GLOBAL X INSIGHTS

Inflection Points: Roll with the Changes

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This month's title was the lead track on REO Speedwagon's 1978 album You Can Tune a Piano, But You Can't Tuna Fish. It seems oddly descriptive for an economy and financial markets grappling with very high levels of uncertainty.

By most indicators, the U.S. economy was quite strong at the start of 2025. Inflation was moderating, consumer spending remained reasonably solid through March, manufacturing started expanding again, and business optimism was up.[1] The early days of first-quarter earnings season offer a similar retrospective assessment with most large banks beating earnings while maintaining strong balance sheets and the Tech and Industrial sectors reporting earnings gains of around 20%.[2] But Q1 is unlikely to reflect the year ahead.

The economy's strength combined with the potential for modest tax relief and deregulation served as an optimistic foundation for our 2025 Outlook.[3] We also identified sequencing and communication around the Trump administration's domestic economic policy as the single biggest risk, a risk that has materialized.[4] Economic fundamentals remain reasonably healthy, but growth is likely softer as uncertainty erodes confidence, which may stifle corporate animal spirits and consumer spending. Lower taxes and investment in the U.S. to onshore supply chains could help, but that will take time. Near-term damage has been done, and some of the catalysts for better growth are likely pushed out to at least 2026.

Investors face some big questions in the current environment, namely what comes next, and what strategies may be attractive.

