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When the only way out is through

"When one door closes, another opens, but sometimes it's Hell in the hallway."

– Elisabeth Kubler-Ross

The Through Line: The old adage that suggests "when one door closes, another opens" is really only half the story. Significant transformation is rarely as easy as moving seamlessly from one chapter to the next - more often, we must traverse a messy middle. Given the rapid pace of change since the new U.S. administration took over a month ago, we find ourselves in precisely that territory. While there is no going back, the observant can see signs of what the environment looks like on the other side of that door.

Change is hard

In the U.S., a great deal of policy spaghetti has been tossed at the wall in the past 45 days, and figuring out what sticks, what stains, and/or what slides off is both art and science. We are not going back to the old ways: vote tallies in democracies around the globe have told us people are tired of the status quo and aching for something new. But what does "NewCo" look like?

Change always sounds so alluring (think of the excitement of making fresh resolutions every New Year's, for example). Yet the daily actions required to turn resolutions into a steady new direction can become irksome, worrisome or downright tedious. While the last U.S. election saw a plurality vote for change, some are finding it difficult to adjust in the short run according to a variety of recent surveys and economic reports.

Souring sentiment?

This week's consumer confidence report from the Conference Board, for example, showed the biggest month-over-month decline since the fall of 2021. Similarly, last week's University of Michigan consumer sentiment survey showed deterioration in several confidence factors for current and future expectations, as well as a surprising jump in future inflation expectations. Several other studies out last week also generated headlines that highlighted wavering confidence amid concerns over potential tariffs, government employee layoffs and aid cut backs.

While the reports made for splashy headlines, BMO U.S. Wealth Management CIO Yung-Yu Ma, Ph. D., has long noted that sentiment surveys typically have very little (if any) predictive impact on economic outcomes. Souring sentiment often leads observers to jump to the conclusion that spending may slow. In the short-term, though, there is no reliable correlation between sentiment as expressed to pollsters and whether or not aggregate consumption continues. That relationship is much more tied to employment status.

Business sentiment, as reported recently by the National Federation of Independent Business Survey (NFIB), has also shown signs of wavering as policy uncertainty has increased in the past month. However, it's important to note this slight moderation is on the back of a large post-election jump when prospects for a potential reduction in income taxes and a lighter regulatory touch burned bright.

Dr. Ma notes that while sentiment surveys in general have little predictive value – especially relative to accurately forecasting future inflation – large persistent moves in opinion do bear watching lest they translate into significantly delayed activity.

Bottom line: No one likes uncertainty, and a slew of new policies coupled with hard-to-plan-for impacts from as-yet-unspecified tariffs cloud the near term view. If resolutions or clarity on tariffs come relatively quickly then sentiment could swing back to more constructive in short order. **There is often a disconnect between what households and business leaders tell pollsters versus what they actually do. Ignore the headlines and follow the spending and investment decisions.**

Follow the money – and the policy proposals

The U.S. is largely unique among developed countries in that consumer spending accounts for over two-thirds of GDP. Consumers in aggregate have benefitted from globalization in recent decades as companies have spread supply and logistics activities to the most efficient parts of the globe and cheaper goods and services have flowed back to America. Though benefitting in the whole, key technological knowhow and jobs in certain sectors were lost as production of everything from textiles to semiconductors, drugs, batteries, robots, precision parts and numerous other goods was shipped elsewhere.

This intricate web of activity is the crux of many of President Donald Trump's campaign promises and early policy proposals. The ultimate goal is to rebuild key manufacturing prowess – and all the knock-on activity that goes with it – inside America's borders. President Trump wants what's purchased in the U.S. to be made in the U.S. and is encouraging this goal from many angles – from threats of tariffs on specific goods and industries to enticing direct foreign investment and M&A inside the country. Squarely on the Republican agenda are reinstating accelerated depreciation, fast-tracking permitting, reducing regulatory oversight and cutting the overall corporate tax rate for companies who manufacture in the U.S. – all with the goal of rebuilding America's industrial strength.

This type of change will not come quickly. It took decades to spread supply chains around the globe and it will undoubtedly be an intricate process to shift them back home. As we detailed in last week's [Weekly Strategy Perspectives: Nauseously Optimistic - BMO Private Wealth](#) many manufacturing leaders have been stymied in their search for domestic manufacturing capacity – but continue to try. The sooner tariff, tax and other policy can be settled, the sooner these companies can move to step up R&D, capital expenditures and joint venture activity.

Bottom line: Reshoring could help diversify the American economy from being lopsidedly dependent upon consumption, but it will take time, investment and a raft of constructive policy changes to get there.

Tariffs – please rip off the Band-Aid

Capital markets initially gyrated in response to various tariff announcements (or lack thereof in President Trump's first week) but have greeted more recent comments with a collective shrug. Companies, on the other hand, are finding it exceedingly hard to scenario plan with the shifting daily news. While businesses are doing what they can to plan and prepare, some evidence from recent reports indicates that investment and orders have slowed somewhat pending more clarity. Some companies that tried to proactively bring goods into the U.S. in anticipation of possible tariffs are footing extra storage costs. On the plus side, we can see early evidence of stepped-up activity from foreign manufacturers who are exploring the possibility of shifting capacity from Mexico into the U.S. and/or expanding existing plants already here.

