Yardeni Research

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Morning Briefing

Anatomy Of A Correction

Check out the accompanying chart collection.

Executive Summary: A dovish faction has been forming within the Federal Reserve Board, dissenting from Chief Powell's hawkish party line. Rather than wait and see whether tariffs deliver greater blows to the economic or the inflation outlook before changing monetary-policy course, the doves claim that the economy is more vulnerable and espouse lowering the federal funds rate sooner rather than later. Dr Ed sides with Powell & Co. So does the data: So far, there's more evidence of tariff-induced inflationary pressures than economic weakness. ... Also: The recent stock market correction partly reflects late January's revaluation of tech stocks in reaction to the Deep Six ramifications. Now investors may be embracing the Mag-7 once again. ... And: Dr Ed reviews "Companion" (+ +).

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Fed I: Waller vs Powell. The financial markets have been obsessed with Trump's Tariff Turmoil (TTT), and rightly so. That means that the financial markets have been less preoccupied with the Fed. Indeed, Fed Chair Jerome Powell has signaled several times that monetary policy is on hold because of the uncertain economic effects of TTT. While the tariffs are likely to slow economic growth, they are also likely to boost inflation, at least temporarily.

Last Thursday, Fed Governor Christopher Waller publicly dissented from the relatively hawkish party line promoted by Powell & Co. in recent weeks. His dovish stance is that TTT is likely to weaken the labor market in coming months, while any inflationary pressures are likely to be temporary. So he is ready to lower interest rates sooner rather than later.

It's becoming apparent that Waller is doing his best to ingratiate himself with Trump & Co. so he might be considered as a candidate to replace Powell when his term as Fed chair expires in May 2026. Stock investors liked what Waller had to say on Thursday. Joining Waller's parade that day was Cleveland Fed President Beth Hammack. In a separate interview, she said the central bank might reduce interest rates as early as June if it were to have clear evidence of the economy's direction by then.

We side with Powell & Co. So far, the data show that consumer spending and the labor market remain remarkably resilient. At the same time, inflationary pressures are mounting, according to regional and national business surveys. Consumers' inflationary expectations are also rising.

Let's compare the recent comments coming from the Waller camp versus the Powell camp:

(1) "It wouldn't surprise me that you might start seeing more layoffs, a tick up in the unemployment rate going forward if the big tariffs in particular come back on," Waller said Thursday in an *interview* on Bloomberg Television with Michael McKee. "I would expect more rate cuts, and sooner, once I started seeing some serious deterioration in the labor market." Waller reiterated his view that the inflationary impact of Trump's tariffs should be temporary. He first said so on April 14 in *remarks* prepared for an event in St. Louis.

(2) On Friday, April 11, a few days before Waller spoke in St. Louis, Federal Reserve Bank of New York President John Williams joined the chorus of Fed officials who've signaled their intent to keep rates on hold as they wait for more certainty about the impact of TTT. He *said*, "During times of turbulence and uncertainty such as these, well-anchored longer-run inflation expectations are critically important for ensuring sustained price stability." He added, "It is critically important to keep inflation expectations well anchored as we pursue our goals of maximum employment and returning inflation to our 2% longer-run objective."

Also on April 11, Minneapolis Fed President Neel Kashkari and Boston Fed chief Susan Collins reiterated their views that Trump's tariff policies may make rate cuts less likely this year.

(3) Of course, we give the most weight to the views of Fed Chair Powell. On July 16, in *prepared remarks* presented at the Economic Club of Chicago, Powell observed, "Tariffs are highly likely to generate at least a temporary rise in inflation. The inflationary effects could also be more persistent. Avoiding that outcome will depend on the size of the effects, on how long it takes for them to pass through fully to prices, and, ultimately, on keeping longer-term inflation expectations well anchored."

Powell concluded, "For the time being, we are well positioned to wait for greater clarity before considering any adjustments to our policy stance." Powell is apparently in less of a rush to lower rates than is Waller.

Fed II: More Inflation than Stagnation. So far, the data that the Fed depends on to make monetary policy is showing that TTT is boosting both consumer spending and inflationary pressures. Importers have been scrambling to front-run tariffs. The surge in imports depressed Q1's real GDP growth rate, probably to +/-0.5% (saar) (*Fig. 1*). But Q2's growth rate is likely to be 2.5%-3.0%, boosted by retail sales as consumers scramble to buy in advance of tariff-related price increases.