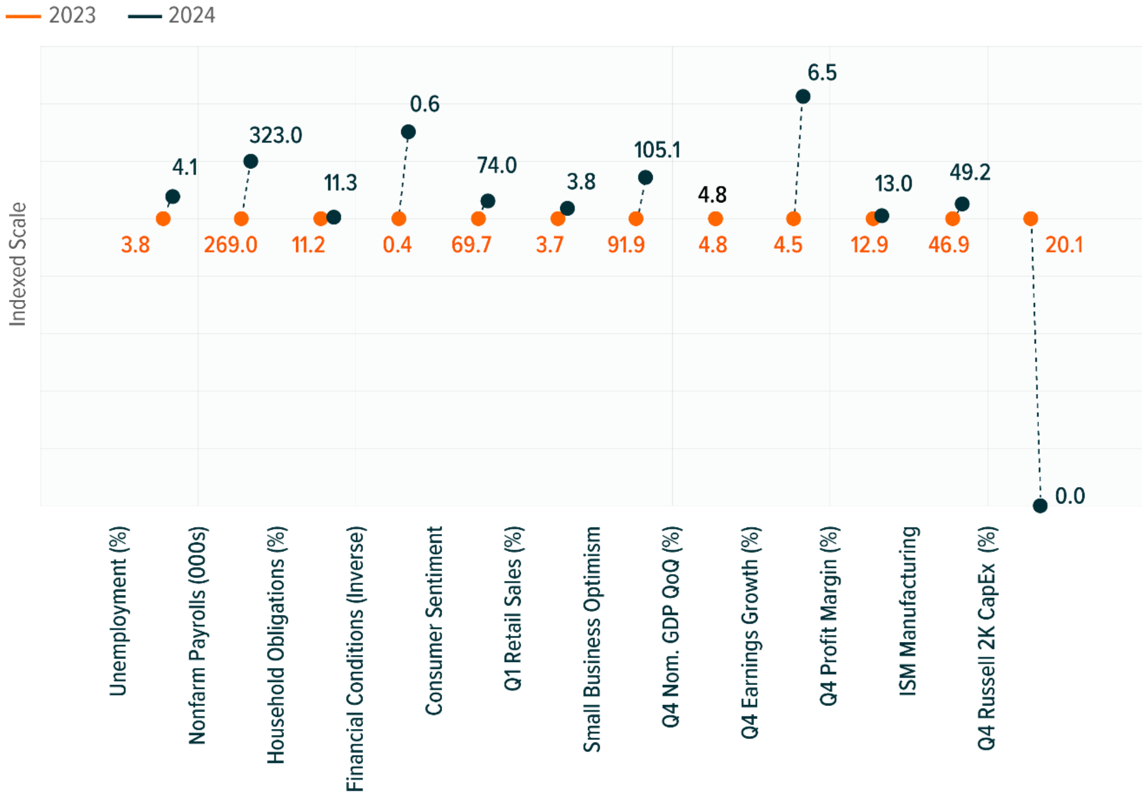
Key Takeaways

- The economic damage that the new administration was willing to incur in pursuit of policy goals was larger than expected, and the impact of on-again, off-again tariff reversals is meaningful.
- Companies had expected uncertainty in cost structure from tariffs, but the erosion of consumer sentiment now puts revenues at risk, making forecasting and capital investment more challenging.
- Hedged strategies and lower-beta themes can offer ways to stay in the market while reducing risk, and there may be good entry points in long-term secular growth themes.

You Can't Tune a Piano if You Take a Sledgehammer to It

The U.S. economy was looking quite good to start 2025, perhaps even better than the beginning of 2024. Unemployment was up, but households were not overextended, financial conditions were loose, and sentiment was strong.[5]

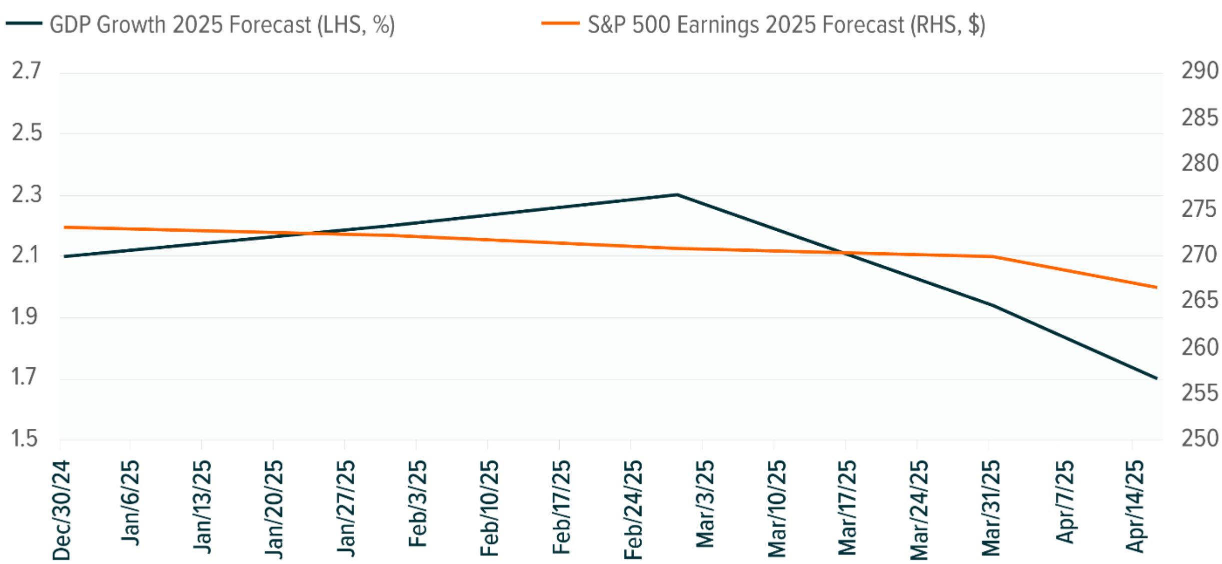
STRONG FUNDEMENTALS TO START 2025



Source: Bloomberg as of April 16, 2025.

Economists remained reasonably optimistic through the start year, revising GDP growth estimates higher as late as February.[6] The consensus year-end target price for the S&P 500 reached 6,873 in late February before strategists started revising numbers down in mid-March over trade concerns. The target for the S&P 500 is only down 4%, with earnings revised 2% lower, but those numbers could be soft.[7] It appears that many economic, market, and geopolitical forecasts did not appreciate the economic turmoil that the new administration was willing to tolerate in pursuit of its policy goals.[8]

