



Market Commentary
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English Version

Insigneo Weekly Dispatch

Making Sense of Recent Market Volatility

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Making Sense of Recent Market Volatility

Basing its outlook on the first Trump administration, the market thought that it knew exactly what a Trump 2.0 administration would look like and quickly priced in these expectations. However, the story has not played out as it expected.

Periodic market drawdowns, within the context of a long-term bull market are healthy, as they serve to take the proverbial froth off the markets and re-rate expectations back to more reasonable levels. We believe that we could be in the midst of such a re-rating.

Attractive, long-term, buying opportunities will likely arise from this pullback, we might just not be there quite yet. If the fears of recession prove to be just that, fears, this pullback could be short-lived. However, if the possibility of recession grows stronger, the market could continue to trend lower.

They say that knowledge is power. However, recognizing what you know, as well as what you do not know, can be even more powerful. The stock market came into 2025 thinking that it knew exactly what the new Trump administration would mean for the year ahead. Investors expected the implementation of a business-friendly environment from day one, accentuated by lower taxes and less regulation. Tariffs and the possibility of higher inflation appeared to be in the distance, while a recession was close to being written off. Topping it all off, during his first administration, President Trump appeared to be in tune with equity markets, almost appearing to view their performance as a reflection of his presidency. Basing its outlook on Trump 1.0, the market thought that it knew exactly what a Trump 2.0 administration would look like and quickly priced in these expectations. From the day after the election through its recent highs on February 19th, the S&P 500 rose 7.5%, while the Nasdaq rose close to 11%. The markets were certain that they knew what was coming. However, certainty is the last thing that is being reflected in the current market environ-

ment. In the words of Mark Twain: “It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.”

Markets do not like uncertainty. A reasonable degree of uncertainty is acceptable, in fact, it is inherent in market dynamics. After all, uncertainty drives volatility, creating a level of risk that investors attempt to price. However, the degree and duration of the current uncertainty plaguing markets is creating an abnormal amount of volatility, exacerbated by the fact that investors were expecting a completely different outcome.

Instead of lowering taxes before imposing tariffs, as was the case during Trump’s first term in office, the new administration appears to be doing things in reverse, focusing on tariffs first, not taxes. This is not what the market was expecting. Additionally, the changing ways in which tariffs are being used is injecting a high degree of uncertainty into expectations. The uncertain nature and implementation of tariffs is enough to create volatility, but the resulting prospect of increased inflation, as well as the increased possibility of recession, is creating outright fear. Intensifying the situation is another variable that caught the market by surprise. Instead of a president that was sensitive to equity markets, as was the case during his first term, the new administration appears to be more focused on the long-term stability of the economy. Treasury Secretary Scott Bessent made this clear when he stated that the administration is focused on working on the “real economy” and is not worried about market volatility. According to sources that know Mr. Bessent well, he is a man that stands by his word. Appearing to take a page from the Milei administration, President Trump has alluded to this dynamic himself, saying that the current policies could lead to “short term pain for long term gain.” Like a child used to being placated, the market did not like it when it did not get what it expected. What has ensued over that past month has been nothing short of a wild ride.

From its high on February 19th, the S&P 500 has pulled back 10.5%, finding itself slightly in correction territory as of the time of this writing. The tech-heavy Nasdaq 100 already finds itself firmly in a correction, down 15% off its highs, while the traditionally more stable Dow Jones Industrial Average has retreated 9.75%. All three indices have given back all the gains accumulated since the election, and more. Additionally, all three indices have broken and remain below their 200-Day Moving Averages. This is important because, since the beginning of 2023, all three markets have only touched or broken below this moving average briefly and have quickly bounced back. Over the past five years, the only time that the markets failed to bounce back above their respective 200-Day Moving Averages was in early 2022, after which the S&P 500 proceeded 30% lower, along with the Nasdaq 100 which fell 35%. We are not saying that this is what is going to happen, but it is always important to consider all possibilities.

