March 2025

From the front page of yesterday's WSJ:

S&P, Nasdaq Log Worst Quarter Since ’22

BY KAREN LANGLEY

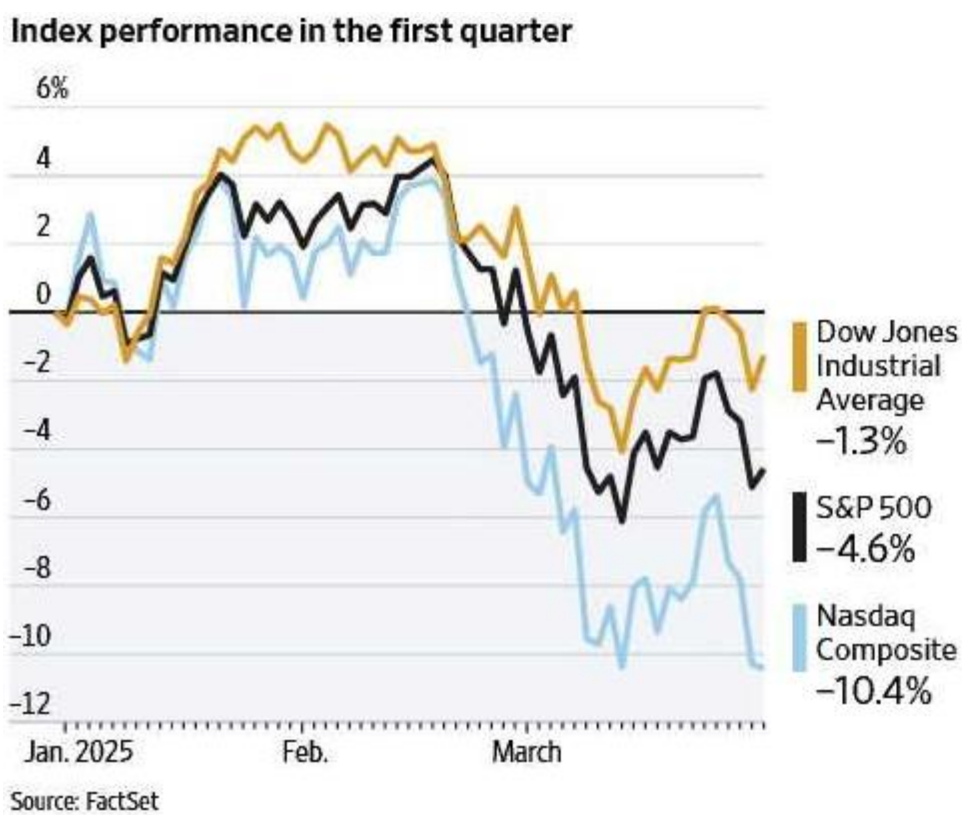
Worries about tariffs and the economy sent the S&P 500 and Nasdaq Composite to their worst quarters since 2022, a setback that is pushing some investors overseas.

The Trump administration’s whipsaw rollout of a tariff fight with America’s biggest trading partners has analysts trimming forecasts for economic growth and lifting estimates for inflation. The tech trade that carried indexes to new highs is fizzling. Investors big and small have been shifting bets to Europe—where new spending plans could jolt a lethargic economy—and beyond. ...

The S&P 500 is struggling to claw its way out of a correction after falling 10% from its February record. The tumultuous quarter left the U.S. stock benchmark far behind the gains of indexes overseas. The dollar has weakened, leaving investors wondering if the pullback from investing in U.S. assets heralds the start of a long-term regime.

It is a far cry from the end of 2024, when the S&P 500 capped a second consecutive year of more than 20% gains. Cooling inflation had allowed the Federal Reserve to lower interest rates three times in a row. Election Day victories by President Trump and congressional Republicans seemed to presage tax cuts, deregulation and boom times ahead. ...

While European stocks have long been cheaper than U.S. shares relative to companies’ earnings, the continent’s sluggish economy and less techoriented market had turned off many investors.



Now, with the U.S. warning Europe not to take its military protection for granted, Germany and other countries have announced major increases in military spending that some economists think could jumpstart the region’s economy.

Investors are rushing to get in on the action. The Stoxx Europe 600 index has outpaced the S&P 500 by 9.8 percentage points this year, its largest quarterly lead since the start of 2015, according to Dow Jones Market Data. ....

Bank of America's March global fund-manager survey showed a record rotation out of U.S. stocks, leaving a net 23% of respondents underweight shares of American companies. Preference for eurozone equities, meanwhile, leapt to its highest level since July 2021. ...

The tech giants have pulled back recently. Nvidia, the darling of the artificial-intelligence boom, stumbled after the emergence in January of an AI model from Chinese company DeepSeek that appeared to rival Western versions while using less-advanced chips. Its shares are down 19% this year, while Apple and Microsoft have both fallen about 11%.

Most S&P 500 sectors are higher so far this year. Groups that tend to be resilient in downturns, such as healthcare, consumer staples and utilities, have advanced, but so have financials, a segment whose fortunes are closely linked to the health of the economy.

Still, investors' nerves remain evident. Gold, seen as a haven in times of trouble, has rallied 19% this year, notching its biggest three-month gain since 2011, and is trading at records. And investors who have grown more worried about the economic outlook have snapped up Treasurys, driving the yield on the benchmark 10-year note down to 4.245%, from 4.577% at the end of last year.

From Global Investment Strategy last Thursday:

Second Quarter 2025 Strategy Outlook: Into The Abyss

I. Macroeconomic Outlook

The US Economy: Consumer Spending Starts to Buckle

The US consumer has been the key locomotive propelling the US economy over the past few years, with personal consumption accounting for more than four-fifths of all GDP growth since 2020. US consumers have also buttressed global growth.

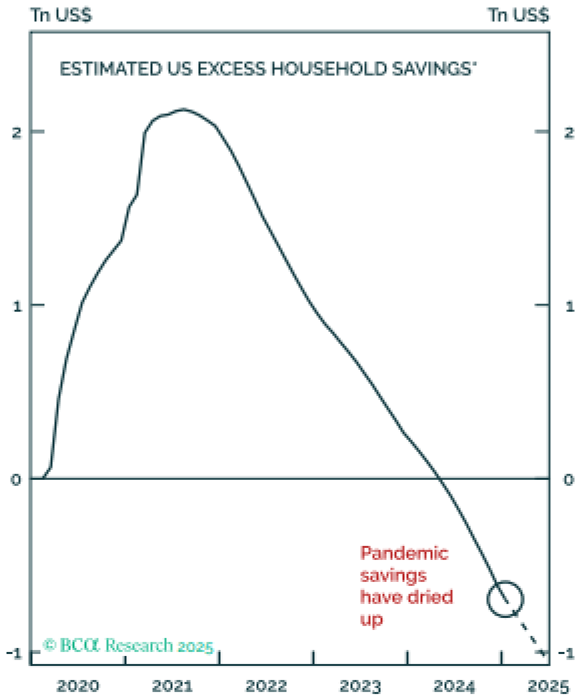
This can be seen in the fact that US import volumes have grown swiftly since 2022, whereas non-US imports have stagnated (**Chart 1**). It is thus concerning that recent data on US consumption have been on the weak side. So-called "control group" real retail sales – which exclude restaurants, autos, building materials, and gasoline – rose by only 0.5% in January and February relative to the 2024 Q4 average. On a 3-month/3-month basis, control group sales were up 2.8% annualized as of February. This compares to an average growth rate of about 5% in the second half of 2024. Outside of the control segment, real restaurant sales were down 7.1% on a 3m/3m basis; building materials sales were down 13.5%; and auto sales were down 1.9%.

CHART 1
US Consumers Have Been Propping Up Global Growth

SOURCE: CPB NETHERLANDS BUREAU FOR ECONOMIC POLICY ANALYSIS, IMF, AND BCA CALCULATIONS.

CHART 4

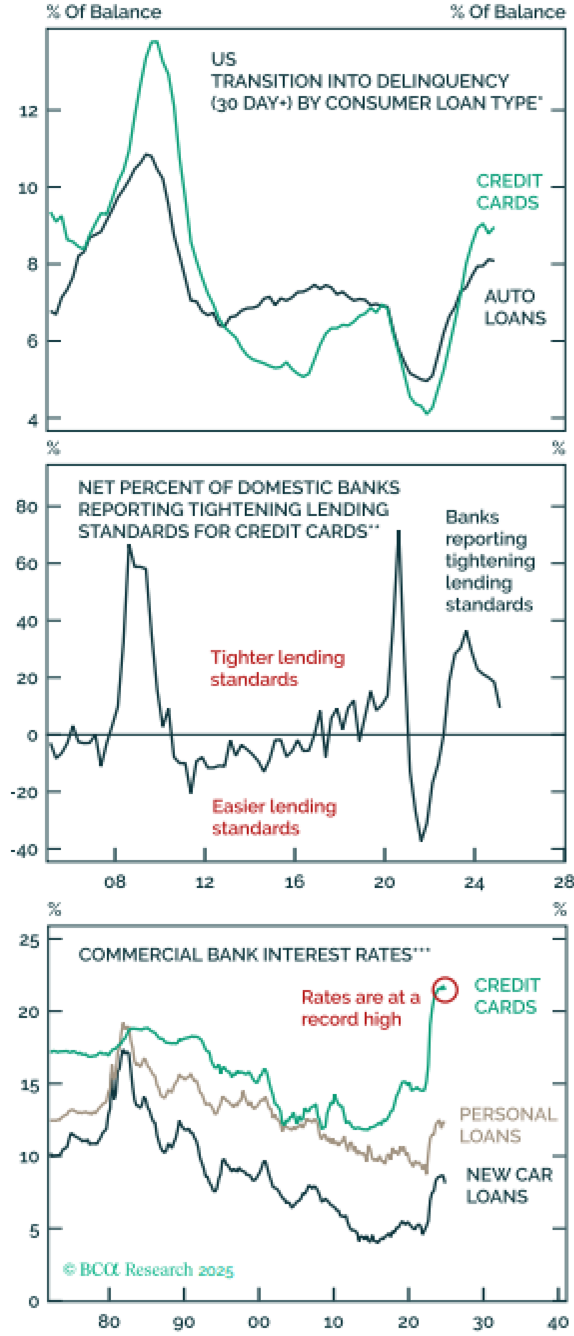
A Depletion In Excess Pandemic Savings



* SOURCE: "DATA REVISIONS AND PANDEMIC-ERA EXCESS SAVINGS", H. ABDELRAHMAN AND L. OLIVEIRA, FEDERAL RESERVE BANK OF AN FRANCISCO, NOVEMBER 8, 2023.

CHART 7

Delinquency Rates On Credit Cards Are Back To 2011 Levels, While Lending Standards Have Tightened



* SOURCE: FEDERAL RESERVE BANK OF NEW YORK. SERIES SHOWN AS A 4-QUARTER MOVING TOTAL.
** SOURCE: FEDERAL RESERVE. SENIOR LOAN OFFICER OPINION SURVEY.
*** SOURCE: FEDERAL RESERVE.

The deceleration in consumer spending has pushed the Atlanta Fed's GDPNow model's estimate of Q1 real PCE growth down to 0.4%. The model is tracking overall GDP growth of 0.2% for the first quarter after adjusting for the anomalous surge in gold imports earlier this year.

The weakening in consumer spending has been echoed in sentiment surveys. Both the Conference Board and the University of Michigan surveys have experienced a sharp deterioration in confidence.

There is little doubt that the prospect of higher tariffs has contributed to the worsening in the consumer outlook. However, that is not the entire story. Even before the trade war began, consumer finances were looking increasingly stretched.

Over the course of two years, US households spent the $2 trillion that they had accumulated during the pandemic (**Chart 4**).

Outside of money market funds – which are generally held by the wealthy – bank deposits are back to pre-pandemic levels as a share of disposable income. For the bottom 20% of income earners, bank deposits in real terms are lower than where they were in 2019.

With little savings to spare, many households have turned to borrowing, only to find themselves unable to pay back debt. Nearly 10 million Americans are overdue on their student loans following a 4.5-year debt payment moratorium that expired at the end of last September. Delinquency rates on credit cards and auto loans have risen to levels not seen since 2011 – a year in which the unemployment rate was double what it is today (**Chart 7**). Reacting to the deterioration in consumer finances, banks have tightened lending standards while lifting credit card interest rates to the highest level in history.

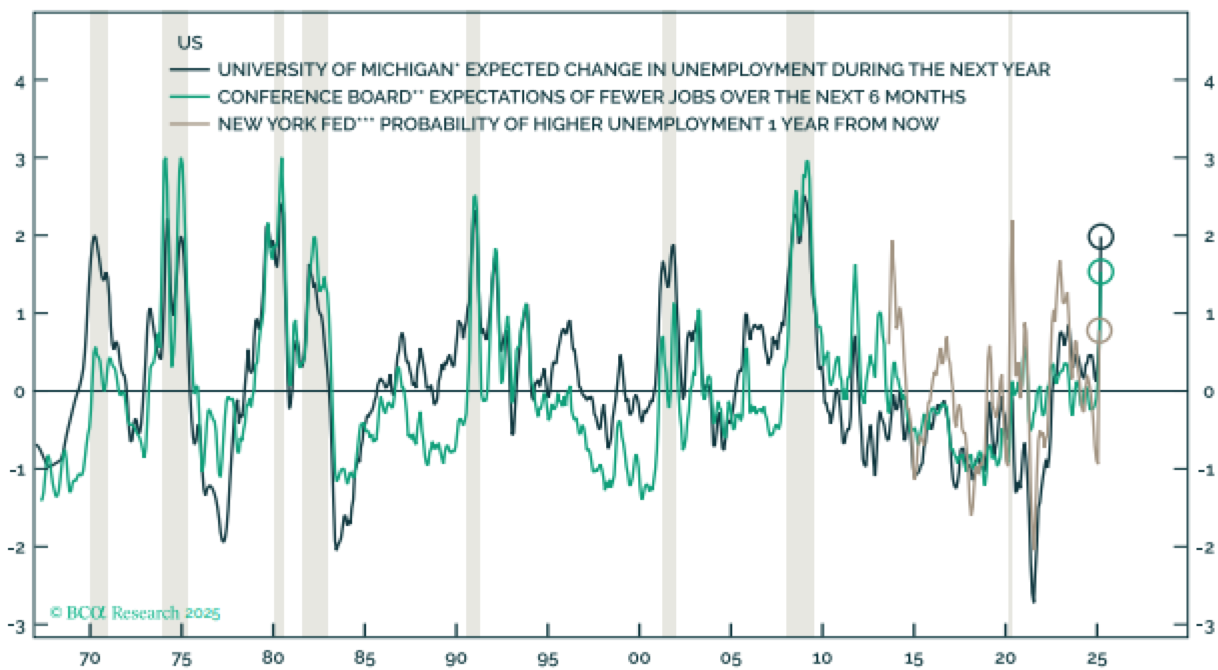
Keep an Eye on the Labor Market

The risk is that slower consumer spending leads to a weaker labor market, less income, and even slower consumer spending. This was less of a risk three years ago when the job vacancy rate exceeded 7%. Back then, almost anyone who lost their job could walk across the street to find new work. That is not the case anymore. The job openings rate stood at 4.6% in January. This is dangerously close to the threshold of 4.5% that Fed Governor Christopher Waller has identified as ... the point where any further decrease in openings could trigger a vicious cycle of rising unemployment.

Worryingly, real-time indicators from Indeed and LinkUp suggest that job vacancies fell further in February and March. This has been echoed in expectations of higher unemployment in the University of Michigan, Conference Board, and New York Fed surveys (**Chart 10**). It has also been echoed in an increase in the U-6 unemployment rate, which includes discouraged workers and those who are involuntarily employed part-time. In February, this broader measure hit its highest level in more than three years.

So far, initial unemployment claims have not risen very much. However, that may be small comfort. Claims are a better leading indicator for when a recession is likely to end than when it is likely to start. That is simply because firms usually stop hiring before they begin firing when an economy is entering a recession; in contrast, firms usually stop firing before they begin rehiring when an economy is exiting a recession.

