Osprey
PRIVATE WEALTH

April 2025 Commentary

We ended 2024 on a relatively good note based on several metrics. The Fed managed to bring inflation down to 2.8% as measured by the core PCE index. Although not as low as the Fed's stated target of 2%, we were gradually headed in the right direction. The unemployment rate barely increased during the year from the prior year end level of 3.7% to a reasonable 4.1%. GDP in the fourth quarter grew at a moderate 2.4% annual rate and consumer confidence was at a healthy level of 109.5. This was not a bad set up for 2025 and goes a long way to explaining why the S&P was up more than 23% in 2024.

New Administration

The new administration has been in place for a little over two months and has set its sights on making dramatic changes to the status quo.

Executive orders have been signed at a rapid pace, covering issues such as the border, the size of the Federal government and tariffs. The President is pushing the bounds of the Executive branch and as one would expect the Judicial branch is challenging the degree of his authority. Time (and likely the Supreme Court) will determine where the boundary lies.

Ramifications from such a frenzied approach will have significant implications on the economy, the stock market, and perhaps society as a whole. While it is challenging to draw too many conclusions in such a fluid environment where policy can change from day to day, we will explore a few of the economic and market challenges we face.

Tariffs

As everyone is likely aware, uncertainty is neither a friend of the economy nor the market. The initial anticipation of lower tax rates and less regulation allowed the S&P 500 to get off to a strong start and it was up over 4% by mid-February. More recently however, this optimism has been completely overwhelmed by the constant on again/off again barrage of tariffs with many of our main trading partners.

This reminds us of the game Red Light, Green Light we played when we were children, only this is no game and the consequences of pushing it too far could spell trouble for both the economy and the market.

It is a widely accepted belief amongst economists that tariffs in and of themselves act like a tax by making items more expensive, at least in the short to medium term, and therefore add to inflation. President Trump is playing a high stakes game of Poker, betting that he can use tariffs as a cudgel to force our trading partners to accept more favorable trading terms for the United States before doing long term damage to the economy.

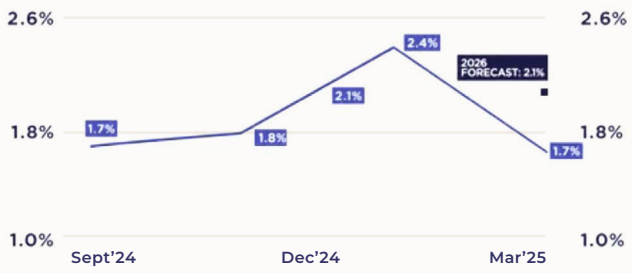
It is far too early to predict the net effect of this policy. On the one hand, companies such as Hyundai have stated that they plan to create 14,000 new full-time jobs in the U.S. by 2028. While on the other hand, Alcoa says the estimated 25% levy on aluminum imports will result in a loss of approximately 20,000 U.S. jobs.

Opinions as to the pros and cons of such heavy-handed tactics abound. Those in favor point to many situations with other countries where our goods face steep tariffs, while the other countries have access to our market at significantly lower tariff rates. This has led to persistent trade deficits with many of our trading partners including, China, Japan, India, Europe, Canada and Mexico.

Those opposed point to the high likelihood of higher inflation and the potential loss of access for our products into other economies. These outcomes would cause an economic slowdown and raise the chances of our economy falling into a recession. Goldman Sachs recently raised the odds of a U.S. recession in the next 12 months from 20% up to 35%. With broad tariffs now in place, those odds seem likely to continue to climb.

2025 GDP Outlook

Forecasts from CNBC FED survey



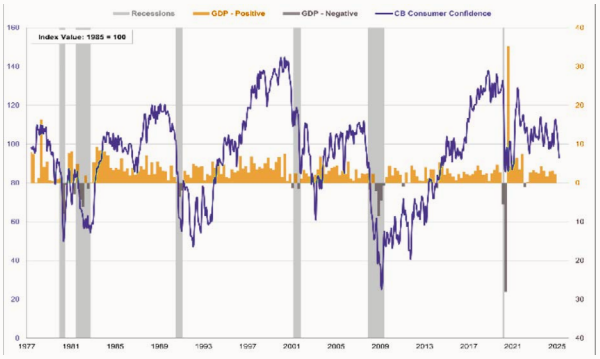
CNBC Fed Survey

As the chart above indicates, expectations for a slowing economy are already being taken into consideration. We would expect the outlook for 2025 GDP growth to continue to soften and a recession before the end of the year cannot be ruled out.

Consumer Confidence

One consequence of the uncertainty that the Trump Administration has caused is how it impacts the psyche of the consumer. The Consumer Confidence Index has dropped significantly from November 2024's 112.8 reading to March's 92.9.

Conference Board Consumer Confidence Index



Source: Advisor Perspectives

As you can see from the chart on the left, sharp drops in consumer confidence can cause consumers to hunker down and put off unnecessary expenditures. Although not a perfect indicator, when the index drops into the low 90s, it often predicts an imminent recession.

