WEEKLY STRATEGY
Perspectives

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Global Policy Pivots – Transitory or Enduring?

"An object in motion tends to stay in motion unless acted on by an outside force."
– Sir Isaac Newton's First Law of Motion

The Through Line: While meant for moving objects, Newton's first law applies to *trends* as well – and President Donald Trump clearly qualifies as the outside force prompting pivots in a wide swath of global trade, security and political alliances. The world is in a tricky spot given the depth and breadth of change introduced in the past two months. Deciphering what endures versus what reverts will require patience and time. For investors, a cast-iron stomach, along with broad diversification, should be helpful as markets are likely to remain roiled until new trends are firmly established.

Unleashing vertigo

The policy onslaught introduced by U.S. President Donald Trump on his first day in the Oval Office put the world on notice that he intended to swiftly alter the status quo. While the administration's activities may seem chaotic based on the sheer number of announcements (amplified by intense media coverage), policy outlines were evident even before the election was decided. There are some core pillars:

- **Unwind globalization** – bringing manufacturing and related jobs back to the U.S. and rebuilding the middle class
- **Reduce government spending, waste and regulatory interference** – to help get the nearly $2 trillion annual U.S. budget deficit back in hand
- **Control the border** – using immigration enforcement, deportations and tariff policy
- **Hard code tax relief** – specifically the personal income tax cuts from the Tax Cut & Jobs Act (TCJA) passed during President Trump's first term that are set to expire at the end of this year. If allowed to expire, an effective (and large) tax increase goes into effect. In addition to extending TCJA, campaign promises relative to "no tax on tips or social security" and increasing the State and Local Taxes (SALT) cap are also in scope, provided enough revenue can be raised from other sources
- **Refocus U.S. policy priorities to within America's borders** – including energy independence and geopolitical support

Virtually all these things were discussed during the campaign and in the interlude between Election Day and inauguration. Yet few observers expected they would be addressed simultaneously and using multiple tools. Cue the collective vertigo as we attempt to keep up. Clearly capital markets have also had difficulty finding their footing, the equity markets in particular. They have declined sharply over the last two weeks after setting all-time highs in late February.

DOGE – unexpectedly ferocious policy tool

While the newly created Department of Government Efficiency (DOGE) was not new news either, its sanctioned and immediate reach into all areas of the government shocked virtually everyone. Reducing waste and inefficiency is a noncontroversial goal in the broadest sense. But Main Street noticed when the changes entailed indiscriminate firings of large percentages of staff, immediate disruption in wide swaths of services that individual citizens interact with daily, and implementation with the elegance of a chainsaw rather than a scalpel.

Pain then gain

Nudging the world's largest economy toward a better balance between consumption and manufacturing is not likely to entail quick fixes. Similarly, unwinding entrenched processes takes time because attached to each penny spent are voting constituents with a vested interest in supporting the status quo.

Further complicating the choices is the fact that America's current run rate of overspending adds nearly $2 trillion annually to the existing record pile of accumulated government debt.

In President Trump's first term, tax cuts (the TCJA) came first in 2017 while tariffs (more focused, smaller amounts and mostly levied on China) came in 2018. Markets liked the stimulative pro-growth nature of the tax cuts and rallied in 2017, but they struggled with the trade war in 2018.

Trump 2.0 is presenting markets with the opposite scenario: tariffs and already escalating trade wars first, with the promise of more pro-growth policies (tax extension, reduced regulation) coming later. The President and various members of his economic team have been omni-present on a variety of media in the last week or two, explaining that a period of "transition[i]" will be needed as the economy "detoxes" from a reliance on government spending and that building a strong economy means we[ii]"can't really watch the stock market.[iii]" In short, it's **veggies before dessert**.

Still. Really. Tariff-ied

Though markets are often credited with being forward looking discounting mechanisms, investors have found it tough to get past the near term pain long enough to focus on theoretical gain that may or may not come in the future. Obviously complicating matters further is all the ping-ponging over specific tariffs (who, what, when) and the hasty withdrawal of some policies (either through admission that something got broken that should not have been broken or through court order).

