On Recent Market Volatility:

Recession, Tariffs, and DOGE: Where Is the U.S. Headed?

You're not alone if you're concerned about the economy and your finances. News site headlines and chyrons scrolling across cable TV channels probably aren't helping, either: Dow on track for worst week since March 2023! Washington braces for a government shutdown—as DOGE cuts continue! Recession fears are rising! But is all this bad news past or prologue? Are we looking at a snapshot or a taste of things to come? In this Insight, The Cerity Partners Investment Office shares their thoughts on what's happening and where we might be headed.

What are the probabilities of a recession in the U.S.? How have they changed since the beginning of the year? What indicators are we watching to confirm that a recession has started or is increasingly unlikely to happen?

Predicting recessions is notoriously difficult, leading to variations of the quip that "economists have predicted five of the last two recessions." In the aftermath of the 2022 inflation spike and equity market collapse, for example, economists called for an impending recession in mid-2023. That recession never materialized. Instead, the S&P 500 generated over 20% returns in 2023 and 2024.

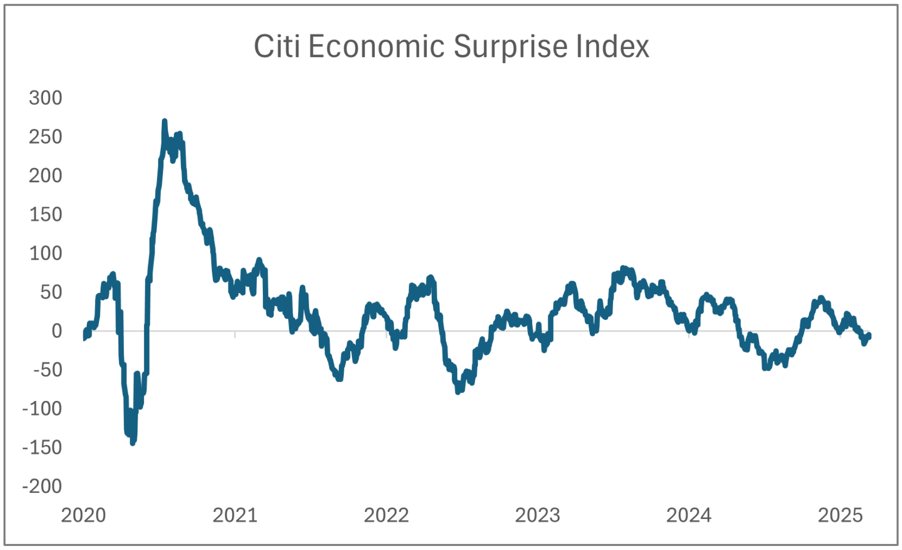
As of March 11, Bloomberg shows economists forecast only a 25% probability of a recession over the next 12 months, up slightly from 20%, where it had been for most of 2025. Given some weaker economic data and the equity market downturn, we suspect that probability will increase in the coming weeks. The risks are undoubtedly higher, but we believe a recession can be avoided.

Our focus is on a few areas. We are closely watching data around the consumer and labor market. Consumer confidence has fallen (a negative), and recent employment data has trailed expectations (also a negative). Potentially offsetting both is data on the economy itself: Recent data from the Institute of Supply Management showed continuing strength in services (a positive) and moderate growth in manufacturing (a slight positive). Corporate earnings, while backward-looking, have also been strong. Fourth quarter earnings growth for the S&P 500 clocked in at over +18%, year-over-year based on Factset data. At a minimum, those earnings show a healthy corporate sector (a positive). As we heard one pundit note, the U.S. economy is "running on fewer cylinders" as the mixed data above suggests.

Some recession risks are more challenging to track. We talk a lot about "animal spirits" as an example. The idea is that the populace can talk itself into a recession. Nervous consumers see the headlines and slow their spending, which causes the data to weaken, creating more nervousness and less spending…and, eventually, a recession. While the risk of this negative spiral is a concern, we also see potential positives that could counteract it.

