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Food for Thought

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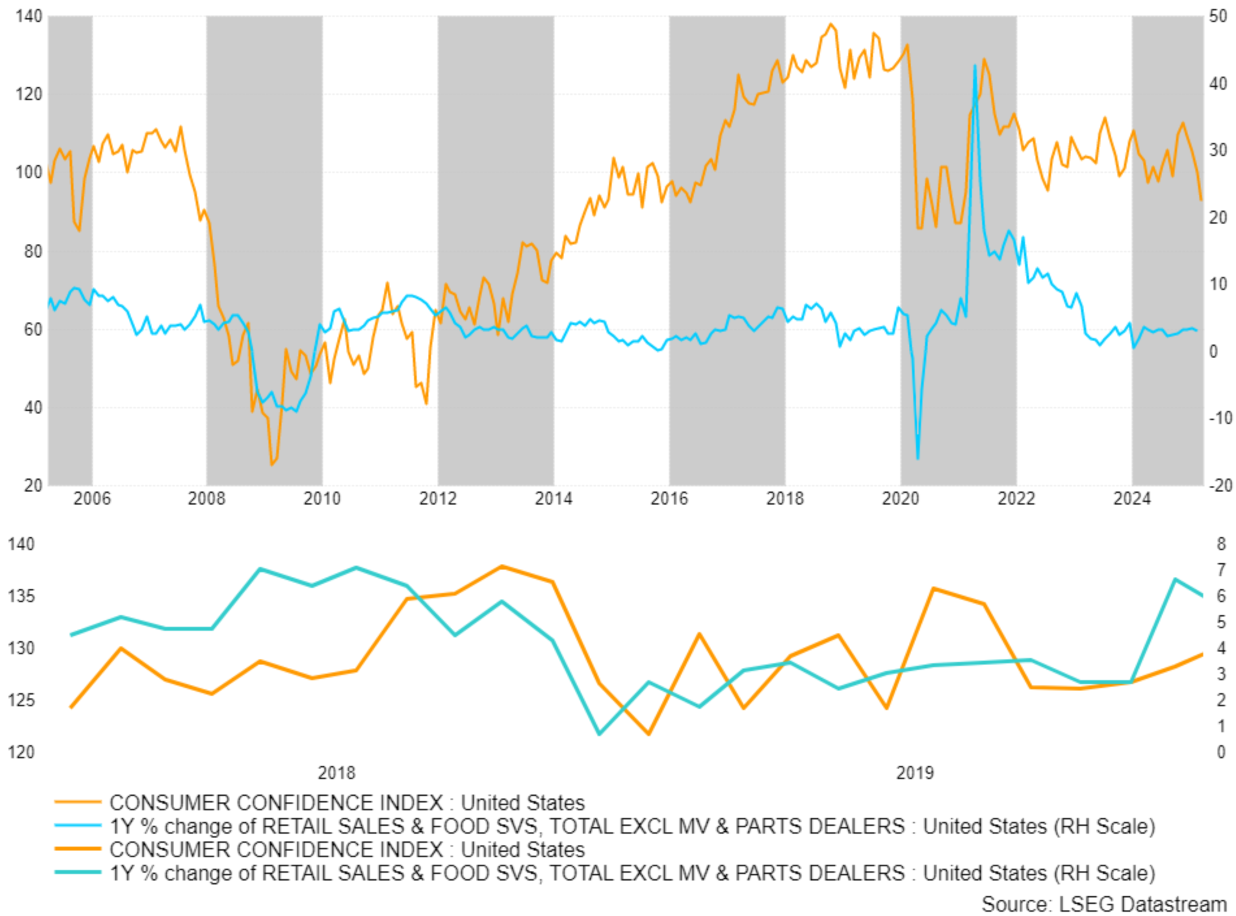
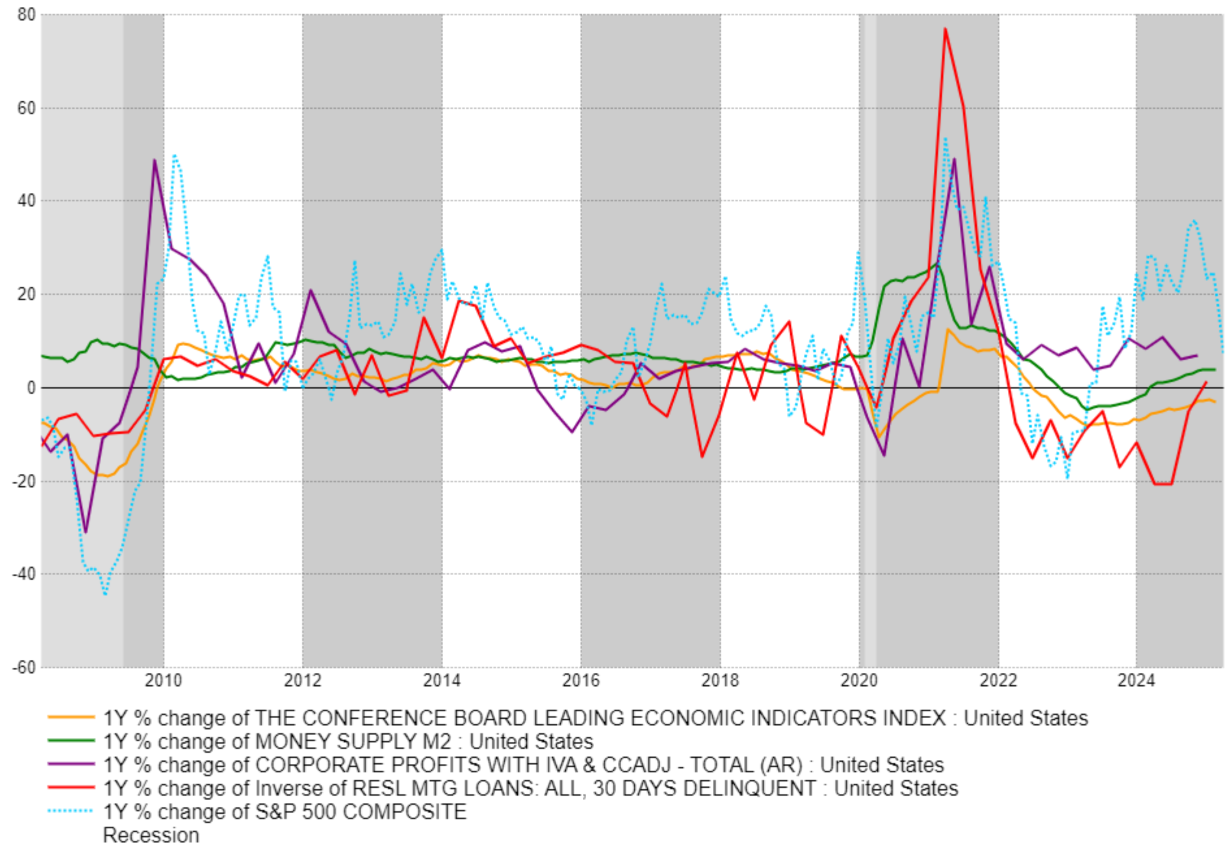
Comedian Lewis Black had a standup routine back in 1998, before the days of smart phones, 24-hour news and a fledgling internet. You know, happier times. In that routine, Mr. Black had a part of his routine where he discussed eggs and how they were good for you, then they were bad, then only parts of eggs were good for you. In the end, he just wanted them to make up their mind. I use that intro, to this quarter's letter on purpose. The market just wants minds made up around tariffs so it can get a better idea of how things will go. Don't worry! This will not be a political letter, nor will I opine on tariffs. You can find enough of that without me. What this will be is a letter focused on the fundamental backdrop.

