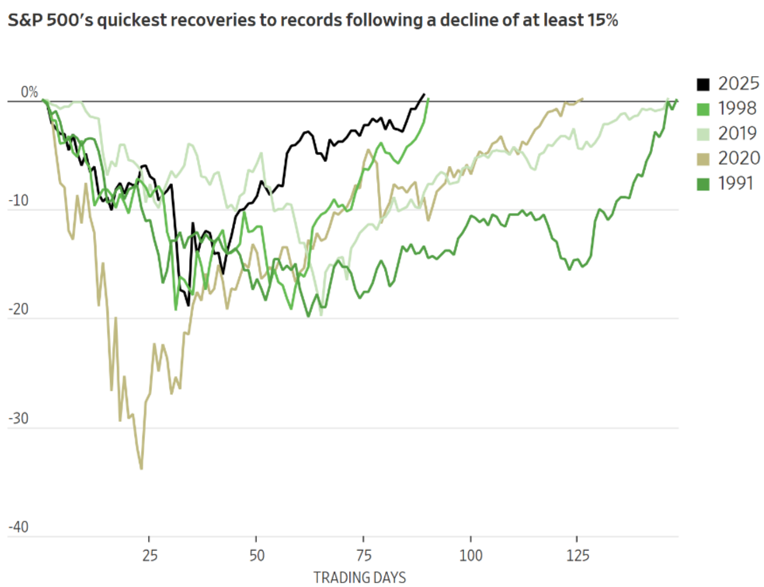
PANIC TO MANIC

That Was Quick

The equity markets have been on a rollercoaster for the last few months, and if you weren't paying attention, you may not have noticed the ride we've been on given where prices stand today. The dramatic swings driven by fear and greed were on full display in the second quarter. The S&P 500 has risen around 25% from the "Liberation Day" lows in April. The 89 trading days, in between record highs set in February and June, mark the quickest ever recovery back to a closing high after a decline of at least 15%. For perspective, other quick recoveries occurred in 2019 (146 days) and 2020 (126 days), as shown in the graph below[i]. These were following the shocks of the trade war in President Trump's first term and the economic shutdown at the onset of the pandemic, respectively. In April, the market was discounting the high degree of uncertainty in trade policy but now seems desensitized to that "wall of worry". Fear quickly turned to greed, as investors bid up risk assets, with the tech-heavy Nasdaq and the price of Bitcoin surging around 35% and 50%, respectively, from their April lows. At the end of June, the forward P/E of the S&P 500 was historically expensive at 22.0x, as compared to the 5, 10, and 30-year averages of 19.9x, 18.4x, and 17.0x, respectively[ii].



The Reality of Uncertainty

A common question from clients has been how to invest given the uncertainty caused by chaotic trade policy. Attempting to successfully trade around policies, typically posted to social media by the President, and the sensational headlines that cover them, is futile. Emotional investing and attempting to time the market, based on one's personal feelings about these policies, is also not a sound approach. The reality is that investors who sold equities in April based on peak trade uncertainty missed the historic rally in U.S. stocks that followed. Regardless of the cause of uncertainty, this reinforces the importance of remaining invested during bouts of volatility and not selling into panic. Conversely, patience can be required when facing a manic rally, as price matters when investing, instead of indiscriminately buying and chasing returns. Markets won't run on uncertainty for long, and if upcoming corporate earnings are muted versus expectations, high valuations will likely come under question with a pullback in prices.

Due diligence and analysis are required in assessing how trade policy impacts each company and the industry in which it operates. If changes are to be detrimental to company performance and RMC's investment thesis, selling out of a position is sensible, even at a loss. RMC maintains a long-term view on client investments, though, viewing them on a multi-year basis instead of focusing on short-term performance. Well run companies have experienced management teams that can navigate how to best manage tariff implications, as they must do when managing supply chains or changes in tax codes. As publicly traded companies, however, they are not immune to sharp market downturns, and there may be opportunities in high quality companies if their stock prices are impacted by temporary market weakness.

Uncertainty vs. Resiliency

Trade policy is not the only market story – global military conflicts, fiscal negligence from Congress, and interest rate cut speculation are others – but markets have reacted mostly on the clash of trade uncertainty versus economic resiliency. The initial shock of "Liberation Day" abated as some tariff deadlines have been delayed, others are not as punitive as proposed, and others are being used as leverage over other countries for national security or foreign policy goals. The resiliency of the U.S. economy also restored confidence in investors, with job growth better than projected over the last three months, the unemployment rate back to 4.1%, and tariff-driven inflation yet to materialize. Clarity was provided with the passing of the One Big Beautiful Bill Act as well. A relevant highlight is that tax rates are not increasing, as it made permanent many of the provisions from the 2017 Tax Cuts and Jobs Act that were to expire at year-end. Additionally, 100% bonus depreciation was restored, allowing businesses to fully expense capital equipment in year one, which can incentivize investment in new equipment and facilities.

The uncertainty of trade policy remains, however, which has implications for inflation and the Fed's rate path. Some economists anticipate that the impact of tariffs will show up in inflation figures in the coming months. Inventory front-running led to a surge in imports to the U.S. to start the year, which likely delayed the impact from tariffs thus far. While tariffs increase production costs, depending on the product, these may be absorbed along the value chain and not hit consumers as much as anticipated. Inflation, as measured by the consumer price index ("CPI"), recently rose 2.7% year-over year in June, up from 2.4% in May, but was in line with expectations. From an inflation measure perspective, tariff-driven price increases are generally not a sustained trend, rather, they would be a temporary increase of certain prices. The headline inflation figure has most recently been driven by shelter costs, with shelter accounting for roughly 35% of CPI (includes owners' equivalent rent, rent of primary residence, and home insurance)[iii]. Thus, even if tariffs do show up in inflation figures, the declining trend of shelter costs could keep the headline figure lower than anticipated. With employment figures showing resilience and market valuations at historic highs, the Fed may be hesitant to cut rates further before understanding the impact of tariffs on consumer prices.

[i] The Wall Street Journal; Dow Jones Market Data
[ii] JPMorgan Asset Management; FactSet
[iii] JPMorgan Asset Management