



## A Week of Whiplash: What's Behind the Market's Mood Swings?

KATHY JONES: I'm Kathy Jones.

LIZ ANN SONERS: And I'm Liz Ann Sonders.

KATHY: And this is *On Investing*, an original podcast from Charles Schwab. Each week we analyze what's happening in the markets and discuss how it might affect your investments.

Well, hello, Liz Ann. Lots of headlines to discuss again this week. Some of them revolve around tariffs and, of course, Greenland. What do you make of what's going on in this latest round of international affairs?

LIZ ANN: You know, it reminded me a bit of the first week in April of last year when there was certainly anticipation of the so-called Liberation Day announcement of tariffs, but prior to the actual announcement, it was a somewhat benign assumption about what would be announced. And what we actually got was much more significant, and markets went into a tailspin, and it was the trifecta of weaker equity market, bond yields spiking, which meant bond prices going down, and the dollar going down. And we had that a bit yesterday exacerbated by what happened to Japanese bond yields as well. And I'm going to turn back to you in a second for your thoughts on that.

But as we're taping this, it's the day after that tumultuous day that was the initial reaction, and we're seeing a bit of a rebound. I think the reaction, again, was a combination of the trifecta of market weakness and the fact that the trade war is back in the spotlight and more meat being put on the bones of what this is likely to mean, not just to the U.S. economy but European economies.

I'm going to go off on a slight sidebar here, now that tariffs are back in the spotlight. I did an event last week, and it was a with a relatively senior person and who was the moderator, and I made the off-handed comment about notwithstanding the headlines ... you've heard me say this a million times, "Notwithstanding the headlines of tariffs on ... European Union or tariffs on China, tariffs on Canada," fill in the blank of the country, the tariff is paid for by the U.S. company. And there have been recent studies that have been done, including recently published in *The Wall Street Journal* about the fact that the adjustment by exporters to sort of offer an offset to U.S. companies that are importing goods from their countries accounts for, at best, 4%. And that means that 96% of the costs of tariffs are being borne by the combination of companies, if they are eating it in their business and eating it in their profit margins, and consumers, via the pass-through from companies to consumers.

So I think we're now facing another escalation of a trade war in an environment where there seems to be at least some broader knowledge of who takes the hit when it comes to these trade wars. So that may be a component of why we saw a market weakness.

The other interesting thing is, yet again, we saw a surge in precious metals. So you know, prior to the early action this week that was pretty tumultuous, I was getting a lot of questions around "Why do think the market has been so calm and basically is ignoring all these geopolitical concerns?" Whether it was Venezuela, more recently Greenland, now a relaunching of a trade war with the European Union, and my response was, "Well, we may not be seeing it directly yet in terms of equity market weakness and or volatility, but the continued surge into asset classes like gold and silver has sort of been, for lack of a better word, the play by investors." And that's where the momentum has been. And this is still a very momentum-driven market.

We've historically thought of momentum as generically areas like high beta and tech within the equity market, but momentum can be in anything. In this case, it's in those perceived safe havens that are precious metals and, you know, on a day like today, as we're taping this, where you see a little bit of a rebound, I think that also reflects that, at least among the retail traders, which have become such a powerful cohort driving a significant amount of daily trading volume, they're still believers in the combination of "buy the dip," the so-called TACO trade, which stands for "Trump always chickens out."

Thinking back to what happened on April 9 in the aftermath of the turmoil that was unleashed on April 2, where the decision was made on the part of the administration to delay by 90 days the tariffs, and the market took off like a rocket-ship. So I think there's the muscle memory of that that sort of reinforces the notion of "buy the dip" is the right move. Whether that can persist on an ongoing basis, I don't know. I think it was last episode you and I talked about a bit of complacency. And I know you felt that in the bond market. So I'll turn it back to you on your reaction to what happened in the bond market on that difficult day, which as we will launch this episode was, I guess, three days prior. I always want to put individual days in the context of when people will be listening to you and I ramble on here.