The Federal Reserve

All of this uncertainty makes the Fed's job of balancing their two main objectives, full employment and mild inflation more challenging. President Trump has been aggressively suggesting that Powell needs to lower interest rates now. The Fed Chairman has thus far taken a wait-and-see approach. He is concerned that inflation is still too far above the Fed's 2% target, with the most recent core PCE Inflation reading in February coming in at 2.8%.

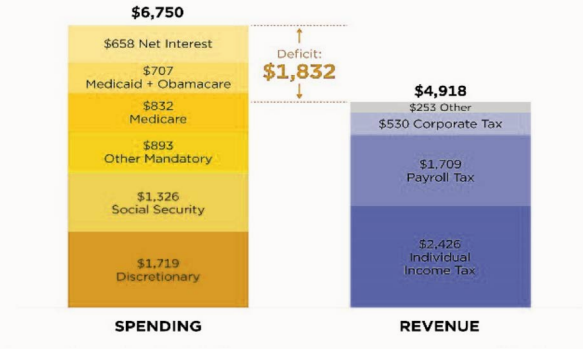
The Fed can remain patient on rates for now with the unemployment rate at a relatively low 4.3%; however, they may be forced to act if unemployment spikes over the coming months. Current expectations are that as the economy slows, the Fed will end up cutting rates 2-3 times before the end of the year.

National Debt and Refinancing

As we exited 2024, perhaps the greatest economic concern had to do with the country's exploding deficit of over $36 trillion.

Equally alarming is the fact that the U.S. is currently expected to add to this deficit at a rate of nearly $2 trillion per year.

Federal Revenue vs. Spending
For fiscal year 2024, in billions



Source: Congressional Budget Office

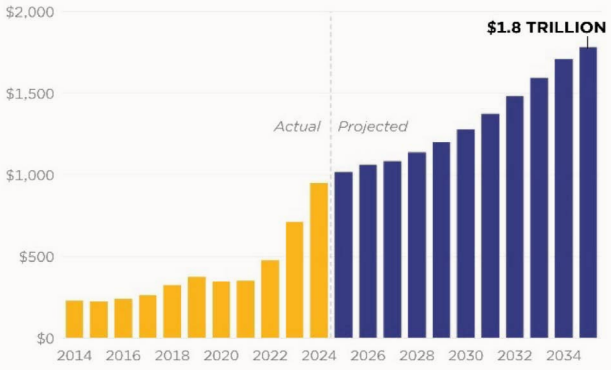
Running yearly deficits of this magnitude in a non-crisis environment is reckless and not sustainable over the long run without the risk of an economic calamity.

There are a few ways that this problem can be addressed and none of them is pain free. One of the ways the Trump administration has decided to confront this problem was by creating the Department of Government Efficiency (DOGE). The President appointed Elon Musk to lead the daunting and controversial effort.

DOGE has moved quickly (some might say recklessly) to cut waste and fraud in the government. While getting rid of fraud seems reasonable to many, eliminating or dramatically shrinking entire agencies like USAID and the Department of Education has further divided the country. DOGE has a limited ability to affect these changes. In many cases lawsuits have been brought to challenge their authority. In order for many of the cuts to go into effect it will require a vote in Congress.

Another way to cut government spending is to lower interest rates. Financing the debt is one of the government's largest yearly expenses and as you can see from the chart below the problem is growing.

Interest costs adding up
In billions of dollars



Source: Congressional Budget Office

As stated previously, the uncertainty over the outcome of the implementation of the tariffs has increased the likelihood of a recession. This concern has caused the interest rate on the ten-year treasury (for example) to drop from 4.57% at the beginning of the year to about 4% now. If we enter a recession this rate will likely drop considerably more.

$9 trillion in U.S. debt (+/- 25% of the country's total debt) needs to be refinanced in 2025. It has been estimated that for every basis point (1/100 of a %) that rates come down the U.S. will save $1 billion per year. If this year's debt refinancing can be accomplished at a 1% lower rate than the rates at the beginning of the year, then it would save roughly $100 billion per year.

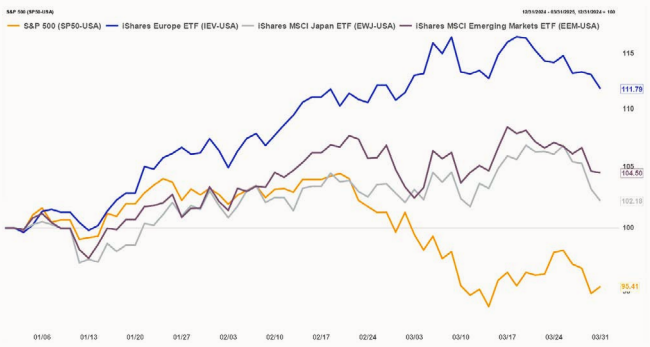
U.S. Equities

The uncertainty over U.S. policy and the economy has caused a lot of rotation away from last year's winners. The Magnificent 7 (Amazon, Apple, Alphabet, Microsoft, Meta, Nvidia, and Tesla) as measured by the Bloomberg Mag 7 Index was down 16% for the quarter and off 21% from the December 2024 peak placing it in bear market territory.

