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Weekly Relative Value

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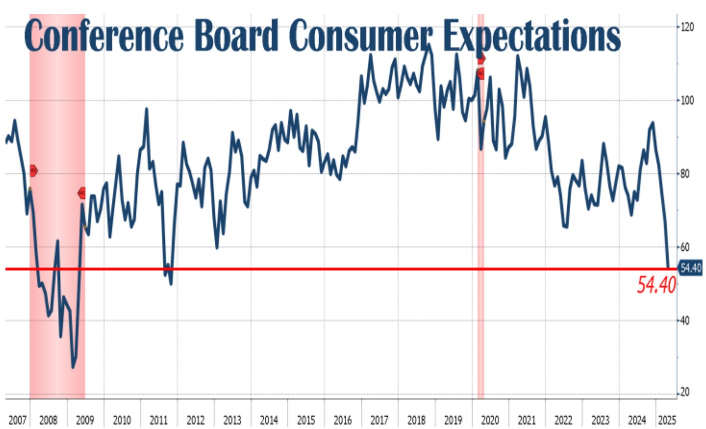
WEEK OF MAY 5, 2025

The Good, the Bad and the Ugly

Last week we saw a bevy of important economic updates covering the latest in economic growth, labor market conditions, inflation, consumer confidence and trade. Some reports were good, some bad and others ugly. Read on.

First, like the University of Michigan Consumer Survey, the Conference Board's Consumer Confidence Survey for April delivered another gut punch. Topline confidence fell from what was already a four-year low last month (93.9) down to 86.0 in April (fractionally above the April 2020 pandemic crisis level of 85.7).

More importantly, "expectations" about the future were shockingly worse. Uncertainty and tariff worries have sent expectations about the future through the floor, with consumer expectations actually falling by 37.5 points in six months, to 54.4 points, the biggest drop in 14 YEARS. Below 80 usually signals a recession. It is surprising that future expectations are even worse than they were during the height of the pandemic.



It's the future expectations where the bearishness is so clear. The share expecting business conditions to get better in six months fell again, from 17.8% to 15.7%, while the share expecting it to worsen soared to 34.8%. That is the highest since March 2009 — beating the 2011 debt ceiling crisis and the pandemic in 2020.

THIS WEEK

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- IF IT WASN'T FOR TARIFFS
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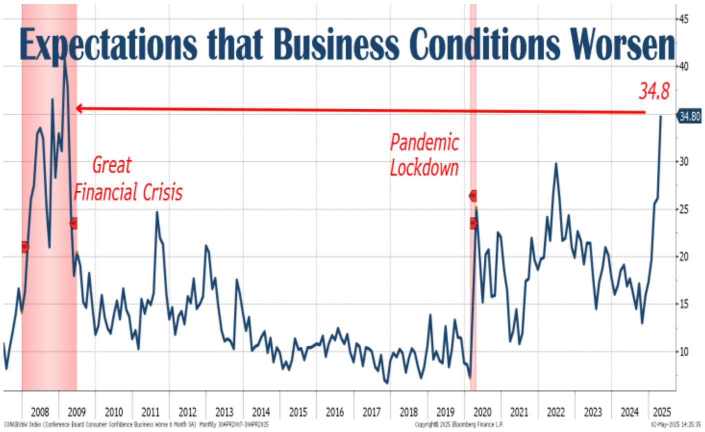
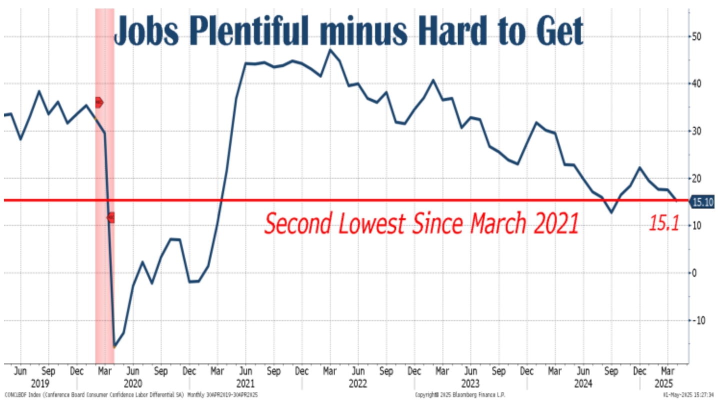
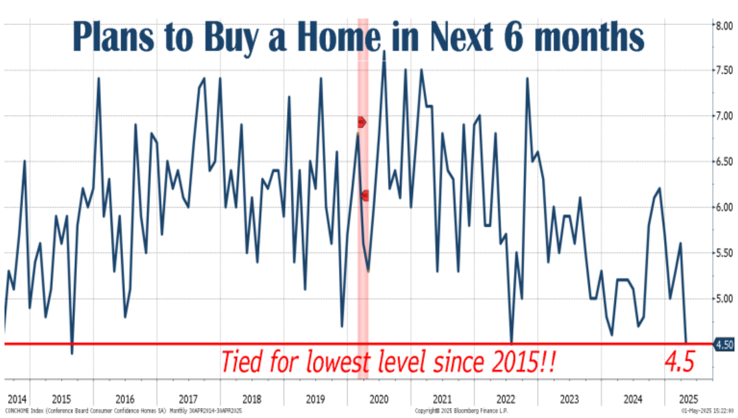


