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Weekly Relative Value

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WEEK OF JUNE 2, 2025

Here Come the Judges

"The challenged Tariff Orders will be vacated and their operation permanently enjoined." — Summary judgment of U.S. Court of International Trade

Here come the judges!

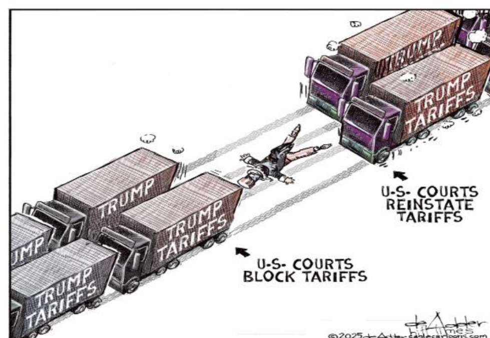
The big news last week was the U.S. Court of International Trade's ruling that the White House wrongfully used an emergency law to lower this tariff boom on America's trading partners, including the 10% baseline levy.

Please note the court skipped over the plaintiffs' motions for an injunction as moot and went directly to issuing a summary judgment.

By the way, the ruling was unanimous in the right court, and one of the judges was appointed by President Trump, another by President Reagan.

The decision blocked tariffs on Mexico, Canada, China as well as a flat import tax on almost every U.S. trading partner. According to Bloomberg Economics' calculations, the ruling would reduce the effective U.S. tariff rate to below 6% from a high of almost 27% last month — an astronomical level that risked stagflation for the U.S.

However, less than 24 hours later, after the Court of International Trade issued a ruling to block many of Trump's tariffs, the U.S. Court of Appeals ruled the import levies could remain, as it reviews arguments from both sides.



THIS WEEK

- "STALLED"
- MAKE WEALTH INEQUALITY GREAT AGAIN
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While this was an earlier development than anyone expected (and isn't permanent), it will only serve to keep economic UNCERTAINTY elevated and merely delay the timeline for clarity beyond July 9.

It looks to me, in the end, the Supreme Court will eventually have the final word on the tariff file.

Meanwhile, White House trade adviser Peter Navarro said that the Trump Administration will seek to enact trade tariffs through other means if it ultimately loses the court fights over its trade policy:

“I can assure you, American people, that the Trump tariff agenda is alive, well, healthy and will be implemented to protect you, to save your jobs and your factories.”

Where this goes from here is up in the air. Why make a “deal” when you don’t have to? And what happens to all the multi-billion dollars of announced investment plans to circumvent the tariffs? And the BIG question is does this court ruling represent a permanent setback to President Trump’s tariff agenda, or is this going to prove to be a temporary bump in the road? There are more questions than answers.

As such, the period of policy uncertainty is entering a new chapter. What investors and businesses will have to grapple with now is what other legal challenges come our way and what workarounds the administration adopts. Either way, the elevated uncertainty around trade is definitely not behind us by a long shot. And uncertainty is the enemy of decision-making, especially capital spending and hiring plans. Businesses are paralyzed and the billions in tariff revenue expected to help offset the cost of President Trump's tax bill could all but vanish.

"As the courts now play a larger role in the outcome of Trump's tariffs, trade policy uncertainty will only become more entrenched, stifling business investment and consumer spending on durable goods."
— Bernard Yaros, Economist, Oxford Economics

Bottom line: Thanks to the Appeal Court’s ruling, tariffs are still on. However, with the courts now involved in trade policy the high level of economic uncertainty that has triggered a mix of panic and paralysis is not likely to subside all that much. Especially with there also being very little clarity on the fiscal front.

Businesses will continue to sit on their hands when it comes to capex and hiring plans, and for investors, it seems to me, now that the courts are getting involved, the current super-elevated level of uncertainty is going to be lengthened, if not even heightened.

"STALLED"

*"China is an adversary, **but what I really worry about is the enemy within**. **Can we get our own act together**, **our own values and capabilities.** This time is different… **we have to get our act together and quickly**."*
— Jamie Dimon, Chairman and CEO, JPMorgan Chase

U.S. Treasury Secretary Scott Bessent let the cat out of the bag last week when he said that the trade talks with China are "a bit stalled," and this is not exactly a sign that any bilateral trade "deal" is coming our way soon.

For a brief background, China is an export-led economy with 20% of its gross domestic product (GDP) coming from exports. The U.S. share is still China's largest external market. Together the U.S and China have accounted for 40% of the World's GDP since 2010.

