INVESTMENTS

From the desk of: New York Life Investments' Global Market Strategy team

Lauren Goodwin · Julia Hermann · Michael LoGalbo

Shifting risks; not yet shifting reality

Market volatility and February CPI report: 4:45PM EST, 12 March 2025

Takeaways

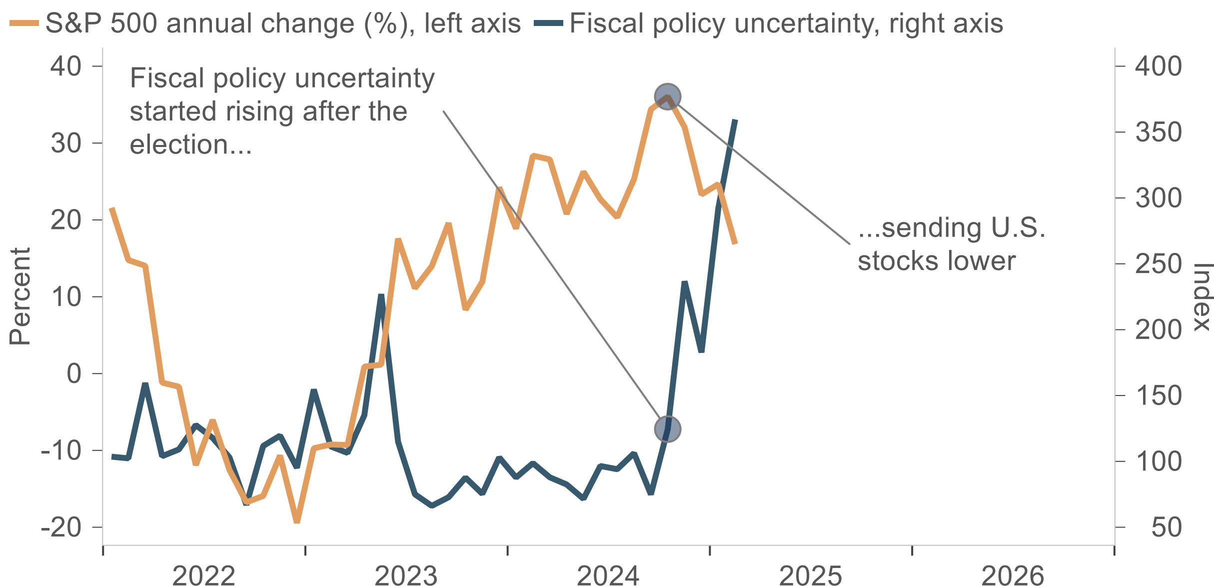
- **Uncertainty is the driver**: Market selloff is fueled by policy unknowns, not economic fundamentals.
- **Equities under pressure, credit stable**: Stocks are bearing the brunt of volatility, while credit markets remain resilient.
- **Policy clarity needed to stabilize**: Trump administration actions or a more dovish Fed could ease market stress.
- **Position for sticky inflation and higher volatility**: Focus on quality in credit and equities; consider inflation hedges.

Uncertainty's grip on markets

Nobody likes uncertainty – least of all the markets. And so far, this year, we have plenty of it. A new U.S. administration with a new economic vision; potential peace in Ukraine; stop-and-go tariff policy; geopolitical tumult; you name it. Equity markets have responded, nearly 9% off the S&P 500's highs from earlier this year.

There are two important things to note from this year's selloff. First: contrary to most major market moves, this selloff isn't driven by a disruption to the fundamentals, such as economic growth or earnings. Instead, it's uncertainty itself driving the leg down.