Meanwhile, the labor market remains strong. However, the regional and national business surveys are showing that higher prices-paid indexes are pushing up prices-received indexes, suggesting mounting inflationary pressures. Let's review the latest data:

(1) *Consumers.* The Consumer Sentiment Index (CSI) is among the softest of the soft economic data. Yet the hard data on consumers remain robust. The CSI fell in April to 59.8, matching previous cyclical lows that coincided with recessions (*Fig. 2*). The CSI measures of expected inflation over the next 12 months and over the next five years jumped to 6.5% and 4.4%, respectively, in April (*Fig. 3*).

These readings are well above the Fed's 2.0% y/y inflation target. Inflationary expectations clearly are not "well anchored."

Consumers are buying in advance of expected price increases. That's plain to see in US total motor vehicle sales, which jumped to 17.8 million units (saar) during March, the highest pace since April 2021 (*Fig. 4*). The Redbook retail sales index rose 7.0% y/y through the April 18 week (*Fig. 5*). Interestingly, sales of discount stores is up 8.9%, but department-store sales is up only 2.4% (*Fig. 6*).

(2) *Labor market.* We've often said that American consumers spend when they are happy and spend even more when they are depressed. Of course, that requires that they remain employed. They are currently extremely depressed according to the CSI, but they are still spending because they are still employed, as evidenced by the low readings for both initial and continuing unemployment claims so far this year through mid-April (*Fig. 7*). March's measures of job openings remained relatively high (*Fig. 8*).

(3) *Inflation.* Consumers are right to be worrying about the inflationary consequences of TTT. The regional business surveys conducted by five of the Federal Reserve district banks are showing that prices-paid and prices-received indexes jumped sharply in March and April

(*Fig. 9* and *Fig. 10*).

Strategy: The Magnificent-7 Are Still Magnificent. The latest correction in the S&P 500 was led by a short and shallow bear market in the Magnificent-7 stocks. Trump's Tariff Turmoil clearly drove lots of the selling pressure. However, the stock market selloff this year was also attributable to the downward rerating of the elevated valuation multiples of S&P 500 Information Technology sector stocks, and particularly the Mag-7, which began after the release of open-source Deep Seek on January 24 triggered investor fear that capital spending on AI infrastructure would nosedive. Consider the following:

(1) SPY (the S&P 500 ETF) fell 19.0% from February 19 through April 8. The Roundhill Magnificent Seven ETF (MAGS), which is equal-weighted and rebalanced quarterly, dropped 26.7%, while the XMAG ETF (which is free-float cap-weighted) declined only 16.2% over this period (*Fig. 11* and *Fig. 12*). Since April 8, SPY is up 10.9%, with MAGS up 14.8% and XMAG up 9.4%.

(2) The forward P/E of the Mag-7 plunged from 30.0 at the start of the year to 21.7 on April 8 (*Fig. 13*). Over that same period, the forward P/E of the S&P 500 fell from 22.4 to 19.2, while the forward P/E of XMAG declined from 18.6 to 17.8. The forward price-to-sales (P/S) ratio of the Mag-7 plunged from 7.7 at the start of the year to 5.6 on April 8 (*Fig. 14*). It is back up to 5.9. The forward P/S of the S&P 500 excluding the Mag-7 edged down from 2.2 to 2.1 over this same period through the April 17 week.

(3) While the Mag-7's share of the S&P 500's market capitalization has dropped from 32.0% at the start of the year to 28.4% currently, the Mag-7's forward revenues and forward earnings share both are at new record highs of 11.8% and 22.6% (*Fig. 15*).

(4) Also at a record high is the collective 26.2% forward profit margin of the Mag-7 at the end of April (*Fig. 16*). That's more than twice the 11.9% forward profit margin of the S&P 493!

(5) Analysts' consensus expected (i.e., forward) short-term growth rates for the revenues and earnings of the S&P 500 have been declining since the start of this year, led by the Mag-7 (*Fig. 17* and *Fig. 18*). The forward revenues growth of the S&P 500 currently is at a still-solid 5.3%. The comparable series for the Mag-7 is down from 13.8% at the start of this year to 12.1% currently. The forward earnings growth rates of the S&P 500 and the Mag-7 currently are down a couple of percentage points since the start of this year to 11.5% and 17.2%, respectively. Those are still robust readings.

