TD Asset Management

Market Perspectives 10 Minutes

From the Desk of the Public Equities Team

That Bears Watching – "Liberation Day" from a Bull Market

By Damian Fernandes, CFA, Managing Director, Portfolio Manager, TDAM and Jose Alancherry, CFA, Vice President, Retail Client Portfolio Management, TDAM, as of March 2025.
(April 10, 2025)

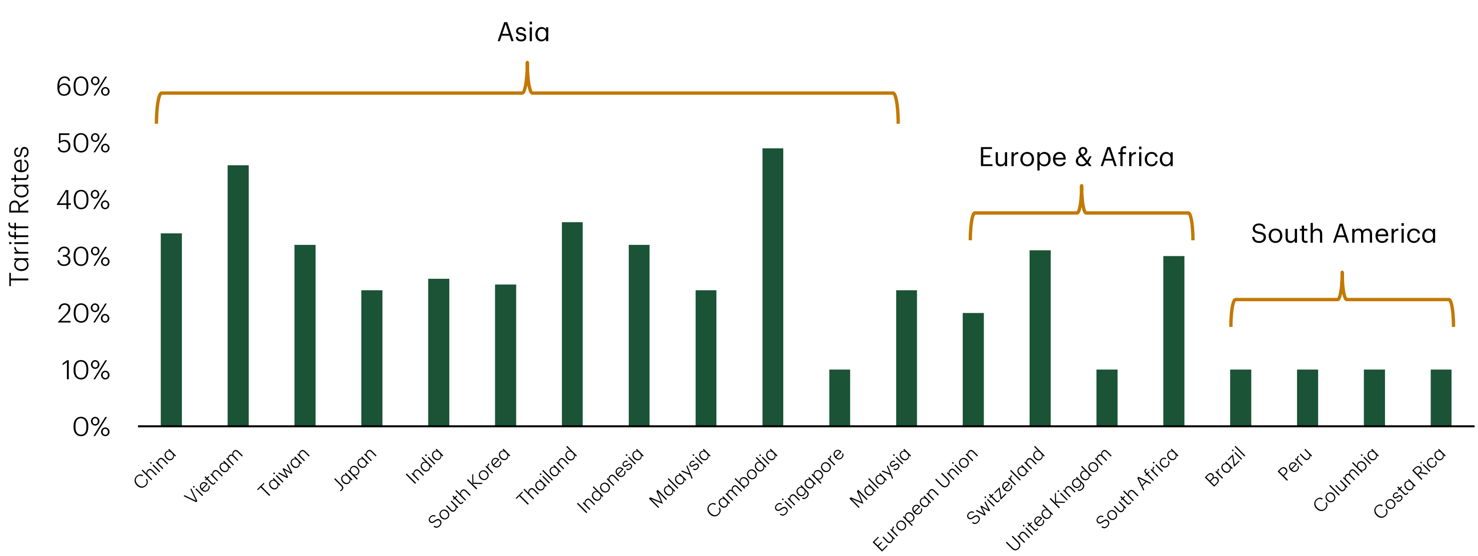
Our business is about working with you – the investor and long-time unitholder. The better you understand the rationale for our decision-making, the more clarity you have on how returns follow.

The Week that Was – This felt like the entire season of a limited run TV series, let's dive in!

Episode 1 – Global Tariff Armageddon

There was an abundance of caution heading into April 2 – the S&P 500 ("the market") was already down approximately 10% with defensive sectors leading. And then "Liberation Day happened" – suffice to say the magnitude, the questionable calculation methodology, and the punitive degree of announced tariffs exceeded almost any but the wildest expectations. **Chart 1** below shed some light on this. The announced tariffs, if maintained, would place the overall tariff burden higher than the Smoot-Hawley Act of 1930 (widely considered by financial historians as exacerbating the Great Depression). Asia was singled out, Europe was targeted, but trading partners in the Americas (including Canada) were largely spared.

