Sabrient Systems

Sector Detector

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Cutting through the noise, earnings and liquidity will drive the stock market

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Overview

Market indexes regained all of their losses since the president's "Liberation Day" tariff announcement one month ago, culminating in an historic +10% 9-day rally for the S&P 500 (and +18% from its 4/7 intraday low) that sent it back above its 20-day and 50-day moving averages to test resistance at its 200-day. But was this just a short-covering relief rally as bearish commentators assert? I said in my April post that the $10 trillion that left the stock market was not the "capital destruction" they claimed, like a wildfire burning down homes, but rather a rotation into the safety of bonds and cash that could quickly rotate back. Sure enough, when retail investors swooped in to scoop up the suddenly fair valuations of the capitulation selloff, leveraged algo momentum traders quickly joined in. But while I think the longer term holds promise, the chart became short-term overbought (and is pulling back this week), and macro conditions are still treacherous, keeping investors jittery and headline-driven. So, the market remains fragile even as we wind down a solid Q1 earnings reporting season, with the FOMC policy announcement on tap this week.

Nevertheless, in my view, positive signs are emerging to suggest: 1) the trade war (particularly with China) and the hot war in Ukraine will both find their way to a resolution, 2) the fiscal legislation ("one big, beautiful bill") with new tax cuts working its way through congress will soon be passed, 3) the size and scope of federal government that has crowded out the private sector is shrinking and making way for *re-privatization* and *de-regulation* of the economy to unleash organic private sector growth, 4) corporate earnings and capex commitments remain strong, and 5) the Federal Reserve will ensure liquidity growth and restart its rate-cutting cycle like other central banks—and liquidity leads pricing in risk asset markets, gold, and cryptocurrencies. So, I think the noise will quiet and the clouds will clear, making way for a renewed focus on corporate earnings and global liquidity to power forward the economy and stocks. And don't forget—the market loves to *climb a wall of worry*, which means it discounts the future and typically turns well in advance of the economic and sentiment metrics.

Of course, the biggest news that juiced the stock market is the apparent offramp forming for the trade stalemate between the US and China. Publicly, China has been saber-rattling as a Trumpian bargaining tactic, in my view, and to stoke the flames of political division in our country with midterms on the docket next year—something the CCP doesn't have to worry much about. Indeed, it has been loath to give an inch even though its economy was already struggling with deflation, a long-running property crisis, sluggish consumer demand, overcapacity, and weak business and consumer confidence well before the recent tariff escalation. Its services PMI just hit a 7-month low, its manufacturing PMI has officially fallen into contraction at 49.0, and its new export orders component plunged to the lowest reading since the pandemic at 44.7. And although China insists the US "unilaterally" started the trade war, the truth is we are finally pushing back after years of turning a blind eye to their tariffs, IP theft, forced technology transfers, hacking, state subsidies, dumping of goods, fentanyl trafficking, and currency manipulation.

In my view, the US is in far better position to weather a brief trade war than mercantilist China. As Treasury Secretary Scott Bessent said, *"China's business model is predicated on selling cheap, subsidized goods to the US, and if there is a sudden stop in that, they will have a sudden stop in their economy. So, they will negotiate."* Both governments know that an escalating trade war with big tariffs and a tight US Federal Reserve is especially bad for China. The dollar/yuan exchange rate is crucially important to China, and the dollar today is nearly as strong it has been against the yuan since yuan's devaluation during the Global Financial Crisis. With its massive dollar-denominated debt, a weaker dollar relieves China's financial strain by boosting global liquidity to the benefit of both countries. So, despite its saber-rattling, China needs a trade deal that ensures a weaker dollar to shore up the yuan and reduce capital flight.

Indeed, we are now hearing from China that "the door is open" to trade talks, and its security czar is evaluating ways to address the use of Chinese precursor chemicals by Mexican cartels to produce fentanyl for distribution in the US. Moreover, although the Port of Los Angeles announced that volumes will fall be 1/3 as several major American retailers are halting all shipments from China, in reality, American businesses as usual are finding a way to succeed (and skirt the most onerous tariffs) by rerouting supply chains through 3rd party countries like Vietnam and Mexico ("trans-shipping") and delivering to bonded warehouses to delay the official receipt of goods. Also offsetting the tariffs is the 10% drop in the dollar index.

Looking ahead, although volatility likely will remain elevated for the next few months, unless something crazy comes out of left field, I think the market has seen its lows, and the path of least resistance is higher. American consumers, corporations, and entrepreneurs are optimistic by nature and are always pushing boundaries and seeking a path forward, rather than sitting on their hands waiting for government to tell them what to do. And of course, President Trump is not one to sit on his hands for one minute in his effort to “fix” our unsustainable “death spiral” of inflation, debt, deficit spending, offshoring, and hyper-financialization.

But then we have the FOMC, whose members have been quite happy to sit on their hands in the face of tariff turmoil, falling inflation, and slowing GDP and jobs growth. Among the 19 FOMC participants (the 7 Board of Governors and 12 Reserve Bank regional presidents, which includes both the 12 voting members and the 7 non-voting members who serve as voting members on a rotating basis), they almost unanimously (18 of 19) agreed at their March meeting that growth and employment risks are skewed to the downside while inflation risks are skewed to the upside. Overall, the Fed has taken a dovish stance but will be *reactive* to sudden distress in growth and jobs rather than *proactive* in preventing such distress.

Although Fed Chair Powell often talks about tariffs as being *inflationary*, in fact tariffs are *deflationary* like all forms of taxation—i.e., without a commensurate increase in income or credit, they necessitate a rethinking and reallocation of one’s existing disposable income. Furthermore, Powell & Co. seem to be ignoring the deflationary signals of falling oil prices, slowing household consumption, declining savings rates, and rising delinquencies. Inflation metrics are pulling back after being propped up by elevated energy prices and long-lag components (like shelter costs) and the prior administration’s profligate federal deficit spending that overshadowed—and indeed created—sluggish growth in the private sector. I talk more about inflation expectations in my full commentary below.

