Summer 2025

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Recent Economic Events

Economics has been Trumped by politics (pun intended). The impact of on and off tariffs has not only caused great uncertainty, it has also resulted in actions that triggered a contraction in first-quarter GDP. The wait-and-see attitude among businesses foreshadows a pause in investment plans. Because of implementation delays and carve-outs, inflation statistics have not yet reflected the levies' cost. The labor market has shown some resilience, but it is clearly softening. Interest rates have been kept high by the Moody's rating downgrade and the profligacy of the GOP reconciliation bill.

First-quarter GDP contracted by 0.2%, primarily due to a surge in imports as businesses tried to front run tariffs. Most of the huge increase ended up in bloated inventories which, given the math of GDP calculation, was an offset. If we sort out the impact of trade, inventories and government purchases to get to a statistic known by the unwieldy title of Real Final Sales to Domestic Private Purchasers (what I call core GDP), the economy grew by 2.5%. This is down from the roughly 3% level we enjoyed for the previous two years but is still a healthy statistic. It implies that spending held up. However, there's a twist in the details. Consumer spending, the prime driver of the American economy, downshifted to 1.2% growth in the first quarter from 2.7% in the fourth quarter last year. Making up for that slowdown, business investment jumped 7.8% as spending on AI data centers drove growth. It appears that outside AI, capital expenditure plans have stalled.

Core PCE inflation registered 2.5% year-over-year in April. This was the lowest print since 2021, suggesting ongoing disinflation. However, the impact of tariffs had not yet worked its way through the supply chain. Furthermore, while the annual rate slowed, the more sensitive three-month rate picked up steam. With most companies indicating that they will pass all or most of the tariff cost on to their customers (even in the face of pushback from the White House), the inflation shoe has yet to drop.

Contrary to expectations, job openings rose to 7.4 million in April from 7.2 million in March. While this is down substantially from the peak a few years ago, its level still exceeds the total of unemployed Americans. On that front, the US economy reportedly produced 139,000 jobs in the month of May, but job creation figures for March and April were revised lower by 95,000, leaving the net gain at a paltry 44,000. The unemployment rate held at 4.2%, helped by a drop in labor force participation to 62.4%. Wages advanced 0.4% in May, bringing the annual gain to 3.9%. These statistics show labor market resiliency, albeit on a weaker foundation than what we saw pre-tariffs.

Recent Economic Events-continued

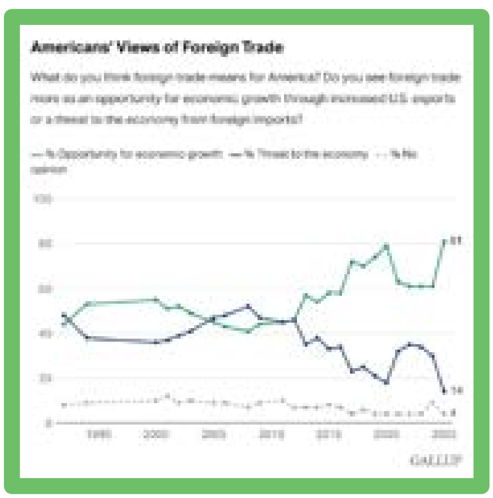
As the House of Representatives was wrestling with its Big Beautiful Bill, Moody's decided to join Standard & Poor's and Fitch in reducing the United States's credit rating from AAA to AA+. They cited political dysfunction and fiscal excesses. Who could blame them? The impact on interest rates was predictable. The Federal Reserve is now likely on hold until the fall and elevated mortgage rates will help keep homes unaffordable for most Americans. Existing home sales in April were the lowest since 2009. New home sales were not as bad, but much of that was due to builder concessions and homes with smaller square footage.

The American economy is facing some real headwinds, some of which are self-inflicted. Because they are, we have a good chance that the underlying strengths of the country will reassert themselves once some policy clarity is established. The US economy is second to none in its adaptability, but to adapt, it must know what the new landscape entails. I am hopeful that the President and his congressional supporters will realize this and reduce uncertainty as the summer unfolds. If they don't, I am afraid that the broken-clock recessionistas will prove right.

Guest Commentary*

** Written by James Michaelson. The views expressed are solely those of the pseudonymous author whose identity will be protected by Jamesson Associates.*

Donald Trump is frustrated. His vow to end the war in Ukraine on day one has run into the intransigence of Vladimir Putin. Tariff Man's announcements have caused uncertainty rather than capitulation. His BFF, Elon Musk, is now dissing his Big Beautiful Bill as a "disgusting abomination". Even some Congressional Republicans have rediscovered their backbones as they review the provisions of the bill. And then there is Jay Powell, who has refused to do the President's bidding by lowering interest rates.



Part of the President's frustration comes from the incompatible goals of his policies and his tendency to create his own version of reality. Let's start with Ukraine. A threat to suspend military aid, pull back from NATO, and a televised dressing down of President Zelensky at the White House might have led Ukraine to negotiate, but it strains belief that it would bring Putin to the table. Mr. Trump now muses that Russia may not want peace after all.

The President usually has excellent political instincts, but on trade, it appears he has massively misconstrued the situation. A recent Gallup poll shows an amazing 81% of Americans believe that trade is an opportunity for the country, not a threat. In this polarized age, I'm not sure that even Mother Teresa could find that much support.