The U.S has relied on China to provide high-quality, low-cost goods that income-constrained American consumers needed in order to make ends meet. And China, of course, also served as a major source of foreign capital that came in handy to fund our budget deficits. And unbeknownst to many, China, by the early 2000s, had become our third largest and most rapidly growing export market.

I call it co-dependency.

In Trump's view, China, as the largest piece of the U.S. trade deficit, has led the way in, to use Trump's words, ripping us off for decades. Last week Trump claimed that his tariffs devastated China, and he made a deal purely to save the Chinese from civil unrest, not to help us. He also claims that China is violating that agreement, and as a result, it's no more Mr. Nice Guy.

"China HAS TOTALLY VIOLATED ITS AGREEMENT WITH US. So much For Being Mr. NICE GUY!"
— President Donald Trump

Meanwhile, China accused the U.S. of unilaterally introducing new discriminatory restrictions, including new guidelines on AI chip export controls, curbs on chip design software sales to China and the revocation of Chinese student visas.

"If the U.S. insists on its own way and continues to damage China's interests, China will continue to take resolute and forceful measures to safeguard its legitimate rights and interests," the Chinese Ministry of Commerce said. It also said the U.S. violated the consensus reached between Trump and Xi on Jan. 17.

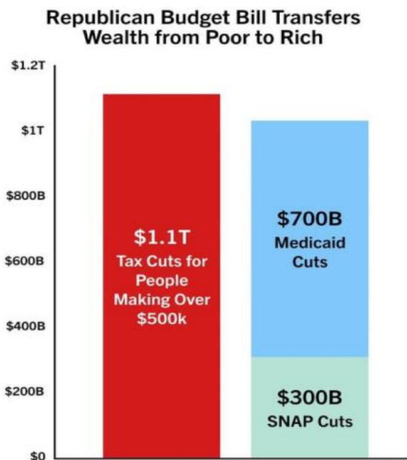
Bottom line: Due to major uncertainty around tariffs and other types of trade-related frictions, look for economic growth to take a hit on 40% of the world's GDP. The implications for both economies — and world economic growth — are squarely to the downside.

The risks may actually be greater in the United States as China can be expected to do what it did successfully in Trump 1.0, which will be to expand its share of the world export market.

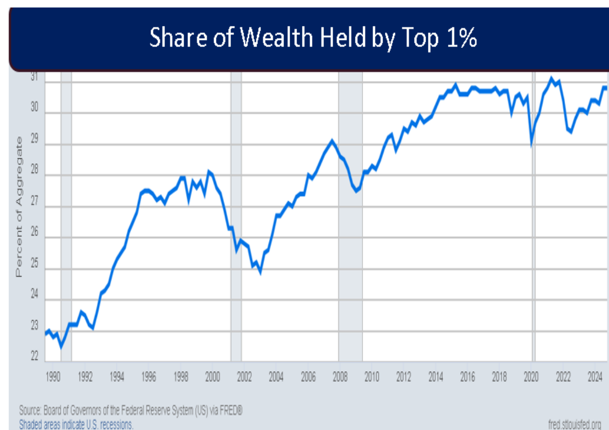
All that said, both economies come out losers, and China will have difficulty reaching its 5% growth target, and the United States faces an uncertain financial future as the twin deficits spiral higher and depleted national savings erode further.

MAKE WEALTH INEQUALITY GREAT AGAIN

For all the talk about no taxes on tips and overtime to highlight how much the government cares about the "little guy," the reality is that when you sift through the budget bill that passed the House on the way to the Senate, **there were $1.1 trillion of tax reductions for those earning over $500,000 a year and an equal $1.1 trillion of spending cuts to Medicaid and food stamps.**



To be clear, in no way am I defending waste and fraud, nor am I switching from economics to social work, but UNQUESTIONABLY, in its current form, this budget will serve to ONLY worsen the gaping income and wealth inequalities in this country.



