Accredited Wealth Management

Investment Commentary

March 2025

Since the start of this year, we have seen a broadening out of market returns and portfolio diversification is paying off. This is playing out in several ways, geographically, by sector and theme. Below we highlight some of the shifts in financial market performance so far through the end of February.

- The equal-weighted S&P 500 index has outperformed the market cap-weighted index. The result of the Magnificent Seven and other large cap stocks in technology and artificial intelligence themed stocks underperforming.
- Foreign stocks are outperforming US stocks by a wide margin, especially European stocks. Through the end of February, European stocks are up 10.5%, the MSCI EAFE Index is up 7.3%, while the S&P 500 is up 1.4% and US small cap stocks are down (2.9%).
- Globally we are seeing new leadership at the sector level, with the financial sector up 8.5% and healthcare up 7.4%; while technology is down (3.4%), and consumer discretion is down (2.4%).
- Uncertainty around economic and trade policies has led to lower yields, contributing to core bonds returning 2.7% year-to-date. It has also helped interest-sensitive sectors like real estate investment trusts, returning 4.8%
- As we enter the beginning of March, the above trends look to be continuing and maybe even accelerating.

Below we share some thoughts on the current market environment and things we are watching closely.

Still Walking the Tightrope?

In January we wrote that the financial markets were balancing on a tightrope. Suggesting that financial markets were balancing competing forces, with the positive forces being a strong economy, good earnings, the potential for tax cuts, and less regulation. While the negative forces included high valuations, potentially higher inflation and interest rates, and chaotic economic policy. As we write this commentary in late February, the financial markets have balanced these competing forces fairly well, managing to stay on the tightrope for now.

We must admit the level of chaos in economic policy seems to be ramping up, and in fact, this may be by design as explained by Steve Bannon, former adviser to President Trump, in a recent interview. Bannon described that the president's strategy is to make every day a "day of thunder." Essentially, Trump is betting that the media can focus only on one thing at a time. If the administration comes out with 100 things at once, explained Bannon, the media will be overwhelmed and not able to keep up. We are concerned this may start to take a toll on market participants, if investors become overwhelmed by the chaos, they may lose faith in the positive forces mentioned above, making staying on the tightrope a far more challenging endeavor.

To help filter through the noise and focus on the 'signal', we think it is important to understand the economic philosophy that is driving the Trump administration's aggressive policies. In the next section, we highlight the economic strategy of Scott Bessent, the current Treasury Secretary, that is driving policy for the Trump administration.

Understanding 'Bessenomics'

Scott Bessent is a respected Wall Street veteran, and his economic strategy can be summarized by his 3x goals of: 3% real economic growth; a federal deficit of 3% or less; and an increase in domestic oil production of 3 million barrels per day. To achieve his 3x goals, the Trump administration will focus on the following policies:

- Pressure the Federal Reserve to run an easy monetary policy to boost growth and stabilize the public debt-to-GDP ratio.
- Curb immigration.
- Use import tariffs and dollar devaluation to create manufacturing jobs in the US.
- Extend the 2017 tax cuts and lower other taxes at the margin.
- Reduce red tape, enact broad deregulation, promote oil production, and limit government involvement in the economy.

The challenge is the first four items above are inflationary, and the only way Bessonimcs can work is to reduce fiscal spending and have interest rates trend lower. Simply put, Bessonomics will not work unless borrowing costs (interest rates) are low enough to make debt dynamics sustainable and keep the economy growing. Both of these objectives may be difficult to achieve without forcing an economic slowdown, which raises the risk of a recession later this year.

Signs the Tightrope is Getting Wobbly

We are starting to see signs that economic growth has slowed in recent weeks. This can be seen in the weaker data on retail sales, consumer confidence, services purchasing managers' index (PMI), and the Citi US Economic Surprise Index dipping into negative territory. A key contributor to the slowdown is uncertainty around policy, especially in the areas of trade and fiscal spending. Already we have seen effective tariff rates rise by 1.7% this year according to BCA Research, which is the equivalent to the entire increase observed during Trump's first term. This of course does not even include potentially huge tariff increases being threatened against Mexico, Canada, and others that are set to go into effect today. These policies are hindering economic growth prospects by increasing future inflation expectations, constraining the Federal Reserve's ability to cut interest rates, and creating an uncertain environment for business leaders. With respect to fiscal policy, the biggest source of uncertainty centers around the effectiveness of DOGE (Department of Government Efficiency). A recent Wall Street Journal analysis was able to substantiate only $2.6 billion of the $55 billion in savings claimed by DOGE. In fact, the trend in federal noninterest spending remains slightly above 2024 levels, putting into doubt Scott Bessent's goal of a 3% federal deficit or less. In addition, the indiscriminate nature of DOGE's firings is increasing anxiety that may reduce economic spending and could ultimately increase unemployment by hundreds of thousands of workers. The long-term goal of a more efficient government is admirable, however, the haphazard execution of DOGE's policies and trade policies may have the unintended consequence of pushing the economy and financial markets off the tightrope and towards an economic slowdown or worse.

S&P 500 Beige Book

Each quarter, the research team at Goldman Sachs put together a research report, the S&P 500 Beige Book, summarizing the key themes being discussed on S&P 500 companies' conference call. We always find the report informative and helpful to understand the key issues that corporate management teams are focused on. Below is a summary and highlights of the three key themes discussed in this quarter's report.

- How Tariffs are impacting business
- The strength of the US Dollar and the impact on earnings
- The impact of Artificial Intelligence (AI)

Tariffs: Companies are highly focused on their plans to accommodate potential policy changes under the new administration. Companies discussed a wide range of plans related to tariffs. Some companies are hesitant to act with so much uncertainty, while others are looking for solutions such as pre-ordering items ahead of the tariffs and looking for ways to pass the costs on to consumers.

US Dollar: The trade-weighted dollar appreciated by 6% in the fourth quarter of last year, which can act as a headwind to overall sales and earnings estimates. Companies are looking for ways to mitigate the impact of a stronger dollar and may implement more currency hedging and some may report results using a constant currency, to blunt the impact of a stronger dollar.

The Impact and Plans for AI: There is still a lot of enthusiasm for AI, however, more attention is being focused on how to monetize the investments being made in artificial intelligence. There is wide belief that companies will be able to deploy more tools internally and into their products, allowing employees and customers to benefit.

In general, our portfolios are well positioned for the current environment and have been performing well on a relative basis to the broad markets. If you have any questions regarding this commentary or your investment strategy, please give us a call.

Best regards,

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