Uncertainty, not a growth scare, is driving the market sell off



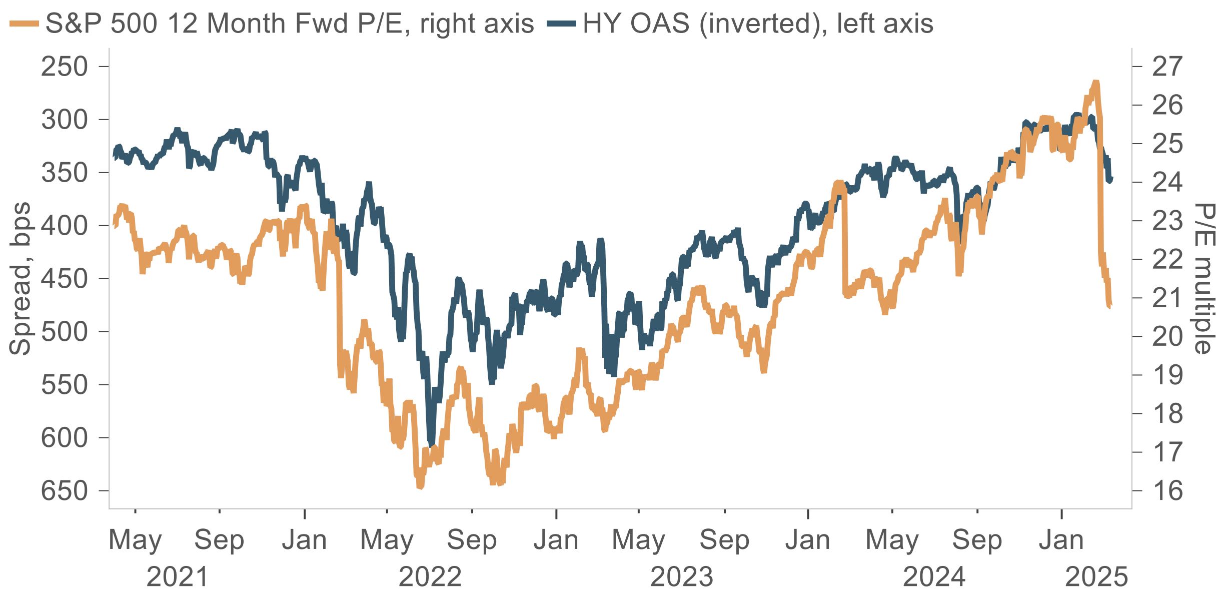
Sources: New York Life Investments Global Market Strategy, S&P Global, Macrobond, March 2025. The S&P 500 Index is an unmanaged index that is widely regarded as the standard for measuring large-cap U.S. stock market performance. It is not possible to invest in an index. Past performance is not a guarantee of future results.

From the desk of: New York Life Investments' Global Market Strategy team

Lauren Goodwin · Julia Hermann · Michael LoGalbo

Second, not all elements of the market are participating equally. Equity markets have borne the brunt of volatility, while credit spreads have seen relatively smaller moves. This makes sense to us. Uncertainty may drive changes in businesses' hiring and capital expenditure plans; it reduces growth upside. However, a slower-but-still-growing economy shouldn't impact companies' ability to pay back debt, especially with cash management improvements among public issuers since COVID-19.

Stocks have seen the most volatility, credit spreads remain healthy



Sources: New York Life Investments Global Market Strategy, Bloomberg, Macrobond, March 2025. The S&P 500 Index is an unmanaged index that is widely regarded as the standard for measuring large-cap U.S. stock market performance. It is not possible to invest in an index. Past performance is not a guarantee of future results.

Looking ahead: what calms the market from here?

After a strong downward mood, any good news (stability, or lack of "bad news") from policymakers or the data can create a bounce. But for markets to really stabilize, we believe the markets need clarity from policymakers:

- **Tranquility from Trump:** Trump's White House has never faced the political test of a bear market – *even during the pandemic*, when we saw a steep but short-lived selloff. President Trump could provide several sources of comfort to investors: rolling back tariffs on Canada, Mexico, and Europe; announcing rollbacks in regulation that spark animal spirits around M&A; or cementing the extension of the Tax Cuts and Jobs Act.
- **The Fed puts its "put" back**: Eyes have naturally moved to next week's Fed meeting, but more broadly, a return to dovish messaging from the Fed could do wonders to support equity price action if warranted. We could see this in the form of greater signaled cuts: consensus now expects up to three 25bp cuts this year, brought on by the shifting balance of risks to growth. The Fed could also support sentiment by accelerating the end of Quantitative Tightening, removing the current balance sheet drag.

Neither of these shifts looks likely in the near term. So, should investors be prepared for things to get worse?

From the desk of: New York Life Investments' Global Market Strategy team

Lauren Goodwin · Julia Hermann · Michael LoGalbo

We've often written that the durability of U.S. economic growth today – driven largely by high-income consumers – is more at risk when the market pulls back. High-income consumers have been powered by 1) strong equity price appreciation, 2) renewed investment income, and 3) record levels of home equity. **If equities were to see a 20% drawdown from highs – a bit over 10% from here – this *could* create a major hit to consumer confidence, and therefore to consumer activity, and therefore to business profits, and therefore to economic growth.**

We believe a 20% selloff threshold clears the bar for policymakers to change tact and could prompt a rollback of tariffs and more dovish messaging from the Fed. Accordingly, a 20% selloff doesn't necessarily represent a descent into recession; it could be a buying opportunity if policy steps in to assuage investors.

