Sabrient Systems
Sector Detector

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The anticipated market correction arrives; time to prepare your buy list

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Overview

The year began with impressive strength and resilience in risk assets despite all the uncertainties around tariffs, trade wars, hot wars, slowing GDP growth, inflation, stagflation, AI impact and capex, and myriad other concerns. The US was considered the rock in a recessionary world, attracting massive foreign capital flight (according to Nasdaq, total foreign holdings of US equities as of June 2024 was $17 trillion—almost double versus 2019). But once the dam broke, stocks, crypto, and the US dollar started melting down in a "waterfall decline" culminating in a "flash crash" on Monday with the CBOE Volatility Index (VIX) nearly hitting 30 before closing at 27.86. As the adage goes, *"Stocks take the stairs up and the elevator down."* But I believe this is a valuation-driven correction, as valuations had become "priced for perfection," and the rapid meltdown will ultimately will give way to a gradual melt-up, driven by rising global liquidity, a weaker US dollar, reduced wasteful government spending, lower tax and interest rates, less regulatory red tape, and the "animal spirits" of a rejuvenated private sector and housing market.

Prop desks and algorithmic trading systems hit sell stops to exacerbate the selloff, with many flipping from long to short exposure, and markets imploded as average investors quickly swung from extreme greed to extreme fear. According to Real Investment Advice, *"The last time the market was this oversold and 3 standard deviations below the [50-day moving average] was in August of last year during the 10% correction as the Yen Carry Trade erupted."* The AAII weekly sentiment survey hit a bearish extreme of 60% on 2/26, after surging from 40% just one week earlier when the S&P 500 was at an all-time high. However, it's important to note that stocks have historically recovered quite impressively over the 12 months following such extreme bearish readings.

The rising bond term premium in Q4 suggested that investors were becoming increasingly anxious about rising deficits and inflation, which also pushed gold higher. Meanwhile, the Fed has maintained tight monetary policy—and high real interest rates—given the uptick in inflation and apparently solid employment reports. However, I have consistently argued that the real-time inflation trend (without the lag in key components) has been falling and that massive government spending and hiring masked underlying issues with growth and employment in the private sector. So, this is not due to anything the new administration has done. As Renaissance Macro economist Neil Dutta recently opined, *"[President Trump] inherited an economy with deep imbalances and a frozen housing and labor market."*

In fact, John Burns Research & Consulting has observed that 3.8 million employees work directly for the government, but an additional 7.5 million workers indirectly receive some or all of their wages from the government—which totals 11.3 million workers or roughly 8% of the total US workforce (134 million) and accounts for much of the jobs growth. This is why I continue to advocate for both smaller government and another 100 bps in Fed rate cuts to achieve a neutral fed funds rate around 3.5% and stimulate private sector growth. As a result, I would expect a 10-year yield to stabilize around 4.0-4.5%, which would justify a forward P/E multiple for the S&P 500 around 20x (i.e., an earnings yield of 5%).

From their highs this year, *"the S&P 500 and crypto have erased a combined -$5.5 trillion of market cap,"* according to The Kobeissi Letter. The highflyers have led the carnage, most notably semiconductor stocks. Meta Platforms (META) is the only MAG-7 stock still positive YTD, while defensive sectors (like staples, telecom, and utilities), gold and silver miners, low/minimum volatility, value, high dividend payers, REITs, and long-duration bonds are among the best performers. The fact that bonds have caught a bid and credit spreads remain tight are positive signs that investors do not fear recession (or economic collapse). But investors continue to be shy about the amount and duration of tariffs, the aggressive DOGE actions, timing of fiscal policy implementation (tax cuts and deregulation), and Fed monetary policy (a Fed put?), and the collective impact on jobs, inflation, GDP growth, and risk asset prices as they retreat from historically high valuations.

To be sure, the Big Tech darlings became overvalued, which is why the equal-weight versions of the S&P 500 and Nasdaq 100 have held up significantly better during the selloff. But keep in mind, the first year of a 4-year presidential term is typically the most volatile during the transition to new policies—and Trump 2.0 ("wrecking-ball") policies are bringing quite a change from the norm. As Treasury Secretary Scott Bessent said, *"The economy has become hooked [on government spending], and there is going to be a detox period."*

So, knowing that he must show significant progress before the 2026 midterms, 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 believes are healing policies that will restructure

our nation for long-term prosperity, public safety, and national security. This is why his popularity among younger voters is holding firm. Although not nearly as extreme, it is like what Javier Milei has done to resurrect Argentina. I expect the political, economic, and market fallout will take its course during H1 2025 before giving way to a rapid building process during H2.

Investors have been increasingly scared away from risk assets at least partly due to the constant carping from both the mainstream media (MSM) and social media (usually misleadingly) about a "growth scare" (as the Atlanta Fed's GDPNow forecast for Q1 plummeted to a recessionary *-2.4%* annualized growth rate), an "inflation scare" (due to tariffs, chickens, and migrant deportations), an "AI scare" (as China may be usurping our dominance with cheaper models, a "trade war scare" (as we alienate our international allies and trading partners), and various other scares that escape me at the moment (perhaps a "Hollywood exodus scare," as celebs move out of country?). This diversified fearmongering has finally come to roost leading to the rapid unwinding of crowded long trades.

