➢ Market and Economic Update – March 2025

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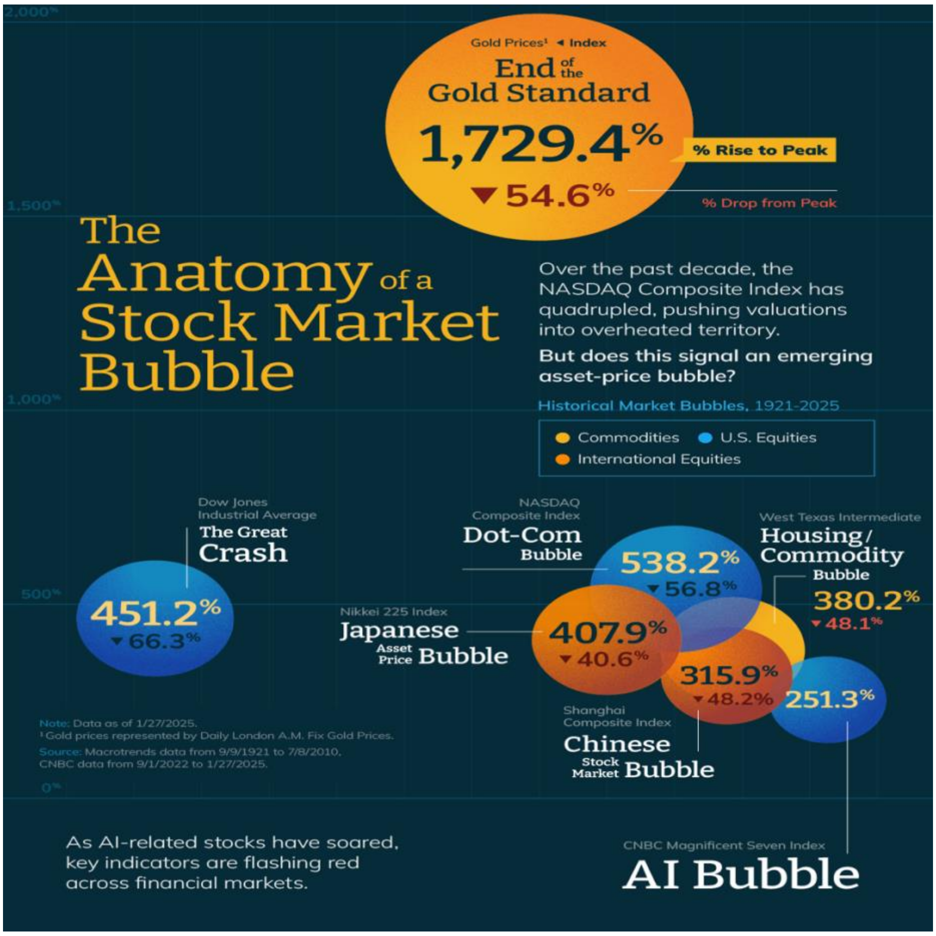
"People calculate too much and think too little."

-Charlie Munger

The Markets

Is the stock market a pricing bubble now?



The graphic above compares markets and trading price bubbles. The date line that runs across the top is difficult to read but running from around 1915 – 2025.

So, the last couple of months, we have been talking about the AI opportunity, and now we are discussing a stock market bubble!?

Well, as Warren Buffett once said (in response to a generally difficult question), “Investing is not easy”.

So, where are we at then?

The good news is that the impact of AI and the opportunity remains strong. Indeed, one of the ironies about markets is that stock market bubbles often expand when new technology emerges (e.g. railways, digital technology).

Navigating this environment becomes increasingly challenging for investors as popular growing businesses feature in the headlines (trading prices, revenue, earnings etc rise strongly).

Some companies will continue to grow long-term. Others fade. Some fall from prominence in spectacular fashion.

Anyway, market prices may grow more expensive from here until a material pullback or correction emerges.

