Donaldson CAPITAL MANAGEMENT

The Outlook
DCM Market Brief

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Stocks are off to a solid start in 2025. The S&P 500 is up 4% this year and is close to reaching a new high. However, the resilience against an increasingly sensational list of headlines is more impressive. Participants have waded through tariffs, DOGE, competitive threats in Artificial Intelligence (AI), a hotter-than-expected inflation report, and disappointing earnings forecasts from some major companies. Yet, overall earnings have been quite strong, with more sectors and companies contributing. This has led to a gradual rotation in market leadership and a subtle broadening of the market base.

The new administration is moving fast and shaking things up. In President Trump's first weeks in office, we've seen tariff announcements, delays, reciprocal tariffs, a crackdown on the border and illegal immigration, federal workforce buyouts, major changes at government agencies, and many other policy items. It's a lot to keep up with, but it's important for investors to focus on what matters most. So far, analysts have not lowered their robust earnings forecasts for 2025. Despite all the noise, the S&P 500 is still expected to grow earnings by 13-14% this year. Unless policy negatively impacts earnings growth, stocks remain in a good position.

Inflation remains a concern, even though it's below its 2022 peak of over 6%. The Core Consumer Price Index (CPI), which tracks the average price changes for everyday items like food, clothing, and transportation, is still around 3%. This is above the Federal Reserve's 2% target and is likely to prevent further interest rate cuts. This is certainly not fatal for stocks, but lower rates are unlikely to be the catalyst to drive them forward from this point. Still, elevated and rising inflation are two different things. It will be important to avoid a reacceleration of inflation.

Perhaps the greatest risk to market performance this year has come from AI developments out of China. In the past month, DeepSeek and Alibaba have introduced large high-performance language models that were supposedly developed at a fraction of the cost of their American peers. While the validity of these claims is still uncertain, they do pose a risk to large U.S. companies that have invested heavily in AI development. So far, the market seems to believe that lower development costs will benefit everyone and may ultimately boost productivity for end users.

Markets have had a lot thrown at them this year, but they have taken it all in stride. The foundation for stocks is still intact. Unemployment is low; if people are working, they are spending, and consumer strength translates into robust earnings growth. AI is an additional catalyst. This is a recipe for success, if policy doesn't get in the way.

Thanks,
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S&P 500: Standard & Poor's (S&P) 500 Index. The S&P 500 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad U.S. economy through changes in the aggregate market value of 500 stocks representing all major industries.

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