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MARKET SIGHT LINES

While Some Caution Is Warranted, There's No Need for Panic

By Michael O'Keeffe, *Chief Investment Officer*

In the last few weeks, we've discussed our "base case," our more negative "bear case," and our more positive "bull case" for 2025. We reviewed this range of potential outcomes, explaining how policy changes in Washington may affect the economy and the markets this year and beyond. Recently, we've seen some economic data that may be signaling a slowdown, and many market watchers are raising the alarm that issues like geopolitical tensions and tariffs are to blame. In this week's Sight|Lines, we further unpack some of this negative data and explain that while some caution is warranted, we believe there is no need to panic.

THE TAKEAWAY: NEGATIVE SIGNALS WILL SURFACE IN A SLOWING ECONOMY, BUT FOR NOW THE POSITIVES OUTWEIGH THE NEGATIVES

As the economy slows, some negative data will surface. But against a backdrop of generally positive economic data, while some caution is warranted, panic would be an overreaction, in our view. In summary:

- The Atlanta FED GDPNow, a quantitative model relying on input data but with no subjective inputs, is currently signaling a GDP decline in the first quarter given the data so far this quarter.
- Numerous other sources that typically include a subjective assessment of data yet to be published are reflecting positive first quarter growth.
- Economists have noted that imports jumped recently, attributed to businesses accelerating purchases ahead of tariffs.
- Notably, gold imports contributed to the trade deficit increase, but this appears to be a one-time move.
- We're watching for a consumer slowdown.
- As we discussed recently, retail sales fell in January, with the decline attributed to cold weather, seasonality, and normalization from an unusually strong pace in the second half of 2024.
- Despite these negative signals, the policy shifts in Washington are generally "business friendly."
- The positive environment includes a solid job market, surging capital expenditures plans for businesses, rising CEO confidence, and planned equipment financing as a precursor to increased U.S. manufacturing.

IN-DEPTH: NEGATIVE SIGNALS ARE ALWAYS ASSOCIATED WITH A SLOWING ECONOMY, BUT A STRONG JOB MARKET, THE PROSPECT OF BUSINESS SPENDING, AND AN ENGAGED CONSUMER STILL SIGNAL POSITIVE ECONOMIC GROWTH GOING FORWARD

As the economy slows, some negative data will surface. But against a backdrop of generally positive economic data, we see continued growth and no recession imminent. So, while some caution may be warranted, our view is that panic would be an overreaction. Going deeper:

- The Atlanta FED GDPNow, a quantitative model, is currently signaling a GDP decline in the first quarter:
  - A recent reading hit -2.8% for the first quarter, influenced by a jump in imports.
  - We expect this figure to rise as more first quarter data feeds are added to the model calculation.
- Numerous other sources, many including a subjective assessment, point to positive first quarter growth:
  - The Bloomberg Consensus Estimate, reflecting many economists, signals 2.2% growth.
  - Individual economists are lowering their estimates, some turning negative, in consideration of the unexpected jump in imports.
- This jump in imports has been attributed to businesses accelerating purchases ahead of tariffs:
  - The goods trade deficit widened by a record $31.2 billion (25.6%) in January on higher imports.
  - Imports rose by $34.6 billion (11.9%), led by industrial supply imports.
- Likely one-time gold imports contributed to this jump:
  - Gold imports of $25 billion are exaggerating the first quarter trade deficit.
- While we're watching for a consumer slowdown, and, as we discussed recently, retail sales fell in January:
  - This decline is attributed to cold weather, seasonality, and normalization from an unusually strong pace in the second half of 2024.
- Despite these negative signals, the policy shifts in Washington are generally "business friendly," supporting many positive signals we are seeing:
  - Stabilized initial jobless claims and an unemployment rate of 4.0%, reflecting a solid job market.
  - Three consecutive months of small business optimism above the 51-year average.
  - The Conference Board CEO confidence levels rose to 60, the highest level in three years.
  - U.S. Equipment Financing Confidence spiked following the election and remains elevated at 66.9, a precursor to increased U.S. manufacturing.

CONCLUSION

Recently we reviewed our "base case," our more negative "bear case," and our more positive "bull case," a range of potential outcomes potentially driven by how policy changes in Washington may affect the economy and the markets. Recent negative economic data may be signaling a slowdown, and many are blaming geopolitical tensions and tariffs, among other things. We've discussed the likelihood of a slowdown, and while some caution is warranted, we believe there is no need to panic.

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