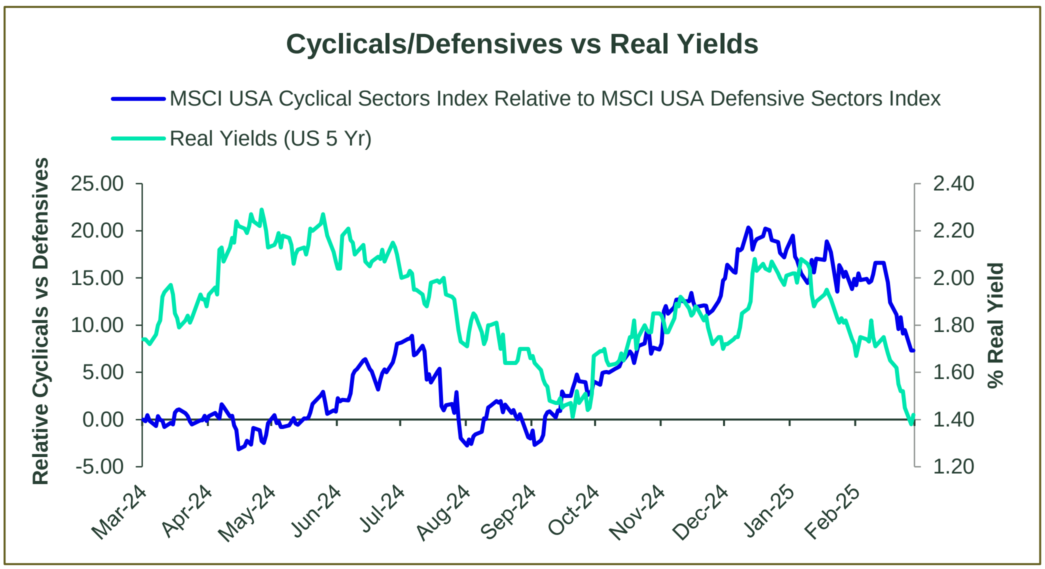
March 6, 2025
Commentary

Weekly Market Update

Insight of the Week

Inflation Or Growth – Which One Is It?

The new presidential term began seven weeks ago, triggering dizzying amounts of executive orders, and inciting tariffs, inflationary impulses, federal layoffs, and the mysterious exertions of the Department of Government Efficiency (DOGE), highlighting only some of the outcomes of an otherwise incomplete list. A market's efficiency is unmatched, even by DOGE's ambitious standards, but the bond market appears unresolved. US 10 yr treasury yields surged higher in Q4 2024 because of economic optimism, with some citing inflation concerns. However, since mid-February, yields have dropped from almost 4.8 to 4.1% due to lower growth concerns. Which one is it and has the equity market reflected these same moves?



Source: MSCI, FactSet, State Street Global Advisors. Total return in USD as of 3/4/2025. Real yields represented by the yield of the US Treasury Constant Maturity Inflation-Indexed (TIPS) 5 Year Index.

The chart above shows the relative relationship between cyclical vs defensive equity sectors, along with 5 year real yields. The path of real yields oftentimes represents future economic growth expectations. Cyclicals sectors tend to have a high sensitivity to the business cycle, having higher profits during times of growth, while the defensive sector has less sensitivity to the cycle. Looking at the cyclical vs defensive pair gives deeper clues of investor concerns below the surface. For instance, even as overall YTD S&P 500 returns[1] are only slightly negative, the cyclical vs defensive pair has seen a meaningful move lower since January, signaling deeper growth concerns. At the same time, we've seen real yields drop

[1] As of 3/5/2025

60bps over the last couple of months. Despite much of the recent narrative about higher inflation, especially relating to recent good's prices, markets are reacting most to the risk of slowing business growth in response to February's flash PMI data.

US equities investors have taken notice, with the S&P 500 down 4.91% over the last two weeks. However, we just finished a healthy earnings season that gave the S&P 500 10% earnings growth in 2024, with slightly higher expectations of 12% earnings growth for 2025. We also expect real economic growth to remain over 2% in 2025. While it's easy to get caught up in the volatility, we don't believe it's time to panic. However, we acknowledge that the market today is more focused on downside risks. For more of our thoughts, please visit When Data and Headlines Don't Quite Match Up: Where We Stand on Markets and the Economy.