ESTIMATES AND REVISIONS ON GDP AND S&P 500 EPS



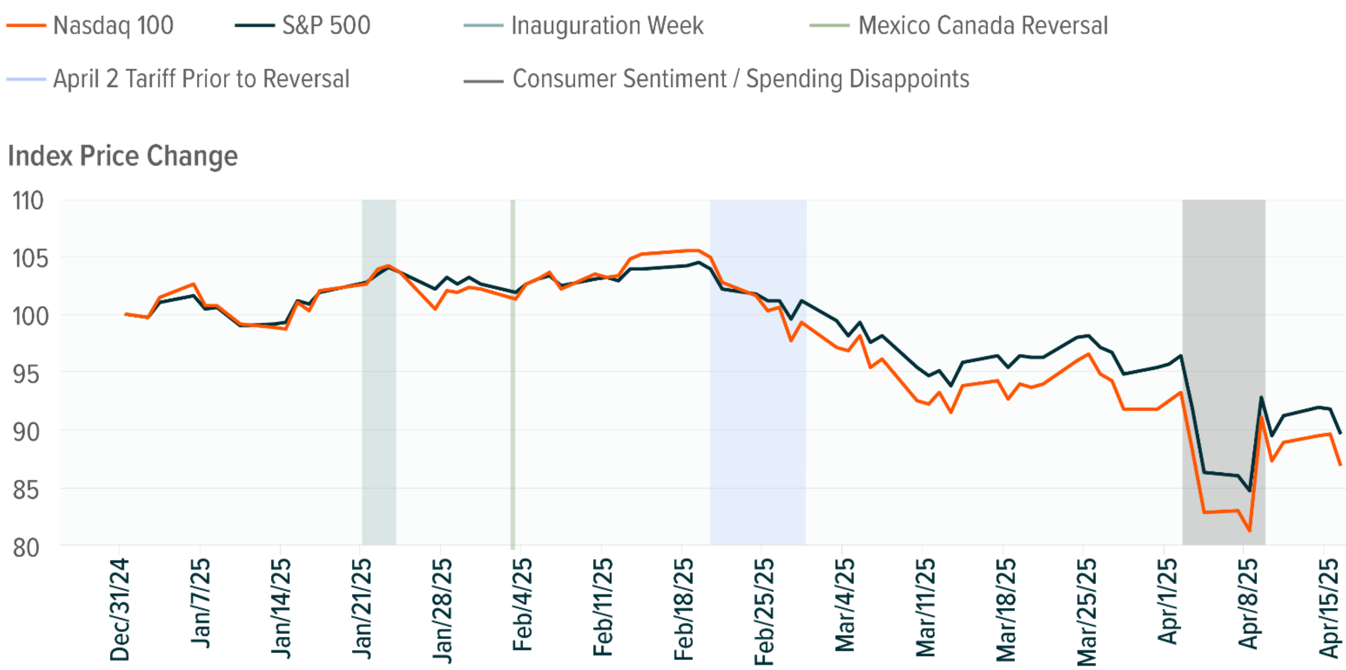
Source: Bloomberg as of April 16, 2025.

While somewhat nostalgic, the goals themselves are arguably well-intentioned. The White House believes that they can onshore manufacturing by reconfiguring global trade and produce 5 million new jobs paying $125,000.[9] On the surface, that seems like a good idea. In reality, their plan has elements of a command, or government-directed, economy that ignores the technological innovation and economic dynamism that have made the U.S. the fastest-growing developed economy since 2020.[10]

Following the April 2 Liberation Day tariff announcement, it seemed that expectations for a Trump market put were overestimated, or at least mispriced.[11] It's still unclear whether tariffs are a primarily bargaining chip or a lasting source of tax revenue.[12] Either way, the administration's conviction in tariffs as a tool to essentially rewire the global economy was underestimated. The threshold on enduring economic distress in pursuit of domestic goals like wealth redistribution seems similarly underestimated.

The lack of clarity presents a complication for investors, grappling with a series of major policy reversals, sometimes at a frenetic pace. On January 27, the White House announced a spending freeze, which they promptly reversed course on two days later.[13] On Saturday, February 1, the administration announced tariffs on Canada and Mexico, only to pause them two days later.[14] The biggest course correction was likely April 10, when the administration announced a 90-day hold on the April 2 tariffs.[15] On April 7, they proposed the first $1 trillion defense budget ever, this after announcing 8% spending cut to the current $800+ billion budget on February 18.[16]

EQUITY SELLOFF AND RECENT EVENTS



Source: Bloomberg as of April 16, 2025.