First, the Fed has the proverbial bazooka in the form of rate cuts. The market currently expects three cuts in 2025, starting in June. If the Fed sees a meaningful slowdown, it could act more aggressively. Finally, we go back to the Trump administration's policy initiatives – particularly DOGE and tariffs – which have created a lot of the market angst in the first place. Neither policy is set in stone. While the administration has described a "no pain, no gain" approach, they likely would prefer to avoid a recession. A slower approach could help ease the angst, allowing the market to breathe a sigh of relief – and the economy to hopefully avoid a recession.

The chart below shows the degree to which incoming economic data is above or below expectations. It shows that slowdowns occur with regularity. We may be in one now. However, a growth slowdown is different from a recession.



Source: Bloomberg as of 3-13-25

What are the likely impacts on the financial markets of federal policies as they evolve on tariffs, DOGE, immigration, taxes, and regulation?

Implementation of tariffs, the Department of Government Efficiency (DOGE), and deportation of undocumented immigrants have been among the first policies enacted in the Trump presidential administration. Tariffs and deportation have caused concern in financial markets, primarily because of their potential to increase inflation. Should inflation occur to such an extent that workers are forced to negotiate higher compensation, an undesirable new wave of inflation could occur. This would be the difficult wage-price spiral in which increasing goods prices create increasing wages, which in turn causes employers to raise prices on their goods and services, in a potentially perpetual manner. If this were to occur, the Federal Reserve could be forced to resume raising rates. The adjustment would be unpleasant for financial markets currently looking for rate cuts.

DOGE actions are taking the form of mass layoffs of government employees. Their impact could be amplified by reduced revenues at government contractors, who may also be forced to let go of workers. If enough workers become unemployed, overall consumption and GDP could decline. Combined with the abovementioned inflationary impact, this could create a stagflationary environment. Corporate profits would decline, and financial markets – both stocks and bonds – would decline.

These are not definite outcomes, however. It is unclear how much inflation the tariffs will cause. Some of the price increases may be absorbed by producing nations. Even though tariffs are likely to increase consumer inflation, they may not be sufficiently high to cause the wage-price spiral. Without that phenomenon, the inflation will be one-time and not a sustaining, new wave. The Fed would likely look past a one-time price hike. Deportation has thus far been limited to a few thousand individuals—an almost inconsequential number in a workforce of 160 million. Government layoffs are much larger. However, even a theoretical 20% reduction in the federal workforce (or 500,000 people) might quickly be absorbed in an economy that grew jobs by 175,000 a month in 2024.

Finally, while financial markets are understandably focused on the negatives listed above, and the back-and-forth uncertainty with which policies are being implemented, there are policies to come that may potentially be positive for financial markets. If a lower federal deficit trajectory can come from DOGE, combined with a lighter regulatory framework and an extension of most of the Tax Cut & Jobs Act, that would represent a beneficial environment for financial markets. Whether that happens remains to be seen. However, it is at least worth considering, particularly at a time when the media seems hyper-focused on the potentially negative outcomes we've mentioned.

What are the most likely actions by the Federal Reserve in coming months? How might their actions affect both the economy and the financial markets?

In December, policymaker forecasts called for an average of two interest rate cuts in 2025, per Bloomberg. Currently, markets believe that three cuts may be more probable. Overall, markets expect another interest rate cut soon. The key question currently is whether we see a cut in May, June (more likely), or July (less likely).

According to fixed income markets, it is highly unlikely that the Federal Open Market Committee (FOMC) will cut interest rates at its next meeting on March 19, and we agree. In a speech last week, [Federal Reserve Chair Jerome Powell said](), "While progress in reducing inflation has been broad based, recent readings remain somewhat above our 2 percent objective. … Many indicators show that the labor market is solid and broadly in balance." So, with inflation above target and a robust job market, it appears unlikely a rate cut is imminent.