CHART 10
Unemployment Fears Are Rising



* SOURCE: UNIVERSITY OF MICHIGAN, SURVEY OF CONSUMERS. SCORE IS THE PERCENT UNFAVORABLE MINUS THE PERCENT FAVORABLE PLUS 100.
** SOURCE: THE CONFERENCE BOARD.
*** SOURCE: FEDERAL RESERVE BANK OF NEW YORK.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS. ALL SERIES ARE SHOWN AS A 3-MONTH MOVING AVERAGE EXCEPT FOR THE LATEST DATA POINT. SERIES ARE STANDARDIZED AND TRUNCATED AT 3.

Hiring is exceptionally low at the moment. Job cut announcements – which often lead layoffs – have spiked, while the number of workers that firms are planning to let go under the WARN Act rose to the highest level in 18 months in February.

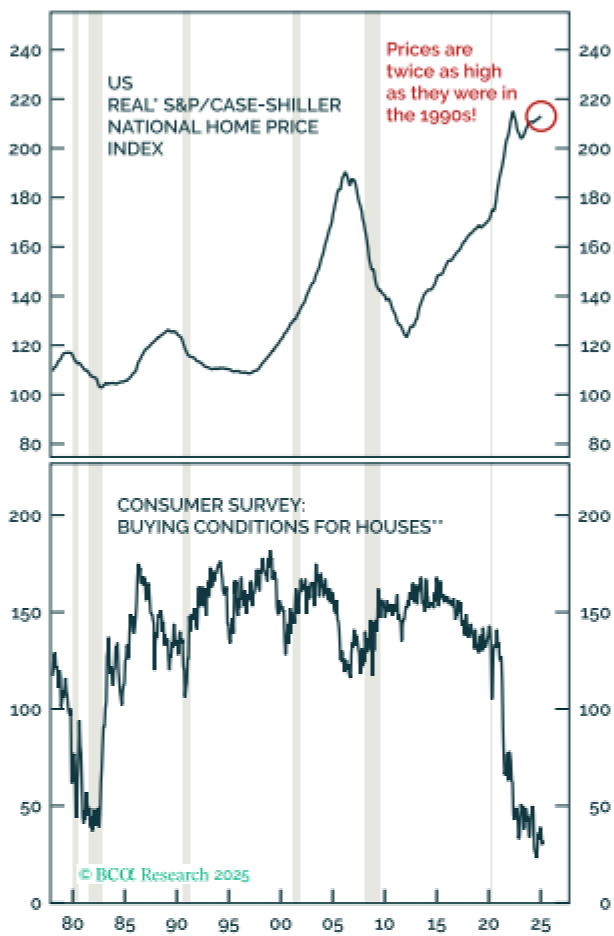
US Housing: False Dawn?

One part of the economy that has shown a bit more pep recently is housing. Both housing starts and existing home sales have perked up since last summer. This is not particularly surprising. Mortgage rates are no longer rising rapidly, which has removed a major headwind to housing. The problem is that mortgage rates have not fallen much either.

The 30-year fixed mortgage rate is currently 6.65%. While this is similar to where it was during most of the 1990s, US home prices are now twice as high in real terms as they were back then (**Chart 13**). As a result, home affordability remains very poor.

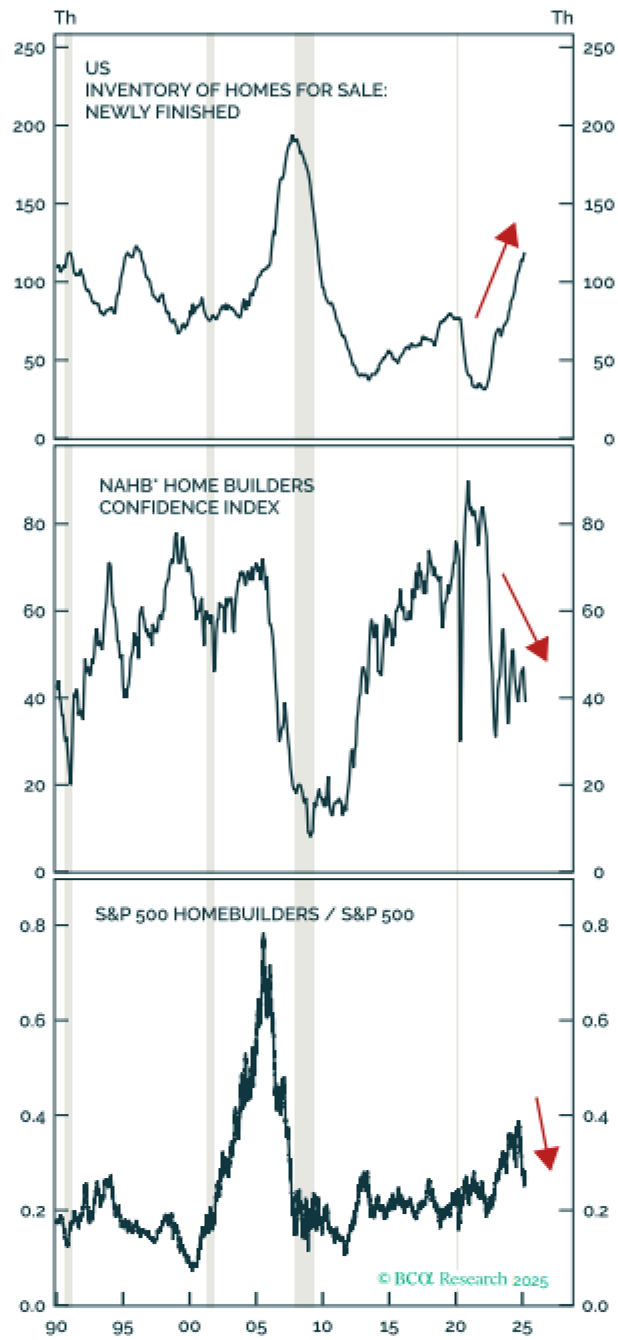
Although homebuilders have cut prices in some markets and

CHART 13
Housing Affordability Remains Very Poor



* DEFLATED BY HEADLINE CPI AND REBASED TO JANUARY 1975 = 100.
** SOURCE: UNIVERSITY OF MICHIGAN, SURVEY OF CONSUMERS. QUESTION POSED: GENERALLY SPEAKING, DO YOU THINK NOW IS A GOOD TIME OR A BAD TIME TO BUY A HOUSE?
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

CHART 14
Home Inventories Have Risen, While Homebuilder Sentiment And Share Prices Have Weakened



* SOURCE: NATIONAL ASSOCIATION OF HOME BUILDERS.
NOTE: SHADED AREAS DENOTE NBER-DESIGNATED RECESSIONS.

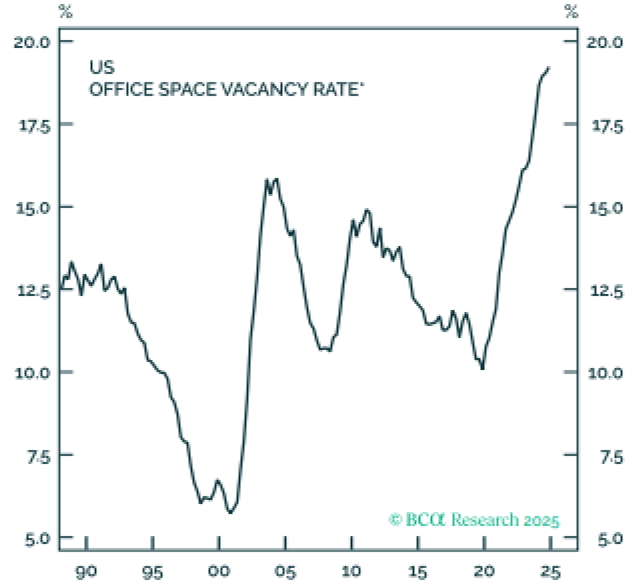
are offering interest rate buydowns, the inventory of newly built unsold homes has risen to the highest level since 2009 (**Chart 14**). Homebuilder sentiment has dropped, as have their share prices.

Meanwhile, 20% of home mortgages are on track to have rates in excess of 6% by the end of this year, up from less than 4% of mortgages in 2022 Q2.

CRE: From Bad to Ugly

Despite a lot of consternation from corporate leaders and President Trump over remote work, the share of job postings offering remote/hybrid positions on Indeed has edged higher in recent months. Nationwide, 24% of employees worked at least partially from home in February 2025, a slightly higher proportion than two years ago.

CHART 17
The Office Vacancy Rate Is At The Highest Level On Record



* SOURCE: NCREIF.

Given the structural decline in office space demand, it is not surprising that landlords are having trouble extending leases. The office vacancy rate stood at 19% at the end of 2024, the highest level on record (**Chart 17**). Delinquency rates on office loans continue to climb. Perhaps even more worrying, delinquencies are rising in other segments of commercial real estate, including apartments and hotels (**Table 1**).

Over 70% of CRE loans are held by regional banks whose balance sheets are more vulnerable than those of the larger money-center banks. It is probable that we will see another wave of banking stress as loan losses increase.

TABLE 1
The Problems In CRE Are Spreading Beyond Offices

CRED iQ OVERALL DISTRESSED RATES BY PROPERTY TYPE* DELINQUENT AND / OR SPECIALLY SERVICED LOANS						
MONTH	OFFICE	MULTIFAMILY	RETAIL	HOTEL	INDUSTRIAL	SELF STORAGE
Aug-23	9.4%	5.0%	10.7%	7.7%	0.4%	0.0%
Sep-23	10.8%	4.7%	11.2%	8.3%	0.7%	0.1%
Oct-23	10.5%	5.1%	9.5%	8.9%	1.8%	1.3%
Nov-23	6.8%	2.9%	6.6%	6.4%	4.4%	1.3%
Dec-23	9.9%	4.0%	8.4%	8.0%	0.6%	1.1%
Jan-24	10.5%	2.6%	8.0%	6.7%	0.3%	14.4%
Feb-24	11.0%	3.4%	8.4%	6.9%	1.3%	0.1%
Mar-24	11.4%	3.7%	9.5%	7.7%	0.6%	0.1%
Apr-24	11.7%	7.2%	11.9%	8.7%	0.4%	0.1%
May-24	11.1%	7.1%	11.3%	9.4%	0.5%	0.1%
Jun-24	11.5%	7.4%	11.7%	8.1%	1.0%	0.1%
Jul-24	12.2%	8.4%	11.8%	7.8%	0.8%	0.2%
Aug-24	13.0%	11.0%	10.6%	8.4%	4.6%	0.1%
Sep-24	14.8%	11.2%	11.4%	8.6%	0.6%	2.4%
Oct-24	14.8%	11.0%	11.7%	9.0%	1.2%	3.6%
Nov-24	15.5%	11.2%	11.5%	8.6%	0.6%	1.7%
Dec-24	17.2%	12.5%	10.9%	9.9%	0.8%	1.6%
Jan-25	17.7%	12.9%	10.8%	10.4%	1.6%	14.2%
Feb-25	19.3%	13.0%	10.7%	10.2%	0.5%	2.0%

* AS OF FEBRUARY 28, 2025.
SOURCE: CRED iQ.

Capex Relapse

Economists often describe capital expenditures as a form of "derived demand." This is another way of saying that companies do not invest in new capacity for its own sake, but rather to meet demand for whatever it is that the firm is producing. This implies that a slowdown in consumer spending will reduce capex regardless of what else is happening in the economy.

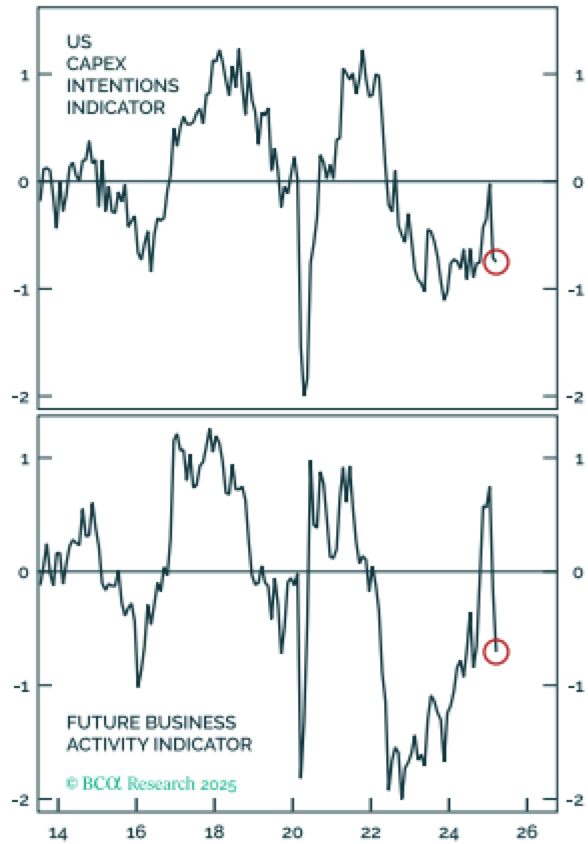
Consistent with the observation above, capex intentions have given up their post-election bounce and are back to the low levels that prevailed last year (**Chart 19**). The regional Fed manufacturing purchasing manager indices have swooned, with the future conditions components getting hit the hardest.

Manufacturing construction also appears to have peaked after a multi-year upcycle. President Trump has frequently talked of repealing the CHIPS Act and the IRA, two key drivers of the manufacturing construction boom.

Many investors are hoping that higher tariffs will incentivize domestic manufacturing activity. We are skeptical that this will happen. Manufacturing construction did not respond favorably to higher tariffs during the first Trump administration. If anything, as we discuss below, the impact on both construction and the broader economy is likely to be more negative this time around.

CHART 19

Capex Intentions Have Given Up Their Post-Election Bounce



AVERAGE OF STANDARDIZED FUTURE BUSINESS CONDITIONS AND CAPITAL EXPENDITURE EXPECTATIONS FOR THE NFIB SURVEY (3-TO-6 MONTHS), DALLAS, KANSAS CITY, NEW YORK EMPIRE, PHILADELPHIA, AND RICHMOND FED REGIONAL MANUFACTURING SURVEYS (6 MONTHS). SERIES ARE TRUNCATED AT -2. LATEST DATA POINT IS AN ESTIMATE.

Tariffied

Recessions often begin when an economy becomes vulnerable to a downturn and is then hit by a major shock. Unfortunately, a global trade war would represent such a shock. The trade war will negatively affect the US economy in at least six ways.

First, higher tariffs will push up consumer prices, depressing real incomes in the process. Import prices rose 0.4% in February against Bloomberg consensus expectations of a 0.1% decline. The CPI swap market expects inflation to rise to about 3% over the next 12 months.

Second, higher inflation will curb the ability of the Fed to respond to slower growth by cutting rates aggressively. During Trump's first term, the PCE deflator was 6% below where it would have been if prices had risen by 2% since the Global Financial Crisis (**Chart 22**). Today, the price level is 1.2% above its trendline. The Fed has no choice but to tread carefully.

Third, higher tariffs will raise costs for companies, owing to the fact that more than four-fifths of global trade is in primary, intermediate, and capital goods. Higher input costs alongside slower global growth will reduce corporate profits.