With 1st quarter earnings almost here, let's start out by focusing on what drives those earnings …. spending. With consumer spending responsible for so much of the US Economy, starting there makes the most sense. What we have heard is that Consumer Sentiment has dropped. That is true, but it's probably better to watch what consumers do instead of what they say. While retail sales have dropped off from the post-Covid surge, they remain largely, in line with what we've seen since the Great Financial Crisis.



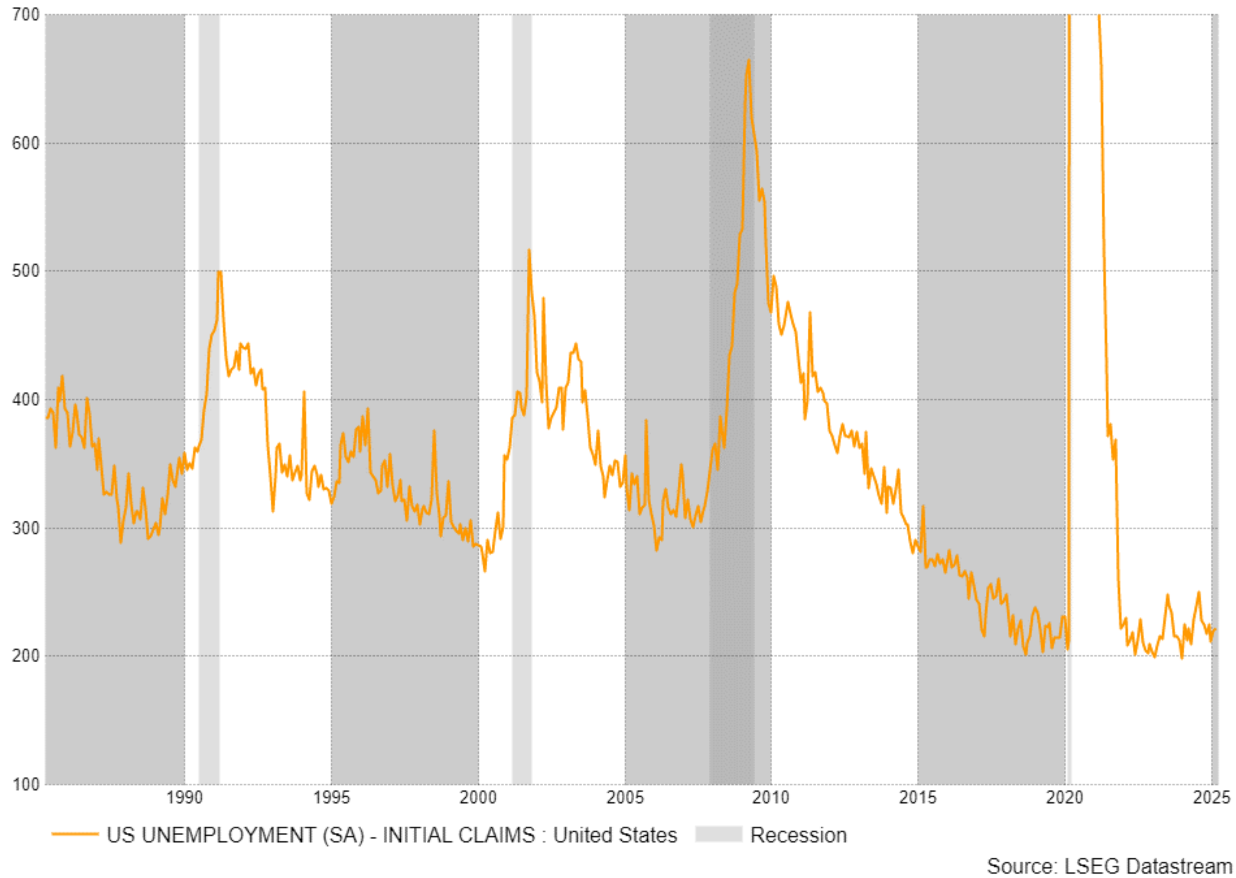
What I also highlighted, in the chart above, was how Consumer Confidence and Retail Sales reacted when tariffs were initiated in 2018. There was a pullback after tariffs were initiated, but ultimately recovered along with more clarity around tariff policy. It might not be surprising to see a similar reaction from consumers in this time.

So where does that leave us? In the chart below, we are seeing the Money Supply (M2), the Leading Economic Indicators, and Residential Mortgage Applications are increasing while Corporate Profits remain stable. Against that backdrop, we are seeing the S&P 500 slow down. When you look at these components blended, this is similar to the prior chart where the S&P 500 is like a sentiment indicator for the investor. What we are seeing is that investors are worried about the effect of tariffs on Corporate Profits. In a word, uncertainty.

