Weekly Relative Value

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WEEK OF MARCH 31, 2025

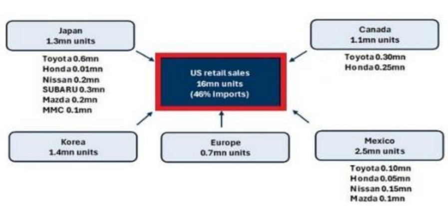
Enjoy Your $80,000 Honda

"I couldn't care less if they raise prices, because people are going to start buying American cars." — President Donald J. Trump

Trump finally pulled the trigger and lowered the boom on the auto sector. In doing so, the North American motor vehicle supply chain was torpedoed by one executive order. Tariffs on Canada and Mexico? Really? That's almost like putting tariffs on New York from California or Texas. You can't just unwind those very integral, complex parts of the economy without massive disruption.

The 25% tariff on the non-U.S. content in all vehicles and parts begins on April 3 and will wreak havoc on production and employment across the continent. To put this into perspective, 16 million cars are sold every year in the U.S., of which 46%, or 7.4 million, are imported. Moreover, the U.S. imported $474 billion in automotive products in 2024, with nearly half coming from Mexico, Japan, South Korea, Canada and Germany.

Exhibit 1: Vehicles produced abroad account for nearly half of US auto sales
Vehicle units exported to the US



Each company's export volumes by region are GS estimates
Source: Company data, Data compiled by Goldman Sachs Global Investment Research

THIS WEEK

- ON DAY ONE…
- TIT FOR TAT
- WHY THE TARIFFS?
- YOUR WORD IS YOUR BOND
- THE BIG PICTURE
- STAGFLATION?
- A VOTE OF NO CONFIDENCE
- JOB CUTS AND UNEMPLOYMENT
- WHERE'S THE HOUSING SHORTAGE?
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

It's not that the just-imposed auto sector tariffs are reckless economic policy (I mean, come on — the United Auto Workers (UAW) are openly cheering the move!), but the haphazard way trade policy, in general, is being conducted is keeping levels of uncertainty painfully high. The impact on the broad macro data has yet to be felt, but just wait.

As for the UAW's glee**,** let's see how long those smiles last as the layoffs pile up. Even if there is long-term success in bringing all of these auto facilities to the United States, that process will take years. In the meantime, we are now in an extended period of upheaval and instability.

Meanwhile, Union Bank of Switzerland analysts found that the 25% tariffs on cars and parts from Canada and Mexico will completely wipe out the profits at Ford and General Motors. Frankly, no auto company on earth is profitable with a 25% tariff, and production cannot shift into the United States within seven days. Many more layoffs lie ahead.

And according to news sources, President Trump has told U.S. auto companies not to raise prices. I have no doubt Trump will use every lever to deny federal procurement contracts to automakers who fail to bend to his edicts/"wishes." That is, if he could remember this afternoon what seemed so important to him this morning.

Trump can "browbeat" all he wants – just like Biden did to no effect. It's theatre. Manufacturers will price however they want to. Trump is being as ridiculous as Biden and Harris. And that's pretty ridiculous. Think about what happened in 2018. Tariffs were raised on washing machines and dryers, and U.S. manufacturers matched the price increase. Since then, sales of washing machines and dryers have not recovered to 2017 levels.


BUSINESS | AUTOS

Trump Warned U.S. Automakers Not to Raise Prices in Response to Tariffs

Threat came in a call earlier this month, in which carmakers feared punishment if prices go up

By Josh Dawsey Follow and Ryan Felton Follow
March 27, 2025 9:00 pm ET

Gift unlocked article

Bottom line: Don't be surprised if U.S. auto sales take a nosedive in the coming months. The hit to output and employment will come far in advance of any potential shift in factory production to the U.S. Is this "winning"?

One thing that is obvious to me is that the U.S. auto industry needs a new lobby group.