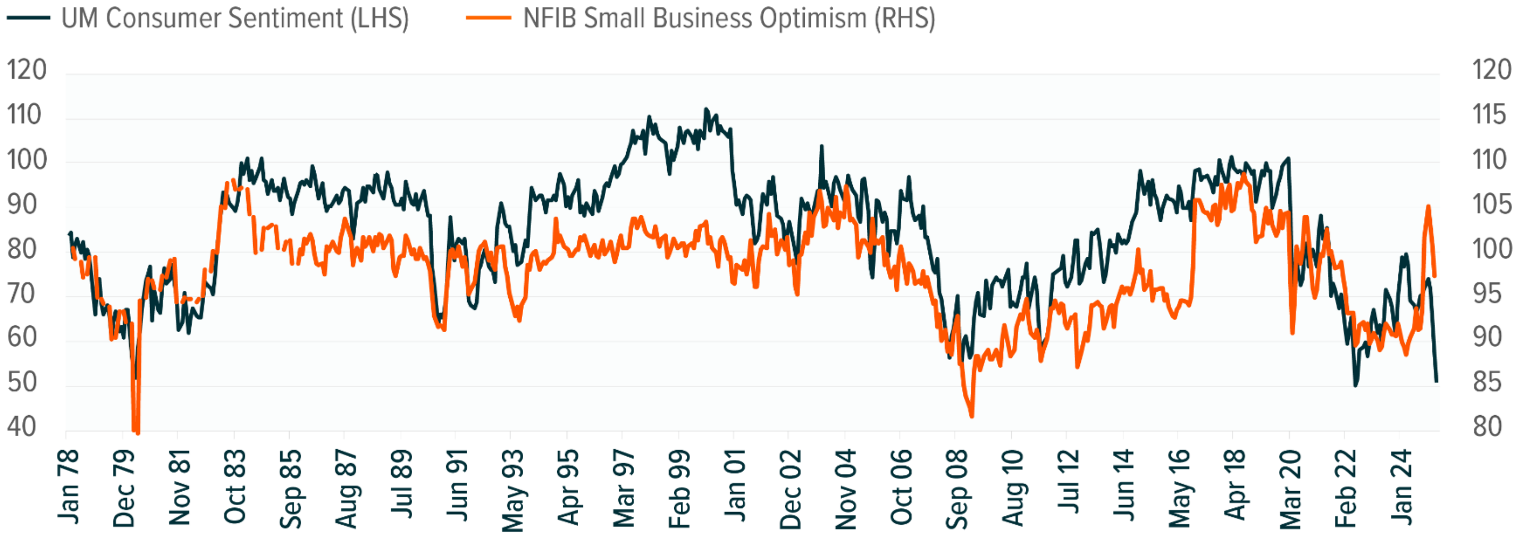
Critically, the about-face on tariffs has brought U.S.-China tensions back into the fore, with very few options to deescalate in the short term. The decision to delay tariffs on the rest of the world while placing very high tariffs on China suggests that rebalancing this relationship is a centerpiece of the administration's policy. This thesis was partially confirmed when Treasury Secretary Scott Bessent discussed striking trade deals with Asian allies like Japan and India to gain leverage over China ahead of negotiations.[17]

New trade deals are likely to take time and, in some cases, might prove elusive, which could push negotiations on mutual tariff relief between U.S.-China further out. Meanwhile, U.S. credibility as a reliable trade partner has suffered, and China is seeking to capitalize by reaching trade deals with U.S. allies like Japan and South Korea.[18]

Can't Fight This Feeling

Federal Reserve Chair Jerome Powell discussed risks of economic slowdown at the Economic Club of Chicago on April 16, noting that the risks to price stability and full employment were rising.[19] Backward-looking numbers like retail sales and industrial production have held up, but forward-looking numbers like consumer sentiment and small business optimism are eroding. Consumer sentiment hit the second lowest reading since the late 1970s, beat only by June 2022, when the economy was coming out of the pandemic.[20] While forecasters may have overestimated the administration's focus on growth, it seems that the administration underestimated how quickly sentiment can turn. They are also likely to discover just how hard it is to restore.

