NATIXIS INVESTMENT MANAGERS | SOLUTIONS

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PORTFOLIO ANALYSIS & CONSULTING

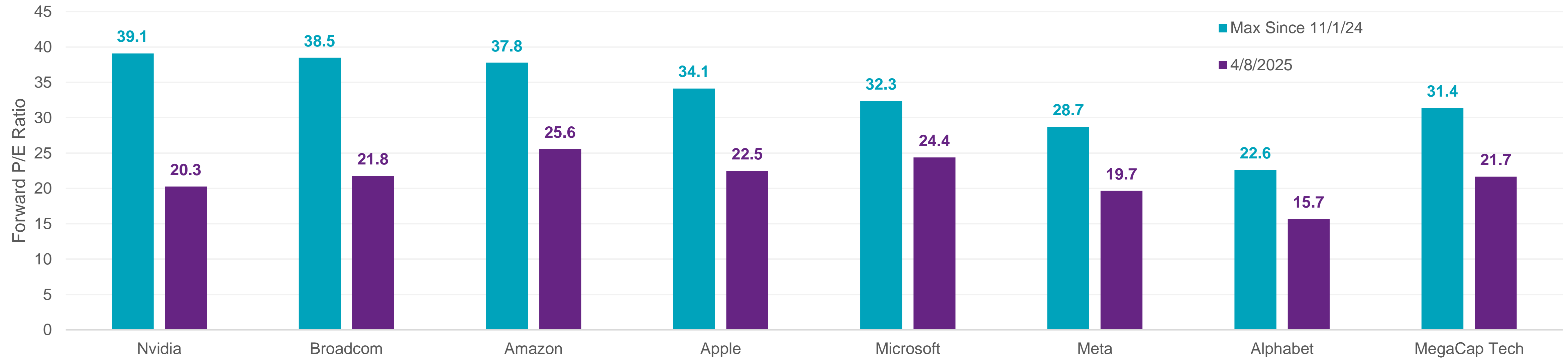
Charts and Smarts®

Jack Janasiewicz, CFA® – Portfolio Manager and Portfolio Strategist

Garrett Melson, CFA® – Portfolio Strategist

Sharp Dressed Man

Forward P/E of Megacap Tech (11/1/24–4/8/25)



To say the year hasn't gone to plan would be an understatement. Another year, another outlook up in smoke just months into the new year. While tariffs and the escalating trade war are receiving all the attention, and rightly so, the script was ripped up for the Magnificent 7 well before the escalation on the trade front. Whether it was a belated overreaction to the DeepSeek headlines of late January or rising concern of the growth outlook in the wake of Walmart's disappointing guidance in February, the selloff from all-time highs began not as a true growth scare, but rather an unwind of crowded positioning in high beta and high momentum names – a point we emphasized last month. High beta and momentum are adjectives that perfectly describe the Magnificent 7 and AI trade over the past year. While the unwind may have played out, the derating process certainly hasn't concluded for megacap tech as valuations have continued to tumble as the selloff has intensified. Swapping in Broadcom in favor of Tesla in the Magnificent 7, the previously high-flying tech names have now derated 35%, on average, from their respective recent highs, while the cap-weighted Magnificent 7 has derated over 10 full turns on a forward P/E basis. The richest of the lot, Amazon, now sits at under 26 times, while Alphabet rounds out the bottom, under 16 times forward earnings. The strongest firms with the best products, widest moats, and strongest balance sheets now trade collectively at just 21.7 times forward earnings. Of course, there are good reasons for the continued rerating given these firms are among the largest multinationals with meaningful revenue and supply chain exposures abroad and are prime targets for retaliation via both trade restrictions and regulatory burden. Indeed, the market is hard at work discounting the scale of negative earnings impacts, but given the looming US and global recession barring a de-escalation that will see few firms able to evade earnings damage, these are still the firms that hold the exact characteristics investors are likely to rush for as the outlook continues to sour. Megacap tech is no longer expensive and arguably may be more accurately reflecting that dimmer outlook than what fellow sectors and industries are pricing.

Source: Portfolio Analysis & Consulting, FactSet. Megacap Tech represents market cap weighted average multiple of Nvidia, Broadcom, Amazon, Apple, Microsoft, Meta, and Alphabet. Forward P/E represents price-to-earnings ratio based on the next 12-month earnings estimates.