The labor market outlook is similarly worse than last month's already bad report. The labor market differential number (share reporting plentiful jobs minus the share saying jobs are hard to get) is the second-lowest since March 2021, at 15.1, down from 17.5 last month.



Lastly, plans to buy a home in the next six months declined to just 4.5%, down from 5.6% last month and tied for the lowest since 2015. Tariff-related uncertainty is freezing consumer activity in place. All of this, combined with the low job openings data in the Job Openings and Labor Turnover Survey (JOLTS), shows a bearish outlook in the survey data that is expected to hit the hard data soon.



Bottom line: The Conference Board Sentiment Index was the latest in "soft data." If this sentiment morphs into action, there will be troubles ahead.

AS TEXAS GOES…

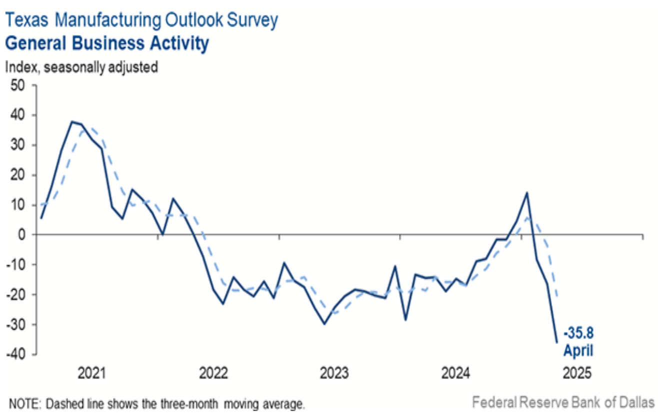
*"This loss of freight in the market will bleed into every area of transportation. I have already **had to make the heartbreaking decision to lay off one third of my staff**. Any further cuts would cripple our ability to operate at even the most basic level. At this point, **we are staring down the very real possibility of shutting down entirely**. **Ten years of fighting to keep a company alive and people employed through a global pandemic, the freight recession of 2023-24, and now this."**— Anonymous comments from a trucking company in Texas*

Texas is the second largest state economy in the U.S, behind only California, and it is one of the largest economies in the world, rivaling many countries in term of gross domestic product (GDP). So, what happens in Texas has a material impact on the national economy.

The Dallas Federal Reserve Bank does monthly surveys of both manufacturing and service businesses in its district. While the data isn't national, it comes from the region where some of the strongest growth occurred in recent years. So, other things being equal, we would expect businesses there to be among the most optimistic.

Respondents are asked "What is your evaluation of the general level of business activity?" versus the prior month. They can answer either "Improved," "Remained the Same," or "Worsened."

Manufacturers responded with a horrible reading of -35.8 in April from -16.3 in March (and more than twice as bad as the already-downbeat consensus estimate of -17.0). This makes it three months in a row of negative readings, and this print took the index down to its most depressed level since May 2020. The six-month forward component has gone from +7.7 in February to -15.2 in April, so it is a waste of time to expect a turnaround any time soon.