To be fair, government spending (to the tune of nearly 6.5% of GDP) exacerbated the inflation and private sector malaise it created by making it difficult for the Powell & Co. to justify helping out the private sector with lower interest rates, thus crowding out the efficient capital allocation and high return on investment of the private sector with the inefficient capital allocation of bloated government boondoggles. Economist Michael Howell of CrossBorder Capital reminds us that *“public debt is expanding faster than private debt, fueled by welfare commitments and rising interest burdens, ensuring persistent liquidity growth.”* Importantly, Howell persuasively asserts that, *“monetary policy must prioritize liquidity over inflation”* concerns, so the Fed’s current hands-off, higher-for-longer, reactionary approach risks causing a liquidity crunch. In his view, *“The modern financial system is a fragile, collateral-driven mechanism, and one that requires constant intervention [through proactive management] to avoid collapse.”*

As Andrew Lees of MacroStrategy Partners has pointed out, *“Economies naturally self-order productively when not constrained by excessive regulation and over-bearing government intervention. The current "financialized" economic system as it is, is dependent on debt and unproductive use of capital (Wall Street vs Main Street).”* The private sector has proven to be much better at the efficient and highly productive allocation of capital to maximize ROI. So, as Secretary Bessent has described, the Trump administration seeks to reduce the budget deficit to 3% of GDP and increase real GDP growth to 3%, which would lead to the same kind of small-government/strong-private-sector economy that has turned around a foundering Argentina under President Milei.

The May FOMC meeting convenes this week, so we shall see. CME Group fed funds futures show only 3% odds of a 25-bp rate cut, but increases to 32% at the June meeting, and 78% odds of at least 75 bps (3 cuts) by year-end. In my view, they should be readying for 50 bps in rate cuts by July and a target neutral rate of around 3.25-3.50% by early 2026. Certainly the 2-year Treasury yield (the shortest term that is substantially market driven) at 3.80% (as of 5/6) is signaling to the Fed that rates should be much lower than the current 4.25-4.50% fed funds rate. According to a recent post by AlpineMacro, *“…the current 10-2 year spread in the bond market is not sustainable, particularly if the economy slows sharply. Ultimately, the long end of the curve will gravitate to the short end, particularly when investors realize that tariff-induced price increases are temporary.”* Notably, projections on bond issuance from Secretary Bessent suggest a gradual return to an 80/20 split between T-bonds & notes (80%) versus T-bills (20%) going forward as opposed to the nearly 100% allocation to T-bills (< 1 year) under his predecessor Janet Yellen.

I have been insisting for some time that the FFR needs to be 100 bps lower, as the US economy's headline GDP and jobs numbers were long artificially propped up by excessive, inefficient, and often unproductive federal deficit spending, while the hamstrung private sector has seen sluggish growth. Moreover, today’s DOGE-led spending cuts, trade war uncertainty, and with budget reconciliation and fiscal legislation still in progress have removed much of that artificial stimulus. But regardless of the May FOMC decision, I expect the rate-cutting cycle to restart in June and signed trade deals with our 18 key trading partners beginning this month.

But for the near term, until those things come to fruition, I continue to expect stocks will remain volatile (with VIX above the 20 “fear threshold” but below the 30 “panic threshold”). CNN's Fear & Greed Index just jumped from "Fear" to “Greed” on the dial but remains volatile. The American Association of Individual Investors' ("AAII") Investor Sentiment Survey has shown more than 50% bearish (vs. historical average of 31%) for 10 consecutive weeks, which is the longest streak since 1990. Capital flows reflect a sharp drop in foreign capital flight into US bonds and equities over the past two months in something of a “buyers’ strike,” adding pressure to the US dollar. And last week saw a negative Q1 GDP print, somewhat offset by an upside beat from the jobs report and rising labor force participation.

There are certainly plenty of high-profile bears. One market technician I respect a lot, A.J. Monte of Sticky Trades, still believes stocks will eventually retest their pandemic lows (!). He warned of the dreaded “death cross” when the 50-day moving average crossed down through the 200-day moving average on 4/12. And then we have Christoper Wood of Jefferies, who believes that US stocks saw a permanent (!) peak last December (at lofty valuations) and will never (!) see those levels again—much like Japan’s market peak in 1989. Instead of US stocks, Wood thinks investors should buy Europe, China, Japan, and India. Others have pronounced that the US brand is permanently damaged and that we have witnessed the end of “American exceptionalism.” Heavy sigh.

Call me overly patriotic with rose-colored glasses, but my view is a little different. Capital tends to flow to where it is most welcome and earns its highest returns, so the recent falling tide of foreign capital flight leaving the US will surely return once visibility clears and the dollar firms up. Most any foreign investor will tell you there is no other place in the world to invest capital for the innovation and expected return than the US given our entrepreneurial culture, technological leadership in disruptive innovation, strong focus on building shareholder value, low interest-rate exposure, global scalability, wide protective moats, and our reliable and consistently strong earnings growth, free cash flow, margins, and return ratios, particularly among the dominant, cash flush, Big Tech titans, which continue to use their piles of cash to seed AI startups and other disruptive technologies. Notably, the US boasts more than 50% of the world's privately owned late-stage start-ups valued at over $1 billion (aka "unicorns") and leads in R&D spending and patent applications.

