Richard Rose Wealth Management March 3, 2025

Good morning,

What's in this week's Report:

- How Real Are Stagflation Risks?
- Weekly Market Preview: Are Tariffs Delayed Again?
- Weekly Economic Cheat Sheet: Will the "Big Three" Monthly Economic Report Confirm Slowdown Fears?
- Why Are Investors Worried About Washington? (Four Reasons)

Futures are modestly higher following solid Chinese economic data, and investors await more details of the looming tariffs on Mexico and Canada.

Economically, the Chinese manufacturing PMI rose to 50.2 vs. (E) 49.9, implying that stimulus is starting to flow through that economy.

The 25% tariffs on Mexico and Canada start tomorrow, although markets still expect they will be delayed.

Today's focus will be first on trade/tariff headlines. Any delay in the 25% tariffs on Mexico and Canada will be an obvious positive and reinforce the market's belief that tariffs are just a negotiating tool.

Economically, the first of the "Big Three" monthly economic reports comes today via the ISM Manufacturing PMI (E: 50.6) and the stronger that number, the better.

Market	Level	Change	% Change
S&P 500 Futures	5,991.25	28.00	0.47%
U.S. Dollar (DXY)	106.87	-0.74	-0.69%
Gold	2,885.30	36.80	1.29%
WTI	70.13	0.37	0.53%
10 Year	4.256%	0.027	0.64%

Stocks

Last Week (Needed Context as We Start a New Week)

Volatility continued to grip markets last week as trade war fears, economic growth worries and underwhelming mega-cap tech earnings weighed on the major indices. The S&P 500 fell 0.98% on the week.

An early-week bid in stocks, thanks to benign EU inflation data and optimism about a Russia-Ukraine ceasefire deal, ultimately gave way to a late-day selloff amid President Trump's new tariff threats and a strong bid in Treasuries starting to raise concerns about the economy. The S&P 500 ended down 0.50%.

Trump's tariff comments remained a drag on sentiment early Tuesday before a dismal Consumer Confidence report, that reeked of stagflation, saw selling pressure pick up significantly. The S&P 500 held support at 5,900 thanks to some dovish Fed speak (Barkin) and the index ended the day off the lows, down just 0.47%.

The midweek relief rally continued Wednesday morning, as big-tech stocks rallied in sympathy with their Chinese counterparts after DeepSeek announced that their flagship interface was accessible again after weeks of being restricted. More tariff chatter from Trump's first cabinet meeting saw the market roll over into the afternoon, and the S&P 500 ended basically unchanged (+0.01%).

Stocks opened flat Thursday as investors digested initially well-received quarterly earnings from AI-darling NVDA; however, a strong domestic GDP print and "hot" Durable Goods Orders report sparked hawkish money flows, and equities began to turn lower shortly after the open. An increasingly urgent selloff in NVDA, despite the initially "good" reaction to Q4 earnings, saw mega-cap tech come for sale hard in afternoon trade, which weighed on the broader markets into the close, leaving the S&P 500 down a steep 1.59%.

Equities gapped lower on Friday but quickly stabilized thanks to a benign Core PCE inflation print ahead of the bell. However, a decidedly unsuccessful meeting between President Trump and Ukrainian President Zelensky poured cold water on the early optimism. Stocks rolled over to fresh lows for the week before reports of a potential trade agreement between the U.S., Canada and Mexico sparked an end-of-month relief rally that saw the S&P 500 claw back to close higher by 1.59%.

<u>How Real Are Stagflation Risks?</u>

The financial media has jumped on the narrative that stagflation risks (elevated inflation and stagnant growth) are rising, and that's one of the reasons stocks have declined over the past week and a half. More directly, concerns are growing that the administration's policies (namely tariffs and tax cuts) will promote stagflation by firming inflation and restricting growth.

However, while sentiment surveys reflect this concern, as we and others have shown, there are legitimate reasons to be skeptical of the conclusions in these surveys given the intense divisions and opinions of either side of the political spectrum. Put bluntly, people's view of the administration is likely impacting their future view of the economy. While that can become a self-reinforcing phenomenon, the best thing to do in times like these is to stay focused on actual data because that will tell us if growth is genuinely slowing.

So, how real are stagflation risks? So far, not that real. First, there's not a lot of economic "stagnation" out there. Yes, jobless claims rose to 242k but that's still very low, historically speaking, and certainly not a level that implies a slowing economy. January retail sales and the February flash PMIs were soft too. Still, there are legitimate reasons to wait for more confirmation before reading too much into those reports (awful winter weather). However, many other economic metrics remain solid including Durable Goods and the flash manufacturing PMIs. The bottom line is that some data has been disappointing compared to expectations, but it's far from implying the "stagnation" we see in "stagflation."