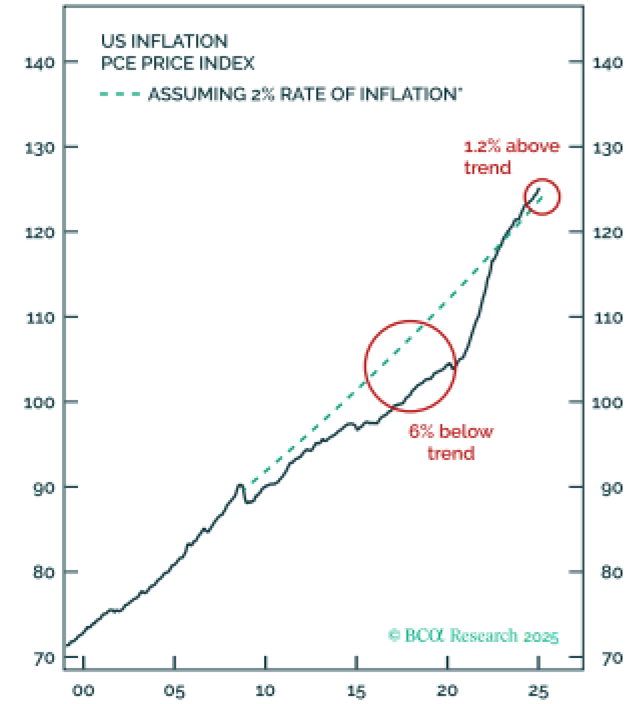
Fourth, the ham-fisted way that the tariffs have been rolled out has led to a spike in business uncertainty (**Chart 24**). When companies cannot plan for the future, they tend to sit on their hands, abstaining from new hiring and investment. The IMF estimates that the damage to growth from uncertainty over tariffs can be as large as the tariffs themselves.

Fifth, tariff worries have contributed to both the recent selloff in stocks and the widening of credit spreads. Along with the rise in bond yields since last September, this has produced a tightening in financial conditions. We estimate that the loosening in financial conditions boosted GDP growth by 0.5% in the last three quarters of 2024, but that the subsequent tightening will shave about 0.3% from growth in the first three quarters of 2025.

Sixth, foreigners will retaliate against US tariffs. This retaliation will not only include higher tariffs against US exports but various other costly actions. For example, the US exported $320 billion in military equipment in 2024, accounting for 15% of overall goods exports. Canada and Portugal have already said that they are rethinking their decision to buy F-35 fighter planes. Then there is the $100 billion in service exports that foreign travellers generate every year. In February, the number of Canadian travellers to the US dropped by 18%, or nearly half a million, compared to a year earlier.

CHART 22

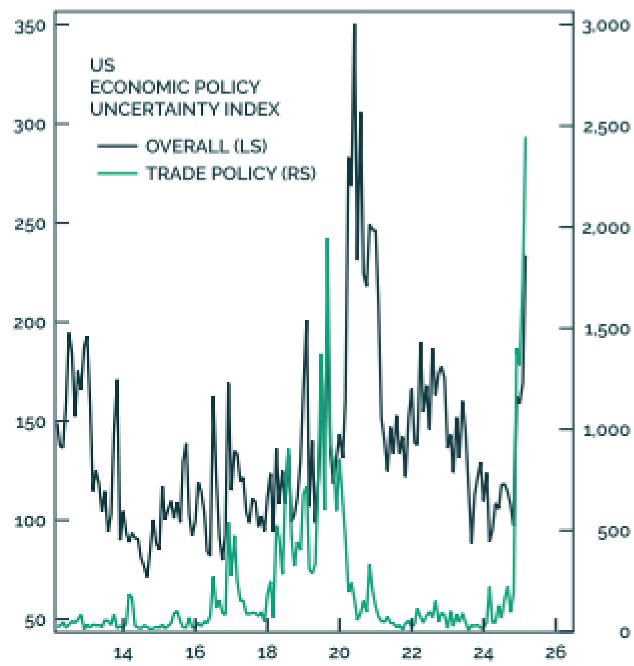
With Prices Now Above Their Long-Term Trendline, The Fed Needs To Tread Carefully



* SINCE OCTOBER 2008.
SOURCE: BUREAU OF ECONOMIC ANALYSIS (BEA).

CHART 24

Uncertainty Has Spiked



SOURCE: BAKER, BLOOM, AND DAVIS; ECONOMIC POLICY UNCERTAINTY.
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No Help from Fiscal Policy

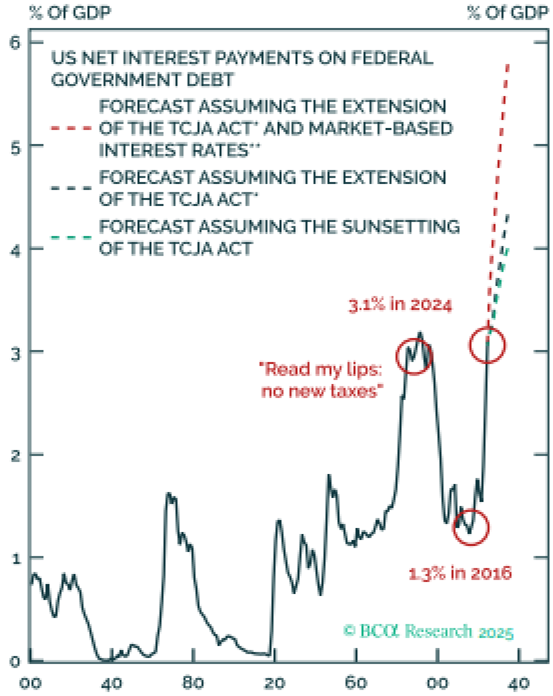
The severity of recessions is typically a function of both the magnitude of the economic imbalances going into the downturn and the aggressiveness of the policy response. When imbalances are small and the policy response is strong, recessions are often shallow and short.

The good news for the US economy is that private-sector imbalances, outside of a few areas such as commercial real estate, are not especially large at the moment. The bad news is that the policy response is likely to be muted. This is true for monetary policy, where the spectre of tariff inflation will limit the Fed's ability to cut rates. And it is true for fiscal policy as well.

In contrast to the private sector, the US public sector is highly indebted. Rolling over all that debt was not a major problem when real yields were low, but that is not the case anymore. As a share of GDP, interest expense on federal government debt has doubled since 2016. It is set to double again over the next 10 years if the tax cuts that are set to expire at the end of this year are made permanent and bond yields evolve in line with current market expectations (**Chart 27**).

CHART 27

Interest Costs On The Federal Debt Are Set To Soar Into Unchartered Territory



* CALCULATIONS USING THE CBO'S ESTIMATES OF BUDGETARY EFFECTS OF SELECTED ALTERNATIVE ASSUMPTIONS ABOUT REVENUE POLICIES RELATED TO THE 2017 TAX ACT (MAY 2024) AND THE CBO'S 10-YEAR BUDGET PROJECTIONS (JUNE 2024).
** CALCULATIONS BASED ON THE FUTURE PATH OF 10-YEAR TREASURY YIELDS IMPLIED BY THE FORWARD CURVE.
SOURCE: US CONGRESSIONAL BUDGET OFFICE, OFFICE OF MANAGEMENT AND BUDGET, IMF, AND BLOOMBERG FINANCE L.P.

If bond yields stay where they are, the primary budget deficit would need to decline by 3.4% of GDP to stabilize the debt-to-GDP ratio at current levels. Some fiscal tightening would allow yields to fall. However, budget cuts of around 2.5%-to-3% of GDP would probably still be necessary to bring the deficit down to a sustainable level.

Reducing the deficit to such an extent would be very difficult in the current political environment. Spending on defense and mandatory programs such as Social Security, Medicare, and Medicaid account for 85% of non-interest government spending.

Moreover, there is not much interest in reducing discretionary spending. For example, just this week President Trump touted how he was closing the Department of Education. However, almost all of its key functions, such as administering Pell Grants and student loans, will simply be transferred to other government departments.

There is scope to increase the efficiency of government operations, which is ostensibly what DOGE has been tasked to do. However, so far, DOGE has generated more chaos within the federal bureaucracy than actual savings, with numerous examples of people being fired only to be rehired a few days later.

The discussion above suggests that if the Trump administration tries to push more large-scale unfunded tax cuts through Congress, the bond market could rebel. Ultimately, we expect Congress to extend the expiring tax cuts while also cutting taxes on tips. The latter would reduce revenue by $10-to-$55 billion, a fairly manageable sum. Coupled with very modest cuts to discretionary spending, this should leave federal fiscal policy broadly neutral over the remainder of the year.

At the state and local government level, fiscal policy is likely to become less stimulative, implying a negative fiscal impulse. State and local government employment dropped early on during the pandemic but then rebounded swiftly thanks in part to generous transfers from Washington. State and local government payrolls increased by 31K per month over the past 12 months, more than three times as fast as the average during the prior 10 years. According to the National Association of State Budget Officers, state spending is set to slow sharply this year.

Maintaining Our 12-Month US Recession Probability of 75%

We raised our 12-month recession probability from 65% to 75% following the November presidential election. In our Annual Outlook, we speculated that the recession would begin in May. We are still comfortable with that conclusion, although we would not completely discount the possibility that the recession began in March.

Europe: Waking From Hibernation?

Investor sentiment towards Europe has surged since the start of the year. This newfound optimism hinges on expectations that Europe will boost spending on defense and infrastructure, thus giving the economy a much-needed lift.

While we agree that increased spending will support growth, we would make two qualifications: First, Germany is the only major economy in Europe that has enough fiscal space to significantly raise government outlays. France, Belgium, Italy, and Spain all have government debt-to-GDP ratios above 100%. In the UK, gross government debt hit 102% of GDP in 2024. Public-sector borrowing surprised on the upside in February, which only heightens the need for the Labour government to curtail spending.

Second, even though Germany's upper house of parliament has approved a constitutional amendment to loosen the so-called debt brake, it will take at least a year before this translates into meaningfully more spending. Meanwhile, European financial conditions have tightened since the start of March on the back of higher bond yields and a stronger euro. The rise in bond yields across the whole euro area is reminiscent of what happened in the early 1990s during the period of German reunification.

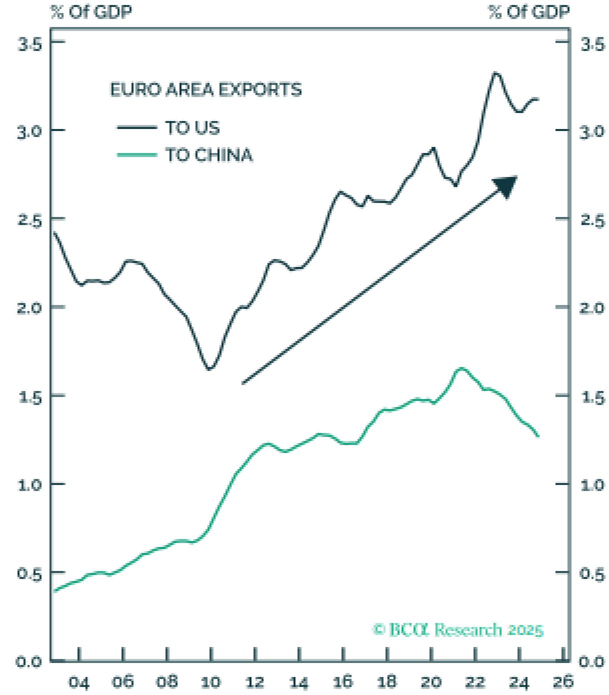
The tightening in financial conditions is coming at an inopportune time for Europe. Although recent economic data has generally come in somewhat better than expected, activity has been flattered by the tariff front-running. President Trump has pledged to raise tariffs on European goods on April 2. As a share of GDP, EU exports to the US have nearly doubled since 2010 (**Chart 30**).

As in the US, the insulation around the European labor market is wearing thin. According to Indeed, job openings in France, Germany, and the UK continue to trend lower. Although the overall euro area unemployment rate has not yet risen, this disguises important regional variations: Whereas unemployment continues to decline from elevated levels in Southern Europe, it is rising in Northern Europe.

Then there are the long-term challenges. According to a survey conducted by the European Commission, German companies are less competitive now than at any time during the past 30 years (**Chart 33**). China is increasingly taking market share in the high-end industrial markets that Germany once dominated. Meanwhile, Europe's population continues to age rapidly,

CHART 30

Trump Tariffs Will Hurt EU Exports To The US Which, As A Share Of GDP, Have Doubled Since 2010



SOURCE: EUROSTAT.
NOTE: SERIES SHOWN AS 4-QUARTER MOVING TOTAL. LATEST DATA POINT IS AN ESTIMATE.

CHART 33

German Companies Are Less Competitive Now Than At Any Time Since Reunification

NOTE: SERIES SHOWN STANDARDIZED.
SOURCE: EUROSTAT.

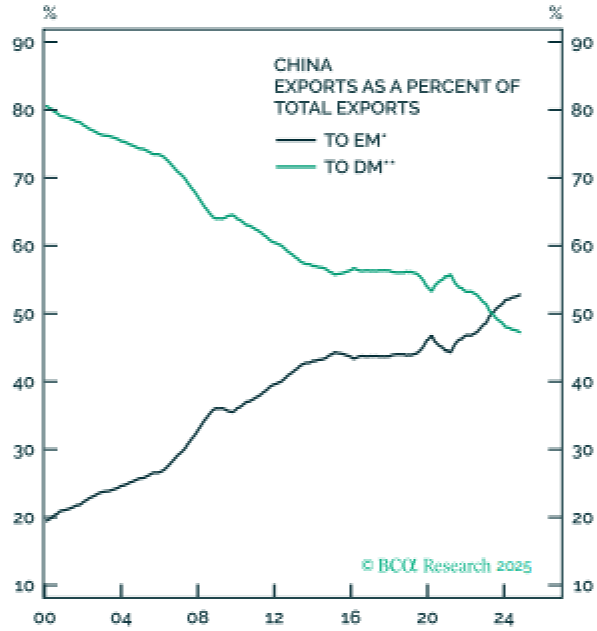
which will further reduce the ratio of workers-to-retirees. The immigration system also remains dysfunctional. Even among second-generation immigrants, educational achievement and labor participation are lower than for non-immigrants.

China: More Stimulus Needed

So far in 2025, Chinese economic activity has been on the strong side. The January-February data on industrial production, retail sales, and fixed-asset investment all came in above expectations. Government programs designed to encourage households to trade in old consumer goods for new ones have buoyed activity.

Tariff front-running has also helped. Normally, Chinese import and export growth follow the same trajectory. This changed in the second half of 2024, with import volume growth weakening even as export growth strengthened. Chinese exports to the US rose 13.6% in 2024. Port of Los Angeles container volumes were up 17.4% in the six months to February 2025 relative to the same period a year earlier.

CHART 37
China Is Less Dependent On The US And Other Developed Markets

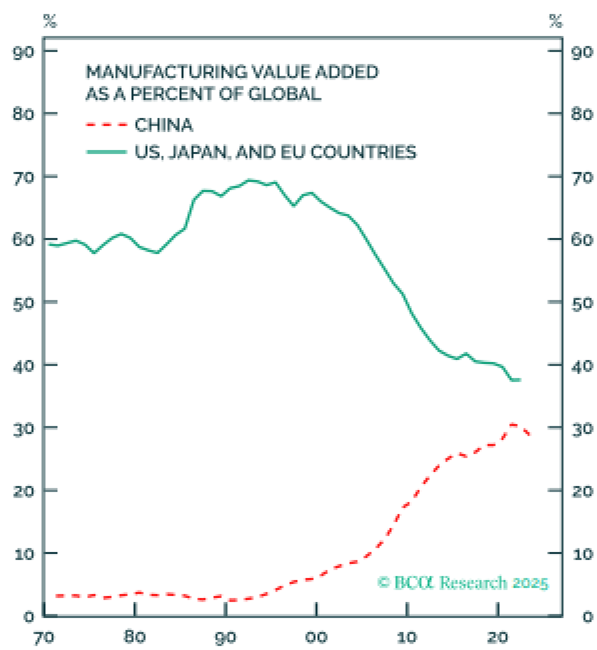


* EMERGING & DEVELOPING ECONOMIES AS DEFINED BY IMF.
** ADVANCED ECONOMIES AS DEFINED BY IMF.
NOTE: HONG KONG'S EXPORTS ARE INCLUDED IN CHINESE EXPORTS; TAIWAN IS CLASSIFIED AS AN ADVANCED ECONOMY AND KOREA IS CLASSIFIED AS AN EMERGING ECONOMY.
SOURCE: IMF AND BCA CALCULATIONS.

China is less dependent on the US and other developed markets than in the past, with more than half of Chinese exports now going to other emerging markets (**Chart 37**). The problem is that those emerging markets only account for 25% of global GDP. The ASEAN countries collectively run a merchandise trade deficit of 4.5% of GDP with China, up from a deficit of only 0.5% of GDP in 2011.

