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Investment Institute

State of the Markets

From the desk of Darrell L. Cronk

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Against the wind

"Well those drifter days are past me now/I've got so much more to think about/Deadlines and commitments/What to leave in, what to leave out." — Bob Seger

March is one of those wonderful months when warm sunlight begins to thaw winter's tight grip, and the hope of spring brings a smile to most every face. The warmth of the light reminds of summer's impending arrival, but walk down the shady side of the street, and the brisk wind in your face feels like winter. That biting wind rarely perseveres, however, and leaning into it gets you one step closer to summer. So it is with bull markets. They have brilliant moments in the sun, but they can also force investors to pull up a collar against the chill winds of repricing and volatility.

Long-time students of the markets understand well that drawdowns and corrections are not only normal parts of bull markets, but healthy for the bull to extend its life. Wise investors not only expect them, they seek to capitalize on them to rebalance or deploy capital. To solidify this point, during the past 80 years, the Dow Jones Industrial Average Index corrected between 5% and 10% on 43 occasions with an average recovery period of three months. It corrected between 10% and 20% on 15 occasions with an average recovery period of eight months. The latest market angst, as of March 10, has markets off between 5% and 10% from mid-February all-time highs.

Sentiment is shaky — but hard economic data remains on stable ground

The noisy headlines around geopolitical, trade, and fiscal policy have fueled a heightened state of uncertainty. The good news up to this point is that the actual delivery of policies has been milder than the more extreme measures proposed. Certainly, the economic data in what we call "soft" economic indicators like surveys, confidence, and sentiment have slipped in the first quarter from high levels to start this year. However, we have yet to see sentiment spill materially into the "hard" economic data, like actual consumer spending, capital expenditures, and company earnings. We will watch this trend closely.

For the economy specifically, the pace of hiring has been solid, spending on capital equipment and inventories has been reversing from last quarter's drag as many companies scrambled earlier this year to make purchases ahead of impending U.S. tariffs on global trade partners, and green shoots indicating a lift in manufacturing growth have emerged for the first time in several years. That is not to say that the flowers of springtime are fully

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in bloom. A slowing in service sector growth, cooling labor income gains, and a consumer running against the cold wind of several years of price increases across numerous spending categories all appear to be denting first-quarter gross domestic product (GDP) growth.

Winds of policy change have investors cautious

The on-again, off-again tariff increases applied to Mexico, China, and Canada, our country's three largest trading partners in that order, have equity prices settling back to levels we last saw pre-election in the fall of 2024. Tariffs are not new, and even before the latest flurry, the U.S. Commerce Department lists just over 12,500 current products tariffed across 200-plus global trading partners.

We would guide investors to look for the signal through the noise of tariff headlines, and focus not on what gets threatened, but on what gets implemented. The administration is using tariffs somewhat uniquely as short-term tactical tools to accomplish longer-term geopolitical goals. However, the administration does have a long-standing belief that tariffs are both a means to an end and an end unto itself. Tactical tariffs have been and likely will continue to be applied and rolled back based upon how well they accomplish key goals and move key metrics. Other tariffs may prove more durable — supporting priorities to close long-standing trade or capital account deficits and reshore key supply chain and important industrial complexes.

Similar shifts appear underway in fiscal policy from efficiency-enhancing to austerity-inducing proposals. The newly formed Department of Government Efficiency (DOGE) has garnered much attention in both its tact and actions. It remains to be seen what longer-term impact it may have on the fiscal policy path, but to put some numbers behind the impact thus far, its own website lists $105 billion of savings (as of March 10), which is just over 1% of 2024 fiscal outlays of the government. Federal employee job layoffs have been material, affecting over 60,000 employees across almost 20 different government agencies. Together with the 75,000 government employees who self-selected an early retirement offer, the total represents roughly 6% of the roughly 2.2 million federal civilian workforce and could be a catalyst for higher unemployment numbers in coming months. While there is much debate about the process, the focus on spending cuts should not be surprising. If you look at federal outlays as a percentage of GDP, they have been rising for 15 years (since year-end 2010) — from 13% of GDP to 22% of GDP. This rise in federal spending has been a substantial contributor to inflation.

The bond market has also been volatile. Interest rates have been caught in a tug of war between caution from lower growth expectations and inflationary pressures from policy priorities. We still believe interest rates are largely range-bound on the intermediate to long side of the yield curve. The Federal Reserve (Fed) will have a challenging time materially lowering interest rates, in our view. Stubborn inflation and an economy still showing solid trend growth are likely to push the Fed to the sideline even as it would prefer to make monetary policy less "meaningfully restrictive," as Fed Chair Jerome Powell has stated at his past several post-meeting press conferences.

The importance of runnin' against the wind

Winds of change have blown hard over the past five years, often skewing our view of the horizon. In fact, five years ago to the month, the global economy experienced a set of powerful shocks by way of a pandemic, supply-chain disruptions, and commodity price pressures. Then three years ago to the month, as inflation soared, the Fed initiated a furious pace of monetary policy tightening that took us through the summer of 2023. Two years ago in March, three regional banks failed, sending markets spiraling downward. Here we are in March again, and we're seeing the beginnings of what could be a seismic re-ordering of geopolitical forces and global trade policy. Amazingly, through these gale force winds, through the warm breezes and Arctic gusts, through sharp political

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reversals and global disruptions, the U.S. economy and markets have consistently risen above the rest of the world.

When you lean against the wind, sometimes it's two steps forward and one step back. It can be easy to stray from the path — who, in the end, could say that they had chosen the way they moved through it? As the motivational writer William Arthur Ward reminds us — "the pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails." So for us, and for the investors who rely on us, it is imperative at this moment to gauge our location against the horizon and adjust our sails, knowing from history that as the uncertainty resolves itself or fades into the past, we are likely to come out stronger on the other side.

When things change, we often stand still because we feel like we can't make a decision. But like a bicycle that falls over if it doesn't move forward, investors should avoid allowing the fear of the unknown to impede progress. Historically, in times of uncertainty, prices have provided the best opportunities, and wise investors keep pedaling. We have been here before, and we will be again. Mark the time and embrace the moment.

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