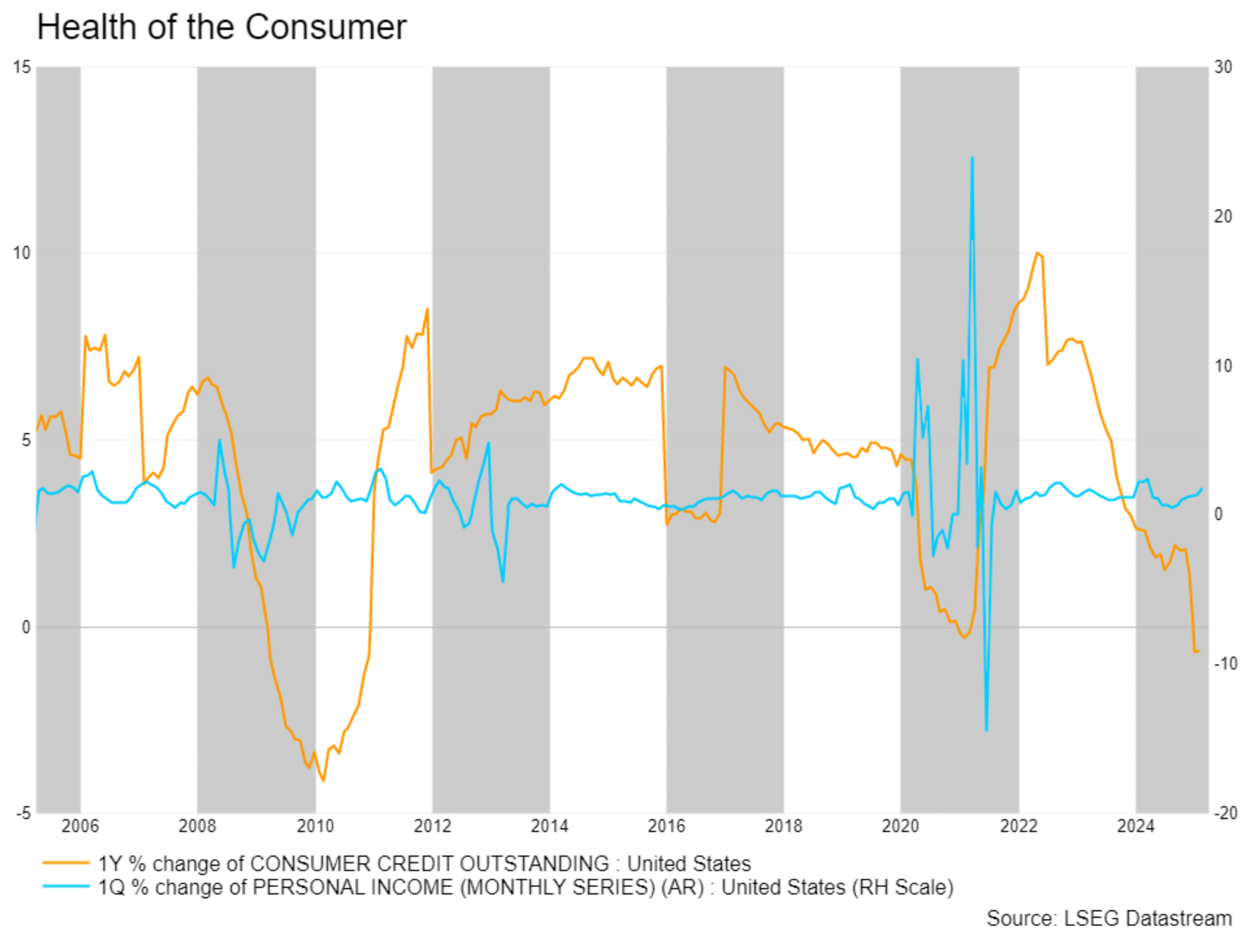


Source: LSEG Datastream / Brant Rustich

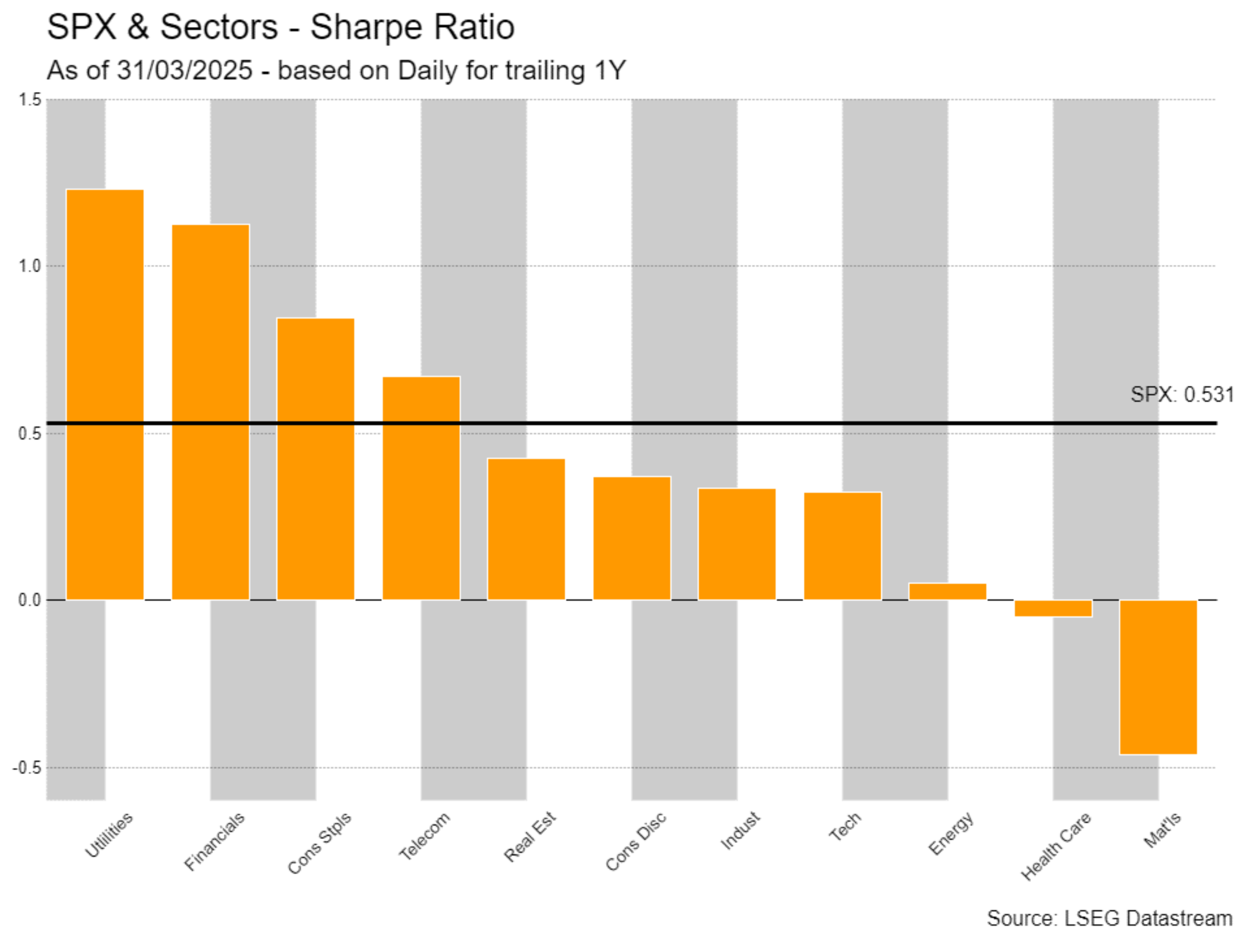
When we combine the drop in Consumer Sentiment and the S&P 500 Composite, it isn't surprising to see volatility pick up. With 1st Quarter earnings season getting ready to kick off, we will learn a lot more about profit outlooks and more importantly, corporate outlooks on jobs. If we keep the current environment of low hiring and low firing equilibrium, it could allow consumers to keep spending even if their sentiment says otherwise. As it stands now, we are still looking at some of the lowest unemployment levels we have seen in 40 years.



While the jobs picture is helping the consumer, the consumers are also putting themselves in a better place. They have been reducing outstanding credit while also seeing their incomes increase. This could also help provide a bit of a buffer for some economic shocks.



Looking through the volatility, we can look at the S&P 500 sectors to see which are currently offering the best risk adjusted (Based on Sharpe Ratios) return opportunities. Those sectors that have the biggest concerns for tariff impacts are showing Sharpe Ratios that are less than what the S&P 500 provides. While some traditional, defensive sectors are shining now, not all “defensive” stocks maybe as defensive as it might imply. In the case of Utilities and Communication Services, there are likely some ties into the AI narrative. After all, you need power to run the server farms, and you need communication services to distribute the data created in the server farms.



With all of this to digest, it's no wonder the market is volatile right now. Trying to figure out the impact of tariffs is a lot like the conundrum Lewis Black humorously described with eggs. It may take time to understand what form tariffs may take and what level they may be. All the while, opinions on tariffs may change. Clarity is what we are really wanting on the menu. Making investment decisions on what ifs winds up being more of an exercise in emotion and like market timing, can make success much harder to achieve. Investing based on fundamentals and your goals can help take some of that emotion out and keep your objectives in sight.

Just some food for thought as we find out whether tariffs, like eggs are good or bad for us.

That's all for this quarter's note, but please let us know if you have any questions or concerns.

We are here to help!

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