Cetera® Investment Management

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Commentary

Reasons to Be Optimistic in This Downturn

- U.S. equities have been under pressure on concerns around tariffs, economic growth and AI uncertainty.
- Weakness could be a buying opportunity.
- With heightened market uncertainty, diversification is even more prudent.

Despite the recent stock market volatility, we continue to expect stocks to have a good, though not great year. Historically, when we have an environment with modest U.S. economic growth, moderating inflation, the Fed not raising rates, and double-digit earnings growth, U.S. equity indices have generated respectable annual results.

This year U.S. equities, as measured by the S&P 500, are down nearly 2% and just experienced their worst week since September. Driving this weakness has been uncertainty around the impact of President Trump's tariff policies on the economy and inflation. Markets are also feeling pressure from a waning consumer outlook, tepid manufacturing new orders, continued housing weakness, and rising worries that the significant corporate spending on artificial intelligence (AI) buildout may not provide the level of benefits that companies had anticipated. The last point has been exacerbated by a high stock market valuations and the significant number of technology-related companies found in the top 10 largest S&P 500 companies. Given that the top 10 largest companies represent about 35% of the index, weakness in these stocks has intensified selling pressures. The tech-heavy Nasdaq Composite is down nearly 6% this year and fell into correction territory (10% decline from prior high) last week.

Since our last broad market correction in October of 2023, when equities fell 10% from the prior peak, any ensuing market weakness has proven to be a buying opportunity. Given our expectation that equities will finish 2025 on a positive note, we believe this will again be the case as investors will likely use this weakness as a buying opportunity. We believe there are some key reasons to be optimistic:

- The economy is moderating; however, we attribute much of this recent moderation in data to extreme cold January weather as we saw the coldest January since 1988. This had a clear and direct impact on weather-related economic activity as evidenced by the slowdown in services and construction hiring. With February proving to be milder and some early readings showing a bounce back, we do not expect January to be a start of a downward economic trend. Furthermore, the labor market and backbone of our economy remains stable.
- Tariffs remain both a growth/inflation concern, however, the Trump administration continues to refer to them as "retaliatory" and not "universal." The administration has threatened or raised tariffs on those countries where exports to the U.S. represent a sizeable percent of their respective GDPs. With these two points in mind, we expect tariffs to have a short-lived market effect as investors may view them as a negotiation ploy. Furthermore, if we use 2018 tariffs as a base case, and tariff negotiations linger longer than expected, it is reassuring to know that the market reaction was short-lived as equities returned quickly to pre-tariff levels by May of 2019.
- The overall environment for equities looks good as 2025 corporate earnings growth is expected to be strong and there will likely be a more corporate friendly regulatory backdrop.
- Back on February 19th, the S&P 500 closed at a record high of 6144 but then market concerns sent this index close to a key support level at its 200-day moving average (5733). The index has bounced off this level and possibly suggests that much of the selling is over. However, even if it is not over, our worst-case scenario barring an unforeseen market surprise would be a market correction and down to around 5500. A selloff beyond that is not as likely as larger selloffs are usually associated with an economic recession, a scenario we find unlikely at this time. Furthermore, there is over $7 trillion of in money market assets that could be deployed by investors to buy stocks at lower prices and cheaper valuations if markets decline further.

Headwinds overhanging equities right now. While some of these may take time to be resolved, we do believe most of this weakness is behind us. Regardless, we think it is prudent to be well diversified to mitigate unexpected risks. Importantly, stay focused on your own long-term financial goals and avoid getting caught up in market enthusiasm or trying to call the next bear market. Please consult your financial professional for guidance during these times.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

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