June Private Client Letter | Not Quite Ready to Send an "All-Clear" Signal

by John E. Chapman

Another month has come and gone, and we're now at the two-month anniversary of the "Liberation Day" ceremony at the White House Rose Garden. The event set off a massive roller coaster in global financial markets, even though markets are little changed from where all of this started in early April.

During the early stages of the tariff selloff, we saw "soft" economic reports (sentiment, confidence, etc.) drop rapidly while the "hard" data signaled a degree of resiliency. Then, late in May, federal court decisions dealt a significant blow to President Donald Trump's sweeping tariff policies, casting uncertainty over a central pillar of his economic agenda. The legal battle centers on whether Trump overstepped his constitutional and statutory authority by imposing broad tariffs using emergency powers.

The court's decision invalidated the so-called "Liberation Day" tariffs and other broad levies imposed under the International Emergency Economic Powers Act (IEEPA), but did not strike down all of Trump's tariffs. Notably, tariffs on steel, aluminum, and automobiles—imposed under different legal authorities remain in effect.

As worries over the impact of Trump's tariff policies have receded, U.S. consumer confidence rebounded sharply following a five-year low in April. The Conference Board's Consumer Confidence Index rose by 12.3 points to 98.0 in May, marking the largest monthly increase in over four years. This rebound followed five consecutive months of decline and significantly exceeded economists' expectations.

Investors appear to be increasingly hopeful that the impact of Trump's tariff policies will be much less than originally feared. Still, the recent court ruling, and the administration's expected appeal, only serve to extend the uncertainty going into the summer months just as the full-year earnings estimate for the S&P 500 has been drifting lower. At $262 per share, the earnings growth forecast on the index currently hovers at just 7% for calendar year 2025.

This said, the long-term average forward P/E ratio for the S&P 500 is generally cited as being between 18x and 19.5x, depending on the specific period analyzed and the data source. Accordingly, a calculation of this nature would suggest a "fair value" for the S&P 500 in the neighborhood of 4,700 to 5,100. Please note, this only represents a theoretical valuation anchor. Actual market prices often deviate due to factors like interest rates, economic conditions, and investor sentiment.

It's hard to believe that even as the S&P 500 was on the cusp of a bear market in early April, the index's total return over the last 12 months has been better than average. With a total return of 13.5%, the S&P 500's gain over the last year outpaced the long-term average by 1.5 percentage points. Turning from the S&P 500 to the Nasdaq, that index's gain of 9.56% in May ranks as the second-best monthly performance on record. The only year the Nasdaq performed better in May was in 1997, and there have only been 12 other years when it rallied 5%+ in May (BESPOKE).

Recent market gains will likely face limited future upside as valuations are again elevated as earnings growth continues to slow.

As the tariff story continues to play out, new apprehensions have emerged over the President's "Big Beautiful Bill" and still high deficit spending the bill calls for as it moves from the House of Representatives to the U.S. Senate. Concerns over government spending and rising levels of government debt have triggered a surge in interest rates for long maturity debt. This steepening of the yield curve combined with de-rating pressures related to higher interest rates are likely to produce headwinds for equity prices in the months ahead.

It is notable that JP Morgan Chase CEO Jamie Dimon has recently issued a series of stark warnings about the U.S. economy and equity markets, signaling a notably bearish outlook that contrasts with the prevailing optimism among many investors and analysts. He has described U.S. equity valuations as ***"kind of inflated"*** and asset prices as ***"kind of high."*** He also cautioned that such valuations require ***"really good outcomes to justify those prices,"*** while he sees numerous negatives that could surprise markets.

Our view at Clearwater Capital Partners has not fundamentally changed. We remain cautious about the economic outlook given the unique combination of challenges that persist. The temporary 90-day delay of President Trump's tariffs will soon expire, and it is impossible to anticipate the administration's next move. Meanwhile, businesses are hesitating with investment decisions, interest rates are rising, and geopolitical tensions – particularly between Russia and Ukraine – remain exceedingly high.

Wall Street has a well-known tradition of "climbing a wall of worry". This convention dates back to at least the 1950s and refers to the stock market's tendency to rise despite a constant stream of negative news, or other perceived threats to economic stability. In this respect, markets often rise not because all risks have disappeared, but because they have been exaggerated. Only time will tell if the challenges we face today are being overrated.

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