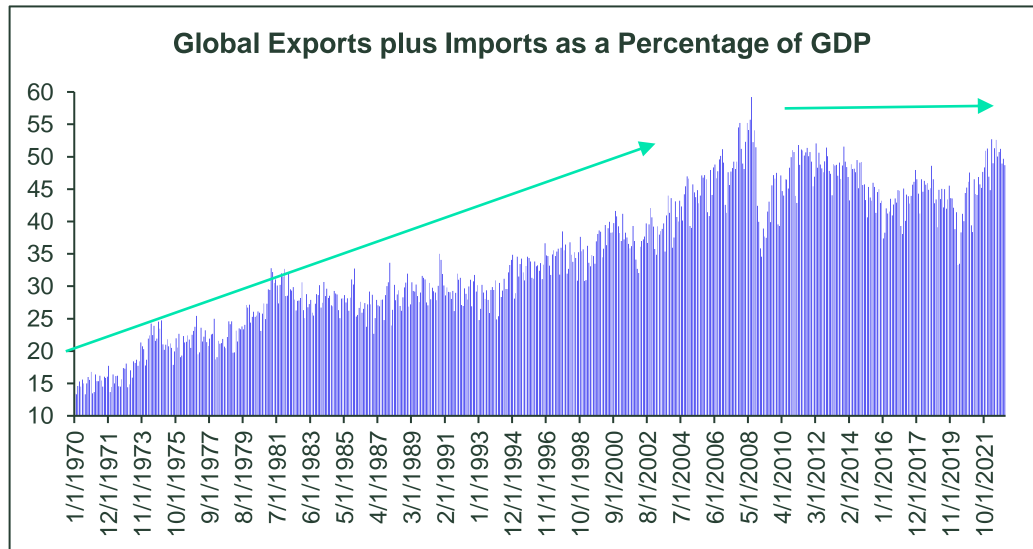
March 13, 2025
Commentary

Weekly Market Update

Insight of the Week

Economic Fragmentation

Prior to President Trump's inauguration, it was known that his administration viewed tariffs as a viable tool to accomplish desired outcomes, so in some regards, we can't be too surprised with all the news of late. However the unknown was, and still is, the degree to which they will be enforced, along with their impacts on growth and inflation across the world.



Source: SSGA Macro Policy, IMF, Macrobond. Annual data as of December 2022.

The chart above shows a 50 year history of global trade (exports plus imports) as a percentage of GDP. The increasing amount of trade over prior decades was a clear trend, leading to more dependence on economies other than their own. Free trade agreements facilitated the easy movement of goods from lowest cost producers to other countries.

However, something seems to have changed since the financial crisis of 2008 where the upward slope of globalism has halted and has now gone sideways. It's not quite de-globalization, but the globalization momentum has clearly stopped. Besides a stop of the trend, what we've also seen over the last 10-15 years has been a shifting of trade to more geopolitically aligned countries. Overall, the current political mood certainly points to further decoupling, which can have implications from economic growth and inflation, to other investment implications such as higher volatility and lower correlations between countries.

Source: MacroBond, FactSet, State Street Global Advisors.

Equities

Where We Stand On Valuations

In last week's edition, we spoke to the heightened volatility in response to tariffs and policy announcements from the Trump administration. This volatility continued throughout the week and ultimately led to a single day drawdown of 2.7% for the S&P 500 on March 10th. Most sectors were in the red with the Information Technology sector down 4.3% on the day. Utilities and Energy were the sectors that held up at 1.0% and 0.9% respectively.

The recent volatility has brought year-to-date performance figures down considerably. The S&P 500 is now down 4.5% YTD, being hindered by the Consumer Discretionary and Information Technology sectors which are down 13.2% and 10.4% respectively.

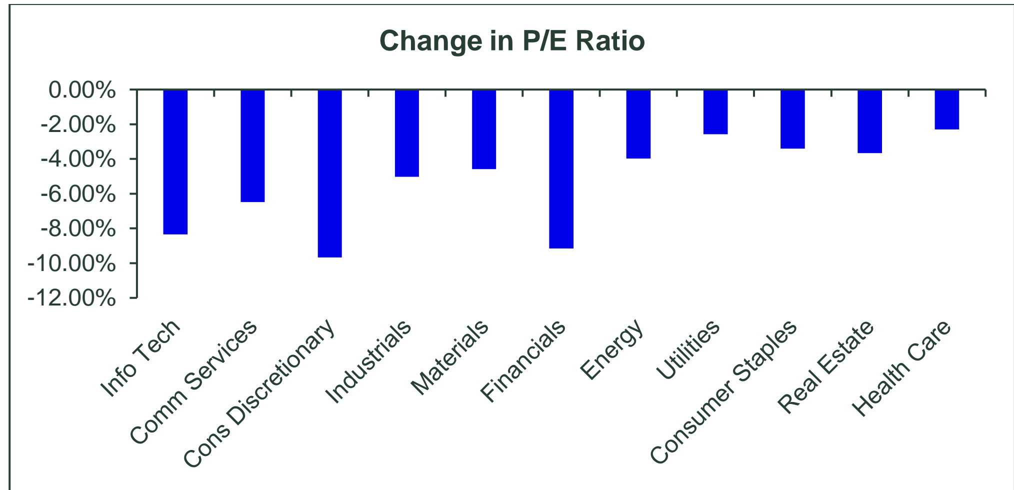
The fluctuating and rapid policy announcements have shaken investor appetite, though with valuations at high levels, some healthy consolidation was likely, and perhaps necessary. We continue to believe recession is a low probability scenario, with a soft landing as our base case. U.S. economic growth has continued to prove resilient, and corporate profits have grown and remained healthy.

