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MACROCOSM

The Other Trump Effect: Uncertainty

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Less than a week after all-time highs for stocks, uncertainty is starting to take a toll.

Update to strategic view

US MACRO, US STOCKS, US BONDS: One of our most respected datapoints, 365 days-ahead S&P 500 forward earnings, has been in …

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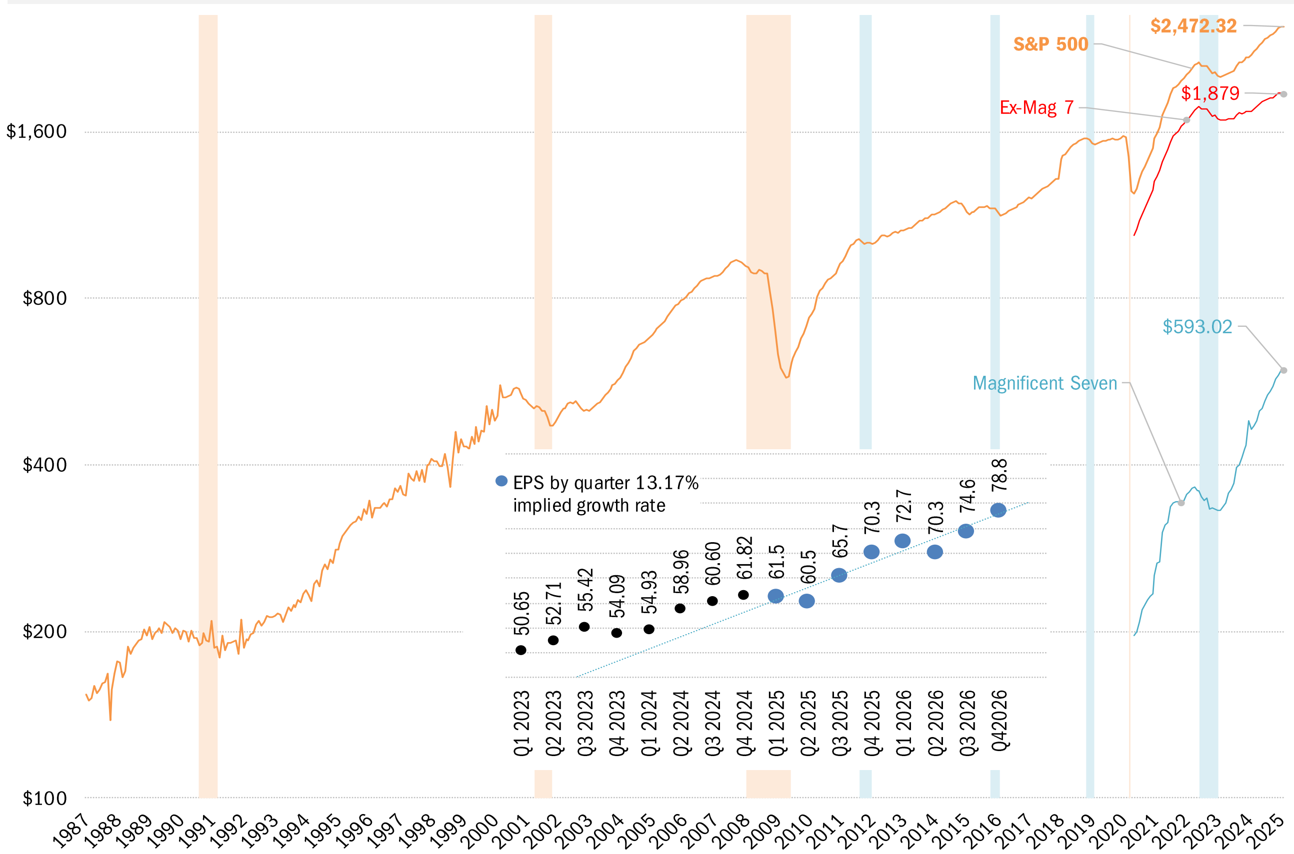
The S&P 500 made all-time highs just five market days ago, and it did it without the Magnificent Seven stocks, which in aggregate are down year-to-date. And most of the inputs we use to inform our data-driven approach to forecasting look great. *But we're seeing small signs of weakness and some troubling trends in some of our most critical inputs, so we're getting the sense that we're probably going to have to endure a risk-off correction here. There hasn't been a real one in over a year*.

