Quarterly Economic Update

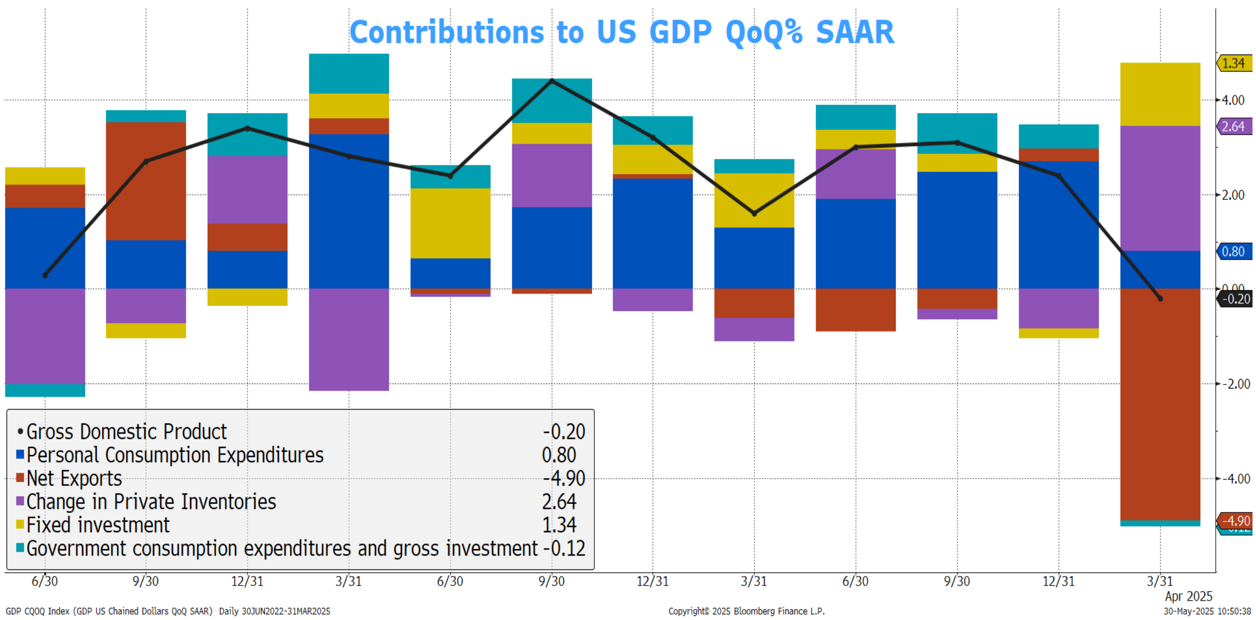
June 11, 2025

MACROECONOMIC COMMENTARY

Economic Outlook

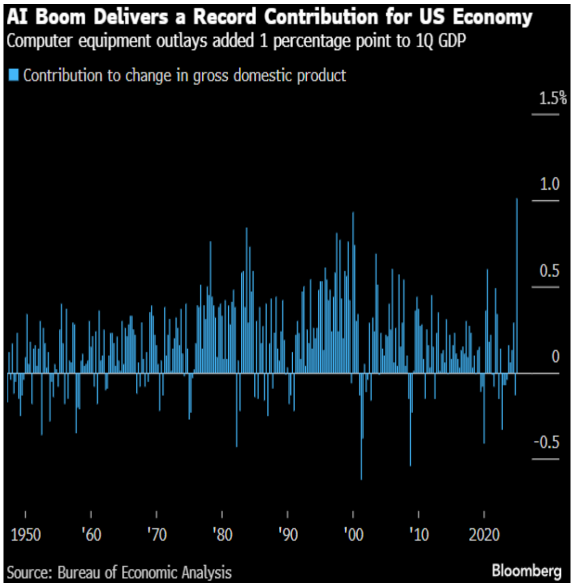
By Bobby Long

Economic growth as measured by Gross Domestic Product (GDP) officially contracted in the first quarter of the current calendar year with real GDP recording a -0.2% decline over the prior quarter. However, a closer examination of the underlying components is needed to gain a better understanding of conditions. The chart below illustrates how real GDP and its various components have trended over the past few years.



Overall, the first quarter was messy with tariff-related impacts affecting the number and leaving the data somewhat difficult to interpret. Large swings in net exports and private inventories were recorded. Net exports are a function of exports minus imports. A surge in imports created a large negative drag on the quarter's growth. This was partially offset by the strong inventory investment. Most likely, both reflect front-running ahead of tariff increases.

Trade data for April show imports returning to more normal levels and a slight uptick in exports, which should serve to reverse the negative contribution these dynamics had in the first quarter as trade balances normalize and inventories are drawn down. While the uptick in exports will be supportive, it may be short lived with recent data showing a sharp drop in new export orders.



Private fixed investment was very strong for the quarter. Transportation and industrial equipment were modestly positive, but the real strength came from investment in information processing equipment and software. Technology-related investment came in at record levels exceeding the prior highs set during the 2000 tech boom. The race to develop artificial intelligence capabilities is fueling the investment and the amount of money being directed towards this will likely remain supportive, however the especially strong quarter also likely reflects a spike in investment ahead of tariff impacts.

Personal consumption remained healthy for the quarter but did noticeably decelerate from stronger levels over the past several quarters. The monthly real personal spending data declined in January and was roughly flat in February. March spending recovered sharply, however April spending was only modestly positive with a contraction in goods consumption. The table on the right breaks down the spending data and shows a broad deceleration in goods spending across categories. There is likely some tariff-induced volatility in these numbers also with consumers ramping up spending ahead of tariffs. This pull-forward in demand likely contributed to the weaker April spending and could dampen spending further over the near term.

Real PCE Spending MoM%

	4/30/2025	3/31/2025	2/28/2025
Headline	**0.13**	**0.73**	**-0.02**
ex Food and Energy	**0.05**	**0.94**	**0.10**
Core Goods	-0.23	1.52	0.23
Motor vehicles	-0.57	10.21	-0.31
Home furnishings	-0.22	0.89	0.42
Recreational goods	-1.89	0.88	0.15
Other durables	0.50	-0.60	-0.73
Apparel	-0.58	0.70	0.08
Other nondurables	-0.45	1.21	0.86
Core Services	0.27	0.46	0.03
Housing	0.22	-0.20	-0.55
Health care	0.26	0.26	0.46
Transportation	-0.10	0.06	0.51
Recreation	0.82	-0.11	-1.31
Food svcs	0.53	2.06	-0.79
Financial Svc	0.79	0.24	0.26
Other Svc	0.34	0.78	0.47

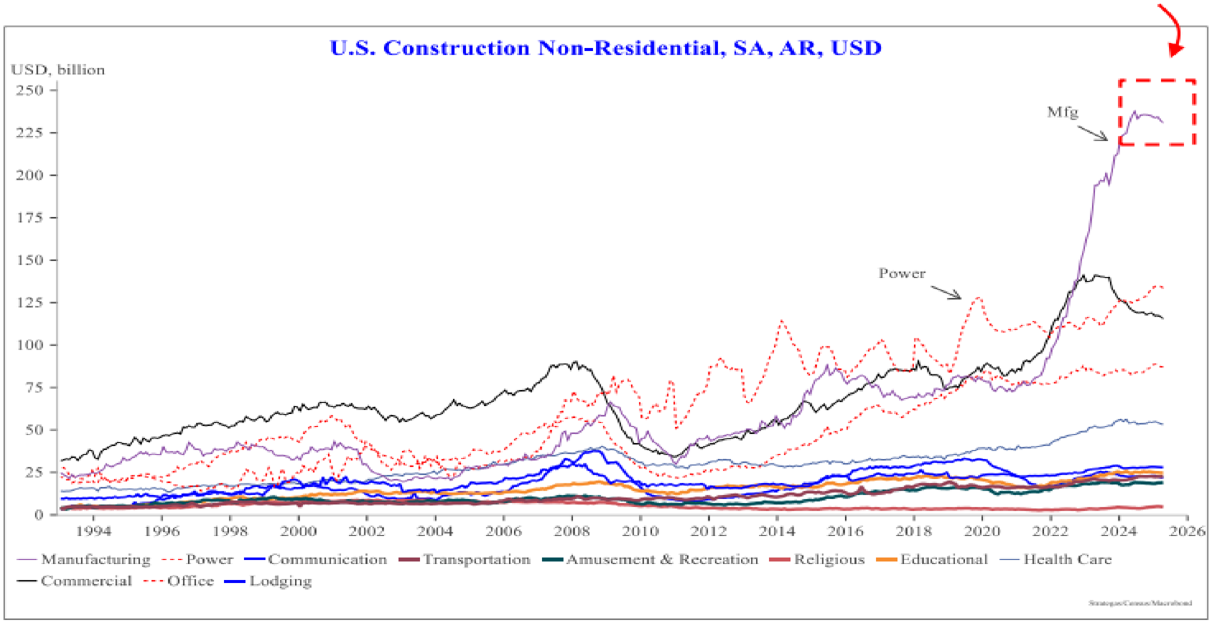
Source: Wolfe Research, Haver Analytics, as of Apr 30, 2025

Manufacturing activity has been mixed, continuing to trend at weaker levels but not showing any clear indications of improving or deteriorating activity. The regional Federal Reserve manufacturing surveys showed some improvement for the month of May, however the Institute of Supply Management's Purchasing Managers Index moved slightly lower and remains below 50 in contraction territory.

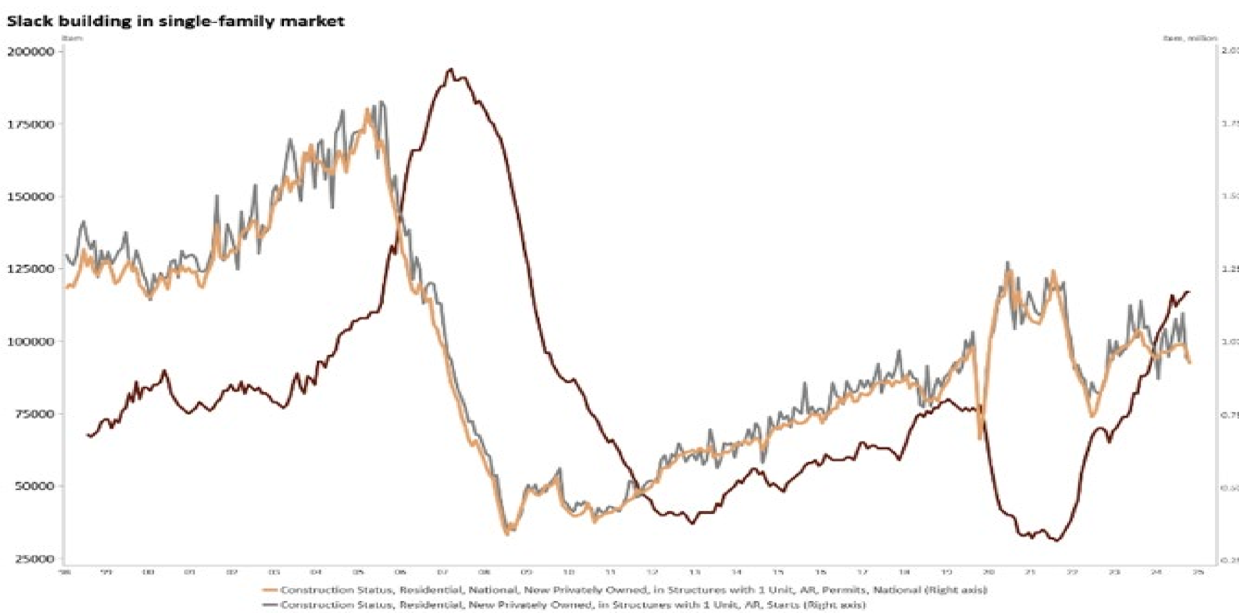
Manufacturing Index	February	March	April	May
U.S. PMI Manufacturing (ISM)	50.3	49.0	48.7	48.5
S&P Global PMI	52.3	50.2	50.2	52.8
Empire State	53.6	48.7	49.3	51.1
Philly	55.3	50.5	43.6	50.7
Richmond	54.0	50.8	48.7	50.7
Dallas	47.6	50.6	46.5	49.2
Kansas City	47.5	48.3	48.4	48.7

Non-residential construction activity has been supportive over the past couple of years. The chart on the following page shows this has been fairly widespread, however much of the construction spending has been concentrated in the manufacturing sector. If we drill down further within manufacturing, we find the surge in spending has been driven largely by construction within the computer, electronic, and electrical industries. This ramp in activity can be traced to policies like the CHIPs and Inflation Reduction Acts that were passed in 2022. As the chart shows, this spending has tapered off more recently. Related spending and investment can continue but are unlikely to provide a similar boost to economic activity going forward. There is also the risk that policy shifts under the new administration could affect funding and investment levels. The current administration has expressed they would like to see more investment and manufacturing capabilities brought back domestically, so this remains supportive, but uncertainty around specific policy and funding support may dampen near-term investment from more recent levels.

