ARGUS ECONOMIC COMMENTARY

March 10, 2025

Flip-Flop February: Our Monthly Survey of the Economy, Interest Rates, and Stocks

Leadership in the U.S. stock market flipped in February, with several growth sectors and some leading indices swinging to negative for the year to date. A variety of factors contributed to this dramatic shift. Sector rotation has been underway since early 2024 and intensified in last year's second half. After two years of AI euphoria, the arrival of DeepSeek and threats from other low-cost alternatives prompted investors to cash-out winnings in AI names and other technology adjacencies.

New policies from the new U.S. administration have contributed to market uncertainty. Fear of tariffs, the highly uncertain Ukraine situation, and DOGE job cuts are causing some equity investors to move to the sidelines and/or shift into bonds. Rising safe-haven demand for Treasuries is pushing down yields, raising the attractiveness of equity income sectors such as Real Estate and Utilities. Financial, Healthcare, Materials, Energy, and even Consumer Staples are all outperforming the long-term growth leaders (Information Technology, Communication Services, and Consumer Discretionary).

The GDPNow forecast for 1Q25 GDP has swung to negative 2.8% as of the beginning of March after being positive 3.9% just a month ago. Pre-buying ahead of imported goods ahead of tariffs and cautious consumer spending after the holiday splurge caused the flip-flop in GDP outlook. We think it is too soon to throw in the towel on 1Q25 GDP, but the environment is certainly dynamic.

The Economy, Interest Rates, and Earnings

The U.S. economy delivered below-consensus GDP growth in the fourth quarter, but still wrapped a solid 2024 year with high 2% growth for a second straight year.

The preliminary (second) report of fourth-quarter GDP confirmed growth of 2.3%, in line with the advance (first) report and a step down from 3.1% growth in 3Q24. Fourth-quarter 2024 GDP reflected ongoing growth in consumer expenditures and government spending, partly offset by a decrease in investments. Imports, which are a subtraction in the calculation of GDP, decreased quarter over quarter.

Normally, fourth-quarter GDP would provide a window on what to expect from the economy in the first quarter. The policies of the second Trump administration represent a major change from those of the Biden administration, lessening the likelihood of clear continuity. Analysis of full-year 2024 may indicate some of the longer-term trends that could influence the U.S. economy in the year ahead.

For all of 2024, U.S. GDP grew to $29.2 trillion from $28.3 trillion at the end of 2023. The consumer remains the biggest growth driver. Personal consumption expenditures (PCE) for 2024 increased 2.8%, up from 2.5% for all of 2023. Fourth-quarter PCE of 4.2% was the strongest in any quarter of 2024. Full-year 2024 spending on goods increased 2.4% versus 1.9% in 2023. Durable goods spending rose 3.3% in 2024, down from 3.9% for all of 2023. Nondurable goods spending rose 1.9% for 2024, more than double the 0.8% growth in nondurables spending in 2023.

Spending on services was steady, with growth of 3.0% in 2024 edging up from 2.9% in 2023. Some of the growth in consumer services spending has been driven by rent equivalent, insurance, and other costs that consumers cannot control and many cannot avoid. Although services inflation has been more stubborn than goods inflation, tariffs can have an unpredictable impact on goods prices.

Full-year 2024 consumer spending growth reflects a subpar first quarter, rising spending in the second and third

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quarters, and a strong fourth-quarter finish. Consumers appear to be adapting to inflation stuck just above the Fed's 2% target resulting in structurally higher prices. We expect PCE within the GDP accounts to continue to send conflicting signals in 2025, while remaining in the 2%-3% range.

Nonresidential fixed investment, the proxy for corporate capital spending, rose at a 3.6% annual rate in 2024; this category grew at a 6.0% rate in 2023. PCE and nonresidential fixed investment represent about four-fifths of gross domestic product. In 2024, consumer spending added 1.87 percentage point to GDP, while nonresidential fixed investment added 0.49 percentage point.

