Market Perspectives
February 2024

Economic growth scare drives equity markets lower in February

Index	MTD	YTD	2024	2023	2022
S&P 500	-1.30	1.44	25.02	26.29	-18.11
Dow Jones Industrial Average	-1.40	3.32	14.99	16.18	-6.86
Russell 2000	-5.35	-2.87	11.54	16.93	-20.44
NASDAQ Composite	-3.91	-2.31	29.57	44.64	-32.61
Europe, Australia, & Far East (EAFE)	1.95	7.32	4.35	18.85	-14.05
MSCI Emerging Markets	0.50	2.32	8.05	10.27	-19.78
Bloomberg Barclays U.S. Aggregate Bond	2.20	2.74	1.25	5.53	-13.04

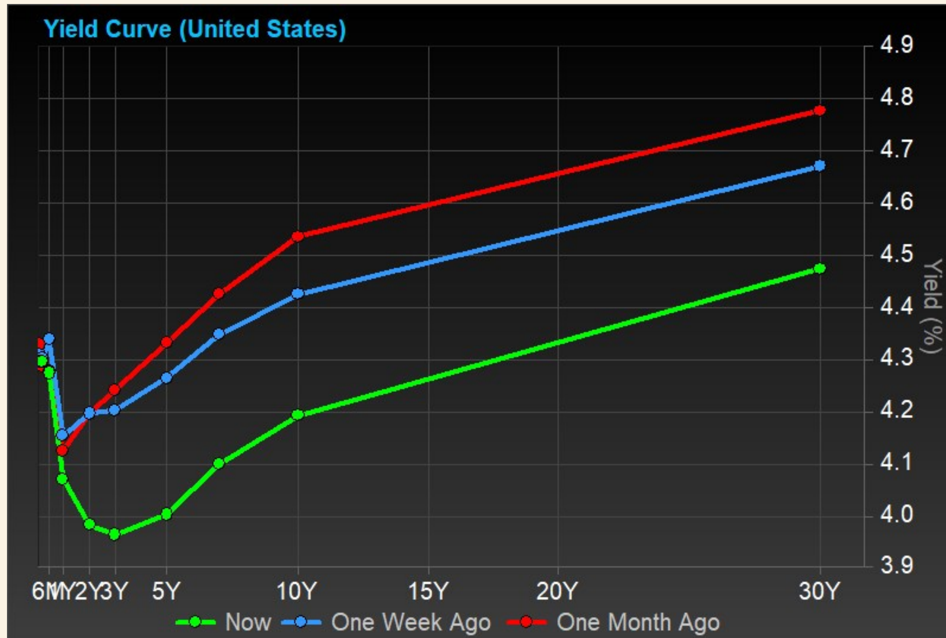
As of 2.28.25; Returns in percent

FINANCIAL MARKET PERFORMANCE

Uncertainty plagued the markets in February causing major US equity indices to fall. Specifically, the Dow Jones fell 1.4%, the S&P 500 dropped 1.3%, the Nasdaq Composite declined 3.9% and the small cap Russell 2000 plummeted 5.4%. The S&P 500 remains positive for the year, while the equal-weighted index outperformed the market cap-weighed official index this month by just under 1.0%. The Magnificent 7 stocks were mostly lower with Alphabet -16.5%, Tesla -27.6%, and Amazon -10.8% being the worst of the group. However, Nvidia gained +3.9% despite a post-earnings report selloff.