The bubble-bursting trigger?

As mentioned elsewhere, market bubbles don’t collapse because trading prices are expensive.

It takes an event, an unexpected piece of news that surprises and upsets the market.

Not a prediction, but a good example from the past and a real possibility in the not-too-distant future is a change in interest rate direction. It might be that interest rate cuts are done or that an interest rate hike is either on the way or turns up with minimal warning.

In August last year, we saw the unexpected increase in unemployment rattle the market. It was taken as a signal that recession was likely on the way, but it did not materialise.

An unexpected and wide decline in company earnings is a potential trigger. The unexpected and sharp rise in US 10-year treasuries is another. There are a number of others, too. They are difficult to predict because the reaction by the market can be random and difficult to gauge at times.

Navigation

Regardless of which measure we apply, trading prices across the market, particularly some popular technology stocks, are generally expensive.

At WISEplanning, we have been quietly building levels of cash. Having some cash available allows us to move when markets unexpectedly decline. Otherwise, we can be scaling back and removing investments after trading prices have dropped, which is not ideal.

For example, whilst Alphabet remains a quality business, the difficult-to-gauge impact of any future anti-trust action means that we can take some profit now, raise cash/portfolio flexibility and remain invested in the company, but with a bit less exposure to US Department of Justice action.

What we would not consider is a wide sweep across the portfolio, indiscriminately scaling back every holding to raise cash. That's because we invest inside the market rather than across it.

Also, our 'game' is investing in the long-term compounding growth of the business, even though the market may not agree at times. We invest business by business, not sector by sector or country by country.

As we go along, we want to narrow the portfolio to better-quality businesses. Scaling back or removing holdings helps us achieve this objective.

Improved quality helps protect our investments and our portfolio. Ironically, it also helps maximise long-term returns.

So, navigating is about the ongoing quest for improved portfolio quality and adjusting the holdings as we go based on the trading price and the long-term prospects of the business.

The market simply provides the entry or the exit point for us. Otherwise, it is 'noise'.

Staying with quality businesses and scaling back specific holdings to build cash/flexibility is generally how we navigate the current environment.

Market conditions

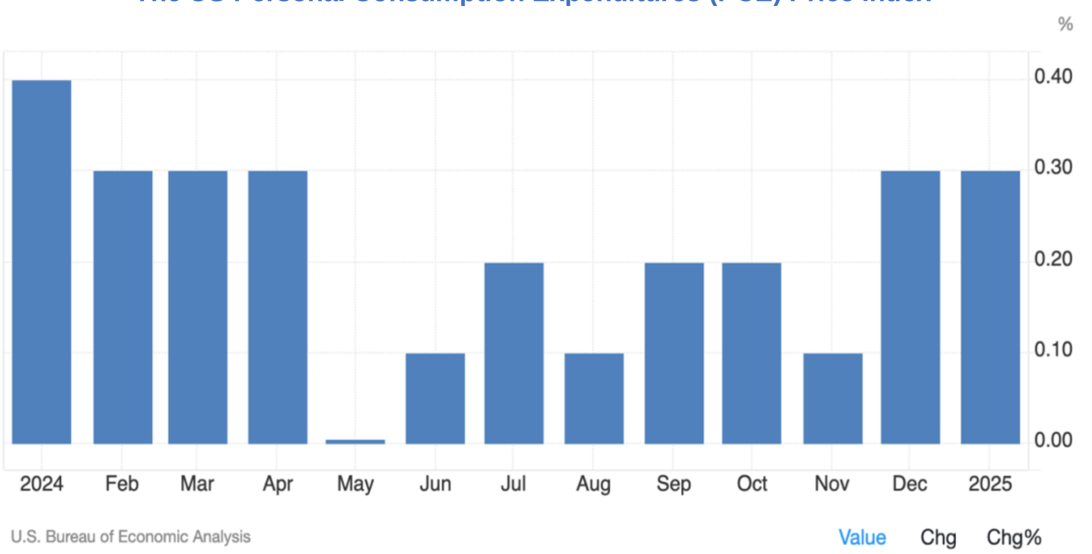
Tariffs, tariffs, tariffs. What do they mean for investors?