Residential fixed investment was somehow positive in 2024, rising 4.2%, as double-digit growth in 1Q24 and surprising 5.4% growth in 4Q24 bracketed negative readings in the middle quarters. With the timing of any further Fed rate cuts uncertain, the housing sector is more likely to recover in fits and starts than to burst into healthy growth. Long Treasury yields near 4.23% are now at 2025 lows, but remain well above September 2024 lows in the 3.6% range; 30-year mortgage rates are still too high around 6.7%. Offsetting rate pressure is intense pent-up demand for home ownership.

Exports grew 3.2% in 2024, and imports rose 5.4%. Although the export-import balance favored imports in 2024, both categories were negative in 4Q24. We expect volatility in this category to intensify quarter over quarter as U.S. tariffs are enacted as proposed and trading partners react in kind.

Another volatile category, the change in private inventories, added seven basis points to 2024 GDP after subtracting 41 basis points in 2023 during the supply-chain crisis. Inventories have normalized, and disruptions to the supply chain have mainly receded.

Overall government spending was up 3.4% in 2024 and added 57 basis points to 2024 GDP growth. Federal spending was up 2.6% last year, while state and local government spending grew 3.9%.

The price index for gross domestic purchases increased 2.4% for all of 2024, compared with a revised increase of 2.9% in 2023. In addition, the PCE Price Index advanced 2.5%, down from 3.8% in 2023. GDP growth with lower price increases gives the Fed room to cut rates going forward.

With February complete, economists and strategists can now parse January 2025 data. The economic picture is mixed. Sentiment indicators across consumers, small businesses, and large company purchasing managers suggest a mix of optimism due to pending de-regulation and concern that tariffs will reignite inflation.

The consumer economy continues to send mixed signals. Jobs and wages are still growing, albeit at a slower pace. The U.S. economy generated 143,000 new jobs in January, below the consensus call of 170,000. Both December and November 2024 were revised higher, and three-month average jobs growth of 237,000 jumped above the full-year 2024 average of 166,000; the 2023 average gain was 251,000 new jobs per month.

Multiple indicators of the employment economy -- including the unemployment rate, wage growth, and the average work week -- remained healthy in the first month of 2025. The unemployment rate dropped to 4.0% in January 2025 from 4.1% in December 2024 and 4.2% for November. Economists characterize the U.S. employment economy as being in a "low-fire, low-hire" phase. Average hourly earnings grew at 4.1% annually in January. Annual wage growth continues to run above inflation, but the premium has narrowed.

Industrial production moderated in January to 0.5% growth after ending 2024 on a strong note with a 1.0% rise in December. All the strength in January came from Utilities, however, with output rising 7.2% in response to frigid weather nationwide. Manufacturing production ticked 0.1% lower in January 2025. For all of 2024, industrial production increased 0.5% -- also led by Utilities output. Manufacturing activity in 2024 was flat with that in 2023. Capacity utilization of 77.8% for January 2025 ticked up from 77.5% in December, but remained 1.8 percentage points below the long-run average.

The NFIB's Small Business Optimism Index reached a six-year high of 105.1 in December 2024 in anticipation of a change to a more business-friendly administration. That optimism was dented somewhat in January 2025 as the index fell to 102.8. The uncertainty index rose 14 points to 100, the highest reading on record. Small business owners cited difficulty in finding and hiring skilled workers to fill open positions; and fewer owners are planning capital investments in the next few months.

While owners of small businesses remain optimistic, consumers appear increasingly concerned that tariffs could cause an uptick in inflation. The University of Michigan Consumer Sentiment Index fell to 64.7% in February 2025 from 71.1% in January 2025. The survey was down 12.2 percentage points from 76.9 in February 2024. All five index components deteriorated, including s 19% plunge in buying conditions on fears that tariff-induced price hikes are imminent.

Retail sales fell 0.9% in January 2025 from December 2024, while rising 4.2% annually from January 2024. Sales data reflected pronounced weakness vehicles & parts and leisure goods; spending grew at general merchandise stores and at food services establishments.

Consumers appear to have closed their wallets in January on inflation fears, not because they had to. Personal Income rose 0.9% in January 2025, strengthening from late-year 20204 data. Personal consumption expenditures

(PCE) fell 0.2% in January after rising 0.7% in December and 0.4% in November.

