# INVESTMENT PERSPECTIVES

MARCH 2025

**Key Takeaways —**

- History may provide a valuable lesson.
- How much is too much federal debt?
- March may bring a chance to increase equity exposure.

## A LESSON FROM THE NIFTY FIFTY

Mark Luschini, Chief Investment Strategist

Over the last few years, investors have poured money into the shares of companies coined the Magnificent 7 (the "Mag 7"). This distinguished group includes, in no particular order, Meta (a.k.a. Facebook), Apple, Amazon, Alphabet (a.k.a. Google), Microsoft, Tesla, and NVIDIA. This collective was corralled because of their similarly outstanding performance and operating metrics, and because they shared the following characteristics: iconic brand, gigantic capitalization, industry dominance, rapid and somewhat predictable growth, copious cash flow, and lofty potential. To be sure, investors have been duly rewarded for their selection. After all, while the S&P 500 index produced returns north of 20% in both 2023 and 2024, something that has not taken place in a quarter century, the Mag 7 more than tripled the cumulative return of the S&P 500 index over those two years!

This year, however, the Mag 7 is off to a rough start and trails the S&P 500 index by a considerable sum. To be fair, not all have lost value since the beginning of the year (though most have), and the stock price of any publicly traded company, even the great ones, fluctuates sometimes wildly over periods of time. However, it does invite critique since so many investors have placed their faith in the Mag 7's continued outperformance as if ordained. Here, history may provide a valuable lesson, which is not intended to indict the Mag 7 or their prospects but rather to offer a sobering perspective.

In the early 1970s, investors flocked to a select group of glamorous growth stocks loosely known as the Nifty Fifty. The earnings growth of these companies was perceived to be so dependable that they were touted as "one-decision" stocks that a shareholder would never have to sell. The stocks flourished for several years, amplified by soaring P/E multiples. Then the bear market of 1973-1974 struck, and these stocks took a brutal tumble even as, in many cases, their earnings kept growing. These highfliers, sporting rich multiples individually and relative to the stock market, a familiar story at least by way of order of magnitude describing the Mag 7 today, undertook a massive valuation de-rating, which caused declines that more often than not far exceeded the loss in the broad market.

What insight might the Nifty Fifty have for equity investors today? The concentration of tech and tech-related companies represented by the Mag 7 have ridden their outsized growth and vast potential to supersized returns. So much so, in fact, that their share of equity market capitalization has advanced to where they represent seven of the eight largest publicly traded companies in the U.S. and, in the aggregate, account for almost one-third of the entire S&P 500's market capitalization. This highly unusual degree of concentration was at a historic level before their share prices lost value in the last couple of months.

While the Mag 7 still commands a sizable valuation premium to the S&P 500, we aren't suggesting that it is not warranted. These are well-managed businesses that have high-quality balance sheets and mostly continue to post enviable growth rates. However, the real insight from the Nifty Fifty and its subsequent unwinding was more about exposing investors' cognitive biases than it was about the underlying companies. It demonstrated the tendency to place undue emphasis on the most recent data and the susceptibility to extrapolating those results far into the future. Behavioral psychologists call this "recency bias." We do not believe the Mag 7 is following in the Nifty Fifty's footsteps, but many other U.S. stocks, and even international equities, may be poised to outperform if the Mag 7 were to stumble.

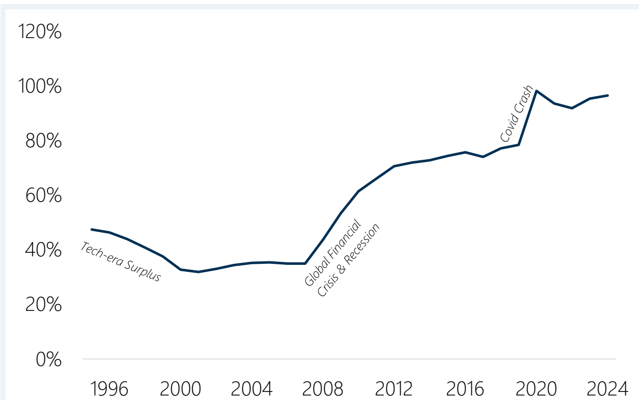
Indeed, the Mag 7 consists of great companies with moats around their businesses, but their premium price demands results that could eventually be challenging to meet due to their own missteps or those of competitive forces present and future. Diversifying beyond the Mag 7 will not immunize a portfolio from falling in value, but it may mitigate the impact should investor sentiment turn less sanguine about them. ■

# AUSTERITY, DEBT-TO-GDP, AND ECONOMIC GROWTH: THE FEEDBACK LOOP

Guy LeBas, Chief Fixed Income Strategist

One of the megatrends affecting interest rates in the U.S. is the amount of federal debt outstanding. Depending on how one measures it, the ratio of Treasury debt to the U.S. economy ("debt to GDP") is about 96%, up from 78% in 2019. Over that period, the U.S. government ran large annual deficits, which were partly a function of the COVID emergency and partly a structural mismatch between spending and taxes. A deficit means the U.S. borrows money by issuing Treasury bills, notes, and bonds. That issuance affects interest rates in two ways: one, deficit spending provides economic activity, and two, deficit spending increases the supply of bonds and, therefore, increases interest rates.