CONSUMER AND BUSINESS SENTIMENT RETREATING

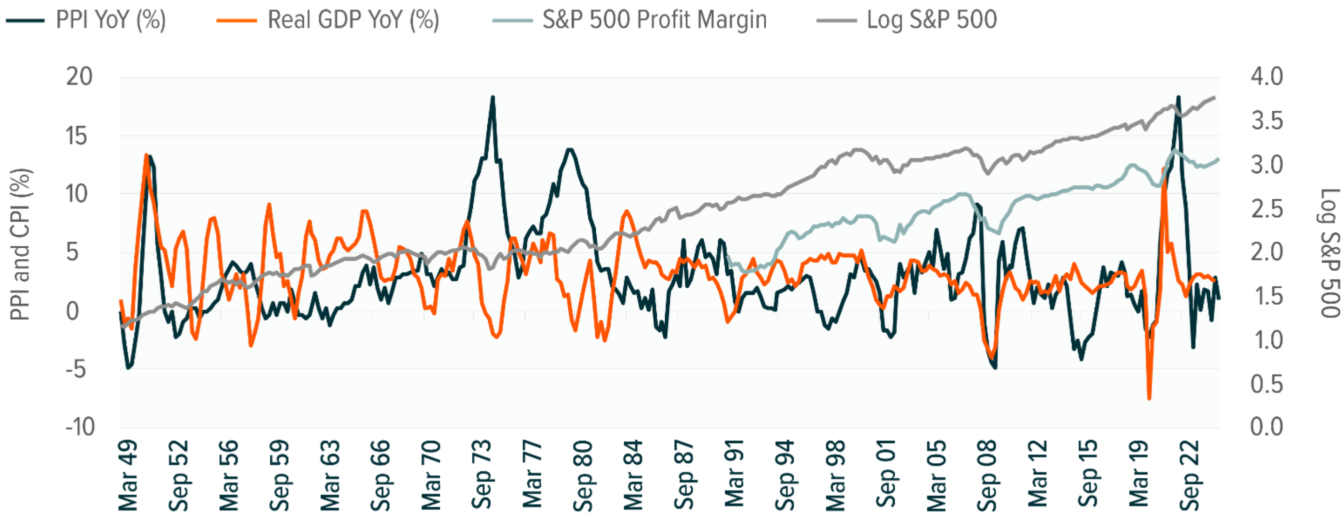


Source: Bloomberg as of April 16, 2025.

Eroding sentiment adds another complication for companies already facing cost uncertainty stemming from tariffs. Based on the White House's April 2 announcement, producer import costs were already going to increase somewhere between 10% and 90%.[21] An increase of that magnitude is tough to manage, but companies did an impressive job managing almost 20% higher prices in mid-2022 while maintaining near-record 13% profit margins.[22] Softening demand and weaker economic growth also mean that revenue is vulnerable and harder to predict.

Historically, companies have largely managed around economic slowdowns or producer inflation, but the combination of the two is problematic. When companies face revenue and cost pressure simultaneously, profitability and prediction become harder and their stocks are not as resilient.[23] This earnings season will prove telling, as many companies could either widen the earnings guidance, or like Delta, pull them altogether.

COMBINED VULNERABILITY TO REVENUE AND COSTS TAKES A TOLL



Monthly S&P 500 Return			Profit Margin Change		
	GDP<3%	GDP>3%		GDP<3%	GDP>3%
PPI<5%	3.1%	2.4%	PPI<5%	-0.03	0.17
PPI>5%	-0.3%	1.6%	PPI>5%	-0.09	0.62

Source: Bloomberg as of April 16, 2025.

Against this backdrop, two potential catalysts for incremental growth that we identified for 2025 are likely delayed.[24] First, manufacturing was set to recover after two years of decline, especially with the new administration looking supportive. That forecast already seems to be evaporating based on recent readings and rising concerns about consumer strength and production costs.[25] Second, renewed corporate investment among small- and mid-sized companies, driven by lower taxes, deregulation, and healthy demand, is likely to go into hibernation.