Globally, China's current account surplus hit a record $723 billion in 2024 Q4. As a share of global GDP, its trade surplus in goods stands near record-high levels. The country's share of global manufacturing value added has climbed from less than 10% to around 30% over the past 20 years (**Chart 39**). With trade barriers against China in developed economies rising and emerging markets struggling to absorb the influx of Chinese goods, it is likely that Chinese export growth will experience a structural slowdown.

CHART 39
China's Share Of Global Manufacturing Value Added Has Climbed From Less Than 10% To Around 30% Over The Past 20 Years



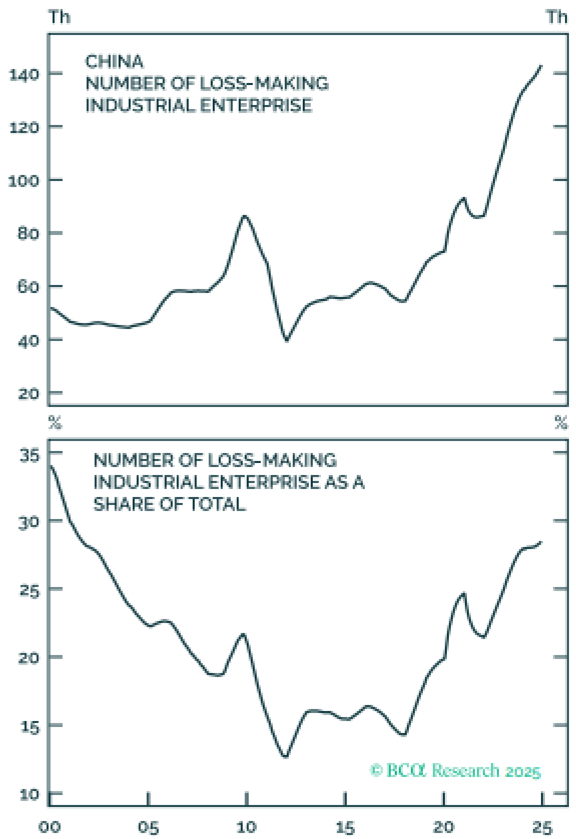
SOURCE: UN DATA BEFORE 2010; WORLD BANK AND BEA DATA FROM 2010.

This is a major problem for the Chinese economy, which is already suffering from overcapacity. The percentage of loss-making firms has been trending higher for the past 12 years (**Chart 40**). Despite dominating the global EV market, Chinese EV makers are struggling from excess production.

Meanwhile, the housing market continues to face challenges. Although home sales have rebounded, most of the improvement has been confined to the secondary home

CHART 40

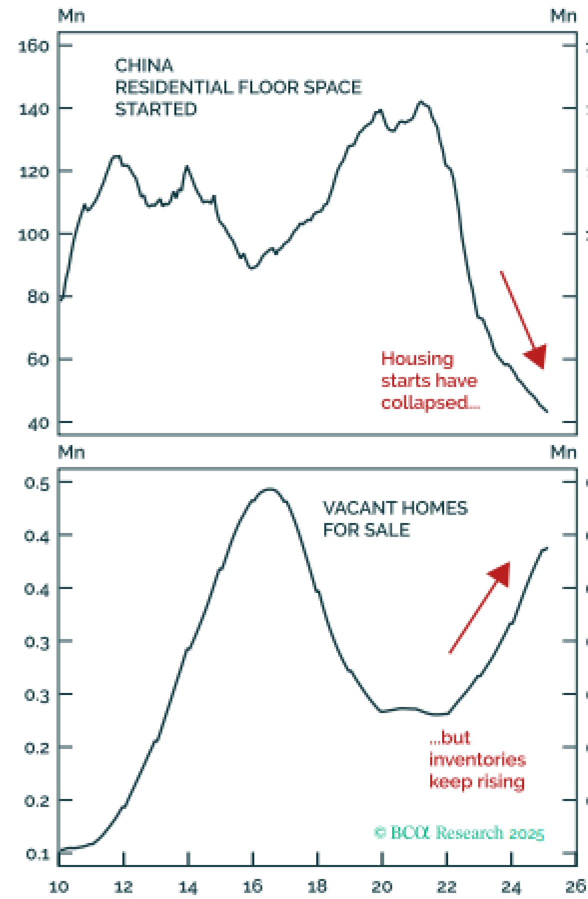
The Percentage Of Loss-Making Chinese Firms Has Been Trending Higher



NOTE: SERIES SHOWN AS A 12-MONTH MOVING AVERAGE.
SOURCE: NATIONAL BUREAU OF STATISTICS, CHINA.

CHART 41

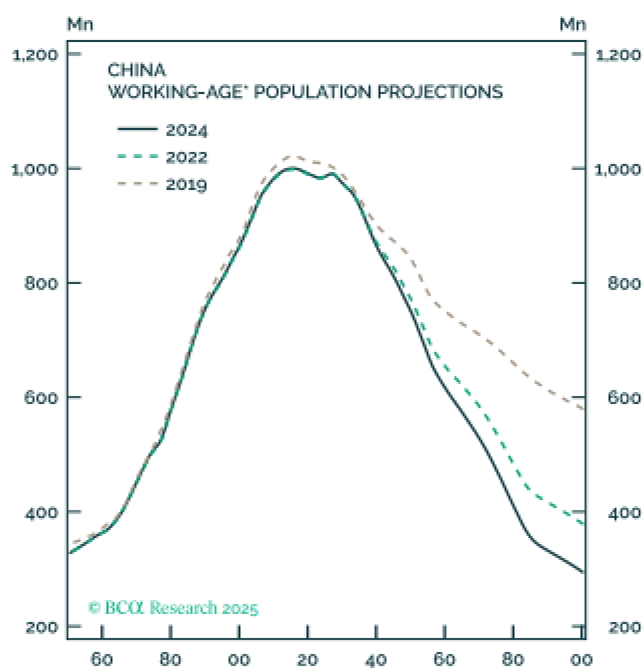
China: Housing Continues To Suffer From Oversupply



NOTE: ALL SERIES SHOWN IN MILLION SQUARE METERS AND AS A 12-MONTH MOVING AVERAGE.
SOURCE: NATIONAL BUREAU OF STATISITCS (NBS).

CHART 42

A Shrinking Population Bodes Poorly For Chinese Housing Demand



* ESTIMATED POPULATION BETWEEN 15-AND-64 YEARS OF AGE.
SOURCE: UN POPULATION DIVISION.

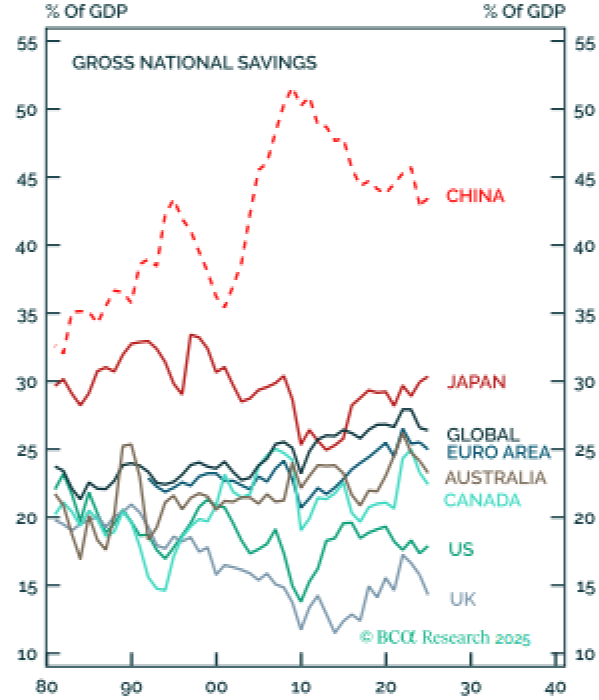
market. Sales of unfinished new homes remain tepid, which is depriving property developers of much needed cash. Against the backdrop of rising new home inventories, housing starts are falling. They are now down 70% from their March 2021 peak (**Chart 41**).

The structural outlook for Chinese housing demand is grim. The UN estimates that the country's working-age population will shrink by 70% by the end of the century, a far worse trajectory than what the UN expected just a few years ago (**Chart 42**). It is doubtful that any policy measures to support the Chinese housing market can overcome this fact.

As an economic identity, a country's savings must either be exported abroad via a current account surplus or channeled into domestic investment. China neither has the ability to maintain its large current account surplus nor its high investment rate. This means that it must reduce its national savings rate, which stood at 43% in 2024 – by far the highest among the major economies (**Chart 43**).

CHART 43

China Saves Too Much



SOURCE: IMF WORLD ECONOMIC OUTLOOK (OCTOBER 2024).

Doing so is proving to be difficult, however. Although, as noted earlier, the government is trying to encourage more consumption, the measures have been inadequate. As was the case last year, fiscal spending is likely to fall short of target in 2025.

The combined credit/fiscal impulse remains deep in negative territory. This suggests that Chinese growth will remain subpar over the remainder of the year.

II. Financial Markets

A. Global Asset Allocation

BCA Research has been around for 75 years for a simple reason: The business cycle is by far the most important determinant of bond and stock prices. If you get the business cycle right, you will usually get asset allocation right.

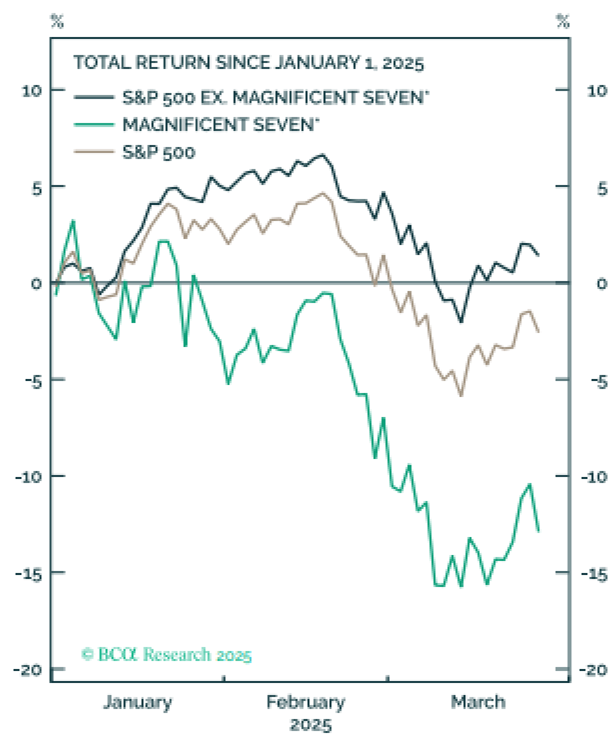
The discussion above suggests that the risks to global growth are firmly to the downside. Ergo, this means that the risks to equities are also on the downside. As such, we recommend that investors underweight equities in relation to cash and bonds over a 12-month horizon. ...

B. Equities

Investors Are Not Yet Pricing in a Recession Although the S&P 500 has fallen by 7% from its highs, all of the decline can be attributed to the Mag 7 stocks (**Chart 47**). They are down 13% year-to-date, compared to the rest of the index, which is up slightly.

CHART 47

All Of The Decline In The S&P 500 Can Be Attributed To Mag 7 Stocks



* INCLUDES AAPL, AMZN, GOOGL, META, MSFT, NVDA, AND TSLA.
SOURCE: BLOOMBERG FINANCE L.P. AND BCA CALCULATIONS.

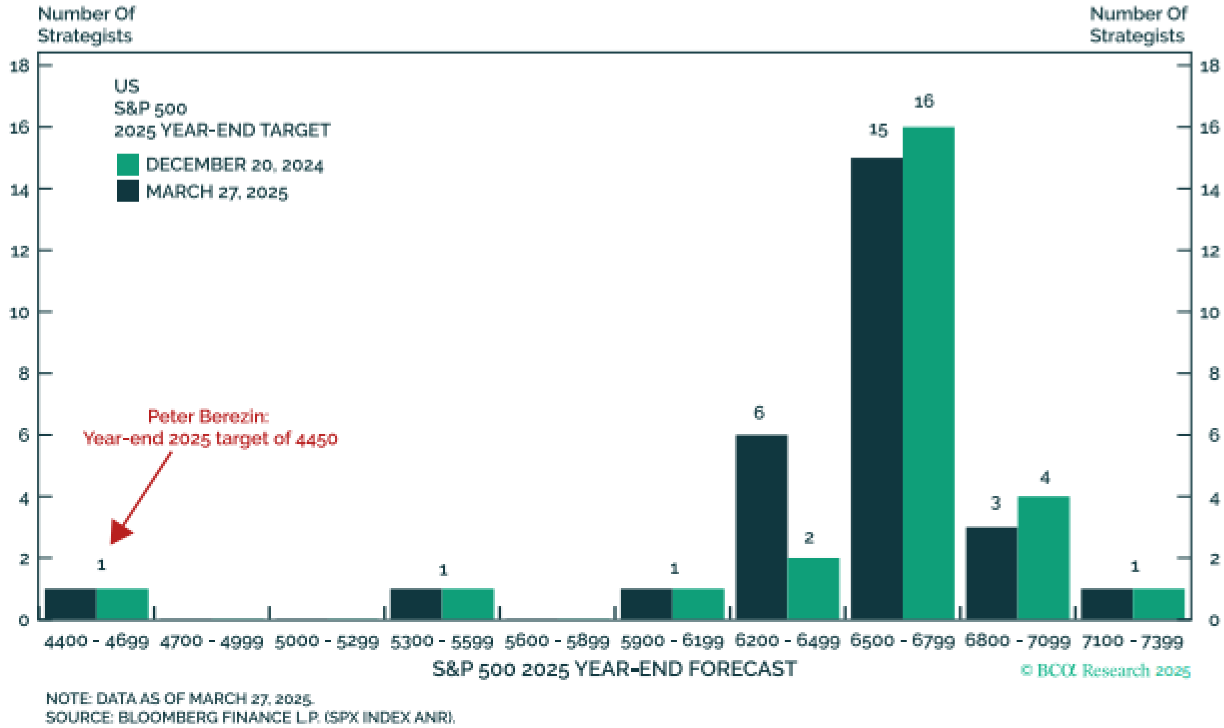
If investors were to price in a recession, the S&P 500 would probably initially drop to between 4500 and 5000, which we regard as an appropriate recessionary fair-value range for the index.

Stocks rarely stop falling when they get to fair value, however. Thus, we expect the index to decline to as low as 4200 during the coming bear market. Our end-2025 target for the S&P 500 is 4450. This is, by far, the lowest in the Bloomberg survey (**Chart 48**).

Although an end-year target of 4450 is very bearish in relation to consensus expectations, one does not need to make any

CHART 48

Bear-zin

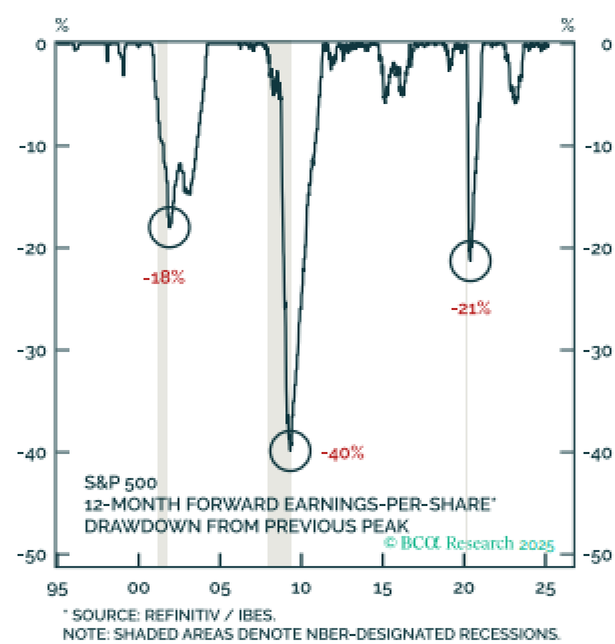


outlandish assumptions to reach it. ... a decline in the forward P/E multiple to 18, combined with a 10 percentage-point drop in forward earnings estimates, would push the S&P 500 to around 4500.