(6) The rebound in the stock market since April 8 was attributable to Trump's postponing his reciprocal tariffs (except on China) and to his more moderate tone regarding the prospect of negotiating a trade deal with China. In addition, he backed off from his recent attacks on Fed Chair Powell.

Also positive: Investors may be returning to the Magnificent-7, which collectively is up 14.8% since April 8, outpacing the 9.4% increase in the XMAG since then. We've observed that AI is just the latest evolution of the Digital Revolution that started in the mid-1960s. It's another technology that increases our ability to process more data faster and more cheaply. So it's increasing the business of cloud computing companies and boosting their capital spending on cloud infrastructure.

(7) Alphabet's Google Cloud Platform (GCP) results, reported last week, support our narrative. In Q1-2025, GCP reported revenue of $12.26 billion, slightly below Wall Street expectations of $12.27 billion but reflecting robust 28% y/y growth. Margins improved significantly to 17.8% from 9.4% a year ago, indicating better operational efficiency.

Heavy AI investments are paying off, with Google Cloud's AI portfolio, powered by the Gemini large language model, attracting new customers and securing larger deals. Developer usage of Gemini doubled to 4.4 million users in six months by Q4-2024.

Capital expenditures are set to rise significantly, with Alphabet planning to spend $75 billion in 2025 (up from $52.5 billion in 2024) to expand its AI and data center infrastructure.

Movie. "Companion" (+ +) is a very entertaining 2025 movie about the not-too-distant future. It's about a weekend getaway to a remote lakeside house. A few of the characters are murdered. Some but not all of the perpetrators are in it for the money. Others are just trying to stay alive. It's a fun and funny plot about humans and humanoids. (See our movie reviews *archive*.)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index jumped 4.7% last week, but remains in a 10.3% correction from its January 23 record high. That compares to a 2.7% gain for the AC World ex-US index to 3.7% below its June 15, 2021 record high. The US MSCI has outperformed the AC World ex-US in just three of the past 14 weeks. EM Latin America was the best performing region last week, with a gain of 7.2%, ahead of EMU

(3.9%), Europe (2.9), EAFE (2.7), EM (2.7), and the AC World ex-US. EMEA was the worst regional performer, albeit with a gain of 2.3%, followed by EM Asia (2.3). The Mexico MSCI index performed the best among country indexes last week, with a gain of 8.0%, followed by Brazil (7.1), Germany (5.0), and the US (4.7). The India and South Africa MSCI indexes were the week's worst country performers, falling 0.8%, followed by Korea (1.0), Switzerland (1.3), and Japan (1.9). In terms of ytd performance rankings, the US MSCI index remains the second-worst country, with a decline of 6.1%, and trails the 6.4% gain for the AC World ex-US. Among the regional indexes, all but two are outperforming the AC World ex-US ytd. EM Latin America is now ahead of the pack ytd, leading with a gain of 18.5%, followed by EMU (16.5), Europe (12.6), EAFE (8.8), EMEA (7.6), and the AC World ex-US. EM Asia is the worst ytd performer, with a decline of 0.2%, followed by EM (2.0). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 30.5%, followed by Mexico (22.6), Germany (22.5), Brazil (16.8), and Sweden (14.4). The worst performing countries ytd: Taiwan (-13.8), the US (-6.1), India (-0.8), Australia (0.6), and Hong Kong (1.2).

US Stock Indexes (*link*): All of the 48 major US stock indexes that we follow rose for the week ending April 25, up from 26 rising a week earlier. The Russell 1000 Growth index was the best performer with a gain of 6.8%, ahead of Nasdaq Composite (6.7%), Russell 3000 Growth (6.7), S&P 500 LargeCap Growth (6.5), and Nasdaq 100 (6.4). The Dow Jones 15 Utilities index, with a gain of 0.1%, was the worst performer, followed by Dow Jones 20 Transports (0.4), S&P 500 LargeCap Transportation (0.7), Dow Jones 65 Composite (1.7), and S&P 500 LargeCap Pure Value (2.0). Just one of the 48 indexes is higher so far in 2025, down from 47 of 48 rising ytd in mid-February and 46 rising for all of 2024. With a gain of 1.8%, the Dow Jones 15 Utilities is in the top spot as the best performer so far in 2025, ahead of S&P 100 Equal Weighted (-2.4), Russell 1000 Value (-2.5), S&P 500 LargeCap Pure Value (-2.5), and Russell 3000 Value (-2.9). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-17.5), S&P 600 SmallCap Value (-15.7), Dow Jones 20 Transports (-15.1), S&P 600 SmallCap Equal Weighted (-14.1), S&P 600 SmallCap (-13.4), and Russell 2000 Growth (-12.3).