Source: Federal Reserve Bank of Dallas

And the same question for service businesses:

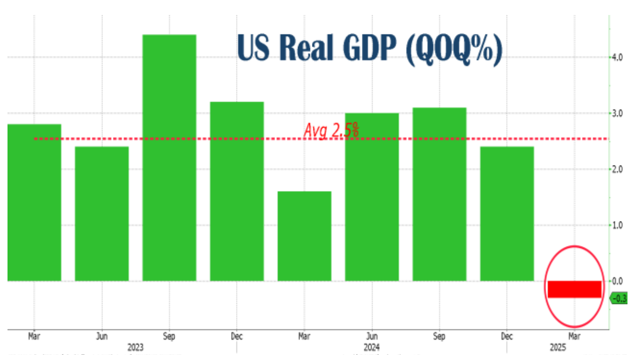
Source: Federal Reserve Bank of Dallas

Bottom line: In both groups, reports had been improving for about two years but have turned downward in the last three months. The change is worse in manufacturing but notable in service businesses as well. In both cases, it is already at or below the low points last seen in 2022. Should Texas fall into a recession, look for the nation to follow.

FIRST NEGATIVE GDP IN THREE YEARS

As for the "hard" data, the Q1 2025 GDP report clocked in at -0.3%, which was much better than the Atlanta Fed's Nowcast model had been measuring. Their final estimate, adjusted for a gold imports anomaly, showed a -1.5% GDP decline in Q1. That said, the best way to look at this number is where the consensus was at the time of the November election when it set at +1.8%. So, clearly, the economy has slowed materially from expectations.

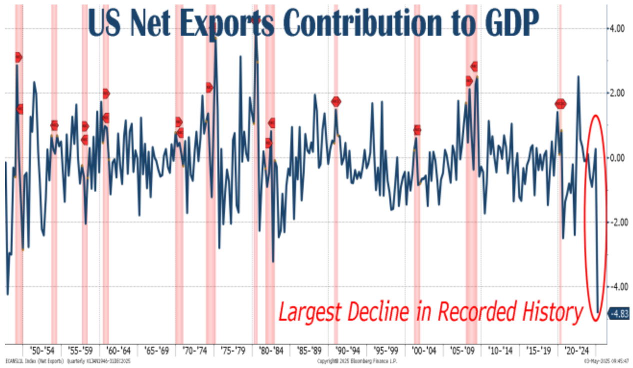
It's also important to highlight that the quarterly GDP reports consist of an "advance estimate" a month after the quarter ends, then two updates. Subsequent data could change the -0.3% advance reading in either direction. Again, this is preliminary, but it sure looks like the economy is making a sudden downshift from the previous eight quarters.



The broad patterns — surging imports, rising inventories, consumer spending spikes — are consistent with U.S. companies and consumers rushing to buy before trade taxes hit.

I often say that debt is future consumption denied as future spending is pulled forward in time. Something like that is happening in this GDP report.

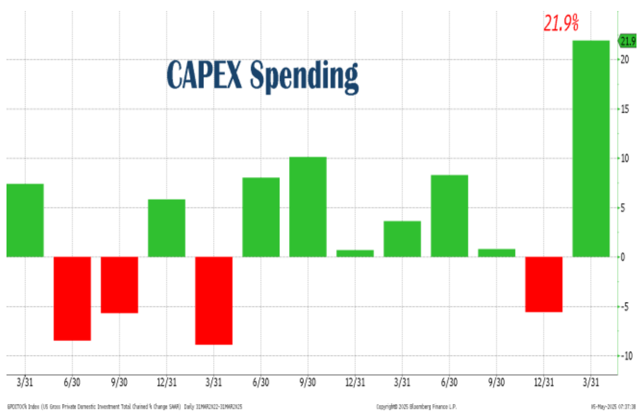
In fact, we have never purchased more foreign products than we just did in the past 90 days. All in an attempt to get us to stop purchasing foreign products. This will will come at a cost to future months. A lot of the imports, capital expenditures (capex) and consumer spending are “borrowed” from future quarters.



On the services side, the most economically sensitive segment of all, restaurants and accommodation, peeled back at a -2.1% annualized pace. Residential real estate remains dead and buried as activity cooled off to a +1.3% rate from +5.5% in Q4, while nonresidential construction virtually stagnated (+0.9%) after a +2.9% Q4 rebound. The Department of Government Efficiency people will really like the fact that government expenditures pulled back at a -1.5% annualized rate, something not seen in almost three years.

