Sabrient Systems

Sector Detector

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My take on the new tariff regimen and the gift of lower asset prices

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Key Points

1. The country's 40-year path into a debt & deficit spending spiral was not working and had to change dramatically, not gradually, and the process to fix it is scary and uncomfortable.

2. The president's "Liberation Day" tariff regime is at once simplistic and perplexing, but the selloff seems overdone, in my view, although the market remains fragile.

3. After an initial price shock, tariffs are *deflationary* like any tax; and countries are already coming to the table to negotiate them down.

4. The US is much less dependent on trade, less vulnerable to trade disruptions, and in far better position to weather a brief trade war than any other country, including mercantilist China, which is saber-rattling as a Trumpian bargaining tactic and to stoke the flames of political division in our country, in my view.

5. The $10 trillion that left the stock market was not lost like a wildfire burning down homes; it simply rotated into bonds and cash and can quickly rotate back if the outlook does not change and we have fiscal stimulus, supportive Fed, and rising global liquidity.

6. Volatility (up and down) may be sticking around through H1 until clarity improves later in the year.

7. For those still contributing to a 401(k), the selloff has presented a long-awaited opportunity to "buy low."

8. Investors may be better served by active stock selection, such as Sabrient's Baker's Dozen, Small Cap, and Dividend portfolios.

Overview

The news has been dominated by President Trump's announced "Liberation Day" regimen of draconian tariffs, which are intended to induce both fairer trade policies from our trading partners and the onshoring of manufacturing. As his words moved from a 10% across-the-board baseline tariff (a nominal amount that initially sent stocks higher) to the gory details of his broader plan, the swan dive commenced. Negative volume went through the roof. Margin calls rained in. Algorithmic trading systems switched from leveraged long to either leveraged short or out of the market completely (thus removing critical liquidity), tripping stop losses and creating a cascade of selling pressure. The next day's weekly AAII Sentiment Survey hit an extreme 62% bearish reading and will likely fall lower in this week's survey. IPOs are being put on hold. The Polymarket odds of an emergency rate cut surged to 285, as did the odds of a rate cut meeting (36% at the May FOMC meeting but a 92% lock by the June meeting).

As of Monday morning's open, the stock market had essentially given back all last year's gains. Chartists are lamenting the failure of scary-bearish chart patterns (like the dreaded inverse flag pattern) that could potentially send stock indexes all the way down to their pandemic lows. The CBOE Volatility Index (VIX) surged above 45 on Friday 4/4 and then touched 60 in the pre-hours on Monday 4/7, which is reminiscent of the pandemic lockdown five years ago.

But are things today really as bad as that, when global supply chains were paralyzed and people were falling ill (and/or dying) en masse? I would say no, and in just a couple of blood-red, gap-down days, the rapid market meltdown already seems overdone, as I discuss further in today's post. As famed value investor Ben Graham once said, *"In the short run, the market is a voting machine, but in the long run it is a weighting machine."*

Although the VIX certainly could still go higher (perhaps a lot higher) and stocks lower, Friday looked to me a lot like capitulation and perhaps the start of a bottoming process leading to a great (and long-awaited) buying opportunity for long-term investors. Just be careful about "catching a falling knife." Many countries (reportedly more than 50) have apparently reached out to fix their trade arrangements, although the biggie, China, is still in saber-rattling mode, at least for now.

Of course, the current selloff also was exacerbated by "priced for perfection" valuations and a complacent "buy every dip" mentality, largely driven by AI exuberance (and its promise of transformation disruption and rapid growth in productivity) and the massive capex allocated for AI infrastructure and datacenters. Furthermore, during the run-up to all-time highs in 2024, hedge funds had become more heavily leveraged long in US equities than at any time since the pandemic lockdown (as much 300% leveraged), essentially pulling forward gains from 2025 based on strong earnings expectations. So, there might be some similarities to the dot-com bubble bursting in 2001 in that respect. But even at its recent high, the overvaluation was nowhere near 1999 levels of the dot-com mania, and we don't have the systemic credit and accounting issues leading into the 2008 Global Financial Crisis. Company balance sheets are quite sound, and although credit spreads have spiked, they remain low on a historical basis.

Even before the 4/2 tariff announcement, stocks were already looking shaky. It was fascinating to watch the charts of the major indexes like the S&P 500 ETF (SPY) and Nasdaq 100 ETF (QQQ) as they struggled for several days to hold support at the 300-day simply moving average, like a sloth hanging from a tree branch, until ultimately losing grip in dramatic fashion following the big tariff announcement. I opined in my March post that it might be time to create a shopping list of stocks but that volatility would likely continue into the tariff target date (4/2) and perhaps into Tax Day (as liquidity draws down for making tax payments). But few (including me) expected the cataclysmic selloff. Volatility may be sticking around for a while until clarity improves, particularly as Q1 earnings season (and forward guidance) kicks off this week.