One US broking firm suggested a 5% decline for the US share market.

Tariffs could also be inflationary. That might be more challenging for some economies because inflation hurts everyday people and businesses. It can create a headwind for most people and many businesses, slowing real economic growth and squeezing incomes.

Also, it may hasten the next (US) rate hike if inflation rises again. There is some evidence starting to emerge now, but it's early days yet. Still, this is becoming an increasingly important indicator to watch.

The US Personal Consumption Expenditures (PCE) Price Index



The above graph tracks the US PCE price index over the last 12 months.

The graph above highlights the monthly increase of 0.3% for the month of January 2025, the same as December 2024, as expected. This means that by this closely watched inflation measure, inflation remains stubbornly above the annual CPI rate target of 2.0%.

Interest rate cuts have slowed with Jerome Powell (US Fed. Governor) suggesting that there is no hurry to cut further with economic growth in the US remaining resilient.

The US Share Market (Dow Jones) March 2024 – February 2025

The above graph tracks the movement in the Dow Jones over the last 12 months.

The all-time high of 45,014 was reached on 4 December 2024. By the end of December, the Dow Jones Industrial Index had drifted back to 42,544 and currently sits at 43,840 (28/02/2025).

Markets are somewhat sensitive but still focused on AI growth.

The US Share Market (Nasdaq) March 2024 – February 2025

The above graph tracks the movement in the Nasdaq over the last 12 months.

The Nasdaq is a share market index of over 2,500 listed companies and is weighted in technology stocks both across the US and internationally.

Comparing the Dow Jones with the Nasdaq, we can see that the Nasdaq can be more volatile. Larger rises and falls compared to the Dow Jones. Over the last 12 months, the Dow Jones is up by 12.44% compared to 16.29% for the Nasdaq.

These gains are higher than the long-term average, so let's be prepared for a slower rise over the next 12 months.

The VIX index

The graph above tracks share market volatility. The higher the line rises, the higher the level of market volatility.

You might have noticed the increase in general share market volatility over the last few months.

You can almost guarantee that, for example, when the market sees slowing growth anywhere, it will not like it.

The market chases growth by the day. Slowing growth is 'the enemy' and will see the Vix Index rise, sometimes sharply.

A rising Vix = lower trading prices. Whilst the rest of the market does not favour lower prices, you and I usually do.