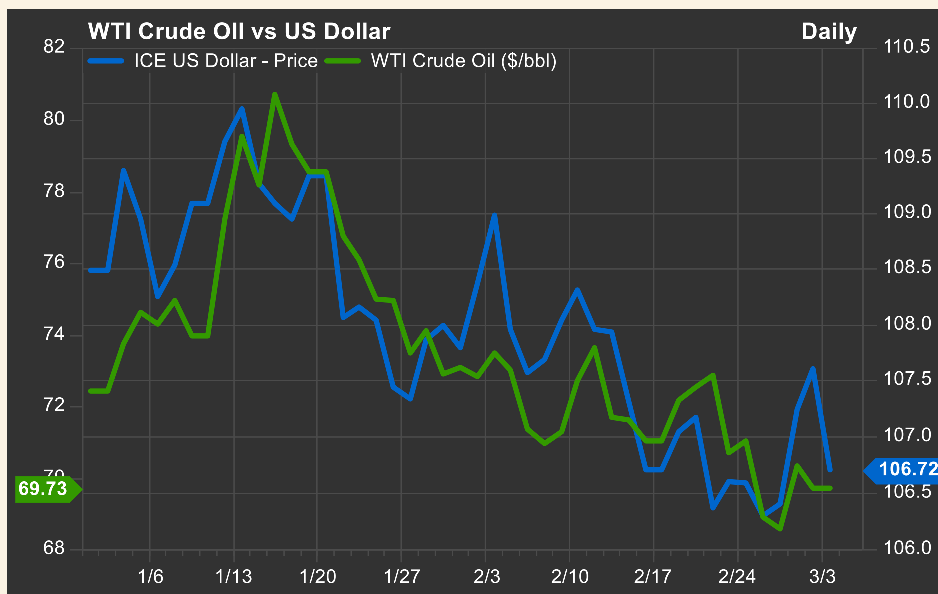
Foreign equities rose during the month, with the MSCI EAFE gaining 2.0%, while the MSCI Emerging Markets Index jumped 0.5%. The decline in the US dollar offset concerns over the impact of Trump's tariffs to push these markets higher.

Bonds rallied during the month as interest rates fell sharply (see below) while investors adopted a "risk off" mentality. The Bloomberg US Aggregate Bond Index rose 2.2% while the Bloomberg Municipal Bond Index gained 1.1%. Both indices are positive for the year.



Source:FactSet; As of 2.28.25

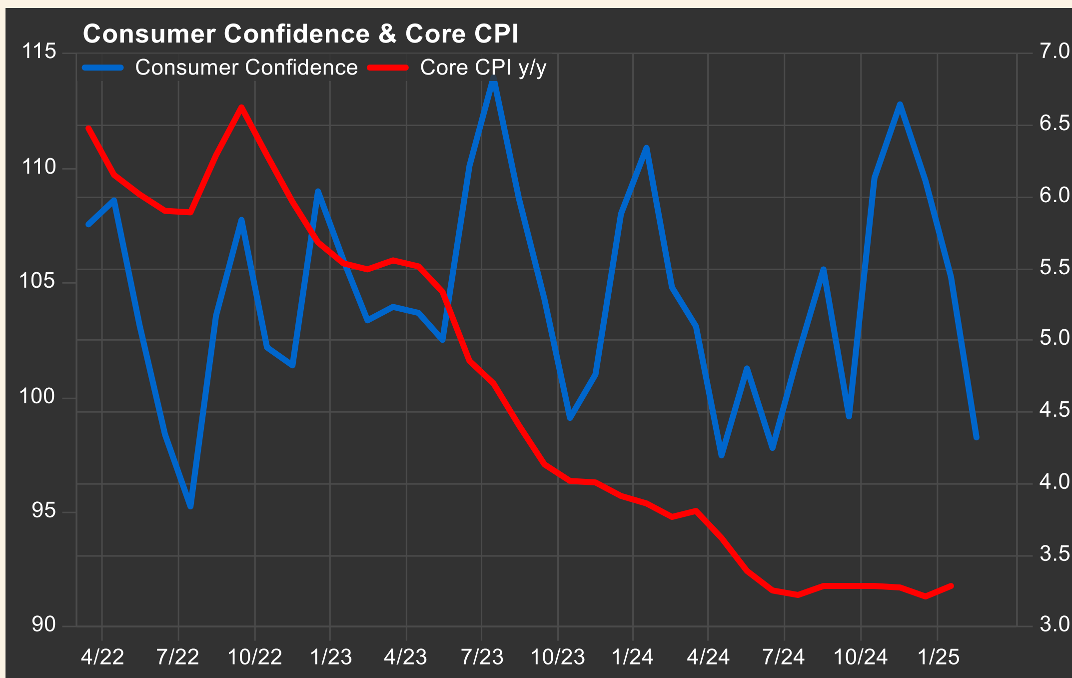
The US dollar fell 0.7% while Gold continued its rally from 2024 and gained 0.5%. WTI crude oil fell 3.8%, its first monthly loss since last November, as investors priced in the potential for an end to the war in Ukraine and weaker global growth. Both the US dollar and WTI crude have been in a downward trend since early in the year.