A decline in the forward P/E multiple to 18 would still leave it well above the average of 16.8 that prevailed between 2015 and 2019 – a period that encompassed most of Trump's first term and which did not include a recession. Likewise, a 10 percentage-point drop in earnings estimates would be less than half of what is typically observed during recessions (**Chart 49**). Considering that analysts expect S&P 500 earnings to rise by 12.2% over the next 12 months – from peak profit margins no less – this suggests that our estimate could be, if anything, too optimistic.

CHART 49

A 10% Drop In Earnings Estimates Would Be Less Than Half Of What Is Typically Observed During Recessions



Favor Defensive Sectors Over Cyclicals,

Neutral on Tech Given the downside risks to growth, investors should favor defensive equity sectors over cyclicals. Our preferred sectors are consumer staples, health care, and utilities. We would underweight consumer discretionary, financials, industrials, materials, and real estate. We are neutral on energy, communication services, and IT.

Our neutral stance on tech reflects the various crosscurrents impacting the sector. On the one hand, we are optimistic about the transformative power of AI and other emerging technologies. On the other hand, tech valuations remain elevated. Although the Magnificent 7 has cheapened since the start of the year, the group still trades at 26.0-times forward earnings. In comparison, the rest of the index trades at 18.8-times forward earnings.

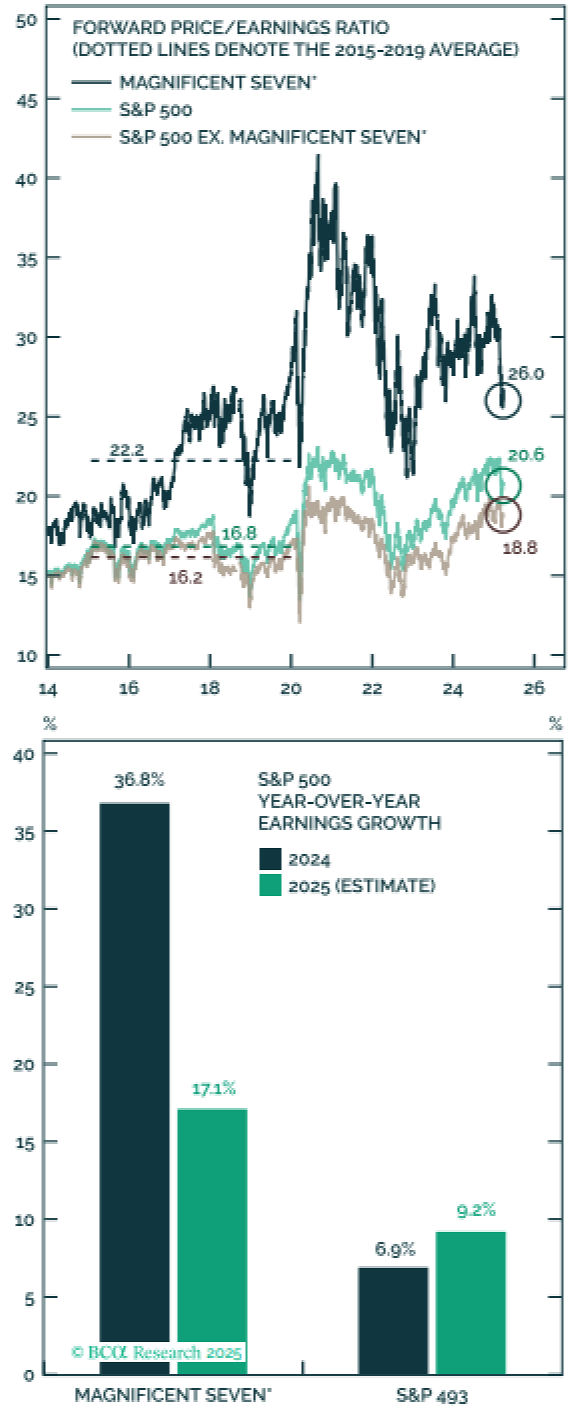
Earnings growth for the Mag 7 is set to slow, falling from 37% 2024 to 17% in 2025 (**Chart 51**). While this is still a healthy rate of growth, our suspicion is that it will slow further as it becomes increasingly clear that the gains from AI will largely accrue to the users of AI rather than to the tech companies which are currently rolling out AI models.

A useful, though controversial, analogy is with shale producers. As is the case for shale production, today's AI models are extremely capital intensive, requiring costly data centers and state-of-the-art GPUs. The depreciation rate on AI investment is also very high, analogous to shale where a typical well produces less than half as much oil in the second year as it does in the first.

Perhaps most importantly, as with shale, the output of large language models has become increasingly commoditized. This is not surprising given that most models use the same transformer-based neural net architecture and similar training sets.

CHART 51

Tech Valuations Are Elevated And Their Earnings Growth Is Set To Slow



* INCLUDES AAPL, AMZN, GOOGL, META, MSFT, NVDA, AND TSLA.
SOURCE: REFINITIV / IBES.

Rally in International Stocks At Risk of Reversing

... If the global economy does succumb to a recession, as we expect, non-US stocks will underperform since they are generally more cyclical than their US peers.

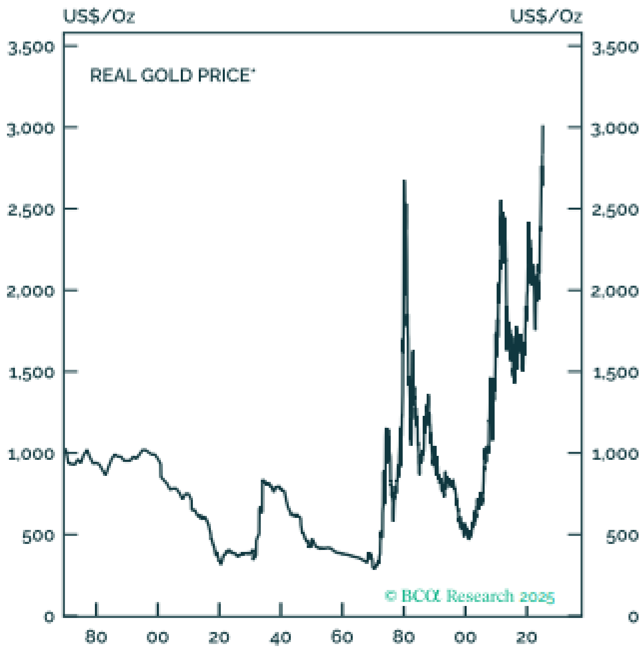
Although non-US stocks will struggle during the recession, they will likely gain the upper hand again once the global economy recovers. European banks are in much better shape than they were a decade ago, which should support stocks and the broader economy. The desire to decrease reliance on the US should also hasten economic integration and pro-market reforms across the EU. ...

Favor Gold Over Bitcoin

Gold has had a good run, with prices rising 85% since October 2022. In real terms, the price of gold has returned to its 1980 peak (**Chart 64**). While some might argue that this is a sign that gold is overvalued, we would contend that the real price of precious metals should trend higher over time, in line with the overall trend in global wealth. This suggests that gold prices still have upside.

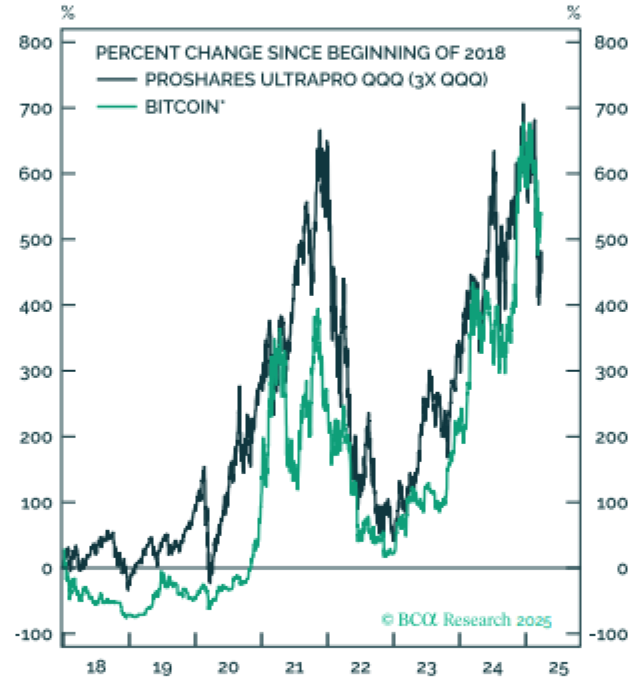
Concerns about government solvency in the major economies are not going away anytime soon. Nor will lingering worries about the US dollar's role as a reserve currency. The share of gold in China's foreign-

CHART 64
Gold Has Had A Good Run But The Bull Market Is Not Over



* DEFLATED BY HEADLINE CPI, IN FEBRUARY 2025 US DOLLARS.

CHART 65
Bitcoin: A High-Beta Play On Stocks



* US DOLLAR TO BITCOIN. SOURCE: MACROBOND FINANCIAL AB.

exchange reserves has increased from 1% in 2008 to around 5%. That fraction is likely to continue rising. In contrast to gold, Bitcoin remains a highbeta play on stocks (**Chart 65**). If the S&P 500 declines over the coming months, the price of Bitcoin will fall. We expect the virtual currency to finish the year at $45,000.

Form the WSJ's Markets A.M. on March 24th:

Talking Ourselves Into a Recession

By Spencer Jakab

In the first Harry Potter book, fearful magical folk say “you know who” instead of “Voldemort” years after the dark wizard vanished. It’s dismissed as superstition, but late in the series a taboo is placed on the name. Anyone who utters it risks a visit from the Death Eaters.

Investors’ least-favorite word, “recession,” shares some of those qualities. As more pundits, economists and journalists say or write it, its frequent use might be cursed. The Economist magazine was early to point this out, tracking media mentions as far back as the 1980s.

On Apr. 5, 2001 it wrote that there had again been a spike in instances of recession and, sure enough, it nailed the start of the economic downturn. It took the professional economists at the National Bureau of Economic Research who officially declare such things seven more months to say one had begun. It wasn’t until late September, following the 9/11 terror attacks, that a consensus of economists polled by The Wall Street Journal even said one was likely in the coming 12 months.

“Its big advantage is that it is instantly available, unlike official statistics, which are always out of date,” wrote The Economist about its “R-Word” indicator.

It might be happening again. The last three weeks have seen a threefold spike in press mentions compared with January, according to media-monitoring service Factiva. Searches for "recession" also hit a multi-year high on Google Trends.

And that doesn't count euphemisms: The White House press secretary, for example, spoke of "a period of economic transition" this month. Last week bond investor Jeffrey Gundlach said we're getting closer to a recession and that Wall Street isn't placing high enough odds on one.

Both talking heads and the public have been wrong before: An even higher level of Google searches for "recession" happened in late 2022. And back then 63% of economists polled by The Wall Street Journal said a U.S. recession was likely in the coming year. For context, just 38% were predicting a downturn on the eve of the greatest postwar slump in December 2007.

There certainly were fundamental reasons to fret in 2022. A rapid series of Federal Reserve rate increases and an accompanying bear market in stocks provided plenty of nightmare fuel. As we now know, that recession never happened.

There also are things to worry about today, with tariffs being at the top of the list, followed by a recent plunge in consumer confidence. Throw in that catch-all word, "uncertainty," which we're suddenly hearing more often too.

Only 22% of professional economists surveyed by the Journal back in January expected a recession in the coming year. Just this morning, though, Deutsche Bank said 43% of fund managers it recently surveyed expect one.

Scary—but then Wall Street's forecasting ability has hardly been magical.

Follow-ups

Five from the WSJ, with the first being from Monday's Markets A.M.:

The Trend Is Your Friend—Until It Isn't

By Spencer Jakab

It isn't hard to understand why some investment strategies perform well in the long run. But one of the best, momentum investing, is a head-scratcher—it's too easy.

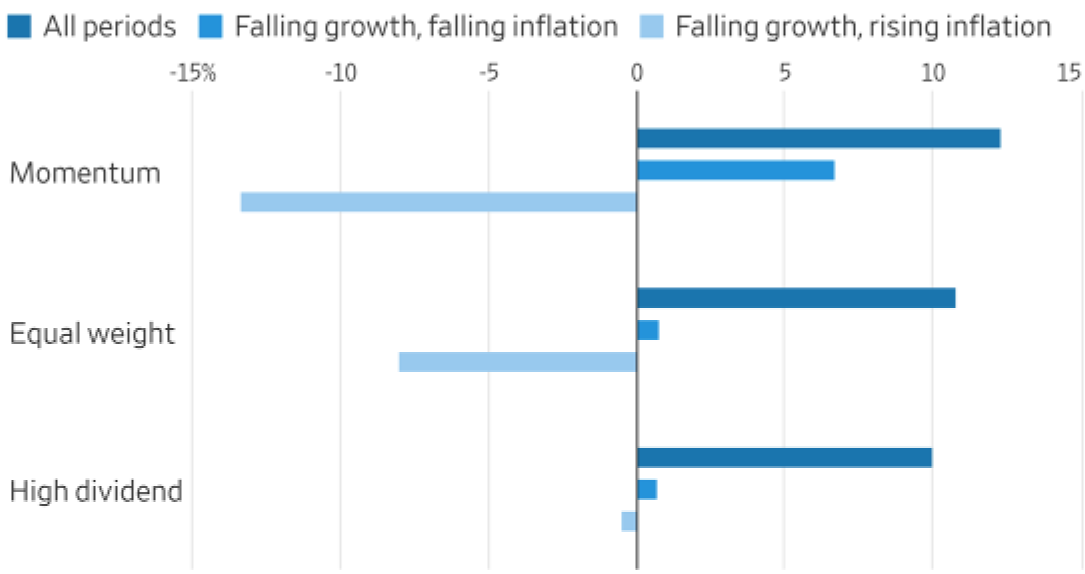
A factor like value works because it's logical to buy low and sell high; quality does well because well-managed companies tend to survive crises and are more profitable; high dividend-paying stocks thrive because you at least get cash, and they tend to have reasonable valuations.

Momentum makes less sense to a thoughtful, long-term investor. It also seems reckless. Essentially, you buy more of what just went up. Many successful strategies require both analytical chops and discipline. Following the crowd is already human nature and is a feature of bubbles.

But it's hard to argue with long-term results: A momentum index maintained by S&P Dow Jones Indices since the summer of 1994 would have turned a $1,000 investment into $28,500 by last summer—71% more than just owning the S&P 500. It also beats value and high-dividend baskets handily while being less-volatile.

"The trend is your friend" has long been a battle cry of speculators. Its superior long-term investing results were first described in a 1993 academic paper that said a stock's return over the previous three to 12 months predicted its results over the next three to 12 months. Unlike other factors—value, for example, which also was first described that year—it has mostly kept working. (Depending on the valuation metrics used, PEG for example, Value still works.)

Performance of S&P 500 index strategies in various macroeconomic conditions



Note: From July 31, 1995 through June 30, 2024
Source: S&P Dow Jones Indices

Not always. Periods of falling growth and rising inflation, which we might be facing in a trade war, are bad for momentum with annualized returns of negative 13.3% and lots of volatility too, according to a 2024 study by S&P. The risk-adjusted return for a high-dividend basket of stocks, by contrast, has been basically flat under the same conditions.

There's more to consider. T. Rowe Price says that some periods of very good performance for momentum have been, with the benefit of hindsight, a "junk rally" preceding a selloff, such as right before 2000's tech bust. In the year through the end of February, the S&P Momentum Index had a blistering return of 30.5%.

If the air keeps coming out of recent winners like the Magnificent Seven stocks then 2025 might be one of those years when momentum disappoints. Strangely enough, these periodic pullbacks could help explain the strategy's persistence.

While value investors tend to be patient by necessity, momentum investors might not be. Many didn't arrive at the strategy through careful study of what has worked before. Instead, they're relying on raw intuition. If they get their metaphorical faces ripped off in the stock market they might not stick around.