KATHY: Yeah, I think it's as you mentioned kind of the combination of what is happening in Japan, Japan's bond market, and the unsettling nature of this whole Greenland discussion and the potential for some sort of conflict with the European Union on trade. So just to sort of back up, in Japan, you know, there's a new prime minister. Her policies include increasing fiscal spending at a time when inflation is near 3%. So she's advocated also a weaker currency to help stimulate export growth. So very pro-growth kind of policies at a time when inflation is the highest level in Japan it's been in decades. Meanwhile, the Bank of Japan, over the last couple of years, has been trying to normalize its policy after decades of holding down yields by holding the majority of the government bonds.

So you know, Japan has by far the highest debt-to-GDP ratio in any major developed country at about 230%. So you have a combination of the central bank taking its foot off the break and saying, "OK, we're going to let these bond yields rise." And then you have the prospect of higher inflation and higher fiscal deficits. And that's just sending yields higher there. And the significance of that to the rest of the world is Japan's market has been something of an anchor in the global bond market. Because yields were so low for so long, Japanese investors were eager buyers of other government bonds, especially U.S. Treasuries.

So the idea is if they're going to repatriate their dollars because their domestic yields are rising relative to everyone else, then that removes that anchor, and it allows all the yields to rise in the major developed countries. You know, and then we get the uproar over Greenland and what does it mean? Are we now entering a trade war with our closest allies at the European Union? Hard to say how that's going to play out. But it definitely was unsettling because, again, you have a lot of buyers of U.S. Treasuries and U.S. dollars in European institutions, and in fact there was one Danish insurance company I think that came out and said, "Well, I'm going to sell all my Treasuries now."

So you have a situation where everything's sort of coming again as it did last April, to a head. So we've got the prospects of inflation here still stuck kind of close to 3%. You have the potential weakening of Fed independence. We're going into the hearings about Lisa Cook, and we'll see where that goes, whether the administration's able to remove someone from the Fed. We have higher fiscal deficits in the U.S. due to One Big Beautiful Bill. And then the market's queasy about international developments. So frankly, as we mentioned last week, it just seemed the market was too complacent.

And we did see the dollar sell off somewhat as well. I think it's an exaggeration to say this is a "sell U.S." kind of market in the long run. It's just really hard to replace U.S. Treasuries and U.S. dollars in a global financial system. But as you mentioned, people are going into things like gold as an alternative. So I think that that's kind of the play that we're in right now. We'll have to see how it all turns out, that these policies move through time very quickly, I think, as we saw last April. So it may be, again, some sort of reversal or some sort of calming comes into the market. But I am not surprised. I guess I'm only surprised that it took so long for the dollar and the bond market to kind of catch on and say, "Hey, things are a little unsettled right now." I think we're in for a stretch of kind of volatility and a bit of a rough time in the markets until we get ... again waiting for clarity.

Liz Ann, one question I want to ask you is about stock market volatility. You know, we start ... I'm sure, as I have gotten a flood of inquiries about what's going on in the market and how to manage through it. I'm sure you've gotten plenty of client calls about, "OK, now what do I do?" If I'm a trader, you might have some ideas of how to trade it, it might be welcome, but for a long-term investor, somebody that's retired, what do you have in mind for what those types of investors should be thinking about?

LIZ ANN: I guess I'd start with what is for the most part our bread and butter, our bailiwick, which are longer-term investors that take a very disciplined approach, or we at least hope they take a disciplined approach. And one of the messages that we often share is that, you know, volatility is just part and parcel of this thing that is investing, and it's really kind of the price of admission for long-term returns. Now, you tend to get volatility spikes, and then it ... generally they ease fairly quickly. So they often show up as sort of quick temporary drawdowns, or they come in conjunction with not kind of permanent loss.

And we know that equity returns are historically lumpy. They can come in short bursts. In fact, what we often remind people if we get a really extreme up day in the market or really extreme down day in the market, historically, they often come somewhat back-to-back. Some of the biggest up days have often followed within a few days if not the day after some of the weakest days and vice versa. And I think, for long-term investors, a spike in volatility should not be a signal to trade.

And one of the sort of action items we've been suggesting during periods of volatility, to the extent you can manage it, for tax implication reasons, other turnover reasons, is volatility can often present itself as an opportunity to rebalance. So I would say the "re-" word that is applicable for long-term investors to volatility is don't react but consider rebalancing.

