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Doll's Deliberations®

Weekly Investment Commentary

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Summary

After record closes on Tuesday and Wednesday, the stock market took a hit Thursday and Friday. For the week, the S&P 500 was down (-1.63%), along with the Dow (-2.48) and NASDAQ (-2.49). There is still a lot of uncertainty surrounding tariffs, taxes, and geopolitics. Earnings are a bright spot amid continued margin expansion, although stretched valuations and softening forward guidance are increasing concerns. Best-performing sectors were utilities (1.50%) and healthcare (1.14%); worst performers were consumer discretionary (-4.28%) and communication services (-3.68%).

Equity markets (Index total return %)	Last week	Year-to-date
DJIA	-2.48	2.29
S&P 500	-1.63	2.42
NASDAQ	-2.49	1.18
Russell 1000	-0.09	4.28
Russell 1000 Growth	-2.76	0.90
Russell 1000 Value	-0.94	4.13
Russell 2000	-0.78	1.53

S&P equity sectors (Index total return %)	Last week	Year-to-date
Communication services	-3.68	4.92
Consumer discretionary	-4.28	-3.35
Consumer staples	0.95	6.50
Energy	1.08	5.96
Financials	-1.98	5.10
Heathcare	1.14	6.53
Industrials	-2.00	2.32
Information technology	-1.78	-0.19
Materials	-2.00	4.73
Real estate	0.44	3.85
Utilities	1.50	6.06

Key takeaways

1. The University of Michigan's consumer sentiment index fell sharply to 64.7 from 71.7 in January, with deterioration across all components. Most significantly, long-term inflation expectations surged to 3.5%—the highest since 1995.
2. Labor market concerns have intensified, with over half of consumers expecting rising unemployment in the coming year—the highest level since 2020.
3. The U.S. economy continues its gradual expansion, with manufacturing's modest improvement offsetting some softness in the services sector. While growth is cooling relative to last year, we are not (yet) experiencing a downturn.
4. Inflation remains sticky, still propelled by the lagged effects of Covid-era surges in federal outlays and money growth.
5. The 4Q earnings have come in strong once again, with 74% of companies beating estimates. Forward guidance, however, has come in softer, largely due to tariff uncertainty and some anticipated slowing in the economy.
6. So far this year, the median return of the Magnificent Seven is 4% below the return of the S&P 500, with only Meta and Amazon outperforming.
7. YTD, the U.S. stock market is very close to the average and median of all stock markets. Many European markets are leading the way.
8. According to Strategas, active managers are off to a strong start this year, with 75% outperforming the S&P 500 in January.
9. President Trump's approval numbers have begun to fall. Many think the mass layoffs are too harsh, and the firings are beginning to impact economic activity.
10. It seems increasingly clear that defense spending will have to increase in Europe, as the U.S. seems to be pulling back on its willingness to defend Europe.

The capital markets path forward remains murky

Global financial markets continue to be whipsawed by shifting threats and demands from the new U.S. administration. Generally, investors are still downplaying the threats and focusing on what is still a choppy, but modestly positive, risk-on backdrop. Monetary conditions are not restrictive in the major developed market economies, and policy rates are still being lowered in some of the smaller economies. Global economic activity is on track to improve.

Perhaps President Trump will finally move forward with significant tariff and trade restrictions and take the risk that this could trigger an end to the global business expansion. In such an outcome, equity and credit markets would weaken notably, providing a clear warning of economic trouble. De-risking would be prudent if such an outcome seems probable. On the other hand, Trump may continue the pattern of his first month, threatening significant action only to ultimately not take any steps to risk derailing the global economic expansion, with minimal damage to the U.S. Risk asset prices could periodically sell off in the face of ongoing threats. However, the choppy risk-on backdrop would likely persist as investors keep looking through the rhetoric and stay focused on the reasonably positive corporate earnings backdrop.

Amidst all the geopolitical and domestic political noise around the globe, equity markets have managed to hold their own, aided by the ongoing relative calm in government bond markets. Credit spreads remain extremely tight and inconsistent with a negative economic outcome; rather, they imply an ongoing low corporate default environment that continues to benefit from the strength in corporate earnings. In addition, global oil prices are holding at the low end of their range, despite elevated tensions in many key oil-producing regions, and are not an impediment to global growth.

International equity markets (Index total return %)	Last week	Year-to-date
MSCI ACWI	-0.03	5.18
MSCI ACWI EX U.S.	0.01	7.00
MSCI EAFE	-0.30	7.98
MSCI EM	0.67	5.50

Fixed income markets (Index total return %)	Last week	Year-to-date
Bloomberg U.S. Aggregate Bond	-0.08	1.03
Bloomberg U.S. Corp High Yield	0.07	1.70
Bloomberg U.S. Gov/Credit	-0.11	0.98
Bloomberg U.S. T-Bill 1-3 Month	0.04	0.58

Alternatives (Index total return %)	**Last week**	**Year-to-date**
Real estate (FTSE NAREIT)	0.96	3.67
Commodities (DJ)	0.98	8.83
Global listed private equity (Red Rocks)	-0.95	5.23
Currencies (DB Currency Future Harvest)	-0.75	-1.31

The euro area economy has been negatively impacted by the more uncertain and threatening global backdrop since 2022. However, Europe has recently started to register positively surprise expectations, although this has mostly reflected the extreme pessimism among investors and analysts. Still, a modest improvement in activity appears to be underway, and conditions for better growth exist.

It is possible that the global economic expansion will ultimately end due to a military or trade war. Absent such wars, we still see this decade's biggest economic threat to be sticky and above-target inflation. While the risk is highest for the U.S., due to its superior economic performance, significantly positive output gap, and accommodative monetary fiscal policies, the threat exists to varying degrees around the developed world. The implication of higher inflation in the U.S. is that monetary conditions will eventually need to tighten to the point where economic growth is sufficiently weak to end the inflation threat. However, the entrenched dovish biases at central banks, and their quick pivot to easing policy last year, underscore that this outcome is far from imminent.

Conclusion

Global growth is slowly firming, led by the still-strong U.S. economy, which implies that the uptrend in corporate earnings will persist, assuming U.S. tariffs are applied only selectively. Thus, the choppy backdrop should persist until a full-blown trade war erupts, there is an upside breakout in bond yields, or economic growth slows.

Source: Bloomberg as of Feb. 21, 2025

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