ON DAY ONE …

*"Starting on day one, **we will end inflation** and **make America affordable again**.*
We'll do that. We've got to bring it down." – President Donald J. Trump

It is important to stress that one of the BIG reasons Trump won the election was his promise to lower inflation on "Day One." But with tariffs, American drivers are about to face some serious sticker shock.

The tariffs will add as much as 15% to the list price. In dollars and cents, that means that the price of a car built in Canada and Mexico will increase by $6,000. And the bite isn't just on units coming in from Canada and Mexico, but everywhere, including Europe and Asia.

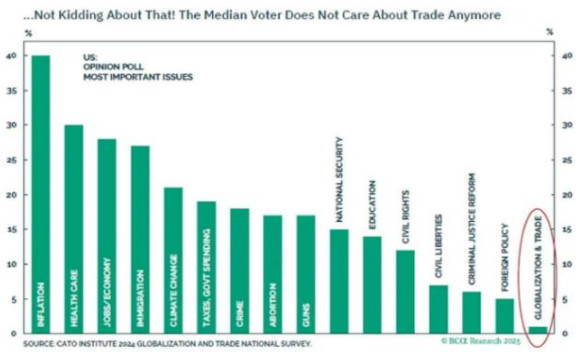
It gets worse if you are in the market for a truck or SUV. The Anderson Economic Group estimates that a 25% tariff on the U.S. neighbors would increase the cost of a full-size SUV assembled in North America by $9,000 and a pickup truck by $8,000. The cost of an electric-vehicle crossover would increase by $12,200.

Thus, while the tariffs are very likely to encourage domestic car production over the “long run,” the near-term collateral damage promises to be substantial, and the reality is that everyone, especially consumers, live in the here-and-now.

Heck, some people will be taking a second mortgage out to buy a car now. Also, Americans will likely hold onto their existing cars for longer and may even switch to buying used cars, so used car prices will rise. Higher new and used car prices eventually increase auto insurance prices, and this tax affects even people who do not buy a car at all.

According to the Cato Institute, it is interesting to note that U.S. voters care deeply about prices, while trade policy ranked dead last on their list. One would assume that a spike in prices after new tariffs would create significant political challenges for the administration.

Indeed, the Yahoo News/YouGov poll shows President Trump's approval ratings declining significantly in recent weeks — with 50% of Americans disapproving of his performance compared with 44% who approve. This will not be a good setup for the 2026 midterms if these numbers persist.



TIT-FOR-TAT

The President has also warned of more action if anybody retaliates. Whether or not automakers raise prices themselves, vehicle prices will almost certainly rise in the United States because of a supply-and-demand imbalance.

So far, the affected countries have yet to announce specific retaliatory measures in the face of threats from the President, but we all know that there will be a tit-for-tat response to the tariffs. Consider Canada, where Trump single-handedly resurrected the Liberal Party. Retaliation is politically popular there!

"His 25 per cent tariffs on cars and light trucks will do nothing more than increase costs for hard-working American families. *U.S. markets are already on the decline as the President causes more chaos and uncertainty.* ***He's putting American jobs at risk****."*

*"I've spoken with Prime Minister Carney. We agree Canada needs to stand firm, strong and united****. I fully support the federal government preparing retaliatory tariffs to show that we'll never back down."***
— Doug Ford, Premier of Ontario.

Here's another unintended consequence that investors should assess. As the White House moves to shrink its trade deficit on goods, the near-record surplus on services looks likely to decline. Indeed, it is the start of this world travel boycott underway against the United States. To wit: there is a widespread move in Canada to vacation at home. April flight bookings to the U.S. are down 75.7%! And the *New York Times* suggests this move is going global — as travel to the U.S. has fallen off a cliff. (See "'Trump Slump' Looms as Foreign Visitors Rethink Travel to U.S."). Goodbye Statue of Liberty (speaking of liberation).