Chart 1: Liberation Day Reciprocal Tariffs

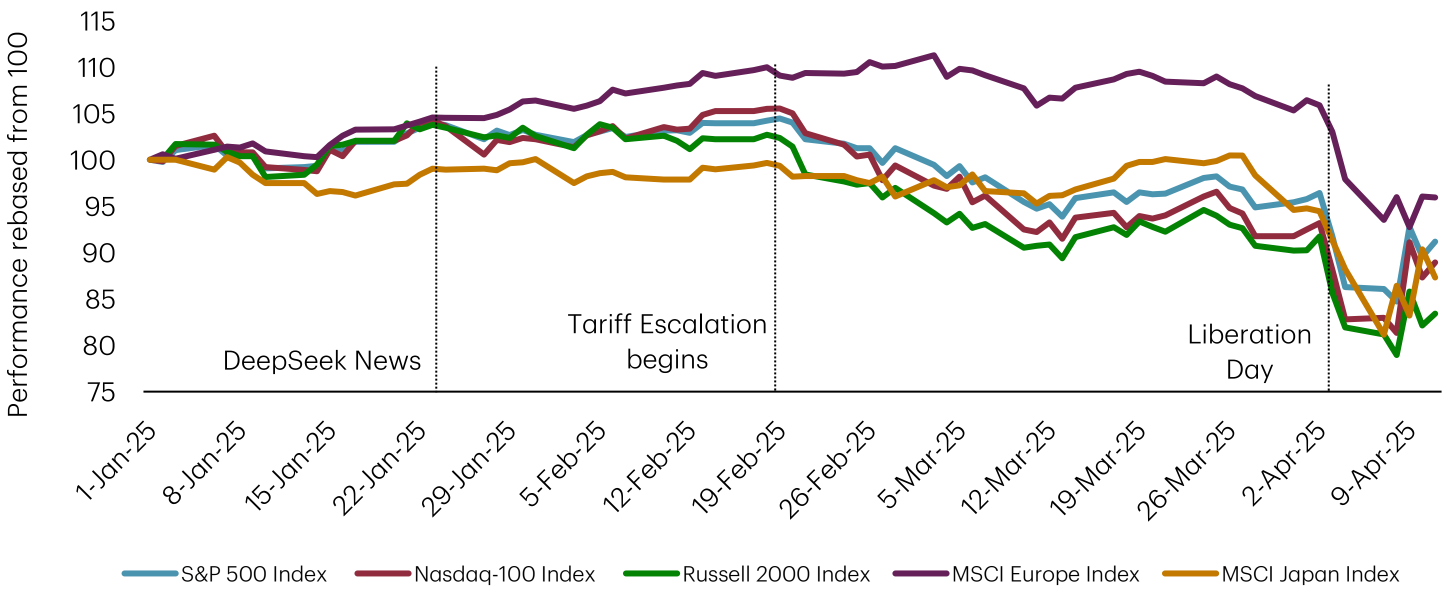


Note: This does not include the baseline 10% tariffs on all countries.
Source: US White House - https://www.whitehouse.gov/

Episode 2 – Global Markets Nosedive

What a week it was – the S&P 500 Index registered the fourth largest 2-day decline in 75 years, the Volatility Index (VIX) was up 100%, and High Yield (HY) spreads widened 100 basis points (bps), in a week! The armchair quarterbacks will tell you they saw this coming, why the surprise?! We disagree with the idea that this was expected - the market seemed to be somewhat fine with tariffs, much likely that a 10% tariff would've been as expected, and it seemed priced in. What the market and we didn't expect was this announcement did not seem to be about tariffs at all - by now, everyone's seen the math behind it, reciprocal trade balances are a very different idea compared to reciprocal tariffs. While the first part of the selloff felt orderly, the April 4 selloff was an indiscriminate (**Chart 2**) rush for the exits where everything sold off, including U.S. Treasuries, with the VIX spiking to peak panic levels.

Chart 2: YTD Returns of the S&P 500 Index, NASDAQ Index, Small-Caps, Europe and Japan



Source: Bloomberg Finance L.P., as of April 11, 2025.

Episode 3 – Never Mind, Was it China All Along?