Companies are finding it virtually impossible to plan without knowing what the rules are. Imagine arriving at the rink only to learn you're curling today rather than playing hockey. The consternation is even now showing up in specific economic numbers in the U.S. and in key trading partners via distorted figures in import/export and inventory. Business angst is also showing up through delayed expansion activity, withdrawn corporate bond offerings (especially evident early this week) and a failure to launch of the pent-up M&A and IPO activity that has been stifled since the 2022 downturn. In recent days, a growing number of consumer-sensitive companies (e.g., retail, airlines) have also cut their guidance on future quarters' growth expectations – largely because they have no way to accurately forecast the impact of tariffs and policy and are opting to set the bar low.

While consumer spending and employment have mostly been solid for the past few years, Yung-Yu Ma, Ph. D., BMO Wealth Management-U.S. CIO, notes (Trade War – ACT II - BMO Private Wealth) *"Even the once stalwart U.S. labor market has seen certain leading indicators, such as temporary employment, turn negative. In the past year, consumer spending was bolstered by the positive 'wealth effect' whereby higher stock prices led to greater spending. This effect has now turned neutral and is at risk of going into reverse if market weakness persists."*

What about the "R" word?

U.S. markets have obviously been risk intolerant in the last few weeks as the decline from recent highs accelerated. While trader nerves are raw, the downdrafts have been orderly for the most part and are not yet indicative of the high-volume panic selling that typically accompanies true market lows.

So far, economic progress has been reasonable, though as noted it is showing signs of increasing stress at the margin. **If policy clarity were to emerge sooner rather than later, the pause in activity could reverse rather quickly. Business, consumer and investor sentiment could rebound as well.** It is also worth noting that the Fed has ample policy room to maneuver should employment soften markedly and/or overall economic growth slow unacceptably. **Dr. Ma does not believe a U.S. recession is likely at this juncture, although markets are expected to continue gyrating until final policy and tariff trends are more clearly defined.**

The elephant picks fights

Remember how exuberant markets were that tariff policy wasn't included in the first round of executive orders (EOs) on inauguration day? The joy was short-lived as double digit levies on the U.S.'s three largest trading partners were announced a few days later. Because it's the world's largest economy, what happens in America doesn't stay in America – it has implications for others such as Canada, the EU, China and Japan. Given space limitations, we will address Canada this week – and save the others for a coming issue.

Consequences for Canada

As the largest purchaser of U.S. goods and steady ally for well over 100 years, Canada has been justifiably wounded by both the trade war and President Trump's repeated trolling about making it the 51st U.S. state.

President Trump is well aware of the disparate economics and the strong position the U.S. comes from – both politically and economically – relative to Canada. BMO Economists note that if a full blown trade war persists, it would likely force the Canadian economy into a recession and push inflation a bit higher (Tariff Trauma) while doing minimal damage to the U.S. economy (though specific industries such as autos, builders and farmers would feel it acutely).

Brent Joyce, CFA, BMO Private Investment Counsel's Chief Investment Strategist, notes that partial offsets to the pain could be provided by a weaker loonie, the green shoots of economic revival already surfacing and the Bank of Canada's globe-leading rate-cutting campaign (link Brent's March Piece). An intensified national spirit has emerged, on full view in the acceptance speech of new Prime Minister Mark Carney, who said that Canada knows what to do when someone else drops the gloves.[iv]

Bottom line for Canada

Short term volatility in markets is likely to continue until some modicum of clarity emerges (though it should be noted that the loonie, fixed income and equity markets have actually held up better than their U.S. counterparts in recent trading sessions). After a politically tumultuous past couple of years, clarity could be coming in a matter of months if not weeks. The threat from U.S. trade is helping unify and focus the country not just politically but economically as boycotts and the search for new trading partners commences. Has a long term pivot away from such ingrained interdependence with the U.S. begun? Time and action will tell.

Implications for investors

The actions of a select few individuals have lobbed an "object" into the trajectory of long standing global relationships, trade agreements and (potentially) military alliances. The implications of these disruptions are causing investors to question the viability of global growth, and indeed many of the ramifications are potentially negative. The ultimate impact depends in part upon how long it takes to clarify policy so businesses, countries and consumers can decide to resume or alter course.

