The Wrong Kind of March Madness

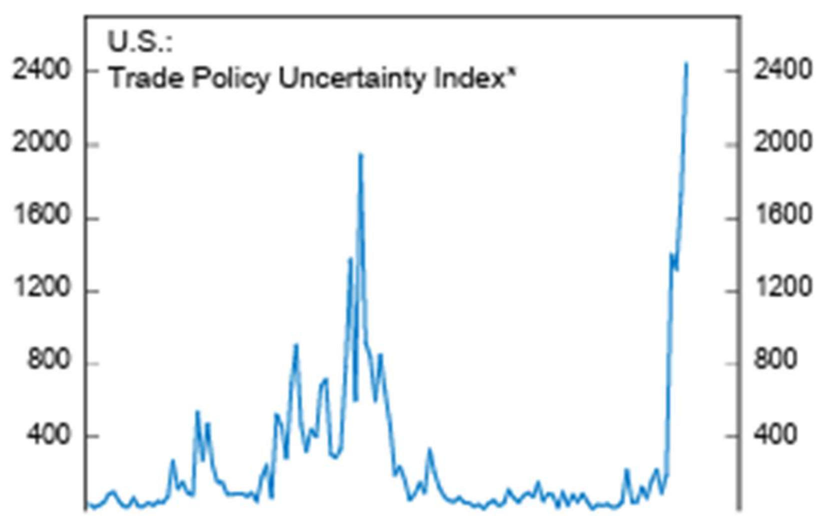
Our investment framework since the November elections has been structured as follows:

a) The business-friendly pillars of the Trump administration's economic policy – deregulation, low business taxes, and a real effort to rationalize government spending – tilt us optimistic about the investment outlook for the next 2-4 years.
b) We expect the first 100 days of the Trump administration to be particularly volatile, and we worry that an overly isolationist approach to trade and global relations could derail the investment-friendly aspects of its agenda.

There is an important assumption embedded in our positive bias, which is that financial markets can act as a governor-of-last-resort against President Trump's propensity to go too far too fast. We base this assumption on Trump's revealed preference for rising stock prices (at least historically), and the market fluency of key cabinet members like Treasury Secretary, Scott Bessent, who is more than capable of articulating the downside risks of a poorly designed policy agenda. The million-dollar question is, "Will Trump listen?" This question is being tested as we speak.

For better or worse, the Trump administration is pursuing a paradigm shift in America's relationship with the world that has ramifications for consumers, corporations, and the financial market outlook. Thus far, the market reaction reflects abject confusion more than any other verdict…first sharply higher, then promptly lower in the case of the U.S. stock market. The Trump administration has not helped its cause by appearing ill-prepared with official announcements that are often delayed or watered down within hours. This sows confusion among consumers and businesses that freezes decision making, prompting many economists to talk seriously about the possibility of a recession.

Policy Uncertainty is Taking a Toll
1-1-2015 to 3-11-2025



Source: Alpine Macro; Economic Policy Uncertainty

Framing Expectations

If the economy slips into recession the stock market has further to fall, in our opinion. However, we consider a recession to be a very low probability for two reasons. First, we expect the Trump administration will eventually respond to negative signals from the stock market and the economy, despite recent tough talk about ignoring any “disturbance” that might arise from the initial phase of their ambitious agenda.

Time Spent in Recession
1-1-1870 to 12-31-2023

Time Period	% of Time Spent in Recession
1870 – 1945	40%
1945 – 1980	20%
1980 – 2023	10%

*Source: Rockefeller International; Financial Times

More importantly, it is very hard to push the U.S. economy into a meaningful downturn for structural reasons that we expect can hold in all but the worst-case scenarios for global trade and geopolitics. To illustrate this point, consider the two tables above and below showing that *the riskiness of economic life has declined dramatically over many decades*.

