Marketline March 2025

Stocks

I promised to revert to a single page this month and I'll keep that promise but we all know a lot has happened in the last few days. First, let's take a bird's eye view: domestic stock indices began correcting in February; the action continued in March, bringing prices down 4% to 8% depending upon the concentration of tech stocks - which performed particularly poorly. Small cap stocks sank by around 9%. The decline from the top of the market in February has amounted to about 17% on the S&P 500. Pundits have complained (as have we) that US stocks have been expensive for a decade, and just lately investors benefited from two back-to-back double-digit return years; it's logical to believe lower stock prices have been baked into the cake for some time.

The precipitating event this time was the tariff program announced by President Trump, which will have a deleterious effect on earnings. No one knows yet the extent of the harm to margins that this tax represents. No one knows how long the tariffs will last, but *investors should think in terms of a long time frame* – because this Administration is counting on that revenue. Tariff rates may decline, but final levels could remain higher than at any time in the post-war period. Notably, foreign stocks fell less their US counterparts in March, but that began to shift in early April: stocks around the world have declined as investors attempt to reprice assets for new risks.

We now have two contractionary forces working in the economy: cuts to federal spending, and the tariff tax. The Fed has also not completed its rate-cutting cycle. We may skate past the ledge of a recession but if the US economy is headed toward building plants that make jeans and stuffed animals – well, that kind of low margin business is a tragic waste of capital. Enhancing our manufacturing prowess in technology, durable goods, and capital equipment would be welcome but will take a decade at least. It's clear we have ceded significant ground in these areas – for instance, Intel has lost its manufacturing prowess over the last decade, delaying next-gen chips repeatedly, and our shipbuilding facilities produce a fraction of the ocean-going vessels that China can claim.

We pointed out last month that earnings reported in the last quarter of the year were not completely wonderful, with many CEOs dishing up soft forward guidance for 2025. The other day we watched Restoration Hardware report a below-expectations quarter, and its stock fell 40%. In about an hour. The first quarter earnings season is advancing, offering an opportunity for more information to emerge regarding how companies are planning around tariffs, but we're not expecting miracles here: it's quite likely that the upcoming month will be a rocky one. That said, as always, the wreckage will also provide a chance to buy good companies at discounted prices - someday.

Bonds:

Last month, we discussed the US's intractable budget deficit. We wrote: "We may be reaching a moment when tax rates must go up and spending must go down." Little did we know that moment was to come in only a few days, with DOGE providing the spending cuts and tariffs standing in for taxes. Notably, most of the economy's growth in the last quarter of 2024 was due to government spending. This is not sustainable, but as we also noted, the deficit has been the longest "crying wolf" situation since I have been in this business. No matter when we deal with this, the process will be uncomfortable, volatile, and may result in a lower asset prices, just like we are experiencing now. Meanwhile, interest rates are plunging. The long bond closed at 4.57% last month, but this minute it's trading at 4.39%. The ten year, used for setting mortgage rates, closed at 4.21% but is sitting at 3.94%. These declines in rates mean that bonds have appreciated this year, buffering the decline in stocks for most portfolios. The Federal Reserve chairman continues to eschew more rate cuts, but he'll come around soon, as his market chastises his tactics.

Among bond sectors, until about last Friday (April 4th) municipals were struggling with enormous supply, with new issues forced to pay ever higher yields to clear inventory. That all changed when rates plunged – buyers swept the shelves clean for the most part. Even investment grade corporate bonds barely deteriorated against comparable Treasuries, rallying just a hair behind government yields. Until that big rally on Friday, we had finally begun to add municipals to portfolios with enthusiasm; now, we need a few days to recalibrate.

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