



Market Commentary
May 2nd, 2025

English Version

Insigneo Weekly Dispatch

Half Time Report – A Season of Dichotomy

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Half Time Report – A Season of Dichotomy

We are seeing a dichotomy in company narratives this earnings season, as companies that are less sensitive to economic activity appear to be relatively better insulated from the effects of tariffs, while economically sensitive companies are not.

Another dichotomy also appears to be present on the economic front, this time between leading indicators such as consumer confidence and manufacturing orders, relative to coincident indicators such as employment and labor market data.

We have maintained our Neutral exposure to US equity markets throughout this volatile period and continue to maintain this stance.

When we think of a dichotomy, we tend to think of two opposing forces, such as light and dark or good and

evil. The interesting thing about dichotomies is that they tend to be mutually exclusive, meaning that most of the time, they can only be one thing or another, not both. At the same time, they tend to convey contrasting, sometimes clashing messages. Curiously, dichotomies can be found everywhere, and equity markets are no exception. This dynamic is clearly evident this earnings season.

A month ago, in early April, Wall Street expected the S&P 500 to experience earnings growth close to 14% for 2025. Just a month later, in early May, consensus growth expectations have been cut by almost half, as the markets now expect earnings to grow close to 8% for the year. Not surprisingly, the unknown impact of tariffs on the economy was the catalyst that drove earnings growth expectations downward. How quickly things can change. It is also no surprise that going into the year's first quarter earnings season, there was a lot of uncertainty surrounding what companies' earnings would reveal regarding the impact of tariffs on growth. This is where a dichotomy comes into view. As we find

ourselves more than two-thirds through the current earnings season, with 70% of the companies in the S&P 500 having already reported, we find a clear dichotomy between companies that see their earnings affected by the prospect of tariffs and others that are not. **In a nutshell, companies that are less sensitive to economic activity appear to be relatively better insulated from the effects of tariffs, while economically sensitive companies are not.**

So far, companies that appear to be relatively unscathed by tariffs are mostly in the Financials and Technology sectors. Within the Financials sector, large financial institutions such as JP Morgan, Goldman Sachs, Morgan Stanley and Bank of America reported better than expected earnings driven by increased trading volumes. It is important to remember that in periods of high volatility, financial companies with a large degree of exposure to trading activity tend to benefit in a disproportionate manner. To this point, Morgan Stanley saw trading revenue increase by nearly 50% over the previous year. In fact, the combined equity and fixed income sales and trading revenue for the financial institutions listed above was over \$30 billion in the first quarter of this year alone. To put things in perspective, \$30 billion is three quarters of the market capitalization of Ford or Target. Investors might feel uncomfortable in periods of high volatility, but trading houses certainly welcome them.

On the Technology front, as of the time of this writing, six of the Magnificent Seven stocks have reported earnings, showing somewhat of a mixed bag of results. Tesla reported numbers that came in below Wall Street's expectations and also removed guidance for the year in light of tariff uncertainty. However, comments from CEO Elon Musk stating that he will be exiting DOGE sooner than expected moved the stock higher. On the other hand, Google reported earnings that beat expectations, highlighting continued strength in its search engine business. At the same time, Microsoft

reported a 33% growth in revenues mostly driven by strength in its Azure cloud business. An interesting point in Microsoft's earnings report was the fact that approximately 16% of the growth in its cloud business was driven by its previous investments in Artificial Intelligence, meaning that the company is already starting to monetize its investments in AI. This is important, as Wall Street was expecting this monetization to take more time. Another company whose earnings showcased the benefits of AI was Meta. The company reported stronger than expected earnings based on increased ad sales. However, management stated that a major driver behind the increase in ad sales was the use of AI technology to better target ad spending, showing that the company is also beginning to monetize its spending on AI. Amazon, on the other hand, reported earnings that, although they met Wall Street's expectations, were not as good as its peers. Growth in its AWS cloud platform came in in line with expectations but paled in comparison to Microsoft's Azure results. At the same time, Amazon provided operating income guidance for the second quarter that came in below the Street's expectations, as tariff uncertainty clouded visibility ahead. Technology giant Apple was also affected by the trade wars, announcing that although sales rose for the quarter, it was incurring \$900 million in tariff-related costs, a number that will likely rise the longer tariffs remain in place. The last of the Magnificent seven, Nvidia, is set to report earnings on the 28th of this month. A dynamic to keep in focus will be the possible impact of tariffs on chips demand, something that is starting to be highlighted by competitors such as Qualcomm.

