Commentary

Tariffs Compound Weakening Economic Data

- The S&P 500 saw its biggest decline of 2025, fueled by news around tariffs.
- While tariffs were in the spotlight, economic data also weakened.
- With high uncertainty, diversification is even more prudent.

Looming tariffs and weakening economic data sent U.S. equities spiraling lower on Monday, as the S&P 500 lost 1.76%, the tech heavy NASDAQ lost 2.64% and the small cap focused Russell 2000 lost 2.81%. Declines have continued this morning. President Trump said that 25% tariffs on Mexico and Canada are set to begin today. According to reports, he also signed an order to increase Chinese tariffs by 10% to a total of 20%. President Trump said he is using tariffs as leverage to secure the borders and prevent the flow of drugs into the United States. Canada and China have vowed to retaliate with tariffs of their own. All these tariffs create a lot of uncertainty as investors try to understand the size and scope of them which now depends in large part on how they are implemented.

While tariff news was front and center, there were additional catalysts sending stocks lower including weak economic readings on the manufacturing sector that also showed a sharp rise in pricing pressures. The combination of slowing economic growth and potentially rising inflation worried investors. February's ISM Manufacturing Index fell slightly below consensus and is teetering on contraction. More importantly, the forward-looking component of this index, new orders, saw a sharp drop and did fall into contraction. The prices index spiked, and the employment index fell. Overall, it was not a good report for investors. Adding to the sentiment, construction spending in January unexpectedly declined. These reports only added to jitters from the previous weeks that saw weak consumer surveys and has many questioning if a recession could be looming. The Atlanta Fed publishes a model forecasting GDP in real-time and estimates for first quarter GDP growth fell to -2.8% with the new economic data inputs. We do warn this model can be widely inaccurate this far in advance and volatile. The Blue Chip economic consensus for first quarter GDP growth is much higher and above 2%.

It is easy to get lost in the data and not see the forest for the trees. Overall, the big picture is that economic growth appears to be slowing, and tariffs are only compounding this and creating more uncertainty. Tariffs are being used as a negotiation tactic, so assuming concessions are met, they could change quickly. The impact is also uncertain as the implementation will dictate the size and scope. A potential government shutdown and government job cuts also contribute to slower growth concerns. All this is on top of already high valuations in large cap stocks. Valuations have been stretched on prospects of artificial intelligence fueled growth. With mounting risks, investors may finally be taking profits and shifting to other parts of the market that are less frothy like value and international stocks.

A lot of what we are seeing was laid out in our 2025 market outlook - economic growth will moderate, and the Fed is likely to cut rates less than markets expected. While economic growth appears to be slowing, we are not expecting a recession around the corner as the labor market remains solid. The Fed is also less likely to cut interest rates as inflation remains sticky and now faces additional price pressures. The last part of our 2025 market outlook, diversification is back, is a key strategy to navigate this uncertainty.

A correction, or a 10% pull back from the peak, is possible and could take the S&P 500 down to the 5500 level. However, keep in mind that corrections typically occur about once a year on average 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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A diversified portfolio does not assure a profit or protect against loss in a declining market.

Glossary

The **S&P 500** is an index of roughly 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of large cap universe.