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Mitch on the Markets

Portfolio Manager Investing Insights

Why Falling Expectations and Volatility May be Bullish

Consumer sentiment is in decline, inflation expectations are rising, small business confidence is sagging, and recession calls are growing. In the short term, this swirling uncertainty has almost certainly been the driver of market volatility. But in the long term, I think it could be bullish.

First, allow me to frame the various—and quite widespread—declines in sentiment and growth expectations.

Let's start with the most critical component of the U.S. economy, the consumer. In March 2025, U.S. consumer sentiment experienced a significant decline of -11%, reaching its lowest point in nearly two and a half years. The University of Michigan's Consumer Sentiment Index dropped to 57.9 from February's 64.7, which was well below expectations and was accompanied by a sharp increase in long-term inflation expectations (see chart below).[1]

ABOUT MITCH ZACKS

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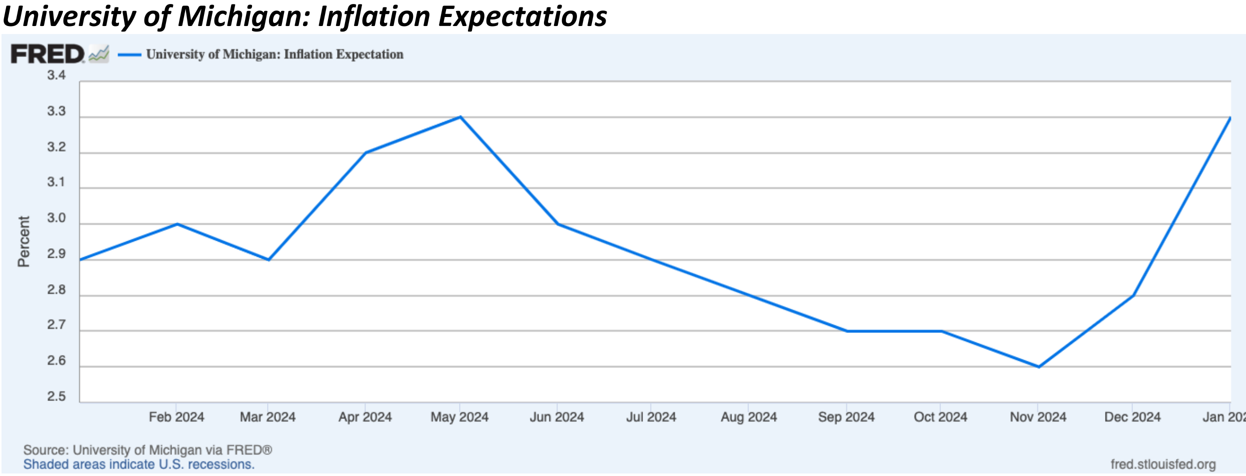
University of Michigan: Inflation Expectations



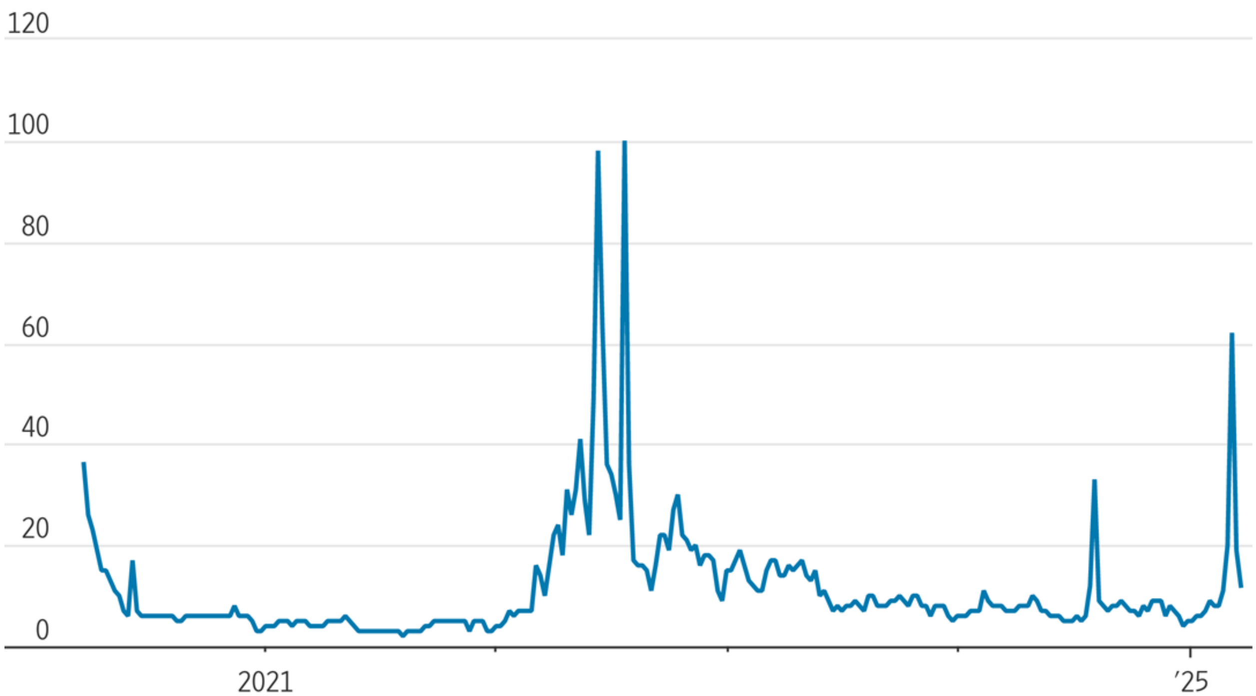
Source: Federal Reserve Bank of St. Louis[2]