In the months preceding the Fed's first rate cut of the cycle in September, optimism returned to the long-depressed housing industry. Market interest rates came down to multi-month lows following the September rate cut, spiked higher into 2024 year-end, and have since moved lower on safe-haven bond buying amid policy uncertainty. The effect of lower rates on housing will be positive. But current 30-year mortgage levels above 6.5% will not move the needle much given the large number of homes with no mortgage or mortgages below 4%. Until rates move a point or two lower, Argus is not looking for a meaningful recovery in housing activity.

The Atlanta Fed's GDPNow model had a whipsaw response to the early January data. From a bold 3.9% growth forecast for 1Q25 GDP issued early in February, GDPNow as of early March is forecasting a 2.8% decline in first-quarter GDP. The shift in outlook from positive to negative reflects the decline in January PCE (consumer spending) and a surge in imports as companies pre-buy overseas goods in anticipation of tariffs.

We believe it is too soon to predict negative 1Q25 GDP based on one month's data, but the prediction shift certainly bears monitoring. Argus' Chief Economist Chris Graja, CFA, is modeling GDP growth of 2.3% for 2025, up from an earlier 2.1% forecast. Growth is likely to moderate but remain positive near the low-2% level in 2026.

The Federal Reserve raised interest rates more than five percentage points between March 2022 and July 2023. After holding rates steady for eight straight meetings, the Fed at its mid-September 2024 FOMC meeting cut interest rates by 50 basis points. The central bank then cut the fed funds rate by 25 basis points each at its November and December FOMC meetings.

Following the September meeting, investors were giddy about prospects for a total two to three percentage points in future cuts. But inflation data refused to cooperate, actually ticking higher as the year wound down. The December meeting was accompanied by a statement suggesting that the pace of any future rate cuts would likely be pushed back in 2025. In January 2025, the FOMC met again and, as expected, took no action. Fed Chair Jerome Powell in post-meeting commentary stated that that the Fed "was in no hurry" enact any further rate cuts that it might decide to hold rates at current levels across 2025.

Where the Fed goes from here may require further progress on inflation, which is stubbornly stalled a half-point to 1.5 points above the Fed's 2% target range. The Fed is cognizant that tariffs historically are associated with higher goods price. Were inflation to rise from current levels, we believe this Fed would not hesitate to return to more restrictive monetary policy (i.e., start raising rates again).

CPI rose 0.5% in January 2025 and was up 3.0% from January 2024; both the monthly and annual readings ticked 0.1% higher from December 2024 levels of 0.4% and 2.9%, respectively. The Fed's preferred inflation gauge, the core PCE price index, rose 0.3% in January, up from 0.2% in December. This metric was up 2.6% year over year in January, down from 2.9% (revised) in December. The annual change has moved little from 2.7% in July 2024.

Bond yields hit multi-month lows following the Fed's September rate cuts, moved higher on inflation concerns mixed with economic optimism following the election, and recently have come down as inflation fears drive safe-haven investing. Both middle-maturity and long-maturity yields are at or near 2025 lows.

The 10-year Treasury yield was 4.23% as of the end of February 2025, compared with 4.58% as of the end of January 2025. The long yield reached a low of 3.75% as of September 2024, while the cycle peak for the 10-year yield was around 4.9% in October 2023. The two-year Treasury yield was 3.99% as of the end of January 2025, versus 4.22% as of the end of January 2025. The two-year yield reached a cycle low of 3.55% in September 2024; the peak level was 5.2% as of October 2023.

Notwithstanding current noise in the market, Argus expects short-term yields to move lower from current levels. Long yields over time are expected to widen their relative premium to short yields. We likely have seen the end to twos-10s inversion in this cycle, although the three-month yield was above the long yield at the end of February.

With the Fed in "no hurry" to cut interest rates further, Argus Fixed Income Strategist Kevin Heal is now modeling two additional quarter-point cuts in 2025; as of year-end 2024, he had been looking for three quarter-point cuts. Two cuts in 2025 would bring the central tendency in fed funds to 3.75%-4.0% by December 2025. Argus also acknowledges the possibility that the Fed holds rates unchanged in 2025, as it continues to monitor the economy, employment, and inflation.

