

# Fortunato Asset Management

## Q1 2025 Market Update



## The Why Behind the Chaos and the Likely Outcome

### The Backdrop

In our last market update in early January we noted the following about the S&P 500's 2025 setup:

- Market forecasts by the large banks/investment houses were high despite near record valuations – a negative sign.
- Consumer confidence in higher valuations for stocks near record highs despite near record valuations – a very negative sign.
- U.S. market capitalization had grown rich compared to the rest of the world – a negative sign.
- By many valuation metrics, the U.S. market was its most expensive in history.. – you get the picture.

The update went on to summarize the current scenario: “In sum we have an expensive S&P 500 with high expectations. Nothing new, but the floor is way down there somewhere, while the ceiling seems just above our heads. The risk profile for the S&P is not in our favor...”

Here's a link:

<https://fortunatofunds.com/newsletters/Q4%202024%20Market%20Update%20Newsletter%20PDF.pdf>

### The Now

With that setup, the market will look for any excuse to drop like volcanic rock. And it's just shed 11% in two days and 16% year to date as I write this, purportedly on tariff concerns.

But is it really about tariffs? Kind of no. In our opinion it's about a reset to an over-valued market, the need to bring down interest rates, and the need to cut government spending.

Everybody knows, "Art-of-the-Deal" Trump likes to negotiate. He warned weeks ago that he was implementing reciprocal tariffs on "liberation day." He and Elon Musk have both alluded to "temporary economic hardships," for months. So why was the market shocked? We don't think it was. Tariffs were just an excuse for the retreat.

## The Then

Will we have a recession? Probably. As we've noted ad nauseum in past market updates, the yield curve inversion predicted it. Will it be deep? We don't think so, two quarters seems about right, though the yield curve inversion was quite deep and long, so we could be wrong there.

The formula for Gross Domestic Product (GDP) is:  **$GDP = C + I + G + (X - M)$** , where C represents consumer spending, I is investment, G is government spending, and (X - M) represents net exports (exports minus imports).

The economy has been held up by high end consumers and massive government spending deficits over the past few years. So let's look at each component:

- Consumer – likely to cut spending. Stock market drops create a negative wealth effect (make people feel poorer). Job losses also hurt consumer spend.
- Investment – likely drops as companies put capex purchases on hold.
- Government – DOGE cuts.
- Exports minus Imports - No idea.

3 out of 4 look sure to slow.

<https://seekingalpha.com/article/4764583-musk-expects-market-pain-i-believe-him>

Why would the administration want a recession or slowdown?  
Answer: Necessity.

The U.S. has \$9T of debt repricing over the next year. \$9 Trillion! Plus another \$1T in issuance to support deficit spending. \$10 Trillion of U.S. bonds have to be