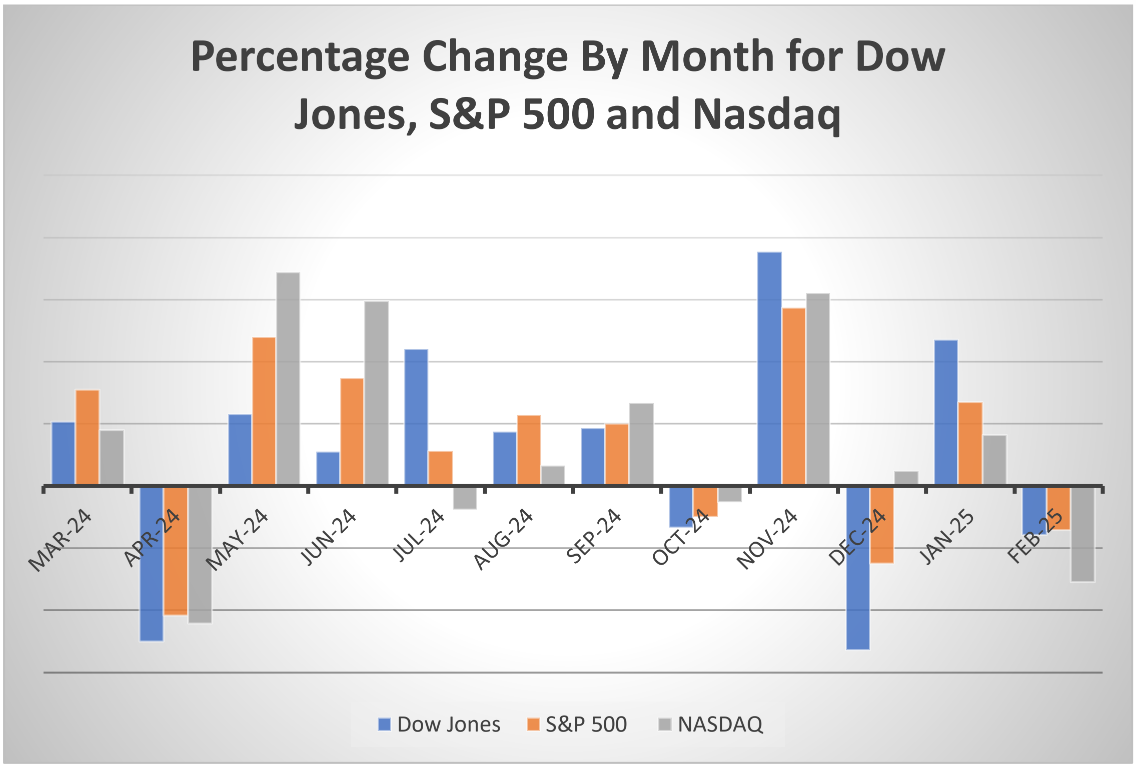
There will be more volatility coming over 2025, for sure.

Share market index movement – USA.

Volatility over February 2025

This was how it went for the 2nd month of 2025:

- The Dow Jones finished the month by –1.58%
- The S&P500 by –1.42%
- The Nasdaq by –3.10%



The graph above tracks market mood and the resulting movement across the Dow Jones, the S&P 500 and the Nasdaq.

Markets have become less buoyant, responding to news that it does not favour. We will see, for example, uncertainty return to the markets once interest rate increases return or unemployment rises.

S&P Earnings Per Share Estimates

The image above shows the percentage of S&P 500 companies that beat earnings estimates.

Interestingly, that 77% beat matched the 5-year average. Not a stellar result. Not a bad result.

Where to next?

US interest rate cuts are slowing down. Now reduced to two over 2025 in the US. Economic growth remains resilient, no recession in sight currently, earnings ok, but mixed, unemployment stable.

Tariffs and global trade uncertainty is here now.

The graph above shows projections on how the US 10% tariffs on Chinese imports might contract real GDP in both countries.

Short-term, we can expect general uncertainty around tariffs. Markets will be skittish on the prospects of some companies that might be affected. Tariffs and their levels are fluid and changeable. That means uncertainty and market volatility.

Elsewhere, the AI opportunity continues to develop, although it will be interesting to see if any chip companies (e.g. Taiwan Semi-Conductor Manufacturing) get caught in the tariff crossfire?

Whilst there remains general market uncertainty around tariffs, we also should watch inflation and interest rate direction.

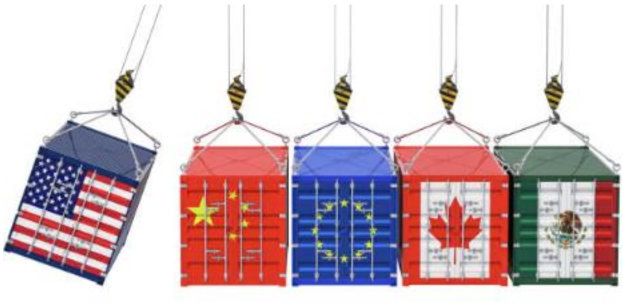
Increasing levels of cash might be beneficial as the Vix Index shows increased market volatility over 2025.