But no matter what you think of the longstanding system of global trade and whether the US was being taken advantage of, there is no doubting that the fiscal path we were on was unsustainable, with a bloated and intractable bureaucracy, wasteful boondoggles, entrenched interests, and funding of corruption, graft, fraud, racketeering, cronyism, kickbacks, and obfuscation both at home and around the world. Until now, no president has been willing or able to adequately address it, including Trump 1.0. But the new Trump 2.0 administration came in well prepared (and with a voter majority mandate) to tackle it head on. I have come to appreciate the method to our president's apparent madness, as I discuss in my full post.

So, is this selloff likely to become a buyable dip rather than the start of a bear market? I would say yes. Although there might be some further volatility into the 4/2 tariff implementation date and perhaps the 4/15 Tax Day, I expect higher prices ahead. Why? First, from a short-term technical standpoint, the S&P 500, Nasdaq 100, and Dow Jones Industrials have diverged well below their 20-day moving averages, and they seem to have found support around their critical 300-day moving averages. Second, from a longer-term standpoint, despite all this chaos and turmoil from an administration emboldened to reverse and repair decades of neglect (and a continual "kicking the can down the road" for future generations to suffer the consequences), I remain optimistic that after some short-term pain during this transition period—including upticks in inflation, debt, and market volatility and a downtick in economic growth—the private sector will be equipped and unleashed to drive robust economic growth through productive, high-ROI investments and hiring.

In addition, as DataTrek Research recently observed, stocks have only fallen more than 10% in a given year in just 12 of the past 97 years, and each was driven either by a new hot war, recession (generally related to an oil price shock), or a Fed policy mistake—none of which are likely. So, don't be too bearish. And as for a long entry point, the VIX can provide some guidance. It closed above 27 this week, which DataTrek considers to be a "capitulation" signal to consider getting back into stocks. And don't forget all the cash sitting in money market funds earning those juicy risk-free rates. As money market rates recede, some of that cash may finally find its way into stocks at these more favorable valuations. Indeed, the rising price of gold may be signaling a global dovish pivot and massive liquidity support, as I discuss in my full post.

Yes, liquidity is key to keeping us out of a recession and a bear market in risk assets. Lower interest rates and a weaker US dollar are long-term economic tailwinds, while debt reduction is a short-term headwind until a rejuvenated (and turbocharged) private sector makes up for the lower deficit spending.

I expect the S&P 500 to rise above 6500 before year-end with a modest double-digit gain. Could it take longer for the expected fiscal stimulus (lower tax and interest rates, less red tape, and smaller government) to serve alongside the incredible promise of AI (on productivity, efficiency, and speed of product development) to boost the GDP such that the 6500 mark isn't achieved until next year? Sure. But I think ultimately an economy driven by organic private sector growth is stronger and more reliable and sustainable than one driven by government (deficit) spending bills. As Elon Musk opined, *"A more accurate measure of GDP would exclude government spending… Otherwise, you can scale GDP artificially high by spending money on things that don't make people's lives better."*

In the view of Treasury Secretary Scott Bessent, we have *"a generational opportunity to unleash a new economic golden age that will create more jobs, wealth and prosperity for all Americans."* Indeed, if the fed funds rate begins to come down toward my 3.5% target, today's slightly elevated valuations can be justified given solid corporate earnings growth, a high ratio of corporate profits to GDP, and the promise of continued margin growth across all industries due to the promise of rising productivity, efficiency, and product development speed from Generative AI, Large Language Models (LLMs), and Big Data. AI investment is not slowing down but simply shifting from a singular "builder" focus to a broader focus on AI applications. This is where productivity enhancement will shift into gear. And don't forget energy, as affordable power is the lifeblood of an economy. Costs must stay low, and Trump 2.0 is prioritizing energy independence and lower energy costs.

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. 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), Arista Networks (ANET), Fortinet (FTNT), Palo Alto Networks (PANW), Palantir (PLTR), Microsoft (MSFT), and Taiwan Semiconductor (TSM). Our models focus on high quality and fundamental strength, with a history of consistent, reliable, and accelerating sales and earnings growth, positive revisions to Wall Street analysts' consensus forward estimates, rising profit margins and free cash flow, solid earnings quality, and low debt burden. These are factors Sabrient employs in selecting our portfolios and in our SectorCast ETF ranking model. And notably, our Earnings Quality Rank (EQR) is a key factor in each of these models, and it is also licensed to the actively managed, absolute-return-oriented **First Trust Long-Short ETF (FTLS)**.