Although companies in the Financials and Technology sectors appear to be relatively better insulated, though not immune, from tariffs, companies in other sectors have not fared so well. Companies in Consumer Staples, like Kimberly Clark, reduced its guidance and reported weaker margins on higher costs of goods sold as a result of tariff increases. Beverage giant Pepsico

reduced its outlook on higher supply chain costs brought about by higher tariffs. Retailing behemoth Walmart maintained its guidance but stated that it was going to “invest in price”, meaning that it was willing to temporarily absorb an increase in prices before passing it on to consumers. However, the ability of the company to absorb price increases will be dictated by the length of the trade war. **As would be expected, companies in consumer-sensitive sectors such as Consumer Discretionary are the most sensitive to increased tariffs.** Many of these companies, such as Delta and American Airlines suspended their guidance, as they cannot reasonably provide visibility in the current environment. Auto manufacturer General Motors saw a strong quarter based on an increase in orders ahead of the implementation of tariffs, but the company recognized that this pull-forward of demand is unsustainable and sees increased costs ahead. Even restaurant companies that traditionally cater to value-oriented consumers such as McDonald’s and Wendy’s are reducing their outlooks based on decreased consumption, as a decrease in consumer confidence is leading to lower spending. At the same time, logistic giants like UPS are reducing their workforce in anticipation of lower demand. To this point, UPS announced that it will be laying off 20,000 workers as demand and shipment volumes decrease.

Interestingly, the trends that we are observing in consumer and demand-sensitive sectors bring up another dichotomy, this time on the economic front. Consumer confidence is at the lowest levels since 2020. This past quarter saw the first contraction in U.S. GDP since 2022 driven by a sharp rise in imports to get ahead of tariffs, while manufacturing activity in the country shrank. However, the jobs report just last Friday painted a positive picture of the labor market, as unemployment remained steady at 4.2% and the labor force added more than 500,000 new jobs. How is this possible? We have to remember that unlike consumer confidence or manufacturing order indicators, which attempt to give an indication of future consumption,

employment and labor market data tend to be coincident indicators. This means that the labor market tells us where we are, not where we are potentially headed. As Mohamed El-Erian put it, strength in the labor market provides the economy with “...momentum going into a difficult period, the question is whether it will be enough to pull us through”. The challenge now is looking forward to the possible scenarios of what could happen if the tariffs remain in place.

According to data from the Port of Los Angeles presented on Bloomberg, companies have approximately weeks, not months, worth of inventory left at their warehouses. If the current tariff regime remains in place, many economists expect that we will start to see empty shelves in U.S. retailers, leading to a supply shock and increased inflation. Increased inflation coupled with muted economic growth could lead to stagflation. However National Council of Economic Advisors Chairman Stephen Miran, one of the architects of the tariff negotiations, stated on Friday during a Bloomberg interview that he would be “surprised if the tariff levels remain the same in a few weeks.”

Going forward, the timing and scope of trade negotiations is going to be critical. If the U.S. economy enters a recession, the S&P 500 could retreat to levels close to 4,600 to 4,700, indicating an 18% to 20% pullback from current levels. If a recession is avoided and stagflation becomes the base case scenario, an S&P 500 level near 5,200 to 5,300 would appear to be fair value, indicating that the market could retreat approximately 7% from its current level. If a successful negotiation of tariffs is achieved and trade deals are reached, the market could move higher towards 6,000-6,300, or approximately 9% to 10% higher than current levels. **As we can see, there are several very different scenarios ahead, each with very different outcomes.** The remaining weeks of earnings season will help shed light on the path ahead, as we will get more data from consumer-oriented companies. At the same time, more releases of economic data will also be helpful in determining

where the economy is going and how the Fed will potentially react. Undoubtedly, tariff announcements between the U.S. and its trade partners, as well as any updates on a revamped tax bill, would also move the markets. **We have maintained our Neutral exposure to US equity markets throughout this volatile period and continue to maintain this stance.** In fast-moving markets, we do not want to reduce equity exposure and miss possible market bounces, but we do not want to increase exposure and risk increased downside. In

short, we want to avoid market timing and keep our focus on the long-term. ■



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