To be sure, the reality of the new administration's aggressive policies to fix many long-festering trade issues has caused much consternation and gnashing of teeth, drawn swift retaliation (particularly from China), disrupted global supply chains, lowered corporate earnings estimates, and raised recession risk (both domestically and globally). In response, just like when the so-called "bond vigilantes" short Treasury notes and bonds (or go to cash) in protest of rising budget deficits and total debt, the "stock vigilantes" went to work shorting stocks (or defensively moving to cash or Treasuries, removing market liquidity and briefly driving the 10-year yield below 4.0%) in protest of the uncertain impacts on the economy and corporate earnings. Or as former Democrat turned Trump supporter Batya Ungar-Sargon sees it, *"Suddenly, everybody is sitting around saying, 'Oh, no, the stock market!' Yeah, the stock market looks like that because the rich [i.e., Wall Street institutional investors and hedge funds] are punishing Trump for siding with the neglected and humiliated American working class over them."* Indeed, the top 10% of Americans by income own 88% of stocks, the next 40% own 12%, and the bottom 50% are shut out.

So, yes, stock portfolios, IRAs, and 401(k) plans are way down, as the evening news keeps telling us. According to Bespoke Investment Group, the Russell 3000 has seen well over $10 trillion in lost market cap since Inauguration Day (1/20). However—and this is an important point—this is not "capital destruction" in the same sense that a wildfire can destroy homes and businesses. The capital pulled from the stock market didn't vanish from the earth. It simply *rotated* into cash and bonds. And it very likely will return to stocks once trade situations are ironed out and visibility improves. It might take several months…or it could come back in a hurry. Be prepared. Perhaps start nibbling at stocks now. If you're like me, you probably received a slew of low-price alerts for your target list. Some speculative investors might be going all-in at current levels. Regardless, for those still contributing to their IRA or 401(k) and not yet drawing on it, this selloff is a gift to be appreciated, in my view, restoring some value back into the market. After all, when you are in long-term accumulation mode, you want to "buy low."

Of course, no one knows for sure how low it can go and when the selloff will bottom—and the bottoming process may be lengthy and volatile. The wild card for stocks going forward is uncertainty around the severity and duration of tariffs, which seem designed by their sheer audacity to induce a swift resolution. After all, there is no underlying malady in the economy that prevents business leaders and entrepreneurs from adapting like they always do, and only pride and prejudice can prevent a quick resolution to most of the trade arrangements.

Political, economic, and market volatility will surely continue during H1. But even if we get a larger correction than I expect, I continue to believe stocks will soon find support and ultimately give way to a gradual *melt-up*, sending the market to back near its highs of Q1 by year-end or early-2026, driven by rising global liquidity, a weaker US dollar, reduced wasteful/reckless government spending and regulatory red tape, lower interest and tax rates, massive corporate capex, and the "animal spirits" of a rejuvenated private sector and housing market. So, if you have been hoping and praying for lower prices in risk assets (including stocks and crypto) or for a lower mortgage rate to buy a house, you are getting them now, with the forward P/E on the S&P 500 at 18.7x as of 4/4 (before any significant downward revisions to earnings estimates), versus 22.7x at its February peak. As the poet Virgil once said (in Latin), *"audentes Fortuna iuvat" — i.e., "fortune favors the bold."*

Because this market correction was led by the bull market-leading MAG-7 stocks and all things AI related, investors now have a second chance to get positions in some of those mega-cap titans at more attractive prices. There remains a persistent sense among global investors of "American exceptionalism" based on ouir entrepreneurial culture, a tenacious focus on building shareholder value, and the mesmerizing appeal of our Big Tech companies that offer disruptive innovation, huge cash positions, reliable and consistently strong earnings growth, free cash flow, margins, return ratios, low interest-rate exposure, global scalability, and wide protective moats.

So, the initial recovery may well be led by the Big Tech titans that are now much more fairly valued, such as NVIDIA (NVDA) at a forward P/E of 21x (as of 4/4). Notably, some of these names have seen their valuations retreat such that they are once again scoring well in Sabrient's growth models (as found in our next-gen **Sabrient Scorecards** subscription product)—including names like Amazon (AMZN), NVIDIA (NVDA), Salesforce (CRM), Alphabet (GOOGL), Meta Platforms (META), Microsoft (MSFT), Broadcom (AVGO), Oracle (ORCL), Arista Networks (ANET), Fortinet (FTNT), Palo Alto Networks (PANW), Palantir (PLTR), and Taiwan Semiconductor (TSM)—two of which (TSM and AMZN) are in the *Q1 2025 Sabrient Baker's Dozen*.

But longer term, rather than the passive cap-weighted indexes dominated by Big Tech, investors may be better served by active stock selection that seeks to identify under-the-radar and undervalued gems primed for explosive growth—many of whom could coattail on the Big Tech names and provide greater returns. This is what Sabrient seeks to do in our various portfolios, all of which provide exposure to Value, Quality, Growth, and Size factors and to both secular and cyclical growth trends.