Moreover, it's not just the Technology sector that is appealing to investors. As BlackRock wrote in their Q2 2025 Equity Market Outlook, *"Commentators will often cite the prevalence of a large number of Tech companies in the U.S. as the driver of U.S. equity dominance. But our analysis points to wider breadth in U.S. quality. Current return on tangible invested capital (ROTIC), a proxy for a company's ability to allocate capital for optimal profitability, is significantly higher in the U.S. than elsewhere in the world, suggesting quality exists not in pockets but across sectors."*

As Kevin O'Leary has opined, *"Our number one export is the American dream. Everyone wants to come to America and start a business and become personally free."* And <u>this will not change</u> just because our president seeks to incentivize the private sector to strategically reshore manufacturing with the ultimate goals of reviving the middle class, narrowing the wealth gap, reducing the trade deficit, ensuring reliable supply chains, and reinforcing national security. Moreover, Trump's federal cost-cutting, tariff regime, and America-First rhetoric does not aim for absolute deglobalization, fiscal austerity, mercantilism, and isolationism as the MSM would have you believe, but rather to simply rebalance a system that had become completely out of balance—and indeed was falling into that aforementioned death spiral of rising inflation, debt, deficit spending, offshoring, and hyper-financialization. The rebalancing involves re-privatization and de-regulation rather than relying on massive government spending—and what I call "smart austerity" to eliminate waste, fraud, abuse, corruption and unaccountability, plus a "peace dividend" from ending the war in Ukraine.

So, I continue to believe the macro uncertainty and jittery market will ultimately give way to a 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.

The early April selloff brought down some of the loftiest valuations among the popular mega-cap stocks, with the forward P/E on the S&P 500 falling to 18.5x on 4/8 versus 22.7x at its February peak and today's 20.6x (as of 5/5). In fact, many of the prominent names in the Technology and Communication Services sectors saw their valuations retreat such that they are scoring well in Sabrient's growth models (as shown in our next-gen **Sabrient <u>Scorecards</u>** subscription product)—including large caps like Taiwan Semiconductor (TSM), Broadcom (AVGO), and Spotify (SPOT) that are in the new *Q2 2025 Sabrient Baker's Dozen* portfolio, and small caps like Freshworks (FRSH), QuinStreet (QNST), and RingCentral (RNG) that are in our new *Sabrient Small Cap Growth 46* portfolio. These portfolios along with *Sabrient Dividend 51* (a growth & income strategy yielding 4.05% as of 5/5) are packaged and distributed quarterly to the financial advisor community as unit investment trusts through First Trust Portfolios.

Indeed, 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 a reminder, the "Size" factor refers to market cap and the Fama French study that showed small caps historically tend to outperform over time. Although that has not been the case for the small cap indexes (like Russell 2000) for most of the past 20 years, I still think the small cap universe is where to find *the most explosive growth opportunities*, even if the broad passive indexes 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.

For each of our portfolios, we seek high-quality, fundamentally strong companies displaying a history of consistent, reliable, and accelerating sales and earnings growth, rising profit margins and free cash flow, solid earnings quality, low debt burden, and a reasonable valuation. Notably, our proprietary Earnings Quality Rank (EQR) is a key factor in each of our growth, value, dividend, and small cap models, and it is also licensed to the actively managed First Trust Long-Short ETF (FTLS).

Sabrient founder David Brown describes these and other factors as well as his portfolio construction process in his latest book. David describes his path from NASA engineer in the Apollo moon landing program to creating quant models for ranking stocks and building stock portfolios. 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 both the book and scorecards by visiting: http://DavidBrownInvestingBook.com.

In my full commentary below, I discuss earnings, gold, tariffs, inflation, global liquidity, the power of free market capitalism, and the imminent "bullish triumvirate" of tariff resolution, tax cuts, and deregulation. 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. Our model likes Technology, Healthcare, Communication Services sectors, and assuming interest rates indeed come down and liquidity rises as I expect, I also like dividend stocks and gold. By the way, I had so much to say this month that I decided to defer until next month my in-depth commentary on the exciting new developments in energy and electrical generation. *Please contact me to speak on any of these topics at your event!*

Market Commentary

First Trust chief economist Brian Wesbury has opined, *"Those who are adamantly opposed to tariffs on free trade grounds need to come to grips with the fact that the trade deficit is not all because of the free will of consumers making the choice to buy foreign goods. Consumption is artificially stimulated [through Keynesian redistributionist policies, taking from those (rich) with a marginal propensity to save and giving to those (poor and middle class) with a marginal propensity to consume], while production in the US is held back by bad policies. We create spending but then don't produce to fulfill demand."*

And as Federal Reserve economist Ricardo Marto found in a study, there has been a massive redistribution of wealth upward, from working people to big business and their shareholders (via dividends and buybacks) rather than using profits for capital investment to expand capacity and hiring. Indeed, since the dawn of the new millennium, US corporations have benefited from increasing globalization (in both trade and capital), which created rising profitability and secular disinflation. The chart below from Goldman Sachs Research (4/8/25) illustrates how the combination of technological innovation, globalization, and rising global trade served to lower labor costs and push profit margins to record-high levels. But now those trends are facing obstacles.

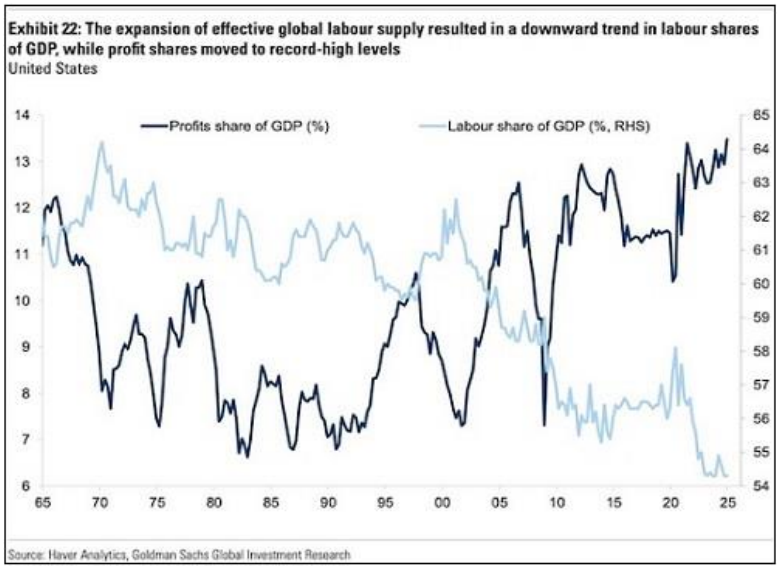


Exhibit 22: The expansion of effective global labour supply resulted in a downward trend in labour shares of GDP, while profit shares moved to record-high levels