The really big positive surprise resided in business capex, which shot up at a +21.9% annual rate,the strongest performance since coming out of the pandemic recession in the Q3 2020. This added more than a point by itself to the GDP headline. Call me skeptical. It seems a stretch that the business sector spent as much in one quarter as it usually does over a two-year period. And there was nothing in the incoming monthly data to suggest anything like this.

However, if this was a good number, when looking at the various Fed surveys, business expenditures are set for a sharp contraction in the next six months. Best to consider this the last hurrah. A payback is coming.



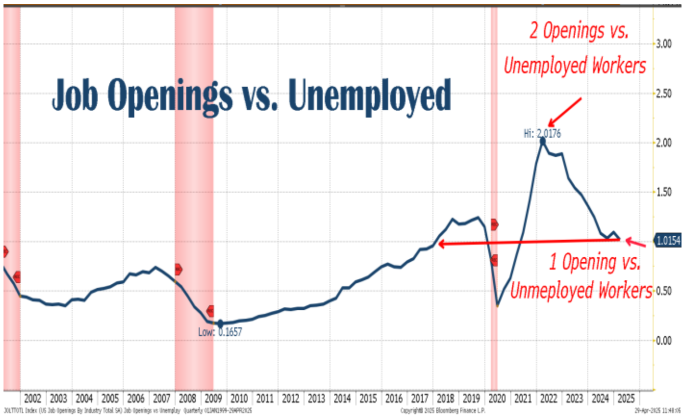
Bottom line: Based on this report, the plain fact of the matter is that the economy was not not as bad as many of us expected. Moreover, investors seem convinced that an outright recession has yet again been held at bay. Nonetheless, I think it is very likely Q2 GDP could be in the red column as well. By definition, that would be a technical recession.

That said, I also hope to see significant policy changes and/or trade resolutions that will lead to a Q3 recovery. Every country has an incentive to negotiate reasonable trade policies so that business can resume. China is no exception. The sooner this gets worked out, the sooner we can recover and move on.

JOLTED AGAIN

Last week, the headlines were flooded with various metrics on the labor markets. And just as we saw last month, the JOLTS data showed slight downticks in the strength of the labor market. Job openings fell -288,000 in March, even larger than February's -282,000 drop. Job openings are now at the second-lowest level since December 2020 (pre-COVID-19 vaccine).

As shown below, the ratio of unemployed workers to job openings is now in balance and back to levels experienced in 2017.



Hires were essentially flat (+41,000), but there was trouble at the construction level. Construction hiring (which is rate-sensitive and affected by the increasingly bad housing sector outlook) was down to just 302,000, which is the second lowest since June 2016 (the lowest being April 2020).

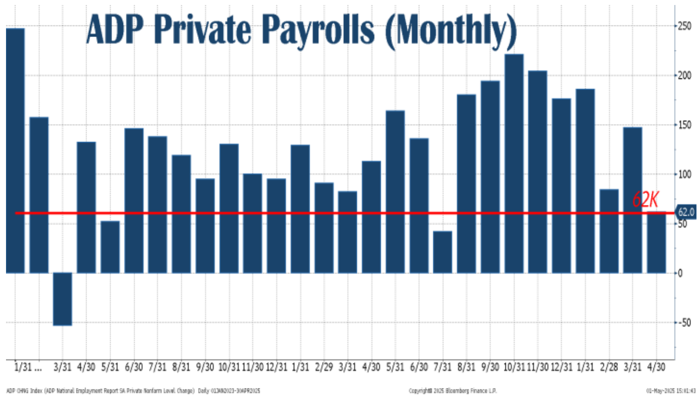
However, there was no sign of an old-fashioned recession pattern in the layoffs data, with layoffs actually down -222,000 in March, and at the lowest level since June 2024. This, on its own, will not prevent a softening labor market. Instead, we are in a "no hire, no fire" economy, where employers are reducing payroll by attrition. Uncertainty is freezing both hiring and firing plans. If tariffs stay in place, we might get a wave of "pent-up" layoffs in the summer or early fall of 2025.

Bottom line: The falling job openings rate is a sign of labor market normalization and by definition puts downward pressure on wage growth. This removes a major concern by which short-term inflationary spikes from tariffs flow through to lasting core inflation. Instead, I continue to view the underlying trend in the U.S. economy as disinflationary, with that trend overwhelming any short-term spikes by late 2025.