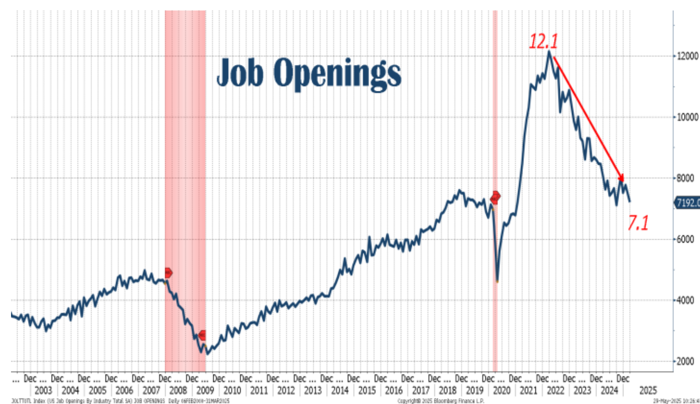
Simply put, a fiscal policy that adds to the debt burden without adding to economic growth compounds the problem of income and wealth inequality. These dynamics, along with a less than vibrant demographic outlook, would seem to me that the "natural rate of interest," which the Fed has been raising the better part of the past year, should soon begin to be lowered.

Bottom line: Through much of the past decade, so much talk in the market was about how the "R-star" (Long term neutral rate) was being depressed by these income inequalities. The Big Beautiful Bill will only further exacerbate the

widening income and wealth inequality. And that should be rather constructive for the Treasury market since it strongly suggests that monetary policy is far tighter than is commonly perceived.

LABOR CRACKS ARE WIDENING

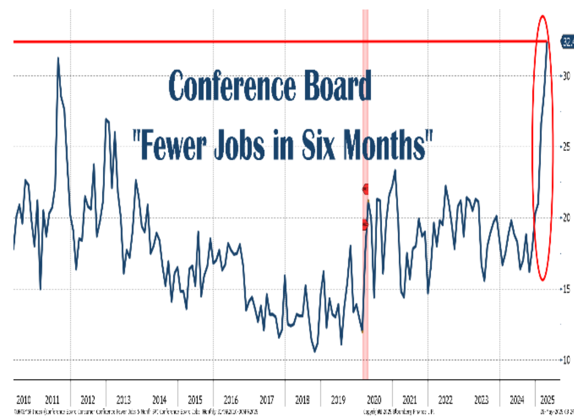
Meanwhile, cracks are starting to form in the labor market. As shown below, job openings have dropped. And this isn't just any drop. Since 2022, job openings have cratered ~60% from over 12.1 million openings to 7.1 million openings today. Similar declines have only occurred three times since 2000.



In another worrisome trend, initial jobless claims hooked up by +14,000 in the May 24 week to 240,000, far above the 230,000 consensus estimate. But what really stood out was the +26,000 jump in the backlog of continuing claims which have now risen for three straight weeks to 1.919 million. That is the highest level since November 2021, when the Fed was pinning the funds rate at zero bound.

This attests to the difficulty that the ranks of the unemployed are experiencing in landing a new job, and not exactly the hallmark of a vibrant labor market or a sign of any wage inflation. Maybe the bond market is figuring all this out. The question is, when will the Fed?

Further, what does it say about a society where twice as many respondents in the Conference Board survey were more bullish on the stock market than on their own job prospects? At no other time in this survey's history has confidence about employment been this low. Then again, who needs to work when we have our nice fat 401(k) plans?

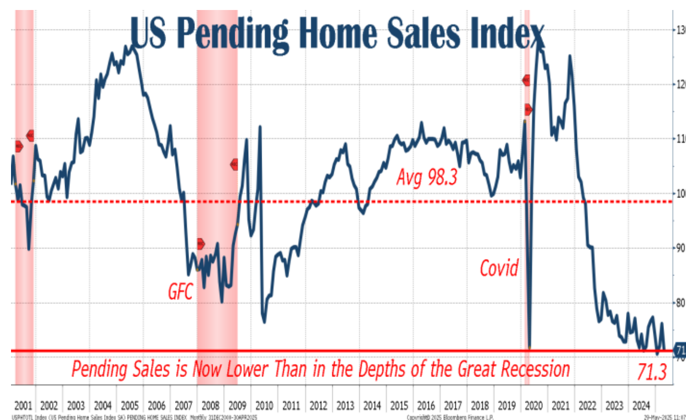


Bottom line: I expect unemployment has bottomed out and we will start to see significant increases in continued unemployment claims. Remember that the labor market is the “glue” that keeps the economy going. If jobs go, so goes consumption and economic growth.

The worst part is that it’s happening when the consumer has burned through excess savings, with credit usage maxed, student loan forbearance ended, and real wages barely breaking even with inflation. In simpler terms: There is no cushion left for many Americans.

ADIOS, SPRING SELLING SEASON!

