Marketline February 2025

I'm breaking with tradition this month: for the first time ever, we're publishing the market comment over two pages instead of one. I promise we'll revert to one in March. But we've received loads of questions about the economy, and it's time for a longer-term perspective on that issue – longer than the last two months. So here goes:

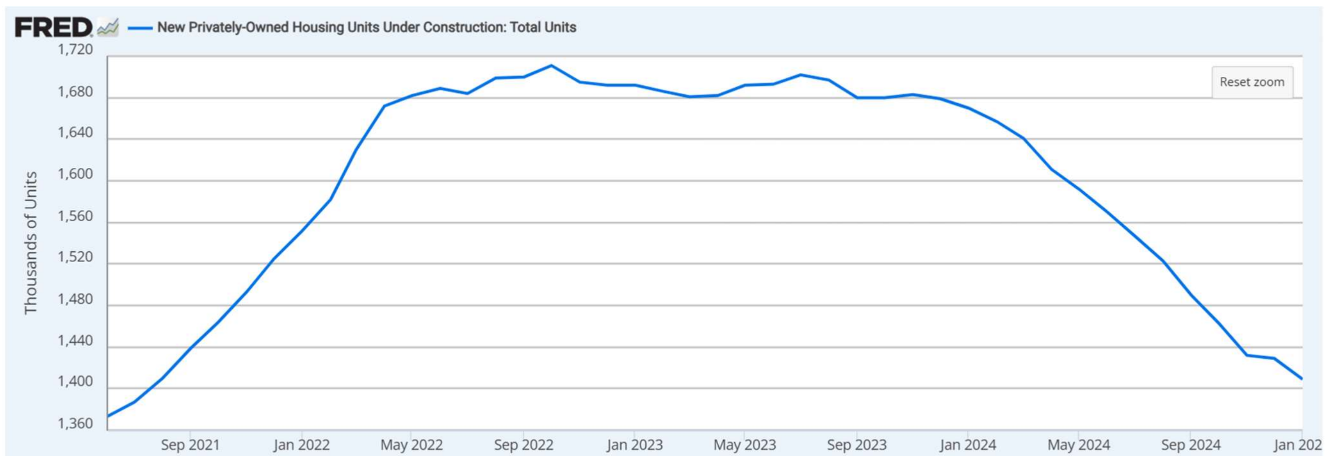
Stocks

After a strong January, the stock market gave back its gains in February and early March. The Dow fell 1.6%, and the S&P tagged along with a similar decline. Over at the NASDAQ, however, prices fell 4%. Technology had a rough start out of the gate this year, too: here in early March as we write this, that segment has logged an official "correction", defined as -10%. The rest of the market is down marginally for the year.

While blaming the market's decline on the political landscape would be easy, things usually are not that simple. For instance, tech companies began correcting in December and certain individual stocks like Microsoft haven't gone anywhere in a year. These stocks comprise a very large percentage of the S&P, so a correction here suppresses the performance of the entire index. Tech companies have produced nominally good earnings – but the stocks are quite overpriced. Earnings have simply not met expectations lately. Notably, we've seen this scenario before, in the summer of 2024, when tech stocks sank 13% and the S&P dropped 7.5%. Yet somehow everyone's forgotten that event in the face of a smaller decline now.

As the earnings season unfolded, other companies disappointed. We already mentioned currency challenges – a rising dollar makes it tough to earn a buck overseas, where 40% of S&P earnings are derived. But it's also become apparent that a couple of years ago, manufacturing activity in the US began to wane. Here's the data from my favorite resource, FRED, the Federal Reserve of St. Louis:

And here's one segment of the housing market:



Looks like these two important segments of the economy started rolling over in the Fall of 2022. Why is that time frame important? It coincides with a nine-month run of interest rate increases by the Federal Reserve. That action had an effect, and like almost all economic effects, it arrived with a lag. Of course, stocks plummeted in 2022 – likely anticipating this fall-off in activity. But we're left with a mild hangover. The ebullience in America's champions – our world-leading tech companies – has obscured deterioration elsewhere. In fact, we're even hearing the "R" word – recession – lately.

Against this backdrop, it's worth noting that more than 650 US companies hiked their dividends in the fourth quarter of 2025 alone, and that trend has continued in 2025. The total amount of dividend increases in 2024 came to $71.4 billion, up from $65.1 billion in 2023. Ordinarily, we wouldn't expect to see a willingness to pay out cash if corporate financial managers were feeling cautious. So how seriously should we take the notion of a recession? That outcome depends substantially on the Fed – read on to see what it's been up to lately….

Bonds:

No one's talking about it, but interest rates have dropped. A lot. In February, the long bond declined from 4.79% to 4.49%. The average thirty-year mortgage rate has fallen from 7% in mid-January to 6.76% now. That's good news for anyone trying to buy a home. This is an irony, because the Fed stood pat last month rather than announcing another interest rate decline. But back when the Fed was reducing rates – starting in September last year - we all remember that mortgage costs were rising inexorably, reaching almost 8%. The market is literally going the opposite way of the Fed, making the point that the Fed is usually behind the curve and blind to events on Main Street.

Of course, inflation worries the Fed, which has caused this pause. January CPI was up at an annual rate of 3.0% - a slight increase over previous periods. But at the same time, the Fed's preferred measure of inflation – the personal consumption expenditures index – decelerated to 2.5%. This split story on inflation may not be enough to make the Fed move; unfortunately, the Fed is always looking in the rear-view mirror, at data describing the past. That's how mistakes are made. Holding off too long on rate reductions might make us more vulnerable to a recession.

Meanwhile, in sectors, municipal bond issuance is setting records. Cities, states, townships, all sorts of civil entities are pumping out bonds like there's no tomorrow. Some of these refund old issues, but far and away most of the money is new, destined for projects from water infrastructure to roads, bridges, and new civic buildings. Right here in Oregon City we have a brand new courthouse up the hill, and the town is working on a charter project for its parks. These new projects will mean hiring labor and buying materials, both of which help boost the economy.

The same is happening at corporations. New issues are coming thick and fast as companies lock in funding for new plants, acquisitions, and simply refunding old debt. Despite the new bond supply, credit upgrades began to outnumber downgrades starting in the second quarter of 2024.

A discussion of the bond market would not be complete without mentioning the federal budget deficit, a topic that's been a worry but without significant consequences for most of my career. I can't recall how many times I've read that the budget deficit will cause us serious pain someday. That day seems never to arrive. But it may be around the corner. The deficits we have accumulated are unprecedented, particularly since we've racked up our worst financing gaps while the economy has been growing. Usually, deficits arise during recessions, and then are paid off in good times. We haven't behaved that way since the 1970s. Today, interest on the deficit is running at more than $1 trillion a year, and it will climb still more as old lower rate bonds mature, to be refunded at today's higher rates. It remains to be seen whether bond investors let us get away with this for much longer; in Germany, rates jumped over the last two days as the country plans big defense expenditures. We may be reaching a moment when tax rates must go up and spending must go down.

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