U.S. MFG CONSTRUCTION, WHICH HAD BEEN A BOOST, NOW FLATTENING



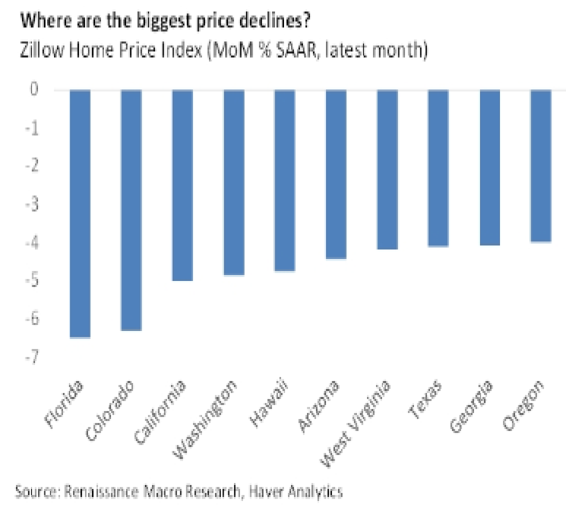
Residential construction is becoming less supportive. Building permits and new housing starts have been a little weaker recently. More concerning is the rising inventory levels of finished unsold new homes, which has increased roughly 30% over the past year. The chart below overlays the three data sets, but expectations should be as unsold new home inventories rise further, homebuilders will slow new construction starts. Existing home inventory for sale has also been rising, adding competition to the market and additional pressure on new residential construction activity.



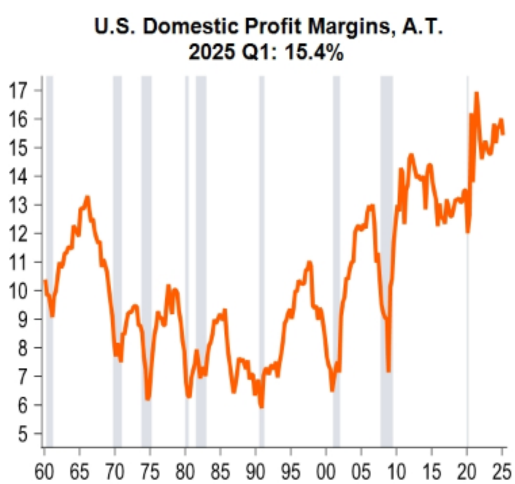
Source: Renaissance Macro Research, Macrobond

Broadly, housing prices have fallen more recently as inventories rise. There may still be a structural undersupply, but elevated price levels and high mortgage rates continue to weigh on affordability which is depressing real demand. Redfin recently reported an estimated 1.9 million home sellers in the market versus 1.5 million home buyers, the largest difference in their records back to 2013. This imbalance is driving inventories to rise and prices to fall.

Home prices are falling more significantly across several markets that have benefitted from strong job growth and population inflows. These markets have experienced the strongest new construction trends. The ten states on the right have experienced the steepest price declines and represent roughly half of the residential construction activity.

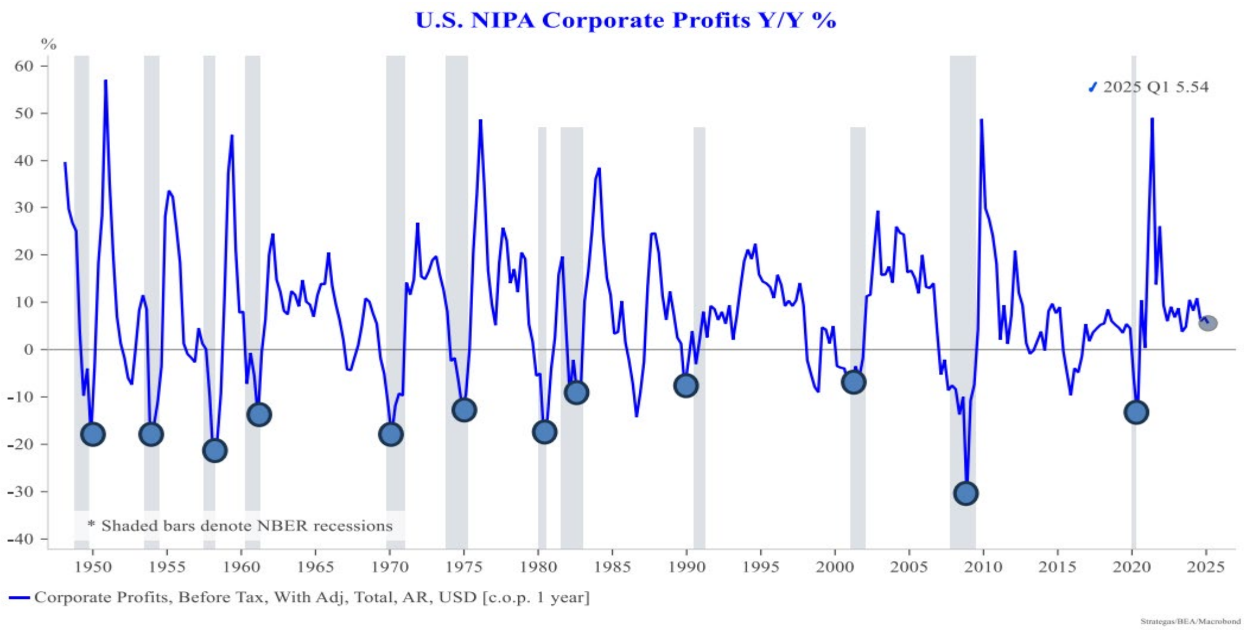


Corporate revenue growth for the first quarter came in slightly weaker but at a still healthy rate of 2.8% y/y. Slower consumer spending may keep revenue growth under pressure as spending strength fades. Corporate profits dipped slightly off of highs, but remain strong and grew 5.5% y/y. Tariff-related uncertainty and impacts will likely pressure revenues and profits over the near term as companies adjust supply chains and cost structures to adapt to policy shifts. If consumers are unwilling to pay higher prices, companies may need to absorb any associated cost increases that cannot be passed on to the consumer.

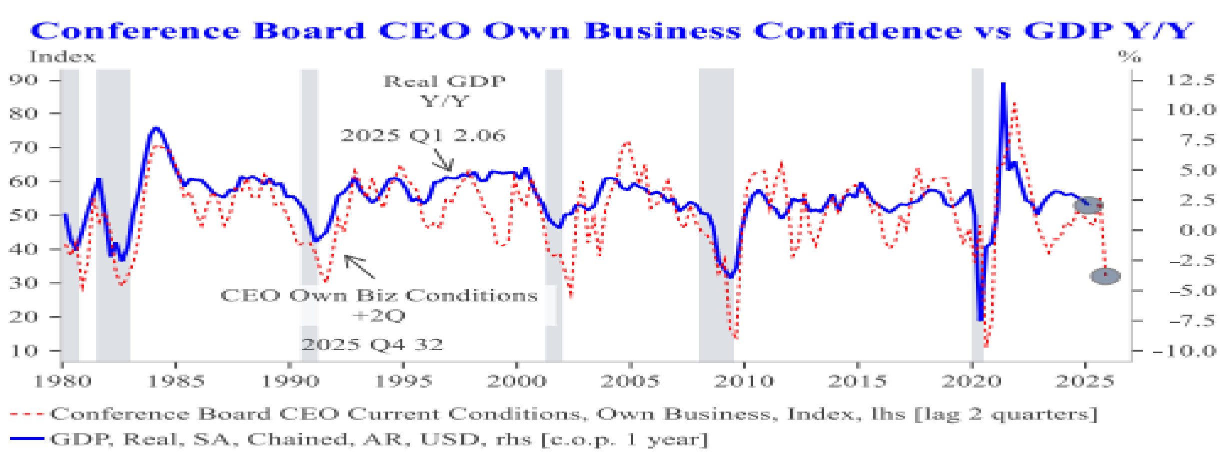


Profit margins remain at very strong levels and are up almost 2% over pre-Covid levels. Lower labor costs and interest expense have been supportive, but these tailwinds will fade. Slower revenue growth and higher input costs will likely pressure margins going forward. Deregulation and tax cuts can help offset these pressures.

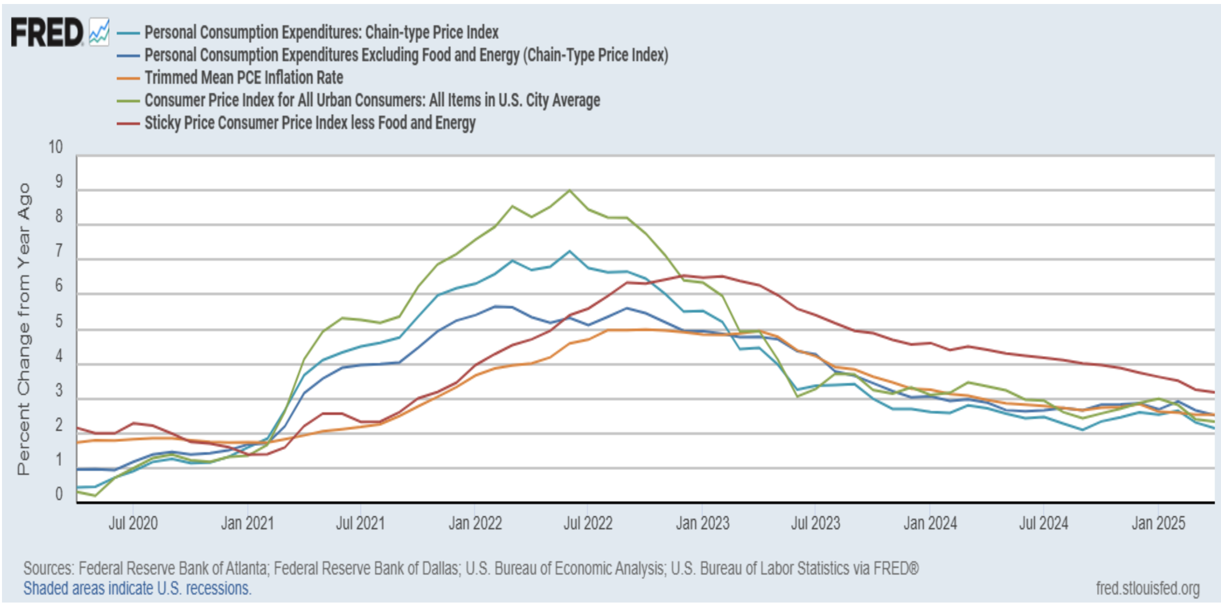
Economist Don Rissmiller with Strategas Research points out that historically recessions do not happen without profit growth going negative. Once profits begin to decline, managements start cutting spending more aggressively on things like capex, advertising, and hiring in an effort to protect profits.