- *Most salient to us, 365 days-ahead forward earnings for the S&P 500 (please see the chart below) have fallen from a peak at $2.472*

S&P 500 365 days-ahead forward earnings (USD billions) | Recession | Undocumented recession



Source, Various, TrendMacro calculations *trillion on January 23*. That's three days after Donald J. Trump was inaugurated.

- A month later, *forward earnings have fallen $9.3 billion, or 0.4%*. That's almost nothing, but forward earnings aren't supposed to fall at all. *They are supposed to always go up*.
- When they go down a lot, there's a recession coming in the next month or two. *When they go down a little, there is a brief period of slight economic contraction, usually a negative GDP quarter but a fall in employment – and usually a steep stock market correction*. We call such an episode an "undocumented recession." The last one started in June 2022, when the Fed began its scorched earth tightening regime to fight inflation that it suddenly decided was not "transitory" (just when it was about to become so). We were steadfast throughout that there would be no recession, and we were right. But there was a very steep correction in equities that made 2022 a lost year.
- Now, at the two-year anniversary of the bottom in forward earnings in February 2023, they've grown by 23.3%. A little less than half of that is due to the Magnificent Seven. *The small forward earnings dip we're in now is the first test of the post-tightening environment*.
- It's revealing to consider the time structure of estimates, rather than just the single point 365 days out (please see the small chart inset in the chart on the previous page). The bottom-up weighted consensus estimates lower S&P 500 EPS in both this quarter and the next, compared to the estimates at year-end for Q4-2024. But after that, a sharp recovery – netting out to 13.17% compound annual growth rate across the eight coming quarters. So the *estimates are gloomy for the short term, but nothing short of spectacular for the intermediate term* (the typical annual growth rate for estimates is about 6%).
- *This deterioration of the near-term outlook is developing as Trump completes the first month of this second term as president, with a flurry of consequential economic policy initiatives and hints (and rumors and hopes and fears) of much more*.
- In this report we'll wander through some – not all – of the elements in play that are getting our attention. And to be clear, *we're not pulling the ripcord* here on the economy or the markets. But, well, *we have some concerns*.

TRUMP RETAINS BROAD APPROVAL, with daily tracking polls still not showing a single day below 50% so far.

US STOCK MARKET INTERNALS are giving a mixed report on what we conceive as "the Trump trade." Contrary to our expectations (see "The Trump Effect" December 11, 2024), year-to-date the Rusell 2000 Index of small cap stocks has underperformed the large cap S&P 500. We had expected Trump, as an economic cheerleader, to stimulate the animal spirits that motivate the grass roots of the economy. Maybe we were just wrong that this would show up in small cap stocks. Or maybe it's Trump's torrent of policy initiatives, some of which, especially tariffs, engender as much uncertainty as optimism (see "There You Go Again: Steel and Aluminum Tariffs" February 10, 2025).

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… shallow decline for a month. This is very rare, and is always associated with sharp corrections in equities. Extended declines predict recessions, but we're not there so far. After two quarters, and out two years, estimates remain very strong. Uncertainty is starting to set in with a flurry of economic policy moves by Trump in only his first month. Small business confidence ticked down, but still exceeds Biden's highest reading. DOGE is driving uncertainty about employment, but we think most fears on that are exaggerated. Tariff risk remains, with Trump's CEA chair a strong and radical advocate of restricting global trade. Trump's approach to the Ukraine war is to frankly call an end to three years of extend-and-pretend. It evokes the possibility he will do the same thing with US deficits and debt, with rumors swirling of a "Mar-a-Lago Accord" that would force a restructuring of US debt held by foreign institutions – arguably, a default event.