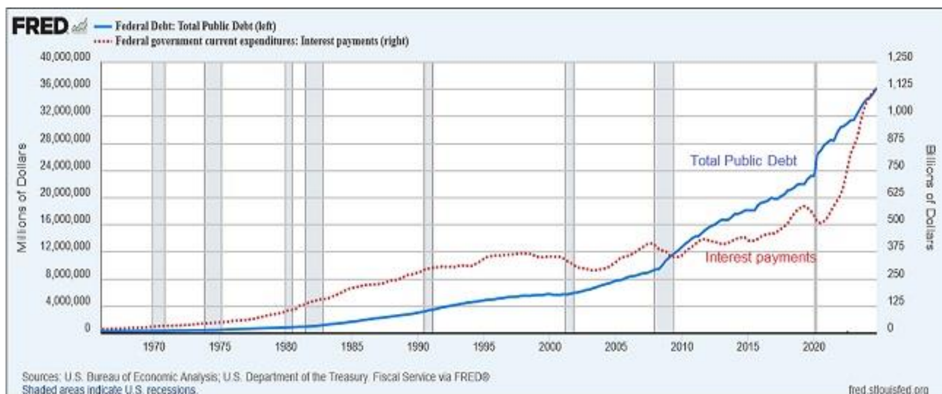
Sabrient founder David Brown describes these (and other) factors and his portfolio construction process in his new book, *[How to Build High Performance Stock Portfolios](#)*, which is available on Amazon for investors of all experience levels. David describes his path from NASA engineer on the Apollo 11 moon landing project to creating quant models for ranking stocks and building stock portfolios in four distinct investing styles—growth, value, dividend, or small cap growth. You can learn more about David's book, as well as the **companion subscription product (Sabrient Scorecards)** that does most of the stock evaluation work for you, by visiting: https://HighPerformanceStockPortfolios.com.

As you might expect from former engineers, Sabrient employs the scientific method and hypothesis-testing to build quantitative models that make sense. We 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.

In my full commentary below, I examine in greater detail the "growth scare," inflation, tariffs, and DOGE shock, equity valuations, and what lies ahead. 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. Click **HERE** to read my full commentary online at Sabrient.com (or to sign up for email delivery of future posts).

Market Commentary

To be sure, our expanding regulatory state, social justice and global priorities, and massive (and largely unproductive, i.e., low-ROI) government spending and "malinvestment" served to artificially support GDP growth and hiring while driving up debt and deficits beyond imagination. Since Russia's invasion in February 2022, the US has allocated at least $175 billion in aid to Ukraine. In FY2024 (which ended 9/30/24), our federal government spent $6.75 trillion and collected $4.92 trillion in revenue leading to a $1.8 trillion budget deficit. As illustrated in the chart below, our total federal debt now exceeds $36.2 trillion, and interest on the debt has gone parabolic to $1.16 trillion/year. Obviously, this is unsustainable—amounting to fiscal malfeasance—which the new administration is determined to fix, with the laudable but formidable goal of balancing the budget within 4 years (i.e., bringing the $1.8 trillion deficit down to zero).



And as for tariffs, my expectation is that they are not intended to be permanent or incite a protracted trade war but instead are simply a short-term way to negotiate with trading partners into treating the US more fairly. Essentially, POTUS is playing a game of chicken with countries who have heavy trade surpluses with us (i.e., they are dependent on exports to the US). But so far, he is getting a lot of pushback both internationally and domestically (from Democrats and the MSM). It will take strong backbone for Trump and his administration to do what no previous administration has been able to do—stand firm against such a concerted onslaught of bitter criticism and obstruction (against both tariffs and DOGE cost-cutting). And while the end goals are laudable and necessary, the path is fraught with danger and uncertainty—which frightens consumers and investors alike. Nevertheless, there's no doubt that Trump revels in both the challenge and the ruffling of feathers.

Despite enormous deficit spending bills passed during the previous administration to make up for the sluggish private sector (including about $4 trillion authorized through the CHIPs and Science Act, Inflation Reduction Act, American Rescue Plan Act, and Infrastructure Investment and Jobs Act), GDP growth remained sluggish. That's what happens when growth isn't organic but forced. And now with spending being cut and importers front-running tariffs, forecasts of Q1 GDP growth (which imports subtract from) are falling.

But oil prices are holding steady, wars seem to be nearing resolution, and the Fed is being careful, and it's rare to have a recession without either a spike in oil prices, a hot war, or a Fed policy mistake—for instance the 2022 recession resulted from the all three: the Russian invasion of Ukraine combined, a surge in oil prices above $120/bbl, and 400 bps of aggressive Fed rate hikes. Long-term yields are also moving lower, reducing the cost of debt financing (including mortgages). The US dollar is weakening, which is a positive sign for global investor sentiment. Rate-cut expectations are rising (now suggesting 3-4 this year, likely starting with the FOMC meeting in May). In sum, lower tax and interest rates, deregulation, energy independence, and smaller government (with less profligacy, waste, fraud, and malinvestment) should boost the underlying growth rate of the economy soon.