And, of course, many will wonder about the impact of the Administration's economic policies on FOMC decisions. In the same speech, Chair Powell also [said]() that the central bank can remain patient in adjusting its benchmark interest rate, citing uncertainty around the potential impact of President Trump's economic policies. "While there have been recent developments in some of these areas, especially trade policy, uncertainty around the changes and their likely effects remains high … As we parse the incoming information, we are focused on separating the signal from the noise as the outlook evolves. We do not need to be in a hurry and are well positioned to wait for greater clarity."

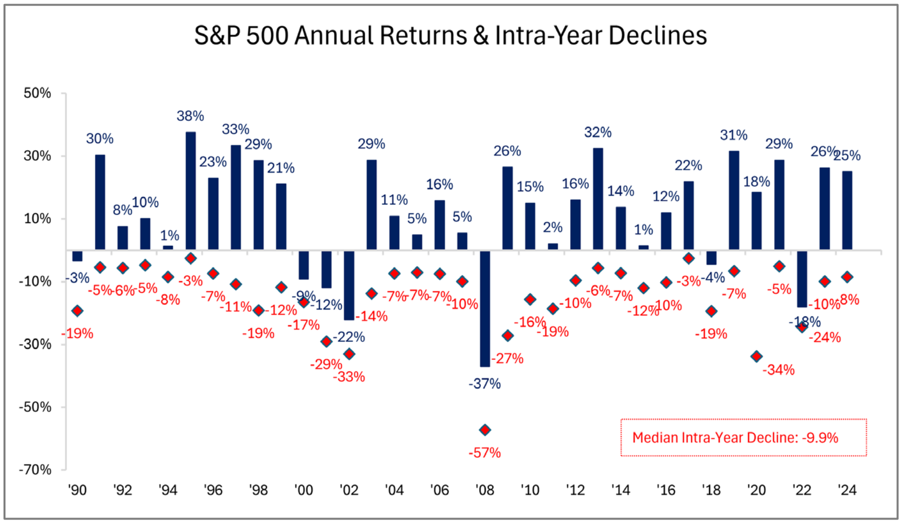
Is the U.S. stock market in a correction or the early stages of a bear market? Should investors be buying this dip? If so, what sectors of the market look most attractive?

Zoom out far enough on a chart of long-term equity returns, and it's easy to conclude that each dip was a buying opportunity. However, achieving that long-term result may require patience and weathering significant market corrections. The same could be true today.

Through March 11, the S&P 500 was approximately -9% below its all-time high on February 19. That drawdown is roughly in line with what history tells us we should expect. From 1990-2024, research from Strategas shows the S&P 500 had a median annual drawdown of -10%. The S&P 500 experienced yearly drawdowns of -20% or more on six occasions over that period, and the S&P had extended multi-year corrections of -57% from 2007-2009 and -49% from 1999-2002. In looking at prior recessions and growth scares, we see -20% as a reasonable mid-point among a wide range of results. That would imply the recent drawdown was roughly halfway there, as of March 11.

We don't believe we are on the cusp of a drawdown rivaling 2007-2009 or 1999-2002. Today's optimism for the "Mag 7" stocks and AI may rhyme with the hype of the "dotcom" bubble, for example. Still, valuations are much more reasonable now: as of March 11, Goldman Sachs estimated the Mag 7 stocks traded at closer to 26x earnings, and the average stock in the S&P 500 traded at just 16x earnings – near the long-term average. In comparison to the 2007-2009 financial crisis, the current housing situation does have some broad similarities to that period. Data from Case-Shiller shows home prices are up over 50% over the last five years, not far from the almost 60% increase from 2002 to the peak in 2006. But we see less cause for worry given better mortgage controls and lower leverage in the financial system. A larger drawdown akin to those periods would likely have a different cause, such as an entrenchment of the global trade war, a resulting global slowdown, and, potentially, stagflation. In other words, it's plausible, but we believe cooler heads would prevail.

We see a few ways to manage the risk of "buying the dip." First, adding exposure to the equal-weighted version of the S&P 500 could offer a more diversified mix of companies at a lower valuation than the market cap-weighted version. Second, we would consider buying areas that may benefit from a bigger investor rotation, such as international stocks and more defensive sectors. Finally, additional equity exposure could be paired with an asset like gold that may offer some protection from a bigger escalation.