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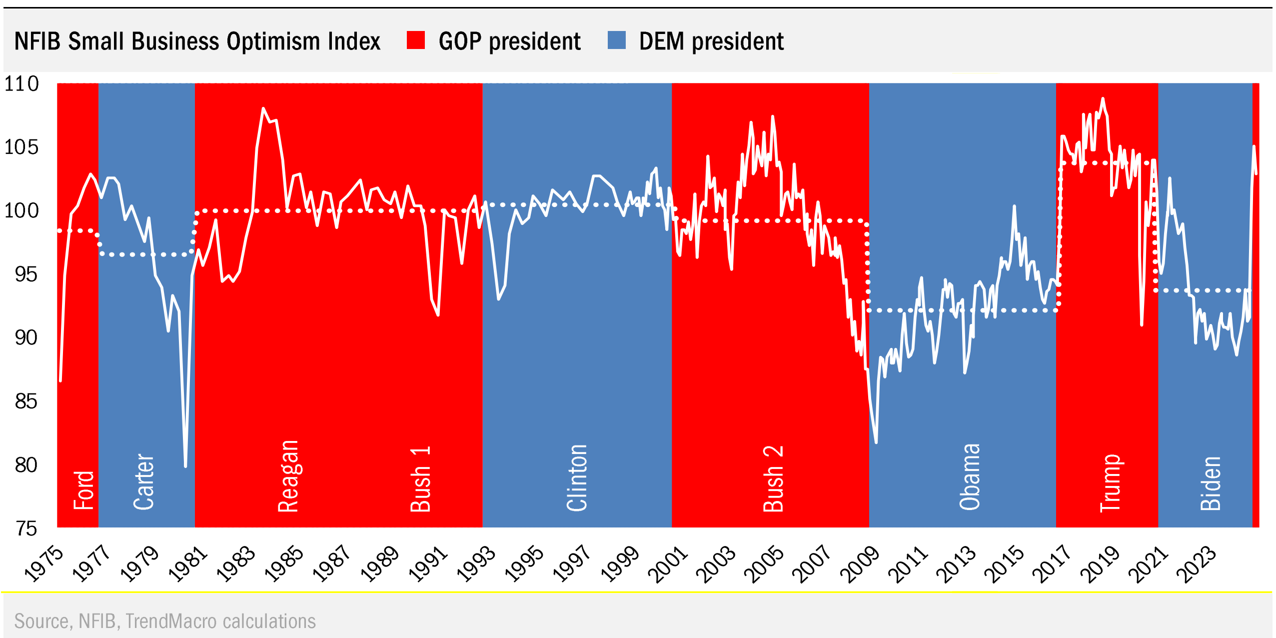
- *We note that within the S&P 500, the underperformance of the Magnificent Seven is itself a significant small cap effect*. But it's hard to not link that up with the industry-specific uncertainty about the economics of artificial intelligence ushered in by the introduction of DeepSeek (see ["On the January FOMC, and the Briefest Word on DeepSeek"]() January 29, 2025).
- That said, AI and the Magnificent Seven have become such a linchpin of equity market performance and economic optimism – and lofty valuations – that any chill wind of uncertainty there is going to be somewhat infectious to economic expectations overall.
- Whatever the cause of a potential shift in expectations and mood, we note that the NFIB Small Business Optimism Index – for us, a symbol of grass roots animal spirits – ticked down for January, for the first time since its surge right after Trump's election (please see the chart below). It's a small downtick to a still-high level, indeed a higher level than ever attained under Joseph R. Biden's presidency. But it's a downtick, and below the average for Trump's first term.



DEREGULATION CONTINUES TO BE A POWERFUL THEME, with *the two sectors we flagged as the most obvious beneficiaries – energy and financials* (see ["Predictions for 2025: Macro and Markets"]() January 2, 2025) – *both with triple the gains of S&P 500 year-to-date*.

WE SEE THE DOGE EFFORT AS MOSTLY A DEREGULATION INITIATIVE, and a very long overdue housecleaning. Going in, this kind of initiative enjoys broad support. According to [the most recent New York Times poll](), 60% of Americans (GOP 78%, DEM 45%, IND 47%) think "government is almost always wasteful and inefficient." And astonishingly, 72% of Americans (GOP 80%, DEM 67%, IND 61%) think "the government is mostly working to benefit itself and the elites."