Policy uncertainty continues to weigh on business confidence and is negatively affecting hiring and investment decisions. The NFIB Small Business Optimism Index increased sharply late last year but has been trending lower in 2025. Larger businesses have also shown deteriorating confidence in their own business conditions. When CEOs and business owners are uncertain about the underlying operating conditions that lay ahead of them, they generally pause any significant investment decisions. As shown in the chart below, a significant deterioration in The Conference Board survey below has historically preceded a contraction in GDP growth.



Despite the inflationary threat from tariffs, recent inflation measures have been somewhat tame. For the month of April, the Personal Consumption Expenditure (PCE) Price Index was 2.1% on a year-over-year basis, and core PCE was 2.5%. The Consumer Price Index (CPI) was 2.3% for the month and core CPI excluding food and energy was 2.8%. According to these measures, inflationary trends have continued to moderate. They are still at levels above the Federal Reserve's target but slowly moving in the right direction.



Monthly inflation data can be more volatile and while there have been threats of a broader reacceleration like we saw earlier this year, monthly trends improved for the months of March and April. Portfolio management and investment fees have been more volatile with recent swings in asset prices. Transportation services, recreational goods, and home furnishings also saw some upward pressure again for the month of April. Rent pressures have remained stubbornly elevated.

US PCE Inflation MoM%

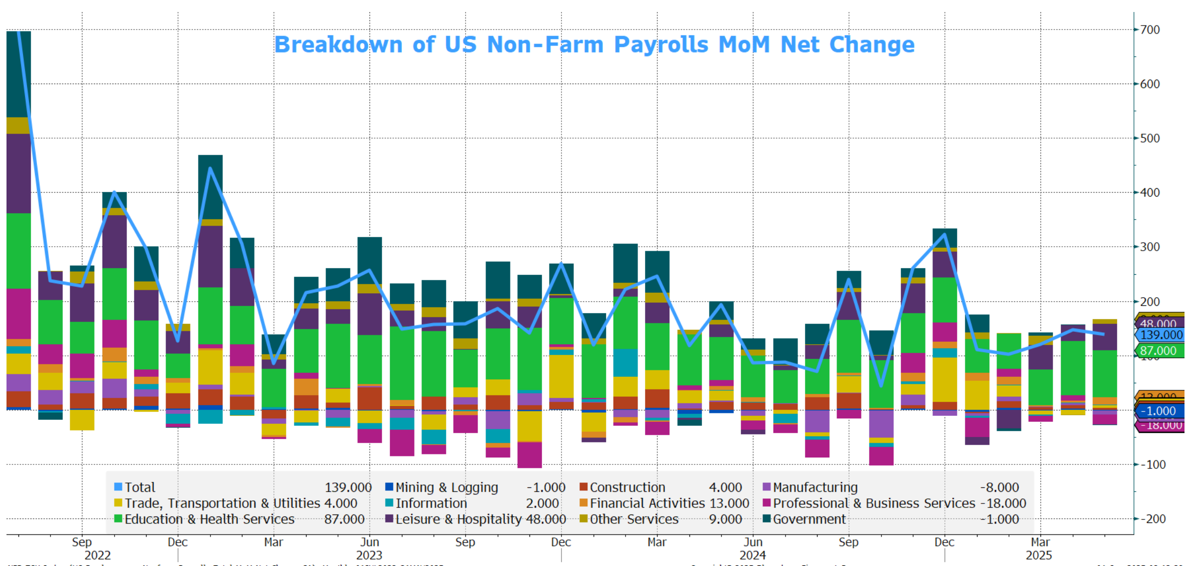
	weight	**4/30/2025**	**3/31/2025**	**2/28/2025**
Headline	*100*	0.100	0.012	0.416
Core	*88.97*	0.116	0.091	0.465
Core Goods	*21.74*	0.27	-0.27	0.41
Motor vehicles	*3.84*	0.02	-0.38	0.11
Home furnishings	*2.43*	0.44	0.00	0.30
Recreational goods	*3.28*	1.47	-0.14	0.52
Other durables	*1.42*	-0.48	0.93	1.10
Apparel	*2.59*	-0.05	0.31	0.37
Other nondurables	*8.19*	0.10	-0.73	0.43
Core Services	*67.22*	0.06	0.21	0.48
Housing	*17.99*	0.45	0.48	0.40
Health care	*16.88*	0.33	0.24	0.30
Transportation	*3.35*	0.74	-0.31	-0.56
Recreation	*3.95*	-0.73	0.36	0.99
Food svcs	*7.23*	0.35	-0.17	0.36
Financial Svc	*7.99*	-1.05	0.18	1.62
Other Svc	*8.50*	-0.07	0.48	0.60
Super-Core	*49.23*	-0.02	0.15	0.54

Source: Wolfe Research, Haver Analytics, as of Apr 30, 2025

So far, tariff impacts are not showing up in inflation data in a meaningful way. Most likely we will begin seeing some inflationary impact on these measures in the coming months. Company managements have been vocal on earnings calls that they see them coming. Small business and manufacturing surveys have both indicated they are raising prices to adjust for higher input costs.

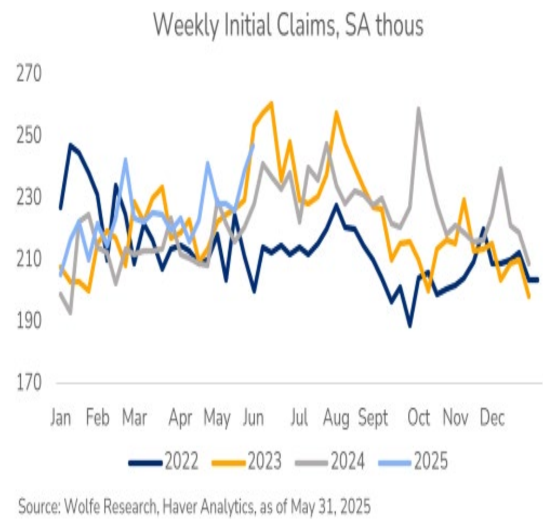
Labor conditions remain supportive with low unemployment, but payroll growth is slowing and likely to run at a weaker pace over the next several months. Job gains as measured by the ADP Employment Report have been much weaker over the past two months with May job gains at a meager 37,000 additions. The Bureau of Labor Statistics reported Nonfarm Payroll additions of 139,000 for the month of May and revised the two prior months lower by 95,000 jobs. This follows weaker job growth earlier in the year, with some rebound in March and April. The healthcare sector added 62,000 jobs in May spread across hospitals, ambulatory healthcare services, and skilled nursing care facilities. Leisure and hospitality hiring has been trending higher over the past few months and added 48,000 jobs primarily in food and beverage establishments. Social assistance employment also added 16,000 jobs. Federal government employment declined 22,000 in the month and is down 59,000 jobs so far this year. Much of this has been offset with hiring at the local government levels.

	January	February	March	April	May
Change in Nonfarm Payrolls (000s)	111	102	120	147	139
ADP Employment Change (000s)	186	84	147	60	37
Unemployment rate	4.0%	4.1%	4.2%	4.2%	4.2%

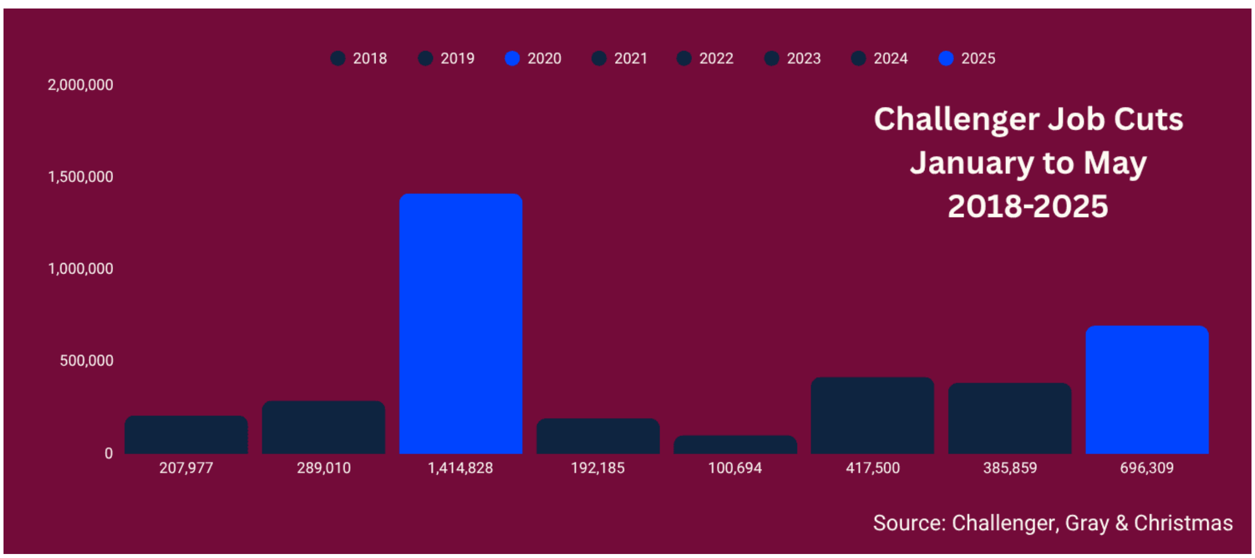


There has been some divergence in the two data sets, leaving questions around the data interpretation, but both do indicate decelerating job growth trends. Slower economic growth should translate to weaker employment gains, but labor supply is also falling with demographic trends leading a large population of older workers out of the workforce. Immigration flows have also boosted the labor supply over the past several years, and changes in policy will serve to reduce the labor force as immigration inflows slow and deportations pick up. The combination of these work against the pace of payroll growth. We would like to see the economy adding closer to 200,000 jobs per month, but the pace looks likely to trend lower over the intermediate term.

Unemployment and layoff data should be watched more closely in a slower growth environment for clearer signs of any labor market weakness. The unemployment rate has ticked up some over the past several months but continues to run at a low rate of 4.2%. Weekly jobless claims data can be volatile and affected by seasonality factors but have been modestly trending higher. We do not see it as an alarming signal at these levels, but the trend should be watched for any sharp upticks in initial claims or a persistent trend higher in continuing claims.

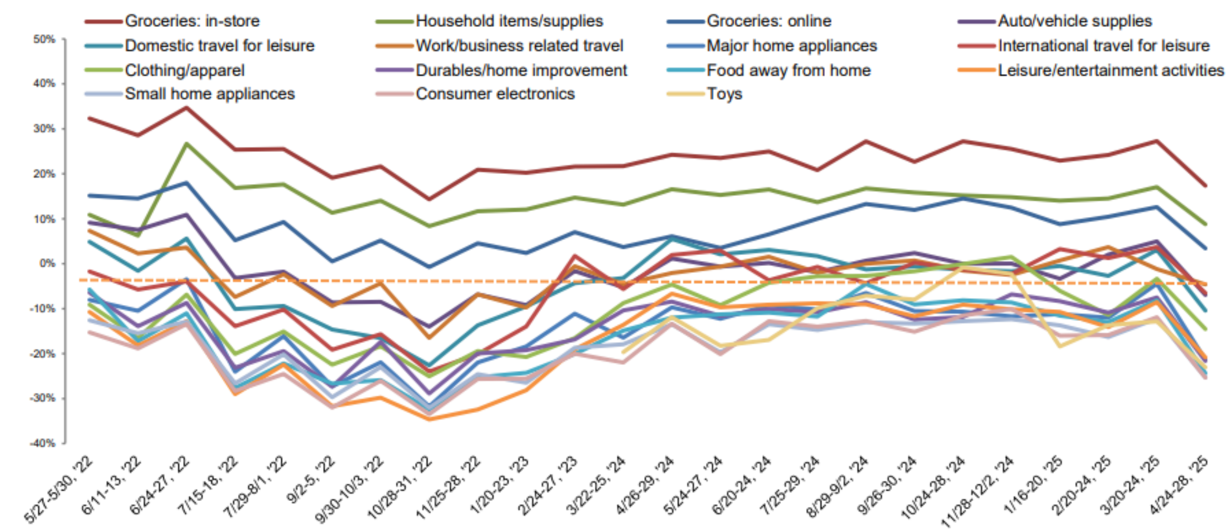


Layoffs have been running a little higher this year according to The Challenger Report. U.S. based employers have announced 696,309 job cuts through the month of May. This is up 80% over the same period of the prior year. The chart below illustrates how this pace compares to similar time periods over the past several years, with 2020 being the only recent year exceeding the current pace.