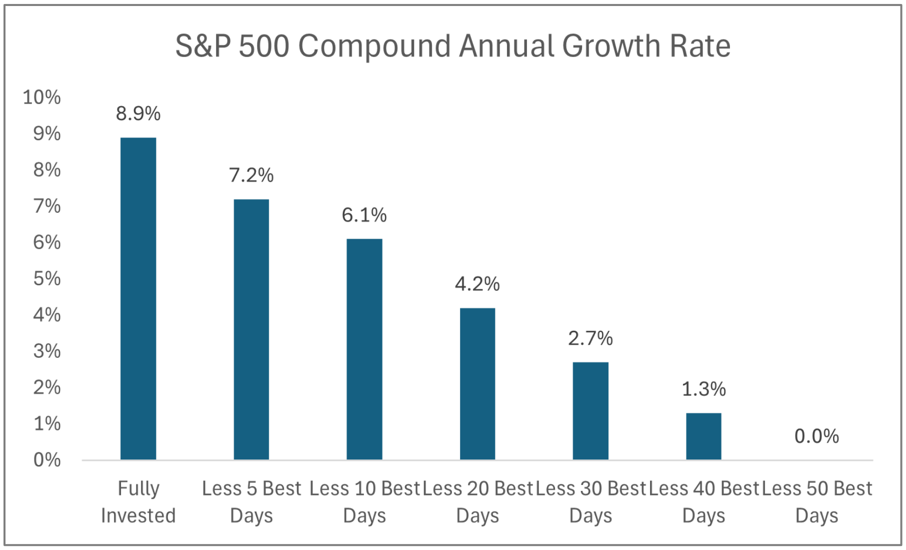
Source: Strategas and Cerity Partners

Why have international stocks outperformed U.S. equities in 2025? Can the trend continue?

After years of languishing behind the U.S. equity markets, international markets began 2025 with strong relative results. The MSCI EAFE Index is off to its best start in many years, even as the S&P 500 has suffered losses this year. While foreign stocks have been trading at what many describe as historically low valuations in comparison to U.S. equities for some time, there could be more than a valuation reset in play. It appears as if the response to the Trump Administration's trade policy has been a catalyst to drive impressive performance in the international markets thus far in 2025. While the U.S. tariff agenda may have fostered an environment of domestic uncertainty, the Administration's "America First" policies seem to be driving pro-growth policy shifts in Europe and Asia. For example, the April 2nd deadline may have driven the European Commission to relax emissions rules, helping automakers potentially impacted by U.S. trade policy. The outlook for a rise in European defense and infrastructure spending was likely impacted by the Trump-Zelensky White House meeting. In China, the National People's Congress meeting pledged a 5% GDP target with growth driven by a meaningful increase to the deficit to boost domestic demand. With economic and earnings estimates rising in Europe, supported by rate cuts by the European Central Bank and historically low valuations relative to U.S. equities, there is reason to believe this trend may be more than short-lived.

How is Cerity Partners adjusting its clients' portfolios in light of rapidly changing federal policy and economic conditions?

Cerity Partners strongly believes it's impossible to successfully and consistently time the market. The chart below shows the potential negative impact of missing the best days in the markets over a long investment horizon. While we don't endorse wholesale moves into and out of investments, we often recommend shifts within asset classes to reflect where we feel the opportunities are the greatest. Currently, we feel that the broadening of the equity rally beyond mega-cap technology stocks, which has been occurring since last summer, is likely to continue. An expanding economy combined with Federal Reserve rate cuts should support profit growth beyond technology stocks. In combination with lower valuations, this should lead to relative outperformance by the equal-weight S&P 500 versus the market-cap weight index. Furthermore, positive real yields along the investment grade yield curve encourages us to overweight this asset class, funded by underweight to high-yield bonds where currently tight credit spreads may not fully reflect risk levels.



Source: Strategas and Cerity Partners