US Exceptionalism – In transition but not over

Uncertainties abound

The US stock market is undergoing a correction, with the **S&P500 down 9% and Nasdaq down 12%** in the last three weeks. Key factors driving this slump include:

- **Chaotic trade policy**: Since January, President Trump has threatened tariffs on imports from Canada, Mexico and China. Constant retraction of timeliness as a bargaining tool has added to increased uncertainty.
- **DOGE cuts**: The Department of Government Efficiency (DOGE) is pushing for significant federal spending cuts, via contract cancellations and headcount reductions.
- **Growth concerns**: Despite a cooling labour market and weaker-than-expected February job growth of 151k, Powell has signaled the Fed is not rushing to cut rates.

These factors are fueling recession fears, which Trump has not ruled out. **The key to remember is this – has a recession ever been created when it is self-engineered? Are these measures reversible? Is the recent selloff overdone?**

Macro indicators point to a slowdown

Equities are starting to price a potential slowdown after recent softening of consumer sentiment and lower employment data:

1. The Conference Board's Index of Leading Economic Indicators shows a slight drop in January, by 0.3 to 101.5, as consumer sentiment and manufacturing hours worked declined.
2. Chicago Federal Reserve's National Activity Index for January shows a marginal drop (0.03) after four months of positive growth (a zero reading means the economy is operating at full potential).

What's next?

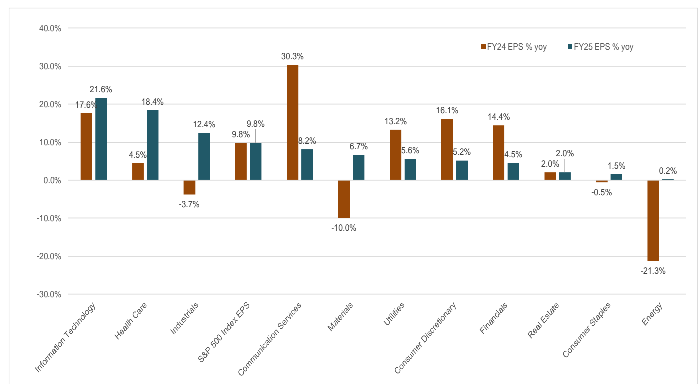
Two events on Mr Trump's policy calendar will have consequences:

1. In early April, the US will announce reciprocal tariffs on 20+ countries. Although the EU, Japan, Vietnam, Taiwan, South Korea and Thailand are likely targets, many of these are already making overtures to the US to avoid them. Such tariffs are inflationary for the US.
2. Later in 2Q25, Trump's **tax legislation promises to be positive for earnings and sentiment**. The US Congress will soon begin negotiating terms of a tax bill to deliver Trump's promised tax cuts (for corporations) and extend tax cuts/allowances for individuals. If Trump's initial 15% corporate tax proposal is watered down (to minimize the deficit) it may disappoint equity markets.

Resilient corporate earnings

While stock market volatility is unsettling, it is important to step back and assess the bigger picture. **Corporate earnings remain strong in many sectors**. S&P500 EPS is expected to grow 9.8% this year (earlier forecast: 12%), a similar growth rate as 2024. Estimates have been lowered for materials, utilities and consumer, but forecasts for IT, healthcare and communication services remain stable.

EPS growth expectations appear fairly resilient



Source: Bloomberg, CIMB Chief Investment Office

With policy rates still high, the **Fed has room to cut rates if the growth scare deepens**. Some argue the **slowdown is government-engineered and reversible** if the economic impact worsens.

Another school of thought is that Trump views the stock market as a key barometer of his administration's success, so a policy pivot is possible if equity prices suffer further. **So the current correction should not end up in a technical bear market (-20% decline from the peak).**

Valuation reset

The **S&P500 PER** peaked at 23x in February, now at **20x, near its historical average**. The **Nasdaq**, previously at 28x, is now at **25.7x, one standard deviation below its mean**. Although not at crisis-level discounts, valuations have reset, making quality stocks more appealing. In the past 20 years, the S&P500's average return was 10% p.a., highlighting the value of long term investing.

Technical support levels

We estimate that the **current correction may have 5-10% more downside to go**:

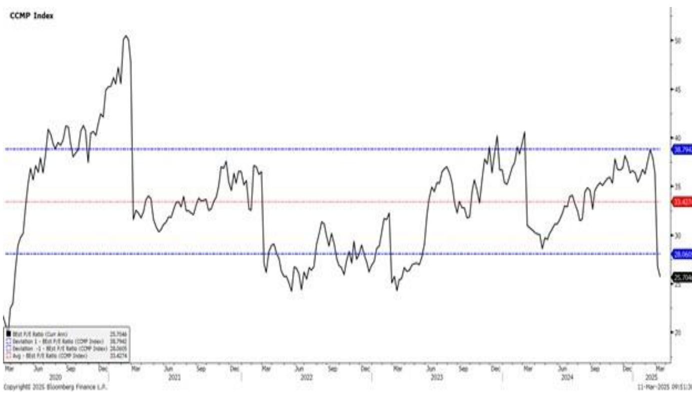
- **S&P500**: Support at 5390 (-4%) and 5130 (-8%)
- **Nasdaq**: Support at 16,530 (-6%) and 15,550 (-12%)

We believe a further correction may offer opportunities to accumulate select quality stocks for long term gains.

S&P500 is at mean valuations

Source: Bloomberg

Nasdaq is at -1 std. dev. from historical mean



Source: Bloomberg

Key risk is a sharp deterioration in corporate profitability due to rising tariffs, layoffs, and falling consumer confidence.

Bond markets spring back

Since peaking at 4.8%, US long bond yields (10Y) have turned from concerns about rising inflation risks (from higher tariffs) to growth concerns. This fueled expectations that the US Fed may need to cut rates by 75bps in 2025, in order to counter potential recession threat (previously 25-50bps cuts only).

Bond market tailwinds

This added to earlier bond market tailwinds:

- A potential pause in the Fed's potential Quantitative Tightening.
- Trump's expressed intention to lower borrowing cost by lowering longer term UST yields.
- Growth slowdown fears from recent spate of weaker economic data and US policy uncertainties.

Near term outlook

In the short term, risk aversion trades may drive yields lower in light of uncertainties over Trump's policy rollout. However, we think it is possible that the market may start to shift from growth risks to inflation risks again in the coming months. **Hence, we reiterate reducing positions in long duration bonds (10y-30y)** in this environment and focus on recurring income with:

- diversified income funds with around 6% income distribution.
- quality corporate bonds with up to 10-year tenor with yields around 5.5% denominated in AUD, GBP and USD.

We recommend reducing exposure to long tenor bonds such as 30y US Treasuries, STRIPS and Australia Government bonds (ACGB).

In conclusion, we think US trade policy uncertainty could continue to increase equity and bond volatility in the short term. US indices could correct another 5% or so and US 10Y could very well rally further. But timing the market to the tee could be a futile exercise if one is long term in this investment cycle.

Hence, we continue to reiterate our call to buy a diversified fixed income portfolio with short duration or a diversified global equity portfolio with income.

Stay calm and stay invested! Time in the market is always better than time away from the market.

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