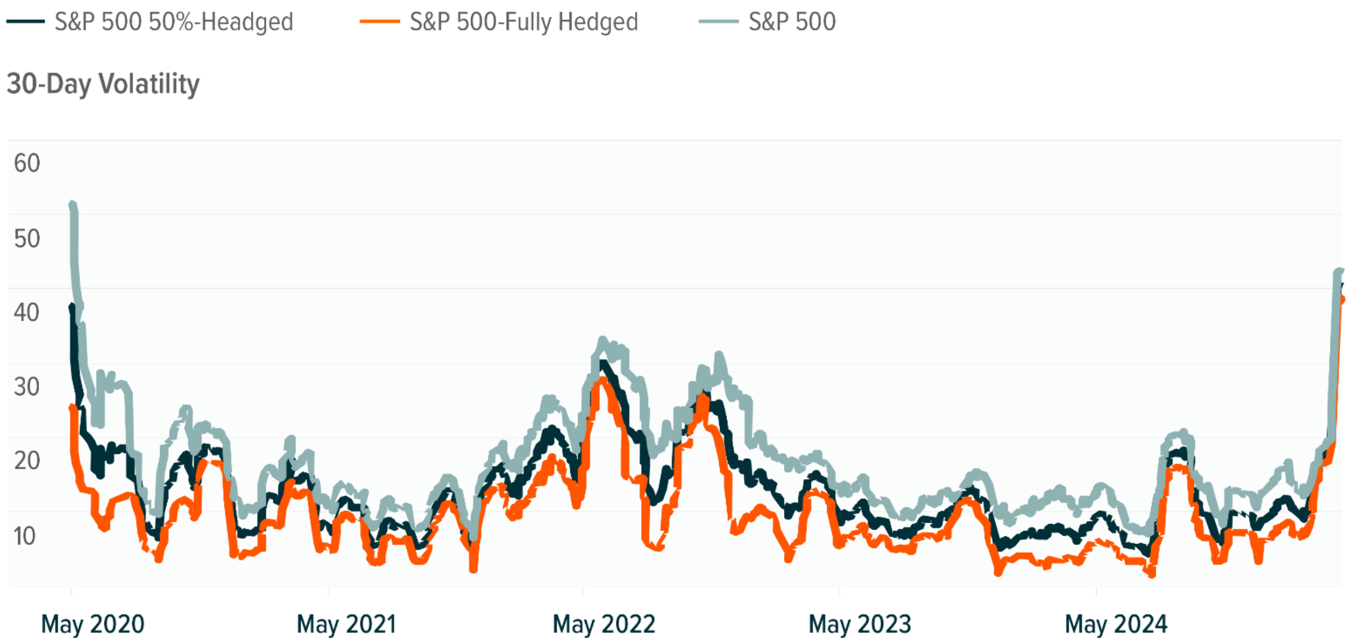
The good news, if there is some, is that the economic damage thus far has been policy induced. Households and banks are well-capitalized. Companies may begin reducing staff, but for now the broad labor market remains resilient.[26] There's also the possibility of a policy reversal or moderation leading to a reacceleration. We still believe that the manufacturing recovery and renewed corporate investment are coming—but those are likely 2026 or 2027 stories now.

Riding the Storm Out

We expect elevated volatility for the rest of 2025, and investors should be prepared.[27] We continue to warn of underinvestment, even in volatile markets. There is no way to predict when markets will turn, and for many investors, the biggest risk is missing a recovery. Historically, markets start moving higher before economic data improves. For risk-averse investors holding cash or short-term treasuries remain an option, but other strategies can help reduce risk while maintaining market exposure.

For example, the most basic hedged strategies generally involve maintaining exposure to an underlying index like the S&P 500 or Nasdaq 100 while simultaneously selling calls as hedge against downside. Called a buy-write strategy, investors typically have exposure to the underlying stocks and generate income through premiums on call option sales. A fully covered call strategy offers income in sideways markets, while a partially covered call strategy offers a mix of upside and income. Both can lower volatility relative to the broad market by their design.[28] The strategies sacrifice upside on the market recovery but still offer a risk-managed exposure.