So I call it volatility-based rebalancing, where more quickly your portfolio might get out of whack. Certain asset classes become larger as a share of your portfolio than whatever your strategic asset allocation might be and vice versa in underperforming assets. And it's sort of a quick way we can force ourselves to do some rebalancing, which is a version of buy low, sell high, and add low, trim high.

Now, in terms of more active traders—the retail traders we often call the cohort—for the most part, they like volatility. It's hard to have a trading edge without pops in volatility, and it kind of widens ranges. It does, in the mindset of lot of traders, kind of improves the risk-reward balance, but it also can raise the cost of making a mistake. And that's why you want to be mindful of sort of overconfidence and leverage. Because I think that's what gets punished, when you have these periods of volatility, is either complacency, as we already touched on, or more extreme overconfidence. And I think you still, even as a trader, you still want to apply those disciplines. Maybe not long-term strategic asset allocation disciplines, which we talked about with regard to long-term investors, but I think even trading disciplines need to be applied when volatility spikes.

And then you've got, more in sort of your world, the income-oriented investors that are maybe living off the gains from their portfolio or living off the income associated with it. So that we just need to be mindful of not reacting in particular and avoid forced selling during downturns, maintain that discipline and really maybe focus on having asset classes in your portfolio that tend to either be somewhat protected during higher volatile periods or actually represent a bit of an opportunity.

So that can be done at the asset class level. That can be done at the factor level. But I think that we sometimes conflate volatility and risk. I mean, again, volatility is sort of the price of admission. It's just a natural part of markets, more so in the equity side of things than the fixed income side of things, although fixed income volatility has had some ripper of periods. But it just means variability of outcomes, where I think true risk is about sort of impairment on a longer-term basis. But again, I'd go back to sort of react versus rebalance. And I think rebalance is the right way to approach and a way to take advantage of volatility.

KATHY: Yeah, and I would say fixed income can be quite volatile from time to time. But I think one thing people have to think about when they are traders in particular, but even long-term investors, is sizing the position correctly so you can tolerate these swings. Oftentimes, the stock market's had this huge run, right? And people are overweight certain stocks and they don't realize that they have now expanded their exposure to one or two stocks or one or two categories. And suddenly, when markets get volatile, you're looking at a drawdown you hadn't really imagined could happen because you hadn't really thought that your allocation was that big. And I think sizing positions, whether you're a short-term trader or whether you're a long-term investor, and making sure that that's intact with what you can handle from a risk point of view is really an important lesson. But I feel like we have to learn these lessons over and over again.

LIZ ANN: We do, and that's part of our job is to remind people. You know, sometimes the tried-and-true disciplines, diversification and rebalancing, are not the most exciting things to talk about, especially when there's so much else to talk about and that seems to capture headlines and kind of the mind share of investors, but the reality is it is those tried-and-true disciplines. They might not be as interesting to talk about, but we always take advantage of periods of volatility to talk about the what and the why and the how, but also remind people that ultimately we have to come back to those traditional disciplines.

Speaking of the bond market and volatility, I saw that you and our colleague Collin Martin published an article on Schwab.com about some potential pitfalls in the bond market this year in 2026. So do you want to give us a few highlights from that most recent publication?

KATHY: Yeah, I'll just summarize it real quickly because it's pretty easy to go on schwab.com/learn and find it. So we, you know, we had done, like as you have, our outlook for 2026, and it's a fairly benign outlook. We expect positive

returns, but not as great as last year in the fixed income markets. But as we sat down to kind of start the year, we looked at that and said, "You know, we should really discuss the risk to the outlook," because there is so much volatility. And it's always good to be kind of aware. We don't want to overemphasize risk, but we do want to make sure that people are aware of what the risk to the outlook is if we end up having to change our minds about our expectations.

So just quickly in summary, inflation surprises in either direction can certainly move the bond market. And we'll have to wait and see how it all plays out, but it's stuck, again, between 2.5% and 3%. If it were suddenly to tick up, for a variety of reasons, like expansive fiscal policy, a weaker dollar, you know, there are things that could drive inflation higher. I think that would take the market a lot by surprise. Inflation coming down would be a welcome surprise. I think there's a potential for that, but probably less disruptive outcome than if inflation goes up then down more than expected.

