Commerce Trust Market Brief with Scott Colbert

April 21, 2025 – Outlook for a U.S. Stock Market Bottom and Tariff Impacts

Scott Colbert: Good morning. It's April 21st, and the markets are just about to open. So far this year, of course, tariffs have cast a pall over the U.S. equity market, with all equity indexes largely down. The S&P 500 (Index) has fallen about 10%. The Nasdaq (100 Index) market, with its concentration of technology stocks, has fallen closer to 13%. The S&P 400 (Index) mid-cap (capitalization), the measure of the next 400 largest companies beneath the S&P 500, is down about 12%. And the small stocks are down about 15%, as measured by the Russell 2000 (Index).

International markets are one modest bright spot where large-cap international stocks (as measured by the MSCI EAFE Index) are up about 7%, primarily due to the falling (U.S.) dollar and perhaps some spark deficit spending overseas getting some of those economies kickstarted. Emerging markets (as measured by the MSCI Emerging Market Index) are flat, though, with the concerns about tariffs.

The bond market is up. Treasury interest rates are down and returns in the taxable market are about a positive 2% (as measured by the Bloomberg U.S. Aggregate Bond Index) so far year-to-date. Munis (municipal bonds) have lagged (as measured by the Bloomberg Municipal Index). They outperformed last year, but they've lagged this year because of worries about possible taxation of municipal bonds.

Underneath those negative returns are results that look even worse. The S&P 500 peaked on February 20th and is now down 16% from its high. And the Russell 2000 looks even worse, clearly in a bear market, having peaked late November, down 25% now from its high November 25th.

The biggest questions that Commerce Trust continues to get has to do with tariffs, and what are their impacts likely to be? We see six things the tariffs are likely to impact the economy and the financial markets in the near term. Number one is certainly higher near-term inflation. You can see that we've modeled out a likely peak inflation around December of somewhere between 3.6% and 4% (as measured by the Consumer Price Index) before it slowly dissipates next year.

Since we're going to have higher inflation, this probably results in number two: lower growth. Recall that real growth is simply the difference between nominal growth and inflation. And if inflation goes up, we're certainly going to see less growth. We will project growth of about 1% this year relative to last year's 2.8% pace. It clearly means a slowdown in productivity, because it's going to cost a bit more to readjust the supply lines and probably resource some of the inputs for U.S. companies.

Number four, this probably also results then in slower earnings growth. The analysts were exceptionally optimistic about earnings growth for the S&P 500 as we started the year, projected to be up almost 14%. That has fallen now to about 10%. And we still think there's likely some decline coming as the year progresses. We see earnings growth probably closer to the mid-single digits. This has obviously resulted in a cheaper U.S. stock market, and while that's rather obvious, what's not so obvious, of course, is the wealth effect, which likely slows down larger ticket purchases.

And then finally, underneath all this turmoil, we see a delayed reaction from the Federal Reserve. The market thinks the Federal Reserve can begin to cut rates as soon as this June or July. And we think it's a back half of the year kind of reduction in rates, simply because this forward surge in inflation that we're likely to get from tariffs is likely to offset their worries about near-term economic growth. As such, they're likely to be on hold longer than the market expects.

The number one question we're getting is what will it take to bottom the stock market? We think that the market needs two key catalysts to find a bottom. Number one is, we have to work through peak tariff uncertainty. And with the 90-day postponement to most of the tariffs, that uncertainty is still out into the future. And number two, we need to see a reduction in recessionary fears.

What will get us to those two points? Well number one is some type of pattern that shows that there will likely be some trade deals going forward. Number two will be the tracking of second quarter GDP (gross domestic product). First quarter GDP is likely to be very, very close to zero. And we need to see some positive growth in second quarter GDP.

Finally, we don't want to see any further cracks in the employment outlook. Recall that employment has been cooling, but the bleeding indicators haven't looked terribly bad. There's still quite a few job openings. The quit rate has been fairly steady. And amazingly, the initial unemployment claims have been remarkably benign, at just about 220,000 per week.

Any uptick in job claims, any loss in employment opportunities, and any reduction in the quit rate are all kind of bleeding indicators likely to result in less job growth. Remember that there's likely to be no recession as long as we have positive job growth. It's negative job growth that pushes us into a recession.

So obviously this is a lot of market news for you to digest. We'll be back in several weeks to talk about how all of this is impacting your portfolio.