Got Me Under Pressure

S&P 500® Price vs Forward Earnings (3/25/96–4/10/25)

The market is a forward discounting mechanism. Given the nature and speed of this selloff, it's no surprise that we've yet to see any downward movement in forward growth and earnings estimates. As a result, the entirety of the selloff has been a story of multiple derating. While that derating certainly captures the massive dent in investor confidence and risk appetite, it is also a reflection of investors' votes on the fundamental damage to corporate earnings. Not all large derating episodes lead to earnings downgrade cycles, but when they do, prices lead earnings and what appears to be purely multiple derating today will ultimately shake out as some combination of multiple compression and downward earnings revisions. The obvious question: how much is enough? Unfortunately, there's unlikely to be much visibility into the potential fundamental fallout anytime soon. As we kick off the Q1 earnings season, it should surprise no one that the resounding theme of reports will be a complete lack of clarity. Trailing earnings matter little beyond confirming that firms and the economy were still on sound, albeit softening, footing entering this shock. It's all about forward guidance, but don't hold your breath for any meaningful details. Will management teams feel comfortable providing any guidance given the massive amount of uncertainty with respect to the duration, size and scope of tariffs and the potential retaliation and economic fallout? Expect plenty of guides to be pulled, a trend that's already emerging before the earnings season is even under way. For now, it's a matter of the blind leading the blind when it comes to earnings estimates.

Source: Portfolio Analysis & Consulting, FactSet. Forward EPS represents the next 12 months' earnings per share estimates.

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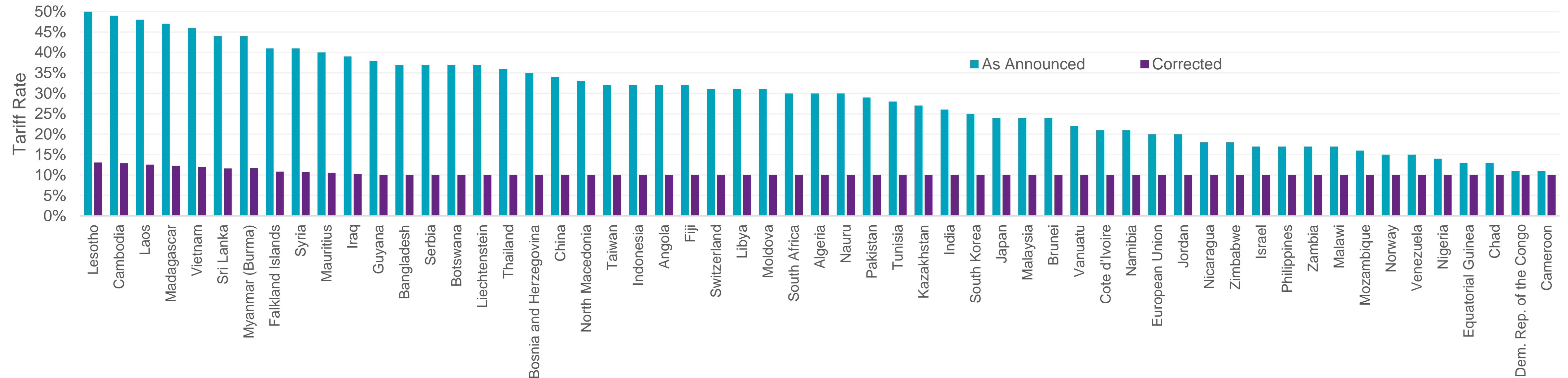
Just Got Paid