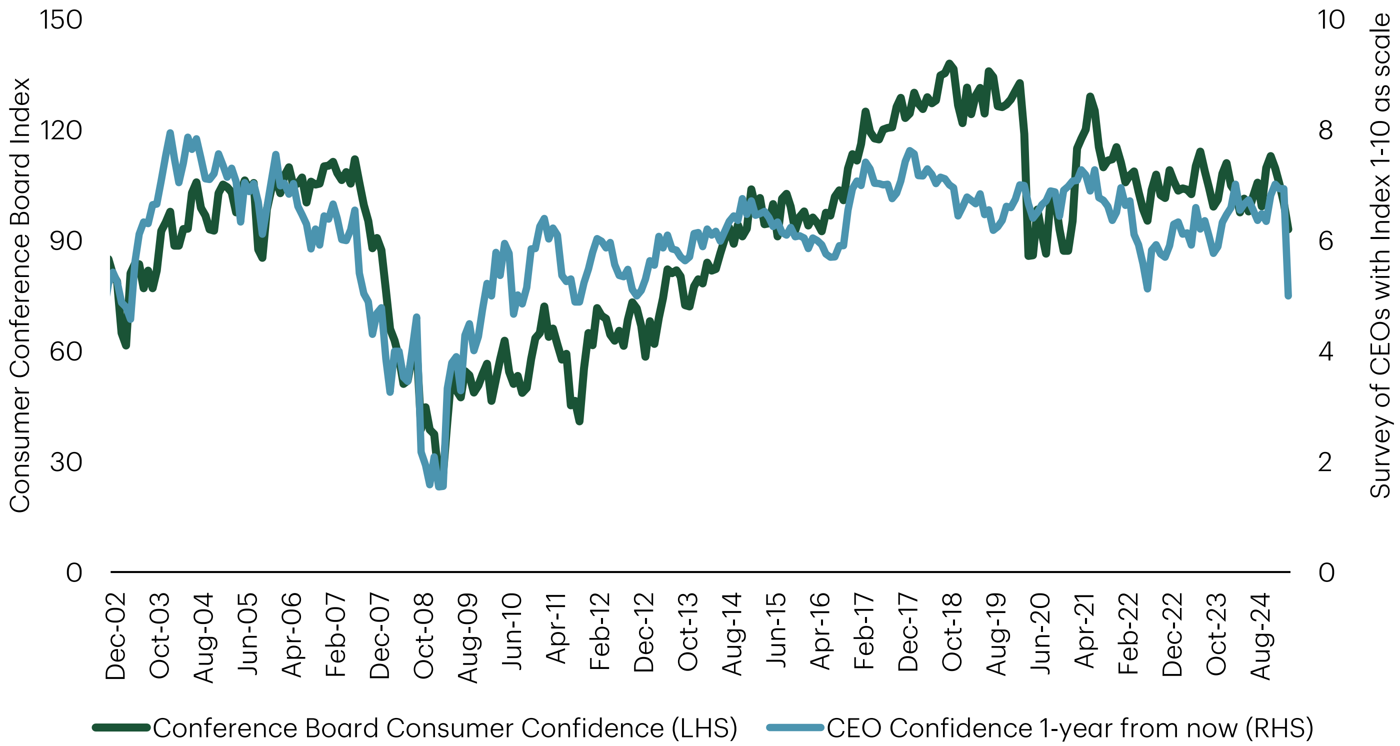
As it became clear that there was panic in the air from New York to Tokyo, a week after Liberation Day, U.S President Donald Trump announced a 90 day pause on all countries except China, where he doubled down and escalated due to their retaliatory moves. It has since been reported that many nations have voluntarily reached out to begin negotiations and the 90-day pause is a starting point, but of course with Trump, anything can be extended or delayed – things change rapidly. It seems Trump may have decided to make peace with the world to go head-to-head with China.