We continue to see the consumer's capacity to spend weakening over the year and expect consumption strength to wane. Labor income growth is likely to be sluggish as real wages and payroll growth slow. Real disposable income is tightening alongside this and the falling consumer confidence across income brackets likely signals this is already being felt. Morgan Stanley's most recent Consumer Pulse surveys conducted in April indicate an increasing number of consumers expect the economy and their household financial situation to deteriorate over the next six months. Across income levels, over 60% of consumers indicate inflation is their top concern. High-income consumers are worried about investment losses and low-income consumers are worried about their ability to pay rent or mortgages. These concerns alone will depress spending levels and the surveys show spending intentions across categories have declined and are now net negative across most categories with the exceptions being groceries and household supplies.

Category Spending Next 6 Months vs. Current: Net Intentions



Source: AlphaWise Consumer Pulse Survey, Morgan Stanley Research. Morgan Stanley's AlphaWise provides proprietary evidence-based investment research.

Economic activity has slowed more recently and will likely slow further over the next several months. Economic data is a little distorted with policy shifts pushing activity around, so second quarter GDP may improve off the first quarter's negative report, but there are other signs of weakening conditions. These weaker conditions are not necessarily pointing towards an economic contraction and there is a path forward that is simply slower growth. Strong consumer spending has driven growth over the past several years and will be less supportive. Stronger business investment is needed to offset this. The policy uncertainty is affecting spending and delaying investment decisions that is adding risk to the equation. Ultimately, increasing tariffs will cause near term volatility in prices that can impact growth as businesses struggle to adjust. Higher prices will either impact profits or consumers, probably both, but they must be absorbed somewhere. Longer term it may encourage domestic onshoring that is stimulative, but near term it can dampen growth and fuel inflationary pressures. We recognize there are increasing headwinds to the current economic expansion but see conditions remaining supportive despite elevated risks.

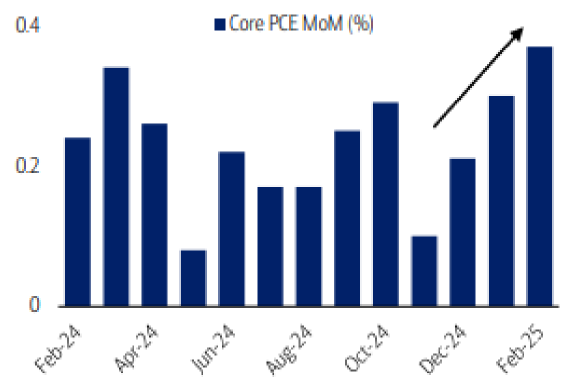
RSA PORTFOLIO STRATEGY

Fixed Income Strategy

By Lance Lachney

At the time of our last meeting, interest rates had fallen drastically since their most recent peak in mid-January. Corporate credit spreads remained reasonably tight at approximately 80 bps despite the recent growth scare and waning consumer confidence. In early March, investment grade spreads began to leak wider as the uncertainty surrounding tariff policies weighed on risk appetite. Despite the European Central Bank lowering the deposit rate to 2.50%, bond yields in the region increased on the prospect of future defense and infrastructure spending. Corporate credit continued to underperform as small business optimism slipped, and growth forecasts were slashed from various retailers and airlines. The Federal Open Market Committee reduced its growth expectations and increased its inflation projections for the year at its regularly scheduled meeting. Treasury yields fell across the curve with Chairman Powell acknowledging that "uncertainty has increased" regarding the economic landscape. Core PCE, the Fed's preferred measure of inflation, climbed for the fourth consecutive month while real consumer spending fell short of expectations. Fixed income returns were minuscule at month-end as higher inflation readings kept yield levels from falling as much as expected given the pullback in the equity market.

Exhibit 2: Inflation accelerated further in February
February Core PCE inflation reached +0.37% in February.



Source: Bloomberg

BofA GLOBAL RESEARCH

In early April, President Trump introduced his tariff plan to the world, imposing a 10% tax on imports across the board, as well as additional country-specific measures and an outright assault on Chinese goods. "Liberation Day" certainly allowed global assets to move freely, as interest rates initially dropped 25bps across the curve and the S&P 500 shed over 10% within a matter of days. Rate expectations soared, with the market pricing in four rate cuts for the year with the first move coming in June. Investment grade and high yield spreads widened materially, rising 20bps and 100bps respectively by the end of the week.

	Apr 4 2025	Change (bp) Week	MTD	YTD
High Grade	114	20	17	32
Financials	114	22	19	31
Industrials	113	20	17	32
Utilities	122	17	14	34

Source: CreditSights, BofA/ML Indices (C0A0)

	Apr 4 2025	Change (bp) Week	MTD	YTD
High Yield	445	98	90	153

Source: CreditSights, BofA/ML Indices (H0A0)

China's retaliation on US goods sent short-term inflation expectations to their highest level since 1981. Treasury yields surged across the curve with intermediate and long-end securities bearing the brunt of the punishment. The curve steepened in the process as long-term yields experienced the largest increase in five years. Within a week, the administration announced a 90-day pause on country-specific reciprocal tariffs, excluding China. Markets rebounded and were able to retrace a good portion of the damage initiated by the "Liberation Day" debacle. Interest rates fell approximately 20bps within the belly of the curve in the following week and corporate credit spreads were able to gain some traction as well. The ECB cut its reference rate once again to 2.25%, as the "outlook for growth has deteriorated" due to trade tensions. With the China rhetoric more subdued, risk assets finished the month on a high note as yield levels continued to drift lower.

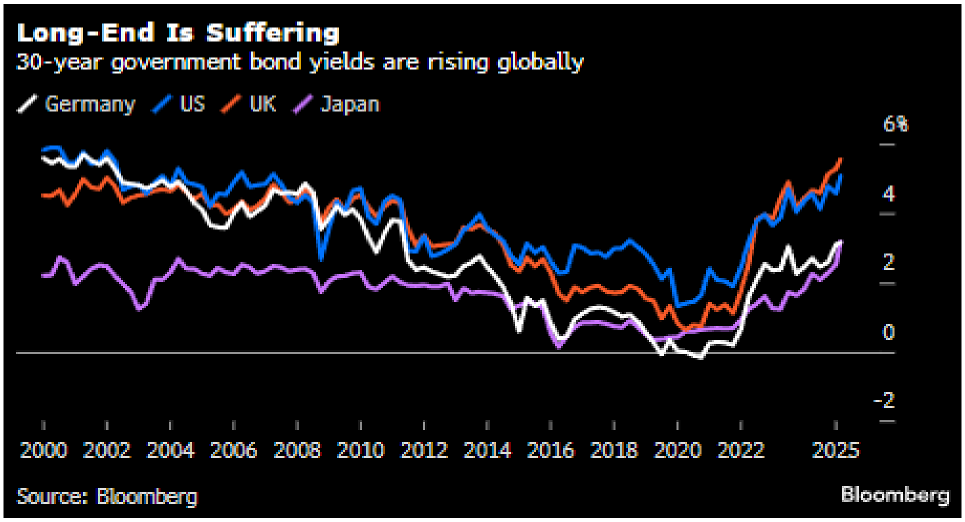
US Treasury Curve Yields

Maturity	Current Yields	Weekly Change (bp)	MTD Change (bp)	2025 Change (bp)
3 months	4.31	7	2	0
6 months	4.18	10	-4	-8
1 year	4.02	19	0	-13
2 years	3.96	31	8	-28
3 years	4.01	37	13	-27
5 years	4.16	45	21	-22
7 years	4.33	50	26	-15
10 years	4.49	50	28	-8
20 years	4.93	50	34	8
30 years	4.87	46	30	9
2s-10s (bp)	53	19	21	20
2s-30s (bp)	91	15	22	37

Source: CreditSights, Bloomberg, Data as of 04/11/2025.

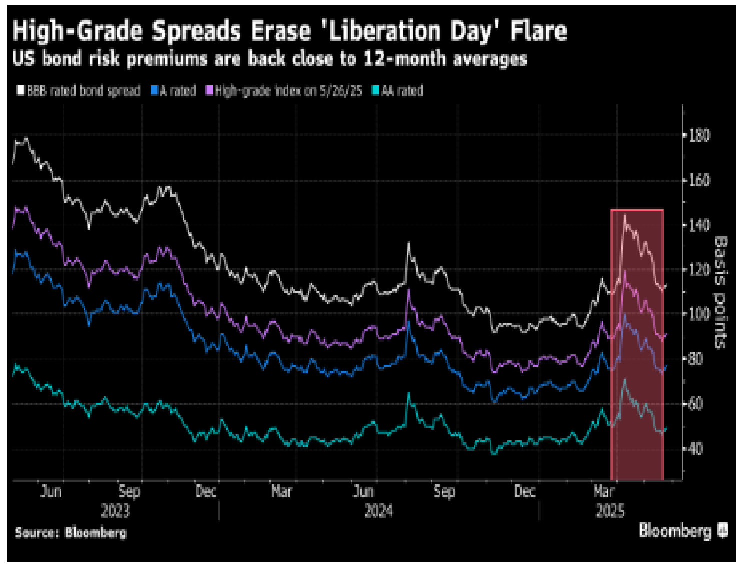
The month of May got off to a slow start as consumer confidence continued to plummet and the economy contracted in the first quarter. However, a sizable portion of this was due to a surge in imports to front-run impending tariffs. Treasury yields methodically pushed higher in the first half of the month as the temperature cooled between the world's two superpowers. The risk-on trade was further enhanced as the US and China agreed to a 90-day truce as talks continued. The reduction in uncertainty helped push credit spreads tighter and equity markets higher. Treasury yields moved higher as Moody's downgraded the country's Aaa rating citing supply and fiscal deficit risks. The end of the month witnessed long-end treasury yields drift upward on deficit concerns and comments from Fed officials on the need to see more progress on the inflation front.

There has been quite a bit of discussion regarding the status of the $29 trillion US Treasury market. It is the benchmark of the global financial system that is used to determine the pricing of assets, and as collateral for funding on trillions of dollars daily. During the upheaval in early April, government yields surged instead of becoming the safe haven we are accustomed to in times of market stress. Several justifications have been offered up as the reasoning for the move - anticipated inflation from future tariffs, policy uncertainty, foreign selling, the unwinding of popular hedge fund trades, fiscal deficits, or simply a move to cash, which currently yields a suitable return. Gold, another asset sought in uncertain times, hit record highs in April and is still hovering in that vicinity. However, the US Treasury market provides the depth and liquidity that no other financial asset can accommodate.



The long end of the maturity spectrum has been summarily punished as of late, not only domestically but around the globe. Long-term borrowing costs have surged in the world's most developed economies as anxiety sets in over fiscal deficits and debt levels. This is important because it translates into more expensive loans for businesses and households, putting their ability to borrow and spend at risk. Each country has its own unique issues that are driving longer-term yields higher. The amount of outstanding treasury debt has been steadily growing since the financial crisis and has gone parabolic over the last few years. The Germans are poised to spend billions on defense and infrastructure in the coming years. A rebound in domestic inflation has begun to spook investors and the Bank of England. The Bank of Japan is attempting to limit its purchases within the JGB market and hopes life insurers and pension funds can fill the gap. In some respect, its simply an issue of supply and demand. Global central banks, who have been purchasing government debt with no regard to price for quite some time, are stepping away at a time when debt burdens are rising. This supply needs to be taken down; however, prudent investors are demanding additional compensation for doing so.