PRIVATE PAYROLLS DISAPPOINT

ADP private sector employment for April showed a big miss to the downside — coming in at an insignificant +62,000 increase, which was about half the consensus estimate of +115,000 and was the weakest tally in nine months.

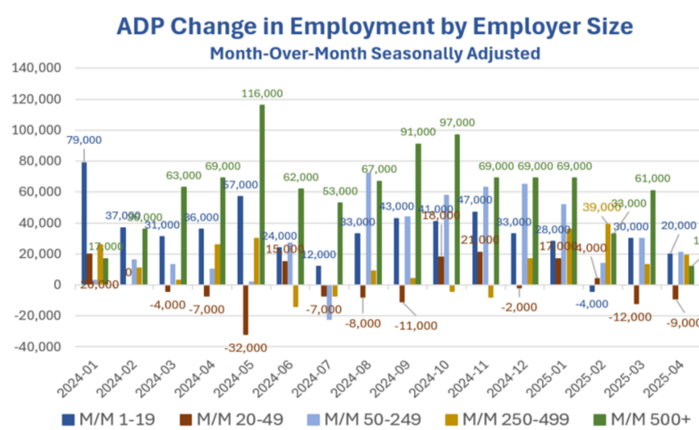
Adding insult to injury was the modest downward revision to March, which is now +147,000 compared to the first report of +155,000.



The principal weakness this time around was in large companies (500+ employees), which practically stagnated (+12,000) — the softest tally since October 2023. But this makes total sense. Why would any business want to expand when it doesn't have any clue what Trump will do with tariffs?

Small businesses (20-49 employees), the ones in the weeds when it comes to the economy, also sputtered with a mere +11,000 job uptick and are far below the twelve-month moving average of +30,000.

In terms of sectors, manufacturing ground down to a virtual halt (+4,000), and the pace of job creation in the once-hot services sector throttled back to just +34,000 from +131,000 in March (the second-faintest pulse in over two years and the third-softest reading since the dark pandemic days of July 2020).



Bottom line: If it weren't for all the tariff uncertainty, the Fed would probably have no problem cutting rates at the May meeting, but that is going to have to wait, based on the cautious rhetoric.

NON-FARM PAYROLLS SURPRISE AGAIN

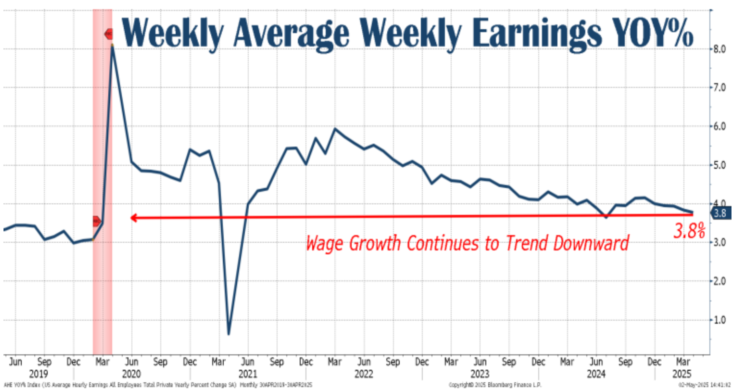
Non farm payrolls in April came in solid at +177,000, above the +138,000 consensus forecast. I should note that while the bond market sold off on this report, March was revised down to +185,000 from +228,000, and the two-month downward revision totaled -58,000. That means that the level of payrolls with the revisions was really just +119,000 above the prerevised level, and as such, the underlying headline number was about +20,000 below where the consensus actually resided. The unemployment rate held in at 4.2%, as widely expected.

And the birth-death model, yet again, accounted for over 40% of that headline payroll expansion (393,000 jobs), the most in two years. It seems odd that with all the uncertainty over tariffs, a plunge in the stock market and rise in interest rates in April, so many new business would start up and hire.

Then, throw in the fact that almost 90% of the headline came from the ranks of the self-employed and about one-third from part-time employment. That is why reading the “non-farm”headlines is quite deceiving because they spit out a quantity but give no information regarding the quality of the jobs being created. But the thing is that most traders don’t typically get much past the headline figure.

Be that as it may, the bond and stock market, as well as the Fed, should actually like the fact that the wage number came in light relative to expectations +0.2% month over month instead of the consensus view of +0.3%. Year-over-year wage growth has decelerated to 3.8%. The three-month annual wage trend, which was running at +4.0% at the end of last year, has grinded lower to just +2.6%, which is the slowest since March 2021.