There may be a Trump put after all – it just may be the bond market he's watching for his cues this time around and not the equity market. Throughout history, political administrations across the world have often found out – you can push your ideas as far as the bond market allows. The constructive take was that this strategy is straight from 'The art of the deal' – begin negotiations with an extreme stance, take a kitchen sink approach and negotiate a deal that both sides walk away from reasonably satisfied. The naysayers will say that 'tariffs' by themselves were the goal itself. Ultimately, we are leaning to the idea that tariffs are a combination of both negotiating leverage and revenue generating mechanism (the 10% tariff has not been repealed) at this point. What concerns the markets is that things are still very fluid, and no one can state with any confidence what the ultimate endgame/steady-state equilibrium will be. Whatever the outcome, Trump will likely claim he played 4-D chess and geopolitical jiu-jitsu and claim victory.

Investment Implications

Despite the tariff policy pivot, in the short run, it will likely be difficult to 'put the toothpaste back in the tube' per se, even if or when we see positive developments on the negotiation front. Even with the pause, the baseline tariffs and the 2nd order effect of declining business and consumer confidence (**Chart 3**) could impact both Gross Domestic Product (GDP) and Earnings Per Share (EPS) growth, and lift inflation higher. The risk to the rest of the world has receded with the pause, but an economic spat between the 2 largest economies will have some repercussions.

Chart 3: CEO Confidence and U.S. Consumer Confidence



Source: Bloomberg Finance L.P., as of March 31, 2025.

It is common to research historical peak and trough price-to-earnings multiples (P/Es), but we caution against reading too much into this for the simple reason that the range of potential outcomes is extraordinarily wide at this moment, so any projected 'E' in the ratio is questionable at best. The street has not recalibrated estimates consensus – while markets have moved sharply in response to the shifting outlook for trade policy and economic growth, consensus earnings estimates have hardly budged this year. The S&P 500 Index has declined by 14% year-to-date (YTD) and by 11% since the April 2 tariff announcements. In contrast, consensus S&P 500 Index EPS estimates for 2025 have declined by just 2%YTD.

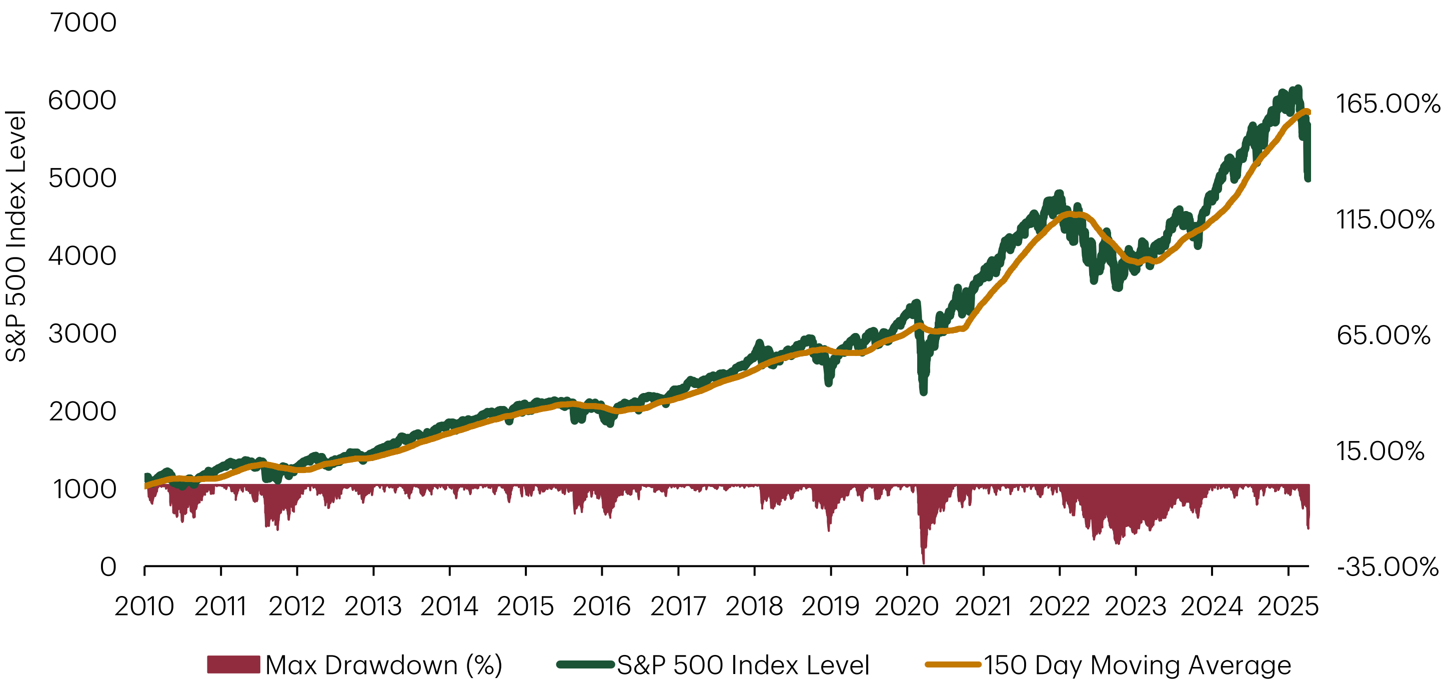
The faster that the market regains a sense of certainty and directionality as to where this is going, the faster we could get out of this shock. Zooming out, this is a self-induced policy driven ending of the bull market - we didn't go down because there was too much risk in the system like the Great recession or a pandemic. It's a case where the hard data shows reasonably healthy wallets and balance sheets, while the sentiments have absolutely cratered. The longer this state of uncertainty goes on, the likelier we face some sort of slowdown. Conversely, the quicker there's a resolution and stable policy equilibrium, the faster fundamentals take center stage again. The sooner