Suffice it to say, this is bad news for the airlines, hotel chains, casinos and theme parks**.** The travel and tourism sector supports nearly 20 million jobs. It dwarves the auto industry. Why would we want to screw with it?

Moreover, American companies are good at making nontangible things: software, movies, TV shows, music and all kinds of business services. These are very profitable and high margin services, and the world happily buys them from us. This has serious implications if we get into a tit-for-tat trade war. Do we really want Europe and the rest of the world to put tariffs on our services? $1 trillion in service exports is a big deal! Think Smoot-Hawley.

Bottom line: There are no winners in a trade war. And there is no doubt the economy is going to take a hit. And yet to come is "Liberation Day" on April 2, when the reciprocal tariffs come into play.

WHY THE TARIFFS?

"There are three truths: my truth, your truth and the truth." — Chinese proverb

What is the “real” purpose of these tariffs?

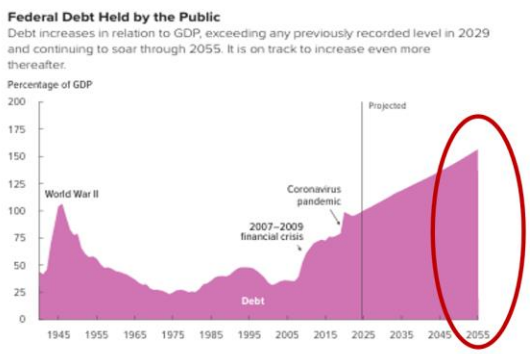
We now know that the tariffs have nothing to do with “national security.” The White House has pivoted from justifying the tariffs as a “national security” threat under Section 232 of the 1962 Trade Expansion Act, to boasting about how this is all about making America a global economic powerhouse again. So, which is it? National security or economic policy?

Many people are saying that tariffs are a great negotiating tool for Trump but admit that they would be harmful to the U.S. economy if actually imposed. If that is the case, how can they be an effective bargaining chip if the other side knows they won't actually be enforced?

“The biggest tax cut in American history for the middle class.…Holistically, as they say, consumers and Americans are going to be better off, including all the jobs they get.” — Peter Navarro, Economist

I believe the tariffs are an attempt to subsidize tax cuts. The administration believes that the proceeds from the tariffs will be used to fund not just the extension of the 2017 income tax relief but allow for new tax reduction as well. However, to achieve that, the U.S. tariff rate would have to soar to 50%, which would even take out the Smoot-Hawley hikes in 1930. History is clear on what happened next.

Some are saying that the tariffs will reduce the deficit. For those who expect fiscal policy to save the day for the economy and markets, keep in mind that the Congressional Budget Office (CBO) just published a warning that there are “significant risks to the fiscal and economic outlook.” By 2035, debt held by the public is expected to reach 118% relative to the gross domestic product (GDP), up from an already troubling 100% ratio this year.



So far, what Congress has done is adopt a call for -$4.5 trillion in tax cuts and -$2 trillion reduction in federal spending over a decade. We are already within a year of seeing the debt/GDP ratio crossing above the World War II peak in the 1940s and continuing on to hit 156% by 2055.

And take note: The CBO calculations do not consider the impact of Trump’s tax cuts being permanent. If tax cuts were made permanent, it would add 47% to the debt-to-GDP ratio within the next three decades. So, bear in mind what the national balance sheet is going to look like in the long term.

Frankly, it is folly to think the tariffs will put much of a dent into the deficit, especially if other countries announce retaliatory measures and recession risks move up even more. This is no attempt to be a Debbie Downer, but rather an attempt to be realistic.

YOUR WORD IS YOUR BOND

"Trust takes years to build, seconds to break, and forever to repair." – Anonymous

Arguably the greatest damage done is a loss of trust in the administration. First, we have a president who has abrogated a contract he himself signed in his first term. Few are batting an eyelash. But the implications of a loss of trust carries enormous risks with it.