Source:FactSet; As of 2.28.25

PERFORMANCE DRIVERS

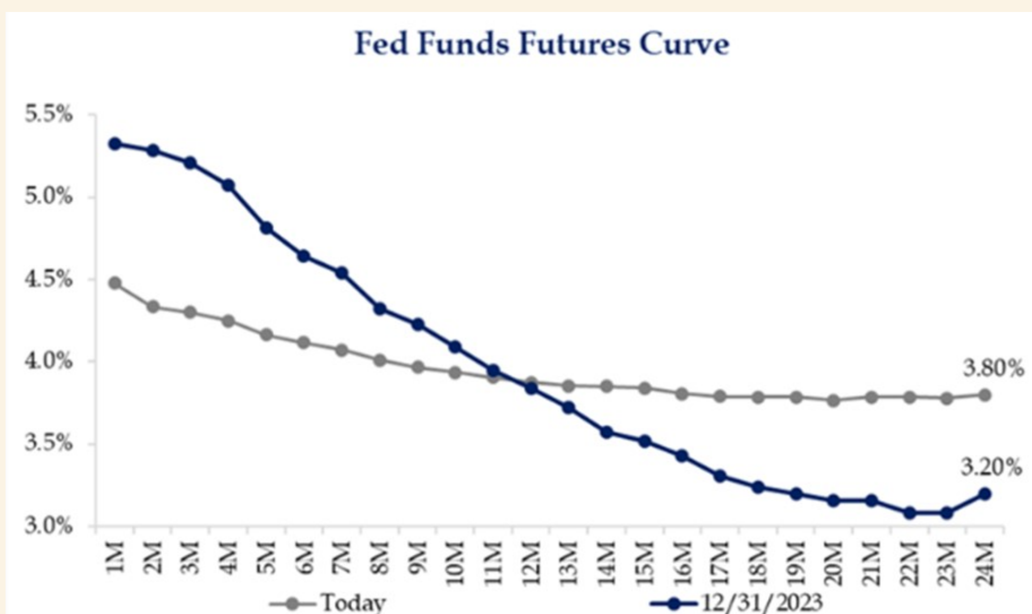
Investors adopted a “risk off” mentality during February amid a number of more bearish narratives including 1) growth/stagflation worries given some softer economic readings, including a material decline in consumer confidence, paired with hotter than expected inflation indicators (see below); 2) ongoing uncertainty around Trump trade/immigration/tax/spending cut (i.e. DOGE) policies; 3) AI secular growth theme concerns; 4) increased retail investor selling pressure worsened by fears around Mag 7 concentration; and 5) cautious/hawkish Fed commentary given hotter than expected January inflation report.



Source: FactSet; As of 2.28.25

Trade war developments dominated headlines in February with President Trump announcing 25% tariffs on Canada and Mexico and 10% on China on February 1st. However, tariffs were ultimately delayed pending negotiations. President Trump recently declared March 4th as the new date for initiation of Mexico and Canada tariffs and has said that China will be charged an additional 10% tariff as of that date. (Note, these tariffs did go in fact into effect on March 4) Analysts continued to flag negative growth implications that Trump's trade and immigration policies may have along with potentially inflationary impacts. The drop in consumer confidence reinforced this fear.