There is nothing inflationary about this from a labor-cost perspective. And, if the truth is always in the price, then the price of labor is signaling a different message than the distorted headline payroll number. Wage growth simply does not ease like this in a strong labor market.



Bottom line: I find it quite unbeliveable that the U.S. economy can shrink, and all the survey data scream recession, but what never seems to change is the resilence in the non-farm payroll report. And investors are not going to price in a recession, despite the soft data emerging from the latest consumer and business surveys and negative Q1 headline for the GDP data until we start to see outright employment declines.

While the non-farm payrolls have yet to buckle, the problem is that once employment begins to falter, the game is over, and the reality is that the labor market is a lagging indicator and always the last man standing on shore when the tide rolls out.

Let me end by stating again that all of the Bureau of Labor Statistics’ monthly data is total garbage. It is the least accurate government report produced and is often if not always wrong, with significant revisions.

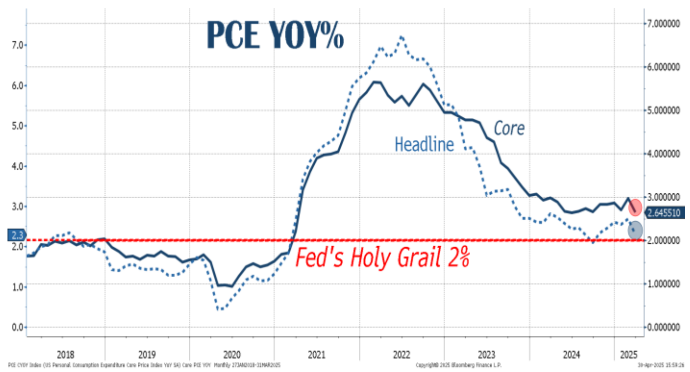
To get a true sense of the labor market, one needs to look at the Quarterly Census of Employment and Wages (QCEW) and Business Employment (BED) reports, which represent a 96% sample of workers. But those reports lag by about five months. I should note that the QCEW reports have been hugely negative and there is every reason to believe QCEW trends will continue. In other words, I expect the payroll headline number to be revised lower.

IF IT WASN'T FOR TARIFFS…

It was a heavy data dump last week, but nothing was as important as the core Personal Consumption Expenditures deflator. The Fed's preferred inflation metric came in flat in March, a tad below the +0.1% consensus estimate. The year-over-year trend receded from +3.0% to +2.6%.

Importantly, the Powell "super core" also was flat. In fact, this was the first time since the deflationary episode in April 2020 that it hasn't been growing. (This is services, excluding housing and energy.)

The Fed looks at this because it is the inflation metric that lines up best with labor market conditions in the once-sizzling, but now softening, services sector. Indeed, services, to the second decimal, came in light at +0.15% month over month — the smallest number since November 2020.



Bottom line: Prior to the trade war, the disinflationary trend had reestablished its downward momentum. Now we wait to see how the tariff soap opera unfolds.

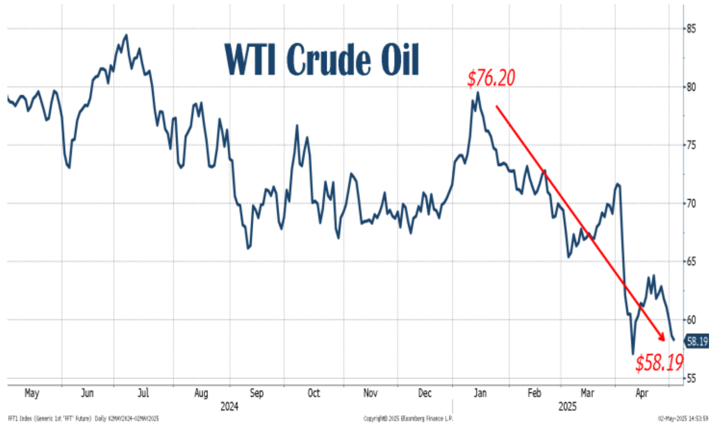
STOCKS UP, OIL DOWN

Ever since the "yippy" comment at the April 9 lows, which coincided with the 90-day reciprocal tariff "reprieve," it is clear that there is indeed a "Trump put. If all it takes is the word "deal," day in and day out, to whip up this much investor exuberance, then suffice it to say that bear markets are definitely a thing of the past. Buy, Mortimer!

