

Equity Market Commentary

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The following views and perspectives are formed by the work of the Applied Equity Team in managing assets for investors.

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- 1 In one of his many memorable memos from July 2024, Howard Marks discusses **"The Folly of Certainty."**

*There simply is no place for **certainty** in fields that are influenced by psychological fluctuations, irrationality, and randomness. Politics and economics are two such fields, and investing is another. No one can predict reliably what the future holds in these fields, but many people overrate their ability and attempt to do so, nevertheless. **Eschewing certainty can keep you out of trouble. I strongly recommend doing so.**¹*

- 2 Don't the last five weeks remind us yet again of the dangers of overconfidence?

I don't know of a single macro expert in early April who spoke optimistically.

All I heard was the doomsday narrative. The likelihood of recession soared, becoming a forgone.... **"certainty."**

Yet the S&P 500 is up 18.1% since April 8th, proving those experts wrong.²

- 3 The additional danger of the **folly of certainty** is keeping investors rooted in **"first level thinking."**

I heard numerous scary predictions of what "Trump tariffs" would immediately cause for the economy (which have turned out to be inaccurate.)

But what was already *embedded* in stock prices was far less discussed.

As Barry Ritholtz explains in his entertaining (and highly recommended) new book, **"How Not to Invest"**:

¹ Oaktree. Memos from Howard Marks. July 17, 2024.

² Bloomberg as of May 13th, 2025.

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

“Second level thinking” requires going past the first recognition, beyond what is obvious.
Thinking beyond the news to how market participants will react to the news.³

4

As per this **second level of thinking**, consider the state of the market on Monday, April 7th:

A. From Goldman Sachs:

*Our prime brokerage data from last week shows that hedge funds net sold the most amount of global equities in the history of our data set (since 2010).*⁴

B. From Bank of America's weekly Global Fund Managers Survey (FMS):

*5th most bearish FMS in past 25 years, 4th highest recession expectations of past 20 years, record number of global investors intending to cut US stocks. FMS max bearish on the macro.*⁵

This positioning suggests to me a lot of **first level thinking**, because:

The S&P 500 was already down nearly -18%,⁶ and:

- A. The highest beta stocks (the riskiest) had performed horribly over the past month. Relative to the market, they had only traded worse in 2% of all months since 1990.⁷
- B. 40% of all NYSE stocks had traded to a new one-year low.⁸
- C. The VIX (CBOE Volatility Index) first hit 50 that day, essentially total panic.

Each of these is a contrarian indicator.

For instance, the S&P 500 has *never* had a negative one-year return when the VIX has hit 50.⁹

5

Second order thinking would have signaled that any change in the news would cause a forced, dramatic, and more bullish repositioning.

Simply put, there was an overwhelming amount of bad news priced into stocks already.

Yet the **folly of certainty** (essentially overconfidence in first order thinking) caught these investors wrongly positioned against a dramatic change in the news: *the Trump 90-day tariff pause*.

As Barry Ritholtz writes:

*Once you recognize how little the experts (and the rest of us) know, you come to recognize how much humility investing requires.*¹⁰

Anyone who was able to say, “I really don’t know what is going to happen, but I know the market is down a lot and that makes me more bullish” might not have sounded as smart as all the doomsayers.

But who ended up being rewarded?

³ How Not to Invest. Barry Ritholtz 2025.

⁴ Goldman Sachs, April 6th, 2025.

⁵ Global Fund Managers Survey. April 2025.

⁶ Bloomberg.

⁷ MSCI Barra, April 5th, 2025.

⁸ Helene Meisler, April 6th, 2025.

⁹ Since 1990, 74 previous times the VIX has breached 50. The one average one year return for the S&P 500 once the VIX breaches 50 is +35% and it has produced a positive return 74 out of 74 times.

¹⁰ How Not to Invest. Barry Ritholtz 2025.

6

Enough of last month's recap... **now what?**

One of my favorite quotes by Adam Parker is so simple and so true:

*Sentiment follows price momentum by two weeks.*¹¹

The market is up 18.1% since that Tuesday in early April, and voila, sentiment is not nearly as negative.¹²

The panic has receded. The VIX has plummeted to 18.¹³

That makes me more nervous than I was in early April.

There is less bad news priced into stocks today.

Sentiment has followed stock prices higher the last 25 trading days.

Said another way, the one-year potential return of the S&P 500 with today's VIX at 18 (a high measure of calm) is not nearly as good as previously, when the VIX surpassed 50 (a high level of panic).

I do notice those same economists who pegged recession odds at high levels in early April have now reversed their predictions.¹⁴

As Tom Lee from Fundstrat likes to say,

Buy with the sounds of cannons, sell at the sounds of trumpets.

I hear a lot more trumpets than I did a month ago!¹⁵

7

Nothing that has occurred year-to-date leads me to change my view from the beginning of the year:

A. 2025 could be a "pause year".

After a cumulative 65% rally in the S&P 500 in just over two years, isn't the market due for a breather?

B. Expect more volatility.

I doubt this is, in fact, the last painful pullback we'll see this year.

Of course, when I articulated this view last week at a meeting, an investor shot back, "what would cause another swoon?"

You know my answer: **"I don't know."**

C. As we have just learned, volatility can be your friend, assuming you can tack against the **first order thinkers**.

In essence, while I highly doubt the absolute returns will match those of the last two years, the alpha (performance relative to the benchmarks) might be even better.

8

Finally, many have asked us, *"is US exceptionalism over?"*

What has defined US exceptionalism is driven by a dramatically higher level of ROE (return on equity) in the S&P 500 than the rest of the world.¹⁶

Simply put, US companies have higher profit margins and more efficiently deploy assets (asset turnover) than companies in the other parts of the world, on average.

That defines US exceptionalism.

But what fascinates me is drilling down to ask anyone posing the "exceptionalism is over" question to me, what

¹¹ Trivariate Research. May 5th, 2025.

¹² Bloomberg, as of May 13th, 2025.

¹³ Bloomberg, as of May 13th, 2025.

¹⁴ Goldman Sachs Chief Economist current odds of recession is 35% as of May 12th, versus >60% in early April.

¹⁵ Fundstrat, May 2025.

¹⁶ At year-end 2024, the ROE of the S&P 500 was 21% versus MSCI World Ex US was 12%. EBIT margins were 116 basis points higher.

their own opinion is.

The response is *never* about the sustainability of those ROEs. (Which would certainly be a legitimate concern.) It's about politics and what is going on in Washington DC.

To which, I am reminded of a great Warren Buffett quote:

*If you mix your politics with your investment decisions, you are making a big mistake.*¹⁷

To be clear, there are plenty of great companies outside the US in which to invest.

However, to base one's view of US exceptionalism being over, or not, on one's political opinion is nothing more than a **"Folly of Certainty."**

Andrew

¹⁷ Berkshire Hathaway Annual Shareholders meeting on May 3rd, 2025.

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