I believe the stars are aligning in the US for a bullish triumvirate of: 1) tariff resolution (including broader trade deals and regulatory parity), 2) tax cuts, and 3) deregulation. In addition, I expect falling inflation leading to rate cuts and rising global liquidity (perhaps including a "stealth QE" such as reduced bank reserve requirements and SLR) and slower balance sheet runoff, particularly as the Bank Term Funding Program (BTFP) and TGA/RRP draw down. According to Michael Howell of CrossBorder Capital (as of 5/6), *"Global liquidity is rising steadily and has reached a new all-time high of US$177.2 trillion, according to measures derived from the weekly balance sheets of the major Central Banks and collateral values. Year-to-date it has expanded by over US$6 trillion."* He expects the liquidity cycle will peak in mid-2026.

Global debt-to-GDP ratio increased for the first time since 2020, reaching 328% on a record $318 trillion of total debt at the end of 2024, according to a report from the Institute of International Finance (IIF) due to slowing economic growth and rising fiscal deficits. Emerging markets, particularly China, India, Saudi Arabia, and Turkey, accounted for about 65% of the global debt increase, and these emerging markets face a major debt rollover challenge with record $8.2 trillion in debt maturing this year. Large budget deficits suggest that sovereign debt could rise by a third by 2028 to approach $130 trillion, increasing repayment risks worldwide.

I will reiterate from my prior posts that our 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. I believe the path to economic sustainability (given our accelerating federal debt and deficit spending spiral) will require another kind of triumvirate (or 3-pronged attack): 1) "inflate away" the debt with somewhat elevated inflation around 2.5% like we saw in the 1950s, 60s, 70s, 2) "cut away" the debt by addressing government waste and spending with the DOGE initiative, and 3) "grow away" the debt by truly stimulating real organic, private-sector-led productivity and economic growth with lower tax rates and deregulation.

Of course, we can only live with slightly elevated inflation, and it is difficult to cut much spending given the dominance of mandatory entitlements and interest payments over discretionary spending. So, the primary driver must be robust private sector organic growth and a productivity growth boom that boosts real GDP growth, keeps a lid on inflation, and widens profit margins—which will provide for both higher wages and rising tax remittances.

As for the corporate earnings outlook, according to Nick Colas of DataTrek Research, Big Tech earnings growth is expected to slow from around +30% in 2023-2024 timeframe to around +17% in 2025-2026; however, outside of the MAG-7 titans, the other 493 companies in the S&P 500 should show improving earnings growth from -4% in 2023 to +13% in 2026. DataTrek opines, *"the net effect is that Big Tech faces valuation pressure, but investors are unlikely to revalue the rest of the S&P 500 to offset that negative re-rating,"* which suggests no multiple expansion. Interestingly, according to Warren Pies of 3Fourteen Research, 26% of the post-Liberation Day drop in forward EPS is attributable to the Energy sector (mostly due to the -19% plunge in oil prices), and if you remove Energy companies, the forward EPS down less than 1%.

The secular AI trend continues to gain momentum, with blowout earnings from Microsoft (MSFT), Meta Platforms (META), and Alphabet (GOOGL), and huge capital commitments from the likes of IBM (IBM), Apple (AAPL), NVIDIA (NVDA), Microsoft (MSFT), TSMC (TSM), and SoftBank (SFTBY). META showed a 16% revenue and 37% EPS surge. And although its stock didn't react quite as well, Apple's release was impressive as it demonstrated its nimbleness to avoid tariffs by shifting iPhone production to India and Vietnam. As Bank of America pointed out, the group of "hyperscalers" lifted their Q1 capex by 62% YoY.

It is evident that big, cash-rich companies have greater ability to adjust quickly to the macro conditions than do smaller companies. For example, higher trading volume and wider bid-ask spreads juiced Q1 revenues in the trading division in the large banks. Goldman Sachs (GS), Morgan Stanley (MS), and JPMorgan (JPM) all just announced record revenue for equity trading, with Goldman's up 27% YoY to $4.19 billion, Morgan Stanley's up 45% to $4.13 billion, and JPMorgan's surging 48% to $3.81 billion. All benefited from greater volume and wider bid/ask spreads throughout the spate of high volatility, even though investment banking dealmaking revenue fell.

As Downtown Josh Brown of Ritholtz Wealth recently advised, *"Stocks—on average through every bear market since the inception of the S&P 500 in 1957—bottom in price a full 9 months before earnings do… By the time earnings are reaching their cycle low, stocks have already been rallying for three quarters of a year in advance of that low. This is why you don't wait to get invested or attempt to sit out the economic or earnings downturns."*

As for gold, keep in mind that it primarily serves as a hedge against excess monetary and fiscal expansion. As such, it has essentially tracked the tremendous growth in US money supply and federal debt over the past 25 years. Although some observers believe gold has become overcrowded as a safety/fear trade, rising liquidity means gold should continue to rise, too. After all, without the gold standard (abandoned by President Nixon in 1971), an ounce of gold went from $160 in 1975 to more than $3,300 today, i.e., the USD lost over 95% of its purchasing power and recently hit a 3-year low against a basket of world currencies.

Notably, the Basel III accord is an international agreement designed to shore up the global banking system in the wake of the Global Financial Crisis by ensuring banks have enough capital on hand to cover defaults and reduce risk. The mandates went into effect for many countries in 2012, and the US will finally adopt it on 7/1 this year, with gold shifting from a Tier 3 asset (low-quality/high-risk) to Tier 1 (high-quality/no-risk, like cash or Treasury bonds), which will further drive demand. So, with central banks, institutional investors, retail investors, and momentum traders all piling into gold, there seems to be no end in sight to gold's rise.