Trading within the portfolio has been relatively stable over the past few months. Most of the fund's purchases have been within the treasury sector. The fund has mainly focused on the belly of the curve, locking in yields of 4.15-4.50%. The purchase of mortgage-backed securities has been executed at attractive levels, adding high-quality assets to the portfolio during this time of market uncertainty. The fund has replaced a few corporate maturities with single A / high BBB names in the 5-10yr sector, receiving yields of 5.25-5.75%. Going forward, the fund is comfortable with its current positioning. Despite a lower allocation at the margin, the RSA's overweight tilt towards corporate credit remains. Corporate debt yields are still attractive and rightfully so, as management teams have been prudent and default risk is relatively stable. However, we must be cognizant of current spreads and their historically low percentage relative to overall corporate yield levels. The labor market appears to be slowing at the margin and that is what will ultimately shift policymakers away from their "wait and see" approach. We still believe that treasury securities will provide safety in an economic and equity downturn. Is there a floor to the term premium, the additional compensation of owning long-term debt in lieu of rolling short-term bonds? Most likely, considering the concerns about fiscal health and supply. While long duration treasury bonds may not perform quite as well as they have in the recent past, it should still provide ample insurance in a risk-off environment. Despite the common reference and declared by us as well, it's never been "risk-free".



Domestic Equity Strategy

By Kevin Gamble

If someone were to have disappeared to a remote island at the beginning of our fiscal year with little to no communication with the outside world only to return at the time of this update (2/3 of our fiscal year complete), he or she might conclude that little has transpired over the previous 8 months given SPX levels are just moderately ahead of where we began the fiscal year. Of course, we all know this would be wrong!

We have now survived the first 100 days of a disruptive-by-design Trump presidency, a sharp tariff tantrum in the U.S. equity markets following the infamous “liberation day” announcement from the White House, a Moody’s U.S. debt downgrade, as well as the subsequent recovery back to levels roughly consistent with where we began following the 90-day reciprocal tariff pause. So, where in the heck do we go from here? Should we join the PANICANs or stay the course?

The Trump presidency has some very noble goals which most Americans would agree with including peace through strength, focusing on the health of the middle class and not just the investing class, reviving America’s critical manufacturing base, and running an efficient federal government. While the goals are noble, accomplishing them all at the same time given some of the large imbalances that currently exist is likely to prove quite difficult.

In an attempt at simplicity, Scott Bessent (our current Treasury Secretary) has outlined a simple 3-3-3 plan to highlight three key goals of the Trump administration, ideally to be achieved by the end of his scheduled four-year term. The three goals include: 1) reducing the federal budget deficit to 3% of GDP by the end of the term from the current roughly 7% level, 2) achieving 3% sustained annual real GDP growth versus the current CBO forecast of roughly 1.9% moving forward, and 3) increasing U.S. oil production by 3 million barrels per day. Bessent sees these three objectives as being consistent with the broader goal of stabilizing our debt/GDP ratio and bringing down inflationary pressures without causing a significant recession.

Exhibit 1: S&P 500 Performance Fiscal Year-to-Date

Source: Bloomberg

Exhibit 2: VIX Index (Volatility) Fiscal Year-to-Date

Source: Bloomberg

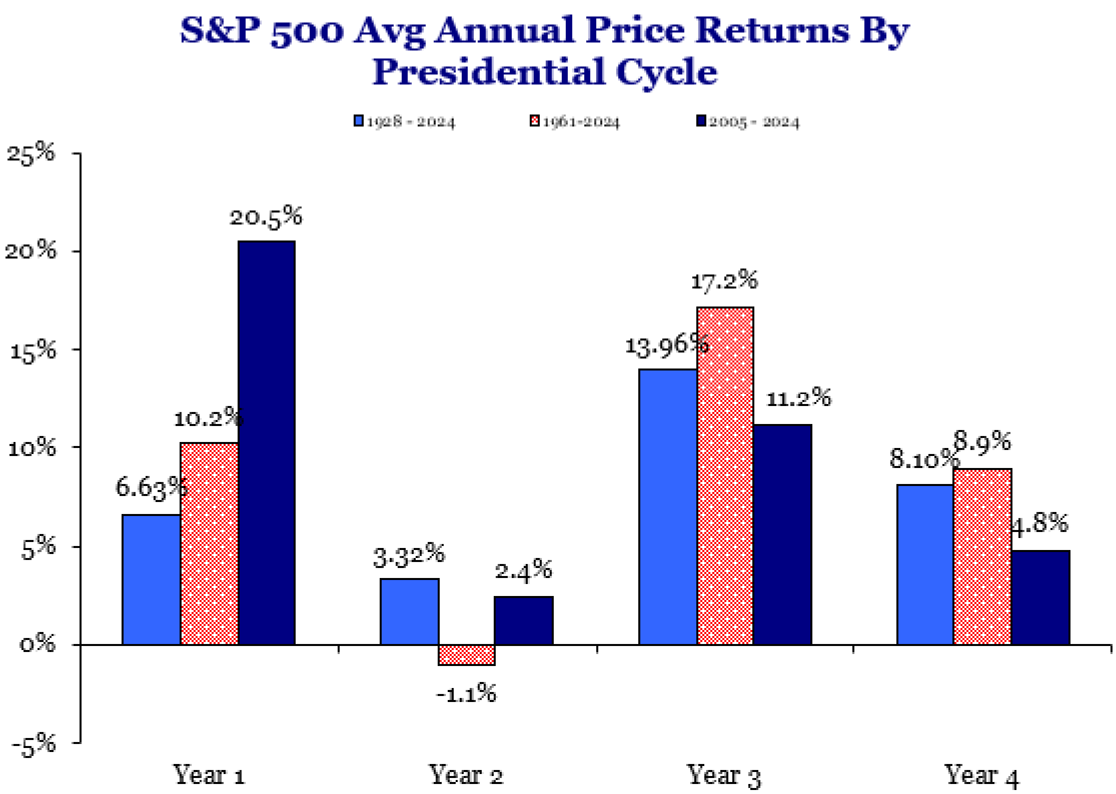
Given the many lingering unanswered questions (Marc's recent RSA *Advisor* article has aged quite well) and the fact that none of us know the future, what we would like to do today is lay out 10 important questions/observations about the current investing backdrop that we think all vested parties should consider.

10 Important Questions/Observations

1) **The first half of the Presidential cycle has historically been the most challenging for U.S. equity markets, but Year 1 has shown significant improvement in recent history.**

Since 1928, the S&P 500 has averaged 6.6% in post-election years compared to 14% in pre-election of Year 3 years and 8.1% in election or Year 4 years. Year 2 of the presidential cycle has continued to be by far the biggest outlier to the downside as it has shown the weakest historical performance across all time periods. In review, President Trump's first term saw 22% gains in the S&P 500 during his first year in office, a slight negative return of down 4% in Year 2, a strong 32% in Year 3, and a solid 18% in Year 4.

Exhibit 3: Historical U.S. Presidential Cycle Returns



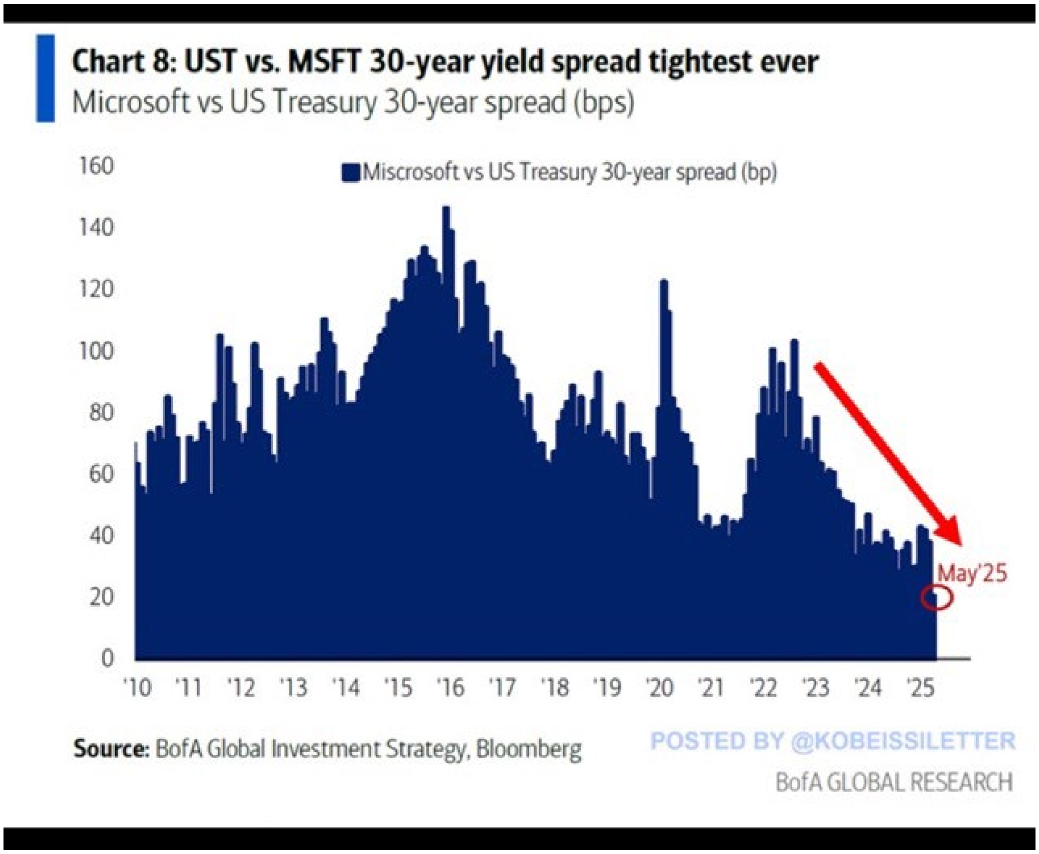
Source: Strategas

2) Is the recent Moody's downgrade of U.S. debt a big deal?

On May 16, after the market close, Moody's downgraded the US credit rating from Aaa to Aa1. If you listen to Treasury Secretary Bessent, he is clearly not expressing public concerns about the debt downgrade and sees it as a "lagging" indicator, but it clearly does not help! The most recent downgrade highlights the fiscal deficit train that seemingly has no end in sight and does not make it any easier for Secretary Bessent to find buyers for all the needed government debt issuance moving forward. It should be noted that Moody's was the last of the three major credit rating agencies to downgrade the U.S. debt following S&P in 2011 and Fitch in 2023. Will resuming QE from the Fed be necessary in the back half of 2025 to finance the expected deficit spending, or will needed treasury debt issuances be forced to compete with other investment options for funds? Will the supplementary leverage ratio "SLR" be changed for banks to allow more treasury purchases? These are big questions worth monitoring closely as we approach the summer months.

Microsoft and Johnson & Johnson now have a higher credit rating than the U.S. government!