As for small caps, which as pointed out by Fama French used to outperform large caps over the long haul (higher risk, higher reward), the small cap indexes have been consistently lagging large cap indexes over the past 20 years, mostly due to their much lower allocation to the Technology sector. For example, the S&P 500 has a massive 17.6% relative overweight to the Tech sector (30.3%) versus the Russell 2000 (12.7%). And if you include the Tech-adjacent MAG-7 names that are categorized as Consumer Discretionary (i.e., Amazon and Tesla totaling 5.3%) and Communications (Alphabet and Meta Platforms totaling 6.4%), the S&P 500 allocation to the MAG-7 is 30.5%, and the combined Tech plus Tech-adjacent allocation is a whopping 42.0%—or a 28.9% relative overweight versus the Russell 2000!

Some might say that small caps are due for a mean reversion versus the S&P 500, but it seems its relative overweight to cyclical sectors like Industrials, Financials, Real Estate, Materials, and Energy (with only noncyclical/secular growth Healthcare having an overweight of 5.9%) rather than to secular growth Technology would make any attempt at mean reversion temporary. Nevertheless, I still think the small cap universe is where to find *the most explosive growth opportunities* (with the notable exception of large cap names like NVDA), even if the broad passive indexes (like Russell 2000) can't keep up. So, insightful active selection is important for small cap investing—which is easier to do given the relative lack of analyst coverage and institutional ownership of small caps.

We at Sabrient have become best known for our "Baker's Dozen" portfolio of 13 diverse *growth-at-a-reasonable-price* (GARP) stocks, which is packaged and distributed quarterly to the financial advisor community as a unit investment trust through First Trust Portfolios, along with three other offshoot strategies based on Value, Dividend, and Small Cap investing. By the way, our ***Q1 2025 Baker's Dozen*** remains in primary market until 4/16, after which time the Q2 portfolio launches. Also, our Small Cap Growth 45 portfolio remains in primary market until 4/21, followed by the launch of Small Cap Growth 46, and Dividend 51 is in primary market paying a 4.25% yield on new purchases.

As a reminder, Sabrient founder **David Brown's new book**, *How to Build High Performance Stock Portfolios*, is available in both paperback and eBook versions on Amazon. And as a companion product to the book, we have launched next-gen versions of **Sabrient Scorecards for Stocks and ETFs**. You can learn more about the book and scorecards, download a *sample scorecard*, and sign-up for a *free trial* subscription—by visiting: http://DavidBrownInvestingBook.com/

In my full commentary below, I examine in detail the new tariff regimen, the case for reducing (but not eliminating) the trade deficit, the liquidity challenge and "debt maturity wall," and the case for tariffs and trade realignment. I also discuss Sabrient's latest fundamental-based SectorCast quantitative rankings of the ten U.S. business sectors, current positioning of our sector rotation model, and several top-ranked ETF ideas. Or click **HERE** to continue reading my full commentary online at Sabrient.com (and to sign up for email delivery of future posts).

Market Commentary

For perspective, the 2020 COVID Pandemic was a Black Swan event that shocked the world with no known remedy or duration, and the ensuing lockdowns that froze the global economy were a fear-based reaction to the uncertain severity, duration, and death toll (-37% peak-to-trough S&P 500 drawdown). Other recent Black Swans included the 2008 Global Financial Crisis (-57% S&P drawdown, while Nasdaq fell -78%) and the 2001 Internet Meltdown (-49% S&P drawdown). 2008 saw a global financial system collapse from overleveraged speculation and mark-to-market accounting rules on illiquid assets that required massive government bailouts. And 2001 saw the bursting of a debt- and VC-driven speculative bubble encompassing internet "irrational exuberance," Y2K fears, and overinvestment in telecom infrastructure.

In contrast, today's sudden trade war fallout is a manufactured crisis (intended to right long-standing wrongs) that theoretically could be reversed in an instant—and indeed seems purposely designed to induce a swift resolution. Although it also generated a fear-based reaction to the uncertain severity and duration, it's simply not the same animal as the other three events—more like a raging bull (in a china shop) than a black swan.

Prior to Liberation Day, investors and traders were already reacting negatively to: 1) the "priced for perfection" valuations and the DeepSeek news release that provided a reality check on AI spending, and 2) the turmoil from the new administration deporting throngs of criminal aliens and using DOGE to confront reckless spending, waste, fraud, and corruption, which had been artificially boosting GDP while crowding out more robust private sector growth. Although the status quo was considered to be everything across the spectrum from imperfect to inefficient to disastrous to suicidal, at least businesses, investors, and consumers felt they had some degree of near-term certainty under which to operate. But maintaining near-term certainty and the status quo means "kicking the can" of surging debt, deficit spending, and crime down the road for our children and grandchildren to deal with. Secretary Bessent likened the situation to a bodybuilder on dangerous steroids—our economy and jobs market may have looked great on the outside (headline numbers) but internally the vital organs were dying.

Trump is having no more of that. He and his new administration seem unfazed by the market turmoil they have wrought, particularly compared to his first term when he surrounded himself with entrenched political veterans and seemed primarily focused on maintaining a strong stock market. This time around, his objectives (and perceived "mandate") are bigger and more important for the long-term health of the US economy—and by extension, the global economy. He wants to prevent the economic calamity before it occurs. We should all agree that the path we are on is wholly unsustainable, and Trump sees himself as the "chosen one" destined to institute his America First version of a global "Great Reset," not the globalists' version drawn up by the WEF.

