"Not So Magnificent"

Market Commentary – April 2025

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.4% in the fourth quarter of 2024. This is higher than the advance and second estimates of 2.3%. On March 19, the Federal Reserve updated its economic projections that were last released in December. It now sees GDP growth of 1.7% in 2025, 1.8% in 2026, 1.8% in 2027, and 1.8% in the "longer run" (beyond 2027). The forecast for 2025 was slashed from 2.1% just three months ago. This reflects a softening of the economy in recent weeks. While the Fed does not see a recession on the horizon, many economic pundits are ringing the bell warning of recession. The scapegoat for a possible recession are President Trump and his use of tariffs to negotiate more favorable trade practices between the U.S. and the rest of the world.

The Federal Open Market Committee (FOMC) is sandwiched between cooling GDP growth and rising inflation (a condition known as "stagflation"). Included with the economic projections on March 19, the Fed *increased* its forecast for inflation in 2025 from 2.5% to 2.7%, with "core inflation" at 2.8%. It is difficult for the Fed to cut interest rates in the face of *rising* inflation. Therefore, the FOMC kept its federal funds rate in a target range of 4.25% to 4.5% at its meeting on March 19. Futures markets see the next 0.25% cut happening by July 2025. As for its balance sheet, the Fed lowered its monthly reduction from $60 billion to $40 billion. On March 26, the Fed showed $6.740 trillion in assets, down $26 billion from February 26. The next FOMC decision on monetary policy is scheduled for May 7.

Technical factors of the market are bearish (more supply than demand), while fundamentals are fairly priced – therefore, we are mildly bearish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) through March 31, 2026 is $277.68, which implies a price-to-earnings (P/E) ratio of 20.2 with the S&P 500 at 5,612. The earnings yield (E/P) of 4.95% represents fair value relative to the 10-year U.S. Treasury note yield of 4.23%. The yield spread has grown to 0.72%, thanks to earnings growth and lower stock prices. Seven of the nine largest companies in the S&P 500 make up $15.0 trillion of the $49.9 trillion index market capitalization with a weighted P/E of 28.4. If 30.1% of the index has a P/E of 28.4, then 69.9% of the index has a P/E of 16.7 for the overall P/E to be 20.2. A P/E of 16.7 is an E/P of 5.99%, which is fairly priced compared to the 10-year Treasury note yield of 4.23% (a yield spread of 1.76%).

A precarious technical setup has developed for the S&P 500. The index sliced through its 200-day moving average to hit a closing low of 5,521 on March 13. It rallied back up to the 200-day moving average (currently 5,760), which proved to be resistance, and it has since fallen again. The index is testing support around 5,500. Moreover, the 50-day moving average (5,894) is racing lower, seemingly destined to cross below the 200-day moving average (a pattern named the "death cross"). Support levels include 5,400 (September 2024 low); 5,120 (August 2024 low); 4,950 (April 2024 low); and 4,800 (2021 high). News in the coming days will likely drive the direction of stock prices. April 2 is being dubbed "Liberation Day", since it is the day when many tariffs will go into effect and President Trump will announce his plan for reciprocal tariffs. We maintain that tariffs are being used by the Trump administration as bargaining chips to negotiate better trade terms. At any time, surprise favorable news could trigger an explosive rally.

The "Magnificent 7", a name arrogantly given to the seven overvalued mega-cap technology stocks which led the market in recent years, have not been so magnificent in 2025. Without dividends, the Nasdaq 100 is down 8.3% in 2025 year-to-date. Just as the Magnificent 7 propelled the market cap-weighted S&P 500 higher, these same stocks are dragging the index lower. The market cap-weighted S&P 500 is down 4.6% this year, while the equal-weighted S&P 500 is down only 1.1%. The mega-cap technology bubble is deflating. Will this take down the entire market or will cash flow into unloved value stocks? Either scenario creates opportunities for active, multi-cap value managers with cash.