Moreover, I believe any near-term increase in unemployment and inflation will be temporary. Ultimately, once Trump's aggressive negotiating tactics shake out, I think we will see disinflation, lower interest rates across the yield curve, lower tariffs and fairer trade, and expanding productivity leading to rising real GDP growth (above 4% in the US), rising corporate margins and earnings, and continued gains in stocks through 2026. However, I believe this correction has marked the top in stock *valuation multiples*, which means renewed gains and new highs will be tied more to earnings growth than multiple expansion, particularly given that other regions (including China, Japan, and Europe) may attract some of the foreign capital that previously had been flowing solely into the US —although I think lower risk-free rates would support a 20x multiple on the S&P 500, assuming solid growth in GDP and corporate earnings.

Reducing wasteful/unproductive government spending frees up those resources for private investment, fostering job creation and higher incomes. In fact, the Hoover Institution suggests that fiscal discipline (including cutting entitlement spending) may boost GDP growth by up to 10% in the short term and 7% in the long term. As Cato's Adam Michel said, *"Fiscal discipline through spending cuts could act like supply-side tax reform and turbocharge other pro-growth tax cuts and deregulation."*

There has been a lot of talk about the so-called "Mar-a-Lago Accord." In a nutshell, as Jim Bianco rightly observed, the tired old ways of addressing the debt and deficit, like adjusting marginal tax rates and baseline accounting, simply do not work, so a whole new approach is required to "*reduce the debt burden, lower the dollar, and bring down interest rates.*" So, in essence, the Mar-a-Lago Accord has proposed/implemented: 1) tariffs to induce "fair trade" and require allies to pay for security rather than enjoy the US continuing to foot the bill for the entire free world, 2) DOGE to root out fraud and wasteful spending (leveraging AI with the revamped AutoRIF app—Automated Reduction in Force), 3) a "peace dividend" by ending the two major foreign wars we have been funding in Ukraine and Gaza, 4) issuance of 100-year non-marketable bonds to lock-in long-term funding at reasonable interest rates, and 4) establishing a sovereign wealth fund 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).

It should come as no surprise that the US has shown a negative trade balance every year since 1975 due to our low savings rate and federal budget deficits. This leads to relatively higher interest rates, which helps to attract foreign capital and keeps the dollar strong, which makes imports relatively cheaper and exports relatively expensive, which further worsens the trade deficit. According to Johns Hopkins economist Steve Hanke, increasing our savings rate and slashing the budget deficit would reduce our current account deficit by increasing demand and reducing issuance of Treasuries on the open market, which reduces interest rates and the dollar, thus reducing imports, increasing exports, and lowering the trade deficit.

However, although the US has indeed been taken advantage of economically—by paying far more in tariffs to trading partners than we charge and turning a blind eye to, for example, IP theft and other violations in order to gain access to China's market—this does not mean that we should try to completely turn around our large current account deficit into a surplus. You see, the current account balance is a record of a country's economic transactions with other countries. It's calculated by adding together a country's net exports, net primary income, and net secondary income. Because we enjoy the world's reserve currency, it means we must maintain a current account deficit in order to satisfy the overseas demand for dollars.

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."* Of course, no one wants that.

<u>Signs of economic distress</u>:

Household debt as a percentage of disposable income has been in an upward trend; it increased to 87% in the fourth quarter of last year, according to the Fed's most recent quarterly report. Credit card balances are now over $1.2 trillion in the aggregate (with an average interest rate over 20%), and more Americans under the age of 40 are seeing their accounts moved into "serious delinquency." The personal saving rate hit a new post-COVID low in the fourth quarter. Lower-end consumers are struggling, as evidenced by Big Lots, Kohl's, and Family Dollar closing down stores across the country.

Furthermore, home sales are sluggish, as are housing starts. Both PMI Manufacturing and Services fell such that the Composite PMI for February was the slowest since September 2023. According to S&P Global, *"At its current level, the index is broadly consistent with the global economy expanding at an annualized rate of 2.2%, falling short of the estimated 3.0% growth seen in the fourth quarter of last year."* Not surprisingly, consumer sentiment is down, as the University of Michigan survey for February fell to 64.7, its lowest level since November 2023. The Conference Board also showed a larger than expected decline, falling 7 points to 98.3. Obviously, people are concerned. So, without profligate federal deficit spending (which Trump and DOGE are taking away) and a surging debt, the economy will need to rely on the private sector to jumpstart economic growth.

There were 694 US corporate bankruptcy filings during 2024, which was the most since 2010 (emerging from the GFC) and up about 8% from 2023. In January 2025 alone, there were 70 filings, which is the highest monthly number since the pandemic shutdown. And the high-yield default rate rose to 5.1% in December, its highest level since 2016.

The BEA reported final Q4 GDP of 2.3%. Although the final reading was unchanged from the prior estimate, the final revision showed upward revisions to inventories, net exports, and government purchases, but downward revisions to personal consumption and business investment—which are the lifeblood of the economy. According to First Trust, business fixed investment (such as equipment, commercial construction, and intellectual property) declined at a 3.2% annualized rate despite the AI spending boom, which was the first such drop since 2021. But the reliance on consumer spending while savings rates are falling (3.8% annualized growth in Q4 vs. 6.7% pre-pandemic), and the overreliance on government spending (about which I have been persistently pounding the table) is nearing an end with DOGE and other reductions to deficit spending. In fact, the US has had a net negative national savings rate for several years, which is clearly unsustainable.

