Commerce Trust Market Brief with Scott Colbert

February 21, 2025 – U.S. Policy Shifts and Market Implications

Scott Colbert: Good morning. It's Friday, February 21st, and the markets are about to open. Returns this year from the financial markets have been very positive so far.

The S&P 500 (Index) winning at 4.19% here domestically. Mid-cap (capitalization) and smaller-cap stocks providing about half that type of return (as measured by the S&P 400 MidCap Index and Russell 2000 Index respectively). International stocks are off to a surprisingly fast start. Large-cap international stocks, as measured by the (MSCI) EAFE Index, are up a whopping 7.98% so far this year. That's more than double their total return last year, and even emerging markets (as measured by the MSCI Emerging Market Index) have provided more than 5% return.

Fixed income too has provided a better return so far, at least for the first six weeks of the year compared to what they did last year. So far, the broad investment grade bond market is up 1.03% (as measured by the Bloomberg Aggregate Bond Index), and even munis (municipal bonds) have offered a positive 77 basis points of return (as measured by the Bloomberg Municipal Index). So basically, you've got to say these are pretty spectacular results already for the first six weeks of the year.

Note though, within the S&P 500, we've had a tremendous broadening of result. In fact, the average S&P 500 stock has basically kept up with the overall market, which is a change of pace. Nine of the sectors within the S&P 500 have outperformed the S&P 500. The only two laggards have been information technology, those are all those large-cap tech companies we always talk about, and consumer discretionary. Think Best Buy (Best Buy Co., Inc.) and General Motors (General Motors Company).

And with the financial markets off to a positive start, economic statistics look pretty good so far too. Recall that we provided about a 2% forecast for positive GDP (Gross Domestic Product) growth when we started the year. And so far we're tracking at about 2.3%, so a little bit better than our expectations.

Employment has come in positive for the month of January, as we expected about 143,000 jobs versus our 150,000 estimate. Not bad, but still a cooling trend on employment. The unemployment rate has surprisingly come down just a little bit from 4.2% to 4%, suggesting perhaps an even tighter labor market, despite the fact that job growth has slowed. Why? Probably because immigration has slowed as well.

Interest rates have been relatively steady. Note that the two and the ten year Treasury are almost the exact same yield today as when they started the year. And credit spreads the extra interest paid relative, say, a risk free U.S. government bond, has remained fairly narrow, with the average triple B corporate still only having to borrow at about 1% higher than the average Treasury bond.

I think the biggest thing that our clients are focused on right now are all the executive actions out of our new administration. And we try to condense these into four separate areas for you to focus on, so you can get a handle on exactly what's going on. With regard to the new administration, President Trump is focused on taxes. He's focused on tariffs. He's focused on immigration and then policy.

Within the taxes, we know that this week is a big week coming up, because he's going to try and push through his extension of his Tax Cut(s) and Job(s) Act. He's likely to have to provide some bone to the Democratic side of the aisle to get it done, which probably means lower state and local taxes. And there might even be a reduction in the corporate income tax for those corporations who basically are domestically focused.

The tariffs are all over the board. And of course, we know that he has a 25% possible tariff on Canada and Mexico and already implemented a 10% tariff on China. They're negotiating with Mexico and Canada. I think the Chinese tariffs, though, are likely to stick.

With regard to immigration, there's been a massive amount of immigration over the previous four years and that immigration has slowed.

And with regard to policy, you're hearing an awful lot about that with regard to the DOGE (Department of Government Efficiency) team and Elon Musk. But clearly there's a focus on government efficiency to help drive down the deficit.

So while the Trump presidency is focused on four broad areas, the markets are basically focused on two. How are the tariffs going to impact the economy, and how much will the DOGE team impact a reduction in the deficit?

With regard to the tariffs, we know who our top trading partners are: Mexico, China, and Canada. And this is where Trump is focusing his efforts to both bring the trade balance more into align, perhaps raise some revenue, and protect some domestic industries that he thinks are important for our national security.

With regard to the deficit, recognize that the federal government spends almost $7 trillion a year, but unfortunately takes in only $5 trillion. Thus, the $2 trillion or so deficit you always hear about. We're clearly not going to save $2 trillion of government expenditures, but we really don't have to. We simply have to cut the deficit down such that the nominal growth of our economy is faster than the growth of our deficit.

Now, that's kind of a word salad. But what that really means is if we grow the economy about 4% nominally this year, that's about a $1.2 trillion increase in the economy. If the deficit is less than $1.2 trillion, all of a sudden our debt-to-GDP ratios start to look better. So the focus here isn't to get to a positive budget surplus, but it's basically to reduce the deficit about by half.

Well, that's certainly a lot of information to digest, and we'll be back in several weeks to talk about how all of it is impacting your investment portfolios.

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