Then momentum becomes less crowded, clearing the way for the strategy to work its weird magic again.

How to Make 267%—or Lose 90%—on Treasury Bonds

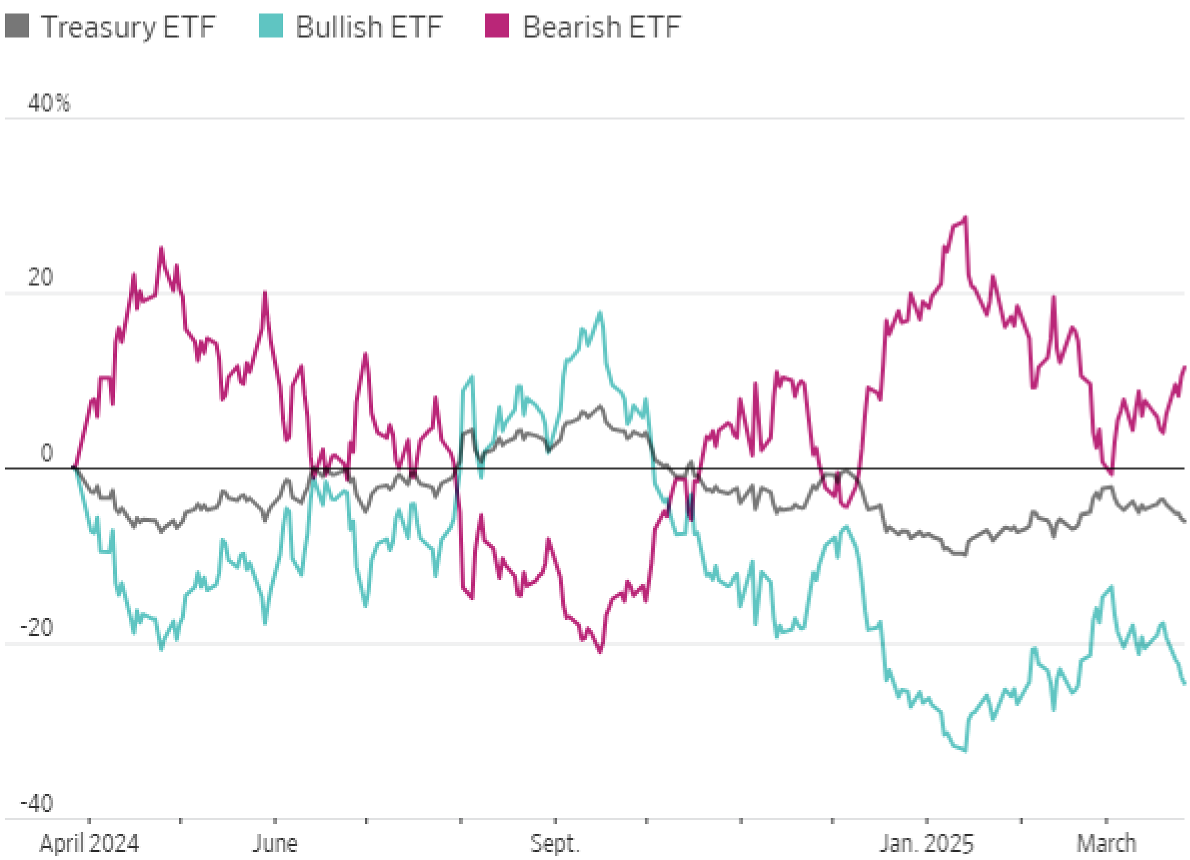
Billions of dollars have poured into leveraged and inverse funds that can magnify the market's swings. Before you join in, you'd better understand what you're in for.

By Jason Zweig
March 28, 2025

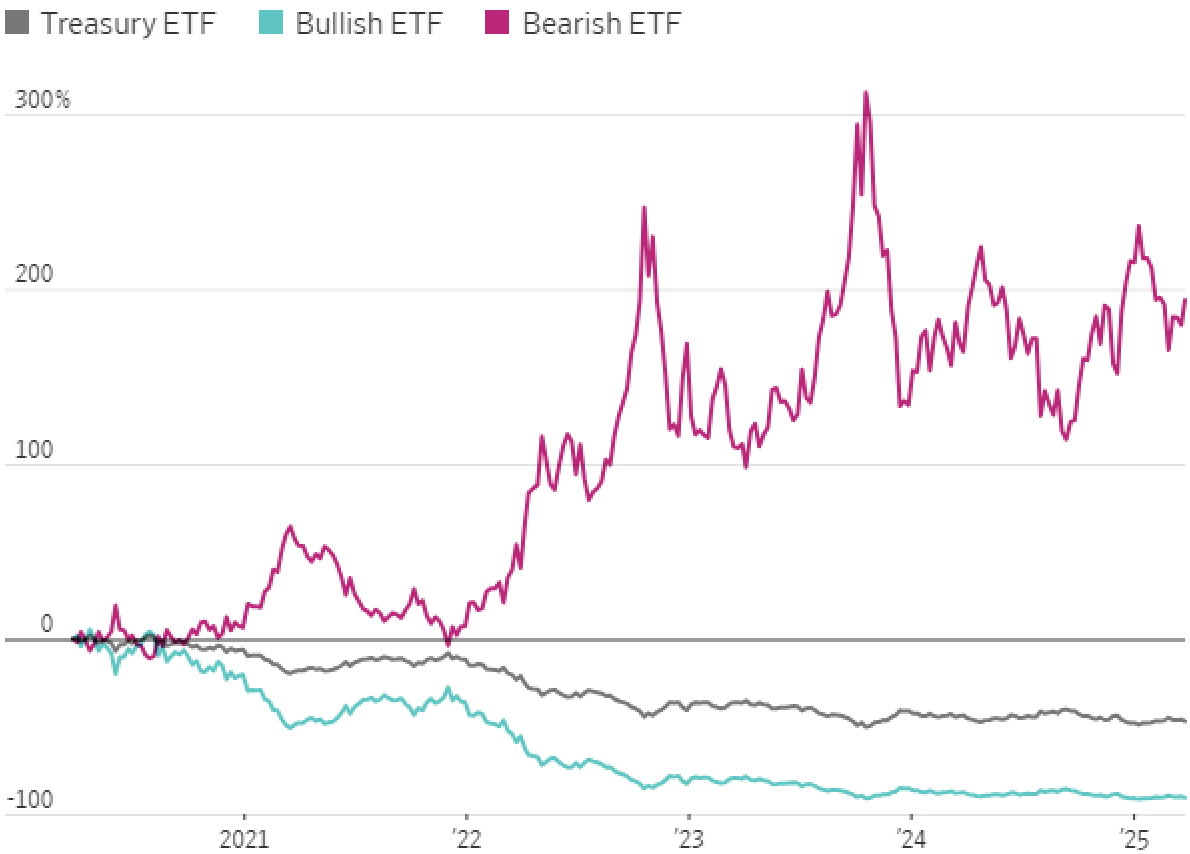
If you'd bought the leading exchange-traded fund investing in long-term U.S. Treasury bonds at its peak in August 2020, you'd have lost 41.3% by now—even after reinvesting your interest income.

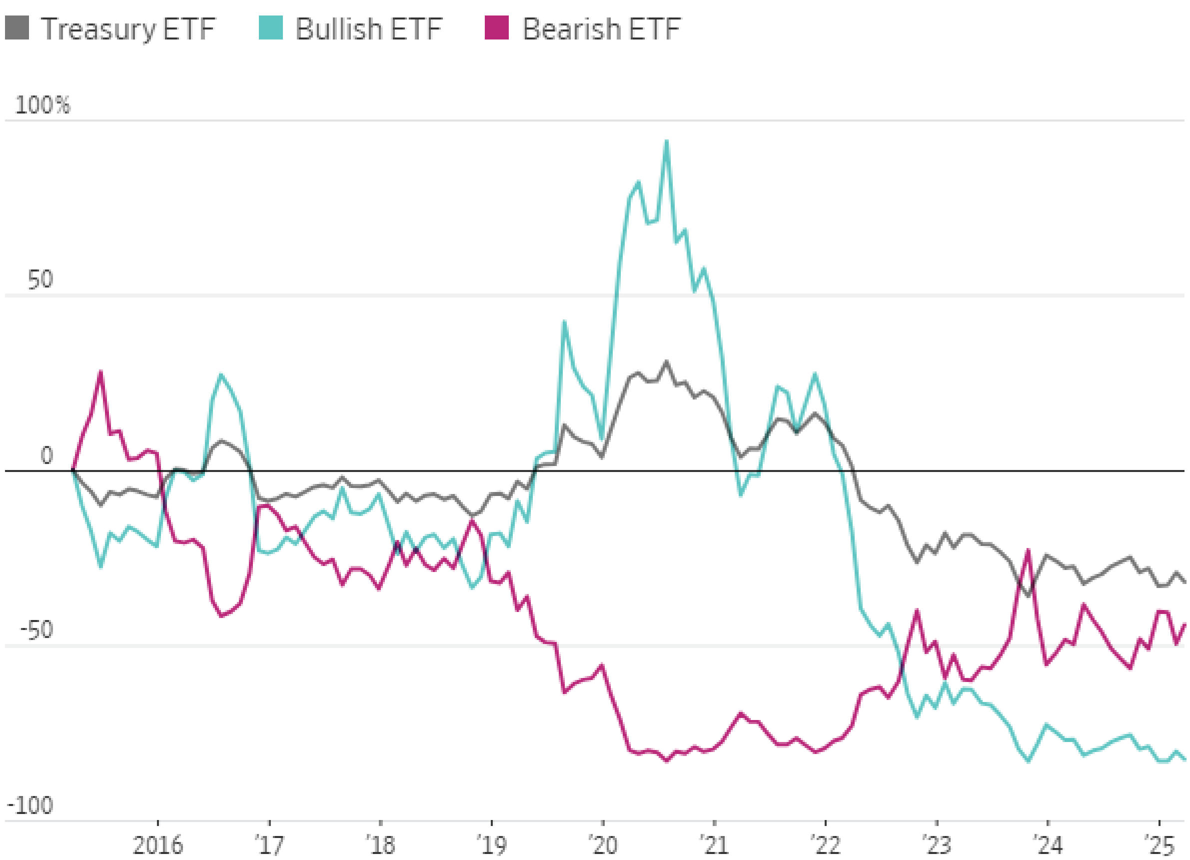
Two ETFs that amplify the daily returns on long-term Treasurys make that wild performance look tame.

Over the same period, the Direxion Daily 20+ Year Treasury Bull 3X Shares ETF, which seeks to triple the daily return of a long-term Treasury bond index, lost 90.2%, according to FactSet. Its mirror-image fund, Direxion Daily 20+ Year Treasury Bear 3X Shares, which aims to deliver three times the *opposite* of the long-term bond's daily return, gained 266.6%.



Note: Performance of long-term Treasurys is measured by cumulative price return for the iShares 20+ Year Treasury Bond ETF. Bullish and bearish are measured by price returns for the Direxion Daily 20+ Year Treasury Bull 3X Shares and Direxion Daily 20+ Year Treasury Bear 3X Shares ETFs.
Sources: FactSet





Even if you are an adrenaline addict, you'd better understand what you're in for before [you try funds like these](#).

Officially, “ETF” stands for exchange-traded fund—a tool that makes investing simple. This subset of ETFs, though, is so sensitive to market moves that the acronym should stand for “extra-touchy funds.” They are anything but simple.

Extra-touchy funds come in two basic forms: leveraged and inverse.

As of the end of February, according to Morningstar, 316 leveraged or inverse ETFs held a total of $115.6 billion in assets, up from 183 such funds with $54.4 billion at the end of 2020.

Leveraged funds use total-return swaps or other derivatives to amplify the daily returns of an index, a basket of securities or even a single stock. Leveraged ETFs can aim to deliver twice or even triple the daily return of the underlying asset, turning a 1% market rise into a 2% or 3% gain; they also magnify losses the same way.

Inverse funds seek the opposite of an asset’s daily return. Depending on how they’re structured, they can turn a 1% daily loss into a 1%, 2% or 3% gain; conversely, they can turn a 1% market gain into a loss of 1% or more.

How touchy are leveraged and inverse funds? As of the end of February, according to data from LSEG Lipper, the bullish Direxion long-term Treasury ETF finished dead last among all domestic long-term fixed-income funds for the trailing three months and the past one, two, three, five and 10 years. But it also topped the charts for the prior month and the year to date.

For the prior month and the year to date, its bearish sibling finished last among all domestic long-term bond funds. But the bearish Treasury fund beat every other competitor over the trailing three and five years. Over different measurement periods, funds like these can generate explosively different results.

What drives this wild volatility?

Imagine two ETFs. One tracks an index directly, without leverage. The other, which is leveraged, seeks to triple the daily return of the index. You’ve invested $100 in each fund, although the leveraged fund gives you $300 in exposure.

Now, to use an extreme example, let’s say the index gained 5% yesterday and loses 5% today.

Your stake in the first fund would have been worth $105 at yesterday’s close. After today’s 5% loss, you’ll have 95% of $105, or $99.75.

The leveraged fund tripled yesterday’s 5% gain, pushing the value of your position up to $115 and your exposure to the index up to $345.

That means today’s 5% drop in the index takes $17.25, or 5% of $345, off yesterday’s closing value of $115. That leaves you with $97.75.

To get back to your $100 starting point, you need a 0.25% gain in the unleveraged fund but a 2.3% gain in the leveraged fund. Of course, if the market went up 5% two days in a row, you’d be far ahead in the leveraged fund. Depending on the path of the market’s changes from day to day, the leverage can enrich you or leave you surprisingly deep in the hole.

That example ignores expenses, which are much higher on leveraged funds. Also, the more volatile the underlying index is and the longer the volatility lasts, the wider the gap is likely to grow between the index’s returns and the performance of the leveraged fund.

In a “trending” or repeatedly rising (or falling) market, you can make a ton of money on such funds. In a jagged market with uneven ups and downs, anything can happen.

Here’s why all that math matters: Getting double or triple the *daily* return of an index doesn’t mean you will outperform the index twofold or threefold in the long run.

“If somebody doesn’t understand that longer holding periods are unpredictable, they shouldn’t be trading these funds,” says Douglas Yones, chief executive of Direxion.

“The volatility of holding longer term is extremely amplified, both up and down,” he adds. To manage that risk, “you need to look at it every single day.”

No one really knows whether individual investors are significant buyers of extra-touchy funds, or whether all the financial advisers using them in so-called tactical portfolios fully understand how they work.

“If you get a whipsaw market, you could find a lot of your profits eaten away or your losses amplified because of the pattern of returns,” says Elisabeth Kashner, director of ETF research and analytics at FactSet. “You have to get the overall direction right, and you have to get the path of travel right.”

Good luck with getting both those things right. And, if you turn out to be wrong, leveraged funds will magnify your mistake.

From March 19th's Markets A.M.

Play Stupid Games, Win Stupid Prizes

By Spencer Jakab

Stocks' rebound from a correction lasted only two days after investors took a glass-half-empty view of strong reports on housing and industrial production Tuesday. Futures are flat this morning, but how investors parse Fed chair Jerome Powell's mid-afternoon comments could determine if stocks end the day in the red or the green

The stock-market volatility of the past several weeks was good for one thing: A silly exchange-traded-fund concept melted down in record time.

Five weeks ago, Defiance ETFs launched its flagship “Battleshares” fund, (ticker ELON). It gives owners double exposure to Tesla coupled with a “short” on Ford Motor. The bet against the Detroit stalwart, founded by Henry Ford a century before Tesla came into being, is used to help pay for the enhanced wager on the EV-maker’s shares.

How’s that working? ELON has lost investors two-thirds of their money.

The fund happens to have launched during a decent stretch for Ford and a very trying one for Tesla shares. Analysts say CEO Elon Musk’s Washington adventures probably exacerbated their decline.

Had such funds existed a century ago, in the Roaring '20s, one might have pitted Ford in its Model-T heyday against a buggy-whip maker and been conceptually right. Even so, the cruel math of daily leverage could have torpedoed that product too.