Indeed, gold stocks have been among the best performers YTD, with the NYSE Arca Gold Miners Index up as much as 50%, and gold mining ETFs continue to score at the top of Sabrient's SectorCast rankings, as I discuss later. In fact, Newmont Mining (NEM) was the top performing stock in the S&P 500 until the latest broad market rally. However, bitcoin, including iShares Bitcoin Trust (IBIT), seems to be behaving less as a store of value and more correlated with Tech stocks and other risk-on assets, as illustrated in the chart below.

Also worth mentioning, the Healthcare sector has been showing signs of perking up. Indeed, Sabrient's SectorCast ETF rankings (described below) see solid value in Healthcare stocks right now, and in fact, 3 of the 13 picks for our Q2 2025 Baker's Dozen (which launched on 4/17) are from the Healthcare sector, which is generally the maximum allocation we allow for that sector. Those names are Gilead Sciences (GILD), ADMA Biologics (ADMA), and Harmony Biosciences (HRMY).

<u>Global liquidity</u>:

A dovish Fed—i.e., lower interest rates, a weaker dollar, and rising liquidity, cross-border lending, and velocity of money—is expansionary and reflationary for the US and for the world, leading to rising trade volumes, rising US exports, lower US trade deficit, and easier conditions for emerging markets to service dollar-denominated debt. According to market blogger and money manager Sam Kovacs, *"A sharply rising DXY is effectively tightening on the global economy, and especially on China and other EM debtors. Conversely, a falling DXY is loosening, liquidity flows freely."*

According to CrossBorder Capital, *"Global Liquidity refers here to the flow of financial capital through World markets that can be used for asset purchases in the financial economy and investment, trade and consumption in the industrial economy. It also reflects the ease with which assets can be converted into cash. Global Liquidity comprises Central Bank interventions; credit provision by banks and shadow banks, and cross-border flows. When banks extend credit, they are essentially creating money, so global liquidity grows, allowing GDP to expand and demand for energy and materials to rise. We estimate it totals around US$175 trillion, or two-thirds bigger than World GDP."* Liquidity (whether rising or falling) leads risk asset markets, gold, and cryptocurrencies.

Global liquidity levels continue to benefit from a combination of a weakening dollar, improving asset values, lower bond market volatility, monetary easing among the major central banks (likely soon to be joined by the Fed), and fiscal stimulus measures in many countries. According to Reuters, the Institute of International Finance (IIF) *"warned that despite high borrowing costs and economic policy uncertainty, its forecast of a $5 trillion increase in government debt this year could rise due to calls for fiscal stimulus and larger military spending in Europe."*

As the likes of China, Germany, Canada, and many others take stimulus measures, their asset prices have shown mean reversion relative to the US and boosted their currencies. However, many of these economies rely on trade surpluses and thus lower-value currencies to drive exports. But now the US wants to lower its trade deficit and increase exports, too, which suggests a weaker dollar—even though that is not our official position. So, will some of those trading partners resort to currency and capital controls?

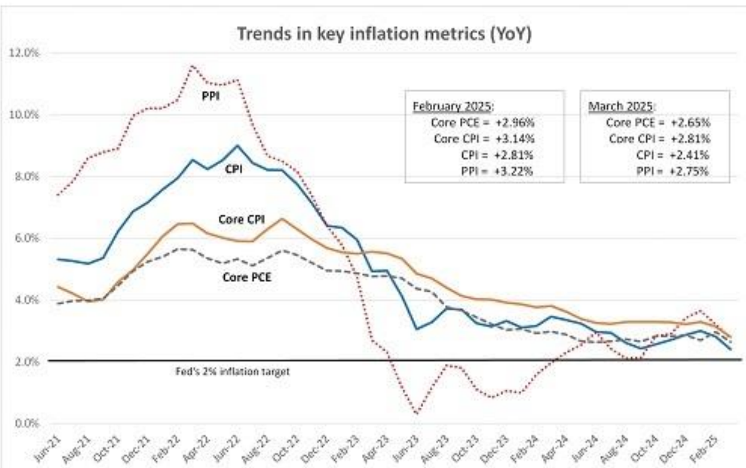
AlpineMacro pointed out the good news that the US economy has broken away from the so-called "liquidity trap," which implies overreliance on zero interest rate policy (ZIRP) and a collapse in the money multiplier, which was our situation coming out of the GFC until 2018, before the pandemic disruption through a wrench into the works. Still, they observe, *"It is crucial to note that broad money supply has been accelerating since 2023, even though the Fed has been shrinking its balance sheet and short rates have been lifted far above zero. These are unmistakable signs that the U.S. has moved out of the liquidity trap…."*

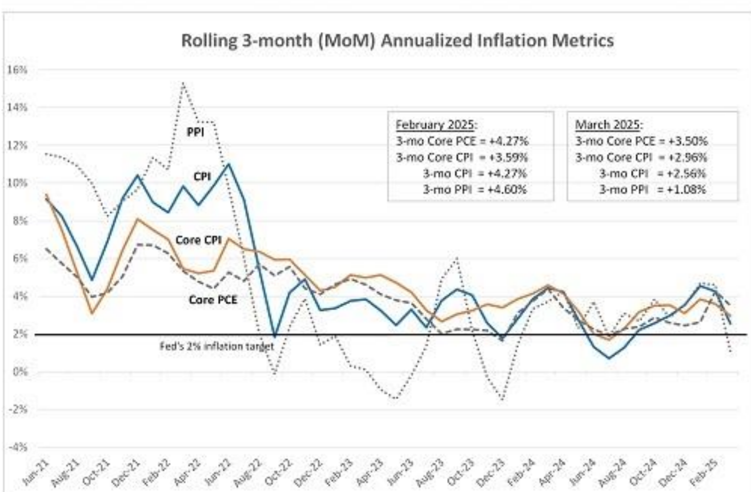
GDP and Inflation:

Real GDP for Q1 was released last week showing -0.3% annualized rate, but as First Trust pointed out, Core Real GDP (focused on consumer spending, business fixed investment, and homebuilding) actually grew a solid 3.0% YoY. The primary drivers for the negative headline number were reduced government spending and a massive 41.3% surge in imports (especially goods at +50.9%, which reflect front-loading ahead of tariffs) that negatively distorted net exports. However, increases in investment, consumer spending, and exports provided some offset.