- Some of the DOGE findings coming out ("Biden sent $2 billion to Stacey Abrams-linked group in green energy 'scheme,' EPA says" are pretty compelling (and are not being effectively rebutted by even the most establishmentarian fact-checking).
- Much of the pushback has been speculative scare-mongering ("How the Trump and DOGE cuts could ruin National Parks this summer") or attacks on the legitimacy or character of Elon Musk ("Here Are the Digital Clues to What Musk Is Really Up To"). It's not clear whether the attacks are working. A recent authoritative poll shows 54% of Americans disapprove of Musk. But at the same time 67% disapprove of Mark Zuckerberg (who is *not* running DOGE).
- Musk's idea for a $5,000 payment to every American as a dividend on DOGE deficit reductions is an interesting idea. As we talk to clients about it, we keep hearing the pushback that it's just a stimulus payment that lacks the economic effects of a tax cut, because it doesn't operate on incentives to work or invest. It may, indeed, give people an incentive – or just the capability – to invest. But as originally proposed, it would indeed work as a "dividend" – a reward for bearing the costs and risks of doing some restructuring of the federal government. The effect on incentives, of course, is to obtain buy-in for that restructuring.
- *Would it be inflationary? The debt-financed $6 trillion of pandemic stimulus in 2020 and 2021 surely was. But this one wouldn't be debt-financed. Quite the contrary, it would be debt-reduction financed. It's not so obvious that it would be inflationary*.
- *All that said, we continue to be skeptical that DOGE will result in anything like the $2 trillion deficit reduction that would occasion a $5,000 payment to every American.* We continue to see DOGE as a means of facilitating deregulation that would not make the government more efficient (at regulating the private sector) but rather to make the private sector more efficient (by getting the government off its back).
- *We don't think DOGE will result in any significant job losses, on net*, though worries about that are a staple of financial media reporting, usually in the "experts warn" mode ("DOGE Layoffs Pose 'Growing' Risk To U.S. Economy And Markets, Says Apollo Economist"). Surely displaced federal employees could do *something* else – especially in an economy with a 4% unemployment rate and the potential for sharply reducing the number of new workers coming into the US, legally or otherwise, across the southern border. And, back to the deregulation theme, when federal workers move from the public sector (where their job was to make life harder for the private sector) to the private sector (where their job is to make things better in the private sector) the efficiency and growth potential of the economy is improved. DOGE should be DOEE – the Department of Economic Efficiency. *But the frequent questions we get from clients who are worried about job losses speaks to sensible uncertainty about this, and form part of the tapestry of data and impressions that are making us a little cautious here.*

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HOPES THAT DOGE WILL SIGNIFICANTLY IMPROVE DEFICITS ARE MISPLACED, because we think they just won't terminate enough federal programs to make a difference. In the grand scheme of things, all that matters to deficits is reform of entitlement programs, and that is a third rail even for DOGE. The impact on deficits will primarily be indirect – *if DOGE-driven deregulation can improve growth, then deficits will be reduced as a share of a larger economy*.

BUT TRUMP'S EFFORTS TO FORCE AN END TO THE UKRAINE WAR POINTS TO MORE RADICAL APPROACHES TO DEBTS AND DEFICITS.

- Ever since Russia invaded Ukraine three years ago, it has been obvious to any realistic observer that Russia would eventually win. There just aren't enough Ukrainians to keep on fighting, nor enough willingness in the West to go to the brink of nuclear war. We said all along that Russia would end up owning Donetsk, Luhansk and Zaporizhia, completing a land-bridge to Crimea – and that seems to be about where this has to settle out now.
- *So Trump's approach, we think, is not so much "surrender" as French president Emmanual Macron has more than hinted, but rather a realistic reckoning with three years of extend-and-pretend by the West.*
- Trump's flamboyant rhetoric – calling Ukraine President Volodymyr Zelenskyy a "modestly successful comedian" and a "dictator" – is designed to create awareness that the West has, at best, been supporting a less than virtuous nation against another that is even more less than virtuous.
- The Trump administration's move in the United Nations to block a resolution calling for Russian withdrawal, and delete language blaming Russia for the war, is designed to create awareness that the invasion had a context that makes it understandable, if not justifiable (in the sense that if you are stupid enough to poke a bear with a stick and it kills you, you can't entirely blame the bear).
- And Trump's demand for Ukraine to grant the US ownership of mineral resources, as compensation for US support the last three years and future security guarantees, is designed to create awareness that the US has spent a bloody fortune on this ultimately doomed crusade, and it did so without any vital interest (which, in the future, the mineral ownership would be).
- *It's all about calling an end to extend-and-pretend in Ukraine – before the otherwise inevitable crisis point that will end the pretending anyway on far worse terms. And this brings us to debts and deficits.*
- We have always called for calm on debts and deficits, despite record levels of both – and debt service, too. But as we talk to worried clients about it, we always have to acknowledge the not-all-that-distant future in which accelerating entitlement obligations would seem destined to overpower any economic growth that could have otherwise solved the problem. Seen that way, *debts and deficits are a game of extend-and-pretend just like Ukraine – so perhaps Trump will try to deal with them the same way*.