Chart 1: Public Debt to GDP




Source: Janney ISG; White House OMB

How much is too much debt? It is impossible to know. In August 2023, the bond markets suddenly focused on the volume of Treasury issuance, and interest rates spiked, with most maturities yielding 5% or more. Six months later, the markets stopped caring much about issuance. What we do know is that most of the time, economics and Federal Reserve (Fed) policy are much more important for the level of interest rates and bond market performance than Treasury issuance.

In 2025, the level of Treasury issuance is subject to two opposite force's themes: spending cuts or "austerity" and proposed fiscal stimulus, which one inclined to irony might call "anti-austerity." Austerity refers to policies aimed at reducing government deficits and debt through spending cuts or tax increases. The Department of Governmental Efficiency is the poster child for austerity; its efforts have thus far resulted in an estimated 300K job reduction. The problem now is a feedback loop between austerity and economic growth: cutting deficits can shrink GDP, sometimes undermining debt reduction goals.

Government spending is a component of GDP, so cuts to spending lower economic output. As an extreme example, Greece's austerity in 2010 ~25% GDP collapse, raising its debt ratio despite efforts to reduce it. The U.S. is not Greece, but the comparison serves as an example of how austerity often fails to achieve debt reduction goals. IMF economists found fiscal multipliers in post-2008 austerity programs ranged from 0.9 to 1.7, meaning a 1% federal spending cut could reduce economic output by 0.9–1.7%. A multiplier above 1.0 would mean that cutting spending would increase U.S. indebtedness. Still, all else equal, these austerity measures are likely to reduce interest rates in the U.S. economy not through reduced bond issuance but more likely through economic slowing.

Table 1: Economic Growth & Austerity: Recent Examples

| Country | Pre-Austerity* | During | Post** |
|---|---|---|---|
| Argentina | 7.2 | (2.5) | 1.3 |
| Brazil | 3.1 | (0.9) | 2.5 |
| Canada | 2.8 | 1.5 | 2.3 |
| France | 2.2 | 0.7 | 1.8 |
| Germany | 2.5 | 1.2 | 2.0 |
| Greece | (0.1) | (6.8) | 1.5 |
| Ireland | 4.7 | 2.0 | 5.0 |
| Italy | 0.6 | (0.5) | 1.1 |
| Japan | 1.8 | 0.5 | 1.2 |
| Portugal | 1.2 | (1.0) | 1.8 |
| Spain | (0.3) | (1.2) | 2.0 |
| UK | 2.6 | 1.0 | 2.3 |
| **Average** | **2.4** | **(0.5)** | **2.1** |

Source: Janney ISG

Just as DOGE is the poster child of austerity, extension, or expansion of the TCJA tax cuts is the poster child of anti-austerity. Congress is debating these anti-austerity measures now, and at this stage, it is difficult to guess what tax policies will change; however, it is reasonable to guess that Congress will work to reduce tax rates and revenues. This is undoubtedly a pro-growth approach that contrasts with the austerity of spending and will presumably generate economic stimulus. However, Congress is by nature a deliberative body, and tax policy takes a while to affect consumer and business behavior.

The challenge with these contrasting policies in the U.S. economy is one of timing. Austerity will drag down growth as soon as the spring of 2025, while anti-austerity will only be positioned to provide stimulus in 2026. Setting aside the private sector economy for the moment, what that might mean for interest rates is that we are chancing a fairly sizable drop in yields in an economic slowdown. Today, 10-year Treasury yields of about 4.20% are already down 0.40% on the year and are beginning to price in a slowdown. While not our base case, if this slowing slides into an outright recession, we can expect a minimum of 1% further Fed rate cuts and yields in the mid-3% area. ■

## A CHOPPY MARCH TO EVENTUALLY HIGHER LEVELS

Gregory M. Drahuschak, Market Strategist

Last month, our hope was for a positive break from the currently mediocre earnings expectations trend. This did not happen. Technical factors suggested potential market weakness could be well contained, but they were not enough to avoid a late-month break that led the S&P 500 to its often-negative result for the month as the S&P and the Nasdaq Composite ended February with their worst weekly results since September of 2024. February was the worst month for the Dow, and the Nasdaq posted its worst month since April 2024.

