March 3, 2025

February Market Recap

A torrent of headlines churned U.S. equity markets in February, which – bolstered by the underlying strength of the U.S. economy – closed down, but still near record highs.

A quick rundown of the ongoing tensions:

- The Trump administration's threat to enact broad-based tariffs on goods imported from Canada, Mexico and the European Union – and to double the new tariff on China – has created uncertainty for producers. The effect on the market may be muted thus far by investors' bias toward seeing the threats as primarily a negotiating tactic.
- Federal Reserve policymakers remained in "wait and see" mode following mixed January inflation reports and a number of weak economic growth reports. Until there is more clarity, this combination of factors will likely stay the hand of the Federal Open Market Committee (FOMC) from lowering interest rates.
- The release of an AI model from China at the end of January called into question the U.S.'s AI dominance – and AI-stock valuations – as well as expectations for related capital expenditures.
- Congressional leaders and the White House are eager to pass a significant budget, tax and debt limit package, but with their narrow House majority, Republicans may find consensus difficult, increasing the risk of a government shutdown.

"The chances of a government shutdown are increasing; however, shutdowns have historically been a non-event for the market," said Raymond James Chief Investment Officer Larry Adam. "Eighty percent of the time, the market is higher 12 months later. Investors need to look past the noise and focus on the fundamentals."

While the U.S. market churned, European stocks have come out strong in 2025 after lagging far behind the U.S. since 2022. Bolstered by deeply discounted valuations, anticipated peace talks between Russia and Ukraine and talks of fiscal stimulus in Germany, Euro stocks outperformed U.S. equities year-to-date by 8.6%.

Before we dive into the details, here's where the major indices stand.

	12/31/24 Close	2/28/25 Close*	Change Year to Date	% Gain/Loss Year to Date
DJIA	42,544.22	43,840.91	+1,296.69	+3.05%
NASDAQ	19,310.79	18,847.28	-463.51	-2.40%
S&P 500	5,881.63	5,954.50	+72.87	+1.24%
MSCI EAFE	2,259.60	2,422.66	+163.06	+7.22%
Russell 2000	2,230.16	2,163.07	-67.09	-3.01%
Bloomberg Aggregate Bond	2,189.03	2,249.06	+60.03	+2.74%

*Performance reflects index values as of market close on Feb. 28, 2025.

Inflation bump needs clarification

A larger-than-expected increase in the January Consumer Price Index (CPI) report, released February 12, was a setback in the Federal Reserve's ongoing battle against heightened inflation, which could lower expectations for interest rate reductions through 2025. However, the report could be the result of a spike in the trade deficit as producers overbought materials in December as a hedge against tariffs or "residual seasonality," a spillover from the holiday season's elevated spending patterns.

The personal consumption expenditures index (PCE), a broader measure of inflation and the one preferred by Federal Reserve policymakers, offered a counter to the CPI. Released on February 28, it showed inflation slightly cooling in January, in line with earlier expectations, helping the down month close on an up day.

Equities need clarification, too

Investors might naturally expect a muted 2025 after back-to-back years topping 25% gains for the S&P 500, regardless of other events. But underneath headline-driven uncertainties, there could still be some gumption left in the bull market. The U.S. economy remains in good shape, AI remains a powerful mover, and bull markets, historically, pull for a bit longer, which has kept valuations high. Eyes remain on tariffs, inflation and interest rates.

Economic data dampens yields

A string of weaker-than-expected economic data releases in February contributed to sharp decline in Treasury yields, particularly at longer maturities. Since its peak in mid-January, the yield on the 10-year note fell nearly 60 basis points to 4.24% by the end of February. Still, the primary driver of interest rates remains inflation and how the Federal Reserve is likely to react to inflationary moves. Meeting minutes from the FOMC suggest its interest rate target will hold steady until inflation clearly improves.

Microcosm or myopia?

The price of eggs is often highlighted in media to bring complex economic issues to the kitchen table, but the egg isn't that illustrative when it comes to grocery costs. Bureau of Labor Statistics data show that retail U.S. egg prices have seen unprecedented price hikes – up 50% from one year ago – on account of an avian flu epidemic and the culling of huge flocks. But more needle-moving foods are stable or even down compared to 12 months ago. Counterintuitively, this includes chicken, whose supply has been affected only slightly by the avian flu.

A European moment

Heading into 2025, the prevailing narrative on Europe was "low growth, low inflation and lower interest rates." The narrative has shifted as relentless news flow has caused investors to reappraise Europe's prospects. The potential for increased defense spending, in light of U.S. reticence on continuing support for Ukraine's defense, may improve European growth prospects at a cost of higher inflation.

Threats of 25% import tariffs on European Union products by the new U.S. administration are largely seen on the continent as a negotiating move, with time and room to negotiate that could see European tariffs on U.S. vehicles reduced as a possible pathway toward compromise.

Meanwhile, in the Article I branch

Capping off February, the U.S. House of Representatives passed a budget resolution providing the foundation for reconciliation with the Senate's budget efforts. The budget instructions, over a 10-year timeframe, included $4.5 trillion in potential tax cuts, $2 trillion in spending cuts and a $4 trillion debt limit increase.

Beyond tax changes, the budget provides for $300 billion in additional spending for defense, immigration enforcement and energy priorities. House leadership has set a Memorial Day deadline to complete the process, with the summer "x-date" deadline to address the debt limit potentially accelerating the process. But the path forward will likely see a significant number of political decisions and hurdles.

The bottom line

As expected, the newly empowered administration spent its first full month vigorously pursuing its policy ideas and setting an agenda, backed by a friendly, if narrowly so, Congress. While some of Trump 2.0's moves are familiar, others are new, and the world and the markets are early in their efforts to triangulate to this new dynamic. The strength of the U.S. economy continues to offer stability, despite the cacophony of daily headlines driving volatility. The market expects this volatility to continue – from inflation, interest rates and policy uncertainty – and has thus far not overreacted.

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