All of this has led to today's "growth scare" narrative. Scott Bessent agrees that the private sector has been weak and that we need to "re-privatize" the economy to achieve more robust organic growth. But he also has said (on CNBC), *"…there's going to be a natural adjustment as we move away from public spending to private spending… The market and the economy have just become…addicted to this government spending, and there's going to be a detox period."* He has also stated, *"We're seeing the hangover from the excess spending in the Biden 4 years. In 6 to 12 months, it becomes Trump's economy."* And regarding the new administration's economic policies, which seek to rationalize and reorder the global economy, he said in a speech to the Economic Club of New York, *"Access to cheap goods is not the essence of the American dream…For too long, the designers of multilateral trade deals have lost sight of this…Wall Street can continue doing well…But this administration is about Main Street."*

Moreover, weak international trade seems to be a greater drag than expected, and a rising trade deficit lowers GDP. Although the Atlanta Fed's GDPNow prediction model had been continuing to forecast Q1 GDP growth running at the same modest 2.3% annualized rate, after accounting for the latest BEA and Census Bureau releases, its Q1 forecast *plummeted to -1.5%* on 2/28. Yes, that's a negative sign in front. As they explained, *"the contribution of net exports to first-quarter real GDP growth fell from -0.41 percentage points to -3.70 percentage points while the nowcast of first-quarter real personal consumption expenditures growth fell from 2.3% to 1.3%."* This was mainly due to companies front-running the expected boost in tariffs and stocking up on imports, as the January trade deficit on goods fell to a record -$153 billion.

And then on 3/3, the forecast was further reduced to -2.8% *as "the nowcast of first-quarter real personal consumption expenditures growth and real private fixed investment growth fell from 1.3%and 3.5%, respectively, to 0.0% and 0.1%."* As of 3/6, the estimate stood at -2.4% as *"the contribution of net exports to first-quarter real GDP growth fell from -3.57 percentage points to -3.84 percentage points."* However, the surge in January's imports coupled with depressed consumer spending (at least partly from the extreme cold) suggest we may have had more normal economic activity in February and March. And many companies (foreign and domestic) have made capital spending commitments in the US, including onshoring manufacturing.

Jobs and inflation:

Many fear that Trump's DOGE initiative to cut federal spending will only raise unemployment and hinder GDP growth. But I think it might actually *reduce* unemployment and boost GDP growth…leading to what some are calling a "small business renaissance." The Cato Institute argues that cutting federal deficit spending (and the huge debt load that must be serviced by over $1.1 trillion/year) can alleviate the "crowding-out effect" in which government borrowing drives up interest rates and hampers private-sector investment leading to lower wages and productivity as well as reduced competitiveness. Likewise, Brian Wesbury of First Trust has observed that growth in bureaucracy is inherently inflationary because the money is taken from the private sector through taxation or borrowing, which crowds out and shrinks the private sector, reducing potential economic growth. "Printing" money for deficit spending on stimulus programs creates monetary inflation. So, cutting spending (e.g., through DOGE) actually helps to boost organic growth and lessen inflationary pressures.

According to Dante DeAntonio, labor economist for Moody's Analytics, about 3 million non-military federal employees account for about 1.9% of total US jobs, and the size of the federal workforce may shrink by about 400,000 (13%) in 2025 from attrition, deferred resignations, and DOGE layoffs. Moody's expects that the private sector should be able to absorb many of those who are laid off.

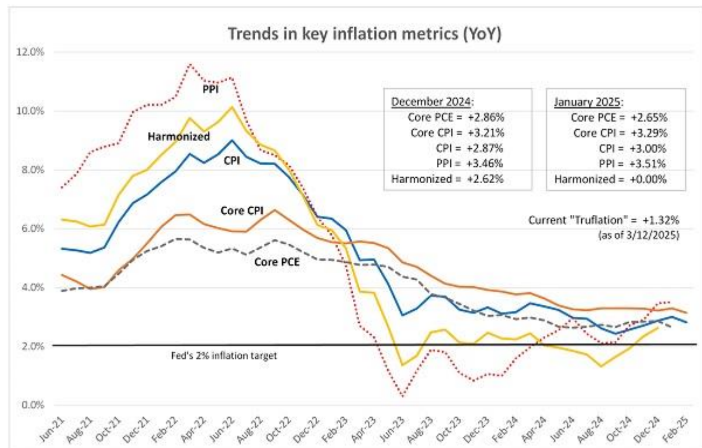
Not surprisingly, the MSM prefers to focus attention on the federal job cuts—even Zoom interviewing random workers from deep in the Dept. of Agriculture or such (who thought they had a guaranteed job for life)—while essentially ignoring all the private sector layoffs that have occurred. Layoffs, furloughs, and reorgs are facts of life in the private sector. Indeed, even the highflying Tech leaders like Microsoft, Meta, Alphabet, HP, Salesforce, Autodesk, Sonos, eBay, Sophos, and Intel are cutting staff, as are non-Techs like Southwest Airlines, JPMorgan Chase, Chevron, Starbucks, Walgreens, and many universities. Where is the attention, sympathy, and teary-eyed interviews with those folks?

