Renaissance Investment Management

March 2025

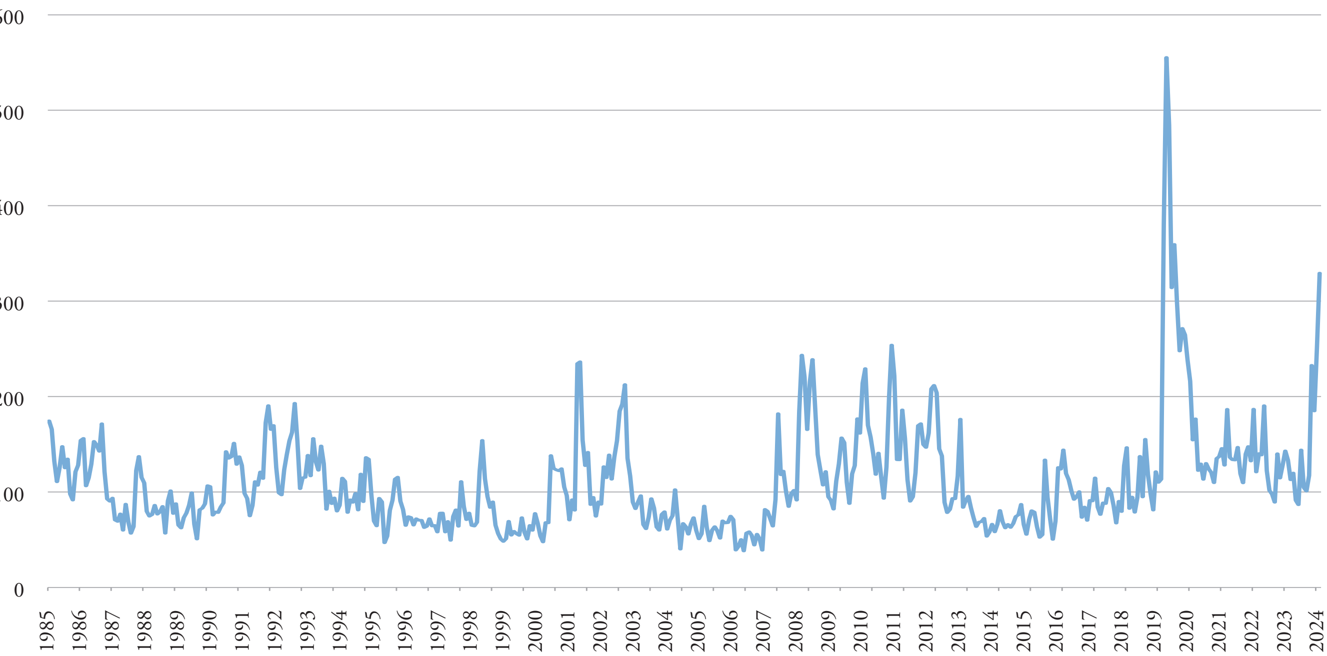
Market Update

Navigating Market Volatility: How Policy Uncertainty Impacts Stocks

In recent weeks, market volatility has increased and market averages have given up most of their gains since the first of the year. Mega cap technology stocks, such as those in the Magnificent 7, have been among the weakest performers.

Much of the blame for the market weakness can be placed on increased uncertainty over U.S. government economic policy. Whether the focus is on proposed regulatory changes, federal budget issues, tax changes, or tariffs, the range of possible outcomes from government actions has meaningfully increased. An index of economic policy uncertainty* has surged to over 300, its highest level since the onset of the COVID crisis in early 2020.

Economic Policy Uncertainty Index for the United States(1)*



Data from 1/1/1985–2/28/2025, monthly, not seasonally adjusted.
(1) Values are monthly averages.
Source: Federal Reserve Bank of St. Louis

This index was consistently above 200 from March 2020 through January 2021. Even so, the S&P 500 posted strong gains over the following year in all of these months. In fact, after the index first moved above 200 in March 2020, the S&P 500 achieved a robust 53.7% price gain over the following 12 months. Looking at every month from 1984 to the present, when the index was above 200, we found that the S&P 500 averaged a gain of 23.7% over the ensuing 12 months, with positive returns 88% of the time.

Of course, positive returns 88% of the time also means that returns were negative 12% of the time. Most notably, after the index rose above 200 in September 2001 the S&P 500 dropped 21.7% over the next 12 months before the market began another uptrend in late 2002 and early 2003.

We would be among the first to admit that the uncertainty in the current economic policy environment is unprecedented on many levels and that history is, at best, an imperfect guide to the future. However, an examination of history can and does suggest that a spike in uncertainty does not preclude good returns from stocks going forward.

* The Economic Policy Uncertainty Index for the United States, developed by economists Scott R. Baker, Nicholas Bloom, and Steven J. Davis, quantifies economic policy uncertainty by analyzing factors such as the frequency of specific terms related to economic policy uncertainty in U.S. newspapers, the number of federal tax code provisions set to expire in future years, and the extent of disagreement among economic forecasters. A higher index value indicates greater uncertainty regarding U.S. economic policy, which can influence investment decisions, consumer behavior, and overall economic performance. The index is published regularly on the Federal Reserve Economic Data (FRED) website maintained by the Federal Reserve Bank of St. Louis.

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REFERENCED INDEX

(Indices are unmanaged and are not available for direct investment.)

S&P 500 Index—The S&P 500 Stock Index is a market capitalization weighted index and consists of 500 stocks chosen for market size, liquidity and industry group representation.

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