<u>The case for reducing (but not eliminating) the trade deficit</u>:

The US trade deficit hit $1.2 trillion in 2024, and its current account deficit was about $1.1 trillion (accounting for strong inflows of foreign capital), both of which are the highest in the world and near a record high for our country. Our large current account deficit is offset by a large financial account surplus, comprising both foreign direct investment of capital (equity) and foreign investors buying US bonds (debt), such that our balance of payments is zero. However, when our deficit spending is too great to be fully covered by foreign investors, the Federal Reserve might monetize the shortfall by "printing money" to buy new federal debt issuance directly and keep on its balance sheet. This is the type of thing that draws the ire of the bond vigilantes. It is also what Trump's team is seeking to avoid, both by cutting spending (both the wasteful kind via DOGE as well as the boondoggle, agenda-driven, or "buying votes" kind via massive spending bills) and by cutting our massive trade deficit with the rest of the world.

Importantly, the administration's push for onshoring factories is not solely about bringing back manufacturing *jobs* to the Rust Belt, as the MSM would have you believe. Yes, many small towns in America have been decimated by factory closings in the name of globalization, supply chain optimization, and "comparative advantage." But the truth is that most Americans don't pine for menial jobs mindlessly turning screws on an assembly line like the 1950s—instead, new "smart factories" would be highly automated using AI and robotics, so there would be fewer low-skill jobs and more technical ones. And it's not about saving workers in emerging market countries from "slave labor" exploitation, because in many of those countries such jobs, pay, and conditions (which may seem distasteful to us Americans) are much more desirable than their other local options (such as working bent over all day in a rice paddy).

Rather, it's also about *national security* by ensuring reliable supply chains and making products domestically (in case of another global pandemic, lockdowns, or war) and *economic security* to lower (but not eliminate) our massive global trade deficit and reduce reliance on foreign capital (or having to monetize debt, if there aren't enough foreign buyers). In summary, the goals are to reindustrialize our hyper-financialized economy, restore strategic security (e.g., pharmaceuticals, semiconductors, autos, shipbuilding), and rejuvenate the broad middle and working classes and Middle America.

The reason we should not aspire to fully eliminate the trade deficit or turn it into a surplus is because we want to retain the dollar as the world's reserve currency. As explained by Alpine Macro, *"…closing the U.S. current account deficit requires either weaker domestic investment, higher savings, a smaller budget deficit, or some combination of all three…the U.S. current account deficit is the primary source of dollar supply for the rest of the world…Moreover, as the global economy expands, so too does the demand for dollars—and, consequently, the size of the U.S. current account deficit…This dynamic means the U.S. current account deficit will persist unless the dollar loses its status as the global reserve currency, or the world experiences a deep contraction in trade and financial flows,"* neither of which would be desirable.

<u>The Mar-a-Lago Accord</u>:

As Jim Bianco rightly observed, addressing the debt and deficit by adjusting marginal tax rates and baseline accounting are not effective. So, to "reduce the debt burden, lower the dollar, and bring down interest rates," the so-called Mar-a-Lago Accord has proposed and/or implemented: 1) tariffs 2) DOGE, 3) a "peace dividend" by ending wars in Ukraine and Gaza, 4) issuing 100-year non-marketable bonds, and 5) establishing a sovereign wealth fund (SWF) by monetizing the US balance sheet (i.e., revaluing to market valuations or privatization of all federal asset holdings, including public lands, natural resource reserves, patents, data, infrastructure, federal entities, office buildings, and gold) of the federal government.

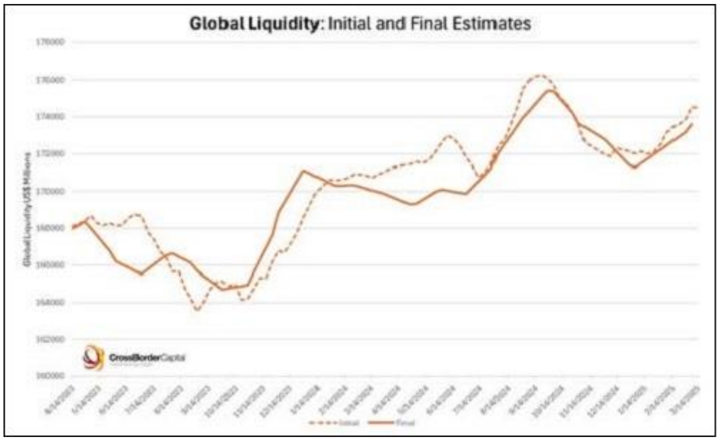
However, Secretary Bessent insists there is no intention to revalue federal gold holdings, but rather he wants to leverage the federally held lands and structures to raise investment capital. In his view, the goal of a sovereign wealth fund would be to achieve higher returns with that capital than simply paying down the debt—which is the cost of capital assuming the 10-year Treasury yield (which briefly fell below 4.0% last week). Bessent thinks we can achieve this easily. (By the way, one of my new favorite pastimes is listening to any Scott Bessent interview—you can't help but like the guy).