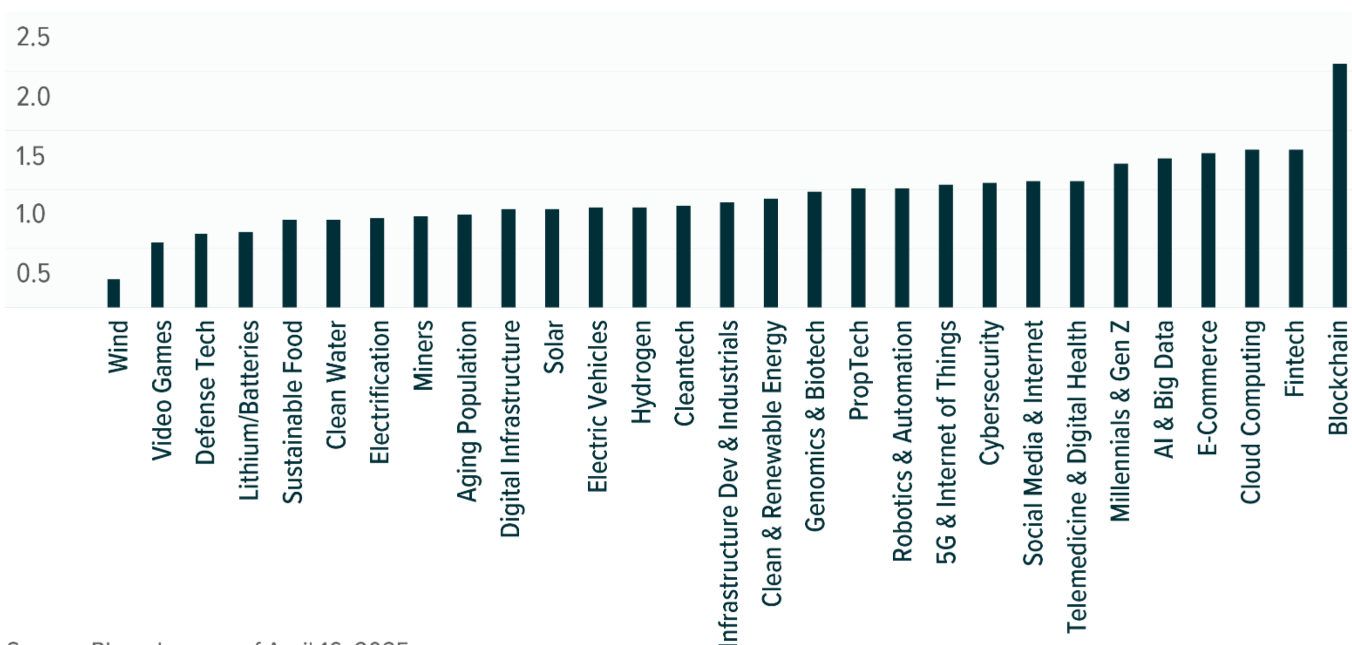
HEDGED STRATEGIES TYPICALLY HAVE LOWER VOLATILITY



Source: Bloomberg as of April 16, 2025.

Another way to remain invested while potentially lowering risk involves thematic strategies that typically have lower beta, or volatility, relative to the market. Thematic investing is largely growth-focused, but there are themes that offer a lower risk profile.[29]