Companies and consumers have been dealing with tariffs since 2018, though the current threats are potentially broader and deeper. We simply won't know the impacts until they're levied. Even then, the staying power of tariffs remains uncertain as feedback (backlash) from capital markets, business leaders and voters could spur a rethink. *We know from experience there is always room for negotiation.*

Bottom line: Like Lucy perpetually yanking Charlie Brown's football at the last moment, consumers and business leaders are psychologically exhausted from tariff uncertainty. The sooner tariffs are in place the sooner responses can be formalized. **Companies have proven their resilience over and over in the last decade – and we fully expect them to do so again.**

DOGE's shock and awe campaign

Rebuilding American manufacturing capacity was a core campaign promise, along with making government run more efficiently. What seemed like an almost tongue-in-cheek concept when tossed out at a late summer rally, the Department of Government Efficiency (DOGE) has quickly taken on a life of its own with a flurry of employee layoffs, spending cuts and aid freezes. Anna Wong, Chief U.S. Economist for Bloomberg Economics, released a detailed model this week, noting that *"DOGE cuts will likely show up first in lower GDP growth as early as the second quarter of this year, with the unemployment rate rising briskly in the second half of 2025."*

BMO U.S. Wealth's Dr. Ma also expects DOGE to have deflationary impacts. He notes that first-level job cuts would likely be accompanied by other knock-on impacts, prompting weakness in what many consider a steady employment market. Such weakness could, in turn, prompt the Federal Reserve to come off the sidelines and get back into rate cutting mode.

Bottom line: Though DOGE has already faced numerous lawsuits in its pursuit of reducing government spending and streamlining processes, the theme of its work is not going away anytime soon. The new administration has campaign promises to keep relative to tax cuts. It is also determined to try to wrestle down the government's budget deficit, meaning the group's work is likely to stay a top priority. Progress on government efficiency can have a positive impact on inflation but could conversely put downward pressure on U.S. growth depending upon how cuts and knock-on impacts play out.

Wrapping it all up

While we know (at least subliminally) that going back through the door we just closed isn't an option, the path ahead can seem unduly challenging when change is happening at a rapid pace. Capital markets have done a reasonable job of adapting in nuanced fashion to the variety of changes. Let's hope business, consumer and investor psyches can also go steadily forward through that murky hallway.

In focus in North America

Jon Borchardt, Sr. Analyst

George Trapkov, CFA, VP and Portfolio Manager

This week

Let the U.S. (political) games begin – Now that both the House and Senate have passed budget resolutions, the arduous process of delivering a final reconciliation bill to President Trump's desk is officially underway. The House resolution aligns with Mr. Trump's call for "one big, beautiful bill," extending \$4.5 trillion in expiring tax cuts, boosting border security and defense spending, and raising the debt ceiling by \$4 trillion – all while promising \$2 trillion in spending cuts to appease fiscal conservatives. The Senate's version is more restrained, offering \$340 billion in security and defense funding, but no tax cut extension or debt ceiling increase. The massive gap between the two plans must be resolved, with committees in each legislative body tasked with using the reconciliation instructions to draft budget targets. **With the current budget resolution expiring on March 14, Republicans must either finalize a reconciliation bill or negotiate a continuing resolution with Democrats to avoid a government shutdown. Tick-tock the clock is ticking.** Getting the house bill across the line at all marks an early win for House Speaker Mike Johnson and President Trump.

Canadian election fever mounts – The Liberal party leadership candidates debated in French and English this week, with the focus on tariff responses and Canadian economic growth. All candidates are expected to increase defence spending and bring it to the 2% NATO target. Tax cuts, immigration and inter-provincial barriers to trade were also part of the debate. The biggest discussion focused on the candidates' ability to counter President Trump's proposed tariffs and how to best position the Canadian economy. Mark Carney, ex-governor of the Bank of Canada, and former finance minister Chrystia Freeland are the two front-runners in the Liberal party leadership race, which will be decided in an election March 9, 2025. Canada's Parliament is prorogued until March 24. **It is widely expected that once Parliament returns, a federal election will be called and must be held on or before October 20, 2025.**

Canadian Bank Earnings – Banks started reporting this week with BMO, BNS and National reporting better-than-expected results. Capital markets earnings were strong while provisions for credit losses were contained. The banks reported higher revenues and strong capital levels. They mentioned that clients are cautious around capital deployment given the geopolitical risk. Loan demand and mergers/acquisitions may slow in the near term as businesses seek more clarity on tariffs.