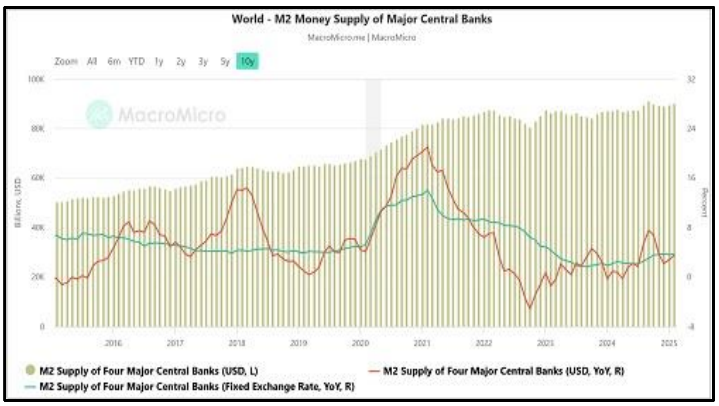
<u>The liquidity challenge and the impending "debt maturity wall"</u>:

While injecting too much liquidity too soon can cause inflation (causing excess demand to outstrip available supply) which of course is a bad thing, good things are also boosted by rising liquidity and money supply, including GDP, corporate earnings, and asset values. It might entail a combination of Fed money creation, a weaker dollar, foreign capital inflows, rising collateral values (aka the "wealth effect" of rising asset prices), and rising velocity of money (number of transactions per dollar in circulation).

So, you just can't flood the markets with liquidity or "helicopter money" like we did during the lockdowns. The Fed has already reduced its COVID-era balance sheet by 25%, from $9 trillion in April 2022 to $6.7 trillion today, but now Fed chairman Jerome Powell plans to slow the pace of balance sheet reduction, which is essentially a move in the direction of quantitative easing (QE)—a quiet way to provide demand for bonds and reduce interest rates while injecting liquidity into the financial system. The two charts below illustrate the rise in global liquidity and global M2 money supply.

Here's the troubling news. As economist Michael Howell of CrossBorder Capital opines, *"Debt may be bad per se, but too much debt relative to liquidity is a disaster in modern economies, because debts need to be rolled over and liquidity is the vehicle. Put another way, financial markets serve as a vast refinancing mechanism, and less so in their textbook role as sources of new capital. This explains why we emphasize balance sheet quantities, not interest rates… Looking ahead, a major bogey investors must face is the upcoming 'debt maturity wall.' This refers to the need to roll over debts termed out during the COVID emergency some 5 years ago, when interest rates collapsed to near zero. These demands peak in 2027, but they begin to bite from around mid-2025."*





Interestingly, as capital rotated during the selloff from stocks into bonds and cash, some commentators believe that Trump's draconian tariffs are part of a deliberate effort to slow the US and global economy into a brief recession to reduce inflation and depress interest rates (by scaring investors into Treasury bonds) so the Treasury Dept. can refinance the impending "debt maturing wall" ($9 trillion of short-term debt coming due over the next 2 years, and $28 trillion of the $36 trillion national debt maturing in the next four years) at much lower rates, then launch massive stimulus into the private sector to supercharge the economy.

As Tanvi Ratna opined on X.com (retweeted by Bill Ackman and others), "*Trump's new tariffs aren't a trade tweak—they're the first move in a full-spectrum reset. $9.2T in debt matures in 2025. Inflation lingers. Alliances are shifting…If rolled into 10-yr bonds, every 1 basis point drop in rates saves approx $1B/year; so a 0.5% drop would save $500B over a decade. Lower yields free up fiscal room… That's where the next lever comes in: cutting the deficit. [DOGE is] cutting $4B per day. At that pace, they'd shave off $1 trillion by end of Sep 25 (if not May). So, here's the big picture: → Lower yields ease the debt wall → Spending cuts restore fiscal discipline → Tariffs jumpstart domestic growth → And geopolitics gets rewritten in America's favor… It's disruption by design—with enormous stakes. If it works, it's a defining success: → Debt under control → Manufacturing reborn → Global leverage restored → Trumpism vindicated in 2026 [before midterm elections] If it fails: → Inflation → Retaliation → Lost midterms → Strategic drift 18 months to find out if the gamble pays off."*

Ripping off the band-aid rather than kicking the can down the road:

However, I don't believe the president wants to induce a recession, nor does he want a crashing stock market, nor does he want a protracted trade war with escalating tariffs (no matter what he states publicly about the juicy $1 trillion per year in tariff revenue amid consequential international negotiations and brinkmanship). But he appears willing to absorb some (very) short-term economic pain in hopes of long-term gain and to pull out all stops to stem our country's 40-year spiral toward economic catastrophe (which has accelerated since the pandemic) that no other president has been willing to address. Trump plays his cards with a poker face such that it's hard to know if he's bluffing and if so how long he might be willing to carry on with the bluff.