I do not make specific stock recommendations in this column, but I've also observed some consumer warning signs from CEOs of consumer-facing companies. The CEO of Delta Airlines, Ed Bastian, said there was “something going on with economic sentiment, something going on with consumer confidence.” And Walmart CEO Doug McMillion echoed those concerns, stating that shoppers appear to be budget pressured, adding that he's noticed certain “stress behaviors [that Walmart] worries about.”

Small businesses have also been feeling a bit uneasy. In March 2025, small business uncertainty in the United States surged to its second-highest level since 1973, reflecting growing apprehension among entrepreneurs about the economic outlook. Related, the National Federation of Independent Business (NFIB) reported a significant decline in its Small Business Optimism Index, dropping 2.1 points to 100.7 in February. These shifts indicate that small business owners are increasingly cautious, potentially scaling back expansion plans and bracing for potential economic challenges ahead.

Finally, there has been a pronounced increase in the mention of ‘recession’ online and in the press. Over the past month or so, recession talk has seen a three-fold increase in the media, and searches for “recession” on Google saw a sharp spike.

Google searches in U.S. for the word "recession," rebased to 100



Source: Google Trends

Google Trends[3]

I want to be careful not to frame these sentiment indicators and fears of recession as overblown concerns. There is fundamental data that supports some caution, and tariff uncertainty could ultimately steer inflation and growth in the wrong direction. It is also fair to say that sagging sentiment and rising inflation expectations can become a self-fulfilling prophecy, as wary consumers opt to save, and businesses hit the pause button on investment and hiring plans.

What we also have here, however, is a rapidly growing "wall of worry," which stocks love to climb over time.

Long-time readers of my columns have seen me make this argument before, whether in the context of earnings expectations or recession fears. As consensus starts to tilt negative and expectations fall, the bar gets lowered for the economy and U.S. corporations to 'over-deliver.' A clear example comes from 2022—Google searches for "recession" spiked then as well, with a majority of economists expecting economic contraction. The recession never came, and the stock market posted exceptional years in 2023 and 2024. As investors and consumers grow more worried and skeptical in the current environment, I see a bigger opening for 'better-than-expected' outcomes down the road.

BOTTOM LINE FOR INVESTORS

It is clear that consumer sentiment, small business confidence, and recession fears are all moving in a negative direction. These concerns may be warranted, and tariff policy could escalate in a way that works against positive trends in growth and inflation.

But history also reminds us that markets can thrive—on a forward-looking basis—when expectations are falling. While policy uncertainty remains a concern, the downstream effect has also created a significant "wall of worry" that lowers the bar for positive surprises. Consumers and businesses may be more adaptable than they're currently getting credit for, and tariff policy may not be as broad and punitive as many fear. Investors should remember that when pessimism dominates, even modestly positive economic developments can fuel market rebounds.

[1] Wall Street Journal. March 15, 2025. https://www.wsj.com/economy/consumers/consumers-and-businesses-send-distress-signal-as-economic-fear-sets-in-f58d0659?mod=economy_feat5_consumers_pos2

[2] Fred Economic Data. February 21, 2025. https://fred.stlouisfed.org/series/MICH#

[3] Google Trends. 2025.