Similarly, the "flation" isn't there, either. Yes, inflation expectations have surged, but as we showed last week, that appears to be impacted by political party affiliation, with Democrats expecting a huge jump in inflation and Republicans expecting virtually none. Recent inflation reports have been firm (including CPI). Still, it's not running away, and Friday's Core PCE Price Index declining solidly to 2.6% is a reminder that while there are some upticks in inflation, it's far from conclusive.

Bottom line is this pullback in stocks is a combination of policy volatility impacting investor sentiment (that is undeniable and this decline is a self-inflicted wound by the administration) and investors worrying about what could happen in the future, not what's happening now. If Trump were to back off tariff threats tomorrow, the talk of stagflation would evaporate because there's no proof in the data yet—just the risk that it may appear due to potential policies.

The takeaway from this dynamic is clear: Watch the data. That's especially true this week because we get the three most important economic reports via the ISM Manufacturing and Service PMIs and the Jobs Report. They will provide a major update on inflation and growth, and at that point, we'll have a much better idea if these fears of stagflation are backed up by data.

The bottom line is that the administration's chaotic and unorganized communication process is leading investors to both extremes. If you support the administration, you likely think the brightest economic days are ahead. If you don't, you believe these policies will lead us into 1970s-style stagflation. Those opinions impact the markets and overshadow actual data in the short term. But beyond the short term, the data will decide it.

Economic Data (What You Need to Know in Plain English)

Last Week

Last week's economic data provided a Rorschach test of sorts for investors. The numbers on growth and inflation were mixed, but since investors are suddenly pessimistic, the mixed data was viewed as more negative than positive, which contributed to the decline in stocks.

Starting with inflation, the numbers were mixed. The Core PCE Price Index, the week's most important report because it's the Fed's preferred measure of inflation, met expectations, rising 2.6% y/y and notably declined from the previous 2.9% y/y, reflecting an easing of price pressures. This reinforces to markets that regardless of when the next Fed rate cut will be, the next move is still a cut (and that's positive). However, reflecting the mixed nature of the data last week, in the revised Q4 GDP report, the Q4 Core PCE Price Index was revised higher to 2.7% from 2.5%, reflecting previous upward pressure on prices. Last week's inflation data pushes back slightly on the idea that inflation is rebounding in a big way and keeps the Fed's next move a rate cut, whether it comes in June, October or December (and this is a positive for stocks).

Turning to growth, data was similarly mixed. Sentiment data remained bad as Conference Board Consumer Confidence plunged to 98.3 from 105.3, the biggest one-month drop since 2021. Similarly, the AAII Investor Sentiment survey was deeply bearish, reflecting the pessimism prevalent amongst investors given the volatility and chaotic nature of headlines from Washington.

However, while sentiment data is bad, hard economic data remains decent. January Durable Goods beat estimates on the headline (3.1% vs. (E) 1.9%) and on the important details (New Orders for Non-Defense Capital Goods ex-Aircraft rose 0.8% vs. (E) 0.3%, and that implies that despite policy volatility, businesses are still spending and investing. On employment, jobless claims did jump higher to 242k vs. (E) 222k, but much of that increase came from Tennessee and Kentucky where there was severe winter weather. The jump caught people's attention, but even at 242k claims, the labor market is still very healthy, and for claims to signal actual deterioration, we'd need to see the four-week moving average move above 260k (currently around 220k). So, while last week's data wasn't bad (it was more mixed), given rampant negative investor sentiment, it wasn't enough to support stocks.

Important Economic Data This Week

This week is suddenly much more important than it otherwise would be because we get the "big three" monthly economic reports. Given rising economic concerns, this week's data has the opportunity to potentially end this pullback or supercharge it.

While there are numerous reports this week, the three that have the potential to move the markets are the ISM Manufacturing PMI (today), the ISM Services PMI (Wed) and the jobs report (Friday). The jobs report is technically the most important of the three, but the ISM Services PMI will be extra important this week because the flash services PMI dropped below 50 two weeks ago. That doesn't happen very often and if we see the ISM Services PMI fall to or through 50, that will be confirmation that there is indeed a growth scare occurring.