Let's be honest. Canada did all it could, as instructed, from the border to fentanyl, but that didn't matter in the end. Mexico deployed thousands of National Guard troops to the border to deter migrants from reaching the United States. South Korea said it would invest $21 billion in expanding U.S. manufacturing. Japanese officials descended on Washington, offering to invest $1 trillion in the United States and buy more American natural gas.

But as we have seen, none of this has mattered. And that means that future negotiations with the White House over anything are going to take place under a cloud of mistrust. No wonder gold, which trades proportionally with global uncertainty, continues to march ever higher.

"The old relationship we had with the United States — based on deepening integration of our economies and tight security and military cooperation — is over." — Mark Carney, Prime Minister of Canada

Bottom line: Trump negotiated the United States-Mexico-Canada Agreement that was signed on November 30, 2018. At the time, Trump proclaimed it was the "best trade deal ever." All parties agreed to review the trade agreement in 2026. The fact of the matter is Trump has no legitimate right to unilaterally break a deal ratified by the Senate 89-10. Spare me the sap about absurd lies on national security or fentanyl — Trump just proclaimed to the world that he may not honor any deal, even those he signs. At some point there is a cost to this lack of trust.

THE BIG PICTURE

Trump wants to undo 40 years of globalization. It's true that globalization has hollowed out America's industrial base, decimated the middle class and left us deeply in debt. It's also slowed the rise of consumer prices and directed most of the Fed-created inflation into our financial markets, propping up asset prices and suppressing interest rates.

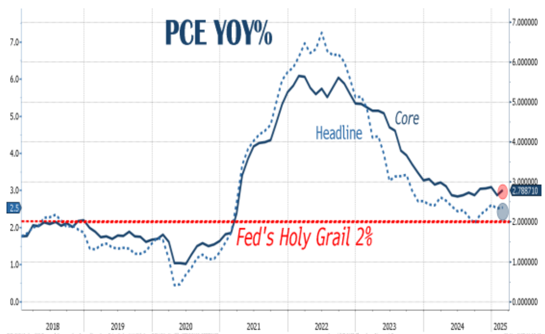
Rising asset prices and debt-financed consumer and government spending created the illusion of economic growth while the real economy suffered. As the rich got richer, the middle class got poorer, resulting in Trump being elected to a second term.

Trump promised to reverse the tide but claimed he could do so in a way that would bring about an instant economic boom. That's the problem. Reversing this process will initially redirect 40 years of inflation out of financial markets and into the real economy. As a result, stock, bond and real estate prices will collapse, while consumer prices and interest rates will soar.

Bottom line: The public is not prepared for this reality, and neither are investors or the Trump administration. That's why, at the first sign of real economic and market pain, Trump will blink. He will desperately embrace the very policies he is trying to reverse. There will be a massive fiscal bailout, with Trump demanding — and likely getting — aggressive rate cuts and the mother of all quantitative easing programs from the Fed.

STAGFLATION?

The core personal consumption expenditures (PCE) deflator came in rather hot, at +0.4% month over month in February, which was above the consensus estimate of +0.3%. The year-over-year trend hooked up a bit to +2.8% from +2.7%, so it is obviously heading in the opposite direction from what the Fed would like to see. In the first two months of 2025, the PCE rose at a 4.1% annual rate — the highest in a year, not to mention the +3.1% rate over the past six months and the +3.6% annualized pace on a three-month basis. Just wait until the tariff effect really kicks in hard in the next two or three months.



The Fed Chairman made the point at last week's post-meeting press conference that the weak "soft" data have yet to show through in the "hard" data. I have news for him. It is in the hard data. The Atlanta Fed Nowcast is now at -2.8% annualized for Q1 real GDP growth. After adjusting for gold inflows that distort economic data, economic activity is *shrinking* at a 0.5% rate in Q1 about to end.