The improved risk on sentiment is also attributed to trade war clouds parting. The White House is shifting from aggressive tariffs towards doing "deals."

While the stock market has recovered nicely from its recent lows, oil prices have plumetted. The oil price is a very big deal and sends a very important message. West Texas Intermediate (WTI) started the year at $72 per barrel before trading to $76.20 per barrel. On Friday, WTI closed at $58 per barrel for a -24% slide. The White House will surely accept this with open arms, but this is not because of "drill, baby, drill."

This is partly OPEC+ and partly the fact that cargo activity has collapsed during this current trade war. The world's five largest containership operators say bookings for eastbound trans-Pacific shipments are down by at least -30% over the past month. In other words, the drop in crude may well be a true negative economic event.



Bottom line: Keep a close eye on oil prices. We're rapidly approaching the price where layoffs start beginning in Texas. ~$50/BBL. Texas is the second biggest economy in the country. If Texas goes into recession, America goes into a recession. It's that simple.

THE LATEST ON THE TRADE WAR

The following quotes come from President Trump's interview on *Meet the Press*, which aired yesterday. It's pretty incredible stuff, but it may help explain the market action overnight:

"The tariffs are going to make us rich. We're going to be a very rich country."

"I don't think that a beautiful baby girl needs — that's 11 years old — needs to have 30 dolls. I think they can have three dolls or four dolls because what we were doing with China was just unbelievable. We had a trade deficit of hundreds of billions of dollars with China."

"They don't need to have 250 pencils. They can have five."

"But they said today they want to talk. Look, China — and I don't like this. I'm not happy about this. China's getting killed right now. They're getting absolutely destroyed. Their factories are closing. Their unemployment is going through the roof. I'm not looking to do that to China. Now, at the same time, I'm not looking to have China make hundreds of billions of dollars and build more ships and more army tanks and more airplanes."

"I think what's — what is a great misnomer is the word "tariff" in many cases, it's not — to me, I don't view it as a tax. I view it as an incentive for people to come into the United States and build plants, factories, offices, a lot of things. I think it's an incentive."

"China's an abuser, but there are other abusers. Many of them are friends, the so-called — I say friend and foe, and friend is oftentimes worse than foe. ***But what people don't understand is, and this is a lot, the country eats the tariff. The company eats the tariff. And it's not passed along at all."***

Bottom line: Frankly, a lot of the comments above are bizarre. But what I find most bizarre is that the President doesn't realize the tariff is a duty that is charged to the U.S. importer — and for that business, it is a trade-off between margin squeeze or cost pass-through. The foreign exporter only suffers the loss of volume sales.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"We are seeing that two-year rates are now below fed funds rates. So that's a market signal that they think the Fed should be cutting."— Scott Bessent, Treasury Secretary

Last week, the 10-year Treasury and long bond (30-year) experienced at 13 basis points and +10 basis points surge in a two-day span. This is not exactly a common event. Part of it reflects the new "risk on" trade mentality from all the so called "deals" being discussed. Part is the "feel good" data in the unemployment report. Part of it is Japan's finance minister introducing a new wrinkle, stating that his country's $1.13 trillion of Treasury holdings "does exist as a card" in this current round of trade talks.

Then there is the Fed. Nobody expects any move at this week's Federal Open Market Committee (FOMC) meeting, but in the wake of what was perceived to be a resilient piece of U.S. labor market data, markets are now pricing in 35% odds of a rate cut by the June 18 Fed meeting, which is far below the 55% probability being attached prior to the release of Friday's report (and nearly 70% just a month ago).

It goes without saying that if the hawks on the Fed read the morning papers, they won't like what they see in the Saturday *New York Times*, that much is for sure: "Companies Are Serving Notice: We're Raising Prices Because of Tariffs" and "Car Prices Expected to Rise as Tariffs on Parts Kick In." We have not come close to seeing the effects of this trade war and the climate of uncertainty .

In contrast to what was an active data calendar last week, we face a dearth of numbers from now to Friday. The key will be Wednesday's FOMC meeting, but the Fed is widely expected to do nothing, and guidance is likely to be on the murky side.

Bottom line: In this environment of extreme volatility, the only prudent thing to do is to stay on 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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