For the first quarter, the best sectors in the S&P 500 were energy (+9.98%), healthcare (+6.54%), utilities (+4.94%) and consumer staples (+4.48%) as investors rotated towards "defensive stocks".

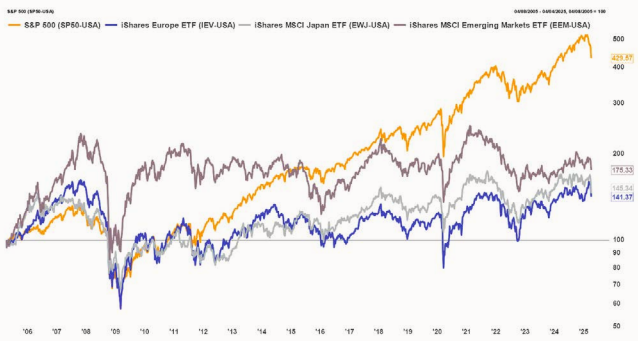
International Equities

International equities in general fared better than those in the U.S. (SP500-Blue). European equities (IEV-Yellow) led the way with a return of 11.8% for the first quarter followed by emerging markets (EEM-Green) up 4.5%, and Japan (EWJ-Orange) up a little over 2%. This outperformance was likely due to a calmer political environment outside the U.S. and the weakening of the dollar. These factors encouraged Europeans to repatriate some of their investment funds.



Source: Factset

While it is true that international equities performed better in Q1, we are mindful that tariffs will have a serious impact on these economies since they rely heavily on exports to the U.S.



Source: Factset

Although there is no guarantee of future outperformance, the S&P 500 has done far better over most longer periods of time as the 20-year chart above demonstrates. The United States has been more innovative and generally has less regulation and lower corporate tax rates.

Gold

Gold, true to its reputation during times of uncertainty, performed exceedingly well and was up 19.3% in Q1.

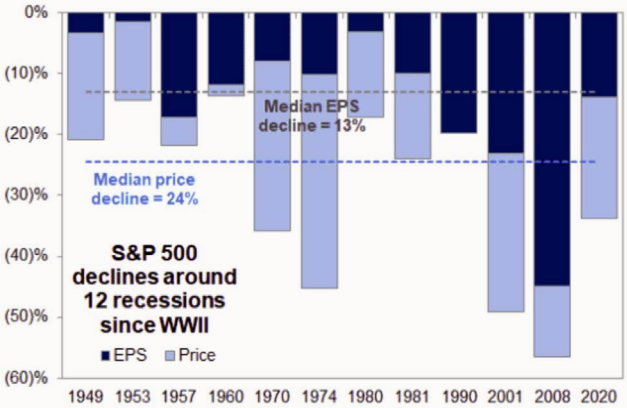
Source: Factset

Gold will likely continue to outperform if the uncertainty lasts and until inflation subsides. We would be careful about chasing this trade at this point as gold is up over 60% in the last 18 months and the momentum could shift quickly if tariffs are removed.

Outlook for Q2

As we begin the second quarter, like everyone else, including the Fed, we are trying to ignore the day-to-day noise and focus on the data. The most recent economic numbers are not bad, but we are acutely aware that the Trump administration's ever changing tariff policies could end up sending the economy into a recession. The chart below shows the impact on both earnings and the S&P 500 during the last 12 recessions.

Exhibit 7: The S&P 500 has typically declined by about 25% around economic recessions



Source: Goldman Sachs Global Investment Research

As of April 5th, the writing of this outlook, the S&P 500 is already down more than 13% year-to-date and more than 17% from the February peak. The Price to Earnings ratio for the S&P has come down from a lofty 22x earnings to a more reasonable 19x. While this is an improvement in valuation, we would not be surprised if the market fell another 10% before stabilizing and then recovering as the year progresses. Earnings growth expectations for 2025 have fallen from approximately 12% at the beginning of the year to roughly 6% now, but we are still expecting growth.

Changing market cycles are to be expected and are an important part of the long-term periodic rejuvenation

of our economy. The companies that we invest in have strong fundamentals and the ability to adapt to new circumstances. That being said, this is a good time to review goals and current needs with clients to ensure peace of mind.

While things are uncertain and may seem bleak now, there are things that can improve and could even potentially cause a sharp recovery in the market. Clearly, the removal or significant reduction of the tariffs would be very helpful, especially if it came with improved trade terms. If the economy slows a bit further, we could see a drop in inflation and the increasing likelihood that the Fed lowers rates a few times before year end. Additionally, the permanent renewal of the tax cuts would be well received by the market. While we cannot predict the future of the market, we are confident that we own quality companies and fixed income securities.

We expect more volatility, particularly in the short run, but we are of the belief that better times will return later in the year.

~ The Team at Osprey

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