Still tariff-ied – The tariff train is set to pick up speed, with a 25% levy poised to be imposed on virtually all goods imported from Canada and Mexico and an additional 10% on China next

week. On March 12, a 25% tariff on all imports of steel and aluminum is also scheduled for implementation. (For Canada and Mexico, these will be stacked tariffs, meaning imported steel from Mexico would face a 50% tariff.) April 2 brings 25% tariffs on autos, pharmaceuticals, semiconductors, lumber and forest products. During a press conference at the White House on Wednesday, President Trump said 25% tariffs on the EU are coming too and the idea of reciprocal tariffs is still in play. Significant drops in both consumer and business confidence have been tied to uncertainty and risk associated with the Administration's trade policies. **Alcoa warned attendees at this week's BMO Metals, Mining and Critical Materials Conference that a 25% tariff on aluminum imported from Canada could cost 100,000 U.S. jobs.**

Strong Canadian economic data continues – Retail sales surged 2.5% in December, much stronger than expected and the highest growth rate since 2022. Gas stations (+4.2%) led the way thanks to higher prices. While it's possible the sales tax holiday helped food and beverage (+3.5%), general merchandise (+3.2%) and clothing (+3.1%), the strength was broad based. On the employment front, we have also seen both robust job growth (+2.0% year over year) and solid real wage growth (+1.6% YOY), as well as longer workweeks. Taking it all together, a proxy of real incomes is up about 4% YOY, and that's also true over the last two years. Even if the retail sales momentum fades (flash estimate points to a 0.4% decline for January), **these figures add to the argument for the Bank of Canada to pause at next month's meeting.**

U.S. consumers feeling gloomier – Over the past week, both the Conference Board and the University of Michigan consumer surveys reported significant drops in consumer sentiment, contributing to broader economic concerns and fueling a risk-off narrative in the markets. The Conference Board's February survey shows consumer confidence falling seven points to 98.3, marking the lowest reading since April 2024 and the largest month-over-month decline since August 2021. The Bloomberg consensus forecast had expected a reading of 102.5. According to the Conference Board, the decline in consumer confidence was broad based, impacting most age and income groups. **Twelve-month inflation expectations rose 0.8% month over month to 6%, driven by persistent inflation, higher household staple prices, and concerns over tariffs.** BMO U.S. Wealth Management CIO Yung-Yu Ma, Ph.D., has long argued that consumer sentiment surveys are typically a poor leading indicator of future economic outcomes, but with an important caveat: on occasion, large drops in current conditions that are not stabilized or reversed quickly can point to impending spending slowdowns.

Next Week

Tariff talk is likely to remain front and center, with the threatened March 4 across-the-board levies on Mexico and Canada looming. The Fed's Beige Book on Wednesday and key jobs numbers in both the U.S. and Canada on Friday will be watched for sentiment and activity clues.

- **Monday 3/3** – Potential tariffs on U.S. imports from Canada and Mexico readdressed
- **Tuesday 3/4** – U.S. President Trump addresses joint session of Congress in de facto State of the Union address, NFIB Small Business Index | Canada Building Permits

- **Wednesday 3/5** – U.S. services PMIs, Fed's Beige Book | Canada labor productivity, services PMIs
- **Thursday 3/6** – U.S. jobless claims, productivity, trade deficit | Canada trade balances
- **Friday 3/7** – U.S. jobs reports | Canada employment reports

Data scorecard as of February 26, 2025

Equity Market Total Returns						
	2/26/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	5,956	-0.9%	1.5%	25.0%	26.3%	-18.1%
NASDAQ	19,075	-2.3%	-1.1%	29.6%	44.7%	-32.5%
DOW	43,433	0.0%	2.3%	15.0%	16.2%	-6.9%
Russell 2000	2,174	-1.0%	-2.4%	11.5%	16.9%	-20.5%
S&P/TSX	25,328	0.7%	2.7%	21.7%	11.8%	-5.8%
MSCI EAFE	8,814	0.8%	9.1%	3.8%	18.2%	-14.5%
MSCI EM	607	-1.0%	5.8%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Treasury		1.0%	2.3%	0.6%	4.1%	-12.5%
Bloomberg U.S. Aggregate		1.0%	2.5%	1.3%	5.5%	-13.0%
Bloomberg Canada Aggregate		0.8%	1.7%	4.0%	6.5%	-11.3%
Bloomberg U.S. Corporate		1.0%	2.6%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.4%	2.0%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.4%	1.5%	0.9%	4.5%	-4.7%
Government Bond Yields						
	2/26/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.26%	4.54%	4.57%	4.57%	3.88%	3.88%
Canada 10-Year Government	2.98%	3.06%	3.23%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.50%	4.54%	4.56%	4.56%	3.53%	3.66%
German 10-Year Bund	2.43%	2.46%	2.36%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.36%	1.24%	1.09%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	2/26/2025 Level	WTD	YTD	2024	2023	2022
USD Index	106.42	-0.2%	-1.9%	7.1%	-2.1%	8.2%
CAD:USD	\$0.70	-0.8%	0.3%	-7.9%	2.3%	-6.7%
Bitcoin	\$84,470.18	-11.4%	-9.9%	120.5%	157.0%	-64.3%
Gold	\$2,916.39	-0.7%	11.1%	27.2%	13.1%	-0.3%
Oil (WTI)	\$68.62	-2.5%	-4.3%	0.1%	-10.7%	6.7%

Data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.



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