Wellington Shields

April 2025

Quarterly Market Strategy Report

Tariff Turmoil

In our April 2024 Quarterly Market Strategy Report we wrote *"if the stock market is forming a bubble, and we think it is, it is still in the early stages. PE multiples are exceedingly high at 24.2 times trailing 12-months and 21 times forward 12-months earnings. Yet during the 1997-2000 bubble, the financial crisis of 2008, and even the post-COVID-19 peak, the trailing 12-month PE reached 26 to 30 times."*

We mention these comments from a year ago because the world seems to have changed so much in the two months since Donald J. Trump became president. But given these comments from a year ago, Trump's tariff threats and the uncertainty they created may have been the trigger the market required for an inevitable correction. In short, a pullback in the market was overdue, and the uncertainties surrounding tariffs were the catalyst. As we expected, the equity market continued to rise last year and by February 19, 2025, the S&P 500 was trading at 26 times trailing earnings and 22 times forward 12-month earnings. This forward PE of 22 in February was well in excess of the long-term average of 14.3 times. In short, from a valuation perspective, it is not a surprise that the equity market had one of its weakest first quarter performances in years.

Testing the Lows

At the March 13, 2025 closing lows, the peak-to-trough declines in the S&P 500, Dow Jones Industrial Average, the Nasdaq Composite index, and the Russell 2000 index were 10.1%, 9.3%, 14.2%, and 18.4%, respectively. This means that the S&P 500's selloff was just short of a 10% drop that defines a correction, and the Russell 2000 declined just short of the 20% drop that defines a bear market. Yet, many of the technology stocks that had been the drivers of the 2024 bull market fared much worse. For example, Nvidia Corp. (NVDA - $108.38) had a two-month peak-to-trough decline of more than 28%. In other words, depending upon the index or stock you choose, equities have been in full-blown correction or bear market in the last two months. By the end of March, the declines of 4.6% in the S&P 500 and 10.4% in the Nasdaq Composite index in the first quarter were the worst since 2022.

As the April 2 deadline for President Trump's tariffs approaches, the equity market is retesting its March lows. From a technical perspective, a

Summary

The S&P 500 may be stabilizing after it experienced a 10% correction. The Nasdaq Composite index rebounded off its 2022-2025 uptrend line and the Russell 2000 index bounced off its pivotal 2000 resistance/support level. These were all important levels of support and the rebounds from these levels make it likely that most of the "fear of tariffs" decline has run its course.

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retest of the lows is a normal scenario and part of a classic bottoming process. There are several factors that suggest a bottoming process is at hand. The S&P 500 seems to be stabilizing after it experienced a 10% correction, the Nasdaq Composite index rebounded off its 2022-2025 uptrend line and the Russell 2000 index bounced off its pivotal 2000 resistance/support level. These were all important levels of support. Rebounds from these levels make it likely that the worst of the “fear of tariffs” may be over. In addition, the American Association of Individual Investors’ survey showed that bullish investor sentiment tumbled to 19.4% and bearishness jumped to 60.6% at the end of February. A combination of 20% or less bullishness and 50% or more bearishness in this indicator is rare and has been a positive sign for the market. The 8-week AAII bull/bear index is as low as it was in November 2022, just after the S&P 500’s 25% decline to 3577.03 on October 12. In short, this high level of pessimism is associated with major market lows.

What history has shown is that financial markets can deal with good news or bad news, but it does not do well in a time of uncertainty. With the 25% tariff on foreign car imports now permanent and the April 2 deadline for reciprocal tariffs on the horizon, the fog of uncertainty should begin to dissipate.

THE IMPACT OF TARIFFS

What history has shown is that financial markets can deal with good news or bad news, but it does not do well in a time of uncertainty. With the 25% tariff on foreign car imports now permanent and the April 2 deadline for reciprocal tariffs on the horizon, the fog of uncertainty regarding tariffs should soon begin to dissipate. That is good news.