THEME BETA



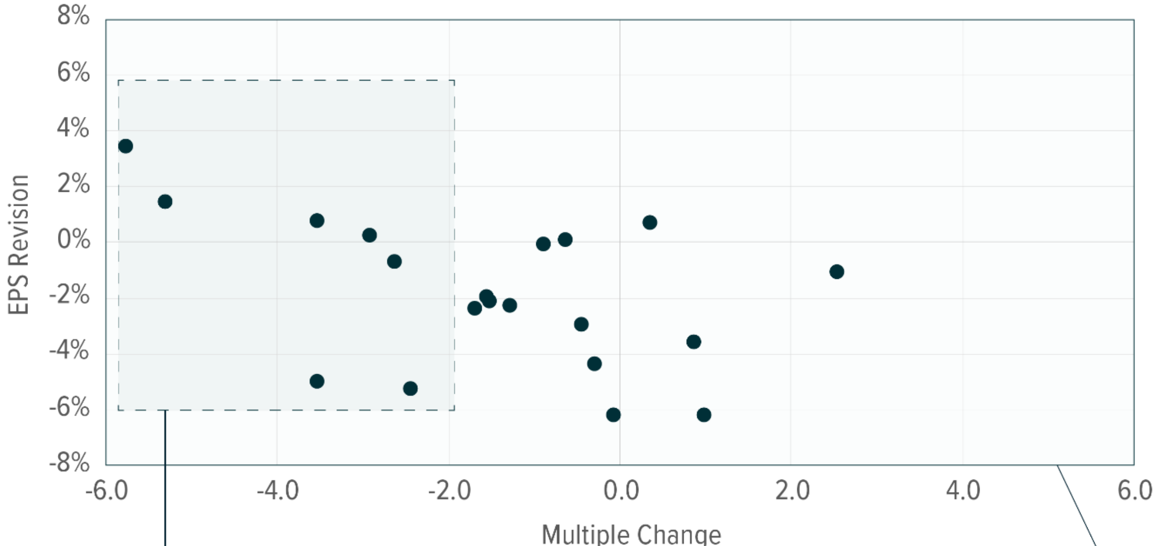
Source: Bloomberg as of April 16, 2025.

For example, Defense Tech has a beta that is almost half of the market's, and in recent weeks its multiple has expanded with stable earnings expectations. These companies typically have long-lived contracts and stable cash flows. U.S. Infrastructure Development has similar characteristics, with companies often engaged to work on multi-year projects. The multiple compression for infrastructure companies has been much lower compression than the broad market. The Electrification theme's valuations have held up relatively well given the concentration of utility companies with stable earnings. Also, some healthcare themes, such as Aging Population, have valuations that have held up against the broader volatility and can help to reduce risk profile.[30]

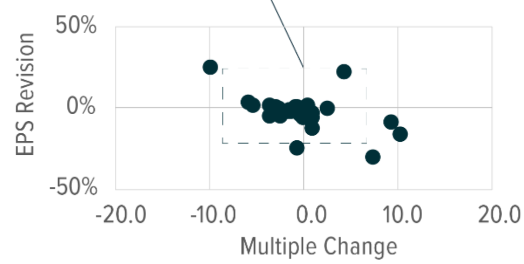
Another strategy to consider is long-term secular growth opportunities that are selling at reduced valuations due to the broad market selloff. This strategy is more suited to those with long investment horizons. Many of the key structural changes in the economy, like industrial automation, AI, and digitalization, are likely to play out in the coming years despite any short-run policy change or uncertainty.[31] Even if investments in these new capabilities slow in the current environment, companies are likely to adopt new efficiency enhancing and revenue generation opportunities over time.

ZOOMING IN ON REVALUATION AND FUNDAMENTALS

Reratings and Revisions



	Multiple Change	EPS
Video Games	-5.8	3%
AI & Big Data	-5.3	1%
Cloud Computing	-3.5	-5%
Fintech	-3.5	1%
Clean Water	-2.9	0%
5G & Internet of Things	-2.6	-1%
Robotics & Automation	-2.4	-5%



Source: Bloomberg as of April 16, 2025.

Much like the broader market, multiples across many themes have contracted despite little change to earnings expectations.[32] For secular growth themes, some of the valuation compression may create meaningful opportunities.

AI & Big Data's multiple contracted by 5.3 times in a matter of weeks.[33] This contraction potentially provides investors who felt like they were left out of the AI boom an attractive entry point. Robotics & Automation is another critical area given the interest in onshoring and the mounting global competition for production and manufacturing. The industrial automation segment will play an important role, and its multiple has contracted by 2.4 times.[34] Two themes related to AI and automation, Cloud Computing and 5G & Internet of Things, are also selling at more reasonable values. For patient investors, this could be an interesting opportunity to add secular growth.

Footnotes

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33. Ibid.
34. Ibid.

* Thematic category indexes available upon request.