Yet speculators have fallen in love with ETFs that magnify daily returns. This usually means aiming for two or three times the performance of a stock or index, or its inverse, by using derivatives.

The combination of funds' daily target, volatility and compound interest means experienced investors rarely hold them, or at least not for long. Fund manager Ted Seides pointed out in a paper 15 years ago that two funds touting double the daily loss or gain of the small-company Russell 2000 Index each cost investors a little over half of their money during the financial crisis.

In the U.S. alone, leveraged funds exceeded $130 billion in assets in December. Their frequent losses mean more shares must be issued to remain viable. The oldest inverse leveraged funds typically have lost 99.9% of their value. But that usually happens slowly enough that new money is attracted by the potential for short-term profits.

Not in this case.

Defiance, which didn't respond to questions, writes that the fund "provides investors with a unique opportunity to gain exposure to the ongoing transformation within the automotive sector, capitalizing on the divergence between innovation and tradition."

Or, as Heard on the Street's Jonathan Weil so eloquently said, it's "like a pro-wrestling promoter pairing a heel or a good guy against a jabroni in a steel-cage match."

A matchup might be savvy marketing in a crowded fund-management industry. But "innovation" doesn't always beat "tradition," and that's all it takes. Financial futurist Dave Nadig, an authority on ETFs, isn't a fan: "One might as well just use your money for kindling."

Other proposed Battleshares would pit weight-loss drug maker Eli Lilly against KFC owner Yum Brands, bitcoin-owner MicroStrategy against JPMorgan Chase and slumping Nvidia against resurgent Intel.

If plans are shelved, sparing speculators from being enticed by similarly dumb ideas, they'll have ELON to thank for it—and, indirectly, Elon too.

From the front page of the March 8-9th issue:

Trump Goes All In for Crypto After His $Trump Epiphany

By Rebecca Ballhaus , Josh Dawsey and Eliza Collins

President Trump regaled a group of high-rollers visiting Mar-a-Lago about all his administration was doing for the cryptocurrency industry. Then he turned to all the crypto money he is making as president.

Trump's personal meme coin, which he launched days before his inauguration, could bring in billions of dollars, the president said with an air of amazement. At one point, he turned to the audience—a group of donors who had each paid $1 million to his super PAC—and asked whether they knew what $Trump was worth. One did, according to people who were at the March 1 gathering. It had a market cap of around $13 billion.

The success of $Trump is one of the starkest examples of the president benefiting from an industry his administration regulates.

Trump, who promised to be the nation's "first crypto president," recounted to the group the Securities and Exchange Commission's recent dismissal of cases against crypto companies, nearly a dozen by Friday. Crypto executives see that as evidence of the industry's liberation from regulatory threats under the Biden administration that limited its growth in the U.S.

Other Mar-a-Lago guests that night included David Sacks, a longtime investor who now leads Trump's cryptocurrency policy. Sacks said this week he had sold his crypto holdings and his company had divested its stakes in certain crypto startups. A representative for Sacks didn't respond to a question about whether his firm retained investments in any crypto startups. For crypto executives, the Trump administration has yielded a spectacular return on their investment.

Between the election and the inauguration, Trump met with at least eight crypto executives, collecting more than $50 million in donations for his inaugural fund and related groups, according to people familiar with the meetings. He asked the donors how they wanted the industry regulated and who should do it.

During last year's election campaign, crypto executives donated more than $16 million to pro-Trump groups. Super PACs backed by the industry spent more than $130 million on pro-crypto congressional candidates in both parties. Trump was president-elect when he signed the memecoin deal, which has generated around $350 million worth of cryptocurrency USDC for entities affiliated with him, according to the blockchain analysis firm Chainalysis. That figure, which includes both trading fees and what are essentially sales of the $TRUMP token, doesn't include some unrealized losses.

For now, crypto sales and trading are now essentially free from federal oversight until Congress creates a new framework. Those rules are expected to be looser than ones that govern Wall Street.

Crypto executives who gathered for lunch last month in Northern California's Los Altos Hills were jubilant. Coinbase had just announced that regulators agreed to drop a lawsuit that sought to regulate the company as a stock exchange. The SEC lawsuits had been a costly obstacle for the industry.

"The topic of conversation was how everybody's cases have suddenly and magically disappeared," said Trevor Traina, a crypto entrepreneur who was at the lunch. "The new badge of honor in Silicon Valley is if the SEC has dropped your case."

This article is based on interviews with more than two dozen cryptocurrency executives, lobbyists, congressional aides and people close to Trump and his family. A White House spokeswoman said Trump was "delivering on his pledge to make America the global leader in cryptocurrency." The Trump Organization and Trump's super PAC didn't respond to requests for comment.

Last weekend, after Trump previewed the creation of a strategic bitcoin reserve, bitcoin rose 9% in 24 hours to about $93,000. On Thursday, Trump signed an executive order establishing the reserve and a separate stockpile that would include smaller cryptocurrencies, a major win for the smaller tokens that had been lobbying to be a part of the stockpile.

On Friday, the Trump administration hosted a crypto event at the White House orchestrated by Sacks. It was the hottest ticket in town.

Among those who wrangled an invite for the few dozen available seats was the cofounder of a crypto project backed by Trump.

Opening the summit, Sacks recounted what one crypto entrepreneur had just told him: “A year ago, you thought it’d be more likely that you’d end up in jail than at the White House.”

‘Scam’ no more

Trump had criticized cryptocurrency for years, calling the industry a “scam” and a “disaster waiting to happen.”

The Biden administration, also skeptical of crypto, took the position that cryptocurrencies should fall under the same investor protection laws that apply to stocks. Biden’s SEC chair, Gary Gensler, said the industry was rife with fraud, speculation and conflicts of interest.

In 2022, a cascade of crypto-market failures and bankruptcies wiped out or froze many investors’ funds and later exposed fraud at FTX, one of the world’s biggest exchanges. Gensler responded with lawsuits against such exchanges as Coinbase and Binance, hoping courts would force them to comply with investor-protection laws.

As the campaign heated up in late 2023, crypto companies began to meet with Trump’s campaign team. They said that embracing the industry would help Trump win support from swing-state voting blocs the campaign was chasing—Black voters and young men, groups that cared about crypto.

“You had the Trump team, I think, understanding increasingly over time that this could help them in western Pennsylvania, this could help them in southwestern Michigan,” said Paul Grewal, chief legal officer to Coinbase. “This could help them knock off key demographic blocks in swing districts.”

Executives also began building relationships with Trump’s family throughout 2023, including with Donald Trump Jr. Trump’s 18-year-old son, Barron, also had a significant role explaining to his father why he should take crypto seriously, people in the industry said.

Former Trump campaign manager Paul Manafort, who had worked with crypto companies, helped usher industry executives into Trump’s circle, said Trump advisers. Manafort didn’t respond to a request for comment.

The companies also reached out to the Biden campaign, and, later, the presidential campaign of Vice President Kamala Harris, but made little progress.

In June last year, Sacks and Traina cohosted a fundraiser in Silicon Valley for Trump with a number of top crypto execs. During the dinner, JD Vance and Traina made the case to Trump on loosening regulations, as attendees criticized Gensler’s approach to the industry. Trump told them he wanted to be the “crypto president.”

The dinner raised $12 million for Trump. In July, he spoke at the Bitcoin 2024 conference where he pledged to fire Gensler on his first day as president and hire cryptofriendly regulators. “The moment I’m sworn in, the persecution stops, and the weaponization ends,” he said. Trump later directed that pro-cryptocurrency language be added to the GOP platform. In September, Trump launched the cryptocurrency venture World Liberty Financial, which promised to “make crypto and America great.”

His sons, Donald Jr. and Eric Trump, serve as the fund's "Web3 Ambassadors," and Barron is "Chief DeFi Visionary." An entity affiliated with Trump and his family members owns 60% of the equity interests.

"Crypto is one of those things we have to do," Trump said at the time. "Whether we like it or not, we have to do it."

The project swiftly drew criticism, including from crypto venture capitalist Nic Carter, who accused Trump's inner circle of "cashing in" on crypto in a news article. Soon after, top Trump adviser Steve Witkoff, who co-founded the project, invited Carter to a Miami coffee shop and told him the startup would be operated with integrity.

Trump has since appointed Witkoff as his top negotiator in the Middle East and for the war in Ukraine.

Carter supports Trump but remains concerned. "Presidents shouldn't be running businesses, especially not stuff where they can directly influence the outcome, which is clearly the case in crypto," he said. As for Witkoff, Carter said, the role of peace negotiator was likely a better fit than crypto kingpin. Witkoff, Carter noted, had pronounced meme coins as "me-me coins."

World Liberty Financial also drew criticism over its potential for foreign entities and those with business before the U.S. to channel money to Trump and his family without public disclosure.

In November, Chinese-born crypto entrepreneur Justin Sun invested $30 million in World Liberty Financial, which was struggling to meet fundraising targets. Afterward, Sun, who was battling an SEC lawsuit accusing him and several of his companies of fraud, became a World Liberty adviser.

Last month, the SEC asked a court to pause its fraud lawsuit, which Sun has called meritless. A representative for Sun didn't respond to a request for comment. The White House didn't respond to a question about whether Trump had played a role in the SEC decision.

Barron Trump, a freshman at New York University, joined strategy calls and contributed industry connections for the family's crypto project, said people familiar with the matter. The first lady's office declined to comment on Barron's behalf.

"The president should be proud of having a son who is that focused and that thorough in his thinking," said Witkoff, who has stepped away from World Liberty Financial since he started working for the White House.

Bo Loudon, an 18-year-old friend of Barron Trump, has touted his connections in calls with cryptocurrency executives seeking access to the Trump family, said two people who joined the calls.

Loudon in one call said it would cost tens of thousands of dollars to keep him on retainer, serving as a conduit to the Trump family, according to a person on the call. Loudon didn't respond to requests for comment.

You're welcome

Crypto executives celebrated Trump's November victory and soon started lining up for dinners with Trump at Mar-a-Lago.

Brad Garlinghouse, CEO of Ripple, in a post on X congratulated the president-elect and ticked off four points for Trump's "100-day checklist," including firing Gensler from the SEC. Ripple gave $15 million to Trump entities, including the inaugural committee, ahead of a Garlinghouse dinner with Trump in January, said a person familiar with the matter.

Lobbyists told clients a donation of $1 million to a Trump super PAC would afford donors an invitation to a large group dinner at Mar-a-Lago, where the president might make an appearance. Donors who gave $5 million or more were promised a meeting with the president-elect.

In early December, bitcoin's price crossed $100,000. Trump marked the milestone with a post on Truth Social: "YOU'RE WELCOME!!!"

During the transition, a friend pitched the president elect on a Trump token, said a person familiar with the matter. Trump and first lady Melania Trump launched their meme coins days before the inauguration.

Executives and investors complained the tokens undermined industry credibility and raised ethical questions. But Trump was antsy to make a deal before he became president, a person who discussed the matter with him said.

Trump has since told Mara- Lago associates the coin might now be worth more than the club itself.

You Can't Escape Politics. Your Investing Decisions Can.

Some ETFs match your portfolio to your ideology. There's just one problem: The stock market doesn't care how you vote.

By Jason Zweig
March 7, 2025

A proposed new exchange-traded fund, Defiance MAGA Seven ETF, would invest in seven companies the manager expects to benefit from the Trump administration's policies.

Defiance's chief executive, Sylvia Jablonski, declined to comment while the fund is still in registration with the Securities and Exchange Commission. However, mixing politics with your portfolio—regardless of your party affiliation—is an old, persistent and pernicious idea.

What makes this kind of investing so fruitless? Let us count the ways.

For starters, any idea obvious enough to occur to you and me is already in the market price. Defense and aerospace stocks are bound to boom in this administration? That was priced in months ago. Coinbase will prosper under President Trump's favorable policies toward cryptocurrencies? That, too, has long been priced in.

Many stocks that got a "Trump bump" up to and after the election have done badly since Inauguration Day—probably because investors who put their money where their vote was drove these companies' stock prices to unsustainable heights.

Between late last September and the end of October, Trump Media & Technology Group's stock more than quadrupled. So far this year, it's lost 34%.

Shares of CoreCivic, which operates private prisons, nearly doubled right after the 2024 election. So far this year, the stock is down almost 12%.

Furthermore, stock prices aren't driven exclusively by presidential policy. Inflation, interest rates, commodity prices, the value of the dollar, wars, natural disasters and changes in other nations' policies are among the countless factors that can knock stock prices up or down. U.S. presidents have some control over some of those forces, but total control over none.

And once your political scruples rule out any kind of stock, you own only a segment of the market—which is likely to behave quite differently from the market as a whole, for better or (more likely) for worse.

Technology is the biggest industry sector, constituting more than 30% of the S&P 500's market value—and contributing much of the market's gain in recent years.

Trump Media & Technology Group share price

Source: FactSet

Tech companies also have tended—until recently—to be "woke," for example by instituting policies to encourage gender and racial diversity. Shunning the woke can mean underweighting technology stocks and overweighting industrial, financial and energy companies.

Political filters can have quirky consequences. The God Bless America ETF (ticker symbol: YALL) has lagged the S&P 500 by 0.7 percentage point since the election. While President Biden was in office, it outperformed significantly.

YALL won't invest in companies that take "politically left" stands on social and political issues. But that's a subjective judgment.

Consider Amazon.com or Facebook parent Meta Platforms. Before the 2024 election, they acted woke. Ever since, they've been scrambling in the opposite direction. They aren't yet eligible for inclusion in the fund, says Adam Curran, YALL's portfolio manager. "I'm a grudgeholder," he tells me.

The Point Bridge America First ETF (ticker: MAGA) owns companies whose employees and political-action committees donate significantly to Republican candidates and have the majority of their assets within the U.S.

The fund holds about 150 stocks from the S&P 500, weighting them equally. Since inception in late 2017, MAGA has trailed the S&P 500 by an average of 3 percentage points annually.

(Over the same period, MAGA has roughly matched a version of the S&P 500 that weights each stock equally.)

Why would a company's political contributions determine its profitability? MAGA's portfolio manager, Hal Lambert, thinks firms that donate to Republicans "have more of a free-market viewpoint and are focused more on their shareholders."

If you’re a Democrat, you might be smirking as you read this. But it isn’t just Republican-leaning portfolios that might disappoint their investors.

Consider ESG investing, which seeks to make businesses and the world [E]nvironmentally cleaner, [S]ocially fairer and [G]overned better—generally from the viewpoint of people who are left of center.

Until recently, ESG was an extraordinarily popular strategy, amassing trillions of dollars in assets.

Yet many people who pumped money into these funds helped neither their own returns nor the causes they sought to advance.

The performance of ESG funds has been mediocre. An analysis published in 2023 of dozens of research studies found that the returns of ESG funds have “on average been indistinguishable from conventional investments.”

One of the biggest such funds, iShares ESG Aware MSCI USA ETF, has underperformed the S&P 500 by an average of about 0.3 percentage point annually since it launched at the end of 2016. Another, Vanguard ESG U.S. Stock ETF, has lagged the market by 0.1 percentage point annually since its inception in late 2018.

As my colleague James Mackintosh pointed out near the peak of the ESG craze, while shunning “bad” companies and investing in “good” ones might give you a warm fuzzy feeling, it isn’t likely to make the world a better place.

You’re not starving “bad” companies of capital or showering “good” ones with surplus money; they’ve already sold shares to the public, so what you do with your dollars seldom has any direct impact.

With political passions running high on both sides, it can feel almost impossible to remain dispassionate.

That’s because, more than ever, politics is about identity: The people who agree with us are right (and good), and those who disagree are wrong (and bad). Politics has become so polarized that our opinions feel like facts, and facts we don’t like are just opinions.

But the stock market doesn’t know or care how you vote. As I’ve written, staying disciplined in your investing approach is one of the keys to long-term success.

Letting your political views penetrate your portfolio is ... unlikely to boost your returns and can wreak havoc on your investing discipline.

