March Private Client Letter

by John E. Chapman

For most of the past year, I have observed that economic "resiliency" in the U.S. may be more tenuous than many pundits have believed. This is important because perceived resiliency supported the soft-landing narrative even as inflation and interest rates remained elevated.

As we make our way through the first calendar quarter of the year, we are beginning to see softer data and a rising concern over the economy's true growth trajectory. The question over this "growth scare" now is whether this is a full-blown slowdown or a short-term anomaly. After rallying approximately 3% to 5% earlier in the year, U.S. Stocks have given up these gains and are now roughly flat from where they began the year.

Uncertainties over the impact of various Trump Administration policies continue to weigh on business owners, consumers, and investors alike. As was observed in our **Outlook 2025** report, **we believe this nervousness is likely to persist for much of the year as the country transitions to a materially different governing philosophy** from what had been in place during the previous Biden Administration.

The recent economic weakness is now observable across a wide range of indicators. Notably, U.S. retail sales declined significantly in January which saw its largest monthly drop since March 2023 and the first decline in five months. The decrease was more severe than economists had anticipated. When adjusted for inflation, the volume of sales decreased by 1.3%, considering the increase in consumer prices reported for January.

We have been closely monitoring consumer debt levels in the U.S. According to the most recent report by the Federal Reserve Bank of New York, American household debt levels, including credit card debt, rose to new all-time highs in the fourth quarter of 2024. Credit card balances rose from the prior quarter to reach $1.21 trillion at the end of December, which is also a record high.

Not surprisingly, the Conference Board Consumer Confidence Index experienced a significant decline in February 2025. This marked the sharpest one-month drop in confidence since August 2021 and the third consecutive monthly decline. Consumers are becoming increasingly pessimistic about future business conditions, income, and employment prospects.

For its part, the University of Michigan Surveys of Consumers also dropped in February and now stands at its lowest reading since November 2023.

As consumer spending and sentiment sours, shifting investor sentiment would not be far behind. The American Association of Individual Investors (AAII) sentiment indicator claims that 60% of retail investors have become bearish. In fact, the percentage of bears in its survey increased sharply from 40% at the prior reading on February 19.

It is notable that the AAII retail investor survey is now the most bearish it has been since September 2022. It is also only the sixth time since 1987 that bearish sentiment has been above 60%, with the five-week change in the index marking its third-largest drop in history. This reading is made all the more challenging in that similarly high levels of retail investor bearishness usually happen only **after** the market has declined significantly.

Certain measures of "stock fragility" (the measure of a company's daily share-price movement relative to its recent volatility) are on track to reach its highest in more than 30 years among the largest 50 stocks in the S&P 500 Index (Yahoo Finance). Data such as this indicates a potential warning signal for the broader market even as stock indexes hover near records.

For the moment, the economy appears to be on reasonably sound footing even as worrisome data is reported. And that is the point – the data **is** becoming worrisome. In addition to the items cited above, housing starts are down, home sales are down, manufacturing activity is sliding, and unemployment claims have been rising. Taken together, it is entirely possible that first quarter GDP could show a negative print as reflected in the Atlanta Fed's GDP Now calculation which is currently indicating -2.8% growth in the first quarter (First Trust).

Do any of the observations above foretell calamity for the economy or the markets? The short answer is "no". Wall Street is known for its ability to "climb the wall of worry" as the country faces various challenges. However, the more nuanced answer focuses on how a combination of negative self-reinforcing trends has the very real potential to bring about a recession or a meaningful correction in the stock market - should a combination of such trends emerge.

It worries me that only a few weeks ago, there were consensus expectations for positive economic activity, earnings growth, and further gains in equity prices. Stock valuations are already quite elevated, and as Bob Doll suggests, there is little room to absorb bad news.

Things are happening very quickly in Washington and around the world. While a strong case can be made that the pro-business policies of Trump's second term could eventually lead to an extended period of prosperity, the key word is **eventually.** One must recognize that many of these initiatives will require legislative support and will take time. As the country transitions toward this new world order, it is not unreasonable to see how volatility and certain dislocations could be triggered. We will continue to monitor all developments.

As always, we never take for granted the trust and confidence you have placed in us. Should you have any current questions or concerns, please reach out to us to discuss.

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