The uncertainty means pricing volatility.

The pricing volatility means lower prices and better buying (providing we have cash on the side).

The Global Economy

By Morgan Edwards – brief bio

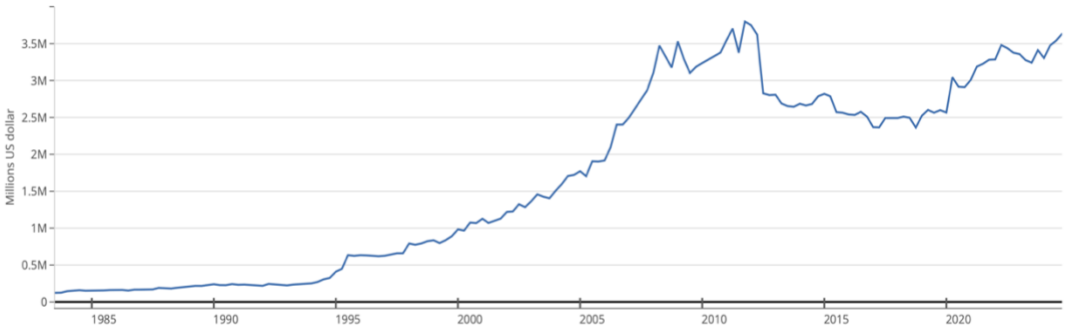


The Times They Are A Changin': Changes to US Foreign Policy

As promised in the November Economic Update, the United States has pivoted away from Western Europe.

Although in its early days, the move represents a significant change in the way international politics and economics operate. This is in the context of tariffs, which the US has now imposed on Canada and Mexico. Tariffs on the European Union are likely to come eventually.

The international economic dominance of the United States has been based on the dominance of its financial system. In order to have a trade deficit, the US has to have a services surplus. In other words, everyone wants to use the US dollar. They want to get dollars to buy US things and, crucially, a lot of banks everywhere else in the world have US dollar liabilities.



The graph above shows the 'cross-border total liabilities of banks with headquarters in United States vis-a-vis residents of All countries (total), all sectors (amounts outstanding / stocks, all instruments in all currencies'.

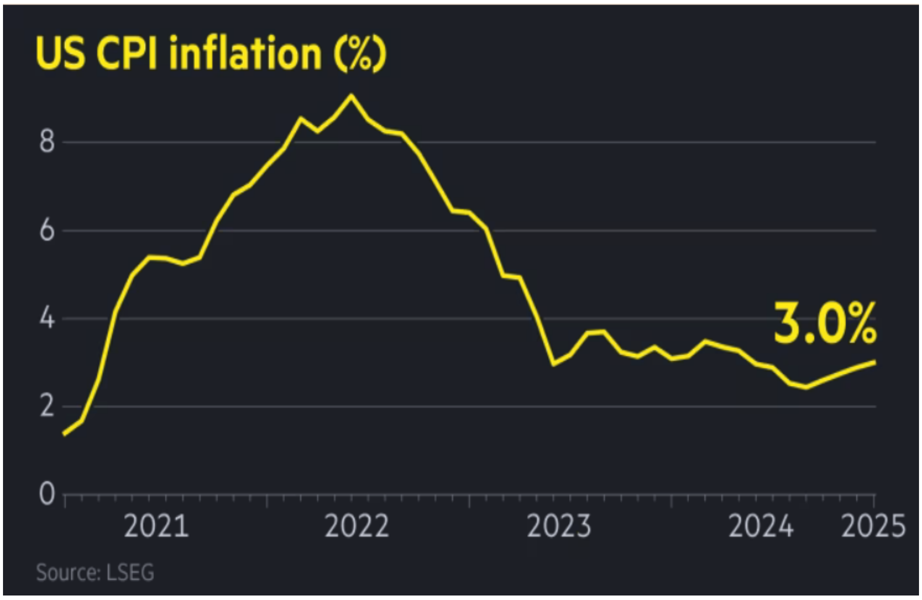
In English, this graph shows the sheer size of US banks and their business around the world. While they aren't graphed, the size of US banking business is markedly higher than China and the United Kingdom, for example.