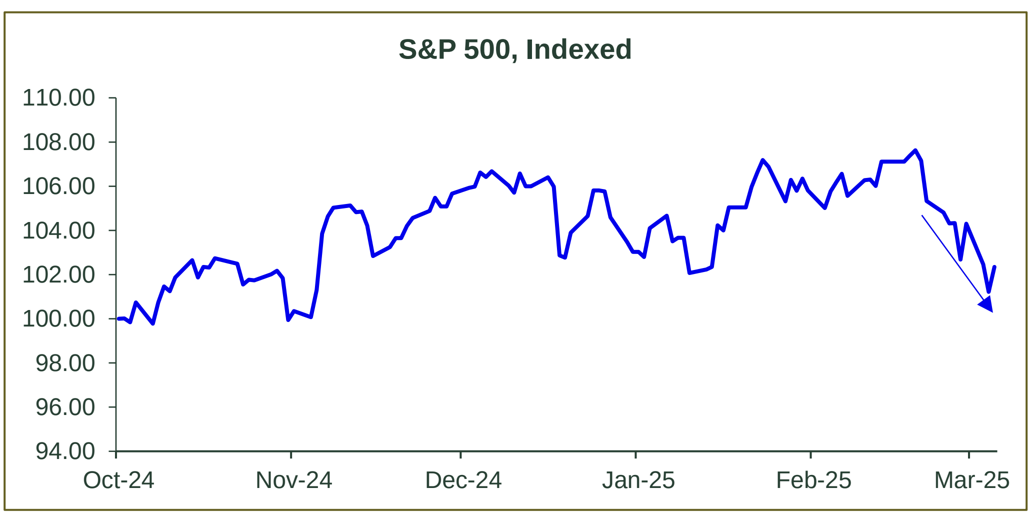
Source: MSCI, FactSet, State Street Global Advisors. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Equities

An Equity Market Focused on the Risks

U.S. equities have experienced heightened volatility, primarily due to the announcement and implementation of new tariffs and escalating policy uncertainty. In early February, President Trump announced 25% tariffs on imports from Canada and Mexico, alongside a 10% tariff on Chinese goods – these measures were delayed but ultimately took effect on March 4th. The immediate market reaction was pronounced; the S&P 500 fell by 1.2pp and NASDAQ lost 0.4pp following the confirmation of the tariffs, reflecting investors' concerns about potential economic repercussions.

The consequences of tariffs could be both beneficial and hurtful for the economy and depend on the scope, duration and retaliatory risks. Depending on how the policymakers navigate tariffs' implementation, it could either foster internal growth and trade balances, or harm export competitiveness and currency. In a recent paper, The Price of Protectionism seeks to consider a plurality of outcomes.



Source: FactSet. Data is from 10/1/24 till 3/4/2025, indexed to 10/1/24.

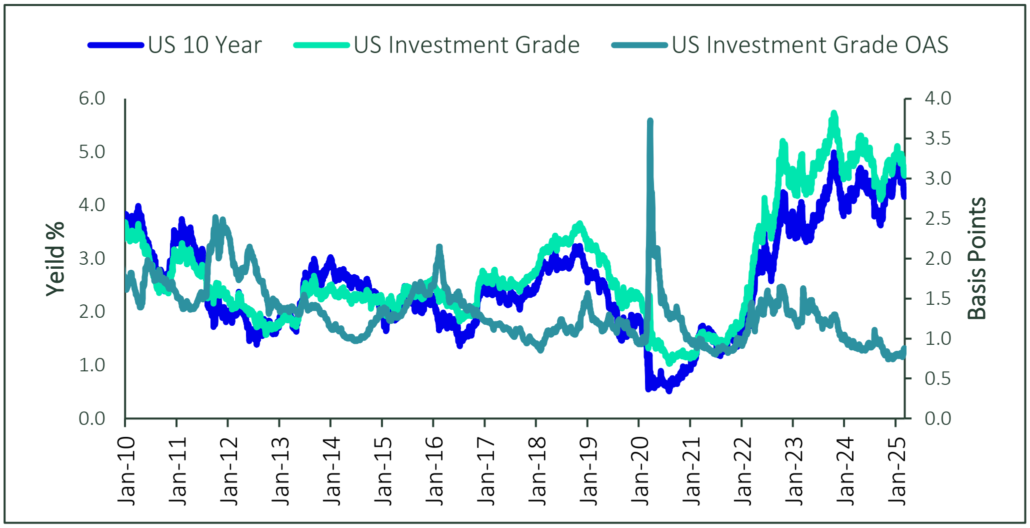
While these developments have undoubtedly contributed to short-term turbulence, the longer-term consequences for the U.S. economy still remain uncertain, leaving investors and policymakers vigilant as the situation unfolds. Strong earnings growth in 4Q'24 came in at roughly 18%, indicating that the fundamental pillars of the market (profitability) remain intact. However, we know the transition mechanism for economic data is lagged, and the market is precariously teetering between news of renewed inflation and slower economic growth. Despite this real concern, and the proliferation of noise, we remain consistent with our views, which still favors the U.S., but with a discerning focus on this administration's policy pronouncements.

