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Markets face headwinds as consumer confidence wanes

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February, historically a challenging month for investors, lived up to its reputation this year. After a strong start in January fueled by AI enthusiasm and recovery hopes, equity markets retreated as consumer confidence deteriorated with mounting policy uncertainties.

The S&P 500 finished February down 1.4 percent, the Dow Jones Industrial Average fell 1.6 percent, and the tech-heavy Nasdaq dropped 4 percent – its worst monthly performance since April 2024. This pullback came despite economic fundamentals that, on the surface, still appear relatively stable.

The U.S. economy expanded at a 2.3 percent annual rate in the fourth quarter of 2024, continuing the moderate but steady growth that has characterized the post-pandemic recovery. The unemployment rate held at 4 percent, essentially full employment, and job creation continued at a modest pace. Inflation, while still above the Federal Reserve's target, showed signs of stabilizing, giving policymakers encouragement to consider rate reductions later this year.

As the policies of the new administration in Washington, D.C., began to take concrete shape, the Conference Board's Consumer Confidence Index in February recorded its steepest drop – 6.7 percent – in over three years. This decline wasn't limited to future expectations – confidence in present economic conditions also weakened.

This sentiment shift manifested in retail performance, with Walmart reporting its guidance for the remainder of the year below expectations, citing weakness in discretionary spending. Higher prices continue to strain household budgets. While wages have risen, they haven't kept pace with the increased costs of necessities. The rapid rise in egg prices due to the bird flu epidemic was a headline grabber in this

regard. For investors, the decline in consumer optimism signals potential trouble for consumer spending, which accounts for nearly 70 percent of U.S. GDP.

Adding to market unease were renewed trade policy concerns. The Trump administration's proclamations regarding 25 percent tariffs on goods from Mexico, Canada, and additions to the 10 percent already directed toward Chinese goods, created uncertainty for businesses reliant on global supply chains. Markets, which had largely shrugged off trade tensions in previous months, reacted with greater sensitivity this time. Companies dependent on imported goods saw stock prices slide as investors questioned the long-term impact of higher import costs.

Bond yields reflected growing economic caution, with the 10-year Treasury yield declining for five consecutive sessions to its lowest level in nearly three months. This movement in fixed-income markets often signals investor concerns about future economic growth.

February's market behavior exemplifies that sentiment often drives short-term stock market volatility more than hard data. There is a divergence between relatively solid economic fundamentals and growing anxiety among consumers and businesses. The stock market doesn't trade on today's economy – it trades on expectations for the future. And currently, those expectations are clouded by uncertainty, which markets intensely dislike.

Adding to market concerns are the ongoing changes in federal government staffing and operations. The Department of Government Efficiency's aggressive efforts to eliminate USAID, reduce federal employment and cut costs across agencies represent a significant shift that will have broader economic implications. Government purchases of agricultural products for foreign aid and federal employment have historically been stabilizing economic forces during downturns. These reductions, while potentially improving long-term fiscal health, may create short-term economic headwinds as thousands of workers apply for unemployment, attempt to transition to the private sector, and government contracts are scaled back.

Despite February's pullback, the broader context remains one of exceptional recent performance. The stock market delivered gains exceeding 20 percent in each of the past two years, well above the long-term historical average of approximately 9 percent annually. Even with February's decline, by the end of the month, the S&P 500 remained essentially flat for 2025 year-to-date. The recent volatility may represent a healthy recalibration rather than the beginning of a prolonged downturn ... unless there are major policy missteps.

Looking ahead, it remains to be seen if weak retail sales in the first two months of the year were primarily impacted by the exceptionally cold weather in January and February. If sentiment remains low and retail sales show further signs of strain, corporate earnings estimates may need downward revision, adding pressure to equity valuations. At the same time, clarity on trade policy or potential interest rate adjustments could help stabilize market expectations.

The Federal Reserve is in a delicate position, balancing inflation management with the need to prevent an economic slowdown. A rate cut might provide a short-term boost to stocks, but only if seen as a proactive measure rather than as a reaction to deteriorating conditions.

In this environment, investors should focus on fundamentals. Defensive sectors such as health care and consumer staples may provide some insulation against volatility. Companies with strong cash flows and pricing power are also better positioned to weather economic uncertainty. If you have conviction in a company's growth prospects and competitive position, you should stick with it during periods of volatility. Day-to-day fluctuations in stock prices are unpredictable and often disconnected from a company's actual performance. Algorithmic trading, options trading and rebalancing of large ETFs and funds add to daily volatility. Long-term investors should resist making reactionary moves based on headlines and sentiment shifts. Market corrections and rebounds are part of the investment cycle.

History has shown that markets often overreact to uncertainty in the short term, but fundamentals drive performance over time. As Warren Buffett famously advised, "be fearful when others are greedy and greedy when others are fearful." Whether February's downturn marks a temporary reset or signals a more significant shift in market dynamics will become clearer in the months ahead. In the meantime, patience, discipline, and a focus on long-term fundamentals remain the best approach to navigating an uncertain market.

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