Bottom Line: Trump put himself into an impossibly bad situation. His tariff threats are literally causing inflation to soar before they are even in place. At the same time, the economy is downshifting. If Trump goes through with any of this craziness, it will blow up the entire economy. Trump needs to take a ceremonial win like he did in 2018, go on Fox News and pretend he changed everything. And then we need to get back to the 2024 economy immediately.

A VOTE OF NO CONFIDENCE

In 1967, the Conference Board created a monthly survey of consumer expectations. The survey consists of 5,000 households and is widely established as the leading measure of U.S. consumer confidence. With that said, according to the Conference Board for March, households have marked down their assessment of the economy, jobs, incomes and equity prices while showing continued interest rate and inflation fears.

The Conference Board's Consumer Confidence Survey weakened to a four-year low of 92.9 from 100.1 in February. On the eve of the election, it was sitting prettier at 109.6. Who knew?

The "present situation" subcomponent dipped to 134.5 from 138.1, but the real action was in "expectations," which fell hard to 65.2 from 74.8. That is the worst showing since March 2013! It is surreal that household views on the future are more downbeat now than at the depths of the 2020 pandemic recession. And it is expectations that drive the economy. I should note that a reading of less than 80 has usually signaled a recession. (See the red hyphenated line in the graph below.)

Expectations over "worse business conditions" over the next six months are up to a three-year high.

On the labor front, the news is pretty grim. The share of households saying they expect to see "more" job gains in the next half-year has declined for four months in a row — to 16.7% in March. Last November, that share was 22.8%. The last time that happened was in 2000 and the double dip recession of 1990 and 1992. Hopes have dimmed in a very short time frame. But get this — the share seeing "fewer jobs" ahead jumped to 28.5% to stand at a fourteen-year high! This survey echoed the University of Michigan surge in expectations of higher unemployment. Perhaps this is the dark side of the AI craze. This suggests that wage growth will be anemic as worker confidence recedes and in turn should lead to a theme of rising savings rates, which are depleted and in dire need of being rebuilt.

Beyond concerns over the labor market, there are other things playing on the minds of consumers. For one, a loss of faith over the bull market in equities. The share seeing more advances on a one-year basis has gone from 57.2% last November — as visions of roads paved with gold followed the election result — to 37.4% as of March. This is the largest drop in stock expectations EVER!

Interest rate fears have risen in each of the past four months as well. A majority, at 55% see the Fed tightening which is the highest reading since May 2024.

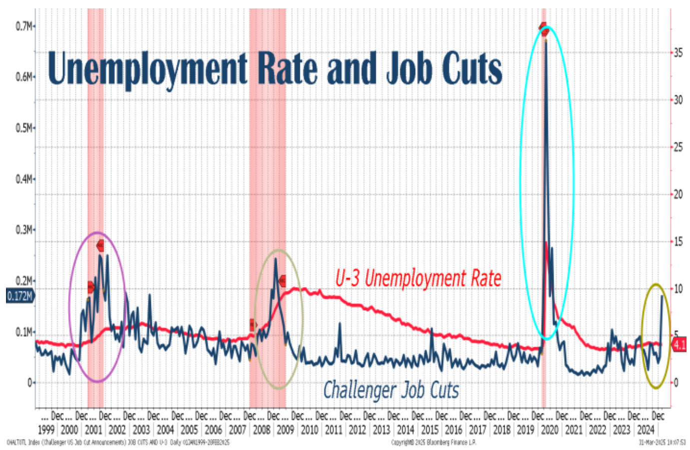
Why? The culprit is tariff fears. The tariff file has the plebs freaking out over inflation. Indeed, the one-year ahead expectation has risen steadily since last year's election: from 5.0% in November to 5.8% in February to a Biden-like 6.2% in March (the highest since April 2023).

Bottom line: Amid the trade war and rising economic uncertainty, consumer confidence is cratering. It's not a surprise since most American's expect tariffs to raise prices which increases cost of living and will create a drag on demand for domestic goods and services (and therefore employment). Expect reduced spending and investment, which will slow economic growth.