Looking at Friday's jobs report, Goldilocks readings in the mid-100k range will be the best-case scenario for stocks as it implies a solid labor market, but nothing too "hot" that it'd make the Fed reconsider any future rate cuts. Other reports this week include the ADP jobs report (Wednesday), jobless claims (Thursday) and Unit Labor Costs (Thursday). Jobless claims will be focused on seeing if last week's spike remains or reverses, while Unit Labor Costs will give us an update on wage inflation (the lower, the better).

Over the past two weeks, investors have become very sensitive to economic data, and anything that implies growth is slowing is now a negative for stocks. So, markets will want to see solid data that pushes back against the "growth scare" narrative. If it does, a solid relief rally should ensue (as long as there are no new tariff surprises). If data is not solid, look for growth-scare worries to increase and for this pullback to continue.

Special Reports and Editorial

Why Are Investors Worried About Washington? (Four Reasons)

Last week I focused on the fact that growth worries stemming from policy volatility and uncertainty in Washington caused the recent market declines, and this week I wanted to identify the specific areas of uncertainty in Washington that are worrying investors so we can monitor if they get better (bullish) or worse (bearish).

Policy Uncertainty 1: Tariffs/Trade. Investors don't know 1) The extent nor 2) Size of looming tariffs on major trading partners including Canada, Mexico, the EU and all other trade partners via reciprocal tariffs. Additionally, the spontaneous nature of the tariff threats has led investors to worry that even currently well-regarded trade partners aren't safe from potential threats. The bottom line is that whether there are tariffs or not, investors need clear and consistent trade policy, and this is the opposite.

Policy Uncertainty 2: Federal Workforce Shakeup. The chaotic nature of the DOGE efforts to make the Federal government more efficient may have actual, negative economic implications (at least near term). The firing (and in some cases, re-hiring) of federal workers, along with retirement offers and emails requiring proof of worth as an employee, have rattled the 2-million-plus federal workforce and companies who hire thousands of contracted employees to fulfill federal contracts. Put simply, this is having a real impact on these workers, who are likely collectively "tightening" their financial belts in response to this uncertainty. The bottom line is that two million federal employees constitute a little over 1% of the U.S. workforce, so they can't directly cause an economic slowdown. However, they can impact corporate earnings and other metrics, and the uncertainty around the size of the federal workforce (and what will happen to those who are fired given private corporations aren't aggressively hiring right now) is a headwind on growth.

Policy Uncertainty 3: Government Shutdown on March 14. The current continuing resolution to fund the government expires on March 4, and despite having control of both houses of Congress, Republicans are apparently not close to agreeing on a spending plan to keep the government open. Given their majority in both chambers, it's unlikely that the Republicans will allow a government shutdown, but if this stretches to an 11th-hour drama, it will add another growth headwind.

Policy Uncertainty 4: Debt Ceiling and Tax Cuts. The U.S. debt ceiling needs to be extended as part of any extension of the Tax Cuts and Jobs Act (TCJA), but despite controlling the Senate and House, Republicans remain far apart on a bill to accomplish those goals. More directly, both chambers of Congress must pass a reconciliation bill allowing them to achieve tax cuts, debt ceiling, and other matters with a filibuster-proof majority. However, the Senate prefers a two-step method via two separate bills, while the House is proceeding with one bill to accomplish all of the main policy priorities. Those two differing efforts need to get rectified if hopes of tax cut extensions are to be realized. Near term, they need to get the debt ceiling passed as part of that bill (or separately) and the longer this drags on, the more that uncertainty will weigh on markets.

Bottom Line

Investors came into 2025 expecting the Republican-controlled government to be a pro-business and pro-growth policy machine. Still, so far, the opposite has happened as tariff and trade uncertainty has erupted, the DOGE efforts are causing chaos amongst the ranks of Federal employees and Congressional Republicans can't make progress on foundational aspects of the pro-growth agenda. Given this, it's not surprising that investors are starting to worry that this is negatively impacting economic growth. However, while this is a near-term negative and clarity on each issue (collectively or one at a time) will remove headwinds from the markets, don't mistake them for permanent negatives.

My experience has taught me that when one party has control, they very seldom willingly do things to negatively impact growth (like shutting down the government, breaching the debt ceiling or spiking unemployment). Despite these early issues, it's still right to view the current administration and government as pro-growth, and likely positive for equities and other financial assets. So, while we could be in for more near-term declines on policy chaos, it's not to the point yet where we need to view Washington as a structural headwind on the markets or the economy (but if it gets to that point, I will let you know, loudly and clearly).