Following a successful 3Q24 EPS season, we increased our forecasts for S&P 500 earnings from continuing operations for 2025 and 2026. For 2025, we raised our forecast for S&P 500 earnings from continuing operations to $276, from $265. Our revised forecast models full-year EPS growth of 12%. For 2026, we raised our forecast for S&P 500 earnings from continuing operations to $307, from a preliminary outlook in the high low $290s range. Our revised forecast models full-year EPS growth of 11%. We will revisit our 2025 and 2026 EPS forecasts when the 4Q24 EPS season is in the books, but are unlikely at this time to make major changes in our forecasts.

The 4Q24 EPS season has wound down except for the usual stragglers in retail and technology. With over 95% of companies having reported results as of the end of February,

calendar fourth-quarter 2024 earnings from continuing operations are up in mid-teen percentages from 4Q23. Of the companies reporting positive growth year over year, more than 75% have reported earnings ahead of consensus expectations. The average earnings “surprise” for these companies is about 7%. By comparison, the average EPS beat against quarterly expectations has been in the 8%-9% range over the past five years and in the 6%-7% range over the past 10 years.

The best EPS growth sectors for 4Q24 have been Financial and Communication Services. All sectors posted positive earnings growth with the exception of Energy, which experienced a 30% EPS decline. Notably, the net profit margin climbed to 12.6% for 4Q24 from 12.2% for 3Q24, while remaining comfortably above the multi-year average in the 11%-12% range.

For all of 2025 at the sector level, the key growth drivers are likely to be accelerating growth in Healthcare earnings; and improved performance from the three sectors (Energy, Materials and Industrial) that dragged on 2024 earnings. Energy could generate positive comparisons beginning in 2Q25, but may have to wait for 2H25, depending on product pricing. Return to sustained growth momentum for the commodity-sensitive Energy and Materials sectors also is dependent on success of the Chinese government’s stimulus program. Tariffs are another wild card.

Other sectors are forecast to hold onto their current strong growth rates for the next year or more. Information Technology is forecast to sustain double-digit EPS growth in the mid- to high-teen percentages through 2026. Utilities growth is forecast to moderate slightly, while remaining above long-term average, aided by AI data center demand for electricity. Other sectors forecast to grow EPS above their long-term averages include Financial, Healthcare, Consumer Discretionary, and Consumer Staples.

For 2026, we look for a continuation of the above-average growth assumptions in our 2025 forecast, while moderating the overall growth outlook slightly. We expect the AI transformation to continue to drive growth in Communication Services, Information Technology, and Consumer Discretionary. We look for growth to slow in defensive sectors, but potentially to pick up in Energy.

Domestic and Global Markets

In the final two months of 2024, the stock market rallied in November on the election outcome and fell in December due to the more cautious Fed tone. Underneath the surface, the ongoing rotation away from growth and AI and toward everything else continued at the index level. Two months into 2025, market leadership has flipped on its head.

At the end of February 2025, the Dow Jones Industrial Average led among the three major indices with a 3.3% year-to-date gain. The S&P 500 hung onto a 1.4% gain after losing half of its January gain. And the Nasdaq Composite was down 2.3% at February-end after being up 1.7% at the end of January.

Another reversal has the Wilshire Large Cap Growth down 3.0% as of February-end, versus a positive 3.0% return for Wilshire Large Cap Value. The Russell 2000 is down 2.9% year to date, even though these smaller, domestic-facing companies are expected to be less impacted by tariffs.

The Barclays Bloomberg U.S. Bond Index, which finished 2024 with just a 0.9% gain, was up 2.3% year to date as of the end of February. Bond returns bounced around all through 2024, and there is no reason to assume they will be stable in 2025. Whereas the past three years were dominated by monetary policy, fiscal policy could have an outsized impact in 2025.

The traditional growth sectors (Communication Services, Information Technology, Consumer Discretionary) fared poorly in February and are struggling year to date. Communication Services is holding onto a 2% gain, down from 9% at January-end; and Consumer Discretionary is down 5.4% after being up 4.4% after 2025’s first month. Information Technology declined in both January and February and is down about 4% year to date. Selling has broadened from the AI sector to nearly every technology niche, including software, computing, and semiconductors.