So, knowing that he must show significant progress before the 2026 midterms (or risk losing his mandate and momentum), Trump is "ripping off the band-aid" to fully reveal the infected wound and wasting no time in addressing it with what he and his team strongly believe are healing policies that will restructure our nation and its global relationships for long-term prosperity, public safety, and national security. Although the odds might be low that he accomplishes his ambitious goals, he thinks doing it hard and fast—again, like ripping off a band-aid—has a better chance of success than relying upon the usual machinations of politics (e.g., committees, studies, hearings, conferences, diplomacy, lobbying, influence peddling, etc.) which always tend to favor stasis.

His formula to calculate each country's new tariff rate is at once simplistic and perplexing (1/2 of our trade deficit with the given country divided by our imports from it, subject to a minimum of 10%), ostensibly meant to strongly encourage onshoring manufacturing. But the president's announcement also was shocking because: 1) most of us had simply grown accustomed to the stark imbalances in the international trading system—some of which hold over from post-WWII reconstruction efforts and/or to give a leg up to developing nations, always tilted against the US—as "just the way it is" or "no big deal," and 2) we've never witnessed a political leader (or anyone else, for that matter) negotiate this way. It is scary and uncomfortable to watch. And it has made the market fragile.

But here's the more uncomfortable reality: Our existing system is not working, and something has to change dramatically if we are ever going to stanch the bleeding and reverse this debt spiral, with the CBO projecting the budget deficit to hit $1.9 trillion this year on $8 trillion in spending (i.e., 24% deficit!) and total debt of $36 trillion. Trump sees this has his mandate—and an opportunity to implement the policies he has envisioned for over 40 years.

The case for tariffs within a comprehensive trade realignment:

All our trading partners have employed tariffs for many years, often with great success, i.e., low inflation and solid economic growth. As explained by Capital Group, there are four distinct motivations for a country to employ tariffs, including decoupling (to reduce overreliance on certain countries for critical goods for national security), rebalancing (to reduce trade deficits with trading partners and boost jobs at home), negotiating (using tariffs as leverage for revised trade deals), and funding (to generate revenue like taxation). Of course, decoupling and funding have the most long-term implications.

Indeed, the administration's stated reasons for raising tariffs are rebalancing trade flows, reindustrialization (included in both decoupling and rebalancing), and raising revenue (aka funding) as its policy goals. Negotiating was unstated but obviously a strong driver. Tariffs are a cudgel to bring recalcitrant trading partners into submission. Fleeting pain for US consumers, but major pain for those misbehaving countries. Higher tariffs generally would be expected to create a stronger dollar since they lower demand for imports priced in foreign currency. Conversely, limiting tariffs would typically lower the dollar's value as demand for foreign currency increases. A strong dollar could help offset some tariff-related costs.

As I discussed in my February post, I believe Trump is playing a game of chicken with trading partners who are ill-positioned to win. Retaliation against the US is like playing chicken on the highway with a Prius against an 18-wheeler—there is no doubt who would win. The new tariff regimen is the largest in over 100 years, but as the saying goes, when the US sneezes the rest of the world catches a cold, so we are in far better position to weather the storm. Rough numbers, the US GDP is around $30T, and China are the EU are both around $18T. Moreover, international trade makes up only about 25% US GDP but a staggering 96% for the EU, 37% for China, and Canada and Mexico are both over 70%. That means the US is less dependent on trade and less vulnerable to trade disruptions than its peers in the region and beyond.

China's 34% retaliatory counter-tariff triggered last Friday's market capitulation, but it's doubtful whether any other country will be willing (or able) to escalate the fight. Even China, whose exports to the US are 3x larger than their imports from the US, is likely using this massive escalation and hostile rhetoric simply as a Trumpian bargaining tactic meant to induce a quick resolution…or because the CCP is seeking to stoke the flames of political division in our country to its benefit. Either way, China's struggling mercantilist economy can ill afford a prolonged trade war as they are currently trying to boost exports to work their way out of the malaise (further increasing their trade surplus at our expense). As Treasury Secretary Scott Bessent has said, *"the trade surplus countries traditionally always lose any kind of a trade escalation."* So, hopefully it's just a short waiting game.

Moreover, respected economist Michael Howell of CrossBorder Capital opined in his Capital Wars on Substack, *"We know two things for sure. First, investors are panicking. Second, China, among others, cannot afford to suffer further economic pain and will likely employ all tools, monetary and Keynesian, to boost her growth. Expect more stimulus ahead… Consider, latest economic data…evidence a skidding World economy. The pace of activity has dropped by a whopping near 300 basis points since mid-December 2024. Tariff uncertainty will reinforce the trend lower, but this slowdown plainly started well before the latest trade tensions. In short, the World is already in recession."* I agree. Neither the EU nor China are in any position to fight a brutal trade war; even before Liberation Day they were destined to be injecting stimulus—the strong gold market is signaling as much—leading to global monetary inflation.