As uncertainty spikes, investors will pivot to safer assets. Economic instability can also tighten credit conditions, cramping economic activity even more. Brace for impact: Markets might get shaky and credit might squeeze tighter. Stay sharp!

JOB CUTS AND UNEMPLOYMENT

U.S. employers reported 172,017 job cuts in February 2025, reaching levels last seen during recessions in 2000, 2009 and 2020. A massive portion of the layoffs came from the federal government, mainly due to cuts by the Department of Government Efficiency (DOGE), while the private sector faced substantial job losses due to tariff related issues**.** As shown in the following graph, the unemployment rate with a lag is expected to rise in the coming months.

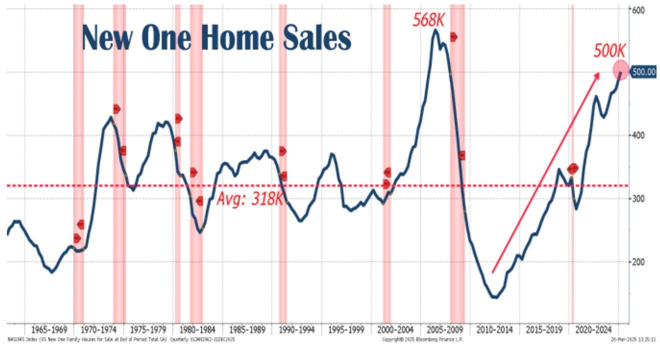


Bottom line: Keep a close eye on the non-farm payroll report from March to be released Friday morning. The consensus forecast is for payroll to increase 138,000. A reading of **<**100,000 payroll could cause a further decline in equities and a strong bid for Treasuries. A rising unemployment rate could push the Fed to reconsider rate cuts.

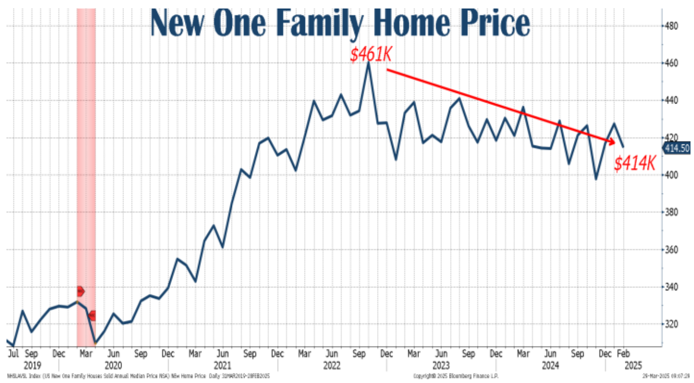
WHERE'S THE HOUSING SHORTAGE?

The housing market seems to have found a bottom. New home sales came in at a 676,000 annual unit rate in February, (+1.8% month-over-month rebound from January when sales sagged -6.9%). That said, the builders remain saddled with a ton of excess inventory.

New single-family homes for sale are now at the highest since October 2007. The backlog of unsold homes remaining elevated at 8.9 months' supply (It was 8.7 months a year ago.) It is also taking the builders a longer time than usual — a median 2.9 months — to make a sale upon completion (up from 2.5 months a year back). This is consistent with the poor customer traffic data seen from the National Association of Home Builders sentiment survey.



If I recall from Econ 101, more supply and less demand leads to lower prices. Indeed, median new home prices deflated by -3.0% month over month ($414,000) and are now down 10% from the record high ($461,000) in October 2022.



Bottom line: There is no housing shortage. There is more supply than demand, and prices will likely continue to decline. See the *Wall Street Journal* article: “Selling Your House This Spring? You Might Need to Cut the Price.”

