

# Financial Market ViewPoints

## Will the Correction Lead to Bulls or More Bears?

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The past month has been a challenging one for investors. While any seasoned investor is quick to talk about the long-term growth of the stock market and the oscillations they experience over their investment horizon, living through each of these periods can easily challenge one's resolve. The current stock market correction<sup>1</sup> for the S&P 500 Index occurred on March 11th and only lasted less than an hour before the market closed above "correction territory". Two days later, on March 13th, the stock market once again entered correction territory, and this time closed near its lows. Since then, the stock market has been slowly grinding higher, until the end of March, in which it rapidly reversed course once again and entered correction territory for a little more than an hour on the 31st.

What has been surprising about this correction is the sheer speed at which it occurred – taking only 14 trading days or roughly three weeks<sup>2</sup> to go from a new all-time high to a correction. Further challenging investors is that some markets, namely those in the developed international segments, have been positive during this time. The disparate level of returns really comes from the key factors driving the current correction and might possibly give investors some insight as to when a recovery might take place.

### Correction Contributors

Undoubtedly, one of the largest contributing factors has stemmed from the potential changes for the United States as the Trump Administration rolls out their ambitious plans. As with all new presidential administrations, there are always changes to how the United States operates and the priorities in which it is focused. The sheer speed and magnitude at which the current administration has been moving has certainly caught most by surprise and created a roller coaster ride for investors in the first quarter of 2025.

In our view, there are three main pillars of the current administration's agenda that is resulting in large swings across markets. These are:

- Federal government employment
- Federal government spending
- Trade or the balance of imports and exports

For each of these areas, there are volumes that can be written about the changes made as well as those that are on the horizon. At a high level, these three primary areas of focus are intended to shrink the size of the Federal Government, improve the country's trade balance with the world, and ambitiously return to a balanced budget. While many would feel that at

*The pace at which the  
new administration has  
moved on policy  
changes has certainly  
contributed to lower  
sentiment, higher  
volatility, and greater  
uncertainty*

*The Trump  
Administration is  
focused on reducing  
Federal Government  
employment and  
spending, as well as  
the balance of trade*

<sup>1</sup> A correction is when the market is at least 10% below its high.

<sup>2</sup> February 19, 2025 to March 11, 2025.

*DeepSeek shook the industry with its ability to produce AI models at a fraction of the cost compared to the current industry leaders*

*About 2% of the recent 10% market correction was driven by the decline in NVIDIA which was the second largest company in the S&P 500 on January 6th*

least the last two are aspirational goals that would make sense for most administrations, the details are what matter here. This is why both the stock and bond markets have been on a wild ride since the start of the year.

In addition to the governmental changes unfolding within the federal government, a second, more nuanced factor, has also created headwinds for the stock market. Up until the latter part of 2024 there has been an “arms race” amongst many large corporations to bring Artificial Intelligence or “AI” solutions into their workstreams to improve efficiency. This has led to a 21st century “gold rush” in which companies are vying for the most powerful chips to run increasingly complex AI models. In turn, the creation of enough data centers to house this computing power, as well as the energy needed to keep it running around the clock has been a boom for many technology companies, with NVIDIA Corporation leading the charge.

What has happened in recent months has been a shift in the AI space from the need for the most computing power at any cost to a more pragmatic approach. This was initially seen by the lackluster investor response from NVIDIA's earnings over the past couple of quarters, indicating that the first inning of the AI revolution might be coming to a close. It became more apparent when a new competitor, DeepSeek, entered the market with blazing fast speeds that cost less to purchase as well as operate. Further confirming the start of the second inning for AI was a recent announcement from Microsoft and others that they were scaling back their plans to open new data centers as the demand for computing power looks to be less than they had anticipated.

The reason why this shift is so important is that many of the major indices that investors use to track the market, such as the S&P 500 Index, are based on market capitalization. As a result, the ballooning values of companies participating in the AI space have propelled them towards the top of the index. For example, the leader in this space, NVIDIA, was the second largest company in the S&P 500 Index on January 6<sup>3</sup> of this year at 7.22% with only Apple Inc. larger at 7.30%. Since then, NVIDIA's stock has fallen more than 27% through the end of March. This means that nearly two full percentage points of the S&P 500's correction (10% decline) are a result of only NVIDIA's stock price collapse. Adding in the declines for the stock prices of other players in the AI space, and it is easy to see how the changes in this segment have significantly contributed to the correction for the S&P 500 Index.