As for inflation, after the one-time reset in services prices (like insurance), which is typical for January, I expect inflation metrics over the coming months to resume their descent (particularly as shelter costs come down), which would allow the Fed to resume its rate cuts—and attract capital back to duration. I follow standard government metrics CPI, PPI, Core CPI, and Core PCE, but also non-standard metrics like the **Harmonized Index of Consumer Prices (HICP)**, which is a European methodology that historically presages CPI due to its real-time accounting of actual costs of home acquisition and maintenance expenses rather than the highly-weighted concept of "owner's equivalent rent" (OER) used in CPI, which typically has a long lag time while composing roughly 33% of CPI and 40% of Core CPI. Another non-standard metric is the real-time blockchain based "**Truflation**," which is published daily based on 30 million data points and also historically presages CPI by several months.

Let's review the full set of January metrics, which came in a bit hot with some first-of-year price resets. As shown in the upper chart below, most metrics rose slightly in January versus December, with the exception of the Fed's preferred Core PCE which fell slightly to +2.65% YoY. As for the alternative metrics I follow, HICP was mysteriously not released for January (February reading will be released on 3/19), but for December it was +2.62% YoY.

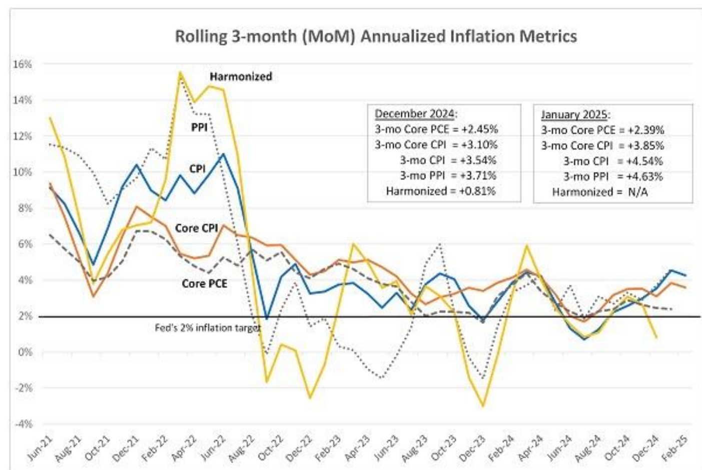
Also, rather than focusing solely on the YoY headline data, which can be skewed for several months by one-time price resets (particularly in services, like insurance premiums and restaurant menu prices), I like to monitor *annualized 3-month rolling averages* for a better handle on the current trend, as shown in the lower chart. For January, while 3-month annualized Core CPI rose to +3.85%,

Core PCE pulled back to +2.39%. Again, the January HICP was not published for some reason, but the 3-month annualized HICP in December was just +0.81%, and I expect the February number (coming out on 3/19) to be similarly low as disinflationary trends continue. Indeed, I wrote in depth in my February post about the downtrend in OER and how real-time lease information suggests it has plenty to fall. For instance, apartment vacancy rates are now above pre-pandemic levels, and an above-average number of multifamily properties are nearing completion and coming to market.



The February readings are just starting to be released this week, with CPI cooling off slightly to +2.81% YoY, while Core CPI slipped to +3.14%, and PPI +3.15%. On a 3-month annualized basis, Core CPI fell to +3.59%. Also notable in the February CPI report is that real average hourly earnings rose just +0.1% MoM in February and are up a mere +1.2% YoY. I am eager to see HICP and Core PCE later in the month.

Lastly, I suggest all readers follow the real-time, blockchain-based "Truflation" metric, which is published daily based on 30 million data points and historically presages CPI. It was low last summer, and indeed CPI readings weakened. And then in December it briefly surged above 3%, and indeed CPI resurged as well. But during Q1, it has fallen off a cliff to as low as **+1.30%** YoY on 3/6, as shown in the chart below, suggesting that CPI and PCE also will soon recede. Indeed, as mentioned above, February CPI cooled a bit, led by the easing in shelter costs that I have expected.



Nevertheless, in my view, maintaining somewhat elevated inflation above 2% might be appropriate to help reduce the giant federal debt by "inflating it away"—as part of a 3-pronged approach in conjunction with "cost-cutting it away" (e.g., DOGE) and "growing our way" out of debt through fiscal & monetary policies that support robust *organic* growth in the private sector—leading to gains in productivity, margins, earnings, jobs, wages, GDP—and ultimately tax receipts.

And by the way, regarding the impact of tariffs on inflation, 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]."*

Global liquidity:

Liquidity growth is critical to economic growth and asset price appreciation. Ultimately, prices of risk assets like bitcoin or growth stocks are tied to global liquidity. It must grow sufficiently to sustain organic economic growth (on both the supply and demand sides of the ledger)—without creating inflationary pressures, which typically happens when government gets too involved in the picking and choosing of winners and losers, like a politburo. Even as the US Federal Reserve stays on pause, the dollar is weakening, which improves global liquidity as the exchange rate of other currencies allows them to buy more. Other central banks around the world are already starting to cut rates and inject liquidity—perhaps as much as $2 trillion into the global economy by some estimates—including China and likely Germany—which should find its way into stocks and bonds.

