short-term peak reached back in mid-February. In a word, yawn.

Sauce for the goose. All of these forces remain good for the equity market goose long-term, and the same can be said for the bond market gander. And we are seeing this reflected in the movement in bond yields today. For example, the 10-Year U.S. Treasury yield closed on Wednesday at 4.20%, and following the tariff news it dropped as low as 4% (lowest levels since early October) during the trading day on Thursday. If you're a bond investor, you're lovin' the tariff news, as the long bond is up over +1% today.

These are not the moves of a bond investor that is worried about inflation. To the contrary, it's more of the move of a bond investor that might be thinking about a recession. But the lower bond yields go, the higher the equity risk premium and the greater the support for stock prices. Moreover, if the market isn't worried about inflation, this means the U.S. Federal Reserve would have increasing flexibility to cut interest rates if needed. And anyone investing since 2009 knows how much the stock market loves it some Fed rate cuts.

Bottom line. Today's stock market moves are certainly jarring, but greater volatility is what comes with a new administration moving at lightning speed in breaking stuff. The good news is that the underlying economic and financial hard data remains sound and the markets are continue to move and behave in an orderly way despite all of the noise.

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