Exhibit 4: Yield Spread of Microsoft Versus U.S. Treasury Bonds

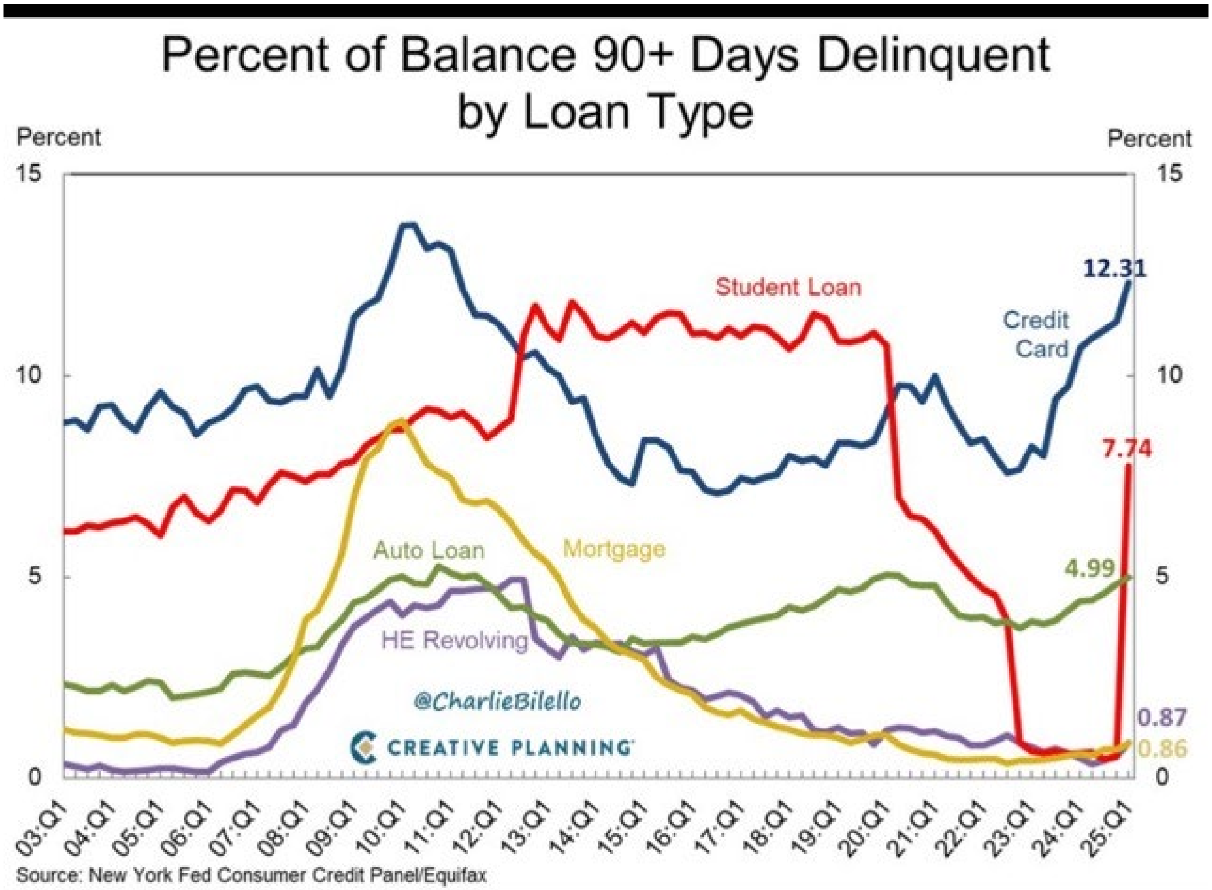


Source: BofA Global Research, Bloomberg, Kobeissi Letter

3) There are undoubtedly rising signs of consumer stress.

Despite the relatively low unemployment rate, there are rising signs of consumer stress as credit card delinquencies have now risen to over 12% of accounts being overdue. In addition, more and more borrowers are simply making the minimum payment on credit cards which is a worrying sign given the high level of current interest rates being charged. Additionally, the use of BNPL or "buy now, pay later" options has also continued to rise for a variety of different purchases with elevated delinquency levels. The rising use of BNPL loans for daily necessities such as groceries is especially concerning. It should also be noted that student loans have once again entered repayment, which is leading to both rising delinquencies and lower consumer credit scores.

Exhibit 5: Rising Loan Delinquencies by Loan Type

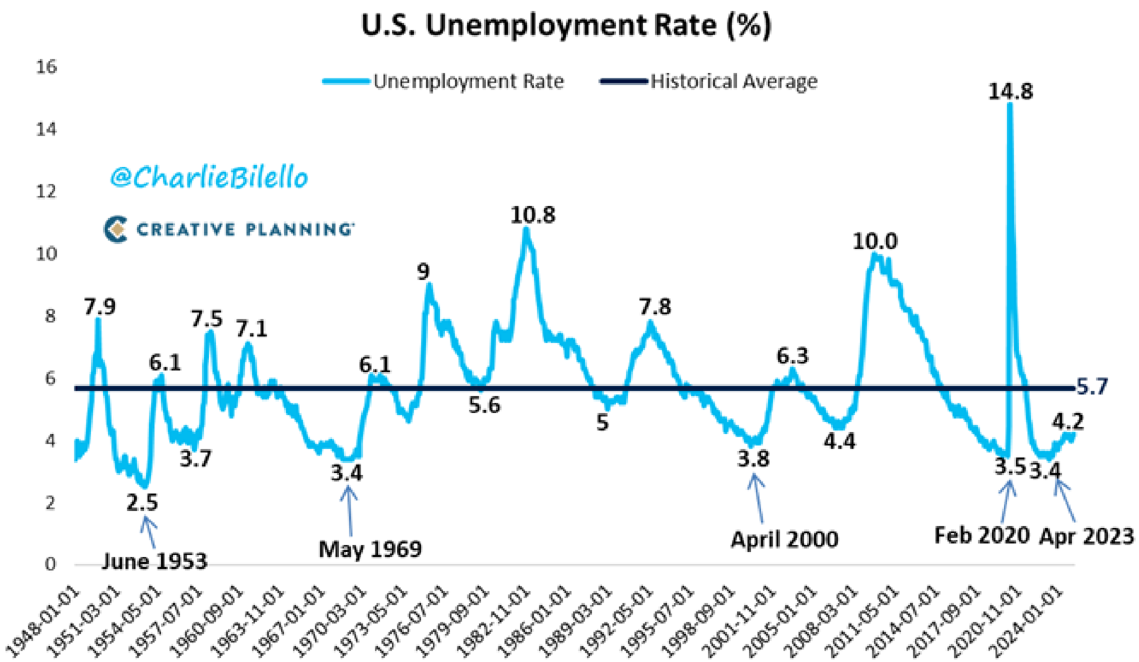


Source: Creative Planning, New York Fed Consumer Credit Panel/Equifax

4) The labor market (unemployment rate) holds the key

When assessing the various economic scenarios and risks moving forward, the health of the labor market really jumps out as a key level to monitor moving forward. As we have written about in past updates, we are approaching a point in the cycle at which labor markets have historically weakened quite a bit. Of course, every period is slightly different, and this period is no exception with retiring baby boomers and immigration issues with which we must contend on the labor front. The Fed would welcome a labor market which stays steady as price levels moderate to their 2% inflation target (goldilocks). A significant weakening in the U.S. labor market would make for a challenging backdrop for the Federal Reserve introducing both deflationary risks as well as stagflationary risks from the likely aggressive policy response.

Exhibit 6: U.S. Unemployment Rate



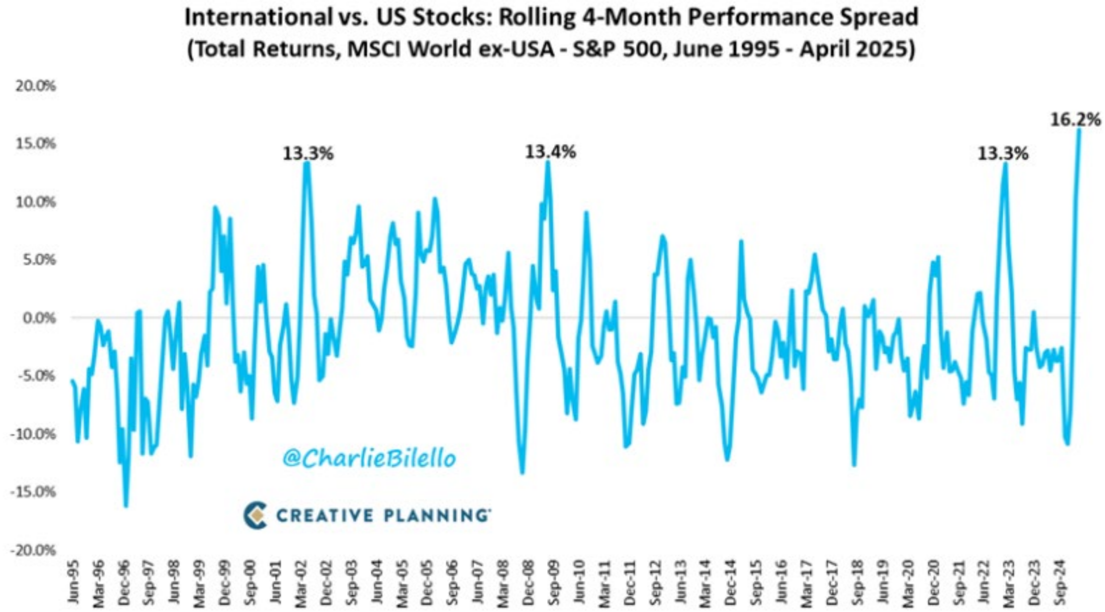
Source: Creative Planning

5) Has strong U.S. equity relative outperformance versus the "rest of the world" peaked?

The U.S. equity market has shown strong outperformance versus the rest of the world for many years prior to this fiscal year (U.S. equities have outperformed international markets for over 15 years). This is in large part due to global capital flow dynamics and associated foreign direct investment into the United States as other nations provide a form of "vendor financing" by proving support to our capital markets. With rising protectionism, increasing domestic tariff levels, and potential threats to the U.S. dollar as the world's only reserve currency, it is a legitimate question as to whether significant U.S. equity outperformance has run its course and set to reverse?

2025 has certainly shown strong signs of a reversal with international stocks showing significant outperformance versus our domestic equity markets. In addition, the U.S. dollar has weakened significantly versus other currencies this year with the DXY down close to 10% on the year further supporting international equity market returns for U.S. investors.

Exhibit 7: International vs. U.S. Stocks: Rolling 4-Month Performance Spread



Source: Creative Planning

6) AI and artificial general intelligence or "AGI" are undoubtedly going to change the world.

It is impossible to know all the implications of the rising age of AI, but it is safe to say we are just beginning to scratch the surface of its potential and promise. Like anything, there will be a lot of good as well as some bad associated with the advancements as artificial general intelligence becomes pervasive throughout society.

On the positive side, there should be plenty of productivity gains in the future as well as advancements in healthcare made possible by artificial intelligence.

There will certainly be job market implications of AI impacting certain sectors and white-collar jobs more than others. Skilled blue-collar workers are likely to be a little more insulated from the effects of AI. Some studies indicate that 20-30% of current jobs could be automated by 2030!

Dario Amodei, CEO of Anthropic and former vice president of research at OpenAI, recently warned that AI could wipe out half of all the entry-level white-collar jobs and spike unemployment to 10-20% within the next five years. Elon Musk has also famously warned that AI has the potential to lead to "civilization destruction."

7) Where does the "one, big, beautiful bill" stand?