Michael Howell of Crossborder Capital reminds us that the best time for investors is when policymakers are trying to stimulate sluggish economies. And indeed, Howell has reported that global liquidity levels are steadily rising in Q1 due mostly to the weakening US dollar and liquidity enhancement from the US Fed and the PBoC. However, he is concerned about the seasonal liquidity drain as individuals and businesses submit tax payments to the IRS and (at least temporarily) reducing spending and investment. The latest FOMC meeting minutes showed policymakers discussed pausing or slowing the quantitative tightening program. As Scott Bessent stated, *"[It would be] easier for me to extend duration when I'm not competing with another big seller."*

As Eric Peters of One River Asset Management opined, *"When faced with existential threats, those in power across the globe will race to boost output, productivity, prosperity, jobs, safety, security, whatever it is that their increasingly restless populations are crying out for. In general, those things all cost money and are best advanced by stimulus, deregulation, animal spirits. Austerity doesn't help. So, expect incumbent governments to panic, spend more and tax less. Fighting for survival.*"

Witness the latest news out of Germany—Europe's largest economy. The new leadership of the Christian Democratic Union (CDU) has formed an agreement with the Social Democratic party (SPD) to overlook the constitutional "debt brake" and invest massively to shore up the country's military and crumbling infrastructure. So, with Germany essentially declaring an existential crisis of economic decline and national security (regarding the fate of Ukraine and Russian aggression), it is now ready to expand deficits and industrial production to fill in the defense shortfall from the US pullback and reignite animal spirits in its economy—and by extension the entire EU.

Some observers say that this new US stance of expecting our allies to protect themselves and pay their own way means that the American empire is over and the stability of the world as guaranteed by American might and hegemony since WWII is returning to the chaos of yore. But I'm not so sure. The US is not pulling back into isolationism. After losing the election, the Biden administration pushed a wave of spending out into the economy, surging the deficit, so Trump is merely recognizing that our spiraling debt is unsustainable, and we can no longer nanny and police the entire world on our own nickel.

Since Trump's inauguration, the deficit has contracted sharply, and I believe he will continue to project US strength and leadership around the world, backstop our allies, and serve as mediators to conflicts, using our economic and military muscle as necessary—but we will no longer pay for it all nor shoulder all the associated burdens and risks. Again, I have grown to appreciate the method to Trump's apparent "madness." As Kevin O'Leary says about deciphering Trump, you have to *"ignore the noise, look for the signal,"* and *"pull the kernel of opportunity out of everything he says."*

Click here to learn more about David Brown's new book and Sabrient's next-gen Scorecards.

Final thoughts:

In my view, Trump 2.0 is not creating a "constitutional crisis" as the MSM's histrionics insist—rather I believe it is thwarting one. The new administration seeks not to dismantle our democracy but to dismantle the bureaucracy. Short-term pain is likely during the transformation from a bureaucratic state back to a constitutional democratic republic and create strategic realignment of the North American economy to protect future prosperity.

Trump is regularly accused of "cozying up" to dictator like Russia's Vladamir Putin, but I believe he is simply trying to lower the temperature from all the years of neocon warmongering, isolating him, and using bellicose language (like "evil war criminal"). As recent history has shown, this approach is a path to war. Instead, Trump seeks to reestablish the trust he had (not only with Putin but also other paranoid authoritarians), deescalate tensions and military mobilization (and all the associated costs), and foster fairer and more fruitful global trade. After all, war is deadly, wasteful, expensive, and inflationary. With DOGE, he is taking back control of federal agencies (most of which fall under the executive branch) from an intractable and unaccountable bureaucracy—rather than setting up committees to evaluate government processes that could take months if not years to complete, likely followed by incremental cuts and reorganizations that change little before the midterm elections. Better to just create shock-and-awe, slash wasteful spending, and then restore what was truly essential while allowing the private sector to ramp up hiring and spending and recharge the sluggish economy.

Indeed, our country is now navigating a transition period characterized by a sea change in political philosophy and leadership—from profligate, wasteful (and often corrupt) deficit spending, a growing "nanny state" (entitlements), limits on free speech (disinformation!), globalism, foreign wars (to support democracy!), open borders, and "kicking the can down the road" on spiraling debt—to one of greater national/border security, nationalism, free speech, rule of law, and a business approach to budgeting and accountability including what I call "smart austerity" that includes ending funding of foreign wars and malinvestment in government's pet projects. Not surprisingly, those who greatly benefited from the longstanding system of waste and corruption are pushing back the loudest.