Moreover, the headline reading far bested the Atlanta Fed's last GDPNow estimate of a -2.7% drop (or -1.5% if you exclude the distortion from record amounts of gold imports). So, the official Q1 report was actually pretty solid if you exclude the skewed impact of net trade (exports minus imports) and government spending. And looking ahead, Atlanta Fed GDPNow forecasts Q2 GDP at +2.2% (as of 5/6). However, the April jobs report (on 5/2) showed that jobs growth slowed and the latest JOLTS report showed the ratio of job openings to unemployed workers ratio has fallen to 1.0.

I have been regularly writing for quite some time about the underlying weakness in the economy and jobs that has been propped up by massive federal deficit spending and surging debt when instead we needed the Fed to soften its tight policy stance and Congress to nurture robust private sector organic growth. The outgoing Biden administration during its final months juiced its already enormous spending that had long supported GDP and jobs growth. This contributed to the spike in inflation in Oct-Jan and pushed the budget deficit to reach $1.3 trillion for the first half of fiscal year 2025 (note: FY2025 runs 10/1/24-9/30/25, so Q1 of any fiscal year refers to 10/1-12/31 or Q4 of the calendar year), marking the second-highest six-month deficit on record. This significant increase in government expenditure was driven by higher costs in Social Security, Medicare, Medicaid, disaster relief, and defense spending, and was further exacerbated by higher interest payment on surging interest rates (caused by the "bond vigilantes").





This contributed to an inflation surge in Oct-Jan with CPI and PPI hitting 3.00% and 3.65% YoY in January. But inflation has been falling for the past two months, with all March readings back below 3%. CPI and PPI came in at 2.41% and 2.75% YoY, and the rolling 3-month annualized rates (which I like to follow for a better view of the current trend) were just 2.56% and 1.08%, as shown in the chart below.

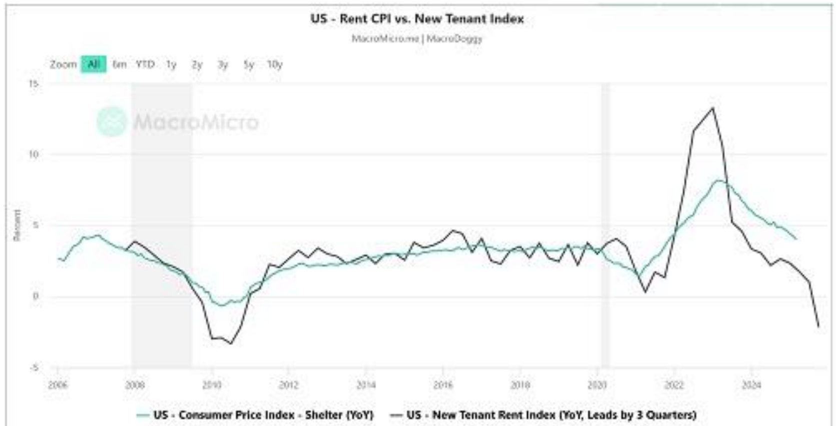
Also, the real-time, blockchain-based "Truflation" metric is just 1.45% YoY, as of 5/5, and the New York Fed's Global Supply Chain Pressure Index (GSCPI), which measures the number of standard deviations from the historical average (z-score), had a negative reading of -0.29 in April, which implies lower than normal supply chain issues. Next week brings the April readings for CPI and PPI. The Cleveland Fed's CPI Nowcast tool projects a continued decline in CPI and PCE in April and May.

Minneapolis Fed President Neel Kashkari said, *"Given the paramount importance of keeping long-run inflation expectations anchored and the likely boost to near-term inflation from tariffs, the bar for cutting rates, even in the face of a weakening economy and potentially increased unemployment, is higher."* However, it bears repeating that it seems clear to me that tariffs are inherently *deflationary* like any tax that lowers real income and aggregate demand, not *inflationary* as so many insist, including Kashkari, many economists, and most of the MSM talking heads. Ultimately, inflation is driven by outsized money supply growth causing demand to outstrip supply. As Brian Wesbury recently opined, tariffs by themselves raise prices on *certain* goods (in a 1-time price shock), this tends to either suppress consumer demand, or compel consumers to seek cheaper alternatives, or reduce corporate profits—if companies (suppliers and/or retailers) choose to absorb some of those tariffs.

Of course, a key component to inflation is oil prices, which have cratered, falling from a recent high of $80/bbl to around $57/bbl. Lowered forecasts of GDP growth (due to tariffs and trade wars) suggest lower demand for hydrocarbons. Indeed, the IEA slashed its estimate of global demand growth in 2025 by 30%. And besides Trump's efforts to bring down oil prices through deregulation (with a target of $50/bbl), OPEC+ effectively announced that it no longer has the oil production dominance to control pricing, so it plans to boost production by over 400,000 bbls/day, and positive developments in US-Iran nuclear discussions suggest sanctions of Iranian oil might be lifted soon.

This article discusses how Saudi Arabia is ready to turn on up the spigot, with this enlightening passage: *"Saudi Arabian officials are briefing allies and industry experts to say the kingdom is unwilling to prop up the oil market with further supply cuts and can handle a prolonged period of low prices, five sources with knowledge of the talks said. This possible shift in Saudi policy could suggest a move toward producing more and expanding its market share, a major change after five years spent balancing the market through deep output as a leader of the OPEC+ group of oil producers."*

So, we have a combination of expected falling demand and rising supply. And falling oil prices would also serve to suppress Russia and Iran, both of whom are heavily reliant on oil revenue.



