LinkedIn Post-19 - 2025-3-11 - The stock market wobble

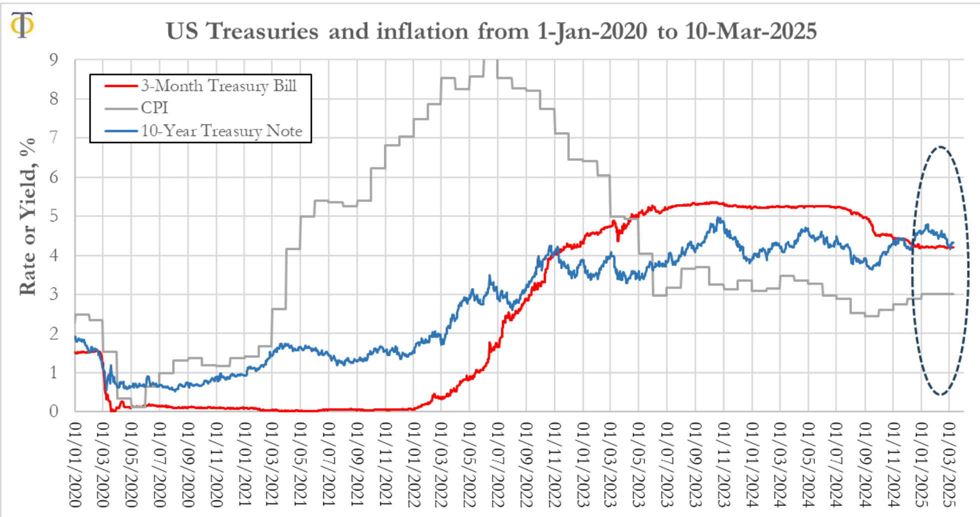
The inflation burst from 2022 to 2024 led to an historic bear market in fixed income assets which tilted investors towards stocks as being the best refuge for protecting against inflation.

The stock market "wobble" of the last couple of weeks is a kind reminder of the downside risks of stock market returns. This puts the S&P500 in negative territory for 2025, albeit at a small loss of -5% or so. Perhaps the wobble will lead to a "correction" if in the next week the stock markets continue their negative trend.

The question that all investors will be pondering after the dust settles from this ongoing episode is: Was this wobble a technical issue, due to the Trump trade tariffs and fear that these could lead to trade wars? Or are there underlying structural issues at play? What is going on, am I missing something?

Hints from the US Treasury market.

When reading Alan Greenspan's biography "The age of turbulence" in late 2007, one quote reminded in my mind ever since: "*I would get up early in the morning and look at the overnight data, including the 10-year Treasury note, because it gave me a sense of where the markets thought the economy was going*". I took that to heart and since then, pay close attention to the treasury market.



As we started 2025, the 10-year treasury yield has dropped about 50 bp from about 4.7% to 4.2%, even as inflation seems to remain stubbornly high hovering around 3%. The 10-year yields are pointing to economic weakness ahead. In our US Economy outlook for 2025 we lay out the case for why there is underlying weakness in the economy which is going to intensify throughout 2025. We expect to see a drop in both inflation and treasury yields in the months ahead, a multi-staged process, that is just at its beginning stages and which the stock market "wobble" seems to sense.

The CAPE ratio

An additional factor that should concern investors is the historically high CAPE (Cyclically Adjusted Price to Earnings ratio) ratio. The stock market seems to be under the influence of a "new tech paradigm" of crypto and AI, which rings eerily similar to the 2000 tech bubble.

In a previous post we analyse the relative value proposition of bonds when compared to expected future returns on the stock market based upon the CAPE ratio. We conclude that the current enthusiasm with the stock market in detriment of the bond market may be misplaced. The inflation episode from late 2021 to the middle of 2024 has led to risk aversion towards bond investments by asset allocators.

Summary

The stock market "wobble" from the last couple of weeks might be a warning sign for events to come. Both weakness in the economy and high stock market valuations relative to bonds are structural issues that are likely to impact stock return throughout 2025.

These processes are slow to unravel, typically manifested through a multi-month saga of stock market routs followed by enthusiastic rebounds. The underlying structural forces are a permanent pull, which are usually obvious with hindsight, but seldom before the events unfold.

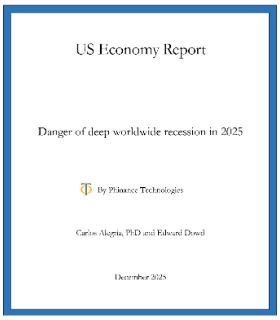
We believe that the rebalancing from stocks to bonds will turn into a flood throughout 2025 as inflation decelerates due to weak economic output, driven by the forces we explain in our US Economy outlook for 2025 report.

Our US Economy outlook for 2025 report:

The full report is an extensive analysis that provides insights into the most consequential forces that will be acting on the US economy in 2025.

The report is aimed for decision makers for investments and risk management, providing a roadmap to understand and successfully navigate the economic conundrum that the US and global economies will be facing in 2025.

The report package includes:
- Full report on the US Economy outlook for 2025
- Executive presentation aimed at executive level decision makers.
- 1h Video with Ed Dowd and Carlos Alegria go through the executive presentation.


US Economy Report

Danger of deep worldwide recession in 2025

By Phinance Technologies

Carlos Alegria, PhD and Edward Dowd

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