Trump starts cutting deals as he's promised and the market-friendly parts of the Trump agenda, extension of tax cuts, new consumption friendly policies, deregulation, etc. should drive headlines on major business news outlets once again.

Market Dislocations and Portfolio Positioning

Normally with the VIX at 45, implying +/- 2.8% daily price moves over the next 30 days, we'd be chomping at the bit to buy the market. Sentiment is so washed out that you are being compensated for running into the burning building. But 'normally' remains the operative word. We have always relied on historical observations and evidence to drive our decision-making, this time around we are flying blind. When the distribution of outcomes remains uncomfortably wide, and valuation of equities not yet extreme, we will be very selective in investing.

Chart 4: Drawdowns are Part and Parcel of Markets and Present Opportunities for Long-Term Investors
Near term positioning is so extreme that you are being compensated to step into the market



Source: Bloomberg Finance L.P., as of April 11, 2025.

Rising tariff rates will force many companies to either raise prices or accept lower profit margins. We expect negative revisions to consensus profit margin estimates in coming quarters, creating a premium for companies with high pricing power. Stocks with strong pricing power outperformed their low pricing power peers by 16 basis points (bps) during the trade conflict in 2018-2019 and have outperformed by 6bps so far this year. Global companies with extensive supply chains in China, and Chinese companies with large exports to the U.S. will likely be most impacted.

Some observations we've noted for now – the Technology/semiconductor story seems to have rolled over. Corporate Credit is rolling over and there has been some damage to cyclical stocks, a sign that a pullback seems priced in the numbers and as stated earlier, the market may be pricing in a slowdown. That said, the point to rush into defense has likely passed, in our view, as the price you're implicitly paying has now skyrocketed. On the positive side, Canadian banks have been holding up. And U.S. homebuilders have found a bounce, which correlates with a lower rate environment and indeed the market is now pricing in approximately 4 cuts over the next 12 months.

In our portfolios, we are generally buying more services versus goods, more defensive versus cyclical, and companies with greater reliance on domestic revenues and operations than those that rely on trade/exports. We believe a prudent approach is to incrementally allocate capital to high conviction names, maintain tight stop losses for weaker holdings, and maximize diversification (across countries, industry groups, and themes). It is key to emphasize – this is not the time to be reactive and make large shifts, rather it may be a time for careful calibration at the edges as we gain incremental information. We remain open-minded to all possible scenarios.

Remain nimble to seize opportunities. Have balance in portfolio exposures. Keep calm and compound on.

Damian Fernandes & Jose Alancherry

For further information,
please contact your TDAM Representative.