MARKET OUTLOOK AND PORTFOLIO STRATEGY

“I do not believe there is clarity in markets, in the media, or in the public about tariff policy or what is coming April 2, because I do not think there is clarity in the administration around tariff policy or what is coming April 2.”
— David Bahnsen, Founder, Managing Partner & CIO, The Bahnsen Group

These tariffs are on, then off, then on again. They’re up, down, then massively up, then suspended. They are deployed for “fairness” in trade and then also because of fentanyl and immigration policies.

Next week, we get another big shock with the vaunted “reciprocal tariffs” against the entire world. You need a timeline and a computer to keep all this straight.

And even if you support a tariff policy, no sane person can defend the sheer impulsiveness of all this. It deprives businesses of any stability with which to plan, invest, hire, or fire.

Meanwhile, the economy is definitely slowing. A Goldman Sachs survey of 150 investors (released last Thursday) showed that 90% had lowered their 2025 GDP forecasts since early December, and three in five claimed that tariffs were "the largest policy risk to the economy" this year.

Beneath the surface, recession risks are being partly, but not totally, priced in. Jeffrey Gundlach at DoubleLine is at 50%-60% odds of a recession. The venerable Bank Credit Analyst says we will be in a recession later in the year. The perma-bull Ed Yardeni has raised his recession risks from 0% to 35%. Big move for Ed. Firm by firm, analysts are highlighting recession risks.

The main drivers of growth in the U.S. economy have been consumer spending from the top wage earners (especially travel and leisure), and government stimulus. Delta has already cut their first-quarter growth. FedEx and Nike are guiding down for the second quarter. What does that say?

As discussed above, consumer expectations have turned dramatically lower. This negative sentiment is now impacting many consumer companies. To wit: The Bank Credit Analyst says 24 of the first 26 retailers providing Q1 earnings guidance and 29 of the first 31 retailers offering first-quarter revenue guidance lowered their estimates.

On the fiscal side, I am hopeful that we can truly eliminate waste and fraud. But for every action there is a reaction. Even if we reduce spending by $1 trillion via DOGE (I'll believe it when I see it!), there would be less stimulus going into the economy. That will leave a mark. Fiscal stimulus does have an economic effect, and taking it away, even though necessary, will have the opposite effect.

After watching the Bloomberg screens on Friday, Mr. Market may be catching on to the grim reality that the U.S. economy is going to be joining the rest of the world on the down escalator.

Now comes "Liberation Day" on April 2. If Trump actually goes ahead and implements the tariffs (and I am not certain he will for very long), it will not end well. The markets will not respond positively. I believe we will be in recession within 90 days or less.

And don't look at the Fed to save the day (at least not now). No help is coming from the Fed, with official after official sounding more hawkish. The latest was St. Louis Fed President Alberto Musalem, who issued a warning against the central bank simply looking through the inflation effects from a looming trade war as being transitory.

He was emphatic:

*"**I would be wary of assuming that the impact of tariff increases on inflation will be entirely temporary,** or that a full 'look-through' strategy will necessarily be appropriate. **I would be especially vigilant about indirect, second-round effects on inflation**."*

Bottom line: The U.S. economy is visibly sputtering, courtesy of the heightened policy uncertainty environment, and a still-restrictive Fed. Unemployment is heading higher, economic growth appears to be contracting while inflation has resumed an upward trajectory. This is not a good combination of circumstances. It's a recipe for the dreaded "stagflation."

Interestingly, the 10-year Treasury yield has declined by -14 basis points to 4.19%. So, what are bonds now seeing, given that the goods sector is prepped for a bout of near-term inflation? Beyond rising recession risks, what they see is that service-sector prices are now set to cool, and they dominate the major price indices. And the major culprit is the residential real estate market.

Meanwhile the stock market is waiting to see what Trump will do next.

Source: Google

This coming week should be quite interesting. While volatility and uncertainty are the main themes, in terms of portfolio strategy, stay the course. Continue to maintain a risk-appropriate ladder strategy while buying bonds on (price) dips.

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at tom.slefinger@alloyacorp.org or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.

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