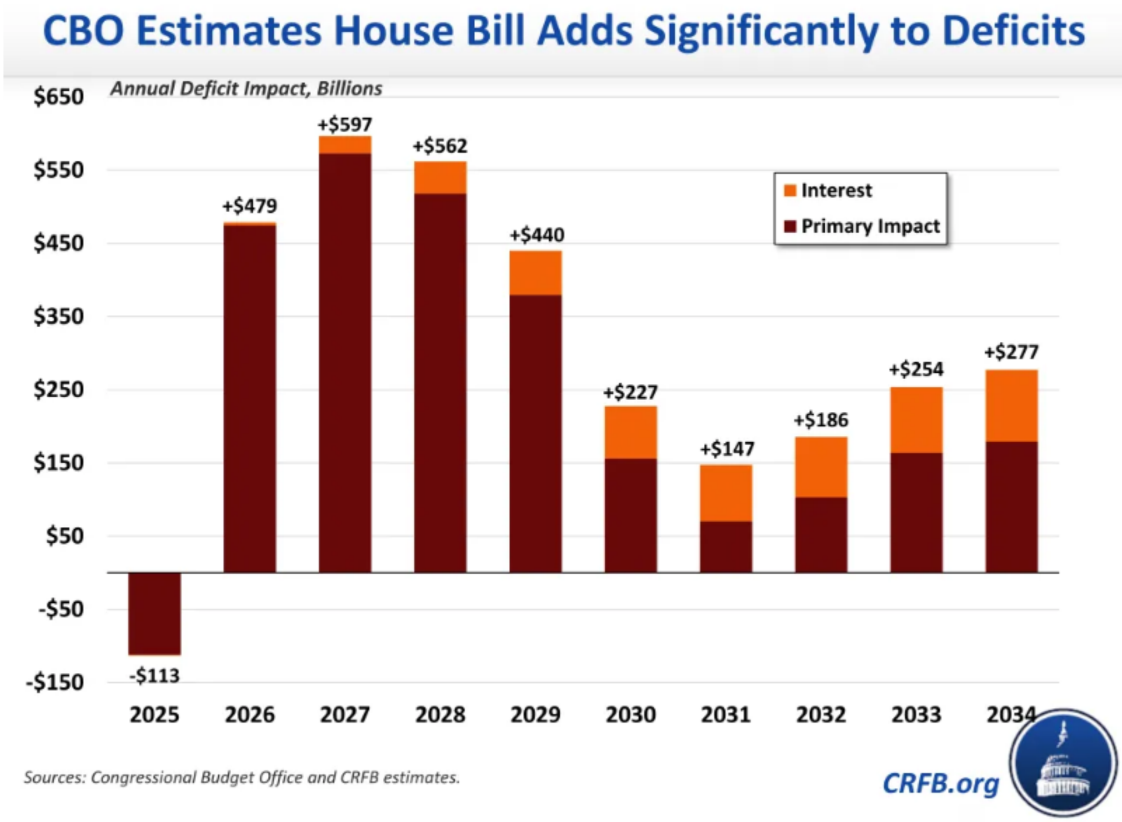
The reconciliation bill has been passed through the House of Representatives by a narrow vote of 215-214 on May 22nd and is now on to the U.S. Senate with a targeted date of passage prior to the July 4th holiday. The timing of the bill is complicated by the rising bond yields in the marketplace as bond vigilantes push back on the large amount of planned deficit spending. The "beautiful" bill also faces some Republican resistance in the Senate from the likes of Ron Johnson, Rand Paul, Rick Scott, and others. In addition, the bill in its current form is being challenged by Elon Musk as not being consistent with both DOGE initiatives as well as Scott Bessent's stated goal of bringing down the Federal budget deficit to 3% of GDP by 2028. He recently tweeted that the current bill is "massive, outrageous, pork-filled and a disgusting abomination."

The bill as written would extend the 2017 TCJA; eliminate taxes on tips, overtime, and interest on U.S. assembled cars only through Trump's term; increase the child tax credit but only through Trump's term; increase the estate tax exemption with an index for inflation; raise the SALT deduction to $40k for incomes up to $500k; and provide various business tax incentives including full expensing provisions. The bill would also importantly raise the debt ceiling by $4 trillion dollars to allow for needed debt issuance to fund these projected deficits well into the future.

On the spending cut side, the current bill significantly cuts Medicaid spending by including work requirements to become effective at the end of next year, cuts to the SNAP program, and a repeal of Biden era green energy initiatives and credits.

The CBO has estimated the bill in its current form would increase the deficit by $3.3 trillion over 10 years including additional interest costs. If passed in its current form, the bill almost certainly continues to exacerbate the K-shaped nature of the recovery in the United States.

Exhibit 8: CBO Estimates of the U.S. House Passed Reconciliation Bill



Source: Congressional Budget Office

8) In a world of U.S. fiscal dominance, is everything backwards with regards to Federal Reserve interest rate policy?

If higher interest rates lead to higher federal deficits and thus more income being pumped into the economy than bank lending is being reduced, are higher interest rates stimulative rather than restrictive? The answer could very well be yes given the current backdrop of fiscal dominance. A good example is found here in Alabama in which our general fund budget has really benefitted from higher interest rates. If this has been the case with higher rates, could the Fed lowering interest rates in the future ironically be a restrictive policy? This could certainly be true before the increased bank lending from lower rates offsets the associated reduction in income, thus making for a tricky situation to navigate moving forward for monetary authorities.

9) China and Russia leaders are getting closer and closer, and the BRICs is rapidly growing in influence

Ever since Vladimir Putin was seen in attendance at the Winter Olympics in Beijing in 2022, the relationship between Putin and Xi Jinping seems to be getting closer and closer.

It should be noted that Putin invaded the Ukraine just four days after the closing ceremonies in China! Fast forward three plus years and President Xi just attended the Victory Day celebrations in Moscow early last month, marking the 80th anniversary of the Soviet Union's victory over Nazi Germany in World War II. This ceremony featured a grand military parade on Moscow's Red Square in which President Xi was a prominent guest of honor, standing side by side with Putin during the event.

The next BRICs summit is scheduled for next month in Rio de Janeiro, Brazil. Will be interesting to see if Putin attends in person given the arrest warrant issued against him by the International Criminal Court for alleged war crimes in Ukraine. The BRICs bloc now currently consists of 10 full member nations including Russia and China as well as Brazil, India, South Africa, Egypt, Ethiopia, Iran, the United Arab Emirates, and Indonesia.

Importantly, the agenda in Brazil includes both advancing governance and reform of financial markets as well as encouraging the use of local currencies and payment platforms to diversify trade and investment flows.

10) Warren Buffett is stepping down from the CEO role at Berkshire Hathaway at the age of 95!

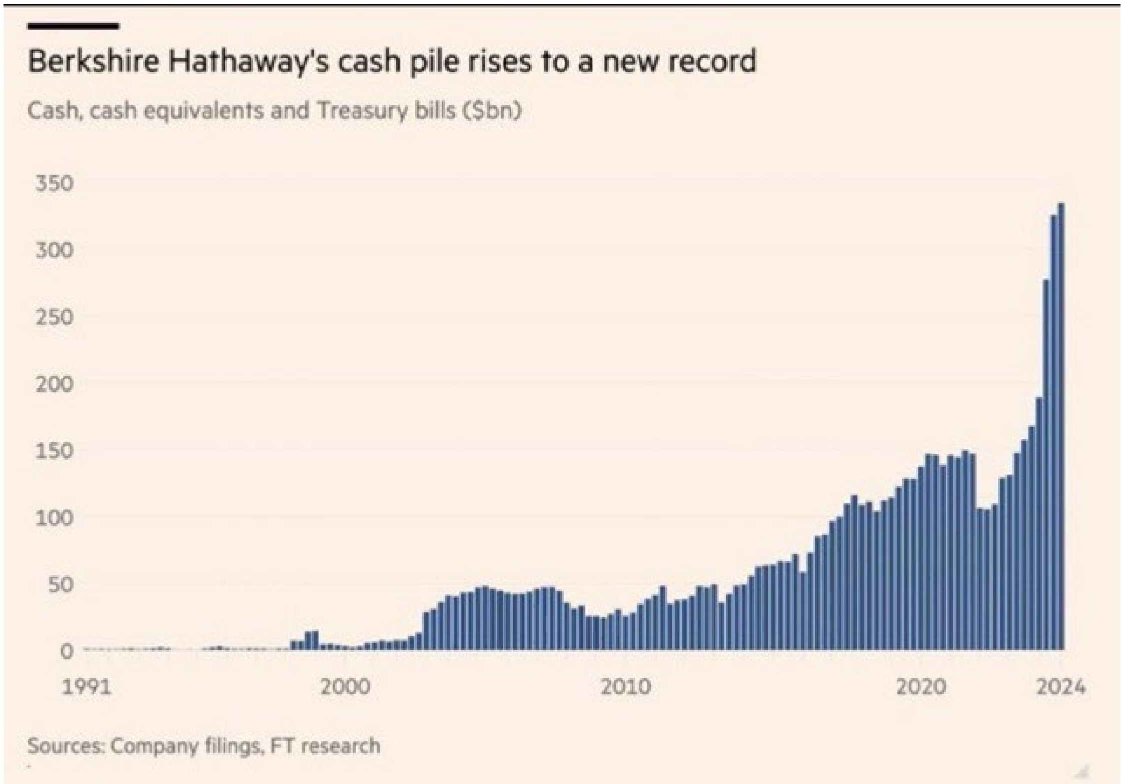
Warren Buffett stepping aside as CEO of Berkshire at the end of the year is certainly a notable event since we last gathered. Interestingly, he is doing so with Berkshire now owning a significant percentage of the U.S. treasury bill market (5.1% at the end of March). In addition, Berkshire revealed in its latest 13F filing they are building a significant stake (spent over $1.6 billion to date) in a company to be named later. This secrecy is allowed and helps Berkshire build a relevant position without undue market volatility in the accumulation phase. While he clearly sees individual stock opportunities, the often-used Buffett indicator which looks at market capitalization relative to GDP remains at elevated levels in the U.S. indicating a fully valued domestic equity market relative to the underlying output of the country.

As Mr. Buffett steps down, perhaps he had the only real solution to our current budget deficit situation when he proposed a law in a 2011 CNBC interview that would make all sitting members of Congress ineligible for re-election if the federal deficit exceeded 3% of GDP!

Exhibit 9: Buffet Indictor

Source: Current Market Valuation

Exhibit 10: Berkshire Hathaway's Record Cash Pile



Source: Company filing, FT research

10 Honorable Mention Questions/Observations:

1) Housing is broken and weakening at the margin – regional differences exist
2) Trump 2.0 is focused on his legacy – (Gulf of America, Canada 51st state, Greenland, Panama Canal, Trump savings accounts for babies, Trump coin, Boeing 747 gift for the Trump Presidential library)….Is there a spot for him on Mount Rushmore?
3) How is Trump reshaping the Middle East?
4) Global capital flows are the name of the game in a debt fueled world – US currently has a negative $26 trillion net international investment position!
5) We need more babies and less OnlyFans!
6) What do the reversals in immigration levels mean for U.S. growth and inflation?
7) Bitcoin at fresh new highs
8) What are the implications of rising bond yields and steepening yield curves in the developed world? Is there multiple risk for the S&P 500?
9) What is Triffin's Dilemma and how does this paradox relate to the U.S. dollar's world reserve currency status?
10) What happens if/when the rise in passive equity investing reverses course?

Equity Strategy Moving Forward

We expect this fiscal year's increased equity volatility to continue to be a persistent factor moving forward. There are multiple reasons for this including geopolitics, trade wars, and the power a single tweet can have over the market.

We continue to see a fairly to fully valued U.S. equity market at the current time which is consistent with most Wall Street strategists' year-end targets and the expectation for roughly $304 per share in year forward earnings for the S&P 500 or 20x expected earnings for the upcoming year. The 5% earnings yield on the S&P 500 based on one-year forward earnings is right in line with the yield on the 30-year U.S. treasury note. Thus, there is virtually no equity risk premium priced into the SPX at current levels.

Within our active funds, we continue to focus on improving our micro equity selection which includes owning quality companies with strong balance sheets, resilient business models, dividend yields, and positive cash flows. We want to continue to actively avoid "zombie" companies which need access to the capital markets to stay afloat given their lack of cash flow.

We see value-oriented equities as relatively attractive versus the longer-duration growth equity assets. Growth equity assets had a strong 15-year relative performance run which arguably peaked with massive QE and negative real interest rates present during the pandemic. While it has certainly not been a straight line given the violent "arm wrestling" match between value and growth for the last few years, we see a reasonably high probability value relative leadership emerges on the other side and takes the performance baton from growth.

We have taken note that the strong momentum off the April low has triggered a Zweig Breadth Thrust indicating rapid and significant changes in momentum for the better. This breadth thrust occurs when the 10-day moving average of the percentage of stocks that were positive daily rises from below 40% to above 61.5% within 10 days. The signal has a strong track record of capturing lows and indicating positive forward returns when looking out over the coming year. While we are encouraged by the strength and breadth of the market rally off the April lows of 4835 in the SPX, we do feel it prudent to collar a portion of our equity portfolio to hedge some downside risk following the strong recovery.