The hotter than expected January CPI report received a lot of attention, while other softer data on growth raised some emerging recession/stagflation fears. Housing continued to be a sticky inflation point in the latest CPI report, and there is now a high bar for the next Fed rate cut, which is currently not expected until the June Fed meeting with only 1-2 cuts expected for all of 2025. In fact, the market's expectation for the terminal Fed Funds rate has now risen to 3.8%, which is not far from today's 4.25% - 4.5% target.

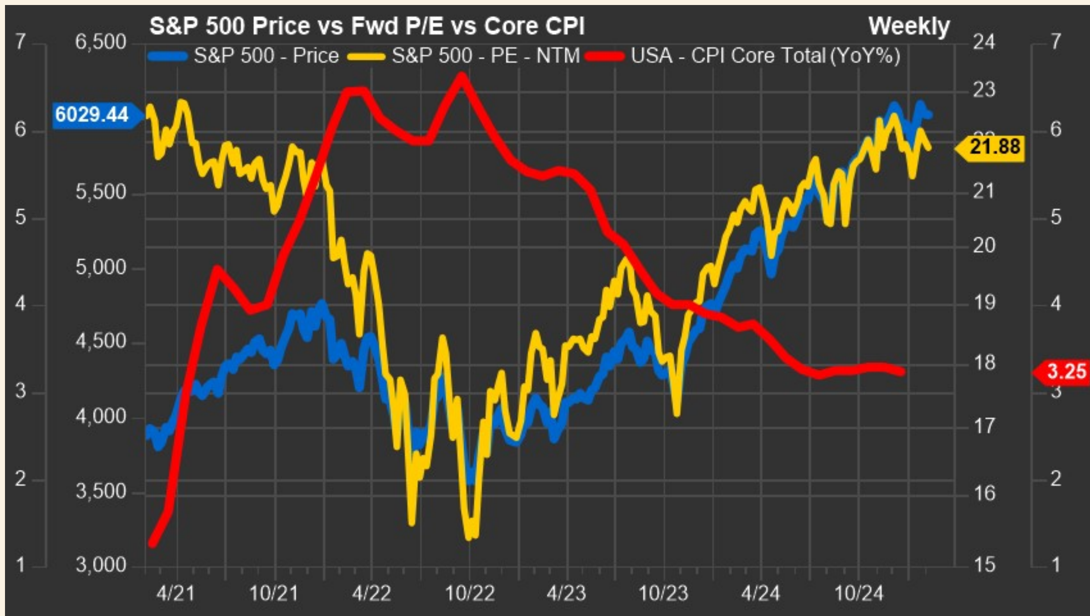


Source: Strategas as of 2.28.25

The hotter inflation readings were notably paired with a softer January jobs report and a January retail sales report that was well below expectations. The January ISM services data was poor, with new orders the lowest since last June, though the ISM manufacturing report was stronger, coming in at the highest level since September 2022. However, both reports contained commentary flagging tariff uncertainty as a key concern.

