Capital Management, Inc.

Special Market Missive

A Series of Self-Inflicted Wounds

March 10, 2025

In our last Weekly Missive of 2024 entitled “An Interesting Economic Parallel,” we enumerated the possible economic policies promised by President Trump. Based on expectations of an emphasis on free market economics, we expected to see another good year for financial markets in 2025. In January, stocks continued increasing before the new president took office. However, once President Trump took charge on the day of his inauguration, he began to implement certain expected changes. Still, they came too fast and too broad, and the changes appeared to be doing more damage than anyone expected, and adjusting to uncertainty became a painful experience.

The initiation of tariffs on many of our trading partners for reasons such as illegal immigration and allowing fentanyl to cross borders triggered a sharp retaliatory response from Canada, Mexico, and China. Threats of tariffs on EU countries elicited similar retaliations. As these “tariff games” were on again/off again, companies’ uncertainty increased. Plans to expand were put on hold due to what would happen. Economic growth models such as GDPNow from the Federal Reserve Bank of Atlanta went from a first quarter growth forecast of 3.9% in January to a -2.4% in March, a swing of 6.3% in two months! President Trump’s comment over the weekend theorizing about the possibility of a recession added fuel to the fire and equity markets responded negatively to the deteriorating economic situation. In such circumstances, market volatility increases due to speculative investors who use various means to sell stocks or who use other derivatives that undermine decisions by legitimate investors.

In addition to the impact of the tariffs, the rapidity of decisions by President Trump on major changes in the federal bureaucracy, i.e., the massive dismissal of employees and cancellation of many spending plans, was likely to have a depressing impact on the economy. As furloughed employees must search for new employment, they will likely curtail their spending, undermining the businesses that served them. The economy should have been able to handle such changes if they were implemented over long periods of time, but this “earthquake approach” may cause further transition problems.

During all this uncertainty, markets have a way of communicating the idea that new economic policies are not working. In 2020, during the onset of the COVID crisis, the stock market plummeted due mainly to the government’s decision to shut down the economy. Once it was clear that the decision was wrong, as reflected in financial market performance, the policies were reversed, and the government injected liquidity into the system. The market recovered sharply, and by year-end, equities had a gain for the year.

Our economy and financial markets are responding to new economic policies, which are increasing uncertainty and leading to turmoil. As in the past, such self-inflicted wounds are healed through decisions that restore investor and business confidence.

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