Decade by Decade Volatility of GDP and Consumption
1-1-1930 to 12-31-2019

Standard Deviation by Decade*

	GDP	Personal consumption
1930-1939	8.52	5.91
1940-1949	9.45	3.73
1950-1959	3.26	2.08
1960-1969	1.59	1.44
1970-1979	2.38	1.93
1980-1989	2.41	1.87
1990-1999	1.41	1.43
2000-2009	1.93	1.71
2010-2019	0.44	0.59

*Standard deviation of annual % change

*Source: Bureau of Economic Analysis (BEA); Strategic Economic Decisions, Inc.

Too Soon to Panic

We share this data about our economy's resilience to support our belief that professional chatter about recessions spins up far more frequently than it should. Recall as recently as three years ago when most economists predicted that surging interest rates would trigger a recession by the end of 2022…then sometime in 2023…and ultimately…never mind.

We are not suggesting there will never be another downturn. Of course there will. Our point is that it takes a lot to topple our broadly diversified / low correlation among industry sectors / dual income household / activist fiscal and monetary policy-supported / service-based economy. We try to frame our investment decisions around this reality.

No One Told the Bond Market

Recent price action in the market for sub-investment grade, "junk" bonds supports our case to remain calm for now. Junk bonds have always been a useful warning signal of stress in the economy because highly indebted companies are naturally vulnerable to economic disruption. When economic stress rises, so does the yield on junk bonds to compensate investors for a rising risk of default (note the dramatic spike in early 2020 in the chart below during the period of maximum uncertainty around Covid). In contrast, the current period of chaos in Washington has barely registered thus far, and the absolute level for this indicator remains near the *bottom* of its 10-year range (per below).

Yield Spread on Single-B Rated "Junk" Bonds
3-11-2015 to 3-11-2025

Source: St. Louis Fed

Unfortunately, the Stock Market Received the Memo

The stock market has been less fortunate thus far due to the vulnerability of corporate profit margins to a potential trade war. Estimates vary, but the consensus seems to cluster around the $12-$15 per share range as a likely hit to earnings for the *S&P 500 Index* due to the various tariffs that have been proposed thus far. Earnings estimates could have further to fall if bilateral trade disputes continue to escalate, and we would expect stock prices to react.

However, a pullback in corporate profit margins is not the same as a recession for the broad economy. A reduction in earnings estimates typically triggers a "standard" correction in the stock market (i.e. 10%-15% drawdown from a recent high), whereas an *economic* recession involves mass layoffs, a ballooning budget deficit, and a bear market for stocks (i.e. 25%-35% drawdown). We believe this is an earnings event.

Dry Powder at the Fed

The Trump administration's attempt to reorient America's place in the world has justifiably captured the primary focus of investors, but monetary policy still matters, and on this front, the news is relatively good. The Federal Reserve (Fed) has dropped its policy interest rate by one percentage point since the height of its inflation fight in 2022, but short-term interest rates remain far from neutral, much less stimulative as a tool of domestic monetary policy. If necessary, the Fed has significant capacity to support the economy with lower interest rates and other tools.

U.S. Interest Rate Policy is an Outlier
Central Bank Policy Targets
As of 3-13-25

United States	**4.50%**
Canada	**2.75%**
Eurozone	**2.50%**
Japan	**0.50%**

Source: Bloomberg

Not All Markets Are Troubled

Stocks are clearly struggling to adjust to the hyperactive and haphazard policy actions coming out of Washington, but thus far the damage has been contained to a normal correction of a magnitude that should be expected every 12-18 months under any market conditions. This is what stocks do.

In better news, bonds are having a good year so far, and unlike 2022 when stocks and bonds suffered together, this year has seen the fixed income markets return to their normal role as a ballast for risk management in a broadly diversified portfolio.

We expected the first 100 days of the new administration to be particularly volatile, and here we are. Volatility reflects uncertainty, but it also creates opportunity. We continue to lean optimistic in the face of heightened uncertainty, and we are on the prowl for opportunity.

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