Given the recent performance, below is a snapshot of the latest P/E multiples across S&P 500 sectors, belong side their historic median over the past ten years. The colored bars represent the adjustment in price that would be needed for the sector to revert to its historical median.

		S&P 500 Sectors	NTM P/E	10Y Historical Median NTM P/E	Price Adj Necessary to Get Back to Historical Norms
S&P 500 Sectors	Growth Sectors	Info Tech	24.81	20.02	-19.31%
		Comm Services	18.33	16.70	-8.90%
	Cyclical Sectors	Cons Discretionary	24.38	22.11	-9.33%
		Industrials	21.41	17.84	-16.68%
		Materials	19.79	17.05	-13.82%
		Financials	15.77	13.34	-15.36%
		Energy	13.87	16.40	18.20%
	Defensive Sectors	Utilities	17.41	17.78	2.10%
		Consumer Staples	21.87	19.90	-8.99%
		Real Estate	17.90	18.08	0.98%
		Health Care	17.51	16.27	-7.11%

Source: FactSet, S&P 500. Next-twelve-month (NTM) P/E used as the valuation multiple. Historical median P/E calculated from 3/12/2015 to 3/12/2025. Real estate median calculated from 09/19/16 to 3/12/2025.

Though the majority of sectors still look rich compared to their historical figures, the bar chart below shows the change in the next-twelve-month price to earnings ratio of the sectors since the end of February. The recent market rout has certainly made valuations more tolerable, particularly in the Consumer Discretionary, Financial, and Technology sectors which were high performers over 2024.



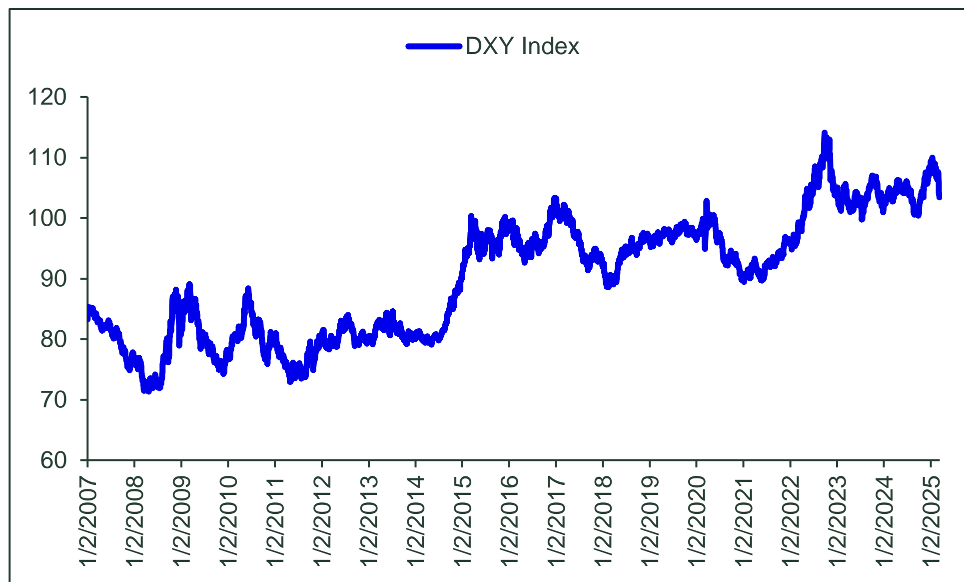
Source: FactSet, S&P. Next-twelve-month (NTM) P/E used as the valuation multiple. Change calculated from 2/28/2025 to 3/12/2025.

Source: FactSet. Data as of 3/12/2025 unless otherwise stated. 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

Cracks in the Bullish US Dollar Story

After a significant period of strength, cracks began to emerge in the bullish US dollar story in February. The greenback dipped 5% since President Trump took office on January 20th, the largest decline since the Global Financial Crisis in 2008. Shakiness in the dollar comes from several sources, chief among them tariff uncertainty, weaker economic data prints, and falling yields.



Source: Bloomberg as of March 12, 2025.

Volatile tariff policy injected a new source of uncertainty into markets. Tariffs of 25% were imposed on a broad set of goods imported from Mexico and Canada (including tariffs on Canadian steel and aluminum that were implement yesterday), and a 10% tariff on goods imported from China. In addition to tariffs on China,

Mexico, and Canada, the administration is expected to implement tariffs on the European Union in April. Thus, we see recent USD weakness as a correction, a well-deserved one, but not yet a durable turn to a downtrend. A more sustained downtrend will likely require a deeper turn in US economic health and less tariff uncertainty.

In addition to weaker economic data the much publicized employment and funding cuts driven by DOGE may weight on US growth expectations going forward. Lower growth expectations have put fed cuts back on the table. Markets are currently pricing in three 25 bps Fed Fund rate cuts through 2025.

Longer term our views have not changed. We have long held the view that the US dollar is likely to fall at least 15% over a 2+ year horizon as US yields and growth fall back toward the G10 average and the US grapples with high fiscal and current account deficits. President Trump's plans to cut spending and implement effective and wide-ranging deregulation that triggers a productivity renaissance without a serious increase in fiscal debt seems unlikely. If historical patterns hold, any Trump stimulus likely accelerates the build-up of US debt and points to a more difficult long run outlook for the US economy, earnings, and the US dollar.

Source: Bloomberg, 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.

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*Pensions & Investments Research Center, as of 12/31/23.
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