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Most economists are describing tariffs as a tax on consumers, but we disagree. Taxes of all kinds are unavoidable, and they are mandatory. Tariffs make imports more expensive, but consumers usually have choices in terms of what they buy or do not buy. In the case of vehicles, American-made vehicles will be a more attractive alternative in the future, and we expect to see consumers buying more American-made and less foreign-made vehicles. The same is true of liquor, wine, and many other products. More importantly, despite what many economists are saying, history has shown that tariffs are rarely passed on directly to the US consumer. In the past when tariffs have been levied, exporters often choose to lower prices, or in the case of China, a country can subsidize exports to the US. Domestic retailers can choose to absorb part, or all of the tariff increase in order to keep prices stable for consumers. This means that inflation may be far less than expected, but many companies that import products or parts from offshore will face margin pressure. From this perspective, the biggest negative from tariffs could be lower margins and lower corporate earnings.

If tariffs persist for a long while (and there is no certainty that they will), we expect consumer behavior will change; consequently, in the aftermath of tariffs, some companies will be winners and some will be losers. But keep in mind that the April 2 “Liberation Day” tariffs will be excluding a variety of necessities such as semiconductors and pharmaceuticals, and as a result, the overall impact will be less broad based than currently forecasted.

It is also important to remember that the US is the largest consumer in the world with a 2024 trade deficit in goods and services of $918.4 billion.

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The deficit in goods alone reached a record $1.2 trillion in 2024. Our largest trade deficit was with Mexico, and it hit a record $171.8 billion last year. The US had record imports from 50 countries in 2024, led by Mexico ($505.9 billion), Germany ($160.4 billion), and Japan ($148.2 billion). This trilogy of imports may explain Trump's focus on imported vehicles. Conversely, the 2024 petroleum surplus was the highest on record at $44.9 billion.

Overall, these statistics explain why the threat of tariffs is a powerful negotiating tool for the US. And despite the current anguish about tariffs, if the tariffs become permanent (which we doubt), the negative impact on our trading partners is apt to be far greater than it will be domestically. Therefore, in our view, our trading partners are more likely to sit at the negotiating table and look for a compromise, than to start a true tariff war.

Sentiment Bias

In this highly politicized environment, it is worth discussing the bias currently found in consumer sentiment indices. The recent University of Michigan consumer sentiment for March fell 7 points to 57. The current conditions component eased 1.9 points to 63.8, and the index of consumer expectations plummeted 11.4 points to 52.6. Nevertheless, these numbers appear to be highly skewed by political party affiliation. Party affiliation data has a one-month lag, but the index of consumer expectations for Democrats fell 12.6 points to 36.8 in February while Independent expectations dropped 6.4 points to 59.1. Conversely, the Republican expectations index rose 2.3 points to 106.6. This data suggests that consumer sentiment data is skewed politically and has a negative bias.

The University of Michigan survey also reveals that optimism, or pessimism may be highly correlated to the news source one chooses to follow. When respondents were asked "during the last few months, have you heard of any favorable or unfavorable changes in business conditions?" the 3-month moving average of Democrats fell 40 points to 29 while the same index rose 13 points to 101 for Republicans. Independent voters had a 9 point decline to 53. This bias in sentiment indices suggests that much like presidential election polls, consumer sentiment indicators may not be a good forecaster of outcomes.

All in all, retail sales may be a better predictor of the health and sentiment of the consumer than sentiment indices. Many indicators point to the market being in a bottoming formation in March and that implies an opportunity for investors. However, individual companies may be helped or hurt by tariffs. This means keeping portfolios diversified and avoiding companies that could face potential margin compression in the year ahead.

All in all, retail sales may be a better predictor of the health and sentiment of the consumer than sentiment indices. Many indicators point to the market being in a bottoming formation in March and that implies an opportunity for investors. However, individual companies may be helped or hurt by tariffs should they remain in force. This means keeping portfolios diversified and avoiding companies that could face potential margin compression in the year ahead.

*Stock prices are as of March 31, 2025 close

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