As investors, we must not exaggerate the impacts simply because the constant barrage of headlines and flip-flops have frayed our emotions. While capital markets have been under pressure, it is important to keep the movements in perspective – we *are not* in a panic selling environment. Given what is transpiring and where markets are coming from, **the movements remain orderly**. Keep in mind the following:

- Economic *slowdowns* do not typically trigger significant or lasting drawdowns on stocks. A recession of any consequence might, but we are not of the belief that current events will propel things to that level. Enough policy has shifted in the past few weeks that could slow overall growth somewhat, but the solid fundamentals that underpinned both U.S. and more recently Canadian economic data, are expected to remain supportive.
- Remember: the markets are NOT the economy though they are influenced by economic activity. Markets react quickly to adjust to new information – then they move on. It is worth noting that the bulk of the market adjustment to the declaration of the Covid 19 Pandemic took three weeks in March of 2020. Markets then staged a multi-year rally from those lows.
- Policy uncertainty is driving the current drawdown with measures of policy uncertainty hitting levels reminiscent of the US debt downgrade/Euro scare in 2011 and COVID 19 in 2020. Historically, these levels of policy uncertainty have augured for strong forward returns on average 3, 6, and 12-months following.
- Double digit pullbacks (even in uptrending markets) are quite normal, as noted in last week's (Weekly Strategy Perspectives: Breathe - BMO Private Wealth).
- Some parts of the market were due for a cleanse.

Not all assets are being hit – and not all stocks are being hit equally. The most expensive, stretched parts of the market are down the most (think NASDAQ). Yes, the S&P 500 closed down 10.1% from its prior peak on March 13, officially entering correction territory, but the equal-weight S&P 500 is not off as much. Most non-U.S. markets are nowhere near correction territory, outperforming their U.S. counterparts. In fact, many remain positive on the year. As of March 13, the MSCI EAFE Index is up 9%, the MSCI Emerging Markets Index is up 3.6%, while the TSX is only down 2%. Currency moves are working to dampen the impacts for Canadian investors as all these equity index returns improve when converted to Canadian dollars; dividends continue to flow, too. More balanced investors are seeing their high-quality fixed income in the U.S. and Canada deliver low-single-digit positive results on the year as of this writing.

While we are mindful of the increased recession/slowdown risk, we pay zero attention to politicians predicting one or refusing to rule one out. Politicians don't dictate how the aggregate economy performs – businesses and consumers do. Policy clarity would help both those constituencies immensely.

Macroeconomic forecasts are currently heavily dependent upon getting to clarity around tariff policy. The range of potential outcomes is wider than is typical, leading to less confidence in the ability to forecast than even three- to-six months ago. Trading on the headlines is never a wise choice and even less so today. On the flip side, relying on diversification is.

Well-diversified investors do not need to trade in this whipsaw environment, they are able to ride out the storm leaning into the portions of the portfolio that are providing sheltering attributes. Experience shows, time and again, it is better to navigate through rather than around volatility. Like any storm, winds can shift quickly. The emergence of policy clarity from the U.S., for example, could come as fast and furious as the chaos up to this point, and turn business, consumer and market sentiment quickly – along with a sharp snap back. We make reasoned moves motivated by our research, experience and analysis – not knee-jerk reactionary moves to fast moving, emotionally charged headlines.

In focus in North America

Jon Borchardt, Sr. Analyst
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This week

Canadian Central Bank cuts rates again – The Bank of Canada cut its overnight rate for the seventh consecutive meeting, this time by 25 basis points to 2.75% as widely expected. This brings the cumulative rate reduction to 225 basis points since the Bank of Canada started cutting just nine months ago. The statement highlighted the firming economic backdrop to end 2024, with better GDP and job growth. However, that strength has given way to the impact of the bubbling trade conflict and weaker consumer and business sentiment. **BMO Economics continues to expect cuts of 25 basis points at each of the next three meetings, taking the overnight rate down to 2%.**

Barreling toward a U.S. government shut-down cliff – Senate minority leader Chuck Schumer said Democrats will not support the continuing resolution (CR) sent over by House Republicans. Eight Senate Democrats are needed to join every single Senate Republican in affirming the legislation for passage to occur. The questions for Democrats, do they want to give House Republicans and President Trump 100% of what they want without anything in return – or be branded as the team that shut the government down? Senate Majority leader Thune is reportedly working on a backup plan. House Republicans passed the CR with no input from either House Democrats or Senate counterparts – then adjourned so they would not have to negotiate any changes. The clock is ticking and if the Senate does not pass this bill by Friday at midnight, the U.S. government will shut down.