In addition, shelter cost is a big component of CPI, and it has a long lag time before it shows up. But as shown in the chart, New Tenant Rents tends to lead CPI shelter cost by about 3 quarters, and it has been falling like a rock. So, with both oil prices and shelter prices cratering, and with the flood of the prior administration's last-minute federal spending behind us, it is more evidence that we should expect subdued inflation metrics going forward, along with a barely positive GDP. The FOMC should feel free to ease rates starting in June.

Final comments:

I would find it entertaining if it weren't so destructive how so many armchair quarterbacks (many of whom I follow and respect) think they know so much better how to implement substantial and rapid change to the longstanding, lopsided trade imbalances and unfair practices than "The Don," who has long proven his chops at fearless high-stakes negotiations (in fact, he literally wrote the book on it). Many of those commentators actually seem to be taking the side of China and other trading partners over the US. As I said earlier, I believe that the main reason China is resisting so ferociously with Trump-style tactics is that they see the discord in our country, and they think they can win by seeding it further.

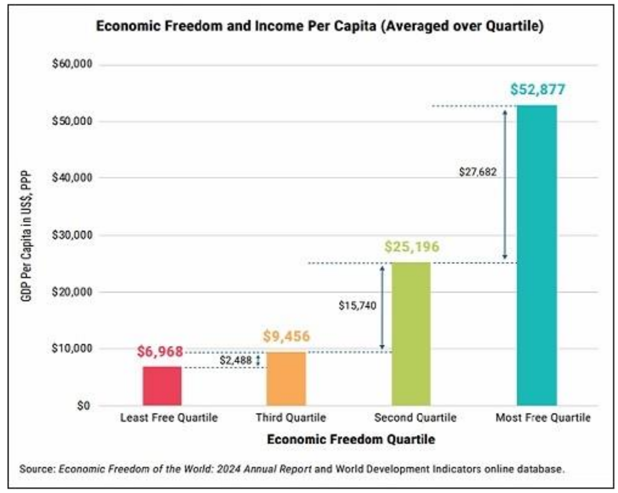
Unfortunately, in a free society, especially one with the level of political dysfunction of ours, it seems we are habitually trying to undermine our own national interests if it helps the primary goal of diminishing the success of the party in power and regaining political power for our preferred party. I am convinced that a unified front to the world regarding fair trade policy, NATO, Ukraine, Israel, immigration, wasteful government spending, etc. would provoke a swift resolution on all fronts—but instead we are "negotiating against ourselves" on full public display and essentially encouraging outsiders to fuel the flames of our domestic dissension rather than acquiesce to our demands and expectations.

Love him or hate him (and I work with folks of both persuasions), you have to admit that President Trump is actually trying hard to fulfill his campaign promises—unlike most politicians, who typically throw up their hands and acquiesce to the "reality" of the deep-state status quo, political power struggles, appeasement of party, and reelection concerns. Also, unlike most politicians, he is saying the same things today (particularly about international trade imbalances and crushing the American middle class) that he was saying 40 years ago. There is a video going around of his appearance on the Oprah show in 1988 to illustrate it.

As Thomas Sowell once said, *"When you want to help people, you tell them the truth. When you want to help yourself, you tell them what they want to hear."* And in my view, the US economy has suffered from decades of "*malign neglect*," which has only worsened since the pandemic, due to a combination of political incompetence and the intentional avoidance of responsibility or accountability, including allowing the debt, deficit, crime, homelessness, drug abuse, border security, public education, public health, infrastructure, manufacturing, and trade policies to gradually erode, with different political views on priorities and tactics to address the erosion resulting in a destructive gridlock. That is the unvarnished truth.

Furthermore, as Secretary Bessent said, *"The economy has become hooked [on government spending], and there is going to be a detox period."* This administration is pursuing the ambitious goal of restoring free-market capitalism (via an unleashed private sector) to our economy—an economic system that remains the only proven system for lifting people out of poverty, creating an equitable distribution of both opportunity and income, and lowering the wealth gap—as opposed to the continued socialist/redistributionist drift of Western society to force equitable outcomes (like a politburo), which history says is always a recipe for failure, stagnation, and corruption. As John Mackey (former Whole Foods Market CEO) wrote in his book Conscious Capitalism, *"Free enterprise capitalism has demonstrably lifted more people out of poverty than any other economic system."*

For those who believe that capitalism is a scourge to our global society and that socialism is the true path to fairness and compassion, let's see what Adam Smith had to say in his iconic book, "The Wealth of Nations," which was published in 1776. As economist Mark Skousen recently reminded us, Adam Smith advocated for a "system of natural liberty" which held that if you maximize freedom for both individuals and businesses, it results in universal prosperity (for rich and poor alike). He wrote, *"Little else is required to carry a state from the lowest barbarism to the highest degree of opulence but peace, easy taxes, and a tolerable administration of justice."* Likewise, the Fraser Institute publishes an Economic Freedom Index that quantifies free market capitalism across the globe, focusing on 5 criteria: size of government, rule of law, soundness of money, regulatory burden, and free trade. As clearly illustrated in the chart below, countries that provide the most economic freedom have lower levels of poverty and higher standards of living, and there has been a sharp reduction in poverty since the fall of the Berlin Wall.



Source: *Economic Freedom of the World: 2024 Annual Report* and World Development Indicators online database.