Understanding the drivers of the recent stock market correction is the first step in creating a plan to navigate any turbulent market. The next step in this process is to identify the most likely scenarios for the bear case (i.e. continued declines) and the bull case (i.e. recovery and a resumption of the bull market rally).

### **The Bear Market Scenario**

Arguably the easier scenario for most strategists and investors to envision during a stock market correction is the case for a bear market. Traditionally,

<sup>3</sup> January 6, 2025 was the all-time closing high for NVIDIA's stock price.

*The three main areas that could breakdown due to the Trump Administrations recent changes are economic growth, employment, and inflation*

*Observations and insights from large public companies can often provide a better idea of economic performance than economic reports*

the drivers that brought the market into correction territory were relatively unknown until the market took a turn. This “surprise” and the fear that followed tends to amplify the possibility of a correction turning into a bear market. This time is no different as the two main drivers of the correction were, for the most part, not on the minds of investors at the beginning of the year.

In this scenario, the clear progression is that the Trump Administration continues with their rapid and widespread restructuring of the federal government and the U.S. economy, but instead of only “cracks” in the economy as a result of these changes there is a major breakdown. This could materialize in a number of different ways. For most strategists, these breaks tend to come in three main areas:

- Economic Growth, generally measured by GDP
- Employment, generally measured by the unemployment rate
- Inflation, generally measured by the Consumer Price Index, although the Federal Reserve or “Fed” is more focused on Personal Consumption Expenditures ex. Food and Energy or “Core PCE”

Economic growth is usually the first component that comes to mind as a prolonged decline (i.e. more than one quarter) is a recession and large declines (generally more than 10%) are considered a depression. The implications of either can be widespread and generally takes years to recover. While it is hard to identify a recession (or depression) ahead of time or even at its onset, there are a few indicators that can show a weakening in the economy. These tend to show up in the Atlanta Fed’s estimate of current GDP in the GDPNow Index. This tool amalgamates the relevant economic data as it is released to estimate the economic growth or GDP rate for the current quarter. While there is plenty of lag between when certain economic reports are released after a month is over, it is the closet gauge that is available to measure “current” levels of growth. Reviewing the reports on the GDPNow Index could be one way to see if the economy is going through more than just a few bumps.

Another way in which strategists and investors attempt to track the health of the U.S. economy is by following some of the largest public companies in the country. The idea here is that these companies are closely attuned to the habits of consumers and the growth of the country, whether it be by shipping goods around the country, selling high demand products, or simply providing funds for people to purchase homes and live their daily lives. Often times the comments and insights coming from these companies can provide a better idea of how the economy is performing compared to economic reports.

Employment is another major category to follow as high unemployment can be a sign of prolonged trouble. Often, it can take quite some time as well as additional support from the federal and state governments to bring people back to work. Fortunately, investors get closer to a real time update on this major area as unemployment data is published on a weekly basis.

*While inflation has fallen below its long-term average, it remains an area of focus as the potential impact of the newly implemented tariffs are considered*

*Net exports soared as companies front loaded purchases ahead of the retaliatory tariffs resulting in a projection for negative GDP growth in the first quarter*

If the bear case scenario is playing out, one would expect to see a significant rise in unemployment (well above 5%).

Inflation is the final major component that can potentially indicate a major breakdown for the economy. The most recent bear market was a result of generationally high inflation, not an economic recession. Not surprisingly, investors are still hyper focused on inflation as it is not clear if the war on inflation is over. Over the course of each month there are various measures of inflation that are reported and can provide some view for the entire country. Personally, though, each person can “feel” the impact of inflation in their everyday life as they shop for groceries, put gas in their cars, and pay their utility bills.

In practice, it will be a combination of the three main factors that we identified, as well as potentially others, that will confirm if the bear market scenario is becoming a reality. Ultimately, while bear markets are challenging, it is important for investors to focus on the long term and make decisions for their portfolio not only based on current events.

### **The Bull Market Scenario**

Conversely, there is also a scenario in which this is just another stock market correction along the path of the current bull market’s rally. In this scenario, the concerns that drove the market to a correction turn out to be less painful than originally feared. Using the same components as in the bear market scenario, there are a clear path of indicators to give an early sign that this has become the more likely scenario.

On the economic front, the big indicator for the bull case would be a strong rise in GDP. As of publication, GDP for the first quarter of 2025 looked fairly healthy across all components with the exception of an outsized decline coming from Net Exports, resulting in an overall GDP decline for the first quarter. Not surprisingly, many companies imported a number of their goods from abroad ahead of the imposition of high tariffs at the beginning of April. Seeing this pattern reverse over the next quarter or two, all while the other components of GDP continue to grow would be a strong indication for the bull case.