What do changes in policy and market pricing mean for key macro factors?

Growth: Investors are lowering growth forecasts and raising inflation projections for 2025. This aligns with our base case of gradual economic deceleration, which factored in Trump's policy agenda, including slower growth and higher inflation. But forecasts—and market expectations for Fed policy—will remain highly volatile given the range of possible outcomes. Recession is still not our base case this year; the likelihood has risen from 5% to 15% in our view. But a stagflation-lite scenario, including slower growth and still-sticky inflation, is increasingly likely. *See allocation approaches below.*

Inflation: After making significant progress, the underlying inflation impulse has stabilized (i.e. no further disinflation is visible). Key to our view that inflation will remain "sticky" is that disinflation in shelter appears to be ending; downward momentum in new tenant rents, a leading indicator of shelter prices, has halted.

Then we have tariffs. We're not buyers of the view that tariffs represent only a one-time increase in prices. Our view is that price levels are already very high and are impacting consumer behavior, making further upward pressure particularly detrimental to consumers and therefore drag on growth. Again – expect a stagflation-lite scenario.

Fed policy: Sticky inflation means that the growth outlook must deteriorate considerably for the Fed to get more dovish. The Fed will likely hold in March.

Tightening financial conditions – including deteriorating equity and bond market valuations – can influence the Fed's growth outlook. But we expect the bar for the Fed to respond to market activity is not yet passed. 2018 gives us a reasonable comparison here – it took 20% equity market downside before the Fed paused rate hikes.

The 10-year Treasury yield: Absent recession, we believe the 10-year will remain rangebound and volatile between 4.0% - 5.0%.

The 10-year yield moves when (1) 10-year inflation expectations move, (2) long term growth expectations move, or (3) investors' risk tolerance changes. Right now, it is the latter item contributing the most to downward pressure on the 10-year – investors are concerned about risk. We therefore anticipate that volatility within the 4.0% - 5.0% range is "live."

INVESTMENTS

From the desk of: New York Life Investments'
Global Market Strategy team
Lauren Goodwin · Julia Hermann · Michael LoGalbo

Asset allocation implications: "buy the dip", or "catch a falling knife?"

In times of market volatility, we commonly see investor paralysis. This time is no different, and perhaps even more the case as investors feel caught in the policy uncertainty. Market timing is challenging, and until policy uncertainty clears there could be more downside to come, particularly for the equity markets.

But in uncertain markets, a 'wait and see' approach risks missing opportunities to build ballast against risks. Instead, investors should use volatility to their advantage and position for long-term themes.

We believe investors may benefit by positioning for stickier inflation and higher volatility ahead:

- Use equity market volatility to seriously focus on quality names.
- We strongly prefer large caps for their stability. We don't expect small caps to durably outperform unless growth is reaccelerating or unless interest rates fall while growth is still strong. Neither of these is in our base case.
- Reduce underweights to international equity.
- Examine ways to stabilize returns, such as through dividend harvesting. Since the dividend-yielding powerhouses are also very high-quality names, this is another way to point a portfolio toward quality. Consider taking equity-like risk in credit but be ready to hold it for 2-3 years.
- Add inflation-aware asset classes such as real estate, commodities, and materials.
- Consider geopolitical hedges such as gold, oil, and crypto.

Past performance is not a guarantee of future results. Active management typically involves higher fees than passive management. This material represents an assessment of the market environment as at a specific date; is subject to change; and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any funds or any issuer or security in particular. The strategies discussed are strictly for illustrative and educational purposes and are not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. There is no guarantee that any strategies discussed will be effective.

This material contains general information only and does not take into account an individual's financial circumstances. This information should not be relied upon as a primary basis for an investment decision. Rather, an assessment should be made as to whether the information is appropriate in individual circumstances and consideration should be given to talking to a financial advisor before making an investment decision.

Investing in the precious metals sector involves special risks, including those related to fluctuations in the price of gold and other precious metals and increased susceptibility to adverse economic and regulatory developments affecting the sector. Crypto currency, such as Bitcoin, is a highly volatile asset class, can become illiquid at any time, and is for investors with a high-risk tolerance. Crypto may also be more susceptible to market manipulation. Crypto is not insured by any government agency including the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC).

"New York Life Investments" is both a service mark, and the common trade name, of certain investment advisors affiliated with New York Life Insurance Company.

SMRU: 7738064