The international reach of the US banking system, through this measurement at least, is 454% bigger than China's, 204% bigger than the United Kingdom's, and 323% bigger than Germany's.

While US foreign policy is shifting at a remarkable and, frankly, alarming pace, the economic dominance of the US is not in decline *yet.* This graph will provide a useful 'canary' for determining US economic and financial dominance in the future.

United States

Inflation (as measured through the CPI) unexpectedly crept up to 3% in the US.



The graph above shows CPI inflation in the US from 2020 to the present day.

This result, while not Earth shattering (the 3% figure is above the 2.9% forecast), comes amidst consumer worries about the potential inflationary impact of tariffs. We'll see these effects, and other fallout, in the next few months.

China

The Chinese CPI rose 0.5% in January, marking the fastest rise in inflation in five months. Conversely, the Producers' Price Index (PPI) (the price of goods as they pass the factory gate) fell (i.e. remained negative) for the 28th month in a row.

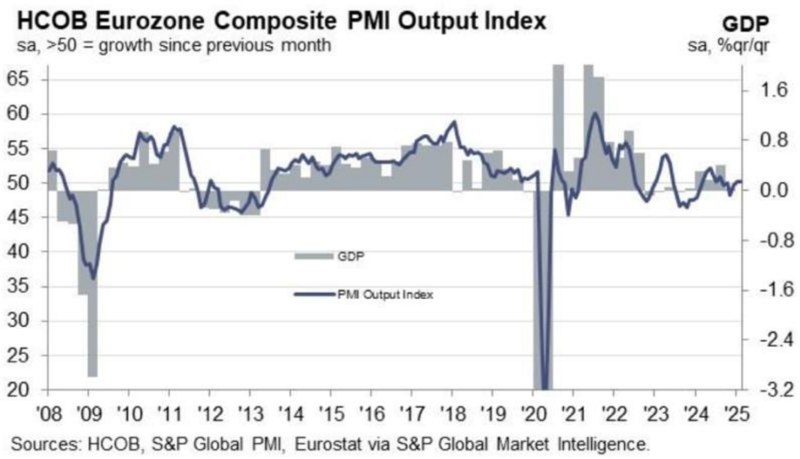
The graph above shows CPI inflation (in blue) and PPI inflation (in red) in China.

The data continues to show the different economic dynamics in China when compared to the rest of the Western world.

Euro Area

Euro Area economic activity continues to slump, as shown by the Purchasers Manufacters Index (PMI). The composite PMI Output Index remained at 50.2 in February.

The magic number here is 50. Anything above 50 indicates positive growth, whereas anything below 50 is negative.