I recommend reading a concise and illuminating article on this topic by market maven Michael Gayed, "How Deregulation and Tariffs Are Shaping America's New Economic Strategy," which was just published in his *Free Markets Report* on Substack. He concludes, *"Tariffs protect US industries by making imports more expensive and less competitive, encouraging consumers and businesses to buy American. At the same time, deregulation slashes compliance costs, making it cheaper and easier for US businesses to invest, expand, thrive, and compete globally. The combination creates a potent pro-business environment for US businesses, where they can scale fast, reinvest locally, and grow rapidly…."*

And as First Trust chief economist Brian Wesbury has said, *"When you combine smaller government with better monetary policy and a better trade environment, I think the future looks really bright."*

And regarding all the expert talk in the media about the inflationary impact of tariffs and the potential for a stagflation scenario, I wholly disagree. As Alpine Macro opined, *"…after a one-time price adjustment when the tariff is implemented, tariffs are thereafter deflationary as they restrain or reduce real income [when either passed along to consumers or by reducing corporate profits]."* Historically, stagflation has been driven by an oil price shock. And in my view, tariffs are similar to raising income or sales tax rates, so Congress can offset them with tax rate cuts in the "one big, beautiful bill" they are working on.

Latest Sector Rankings

Relative sector rankings are based on Sabrient's proprietary SectorCast model, which builds a composite profile of each of over 1,400 equity ETFs based on bottom-up aggregate scoring of the constituent stocks. The *Outlook Score* is a Growth at a Reasonable Price (GARP) model that employs a forward-looking, fundamentals-based multifactor algorithm considering forward valuation, historical and projected earnings growth, the dynamics of Wall Street analysts' consensus earnings estimates and recent revisions (up or down), quality and sustainability of reported earnings, and various return ratios. It helps us predict relative performance over the next 3-6 months.

In addition, SectorCast computes a *Bull Score* and *Bear Score* for each ETF based on recent price behavior of the constituent stocks on particularly strong and weak market days. A high Bull score indicates that stocks held by the ETF recently have tended toward relative outperformance when the market is strong, while a high Bear score indicates that stocks within the ETF have tended to hold up relatively well (i.e., safe havens) when the market is weak. Outlook score is forward-looking while Bull and Bear are backward-looking.

As a group, these three scores can be helpful for positioning a portfolio for a given set of anticipated market conditions. Of course, each ETF holds a unique portfolio of stocks and position weights, so the sectors represented will score differently depending upon which set of ETFs is used. We use the iShares that represent the ten major U.S. business sectors: Financials (IYF), Technology (IYW), Industrials (IYJ), Healthcare (IYH), Consumer Staples (IYK), Consumer Discretionary (IYC), Energy (IYE), Basic Materials (IYM), Telecommunications (IYZ), and Utilities (IDU). Whereas the Select Sector SPDRs only contain stocks from the S&P 500 large cap index, I prefer the iShares for their larger universe and broader diversity.

The table below shows the latest fundamentals-based Outlook rankings and my full sector rotation model:

Sabrient SectorCast Sector Rotation Strategy - As of 4/4/2025
Suggested Top 3 Sector ETFs for Bullish, Neutral, or Defensive Outlooks
Bullish/Neutral/Defensive bias based on SPY vs. 50/200 day moving averages; 30-90-day forward look

Sector	ETF	Outlook Score	Bull Score	Bear Score	Net Score: Neutral Bias	Net Score: Bullish Bias	Net Score: Defensive Bias
TECHNOLOGY	IYW	90	56	39	90	90.0	55.1
HEALTHCARE	IYH	78	48	68	78	59.7	90.0
TELECOMMUNICATIONS	IYZ	67	52	62	67	68.6	77.1
UTILITIES	IDU	48	45	77	48	39.0	89.7
INDUSTRIALS	IYJ	45	55	53	45	70.2	55.3
CONSUMER DISCRETIONARY	IYC	31	59	44	31	77.9	37.0
BASIC MATERIALS	IYM	27	54	59	27	60.3	56.0
FINANCIALS	IYF	22	56	53	22	64.9	45.6
ENERGY	IYE	9	56	56	9	60.1	44.2
CONSUMER STAPLES	IYK	8	43	82	8	17.7	79.7

Sabrient's ***Outlook Score*** employs a forward-looking fundamentals-based scoring algorithm to create a composite profile of the constituent stocks. ***Bull Score*** and ***Bear Score*** are based on price behavior of the underlying stocks on particularly strong and weak days over the prior 40 market days. High Bull indicates a tendency for relative strength in a strong market, and high Bear indicates a tendency for relative strength in a weak market (i.e., safe havens). High for all scores is 100, and higher is better.

I would continue to call the rankings defensive given that preponderance of secular growth, non-cyclicals, and defensives ranked higher than cyclicals, and with so few sectors scoring over 50 in Outlook score. Bullish rankings would entail cyclical and economically sensitive sectors dominating the top half of the rankings with scores well above 50 and defensive sectors in the lower half.