Canada's jobs picture – Employment was flattish in February as the economy added just 1,100 jobs overall following a burst of hiring in the three prior months. Even with the moderation, the jobless rate held steady at 6.6%. Harsh weather in much of the country mid-month may have played a role in these figures. The one super-strong sector was retail and wholesale trade, with an increase of 50,800 jobs – yet another positive indication of a reviving Canadian consumer. Retail strength was offset by weakness in professional and technical jobs, and transportation and warehousing.

Canada selects a new Prime Minister (in waiting as of press time) – By a landslide the Liberal Party of Canada chose Mark Carney as its new leader and "Prime Minister in waiting." Current Prime Minister Justin Trudeau must resign before the former central banker can take over. Once sworn in, Mr. Carney is expected to appoint his cabinet very quickly. Canada's Parliament is not expected to convene until March 24. At that time either Mr. Carney or the opposition parties will likely trigger an early election if Mr. Carney has not yet called one. The Liberals have been gaining in the polls since early January. This election will be a vote on which party and leader are viewed as better equipped to handle the looming tariffs and potential economic challenges facing Canada.

New U.S. tariffs on aluminum and steel – The stroke of midnight on Wednesday ushered in new 25% tariffs on all steel and aluminum imports to the U.S. The potential impact of President Trump's trade policies was already reflected in domestic prices for both metals, as well as other critical inputs like copper and lumber, which face 25% tariffs on April 2. Efforts by the manufacturing and construction sectors to build inventories ahead of the tariffs have driven significant input cost inflation, with U.S. prices for these commodities now trading well above global benchmarks. The Federal Reserve's February Beige Book **noted concerns relative to tariffs were adding uncertainty to the business outlook and posing a risk to capital spending and hiring plans.** Higher input costs have also begun translating into higher prices for consumers as inflationary pressures move through supply chains. Meanwhile, retaliatory tariffs from Canada and Europe introduce yet another layer of complexity for businesses navigating these trade disruptions.

Canary in the coal mine? Continued stress signals from U.S. companies and data – This week, each of the nation's four largest airlines warned that first-quarter earnings would fall below prior guidance. Weather disruptions, the Los Angeles wildfires and recent safety incidents were cited as revenue headwinds. However, what truly stood out were **signs of waning consumer and business confidence.** In a regulatory filing, Delta Air Lines attributed a recent decline in confidence to "increasing macro uncertainty, driving softness in domestic demand." Speaking at an investor conference, United Airlines CEO Scott Kirby noted that weakness in the domestic market initially stemmed from reduced government travel but has since bled over into consumer demand, with economic pressures likely to accelerate in the near term. **A sharp decline in travel from Canada** was also noted. Meanwhile, Southwest Airlines has observed a "softness in bookings and demand trends as the macro environment has weakened." This represents a dramatic shift in tone from the optimism expressed just a few months ago. The outlook downgrade coincides with declining sentiment in recent consumer and business surveys. **While U.S. equity markets rallied on Wednesday following a softer-than-expected inflation report, it's worth noting that lower airfares – down 4% month over month – were a major contributing factor.** All of this raises the question whether the airline industry is the canary in the coal mine, signaling greater turbulence ahead for the broader economy.