Reciprocal Tariffs: As Announced vs Corrected



“Liberation Day” has come and gone, and in its wake we’re left with a trail of devastation throughout markets. While President Trump suggested in the days leading up to April 2 that the so-called reciprocal tariffs would be light, that claim depends heavily on your reference point. Relative to the tariffs calculated by the administration, the tariffs are indeed light, but relative to the actual tariff rates and barriers levied by our trading partners, the announced tariffs were incredibly punitive. The administration has suggested that the calculated tariff rates capture all tariff and non-tariff barriers, but that has proven a shallow defense for markets that quickly reverse engineered the now infamous formula for the announced tariff rates as a simple ratio of each country’s bilateral trade surplus divided by their total exports to the US. To suggest that bilateral trade deficits are simply a function of tariff and non-tariff trade barriers is a fundamentally flawed claim that completely ignores the effects of relative wealth, savings and demand, and comparative advantage, just to name a few. The formula does indeed have roots in economic theory, but the values for the additional variables chosen by the administration demonstrate results in those variables cancelling out. In short, the results of the formula appear to simply be a justification for a desired outcome as opposed to a sound methodology. Correcting for those errors in the way the formula was intended results in far smaller tariff rates. The highest corrected reciprocal tariff rate is just 13.1%, while only 11 countries, the majority of which are smaller trading partners, have rates above the 10% minimum. What was announced was neither light nor reciprocal, representing a sizeable shock to both prices and growth and materially boosting recession probabilities. And while the roll back to a flat 10% rate is a welcome reprieve, we still face an economy that is already organically cooling and now has a persistent uncertainty overhang.

Source: Portfolio Analysis & Consulting, Bloomberg. Based on 2024 trade.

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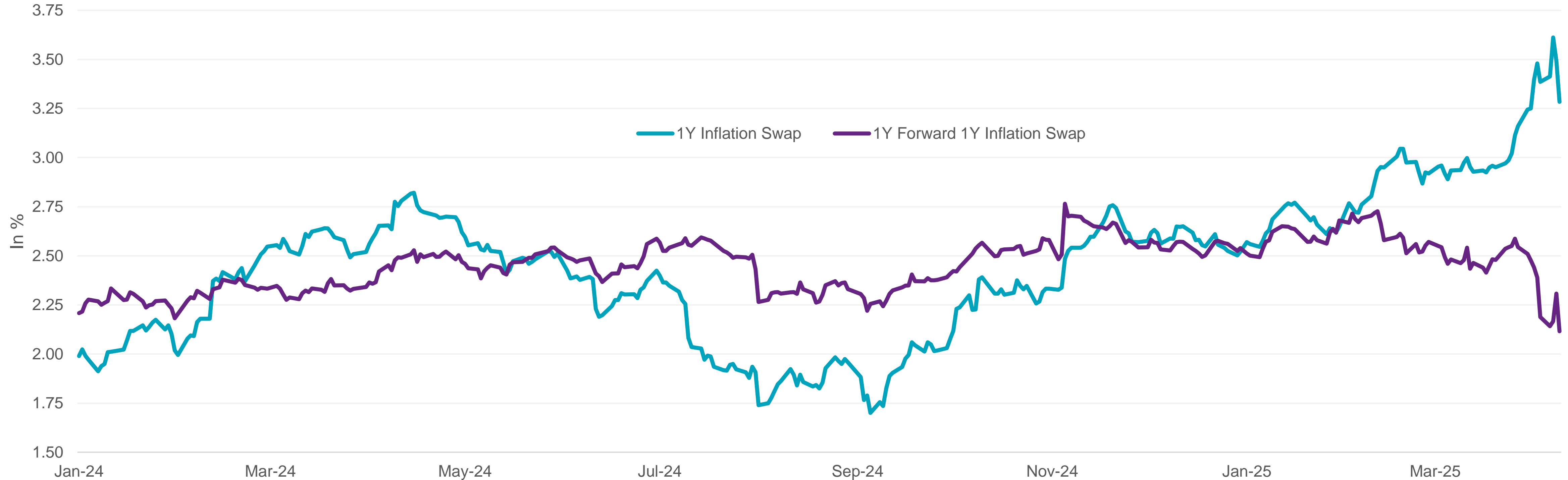
Cheap Sunglasses

Inflation Expectations (1/2/24–4/10/25)



While there are undoubtably upside risks to inflation stemming from President Trump's tariff regime, the message from the market over the past month has been clear: downside risks to growth are greater than upside risks to inflation. That refrain has only grown louder in the days since Liberation Day. Looking at inflation swap pricing over the next year versus the one-year period starting one year from today shows a clear and growing divergence. Despite the roll back of the punitive and questionable reciprocal tariffs, the 10% baseline tariffs remain in effect in addition to 25% rates on steel and aluminum, autos and a 145% tariff rate with China. While the pause on reciprocal tariffs certainly raises hope that we may see similar de-escalation with respect to China, the tariffs, as they stand today, will still represent a meaningful shift higher in the price level as reflected in the one-year inflation swap. But over the ensuing year, markets aren't just reflecting a lack of an inflationary process, but rather softening inflation expectations due to weakening growth. The market is pricing in a one-time, tariff-induced price shock that gives way to a disinflationary impulse as a result of rising recession risks. The narrative of stagflation may be gaining traction, but the market is clearly more worried about recession risks than a durable inflationary impulse.