The rotation toward new favorite sectors includes a pivot toward Healthcare, which is up 8.4% year to date and currently is the best sector. Financial is in second place with an 8.0% gain following a highly positive 4Q24 earnings season. Consumer Staples has become a safe-haven favorite and is up just under 8%. Materials and Energy are bouncing back on de-regulation hopes and the “drill baby drill” mantra from Donald Trump.

Perceived beneficiaries of a lower interest-rate environment are rallying as tariff and inflation fears drive investors out of equities and into bonds. Real Estate and Utilities are both up in the 5%-6% range.

The clear takeaway from the 2024 sector map is impressive breadth, and we continue to believe better breadth bodes well for 2025. Sector rotation also carries risks, however, particularly if it gets too intense. If 2025 features negative performances from the three growth sectors -- which collectively represent about 50% of total market weight -- the overall stock market may struggle in 2025.

During the second half of 2024, the sector rotation into cyclical, interest rates sensitive and defensive names intensified. After the Fed warned of a slower pace of rate cuts in 2025 and the Trump administration floated new tariffs, investors in January 2025 took profits in stocks that appreciated the most in the past two years. The sector rotation reached a new level of intensity in February, resulting in meaningful shifts in sector weights.

Consistent with the relative shifts in sector performance during February, a range of sectors with interest-rate sensitivity, defensive characteristics, and cyclical sensitivity gained weight during February 2025. These include Consumer Staples, Financial, Healthcare, Energy, and the "Little Three" (Materials, Utilities, and Real Estate). Those gains were mainly at the expense of growth sectors including Communication Services, which shed 40 basis points of weight from 9.9% at the end of January, and Consumer Discretionary, which declined by 90 basis points from an 11.4% weighting at end of January.

The biggest of the growth sectors, Information Technology, fell to a 30.7% weighting at end of January from 32.5% at the end of 2024. Information Technology held its 30.7% weighting in February as investors rotated in-sector from AI leaders to "old tech" such as IBM, Cisco, and Corning. Awareness of China's DeepSeek has ignited fears that expensive AI large language models might be overpriced.

We believe the healthy rotation toward rate-sensitive, defensive, and cyclical categories will continue in 2025. We also look for 2025 to be a "show me" year for growth sectors, where companies must prove they are able to deploy AI and also monetize it.

Like the U.S. market, global stocks did better in 2023 than they did in 2022; and most carried that momentum across 2024. Our composite of global bourses rose about 10% in 2024. In 2025, leadership remains intact among mature economies. Some of the worst markets in 2024, such as Mexico, are doing better in 2025. Conversely, some of 2024's winners, such as India, are struggling in 2025

During 2024, Chinese stocks surged on that country's announced stimulus program, the largest since the pandemic era. China is up about 13% year to date. Yet that gain somehow seems tentative while the world waits to see the impacts of export bans and tariffs.

In terms of our themes, mature economies and resources economies tied for the lead in 2025 with a 3.7% gain; the mature economies theme led in 2024 and 2023. Americas markets were up 3.1% at February-end after rising just 6.3% in 2024. BRICs-minus-Russia are up 2.3% year to date after rising 4.2% in 2024.

Conclusion

The stock market is juggling multiple concerns, while also anticipating some positives in a fast-formulating environment. We are concerned that consumer have little excess spending capacity given multiple years of inflation; and that these consumers, particularly those in the lower tiers of the economy, will stage a "buyers' strike" should tariffs lift prices meaningfully.

For the past three years, investors have been attuned to monetary policy. We continue to anticipate a shift in market focus this year to fiscal policy. The new U.S. administration is pledging further tax cuts, and they will either be incorporated into the new budget bill or addressed soon after.

Other promised policies, including widespread job cuts and massive deportations, carry risks of economic turbulence and reawakened inflation. The actual policies that the administration will put before a friendly Congress are still coalescing.

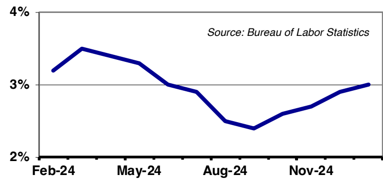
Amid policy uncertainty, the outlook for the economy and for corporate earnings is still solid. Employment and earnings growth remain bright spots, and even slowing 4Q24 GDP growth (relative to 3Q24) was positive at 2.3%.