More signs of flagging U.S. business sentiment – post-election, animal spirits were running high as prospects for a reduced regulatory burden and lower taxes seemed to tee up stronger growth. More recent clouds have appeared, though, as shifting trade and tariff policy impacts the ability to plan and hints at slower growth in the near term. Equity markets are now pricing in increased odds of a U.S. recession. In addition to another round of soft statistics from the most recent PMI and NFIB surveys out this week, the Business Roundtable released a letter urging President Trump's administration to swiftly remove the tariffs or risk "creating serious economic impact." On Wednesday, President Trump met with approximately 100 CEOs at the group's quarterly meeting, where he reiterated his commitment to tariffs, viewing them as a key catalyst for revitalizing domestic manufacturing and generating revenue. He dismissed concerns about a recession and reaffirmed his commitment to reducing the regulatory burden and cutting taxes. BMO Wealth Management CIO Yung-Yu Ma, Ph.D., believes that U.S. fiscal policy has turned contractionary and will remain a headwind to growth in the first half of 2025.

Next Week

A data heavy week with key manufacturing activity readings and retail sales in the U.S. and in Canada CPI, PPI, inflation and housing activity numbers. On Wednesday, all eyes and ears will be intently focused on the U.S. Federal Open Market Committee rates decision – or more accurately the press conference afterward.

- **Monday 3/17** – U.S. February retail sales, March Empire State Manufacturing Index | Canada housing starts
- **Tuesday 3/18** – U.S. Industrial Production and Capacity Utilization | Canada CPI and inflation statistics
- **Wednesday 3/19** – U.S. FOMC rate decision and press conference
- **Thursday 3/20** – U.S. Initial Jobless Claims, Philly Fed manufacturing and February leading economic indicators | Canada PPI
- **Friday 3/21** – Canada New Housing Price indexes and retail sales

Data scorecard as of March 12, 2025

Equity Market Total Returns						
	3/12/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	5,599	-2.9%	-4.6%	25.0%	26.3%	-18.1%
NASDAQ	17,648	-3.0%	-8.5%	29.6%	44.7%	-32.5%
DOW	41,351	-3.3%	-2.5%	15.0%	16.2%	-6.9%
Russell 2000	2,026	-2.3%	-8.9%	11.5%	16.9%	-20.5%
S&P/TSX	24,423	-1.3%	-0.8%	21.7%	11.8%	-5.8%
MSCI EAFE	8,800	-1.6%	8.9%	3.8%	18.2%	-14.5%
MSCI EM	595	-1.5%	3.7%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Aggregate		-0.1%	2.0%	1.3%	5.5%	-13.0%
Bloomberg U.S. Treasury		0.0%	2.1%	0.6%	4.1%	-12.5%
Bloomberg U.S. Corporate		-0.4%	1.5%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		-0.4%	1.3%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		-0.2%	1.1%	0.9%	4.5%	-4.7%
Bloomberg Canada Aggregate		-0.3%	1.0%	4.0%	6.5%	-11.3%
Bloomberg Canada Treasury		-0.2%	1.3%	2.9%	5.0%	-9.9%
Bloomberg Canada Corporate		-0.3%	0.8%	6.9%	8.2%	-9.5%
Government Bond Yields						
	3/12/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.31%	4.21%	4.57%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.07%	2.90%	3.23%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.72%	4.48%	4.56%	4.56%	3.53%	3.66%
German 10-Year Bund	2.88%	2.41%	2.36%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.52%	1.37%	1.09%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	3/12/2025 Level	WTD	YTD	2024	2023	2022
USD Index	103.61	-0.2%	-4.5%	7.1%	-2.1%	8.2%
CAD:USD	$0.70	0.0%	0.1%	-7.9%	2.3%	-6.7%
Bitcoin	$83,107.01	-3.7%	-11.3%	120.5%	157.0%	-64.3%
Gold	$2,934.77	0.9%	11.8%	27.2%	13.1%	-0.3%
Oil (WTI)	$67.68	1.0%	-5.6%	0.1%	-10.7%	6.7%

[*]Benchmark 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. 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 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. 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.

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 Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

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[i] Trump says US economy will experience 'period of transition' when asked about recession chances | Fox Business
[ii] US Treasury's Bessent says economy may slow in shift away from public spending | Reuters
[iii] Trump says a transition period for the economy is likely: 'You can't really watch the stock market'
[iv] Mark Carney warns US, says Canada will win trade war like in hockey | World News - Business Standard