S&P 500 Sectors Performance (*link*): Ten of the 11 S&P 500 sectors rose during the week ending April 25, but only three were ahead of the S&P 500's 4.6% gain. That compares to five of the 11 S&P 500 sectors rising a week earlier when eight sectors were ahead of the S&P 500's 1.5% decline. The outperformers last week: Information Technology (7.9%), Consumer Discretionary (7.4), and Communication Services (6.4). The underperformers last week: Consumer Staples (-1.4%), Real Estate (0.2), Utilities (0.5), Energy (1.1), Health Care (1.9), Materials (2.0), Industrials (3.0), and Financials (3.0). The S&P 500 is now down

6.1% ytd with eight of the 11 sectors also in the red, but only three sectors are underperforming the index. Consumer Staples still wears the crown as the best ytd performer, with a gain of 4.3%, ahead of Utilities (3.2), Health Care (0.2), Real Estate (-0.6), Financials (-0.7), Materials (-1.6), Industrials (-2.1), and Energy (-3.4). These three sectors continued to lag the S&P 500 so far in 2025: Consumer Discretionary (-13.7), Information Technology (-11.9), and Communication Services (-6.1).

US Economic Indicators

Durable Goods Orders & Shipments (*link*): Durable goods orders blew past forecasts in March, led by commercial aircraft. *Durable goods* orders soared 9.2% (vs 2.0% expected); *transportation equipment* orders once again led the increase, climbing 27.0% during March alone, with nondefense aircraft & parts, which are extremely volatile, soaring 139.0%—as Boeing reporting that it received 192 aircraft orders in March, up from just 13 in February. Meanwhile, motor vehicle & parts climbed 2.3% during the month. *New orders excluding transportation equipment* were basically unchanged. Meanwhile, *nondefense capital goods orders excluding aircraft* (a proxy for future business investment) ticked up 0.1% (vs 0.2% expected), following March's 0.3% shortfall, while *shipments of core capital goods*, used in the calculation of the GDP component of business equipment spending, rose 0.3% during the month.

Existing Home Sales (*link*): "Home buying and selling remained sluggish in March due to affordability challenges associated with higher mortgage rates," noted Lawrence Yun, chief economist of NAR. "Residential housing mobility, currently at historic lows, signals the troublesome possibility of less economic mobility for society." *Existing home sales* sank 5.9% in March to 4.02 million units (saar) and were down 2.4% versus a year ago. Single-family sales retreated 6.4% during the month to 3.64 million units, while existing condominium and co-op sales were unchanged to 380,000 units; these sales were down 2.2% and 5.0%, respectively, versus a year ago. *Regionally*, existing home sales fell in all regions during March: West (-9.4% m/m & 1.3% y/y), South (-5.7 & -4.2), Midwest (-5.0 & -3.1) and Northeast (-2.0 & 0.0). *Versus a year ago*, sales were below year-ago levels in the South and Midwest, flat in the Northeast, and showed a small gain out West. The inventory of unsold existing homes at the end of March was at 1.33 million units, up 8.1% m/m and 19.8% y/y. Unsold inventory is at a 4.0 months' supply at the current sales pace, up from 3.5 months in February and 3.2 months last March.:

Global Economic Indicators

Germany Ifo Business Climate Index (*link*): Sentiment among companies in Germany improved slightly in April, with companies more positive about current conditions, while expectations were gloomier. Ifo's *business climate index* edged up to 86.9 points in April from 86.7 in March, led by the *current condition's* component, which rose from 85.7 to 86.4. Meanwhile, the *expectations* component slipped from 87.7 to 87.4. Activity in the *manufacturing sector* fell again in April, after rising significantly in March, as expectations deteriorated. By contrast, the current situation was somewhat better. The *service sector* saw its business climate improve, led by current conditions, while the expectations component was challenged. *Trade* saw its index fall, as both the current conditions and expectations components deteriorated. The weakness was primarily driven by the wholesale sector. Meanwhile, *construction* saw its business climate index at its highest level since May 2023, as expectations improved significantly; current business conditions were assessed as somewhat negative.

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