Source: Portfolio Analysis & Consulting, Bloomberg.

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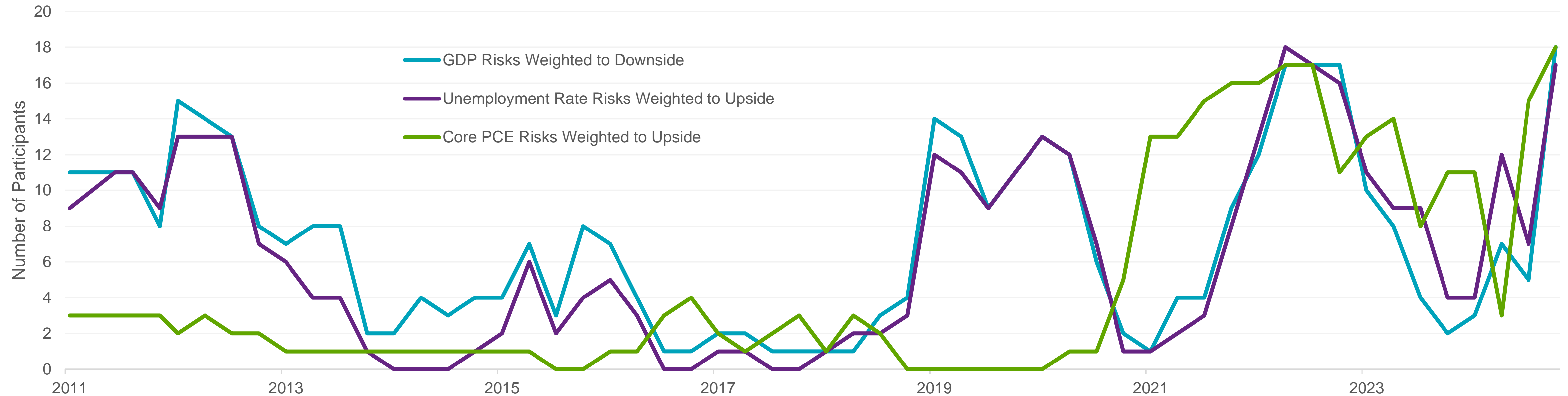
Waitin' for the Bus

FOMC Assessment of Risks to Projections (6/30/11–3/19/25)



While the market may view growth risks as dominating price risks, the same cannot be said for the Fed, at least for now. The balance of risks is a thing of the past. Now it's a matter of how much the dual mandate is set to grow in tension in the months and quarters to come. Unsurprisingly, in the eyes of FOMC participants inflation risks are firmly pegged to the upside while employment and growth risks are pinned to the downside, all the while uncertainty around the outlooks remains extremely elevated. The Fed's reaction function is just that, reactive. Gone are the days of preemptive cuts. Powell and company are in no hurry to continue easing as they await more clarity on the administration's policies and their resulting impact. The Fed is in wait-and-see mode, and while the acute phase of the market panic may now be over as the pause effectively clipped off the left tail of nonlinear deterioration in the economy, we are now back to an environment of passive tightening and linear cooling as labor slack slowly builds. And complicating matters, while there's still room and hope for de-escalation with China, the effective tariff rate and goods mix under the universal 10% tariff and 145% rate on China is arguably more problematic, given the focus on our third-largest trading partner that increases the effective tariff rate on consumer goods. The mandate is in tension and downside growth risks will continue to build the longer the Fed sits idly by for more clarity. And perversely, while time may bring more clarity as to where tariffs will settle, the longer this process is drawn out, more noise is likely to be introduced into the macro data as the effects of paused activity and continued front running ripple through the economy, complicating the Fed's attempts to disentangle tariff effects from structural inflationary forces. The market panic may have abated, but the risks have not, all while the Fed remains sidelined.

Source: Portfolio Analysis & Consulting, Bloomberg.

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