The clear takeaway from the 2024 sector map is impressive breadth -- and based on February trends, we continue to believe better breadth bodes well for 2025. Markets with good breadth would tend to be more durable and better positioned to withstand adverse news than thin and narrowly led markets. Conversely, if growth does not lead the market in 2025, it is hard to envision the S&P 500 advancing 20%-plus for a third straight year.

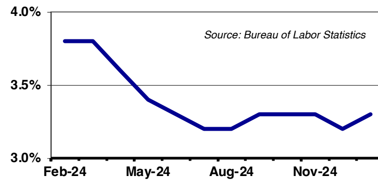
Jim Kelleher, CFA,
Director of Research

ECONOMIC TRADING CALENDAR

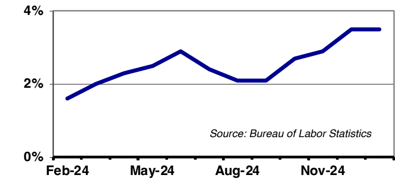
Release: **Consumer Price Index**
Date: 3/12/2025
Month: February
Previous Report: 3.0%
Argus Estimate: 2.9%
Street Estimate: 3.0%



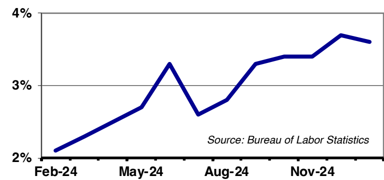
Release: **CPI ex-Food & Energy**
Date: 3/12/2025
Month: February
Previous Report: 3.3%
Argus Estimate: 3.2%
Street Estimate: 3.2%



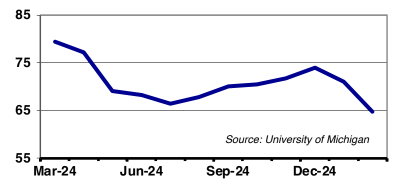
Release: **PPI Final Demand**
Date: 3/13/2025
Month: February
Previous Report: 3.5%
Argus Estimate: 3.6%
Street Estimate: NA



Release: **PPI ex-Food & Energy**
Date: 3/13/2025
Month: February
Previous Report: 3.6%
Argus Estimate: 3.7%
Street Estimate: NA



Release: **U. of Michigan Sentiment**
Date: 3/14/2025
Month: March
Previous Report: 64.7
Argus Estimate: 63.5
Street Estimate: 65.0



Previous Week's Releases and Next Week's Releases on next page.

Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
3-Mar	ISM Manufacturing	February	50.9	50.0	50.5	**50.3**
	ISM New Orders	February	55.1	54.0	NA	**48.6**
	Construction Spending	January	**4.5%**	3.5%	NA	**3.3%**
5-Mar	ISM Services Index	February	52.8	52.0	53.0	NA
	Factory Orders	January	-1.1%	1.6%	NA	NA
6-Mar	Trade Balance	January	-98.4 Bln.	-85.0 Bln.	-91.3 Bln.	NA
	Wholesale Inventories	January	-0.1%	0.3%	NA	NA
	Total Vehicle Sales	February	15.6 mln.	16.4 mln.	16.0 mln.	NA
7-Mar	Nonfarm Payrolls	February	143 K	150 K	155 K	NA
	Unemployment Rate	February	4.0%	4.1%	4.0%	NA
	Average Weekly Hours	February	34.1	34.2	34.2	NA
	Average Hourly Earnings	February	4.1%	4.0%	NA	NA

Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
17-Mar	Retail Sales	February	4.2%	NA	NA	NA
	Retail Sales ex-autos	February	3.7%	NA	NA	NA
	Business Inventories	January	2.0%	NA	NA	NA
18-Mar	Industrial Production	February	2.0%	NA	NA	NA
	Capacity Utilization	February	77.8%	NA	NA	NA
	Housing Starts	February	1,366K	NA	NA	NA
	Import Price Index	February	1.9%	NA	NA	NA
20-Mar	Existing Home Sales	February	4.08 Mln.	NA	NA	NA
	Leading Index	February	-0.3%	NA	NA	NA

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