- *Macron calls Trump's approach to Ukraine "surrender." What might markets call Trump's approach to debts and deficits? "Default"?*
- Trump's tariff threats already reveal his willingness to take large-scale and radical steps in economic policy (see, most recently, "Tariff the World. Save the World." February 14, 2025). It's not clear what he will do, or whether it will even matter (see "How Much Do Tariffs Matter?" January 28, 2025). But much attention has been paid to Walmart's earnings report last week, the day after the all-time high in stocks, claiming that it warned about the negative impact of tariffs. In reality, management said, when asked, "…we feel good about our ability to navigate the environment, whether it's tariffs or other macro uncertainty." But reality be damned – Walmart's stock fell sharply that day, and the narrative was tariff uncertainty. *We keep saying "wait and see" on tariffs. That's uncertainty.*
- And we have pointed out several times Trump's appointment of Stephen Miran to chair the White House Council of Economic Advisors – he is the author of a radical manifesto of global economic restructuring calling, with strong arguments, for dollar devaluation, capital controls and tariffs. In fact, he suggests the sale of US gold as part of a maneuver to devalue the dollar, which may be the catalyst for Trump's visit to Fort Knox to see if the gold is actually still there.
- Now there is talk of a so-called "Mar-a-Lago Accord," evoking memories of 1985's Plaza Accord, in which the finance ministers of the world agreed to cooperate to weaken a sharply appreciated US dollar. We first heard of it when a client alerted us to statements by former Credit Suisse economist Zoltan Pozsar, who has often before predicted catastrophe for the dollar. Pozsar asserts *the Trump administration will drive a restructuring of US debt held by foreign institutions, exchanging Treasury securities for 100-year zero coupon "century bonds."* Pozsar's speculations have now started to be echoed by more mainstream sources.
- To the extent that this exchange is anything less than voluntary, and anything less than economically attractive to creditors, it is simply a cramdown – no, *it is simply a default*.
- We suppose that not having to pay coupon interest for a century is an attractive enough proposition for the US that, perhaps, a non-coercive deal could be struck. But Trump seems to like using more than a little coercion to get the best deal. Think Ukraine's mineral rights. Think Tik-Tok. Maybe we tell Japan the cramdown is compensation for using our "nuclear umbrella." The same rationale wouldn't work with China.
- It's very difficult to know how markets would react to such a thing. On the one hand it's a default. On the other hand, it's a smart end to the extend-and-pretend game that would have led to default anyway. And, of course, it's impossible to know if any of this is even real. *But right now, it's part of the uncertainty pervading markets – uncertainty about what will happen, and for that matter uncertainty about whether that which happens will be our salvation or our doom.*

Bottom line

One of our most respected datapoints, 365 days-ahead S&P 500 forward earnings, has been in shallow decline for a month. This is very rare, and is always associated with sharp corrections in equities. Extended declines predict recessions, but we're not there so far. After two quarters, and out two years, estimates remain very strong. Uncertainty is starting to set in with a flurry of economic policy moves by Trump in only his first month. Small business confidence ticked down, but still exceeds Biden's highest reading. DOGE is driving uncertainty about employment, but we think most fears on that are exaggerated. Tariff risk remains, with Trump's CEA chair a strong and radical advocate of restricting global trade. Trump's approach to the Ukraine war is to frankly call an end to three years of extend-and-pretend. It evokes the possibility he will do the same thing with US deficits and debt, with rumors swirling of a "Mar-a-Lago Accord" that would force a restructuring of US debt held by foreign institutions – arguably, a default event.