Technology (dominated by the Big Tech titans and AI-driven highflyers) remains at the top with a strong Outlook score of 90, despite having by far the highest forward P/E of 21.8x (although down substantially from 29.2x at its high). However, because of its still-strong EPS growth estimate of 18.1% (which might come down as estimates get revised), its forward PEG (ratio of P/E to EPS growth) is a relatively modest 1.20 (only Energy and Financials are lower). Tech also displays relatively stable Wall Street analysts' net earnings revisions (only slightly lowered so far), by far the highest return ratios and insider buying.

Because many Tech stocks are riding secular growth trends (i.e., little cyclicality), no other sector comes close to the consistent sales growth, margins, operating leverage, and return on capital. For example, the three largest US Tech companies—Apple, NVIDIA, and Microsoft—average net profit margins of over 40% and ROE of around 90%. And Tech not only benefits from its own product development and productivity gains, but those products help other companies with their product development, product delivery, and productivity—so Tech benefits by helping all sectors grow and prosper.

Rounding out the top 5 are Healthcare, Telcom, Utilities, and Industrials. Utilities have become more popular due to involvement in the buildout of AI infrastructure and power grid. Notably, 8 of the 10 sectors have seen negative net revisions to EPS estimates from the analyst community, with only Utilities and Telecom solidly positive. At the bottom of the rankings are Energy and Consumer Staples, as Materials has managed to rise a bit in the rankings, while Energy has reversed its brief rise, likely due to falling oil prices. Notably, Telecom, Energy, and Financials display the lowest (most attractive) forward P/Es at 13.7x, 12.9x, and 12.3x, respectively.

Keep in mind, the Outlook Rank does not include timing, momentum, or relative strength factors, but rather reflects the consensus fundamental expectations at a given point in time for individual stocks, aggregated by sector.

Sector Rotation Model and ETF Trading Ideas

Our rules-based Sector Rotation model, which appropriately weights Outlook, Bull, and Bear scores in accordance with the overall market's prevailing trend (bullish, neutral, or defensive), fell to a defensive bias on 3/10 when the SPY closed solidly below its 200-day moving average while also being below its 50-day. *(Note: In this model, we consider the bias to be bullish from a rules-based trend-following standpoint when SPY is above both its 50-day and 200-day simple moving averages, but neutral if it is between those SMAs while searching for direction, and defensive if below both SMAs.)*

Thus, as highlighted in the table above, it suggests holding **Healthcare (IYH)**, **Consumer Staples (IYK), and Utilities (IDU)**. However, if you prefer a neutral stance, the Sector Rotation model suggests holding Technology (IYW), Healthcare, and Telecommunications (IYZ). Or, if you prefer to take a bullish stance (given that the extremely oversold market), it suggests holding Technology, Consumer Discretionary (IYC), and Industrials (IYJ).

Here is an assortment of other interesting ETFs that are scoring well in our latest rankings: Inspire Fidelis Multi Factor (FDLS), Invesco Dorsey Wright Technology Momentum (PTF), Defiance Connective Technologies (SIXG), iShares US Pharmaceuticals (IHE), Horizon

Kinetics Medical (MEDX), iShares MSCI Global Gold Miners (RING), Neuberger Berman Disrupters (NBDS), Global X MSCI Argentina (ARGT), Janus Henderson US Sustainable Equity (SSPX), Roundhill GLP-1 & Weight Loss (OZEM), VanEck Junior Gold Miners (GDXJ), Invesco Semiconductors (PSI), First Trust Innovation Leaders (ILDR), Fidelity Metaverse (FMET), Roundhill Generative AI & Technology (CHAT), ETC 6 Meridian Small Cap Equity (SIXS), Aztlan Global Stock Selection DM SMID (AZTD), Global X Social Media (SOCL), and Alger 35 (ATFV). All score in the top decile (90-100) of Outlook scores.

As always, I welcome your thoughts on this article (whether supportive or critical)! Please email me anytime. Any and all feedback is appreciated. Also, please let me know of your interest in any of Sabrient's new **indexes** for ETF investing, such as *High-Quality Growth* (similar to our Baker's Dozen model), *Quality Growth & Income*, *SMID-Cap Quality Plus Momentum*, *High-Quality Technology*, *High-Quality Energy*, *Quality Legacy & Green Energy*, or *Defensive Equity.*

IMPORTANT NOTE: I post this information periodically as a free look inside some of our institutional research and as a source of some trading ideas for your own further investigation. It is not intended to be traded directly as a rules-based strategy in a real money portfolio. I am simply showing what a sector rotation model might suggest if a given portfolio was due for a rebalance, and I do not update the information on a regular schedule or on technical triggers. There are many ways for a client to trade such a strategy, including monthly or quarterly rebalancing, perhaps with interim adjustments to the bullish/neutral/defensive bias when warranted, but not necessarily on the days that I happen to post this article. The enhanced strategy seeks higher returns by employing individual stocks (or stock options) that are also highly ranked, but this introduces greater risks and volatility. I do not track performance of the ideas mentioned here as a managed portfolio.

Disclosure: *At the time of this writing, of the securities mentioned, the author held positions in SPY, QQQ, FTLS, ARGT, GDXJ, gold, and bitcoin.*

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