On that note, let me close by saying I've become a big fan of the All-In Podcast, which features a 4-person panel of brilliant, successful, but somewhat nerdy entrepreneurs who do not have the charismatic appeal of Joe Rogan and his "cool-guy that everyone wants to hang out with at the plant" demeanor, and their discussions are more cerebral than Joe's layman's approach. I highly recommend their show—not to mention it is an easier 1 hour or so, as opposed to Rogan's 3-hour marathons. On 4/18, they posted a particularly engrossing broadcast. Here are a couple of my key takeaways:

Regular panelist David Friedberg mused, *"Should the role of the federal government be to give out money equally to institutions, or should the role be to give money to the institutions that are going to provide the highest ROI for America?"* In other words, should our federal government redistribute wealth to elevate the research capabilities of universities that are financially needy, or should it seek only to maximize the return on taxpayer money by awarding research grants to those elite research institutions that have the most high-quality talent. He says, *"like any other great technology company, [a top research institution] accumulates capital because it accumulates talent, and that has a network effect."*

And comedian/podcaster guest Tim Dillon made an appearance and shared these thoughts (some with tongue in cheek) on the familiar theme of reviving America's middle and working classes: *"I think Americans overconsume a lot of crap…. I think people have been sold the idea that cheap goods are more important than having a stable, functioning job and family. I think the 'gig economy' has been sold to Americans as a way to offer them freedom at the expense of the stability that used to come with, you know, a job with benefits that you stayed in…but the other component to that is we have to make sure we don't have skyrocketing prices…so you need to find a balance."* And then, his comedic side mused, *"I want to see my friends work in factories…I want child labor. Children are terrorists, many of them. They start fights in malls, they have flash mobs, they run around Chicago trying to kill people that are just trying to have shellfish towers on the river. So, yes, children should work. And my friend should work in a plastics factory. DoorDash is a horrible job…You should destigmatize being an electrician, a plumber, a contractor [not just acquire a useless college degree]…You need to figure out how to reintroduce the idea that this gig economy where people surf from one unfulfilling nightmare to the next should be rethought."*

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 5/2/2025
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	96	60	37	96	90.0	55.9
HEALTHCARE	IYH	64	46	57	64	52.9	77.6
TELECOMMUNICATIONS	IYZ	56	49	53	56	56.0	67.3
INDUSTRIALS	IYJ	42	54	49	42	61.0	54.6
UTILITIES	IDU	39	42	70	39	37.2	90.0
FINANCIALS	IYF	34	54	52	34	58.4	56.6
CONSUMER DISCRETIONARY	IYC	27	53	47	27	54.2	45.0
CONSUMER STAPLES	IYK	26	36	70	26	21.5	84.7
BASIC MATERIALS	IYM	6	48	53	6	37.8	46.8
ENERGY	IYE	3	52	54	3	44.5	47.3

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 say that the rankings have turned neutral this month given that mixture of secular growth, cyclicals, non-cyclicals, and defensives scattered throughout, 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 robust Outlook score of 96, despite having by far the highest forward P/E of 25.3x (although still down from its February high of 29.2x). However, because of its still-strong EPS growth estimate of 17.7% (which has come down a bit as earnings are reported and forward estimates get revised), its forward PEG (ratio of P/E to EPS growth) is a relatively modest 1.43 (only Healthcare, Energy, and Financials are lower). Tech also displays by far the highest return ratios and insider buying activity, and although all sectors have seen substantially negative net earnings revisions from the sell-side analyst community, Technology hasn't been hit as badly as most others.

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, Industrials, and Utilities. Utilities have become more popular due to involvement in the buildout of AI infrastructure and power grid. Notably, Utilities has seen the smallest downward revisions to earnings estimates. At the bottom of the rankings are Energy and Basic Materials, as the trade war has led to large downward revisions to earnings estimates, and oil prices are down sharply. Notably, Energy, Financials, and Telecom display the lowest (most attractive) forward P/Es at 14.7x, 14.0x, and 14.4x, respectively, as of the close on 5/2.

Let me repeat what Josh Brown advised, *"Stocks [tend to] bottom in price a full 9 months before earnings do… By the time earnings are reaching their cycle low, stocks have already been rallying for three quarters of a year in advance of that low. This is why you don't wait to get invested or attempt to sit out the economic or earnings downturns."*
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.

Notably, our ETF rankings show stronger Outlook scores for the cap-weight indexes, like SPY and QQQ, over the equal-weight indexes, like RSP and QQQE, which reflects the higher quality of the mega cap companies that dominate the cap-weight indexes. You can learn more about our gaining access to our ETF Scorecards at: http://highperformancestockportfolios.com

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, but has now moved to a neutral bias. *(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.)* The SPY recently suffered a so-called "death cross" when the 50-day average crossed down through the 200-day, and both are still ominously pointed downward, but it has since recovered its 50-day to start the month of May and is trying to recover its 200-day as I write this.)

As highlighted in the table above, it suggests holding **Technology (IYW), Healthcare (IYH), and Telecom (IYZ)**. However, if you prefer to maintain a defensive stance, the Sector Rotation model suggests holding Utilities (IDU), Consumer Staples (IYK), and Healthcare. Or, if you prefer to take a bullish stance, it suggests holding Technology, Industrials (IYJ), and Financials (IYF).

Here is an assortment of other interesting ETFs that are scoring well in our latest rankings: US Global Gold and Precious Metal Miners (GOAU), VanEck Gold Miners (GDX), iShares MSCI Global Gold Miners (RING), Sprott Active Gold & Silver Miners (GBUG), Fidelity Metaverse (FMET), Invesco Dorsey Wright Technology Momentum (PTF), Columbia Select Technology (SEMI), Invesco Biotech & Genome (PBE), Invesco Pharmaceuticals (PJP), Janus Henderson US Sustainable Equity (SSPX), iShares Technology Opportunities Active (TEK), iShares AI Innovation & Tech Active (BAI), iShares Expanded Tech Sector (IGM), Nuveen ESG Large Cap Growth (NULG), Kingsbarn Dividend Opportunity (DVDN), VanEck Junior Gold Miners (GDXJ), Roundhill Generative AI & Technology (CHAT), Aztlan Global Stock Selection DM SMID (AZTD), Fidelity Fundamental Large Cap Growth (FFLG), Defiance Connective Technologies (SIXG), First Trust Expanded Technology (XPND), First Trust Long/Short (FTLS), and US Global Technology and Aerospace & Defense (WAR). 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, GOAU, gold, and bitcoin.*

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