

**The Novelli Group
At Morgan Stanley
Private Wealth Management**

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Will Spring Storms...

Last November, the stock market cheered President Donald Trump's election, igniting a rally based on expectations of pro-growth policies. But since peaking at a new all-time high on February 19th, 2025, the S&P 500 index has corrected approximately 9% (as of April 1st, 2025), giving back all the past six month's gains, driven by uncertainty and consternation over US trade policy, a government shakeup, and increasing AI competition. The frenetic implementation of Trump's economic policy agenda – tariffs, government efficiency, immigration restrictions, deregulation, and tax cuts – has sown the seeds of both opportunity and disruption. We anticipated these disruptions when we began publishing commentary about 'regime change' and the impact on capital markets.



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President Trump's aggressive tariff stance, including hikes on Chinese imports and threats of broader levies on Canada, Mexico, Europe, and other key trade partners has rattled households, businesses, and markets. These moves, in a few instances delayed or softened at the last minute, have injected uncertainty, spooking both passive and active investors alike. To wit, consumer confidence, as measured by the Michigan Consumer Sentiment Index, has plummeted, with fears of a slowing economy and a tariff-induced price hikes curbing spending intentions. Business, facing higher input costs and trade policy ambiguity, appear to be scaling back investment and hiring, and pausing capital expenditure plans before tariffs fully bite¹. Adding to these spending curbs, the US trade deficit widened to a record high in January amid front-loading of imports ahead of tariffs, suggesting trade could be a significant drag on economic growth in the first quarter.²

Bring a Bountiful Fall Harvest?

On the other hand, deregulation and expected tax legislation are cause for some optimism for later this year. Regulatory rollbacks in the energy and financial sectors could lower compliance costs, potentially boosting profitability, and encouraging risk taking. The extension of the 2017 Tax Cuts and Jobs Act, set to expire in December 2025, could also unleash investment if Congress acts, though timing remains uncertain. Clarity on tariffs may spur opportunities for domestic industries to expand and invest in areas where they can now compete more effectively. Perhaps most importantly, the net effect of Trump's policies could be to avoid a future crisis and set the US economy on a more sustainable fiscal path for the long-term. Along these lines, in recent weeks, Trump's Treasury Secretary Steve Bessent, a 35-year market veteran, said that he was "not at all worried" at about the recent correction calling it "healthy"³, and has described the current period as a "detox" that could usher in a "New Economic Golden Age"⁴.

Earnings Season Could Set the Tone

With Spring also comes Q1 2025 Earnings Season. Over the long run, Earnings growth drives the intrinsic value of a business. Investors tend to be willing to pay a higher Price-to-Earnings multiple for stocks when the outlook for Corporate Earnings is improving (i.e., when there are upward revisions), and a lower multiple when the outlook is deteriorating (i.e., when there are downward revisions). After strong results in 2024, earnings expectations for 2025 have tempered since the start of the year. According to FactSet, initial forecasts pegged S&P 500 earnings

growth at 11.6% year-over-year, but revisions have brought this down to 7.1%, with downward revisions spanning all 11 sectors⁴.

Therefore, Q1 2025 earnings season, kicking off with the big banks in mid-April, could influence investor sentiment and the economic outlook for the next few months. Early reports of continued earnings momentum and a bottoming of downward revisions could bolster confidence. But a wave of negative outlooks based on concerns about tariffs, inflation, and interest rate expectations could signal a broader economic downshift.

Morgan Stanley & Co. has recently noted a bottoming in downward revisions, particularly in the “Magnificent 7” stocks, which could help to improve market sentiment⁶. This is important because Magnificent 7’s Q1 underperformance, along with a stronger US Dollar, contributed to a capital rotation from US stocks to International Markets. With the dollar off approximately 5% from the January 2025 high and mega-cap growth stocks stabilizing, a reversal in flows back into US equities could be supportive of the broader market. Still, with revenue growth expected at just 4.2% in Q1 and higher growth expected in later quarters (12.0% EPS forecast for Q3), forward guidance in April could prove important.

As always, we will be monitoring conditions carefully. We welcome your questions and feedback, and wish you the best for the Spring season!

¹ US Businesses Put Spending Plans on Ice with Tariffs, Tax-Cut Wait, Bloomberg, March 31st, 2025

² US trade deficit hits record high in January on imports surge, Reuters, March 6th, 2025

³ Scott Bessent says he’s not worried about the stock market’s ‘healthy correction’, Fortune, March 18th, 2025

⁴ Trump’s Treasury pick to tout “new economic golden age”, Axios, January 16th, 2025

⁵ FactSet Research

⁶ US Equity Strategy: Weekly Warm-up: A Rotation Back to the US Led by Mag 7?, Morgan Stanley, March 24th, 2025

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