

Commentary

Investor Jitters Rise as Risks Mount

- After three consecutive negative trading days, the S&P 500 again finished lower on Tuesday.
- There are a host of reasons why the market is down, but the main culprit may be stretched valuations.
- With high uncertainty, diversification is even more prudent.

U.S. stocks continue their slide into a fourth trading day as investors grapple with subdued consumer surveys, persistent inflation, possible tariffs, government job cuts, and a potential government shutdown in mid-March. While these factors are on investors' minds, this also comes on top of already high equity valuations. So far, growth and small cap indexes have sold off around 5%, while value stocks and international stocks have fared better. Developed international stocks are even slightly positive during this pullback.

Weak Consumer Surveys – On Friday (2/21), the University of Michigan released their February Consumer Sentiment survey, which slid by seven points from January to a 15-month low. This survey tends to be heavily influenced by inflation expectations. Then on Tuesday (2/25), the Conference Board released its Consumer Confidence survey for February which also dropped seven points, the biggest month-to-month drop since August 2021. Respondents also expressed concerns about inflation, although this survey is more influenced by labor market conditions.

Possible Tariffs – President Trump had announced 25% tariffs on both Mexico and Canada in January but delayed these tariffs for a month. That delay is now set to expire next week, and the President has reiterated that the tariffs will go forward next week. This could change as countries negotiate, but there is also the risk Mexico and/or Canada could retaliate with additional tariffs. This would add to inflationary pressures and uncertainty.

Government Job Cuts – Thousands of government workers have been laid off in recent weeks as President Trump looks to scale back the Federal government workforce. There are likely more job cuts to come, and this creates uncertainty around future unemployment rates. If people don't have jobs or fear losing their jobs, they spend less money, which could impact consumer spending.

Partial Government Shutdown – March 14 is the deadline for lawmakers to pass a bill to extend government spending to avert a government shutdown. A shutdown would impact government spending and have an economic impact. Although, a bill would likely pass eventually, and spending may just be delayed. It appears a deal could come soon, but the closer we get to the deadline, the more nervous investors become. Unfortunately, government shutdowns have become fairly regular in recent decades and are unlikely to have a lasting impact on markets. However, this creates a lot of headlines and can add to near term volatility.

None of these factors on their own may be a huge catalyst for a prolonged sell-off, but the combination of fears on already high valuations could cause more volatility. The fears are valid, however, investors may also be looking for reasons to sell, as stock valuations have climbed higher. The mounting fears could be enough reason for investors to rethink growth expectations and valuations and take profits. Investors are less patient when valuations are high. Through this backdrop, there are also concerns that the significant spending around artificial intelligence may not provide the significant earnings and revenue growth that many technology companies anticipated. Since the technology has driven market growth for the last few years, this uncertainty is a possible reason to take profits.

A correction, or a 10% pull back from the peak, is possible. Corrections typically occur about once a year and the S&P 500 hasn't seen a correction since October 2023. We think it is prudent to be well diversified to mitigate risk. It is important to stay focused on your own long-term financial goals and avoid getting caught up in the market enthusiasm or trying to call the next bear market. As always, please consult your financial professional for guidance during these times.

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