Another main area of focus for the economy would come from corporations as they address their recent performance as well as outlooks. With the next round of quarterly earnings starting in the middle of April, we should soon start to hear how these changes will impact corporate America. By the next earnings season (starting in mid-July), we will see the impact of those changes in corporate earnings. As executives discuss how consumers are shifting their habits around these changes, investors should get a better grasp on whether the bull case is becoming more likely.

Lastly, employment and inflation can go hand-in-hand here. If these major indicators stay near current levels or even improve, it is also supportive of the bull market scenario becoming a reality for investors.

## Conclusion

Unfortunately, there is no crystal ball to help guide us through this challenging period. As a result, it will be prudent to closely follow the various key elements of our economy to identify which scenario is becoming more likely. Despite this uncertainty, the one thing that is certain is that there will continue to be high levels of volatility as investors, strategists, and the market struggle to identify which path we are on. The one area in which we take solace is that historically, recessions and bear markets tend to be brief, albeit quite painful. Once they have reached their bottom, recoveries tend to be equally swift and lead to extended periods of growth beyond just a mere recovery of losses. As a result, we continue to focus on the long term, while adjusting for the rough waters that we currently find our portfolios navigating through.



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## Index definitions

**S&P 500 Index:** is a capitalization weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 500 of the leading large cap U.S. companies.

**Dow Jones Industrial Average Index:** is a price weighted index that is generally considered representative of the U.S. Large Cap market. It consists of 30 blue-chip stocks that are generally regarded as the leaders in their industry.

**NASDAQ Composite Index:** is a capitalization weighted index that is generally considered representative of the U.S. Technology market. It consists of all three tiers of the NASDAQ: Global Select, Global Market, and Capital Market.

**Russell 2000 Index:** is a capitalization weighted index that is generally considered representative of the U.S. Small Cap market. It consists of 2,000 of the leading small cap U.S. companies.

**MSCI EAFE Index:** is a free float-adjusted market capitalization index that is designed to measure equity market performance of developed international markets. The EAFE region includes developed market countries in Europe, Australasia, the Far East, and Israel.

**MSCI Europe Index:** is a free float-adjusted market capitalization index that is designed to measure equity market performance of European developed markets.

**MSCI Japan Index:** is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Japanese market.

**MSCI Emerging Markets Index:** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

**MSCI China Index:** is a free float-adjusted market capitalization index that is designed to measure equity market performance of the Chinese market.

**Bloomberg U.S. Aggregate Bond Index:** is a broad-based flagship benchmark that measures the investment grade U.S. dollar denominated, fixed-rate, taxable bond market. The index includes Treasuries, government-related and corporate securities, Mortgage-Backed Securities or "MBS" (agency fixed-rate pass-throughs), Asset-Backed Securities or "ABS", and Commercial Mortgage-Backed Securities or "CMBS" (agency and non-agency).

**Bloomberg U.S. Government Bond Index:** consists of the U.S. Treasury and U.S. Agency Indices. This index includes U.S. dollar denominated, fixed-rate, nominal U.S. Treasuries and U.S. agency debentures (securities issued the U.S. government owned or government sponsored entities, and debt explicitly guaranteed by the U.S. government).

**Bloomberg U.S. Municipal Bond Index:** covers the U.S. dollar denominated long-term tax-exempt bond market. The index includes four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.

**Bloomberg U.S. Corporate Bond Index:** measures the investment grade, fixed-rate, taxable corporate bond market. The index includes U.S. dollar denominated securities that are publicly issued by U.S. and non-U.S. industrial, utility, and financial issuers.

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**Crude Oil:** is represented by the generic front month futures contract for West Texas Intermediate (WTI) crude oil.

**Gold Spot Price:** is represented by the current spot price of one Troy Ounce of gold in U.S. dollars.

**Inflation:** is measured by the year-over-year change for the Consumer Price Index or "CPI". This index represents the changes in the prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer) and sales and excise taxes paid by consumers are also included.

**Fed Funds Rate:** is the target interest rate set by the U.S. Federal Reserve (Fed) or "Central Bank". This index reflects the Fed's efforts to influence short-term interest rates as part of its monetary policy strategy. The index value is calculated by using the midpoint of the Fed's rate policy when they target a rate range (i.e., 0.25% - 0.50%).

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