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Markets hit a bit of turbulence at the end of February. Although the S&P 500 is only down 3% from its recent peak, anxiety has been growing in certain areas. Concerns about the economic impact of tariffs, federal layoffs, and immigration have led to a more defensive tone. Treasury bonds have increased in value, and stocks in sectors less affected by economic cycles, such as utilities and healthcare, have begun to perform better than the overall market. Despite the recent uncertainty, an overall strong labor market and an exceptional outlook for earnings provide a supportive backdrop. It is tough to be too negative on stocks if that remains true. However, certain stocks will be better positioned than others in the coming months.

Above all, markets dislike uncertainty. Whether you agree or disagree with the policy decisions of the Trump Administration, they have increased uncertainty. When companies are unsure about future policies, it complicates decision-making. As uncertainty rises, investors tend to seek out the least disruptive areas of the market. Recently, we've seen rising inflation expectations, a drop in consumer sentiment, and an increasingly negative outlook for economic growth. It's not surprising that investors have shifted away from cyclical sectors like technology and industrials. The good news is that other sectors have stepped up in their place, and we've not seen a significant pullback for the average stock.

There are many challenges, but there is also a lot of support. For one, the U.S. economy is operating from a position of strength. Despite a slight increase in layoffs, unemployment remains near historic lows. Unless this changes significantly, consumers will continue to spend. Domestic consumption drives 70% of our economy. Even with economic concerns, the outlook for earnings, which is also tied to domestic consumption, has not changed. Analysts still expect earnings to grow over 13% this year, which is the most important variable for stocks.

Additionally, the economy is getting an unusual boost of liquidity. In January, the U.S. hit its debt ceiling. When this happens, no new debt is issued, and the government pays its bills from an account outside the banking system. This injects cash into the economy, keeping bond yields lower and reducing pressure on stocks. This liquidity is expected to remain for several months, allowing time to work through policy issues.

We remain vigilant against the possibility of an economic slowdown, but we believe our companies are well-positioned for that type of environment. We continue to focus on owning companies that consistently grow their fundamentals through diligent management and clear strategic objectives.

Thanks,
Preston May, CBE® | Research Analyst

812.421.3211 | dcm@dcmol.com | dcmol.com