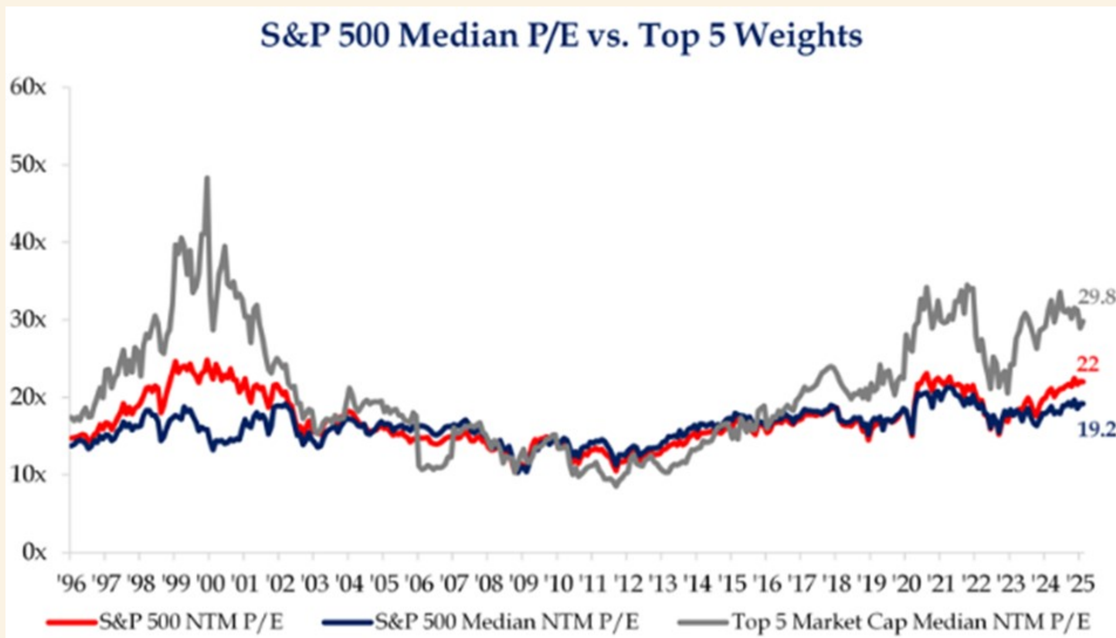
CORPORATE EARNINGS UPDATE

Now for some good news. As of this writing, 97% of S&P 500 companies have now reported Q424 earnings results with earnings rising 16.9% year-over-year, a significant increase from the roughly 10% expected at the beginning of this year. In addition, 75% of companies have reported positive earnings surprises while 63% have reported positive revenue surprises. This is important because, unlike the past two calendar years, P/E multiple expansion is not likely to drive stock prices higher in 2025. In fact, we expect earnings growth will be the key driver of stock gains this year. The chart below shows that, despite earnings growth of only 11% in 2023 and 2024 combined, stocks rose 54% due to a huge bump in P/E multiples. This bump occurred as Core CPI dropped from more than 6% to roughly 3%. We don't foresee this type of disinflation in 2025, so don't expect P/E expansion to be a driver of stock prices. Note that, historically, the S&P 500 annual return is comprised of roughly 50% earnings growth, and 50% dividend yield with P/E expansion being a very small contributor.



Source: FactSet; As of 2.28.25

S&P 500 earnings are currently expected to rise roughly 10% in 2025, which is notably higher than the long-term average of 7%. In addition, Mag 7 companies are expected to account for roughly 35% of the S&P 500's earnings growth. For those concerned about the S&P 500's current valuation of 22x on a forward P/E basis, it's helpful to look at the valuation in terms of the components. In fact, if you exclude the 5 largest stocks in the index, it trades at a much more reasonable 19x.



Source: Strategas as of 2.28.25

WHAT TO EXPECT & INVESTMENT PORTFOLIO IMPLICATIONS

Given the high potential for risk asset volatility over the near term, we believe portfolio diversification is extremely important for investors today. Note that the equity market on average experiences one 10%+ selloff each calendar year, and the last time this occurred was in October of 2023, so you could say we are due for a correction In fact, recent poor economic data and projections of negative 1Q25 US GDP growth are causing volatility in both stock and bond markets (as of this writing, the S&P 500 is down 6.5% from its recent high). Although such volatility is not totally unexpected, if the economy does weaken materially, we'd expect two things to potentially offset the weakness – A) President Trump could very well change course on tariffs and B) the Fed could begin cutting the Fed Funds rate at a much faster pace. Both of these would likely improve sentiment and result in a stock market bounce.

All that considered, we believe a portfolio of US and foreign equities as well as investment grade and high yield fixed income remains appropriate. In addition, the low correlation and risk-to-reward benefits that private investments offer continue to make sense in our view. As always, we believe it's prudent to remain fully invested and not overreact to short-term volatility in the markets.

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