From the WP's Molly Roberts:

Trump’s latest crypto scheme: New tech, same old grift

Don’t let the word “stablecoin” distract from the cash grab.

March 27, 2025

Donald Trump Jr. took to the stage virtually at this week’s D.C. Blockchain Summit to denounce the traditional financial system: “One big Ponzi scheme,” he called it.

So now he's getting involved in cryptocurrency, an industry most widely known for … well, Ponzi schemes. World Liberty Financial, the crypto business created by the president and his sons, said this week that it plans to sell a "stablecoin" — a crypto token designed to hold a steady value, usually of $1. "No game. No gimmicks. Just real stability," World Liberty intoned upon the reveal. The stability part could turn out to be true. But no games and gimmicks? Actually, nothing but.

At the moment, stablecoins are primarily used for storing cash in crypto form, so that it's easy to trade crypto. But advocates hope that eventually consumers will use their product for everyday transactions like, as another panelist at the summit said, "walk[ing] into your local bodega and buy[ing] a ham sandwich." Theoretically, transactions could happen more quickly and cost less.

But stablecoins haven't always lived up to their name. Most notoriously, terraUSD and its sister coin luna suffered a $40 billion wipeout that exposed the operation, which relied on an algorithm to eliminate volatility, as essentially fraudulent. Other stablecoins have also lost their peg, mostly by playing too fast and too loose with their reserves. The good news about World Liberty is that the company at least claims to be developing a stablecoin that's actually stable, backed by suitably boring assets, such as U.S. Treasurys, dollar deposits and other cash equivalents.

But don't be distracted by the fact that this is a crypto product. The games and gimmicks surrounding World Liberty expose it as nothing less than a massive conflict of interest.

What makes this stablecoin any different from all the others already out there? Just look at World Liberty's website, "Inspired by Donald J. Trump," with an image of the president extending his arm like a benevolent monarch. World Liberty lists as its "Web3 Ambassadors" all three of Trump's sons. "Co-founders" Chase Herro and Zachary Folkman's previous entrepreneurial efforts include a company called Date Hotter Girls, a get-rich-quick class for $149 a month and a blockchain protocol called Dough Finance that lost more than $2 million of customer funds in a hack last summer. Much of World Liberty's early code was directly lifted from Dough. Reassuring, no?

World Liberty, a supposedly "pioneering" firm out to "revolutionize" global markets, hasn't actually created much of anything yet. The business has sold a lot of name-brand tokens, separate from the planned stablecoin, with over $550 million raised, including at least $250 million this month. But right now, those tokens aren't even transferrable; *maybe* they eventually will be, if the current rules for crypto change, but only maybe. For now, all the coins do is sit there, while 75 percent of the net revenue generated by the project goes to, you guessed it, the Trump family.

World Liberty has bought a lot of tokens, too, stockpiling power players such as ethereum in addition to darker sheep with many of whose issuers it has formed partnerships. The crypto news site Blockworks also reported on arrangements by which World Liberty would swap its tokens for other blockchains' tokens but take a 10 percent fee. (World Liberty has denied these deals happened.) And everyone knows about Chinese crypto entrepreneur Justin Sun, recently renowned for buying and eating a $6 million banana "artwork" but also notable for his $75 million investment in World Liberty. His long-running lawsuit with the U.S. Securities and Exchange Commission was paused not long after the buy-in. The president has basically provided anyone who wants to gain influence with him an easy way to buy it — even easier than staying at the Trump International Hotel.

This mercenary lens is the best one through which to view the new World Liberty stablecoin. The goal isn't brilliant innovation to transform the future of finance: Trump Jr. admitted at the summit that World Liberty doesn't aim to "invent some sort of new widget and do it better than everyone else." Rather, it wants to persuade tons of people to buy its stablecoins (and engage with its other products), supposedly with a smoother user interface and *definitely* with the alluring brand of the most powerful man in the world.

Presumably, all this purchasing will happen around the same time that Congress passes one of the bills wending through Capitol Hill granting stablecoins legal recognition. And the more people who own World Liberty's stablecoin, the more money it has to buy the backing assets (many of which will be debt belonging to *the government Trump leads*) and reap their interest. It's almost, as Blockworks' Byron Gilliam frames it, as if the president of the United States is personally minting money.

Stablecoin issuance is already a lucrative enterprise; one leading issuer, Tether, raked in $13 billion in profits last year. The company only has around 130 employees. World Liberty's business is likely to boom even bigger should the White House succeed in its goal of establishing friendly regulations for the entire crypto industry, including decentralized finance, or DeFi, which World Liberty is supposed to be an example of. At that point, the project may well become more than a webpage with a photo of Trump on it — and allow people to trade, loan and borrow crypto on its platform. As Zack Guzmán of Coinage Media put it to me: "Start-ups in general are building the plane in the air, and for Web3 it's even more true. … The secret ingredient ... of World Liberty Financial is that they're attached to all of the people literally writing the laws as that plane gets built."

The goal of World Liberty, Trump Jr. said at the summit, is making crypto "easy for everyone else to understand. It's not mystical." He was talking about building a more accessible experience for an "average almost boomer like myself." But he's right on a deeper level. What's happening here — with World Liberty's stablecoin, with World Liberty as a whole and with every other crypto venture Donald Trump has decided to milk for money — has only a little to do with next-generation technology.

The reality is more pedestrian: This looks like a bad, old-fashioned cash grab.

From Morningstar:

You Might Think Industry Growth Drives Stock Returns. Here's Why You'd Be Wrong

Investors, take note: Abnormal growth in earnings is neither persistent nor predictable.

Larry Swedroe Mar 12, 2025

Equities are generally considered to be growth assets, implying that equity market returns show positive correlation with economic growth. That's the conventional wisdom held by most investors, at least in my experience. Conventional wisdom can be defined as ideas that are so ingrained in our beliefs that they go unchallenged. Unfortunately, much of the conventional wisdom about investing is wrong.

One example of conventional wisdom being wrong is that investors seeking high returns should invest in countries that are forecast to have high rates of economic growth, such as India. It certainly seems intuitively logical that if you could accurately forecast which countries would have high rates of economic growth that you would be able to exploit that knowledge and earn abnormal returns. But relying on intuition can lead to incorrect conclusions.

In this case, the wrong conclusion is reached because it fails to account for the fact that markets are highly efficient in building information about future prospects into current prices—investors fail to understand the difference between information and *value relevant* information. The empirical evidence on the correlation of country economic growth rates and stock returns demonstrates this point. For example, in their studies, both Joachim Klement, author of the study "What's Growth Got to Do with It?," and Jay Ritter, author of the study "Is Economic Growth Good for Investors?," found no evidence of a positive correlation between stock market returns and real gross domestic product per capita growth. In fact, Ritter, who studied 19 countries with continuously operating stock markets from 1900 to 2011, found that the correlation between stock returns and the growth rate of per capita GDP was negative 0.39 when measured in local currency and negative 0.32 when measured in US dollars. Investors in 1900 would have been better off investing in companies of countries that experienced lower growth of their economies.

Similarly, the conventional wisdom is that companies that grow their earnings faster (growth stocks) outperform those with slower growth in earnings (value stocks). However, that conventional wisdom is also incorrect. Over the long term, while growth stocks have produced higher returns on assets, higher returns on equity, and faster growth in earnings, value stocks have produced higher returns. From July 1926 to September 2024, the Fama-French US value research index returned 12.79% annually, outperforming the Fama-French US growth research index, which returned 10.09%.

Industry Is Not Destiny

We see the same results when looking at industries—the fasting-growing industries have not produced the highest returns. If you asked most investors which industries and sectors have produced the highest returns to investors, my experience is that most believe that it would be technology and healthcare.

Let's see if that is the case. From July 1926 through September 2024, US stocks returned 10.22% annually. Ken French's data library shows that while high-tech and healthcare stocks did outperform, returning 11.35% and 11.67%, respectively, telecom stocks underperformed, returning 8.96%, and the highest-returning industries were beer (alcohol), returning 11.88%, and smokes (tobacco), returning 12.34%. We see the same results looking at the more recent period of July 1963 to September 2024. US stocks returned 10.64% annually, high-tech stocks returned 11.35%, healthcare stocks returned 11.99%, and both were outperformed by beer, which returned 12.18%, smokes, which returned 14.56%, and guns (defense), which returned 12.77%. Even shops (wholesale, retail, and some services such as laundries and repair shops) outperformed, returning 11.88%.

There is another issue we need to discuss. While investors tend to project abnormally fast earnings growth out into the future, one of the persistent mistakes that analysts and investors alike make is that they underestimate the power of one of the strongest forces in the universe—reversion to the mean of abnormal earnings growth.

Reversion to the Mean of Abnormal Earnings Growth

Expectations of future earnings growth matter a great deal to valuations because investors, in their collective wisdom, assign higher valuations to companies they expect will grow more quickly in the future (growth stocks). In contrast, firms expected to show slower growth (value stocks) are assigned lower valuations.

An implicit assumption in most forecasts is that growth is persistent. While analysts underwrite high growth for companies that have grown quickly and slow growth for companies that have grown slowly in the past, a large body of evidence demonstrates that reversion to the mean of both positive and negative abnormal earnings growth is the norm.

The Evidence

In their 1997 study, "Forecasting Profitability and Earnings," professors Eugene Fama and Kenneth French tested whether the theory of profitability reverting to the mean stood up to the historical data. They examined the profits of an average of 2,304 firms per year for the period 1964 to 1995. Here are their conclusions:

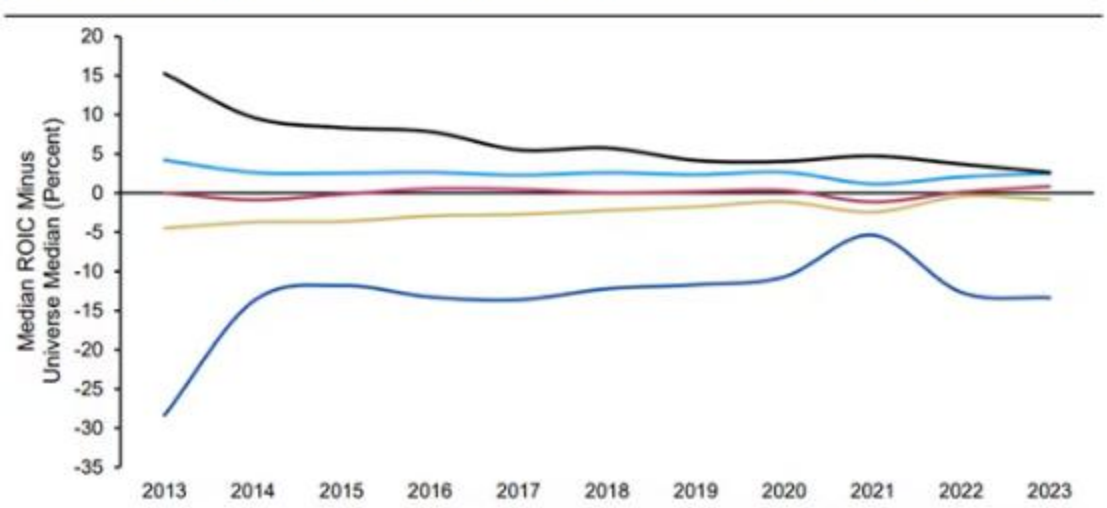
- There was a strong tendency for profits to revert to the mean.
- Reversion to the mean was strongest when profits were highest (greatest incentive for competition to enter) and lowest (greatest incentive to leave an industry and reallocate assets, thereby reducing competition and restoring profits).
- Abnormally low earnings tended to revert even faster than abnormally high profits.
- Reversion to the mean occurred at a rate of about 40% per year.
- Real-world forecasts tended to underestimate the speed at which reversion to the mean in profitability occurred.

Beyond Fama and French

Other studies, written long ago, came to the same conclusions in both US and international stocks. Examples are the 1962 study, "Higgledy Piggledy Growth" the 1993 study, "Returns to E/P Strategies, Higgledy-Piggledy Growth, Analysts' Forecast Errors, and Omitted Risk Factors," and the 2002 study, "The Level and Persistence of Growth Rates." In other words, it has long been known that reversion to the mean of abnormal earnings growth exists. That, combined with the high valuations of growth stocks and the low valuations of value stocks, provides at least one explanation (a behavioral one) for the historical value premium. (Another explanation is that the value premium reflects the greater risk of value stocks.)

Further Evidence

Regression Toward the Mean by Quintile for US Companies, 2013-23



Source: Counterpoint Global and FactSet.
Note: Includes companies listed on the New York Stock Exchange, NASDAQ, and NYSE American; Excludes American depositary receipts and companies in the finance sector and those that do not have an ROIC every year; ROICs are based on the calendar year, adjusted for internally-generated intangible assets, and winsorized at the 1st and 99th percentiles.

In their October 2024 study, "Measuring the Moat," Morgan Stanley's Michael Mauboussin and Dan Callahan provided the above chart showing that abnormal return on invested capital shows a powerful tendency to revert to the mean.

Mauboussin and Callahan also ... analyzed both the ROIC of each industry and the dispersion of ROICs within an industry. ...

They drew the following conclusions ... :

"First, the variance within industries is greater than the variance across industries. This underscores that the industry is important but does not dictate a firm's destiny. All industries have companies that create and destroy value. The second takeaway is that adjusting ROIC for intangibles tends to pull the very high and very low ROICs toward the middle. The median and average ROICs are similar for both the traditional and adjusted calculations, but the distribution has less variance following the modifications."

Why Is Conventional Wisdom So Wrong?

Why is conventional wisdom so at odds with the data? There are several explanations. The first is that there is a general tendency for markets to assign higher price/earnings ratios when economic growth is expected to be high, which has the effect of lowering realized returns. Countries, industries, and companies that are expected to have strong economic growth can be perceived as safer investments. That translates into higher current valuations.

The second explanation is that the conventional wisdom fails to account for the fact that the markets price risk, not growth rates. High *expected* growth rates are built into current stock prices. The only advantage would come from being able to forecast *surprises* in growth rates. For example, if a country (company) was forecast to have 6% GDP growth (earnings growth), and it actually experienced a rate of growth of 7%, you might be able to exploit such information (depending on how much it cost to make the forecasts and how much it cost to execute the strategy). Unfortunately, there doesn't seem to be any evidence of the ability to forecast GDP rates (or corporate earnings) any better than do the markets.

The third reason is that, while economic growth is good for people (producing higher standards of living, and those who live in countries with higher incomes have longer lifespans, lower infant mortality, and so on), equity investors don't necessarily benefit. For example, a country can grow rapidly by applying more capital and labor without the owners of capital earning higher returns. And productivity gains can show up in higher real wages instead of increased profits.

Investor Takeaways

The takeaways for investors are:

- Faster growth in earnings or GDP does not forecast higher returns as markets already incorporate the faster growth into expectations/valuations.
- Industry is not destiny.
- Companies across industries can have higher expected returns.

- Abnormal earnings growth (both good and bad) reverts to the mean faster than the market has historically forecast. Thus, an investment strategy that bets on growth is a strategy likely to disappoint because abnormal growth in earnings is neither persistent nor predictable.

Positions

MEOH - This Canadian IVA System pick is the world's largest producer of methanol. On 3/3 we added 2% positions @ 43.6376 for 3 clients. On 3/10 MEOH was down 12.9% on 3.8 times normal volume on an outage at its Geismar 3 plant in Louisiana. As shown below, 3 insiders added to their positions on the 11th.

Insider Buying:

Trade Date	No. Part	Participants	Net Sell (Shares)	Net Buy (Shares)
03/11/2025	3	Maloney Kevin, Xiaoping Yang...		18,481
09/24/2024	1	O'Donoghue Leslie		2,500
09/17/2024	1	DELBARRE KARINE		353
09/13/2024	2	Parra Gustavo, Xiaoping Yang		10,279
09/12/2024	3	Price Kevin, Richardson Janin...		5,273
09/11/2024	2	Sumner Rich, Xiaoping Yang		12,100
09/10/2024	2	Xiaoping Yang, ALMARZA SERG...		2,700