Keep Calm And Carry On…Part Deux

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Christopher Pike, CFA®
chris.pike@northeastprivate.com
973-422-9140

Christopher Viola, AIF®
chris_viola@northeastprivate.com

Equity markets are in the midst of another growth scare, not totally driven by inflation pressures but rather mostly by policy uncertainty stemming from unconstrained Trump 2.0, in our opinion. But it is not just here in the U.S. where policy is disrupting the economy and capital markets. As we pointed out in our 2025 Outlook, 2024 witnessed national elections across 60+ countries, representing 50% of global GDP. Most recently, we had a national election in Germany, resulting in a right-leaning coalition. In our opinion, the current SOP for government here in the U.S. is what I coin "trial balloon policy," which involves launching a seemingly disruptive policy initiative and seeing who/how supports it, improves on it, or tries to shoot it down. Then, reshape it for public consumption and international digestion.

At the time of drafting this note, The S&P 500 is down over 6% from its record high of February 19th. Much of the sell-off has been driven by high-momentum Technology, AI-related companies, and the Discretionary sector.

Looking back to 2018, markets reacted similarly following the first salvo of Trump tariffs in January 2018. At the time, solar panels[1] and washing machines[2] were levied a 30-50% duty. Subsequently, in March 2018, President Trump placed a 25% tariff on steel[3] and a 10% tariff on aluminum imports, citing national security concerns in both cases.

Through the first quarter of 2018, the S&P 500 fell roughly 8%, and then recovered almost 11% through October of that year. However, another growth scare, technology sell-off, and round two of tariffs policy caused almost a 20% retracement in the S&P 500 during the last two months of 2018. However, by the end of 2019, the S&P had once again recovered, higher by 22% from March 2018 lows, and over 37% from year-end 2018 lows.

In our opinion, the economy remains relatively sound. People have jobs, and while discretionary spending may soften, consumers will still spend. Until we observe more widespread and significant challenges in the labor market, we will remain relatively sanguine about the economy. Further, we believe while inflation is top of mind for many, immigration will still have a modest impact on wage pressures, and while avocados may very well be 25% more expensive next week, we reiterate that tariffs are not inflationary, but rather a price reaction. This means that tariffs, for the most part, are a one-time upward jolt in prices, which could be reversed quite quickly if trade and policy negotiations are successful.

Our hope, in the current case, is that President Trump is "ripping the band-aid off" by following through on more aggressive campaign tariff promises and, hence, front-loading any market sell-off. We still believe much of President Trump's tariff policies are negotiation stances rather than a precursor to a Smoot-Hawley Tariff Act 2.0. At this point, we are still targeting 6,300 in our base case for 2025, which is 8% higher than current levels.

We remind investors that the long-term return for equities is roughly 12% per year and, on a 5-year look-back, over 10%. Allocations matter for both long and short-term planning. So near-term liquidity needs may warrant more cash-like positioning. But longer-term, investors should keep calm and carry on.

If you would like to discuss our views and expectations for 2025 further, please give us a call. We'd love to hear your thoughts.

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[1] President Trump Slaps Tariffs on Solar Panels in Major Blow to Renewable Energy
[2] Office of The United States Trade Representative
[3] Trump declares his trade war: targets steel, aluminum (Axios)

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