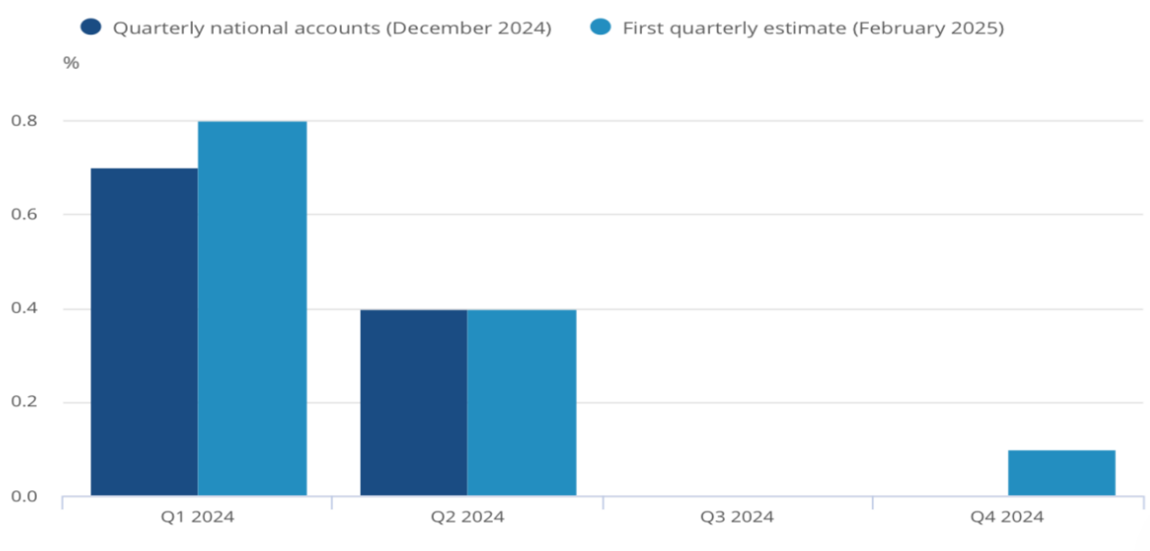


The graph above shows GDP and the PMI output index from 2008 to the present day.

The data indicates prolonged economic stagnation in Europe, with the potential for the ECB to lower interest rates further. This will become more evident as 2025 rolls on.

United Kingdom

Provisional UK GDP data indicated that the UK economy grew at a rate of 0.1% in the fourth quarter of 2024.

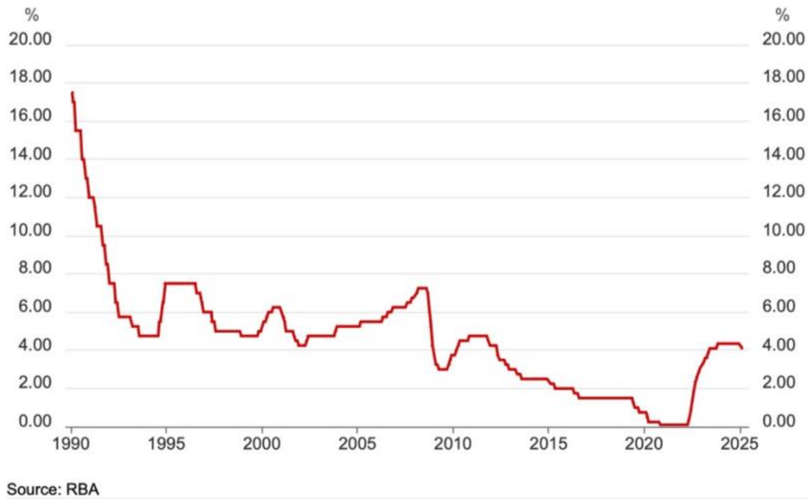


The graph above shows the first estimate of the data (in light blue) and the actual data (dark blue).

It is important to point out that the UK's fiscal surplus was 'weaker than expected' in January. While this may appear to be a good thing, if the government sector is saving, someone else can't be. That someone is the non-government sector, and they are reluctant to spend. If the government realised this, maybe understanding economic activity in the UK wouldn't be so difficult!

Australia

The Reserve Bank of Australia did the unthinkable and lowered their key interest rate by 25 basis points, from 4.35% to 4.10%.