Mr. Trump has admitted that China's Xi is playing hardball on trade discussions and will be

Guest Commentary-continued

"EXTREMELY HARD TO MAKE A DEAL WITH". Speaking of trade deals, there really aren't any. India and the European Union are pushing back in negotiations. While the White House keeps announcing that deals are imminent, it is starting to feel like Trump 1.0 and the evergreen promise of infrastructure week. Perhaps the most galling development for the famously thin-skinned occupant of 1600 Pennsylvania Avenue is Wall Street's embrace of the TACO (Trump Always Chickens Out) trade.

Boosting fossil fuels is theoretically a key initiative of the Administration, but 50% steel tariffs make American drilling a lot more expensive. Making deals in the Middle East to increase oil production and lower its price hardly encourages domestic production, which peaked in December 2024. Rig count is down, not up, under Mr. Trump.

Earlier this year, Elon Musk and his Department of Government Efficiency (DOGE) were rampaging through the government chopping employment, suspending grants, and canceling contracts. They had targeted savings in the trillions of dollars but delivered far less. Much of the wanton slashing of jobs has been reversed as the realization sank in that real services were being provided. Mr. Musk must have concluded that he was doing more harm than good to his brand, so he bowed out. As a parting shot, he criticized the House GOP legislation as a budget buster. A GOP civil war between the diminishing band of deficit hawks, a small number of moderates who want funding for clean energy or Medicaid to continue, and tax cutters promises political fireworks even before the Fourth of July.

The President has been consistent in asking the Federal Reserve to lower rates. Jay Powell has been consistent in resisting because of his concerns over the potential inflationary impact of tariffs and the projected increase in deficits due to the Big Beautiful Bill. Just another example of how reality bites.

Market View

We may look back on President Trump's Liberation Day as the end of the American Century. The chaos released by the announcement of so-called reciprocal tariffs was so significant and immediate that a quick reversal, pausing the fees for ninety days, followed. In the aftermath of the April 2nd announcement, stocks, bonds, and the US dollar all fell. This is not good for America. Recall that when the debt ceiling was not renewed several years ago, the market reaction was a flight towards the dollar and US Treasuries as a safe haven — one populated by borrowings that may not have even been legal at the time. Today America's credibility as a shelter against the storm has taken a hit. The concern was exacerbated by the recent ratings downgrade by Moody's and the irresponsible fiscal package known as the "Big Beautiful Bill". In fact, the cost of protecting against the US government defaulting has increased to a level consistent with a BBB+ rating, not the AA+ that all three major rating agencies have attached to our credit.

> *…America's credibility as a shelter against the storm has taken a hit.*

Market View-continued

Investing in these uncertain times is even more an act of faith than normal. Consequently, I decided to go back to first principles. I believe the following:

1) The world is now multi-polar which means that the US is no longer the automatic destination for global investing.
2) Artificial Intelligence is real. Its adoption will disrupt industries and jobs, but it will not offer the same barriers to entry as did previous technological advances.
3) Many of President Trump's tariffs will stick, and his 2017 tax cuts will be extended.

From these principles, I can recommend that investment dollars should diversify out of traditional growth stocks in the United States. While non-US investments would be logical, I believe more prosaic domestic companies merit consideration as well. This would include those companies that can adopt AI to provide lower costs to themselves and/or real benefits to their customers. Internationally, traditional laggards like Europe and Latin America are now quite interesting because they have room to lower rates and boost government spending to aid growth. America is mostly at the end of its fiscal rope.

The weaker dollar theme is best leveraged with commodities. Commodity cycles tend to be very long in nature. Based on years of underinvestment, it appears that this one is in its early stages. Gold has had a fabulous run over the past few years, but as foreign investors try to shun US assets, gold and other precious metals will be on their list of alternatives. Both operating leverage and attractive equity valuation suggest mining stocks may be the best option in that space.

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I go back and forth on crypto-currencies. The pluses include a market that is maturing and potential support from both Congress and the Administration. The primary minus is high correlation with US equities. Better to hedge than ride along, so I am neutral.

Inflation is destined to be higher than the Federal Reserve's target, implying interest rates will stay higher as well. This means cash and short-term, high-quality fixed income should be cornerstones of your investment portfolio. Since I believe that the President will reverse course if a recession threatens, and tax cuts will be stimulative, high-yield bonds could fit in for a portion of your holdings. I continue to be wary of longer-term bonds as they don't seem to incorporate the risk of US disinvestment along with the spiraling debt needs of the Federal government. If you really want duration, Treasury Inflation Protected Securities make the most sense to me.

Editor's Notes

My spring newsletter was not mailed out but is available on my website. The logistics of printing and mailing from New Orleans were too much to overcome. Since you are holding this edition in your hand and reading it on paper, it marks the return to physical from virtual reality. The difference has been something I have long considered. My grandmother, who was born in a small town in Greece, always made a distinction between talking with someone in person or on the telephone. Few of us would do that today. With increasing digitalization of our lives, how long will it be before we no longer distinguish between our virtual and physical experiences? In fact, I ask you, dear reader, am I real or am I AI? Can you tell the difference? HA, HA, HA, humans!

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