Pallas Perspective

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Market Developments and Policy Impacts

Over the last few weeks, markets have been closely monitoring various tariff threats from the administration. These concerns have been reflected in business surveys, which indicate a deterioration in outlook, in some cases directly linked to trade conflict. Notably, the flash February services PMI fell below 50 for the first time in over two years, signaling contraction. While the manufacturing PMI improved for the fifth consecutive month, the press release suggests this may be due to temporary front-loading ahead of anticipated tariffs. Beyond trade concerns, business sentiment is also being weighed down by risks associated with federal spending cuts.

Evaluating Trump 2.0 Policies and Market Reactions

In assessing how the administration's policies impact risk assets, we continue to weigh both the positives and negatives. On the positive side, current policies have notably boosted international markets, with Europe being the top-performing region year-to-date. The market has also responded favorably to the administration's handling of foreign conflicts, including Russia-Ukraine and Israel-Gaza, which have helped lower risk premiums. Domestically, the extension of the Tax Cuts and Jobs Act and deregulatory efforts in financial and emerging tech sectors, particularly AI, have contributed to market confidence.

However, uncertainty remains. The mounting fiscal deficit and potential budget showdown create an environment of instability. The administration's tariff strategy also raises questions about whether these measures are aimed at fair trade or are more tactical in nature. Immigration policy remains another area of unpredictability

While deportation numbers under the Biden administration averaged 57,000 per month compared to 37,000 under Trump, it remains uncertain how aggressive enforcement will be in the current term. Given that the U.S. requires approximately 500,000 to 1 million new workers annually to offset retirements, labor market dynamics remain a critical factor.

Key Market Indicators and Trends

Consumer Sentiment – With personal consumption expenditure comprising 68% of U.S. GDP, consumer behavior is a key driver of economic activity. Heightened uncertainty due to ambiguous policy signals and the looming threat of tariffs has led to scaled-back spending. Additionally, many consumers perceive current policies as inflationary.

Business Sentiment – The capital expenditure (CapEx) cycle is encountering headwinds. With tariffs on the horizon and a potential budget showdown looming,companies are exercising caution in committing to new investments. Regulated industries remain concerned about federal workforce reductions.

Corporate Earnings – The Q4 earnings season has exceeded expectations, with S&P 500 companies reporting 10% year-over-year EPS growth, surpassing forecasts by 7%. However, only 30% of companies have provided upward EPS guidance, which is below the 10-year average of 42%. This suggests a disconnect between current earnings strength and a more cautious forward outlook, reflecting policy uncertainty, fiscal tightening, and geopolitical risks

Bond Yields – Bond yields are a key indicator as budget and debt ceiling talks continue. Investors are watching bond vigilantes, who could influence fiscal discipline if the government falters. With yields expected between 4.5%-5%, a rise above 5% may signal a loss of confidence in U.S. debt management, affecting other risk assets.

Overall, portfolios remain resilient. We remain committed to a disciplined, diversified investment approach to navigate evolving market conditions.

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