At the same time, the CBOE Volatility Index, or VIX, which attempts to gauge the volatility of the S&P 500, has risen close to 65% since February 19th, to a level of 24.7 points at the time of this writing. To provide some context, the VIX’s average level over the past two years has been 16 points. During the market’s last meaningful pullback in 2022, the VIX reached levels close to 40 points. Considering that the S&P’s current downturn represents the fifth fastest pullback from all-time highs in 75 years, and the fastest in the past three years, we are not surprised that the VIX has jumped 65% over that period. This is what the market does after it realizes that it does not know everything that it thinks it does, it quickly re-prices downwards.

However, not everything that seems bad is bad. Over the past fifty years, the S&P 500 has pulled back, from peak to trough, an average of 10% to 15% per year. As a refresher, a pullback between 10% to 20%

is considered a correction, over 20% is considered a bear market. Yet, over the past two years, since the beginning of the AI revolution, the market had not once been in significant correction territory. Yet, propelled by the Magnificent Seven, it was hard to argue that the markets were not trading at rich valuation levels. Since last year, we have believed that it would not be unexpected if we experienced a healthy market pullback, as equity markets appeared rich and earnings expectations appeared elevated. **In fact, we believe that periodic market drawdowns, within the context of a long-term bull market are healthy, as they serve to take the proverbial froth off the markets and re-rate expectations back to more reasonable levels. We believe that we could be in the midst of such a re-rating.**

As of the time of this writing, the S&P 500 was trading close to 20.45x forward earnings. Using Wall Street's average earnings per share estimate for the index of \$270, this gives us an index price of \$5,521 ($20.45 \times 270 = 5521$), which is where the index currently trades at. This means that, based on the Street's average earnings estimates for the year, the S&P 500 is close to fairly valued, in essence indicating that the previous levels could have been all "froth". But that is not the end of the story. Although the price and valuation of the index have adjusted lower, earnings expectations have not done so in a meaningful way. This means that if tariffs continue to drive the possibility of inflation and recession higher, analysts are likely to adjust their earnings expectations lower, which could continue to push the markets lower in the short term. To this point, Goldman Sachs, JP Morgan, and Citigroup have all recently reduced their current and future earnings expectations. In fact, Citigroup went a step further and reduced its exposure to US equities from overweight to neutral. At the same time, Goldman Sachs reduced its earnings growth expectations for the end of the year from 9% to 7%, while reducing its year-end price target for the index from 6,500 to 6,200. The Street continues to

expect that earnings will grow between 10% and 11% through the end of the year, a number that will most likely also be adjusted lower. We continue to remain neutral on US equities over the next 3 months, and although we entered 2025 with a year-end price target for the S&P 500 of 6,300, we will likely be revising it lower in the near future. Realizing that the mechanics discussed above can be rather overwhelming, the point to remember is that although Wall Street sentiment and market valuations multiples have come down, the fact that earnings expectations have not yet re-rated lower tells us that there could be more downside ahead in the near term.

Again, not everything that seems bad is bad. Notice that even if year-end price targets for the S&P 500 are trending lower, these price levels are still higher than where the index currently sits at. **Attractive, long-term, buying opportunities will likely arise from this pullback, we might just not be there quite yet.** On average, correction pullbacks tend to last between one and six months. The duration of this period of high volatility will likely depend on clarity surrounding the direction and magnitude of tariffs, which could come as soon as April, as well as more clarity surrounding the health of the economy, which could develop over the next six months.

If the fears of recession prove to be just that, fears, this pullback could be short-lived. However, if the possibility of recession grows stronger, the market could continue to trend lower. We would not be surprised if economic growth proved to be lower than expected in the first half of this year. In fact, the current uncertainty could reduce consumer and business confidence, creating a self-fulfilling prophecy that ends up in an economic slowdown. To this point, many consumer-oriented companies, ranging from McDonald's to Target, have already reduced earnings expectations for the year as consumers become more cautious.

What can investors do to navigate this volatility? Two things: First, do not panic. Remain calm and avoid emotionally driven reactions. Do not run for the exits, but do not be a hero and try to catch a falling knife. Second, do not get distracted by short-term volatility and lose sight of the long-term. Just like uncomfortable times are unfortunately a part of life, pullbacks are a normal part of market dynamics. Most importantly, always remember that your financial advisors,

along with a whole team of investment professionals behind them, are here to help you navigate these uncertain times. ■



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