Table 2: S&P 500 Earnings Expectations

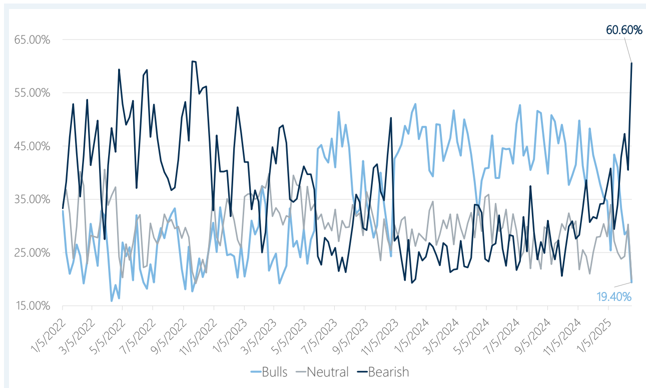
| % Change from Sept. 2024 to Now | |
|---|---|
| Comm Services | -4.6 |
| Discretionary | -8.8 |
| Staples | -5.4 |
| Energy | -14.1 |
| Financials | -2.9 |
| Health Care | -3.5 |
| Industrials | -5.9 |
| Technology | -3.2 |
| Materials | -13.7 |
| Real Estate | -9.5 |
| Utilities | -0.1 |

Source: CFRA — Standard & Poor's; JMS Investment Strategy Group

While February matched its typical lackluster performance, early 2025 results followed the pattern that the stock market often struggles with during the initial month of a new White House administration, as policy uncertainties often overwhelm other factors. With the numerous executive orders issued by the White House, tariff concerns, potential tax changes, and geopolitical considerations provided plenty of uncertainties that weighed on stock prices. On average, however, the S&P 500 is up during the first 100 days of a new administration. So far, the S&P 500 is on track, as it ended February with a 1.24% year-to-date gain.

Earnings for the final quarter of 2024 matched or, in many cases, exceeded expectations. Nonetheless, as February ended, the 2025 consensus earnings estimate had fallen in 11 of the previous 15 weeks. Compared with estimates in mid-September of 2024, through February 28, 2025, the 2025 earnings estimates had fallen for all 11 of the S&P 500 sectors.

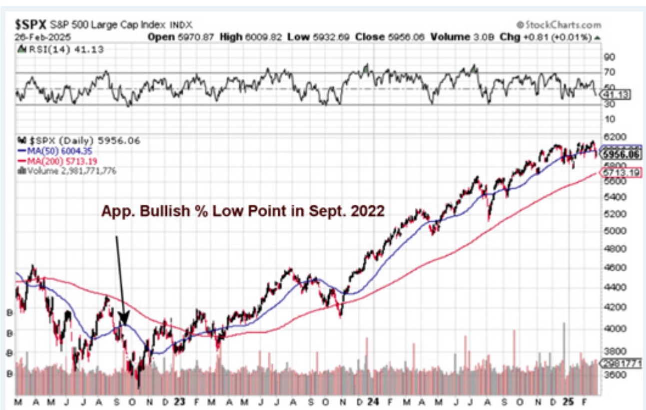
Chart 2: AAII Sentiment Survey — January 2020 to Now




Source: AAII; Janney Investment Strategy Group

After setting an all-time high on February 19, 2025, the S&P 500 succumbed to several news items. A quick sell-off on February 21, prompted by the UnitedHealth (UNH) news and an increasing amount of negative earnings guidance, added to negative sentiment that led to the February 27 survey from the American Association of Individual Investors (AAII) showing the percentage of bullish survey respondents at the lowest level since September 16, 2023, while the bearish percent was the highest since September 9, 2022.

Chart 3: S&P 500 Large Cap Index




Source: Stockcharts.com; Janney Investment Strategy Group

That same day, the S&P headed decidedly lower in fear that the market was discounting a growth slowdown despite the second estimate of fourth-quarter GDP growth matching the 2.3% initial estimate. The market instead focused on the Atlanta Fed's GDP tracker for the first quarter, which fell to -2.8% from 3.9% in early February. Tariff concerns were omnipresent throughout February. These issues and the White House confrontation between

President Trump and Ukraine President Volodymyr Zelenskyy combined to shove the S&P 500 to a year-to-date loss and a break of its technically significant 50-day moving average before rebounding modestly on the final trading day of the month.

Several positives, however, emerged from the late-month disarray.

The S&P slide ended around 5,850, which is a relatively well-established support level. The extremely negative AAII sentiment report immediately brought to mind that extremes like those in the recent report often set the stage for major market upturns not unlike the one experienced the last time the AAII bullish percent was near the current level.

Caesar was victimized by the Ides of March, but in our view, any additional weakness in March will not be a market killer. In fact, investors should react to any weakness or continued volatility this month as a chance to increase equity exposure. ■