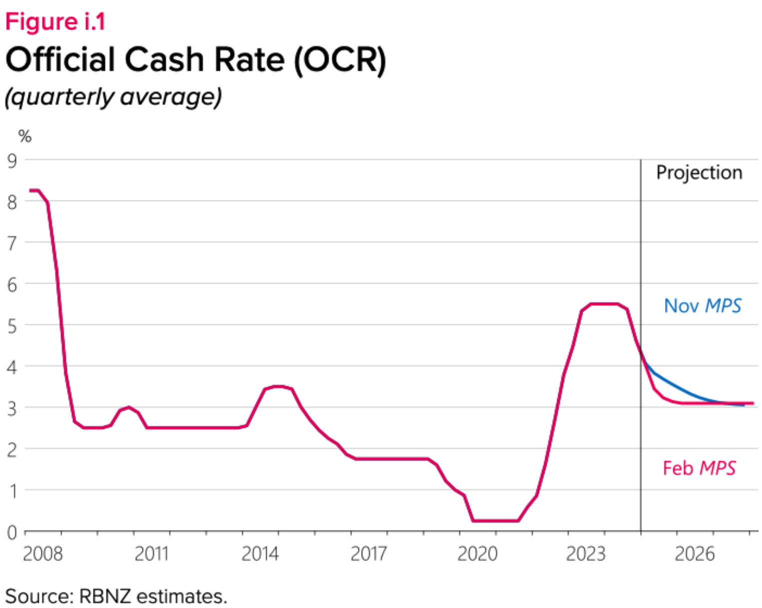


The graph above shows the cash rate target from 1990 to the present day.

The RBA is still frightened of the strong labour market, noting that while the interest rate decision 'recognises the welcome progress on inflation, the Board remains cautious on prospects for further policy easing'.

New Zealand

The Reserve Bank lowered the Official Cash Rate (OCR) by 50 basis points (half a percent) from 4.25% to 3.75%.



The graph above shows the OCR from 2008, with the forecast OCR to the end of 2026 at the right of the graph.

Here, the picture speaks a thousand words. The RBNZ is expecting to lower the OCR quicker than they had anticipated in November 2024. I suspect that it may even go lower too.

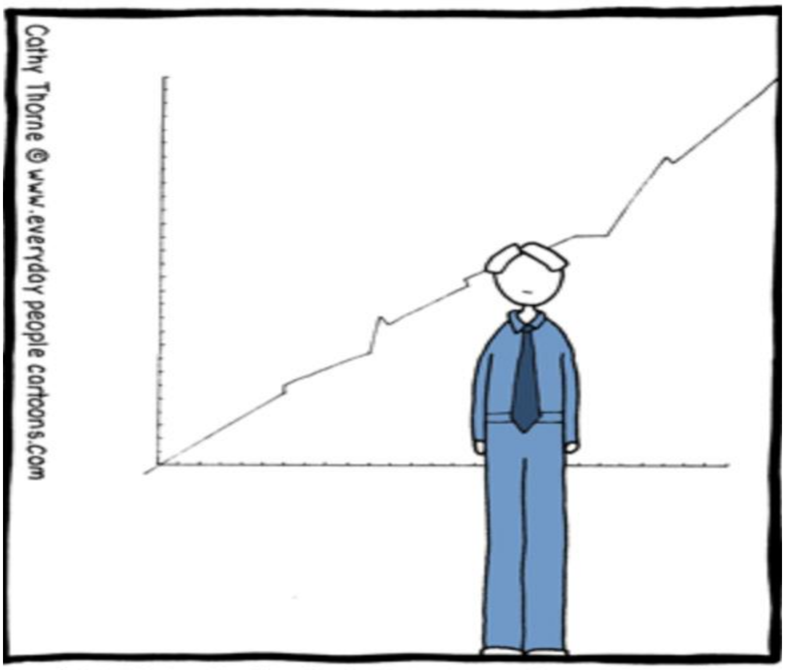
On another note, Adrian Orr, the boss of the New Zealand Reserve Bank, has just resigned. No immediate impact for us, but very interesting.

STOP PRESS: Also ANZ just announced three more rate cuts to go here in NZ.

Conclusion

An awful lot is going on in the international economy at the moment. By the time the next Economic Update rolls around. There'll be some news about the immediate fallout from the first salvos of the trade war, some more inflation data, and some other economic activity data.

2025 is shaping up to be quite a wild ride!



ACCORDING TO THE EXPERTS, I SHOULD'VE STARTED INVESTING WHEN I WAS IN THE WOMB.