As a reminder, Treasury Secretary Scott Bessent has espoused a "3-3-3" economic plan to increase GDP growth to 3%, reduce the budget deficit to 3% of GDP, and boost oil production by 3 million bbls/day. And economist Ed Yardeni might also suggest 3% productivity growth as a fourth "3." In Bessent's view, we have *"a generational opportunity to unleash a new economic golden age that will create more jobs, wealth and prosperity for all Americans."* And as Kevin O'Leary has opined, *"The number one [US] export is the American dream. Everyone wants to come to America and start a business and become personally free."*

Bessent also gave some comfort to the so-called "bond vigilantes" (who short bonds in protest against profligate spending and a rising budget deficit, thus driving up yields) when he reiterated his expectation that DOGE cost savings, faster growth through deregulation, tax cuts, and expansion in US energy supplies (rather than through deficit spending) will bring down inflation and longer-term yields—and ultimately lead to rising tax receipts, falling budget deficit, and lower federal debt.

So, my view is that the relative safety, big cash positions, low interest-rate exposure, wide protective moats, and reliability/consistency of earnings growth of large caps in general and large-cap Tech in particular means these names should continue to have a prominent place within a diversified equity portfolio. However, the extreme performance and valuation divergences (leading to today's meager 1.2% yield on the S&P 500) suggests an investor also should hold a broader set of high-quality stocks across market caps and sectors in anticipation of improving market breadth.

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 3/12/2025
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	89	61	46	89	90.0	56.6
TELECOMMUNICATIONS	IYZ	63	54	59	63	66.4	71.0
HEALTHCARE	IYH	62	45	67	62	46.9	86.4
ENERGY	IYE	42	46	56	42	42.3	55.8
INDUSTRIALS	IYJ	39	51	56	39	52.0	54.5
FINANCIALS	IYF	37	50	56	37	49.2	53.6
UTILITIES	IDU	33	39	71	33	24.4	81.6
CONSUMER DISCRETIONARY	IYC	25	52	52	25	49.4	40.4
CONSUMER STAPLES	IYK	25	39	77	25	21.7	90.0
BASIC MATERIALS	IYM	9	51	58	9	41.9	45.3

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 neutral given that secular growth, cyclicals, and defensives are mixed throughout. 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 89, despite having by far the highest forward P/E of 25.2x (which is down substantially from last month's 29.2x). However, because of its strong EPS growth estimate of 19.0%, its forward PEG (ratio of P/E to EPS growth) is a relatively modest 1.33 (the second lowest behind Financials, which is good). Tech also displays relatively stable Wall Street analysts' net earnings revisions (essentially flat), by far the highest return ratios, and continued solid 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%. How do you compete with that? 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 Telcom, Healthcare, Energy, and Industrials, followed by Financials and Utilities (led by those companies involved in the buildout of AI infrastructure and power grid). Notably, 6 of the 10 sectors have seen either flat or negative net revisions to EPS estimates from the analyst community, with only Financials, Energy, Utilities, and Telecom solidly positive. At the bottom of the rankings are Materials and Consumer Staples, mainly due to having the largest negative revisions to earnings estimates, high forward P/Es, and mediocre return ratios. Notably, Telecom, Energy, and Financials display the lowest (most attractive) forward P/Es at 14.4x, 14.0x, and 13.5x, respectively.

Of note, Energy has been rising in our SectorCast rankings. After a prolonged period of underinvestment, oil & gas companies increased capex by 53% over the past 4 years, according to Deloite's 2025 industry outlook, with forward focus on capital discipline and efficiency, shareholder payouts (dividends and buybacks), as well as ongoing digital transformation, M&A and integration, strategic partnerships, innovation, enhanced productivity, and cost reduction. Additionally, some companies are engaging in increased investments in low-carbon technology projects to help balance the risks associated with the traditional oil and gas market. So, perhaps we will start to see increased sales and earnings projections for the Energy sector as the year progresses.

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 **Consumer Staples (IYK), Utilities (IDU), and Healthcare (IYH)**. However, if you prefer a neutral stance, the Sector Rotation model suggests holding Technology (IYW), Telecommunications (IYZ), and Healthcare. Or, if you prefer to take a bullish stance (given that the SPY and QQQ have bounced from their 300-day moving averages), it suggests holding Technology (IYW), Telecom, 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), Roundhill Generative AI & Technology (CHAT), Global X Blockchain (BKCH), Amplify Video Game Leaders (GAMR), First Trust Dow Jones International Internet (FDNI), AXS Esoterica NextG Economy (WUGI), Invesco AI and Next Gen Software (IGPT), Global X Social Media (SOCL), Alger 35 (ATFV), iShares Technology Opportunities Active (TEK), Global X Clean Water (AQWA), Nuveen ESG Large-Cap Growth (NULG), Trenchless Fund (RVER), First Trust Active Factor Small Cap (AFSM), VictoryShares THB Mid Cap (MDCP), The Emerging Markets Internet (EMQQ), ERShares Private-Public Crossover (XOVR), Defiance Connective Technologies (SIXG), Neuberger Berman Disrupters (NBDS), Global X MSCI Argentina (ARGT), iShares Global Tech (IXN), and KraneShares CSI China Internet (KWEB). 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, gold, and bitcoin.*

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