Source: FactSet. Data is from 10/1/24 till 3/4/2025, indexed to 10/1/24. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Fixed Income

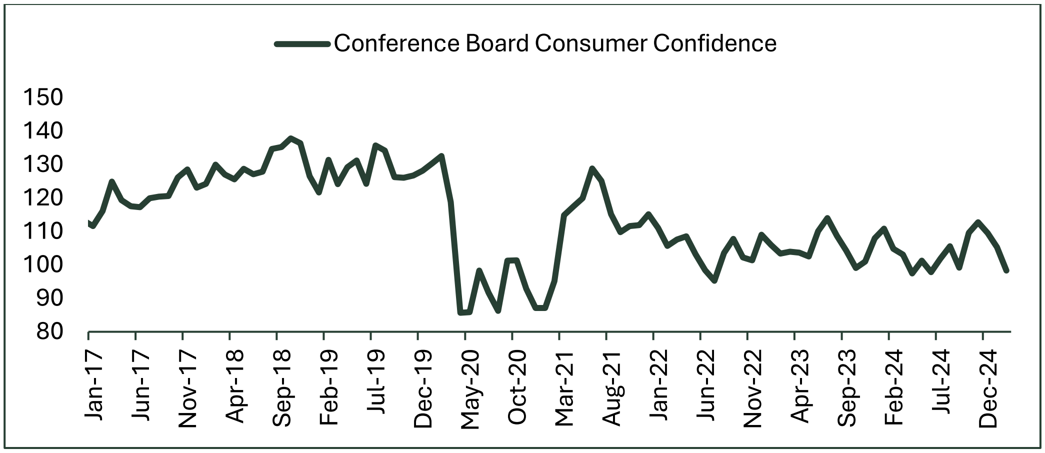
Credit Spreads May Bottom

After reaching record tights early in 2025, credit spreads may be entering a bottoming phase as investors turn defensive amid weaker economic data, declining consumer sentiment, sticky inflation, and rising fears around the impact of tariffs.



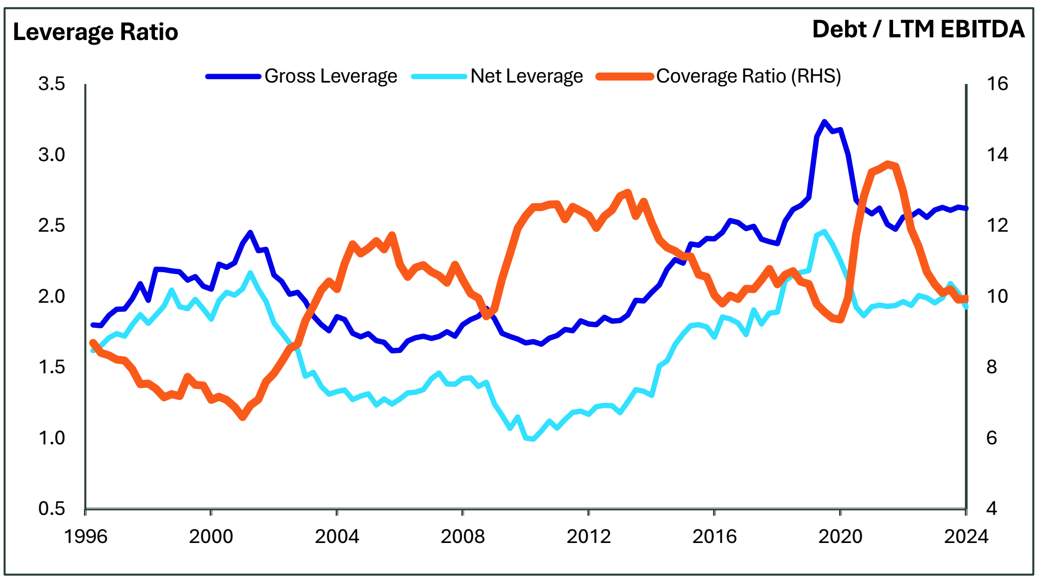
Source: Bloomberg as of March 5, 2025.

Key economic data such as inflation (as measured by CPI) remained sticky as consumers grapple with high energy and food prices. While ISM data came in stronger than expected, economic data overall has surprised to the downside and consumer confidence dropped sharply amid fears of slower growth.



Source: Bloomberg as of February 28, 2025.

Trade uncertainty only exacerbated concerns as businesses try to determine the impacts of tariffs and shifting global alliances. Investment grade spreads, which reached record two-decade tights, have risen 10 basis points since February 20, 2025.



Source: Bank of America as of December 31, 2024.

Strong fourth quarter results, as evidenced by strong profits and growth support tight investment grade corporate spreads, but markets remain vulnerable to economic shocks and shifts in sentiment. Against a backdrop of slower growth, tariffs, and uncertainty related to changing policies, spreads may widen as investors see risks ahead.

Source: Bloomberg, Bank of America. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

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*Pensions & Investments Research Center, as of 12/31/23.
†This figure is presented as of December 31, 2024 and includes ETF AUM of $1,577.74 billion USD of which approximately $82.19 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Currency Risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Generally, among asset classes, stocks are more volatile than bonds or short-term instruments. Government bonds and corporate bonds generally have more moderate short-term price fluctuations than stocks, but provide lower potential long-term returns. U.S. Treasury Bills maintain a stable value if held to maturity, but returns are generally only slightly above the inflation rate.

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