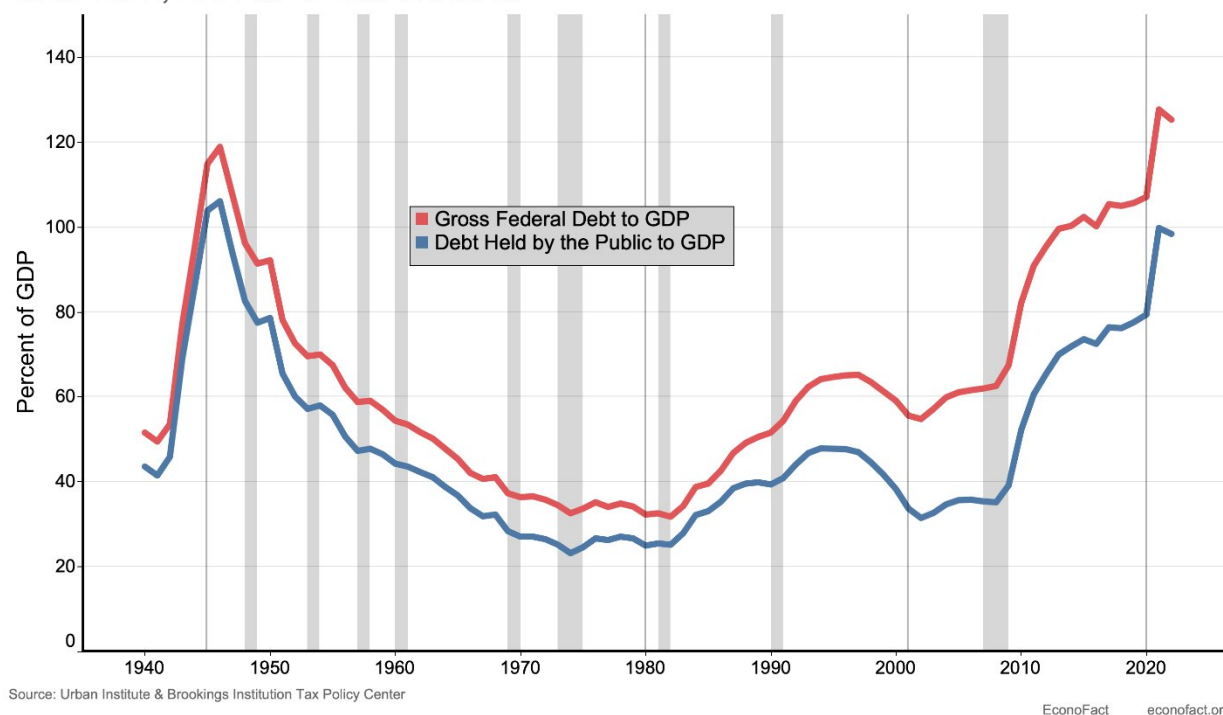
sold. That's more than the GDP of Japan, the United Kingdom, and South Korea combined. Much of that debt was financed at lower rates, so we, the U.S. (the administration) need to bring down yields.

The Federal Reserve can reduce short term interest rates through Fed Funds operations but has few weapons to impact the 10 year bond. So in order to get long bond rates down, you essentially need to bring down GDP and inflation (take a hammer to the economy.) This is one reason Trump has been working to bring down oil prices. Oil prices have an outsized impact on inflation. Of course, oil drops during recessions due to decreased demand.

So this is the reason we need a recession, or economic slowdown. Recall that a recession is nothing more than two quarters of negative GDP growth. Why recessions are actually good for an economy is a discussion I'll hold off on for now.

U.S. Treasury Secretary Scott Bessent has stated his goal is to get the 10-year U.S. Treasury rate down so he can write longer-term debt.

### UNITED STATES FEDERAL DEBT RELATIVE TO GDP 1940–2022, END OF YEAR VALUES



The chart above shows that our current U.S. debt has surpassed even the extreme debt during WW2. This is a VERY serious issue. Many studies show that growth

slows after going north of 100%. Remember the Greek Debt Crisis a few years ago? Debt surpassed 130% there.

Finally, all that Treasury debt refinancing in 2025 may have the effect of crowding out liquidity for other purposes. In that event, we can expect further drops in stocks, bank stocks, gold and even bitcoin for a time.

## **Key Stat for 2025**

We recently did some research on S&P 500 negative years back to 1939. 19 out of 22 times, when the market is negative during the 1<sup>st</sup> quarter, it's down for the whole year. The S&P 500 was down 4.5% in Q1.

I once thought Cathie Wood, CIO of Ark Investments was loony. Now I think she's crazy like a fox and just ahead of the crowd most of the time. Watch her most recent video with excellent explanations for today's investing atmosphere, and U.S. economy prognosis:

<https://www.youtube.com/watch?v=eUvpzFGyHBo>

She posits that we've had a rolling recession and lack of market breadth for a couple years with only the Mag 7 stocks holding up the averages.

An observation from stock price movements supports our view that the current down draft is rooted in recession fears. Small bank stocks, AirBnB, Uber, airlines, for example dropping 15 to 20% or more has little to do with tariffs.

## **Final Thought**

Yellow Post-it notes are stationed like sentinels around my desk, on the sides of file cabinets, stuck to my lamp, on my window trim. Ones says, "Stay Positive 2025," core investment tenets are there, "Optimism Pays, Be Bold, Be Patient, Be Disciplined, Persevere," and finally, "Never Let a Good Crisis Go to Waste." I'll leave it there and wish you a happy spring!

## **All investments involve risk, including the possible loss of principal.**

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