Our active funds continue to underweight the very top of the S&P 500 given the top-heavy nature of the index. While this stance can hurt active returns in very top-heavy years, it makes great sense from a diversification standpoint across our total domestic equity portfolio given our significant long exposure to these heavyweight names through our large, market capitalization weighted S&P 500 index holdings. The top 10 companies now represent a record 37% of the S&P 500 which is a significant level of market concentration in just a relatively small handful of companies. Furthermore, with Nvidia officially joining the $3 trillion market capitalization club and now becoming the largest market cap company recently passing both Microsoft and Apple, just three companies represent 20% of the entire index! The chart below shows that the 10 largest companies are currently outkicking their earnings contribution to the underlying S&P 500 index, and we expect this will converge over time as it always has in the past.

Exhibit 11: Market Cap Versus Earnings Contribution of the 10 Largest Companies in the S&P 500 Index

Source: Goldman Sachs

Of Trade and Capital: A Tale of Two Strategies

Beyond tariffs, capital flow tools are critical to reshaping America's Economy

By Michael McNair

It was the best of times for Wall Street; it was the worst of times for working-class Americans. For decades, Americans watched with growing concern as real wages stagnated, jobs disappeared overseas, and once-thriving industrial towns slipped into decline. Economists assured us this was simply the price of progress - America had moved up the value chain, beyond manufacturing, into a service-driven economy. Meanwhile, our trade deficits widened, our industrial base hollowed out, and government debt soared - trends that have persisted despite varied policy efforts across multiple administrations.

But what if we've been going about fixing what ails our economy all wrong? What if these seemingly separate economic challenges actually share a common cause - one that tariffs alone cannot address?

The Trump administration appears to recognize that trade challenges require a more complex approach. A dual strategy is emerging: tariffs to urgently decouple critical supply chains from adversaries, complemented by capital flow tools, such as a capital flow tax and foreign currency reserve accumulation, that target the source of persistent trade imbalances.

While tariffs are grabbing headlines, capital flow measures may ultimately prove even more transformative in rebuilding American manufacturing strength and rebalancing the U.S. economy.

The Balance of Payments Framework

Most discussions of international trade focus only on the exchange of goods and services. However, this view captures only half the picture. When money crosses borders, it does so in one of two ways: either buying things (trade flows) or buying financial assets (capital flows). These two flows are inextricably linked through what economists call the balance of payments, which can be expressed in a simple but powerful equation:

Trade Account[i] = Capital Account

Any change in one side of the equation must be matched by an equal and opposite change in the other. When a Japanese pension fund uses its trade-earned dollars to invest $1 billion in American tech stocks, U.S. net exports must decrease by $1 billion despite this transaction having no direct connection to trade in goods and services.
This framework reveals why conventional efforts to reduce the U.S. trade deficit have largely failed: they target only trade flows while ignoring the far more powerful role of capital. Today's global financial daily currency transactions dwarf goods trade—often by a factor of 100—making capital flows not just a response to trade imbalances, but a

primary driver of them. Tariffs and other traditional trade tools address only one side of the equation; lasting change requires incorporating capital flow measures into policy, recognizing that real leverage lies in reshaping how foreign capital moves into U.S. financial markets.

Why America Needs Both Tariffs and Capital Tools

Economists may wince at tariffs as clumsy instruments for balancing trade, but they serve a vital purpose beyond economics: protecting America's national security through forced decoupling from hostile supply chains.

The uncomfortable truth is that America's industrial base has become dangerously intertwined with our primary geopolitical rival. Nearly every critical manufacturing sector - from pharmaceuticals to electronics to defense - depends on Chinese inputs. It's a strategic vulnerability that could prove catastrophic in a conflict. Our trillions in defense spending becomes worthless if adversaries control the components needed to conduct and sustain military operations.

After decades of complacency, we've painted ourselves into a dangerous corner. We now have only less bad choices: either endure supply chain disruptions under controlled, peaceful conditions today, or suffer potentially catastrophic supply chain failures during a hot war when our economy is under maximum strain.
Tariffs are certainly disruptive, but that disruption serves a vital purpose: forcing companies to rebuild resilient, secure supply chains before a crisis makes orderly transition impossible.

The Economic Case for Capital Flow Tools

While tariffs address security concerns by urgently decoupling U.S. supply chains, capital flow tools directly target the economic distortions driving imbalances. The administration appears to be developing three primary tools:

1. **The U.S. Sovereign Wealth Fund (SWF)**, The SWF functions as a mechanism to create outward capital flows from the United States, reducing upward pressure on the dollar and making U.S. manufactured goods more competitive.
2. **Reinstating the 30% foreign withholding tax** on interest income, which existed until 1984. This policy would make U.S. financial assets less attractive to foreign investors, particularly central banks, reducing capital inflows that drive dollar strength and the trade deficit.
3. **Potential capital controls** using the International Emergency Economic Powers Act (IEEPA), which grants the President broad authority over international transactions in response to national security threats.

The administration isn't just talking about rebalancing trade, we believe it's assembling the tools to actually do it.

The Withholding Tax: Balancing the Scales

America stands alone among major economies in giving foreign investors a tax advantage over its own citizens. This isn't just unfair, it's self-defeating. Reinstating the 30% withholding tax on foreign investments would correct this imbalance while generating massive benefits:

To start, it's worth noting that this isn't radical policy, it's restoration of American normalcy. Until 1984, foreign investors paid this tax just like everyone else. We abandoned it over outdated concerns about tracking international money flows in the digital age - specifically, fears that foreign investors could easily conceal ownership through complex intermediaries and nominee accounts, making proper tax collection difficult.

Second, this policy would generate trillions in revenue that would come entirely from foreign holders of U.S. securities, not domestic taxpayers. For private foreign investors, this wouldn't necessarily increase their total tax burden. For example, the average statutory top personal income tax rate in Europe is 42.8%. Therefore, European holders of US securities would simply pay 30% to the U.S. government and the remaining 12.8% to their home country. The lost revenue would be borne by foreign governments. Given that most foreign jurisdictions already impose similar withholding taxes on their securities, they would have limited grounds for retaliation. The U.S.'s large negative net international investment position further constrains potential retaliatory measures.

Third, this approach precisely targets a significant driver of our trade imbalances: foreign central banks that currently pay no taxes while accumulating massive U.S. holdings. These institutions deliberately hoard dollar reserves well beyond what's needed for legitimate currency management, creating artificial capital outflows that mathematically force trade surpluses with the US. This strategy is effective precisely because these central banks deliberately target their reserve accumulation toward markets like the US that don't respond in kind and allow unrestricted capital inflows without reciprocal access or countervailing measures. Yet if we introduce a tax on these holdings, these central banks have no superior alternatives to Treasuries, with European bonds yielding just 2.5% and Japanese bonds a paltry 1.3% compared to our 4.5%. Even if they wanted to sell, no other market has the depth to absorb their massive holdings. Rather than triggering a wave of liquidation, such a policy is more likely to incentivize higher consumption in surplus countries - reducing the trade and savings imbalances that create the need for reserve accumulation in the first place.

Finally, this approach offers strategic flexibility through America's network of tax treaties with over 60 countries. These agreements allow Washington to selectively reduce tax rates for allies while maintaining them for adversaries and countries using mercantilist policies - as U.S. tax code states that later laws won't override existing tax treaties unless Congress specifically indicates such intent. This creates powerful leverage to build coalitions for broader economic realignment.

Addressing Common Misconceptions

Critics claim targeting capital flows would spike interest rates, crash markets, and starve America of essential foreign investment. History and economics tell a different story:

Goods, not capital: Dollars entering the U.S. must either purchase our financial assets or our products. There is no third option. Therefore, every dollar a foreigner spends buying American stocks and bonds is a dollar not spent buying American goods and services.
In fact, those US financial assets represent claims on future US production. Thus, when foreign central banks and investors purchase trillions in Treasury bonds, they're essentially deferring their consumption of US goods and services to some unspecified future date. Rather than letting foreigners continue accumulating these future claims on US output, the Trump administration's goal is to see those claims exchanged for current production - creating jobs and higher incomes for Americans today.
That's why threats to 'dump US Treasuries' aren't threats at all—they're promises to buy more American exports! If foreigners sold $1 trillion in US bonds, those dollars would ultimately flow back to purchase $1 trillion in American-made goods and services.
Capital flow tools aren't about restricting trade—they're about redirecting foreign dollars from Wall Street to Main Street. And that's precisely what America's manufacturing heartland has needed for decades.

"America Needs Foreign Capital": America doesn't face a capital shortage—our banks, markets, and investors already have ample resources to fund every worthwhile domestic investment. Foreign capital flooding into Treasury bonds and stock markets doesn't enable additional investment that couldn't happen otherwise.
Instead, it simply replaces what domestic investors would have funded anyway, while simultaneously forcing a corresponding trade deficit that reduces demand throughout the economy. We don't need Chinese savings to build American factories, we need those dollars to purchase American-made goods.
America's investment drought stems from insufficient demand, not insufficient capital. And that demand shortage is directly linked to the persistent trade deficits created by those very capital inflows.

"Higher Interest Rates Are Inevitable": Critics argue that reduced foreign buying of U.S. bonds would decrease demand, inevitably driving Treasury yields significantly higher. This misunderstands how bond markets work. Treasury yields aren't a purely free market - they reflect expected Fed policy rates plus a small "term premium" - the extra yield investors demand for holding longer-dated bonds. Any pressure on yields from reduced foreign buying would only affect this modest premium.

More importantly, the Fed holds the power to counteract any unwanted yield increases through bond purchases or "Operation Twist" operations (which does not increase the Fed balance sheet). Any interest rate spike would represent a Fed policy choice, not an inevitable outcome.

Finally, when foreign capital inflows decline, there's a proportional, corresponding reduction in U.S. debt issuance. If America consumes 100 widgets but only produces 80, we must finance those extra 20 widgets by selling financial assets to foreigners. If foreigners reduce their purchases of our assets, it forces an increase in production relative to consumption, reducing our net borrowing needs.

"Markets Would Collapse": When European nations liquidated U.S. securities equivalent to 15% of GDP during the 1914 crisis, markets initially declined. Yet within two years, the Dow was up 40%, and earnings were up 150% from pre-crisis levels. Why? Because the dollars previously channeled directly into financial markets first passed through the real economy, supporting stock valuations through dramatically improved corporate earnings rather than merely increased buying pressure. When foreigners stopped buying financial assets and instead purchased U.S. goods and services, these dollars increased American incomes and stimulated a manufacturing boom. This boom created a virtuous cycle: rising corporate profits improved market fundamentals, while higher domestic incomes gave Americans greater capacity to invest domestically.

Redesigning a Broken System

America stands at a crossroads in global trade. For decades, we've operated within a system that has failed to function as designed, creating dangerous economic vulnerabilities, and hollowing out our industrial base.

The principal goal of a properly designed global trading system is to allow for temporary trade imbalances but it should contain mechanisms that automatically reverse those imbalances over time. Under the gold standard, relative inflation rates served as the primary rebalancing mechanism. Later, the Bretton Woods system introduced flexible exchange rates to provide a smoother, less painful way to correct trade imbalances.

But countries have gamed the system so that exchange rates haven't been allowed to adjust properly to rebalance global trade. America is the only nation in history to run large, persistent trade deficits for over four decades – all while simultaneously seeing its currency appreciate by 350%. This defies fundamental economic principles, where persistent deficits should trigger currency depreciation and automatic rebalancing. The only explanation for this paradox is that the direction of causality has reversed: It's not American consumption driving our deficits; it's inelastic foreign demand for American financial assets forcing those deficits upon us.

The persistent imbalances that have occurred over the past 40 years are, by definition, the sign of a broken global trading system and why the administration is justified for wanting to redesign it.

While a strong dollar has its advantages, it's entirely different to allow the currency to become so overvalued that it suffocates America's tradable goods sector. This overvaluation has arisen precisely because other countries actively prevent the dollar from depreciating naturally and blocking the currency adjustments that would ordinarily rebalance global trade flows. Far from attempting currency manipulation, the administration's goal is simply to allow the dollar to fluctuate freely and fulfill its intended economic role: correcting persistent imbalances and restoring competitiveness to U.S. manufacturers.

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[i] *The technical identity is: current account = capital account, but we are using "trade account" for simplicity.*