The second is changes at the Fed. We've got a lot of drama around the Fed and rotation, who will be the next Fed chair, whether or not the administration can succeed in removing people from the Fed. All of that can weigh on the market, the bond market, because of uncertainty about where policy goes from here. And that can cause some disruptions in the market. So it's something we're keeping an eye on.

And then the last would be some sort of unforeseen credit event. Again, we don't really see a lot of cracks in the market, but there is a risk perhaps that there's some buried bodies out there—that happens from time to time—or something emanating from private credit, because we have a lot less transparency there. If that were to affect a major institution in one way or another, that could be a credit event that the market's just not priced for. So not to emphasize the negative, but just to emphasize we come up with expectations of forecasts, but there are lots of risks around those forecasts. And we do review it periodically and say, "Should we change our minds about what we expect for the coming year?" And so that was kind of the idea behind that, behind that publication.

So Liz Ann, looking ahead to next week, we've got the FOMC meeting, that is the Federal Open Markets Committee meeting, where they're likely not cut rates, but what else is on your radar?

LIZ ANN: Yeah, I agree. I think there's little likelihood that the Fed cuts rates. I think that they've kind of put themselves in a timeout like they did about a year ago after starting an easing cycle that then they paused for quite a few months. So I think that is probably the easiest bet at this point.

In terms of data, GDP comes out for the fourth quarter, and that is obviously a backward-looking number. It's highly subject to revision, doesn't tend really to be a big market mover. But what's interesting now is that there's a well-watched metric put out by the Atlanta Fed called GDPNow. New York Fed has a version of it that they call their NowCast. And the use of the word "now" within the title of these indicators is because they are what's called Nowcast. So they're taking data as it comes in throughout the course of the reference period, the quarter, and then they regularly update based on the data that's in hand. So it's not really a forecast. It just represents the data they have up to this point.

Not exactly sure there's consistency as to the reason, but there's increasingly been a wider spread between GDPNow and the blue-chip consensus forecast. In fact, if you go on Atlanta, just Google "Atlanta Fed GDPNow," you can pull up quickly a chart of how it's tracking. And they also always show not just the blue-chip consensus at a point in time, but the range around it. Well, right now, GDPNow is tracking at a little more than 5% real growth. And it's only about 1% for the blue-chip consensus. So that's an historically very wide gap between the consensus expectation. It's certainly possible the real answer is going to fall somewhere in between, but it wouldn't surprise me if the GDPNow tracker maybe gets some adjustments to it, which happens every once in a while. So that'll be interesting to see.

You know, claims is certainly one to continue to watch that has reinforced maybe the Fed going on hold because initial unemployment claims have continued to move down. We've had a couple of readings in the sub-200,000. We've even had a down tick or two on a weekly basis in continuing claims, although the spread is still wide between the two, and continuing claims are ... it calculates the number of people who have filed for initial claims have been unable to get a job. So they stay ... they continue to be on unemployment insurance.

We get personal income and spending. We get the PCE price index, which is Personal Consumption Expenditures price index, which is essentially the Fed's preferred measure, even though the Consumer Price Index still tends to be a little more widely watched. We get S&P Global's version of the Purchasing Managers Indexes, both on the services side and the manufacturing side. So see if that corroborates what we have seen with the ISM, the Institute for Supply

Management version of those PMIs, still shows manufacturing in a recession and not having much luck pulling itself out of recession, yet healthier conditions on the services side.

And then we get a lot of regional Fed data out. The individual metrics I don't pay as much attention to, but as you and I have talked about, sometimes the verbatims within those readings are interesting from companies in their respective regions. And then on the more popular inflation metrics, we get the Producer Price Index, which predates the release of the Consumer Price Index. So that's between here and our next taping.

KATHY: So that's it for us today. Thanks as always for listening. As a reminder, you can keep up with us in real time on social media. I'm @KathyJones on X and LinkedIn, and that's Kathy with a K.

LIZ ANN: And I'm @LizAnnSonders on X and LinkedIn, and you can always read all of our written reports—they always have lots of charts and graphs—and you can find them on schwab.com/learn. And if you've enjoyed the show, we'd be so grateful if you would leave us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or more about the show. We will be back with a new episode next week.

KATHY: For important disclosures, see the show notes or visit schwab.com/OnInvesting, where you can also find the transcript.