STEADY INVESTOR WEEK

- **White House scales back April 2nd tariffs**
- **U.S. activity rebounds, inflation climbs**
- **Social Security's new I.D. rule sparks backlash**

Another Instance of Tariff Bark Being Louder Than the Bite

In President Trump's first term, tariff threats resembled what we've seen so far in 2025, but they were ultimately used as negotiation tactics to bring other countries to the table. The tariffs that went into effect were far more modest than originally telegraphed, and most were relegated to China. To be fair, President Trump seems more committed to imposing higher overall tariffs in this term, and the 'bark' has been somewhat alarming to many market watchers—including 25% tariffs on goods from Canada and Mexico, 60% tariffs on China, sector-specific tariffs on autos, semiconductors, and pharmaceuticals, and 'reciprocal tariffs' designed to match the tariffs that other countries impose on U.S. exports. So far, all of these tariff measures have been walked back or avoided altogether. Regarding reciprocal tariffs, the administration initially indicated that these tariffs would be broadly applied to all U.S. trading partners. However, we learned this week that the administration appears to be favoring a more targeted approach, focusing on specific countries and sectors. Treasury Secretary Scott Bessent stated the tariffs would now address around 15 nations, with each country assigned individualized rates based on factors such as existing tariffs, non-tariff barriers, and trade balances. Regarding the sector-specific tariffs, a 25% global tariff on steel and aluminum imports was implemented on March 12, 2025, but additional plans for tariffs have seen adjustments. Initially, President Trump announced intentions to impose 25% tariffs on imports of automobiles, semiconductors, and pharmaceuticals, with these measures expected to take effect on April 2, 2025. But these tariffs now appear to be on hold as the administration turns its focus to implementing more narrow reciprocal tariffs. While we do not see new tariffs as constructive towards U.S. economic growth and inflation, what may matter more to markets is that the tariffs being implemented are far lower and less punitive than originally expected—a positive surprise.[1]

Even as Uncertainty Rises, the U.S. Economy Shows Signs of Resilience

Businesses have been expressing caution as tariff policy and rhetoric take shape. But overall activity continues to hold up. In March 2025, U.S. economic activity experienced a notable uptick, primarily driven by the services sector—which accounts for a majority of U.S. economic output. The S&P Global Flash U.S. Composite PMI, an indicator of combined manufacturing and services output, rose to 53.5 from February's 51.6, marking the fastest expansion in three months. The services sector exhibited significant strength, with its index climbing to 54.3 in March from 51.0 in February. This increase surpassed economists' expectations and suggests robust growth in services-related businesses. Conversely, the manufacturing sector faced challenges, with its index declining to 49.8 in March from 50.5 in February, indicating contraction. This downturn is attributed to weakened demand and ongoing supply chain disruptions. Businesses reported reluctance to expand their workforce due to escalating costs and uncertainties surrounding trade policies. While the U.S. manufacturing sector remains in focus in the context of trade policy, it makes up a substantially smaller slice of overall economic output compared to services.[2]

For Those Nearing Social Security Retirement Age, Some Changes Worth Noting

Beginning March 31, 2025, the Social Security Administration (SSA) will implement new identity verification procedures for beneficiaries. Individuals unable to verify their identity through the online "my Social Security" service will be required to visit a local SSA field office in person. This change affects those updating banking information and families with children receiving benefits who cannot verify a child's information online. The SSA has also announced the closure of several field offices nationwide. According to an Associated Press analysis, 26 out of 47 offices listed for closure by the Department of Government Efficiency are scheduled to close this year, with some closures as early as next month. In response to these changes, the SSA plans to train frontline employees and management on the new policy over the next two weeks. However, concerns persist regarding the potential impact on service accessibility and efficiency for beneficiaries. Beneficiaries are encouraged to utilize the online "my Social Security" service for identity verification, when possible, to avoid potential delays associated with in-person visits. Staying informed about local field office operations and any upcoming closures is advisable to ensure timely access to necessary services.[3]

[1] Wall Street Journal. March 23, 2025. https://www.wsj.com/politics/policy/trump-tariff-reciprocal-deadline-industrial-delay-97508838?mod=djem10point

[2] Wall Street Journal. March 24, 2025. https://www.wsj.com/economy/u-s-activity-picks-up-pace-on-services-strength-surveys-show-b25e1476?mod=economy_lead_pos2

[3] CBS News. March 21, 2025. https://www.cbsnews.com/news/social-security-in-person-identity-requirement-angers-retirees-advocates/

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