The housing market is contracting if not deflating, and we saw that in a major way pending home sales, a forward-looking indicator of “closed sales” of existing homes, plunging by 6.3% in April from March and making a mockery of the -1.0% consensus estimate. Pending sales are now down -3.5% on a year-over-year basis, with the negative trend deepening from -0.7% in March. The decline in pending home sales was seen in all geographical regions and especially by big plunges in the South (-7.7%) and the West (-8.9%), just as inventories for sale are piling up.



To illustrate just how weak this spring selling season has been, I show pending homes sales compared to prior Aprils:

- 2024: -2.5%
- 2023: -8.7%
- 2022: -28.0%
- 2021: -34.8%
- 2020: -0.1% (lockdown April)

- 2019: -31.6%.

Let's face it, it really says something about the state of the residential real estate market that the pending sales index is now the third lowest in the 24-year history of the data series. It is even weaker than the most depressed level seen in the Great Recession, which was dominated by a depression in the housing sector. The worst showing in that severe 2008-2009 economic downturn was 80.2 in November 2008, in the aftermath of the Lehman collapse. Today, it resides at 71.3, or nearly nine points below that mark. And yet, the consensus is for no recession, and the Fed remains as tone-deaf as ever.

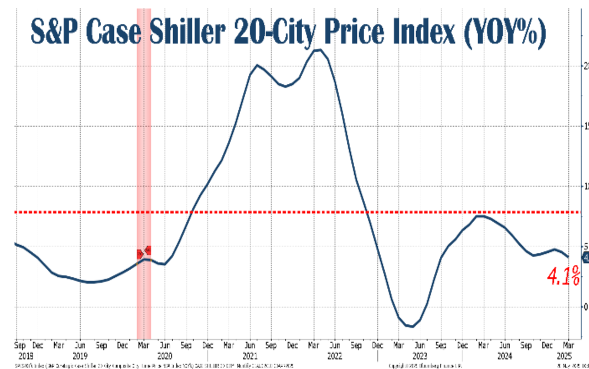
Bottom line: Even though housing is the quintessential leading indicator of the economy with powerful multiplier impacts, the Fed is using elevated UNCERTAINTY as the rationale to keep snoozing.

High prices and elevated mortgage rates bumping against a cooling off in the labor market and personal incomes are kryptonite for this key segment of the economy.

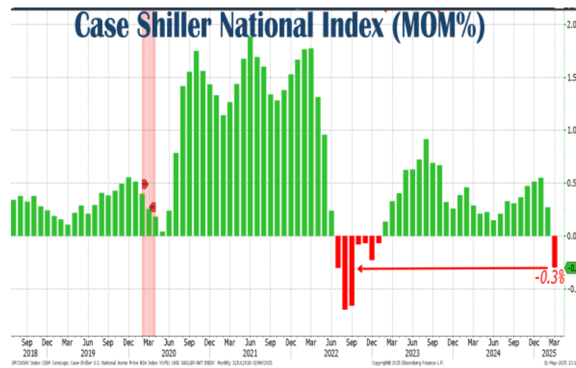
HELIUM COMES OUT OF THE HOUSING BALOON

We are finally witnessing a decisive break in the U.S. home price uptrend line. Median sales prices in the resale market are down -3.0% from the cycle peak. The comparable median sales price in the new home market is down nearly -12% from the nearby highs.

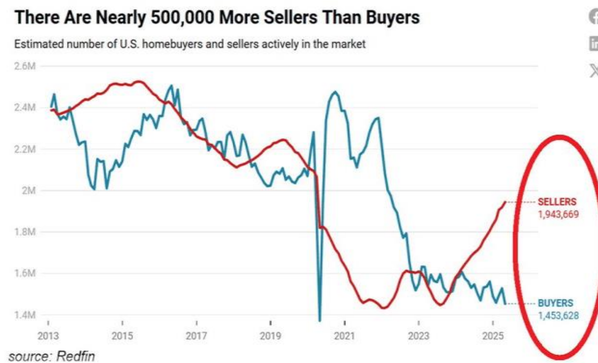
The Case-Shiller Nationwide Home Price Index (the 20-city metric) dipped -0.1% month over month in March — the first negative sequential reading since January 2023. The year-over-year trend has cooled off a lot — from +7.5% a year ago to +4.1% as of March (a nearly two-year low).



The nationwide Case-Shiller Home Price Index fell by -0.3% month over month in March, which was the steepest drop since September 2022 and ended a 25-month string of monthly gains. Year over year, the index is now at 3.37% and back below pre-pandemic levels.



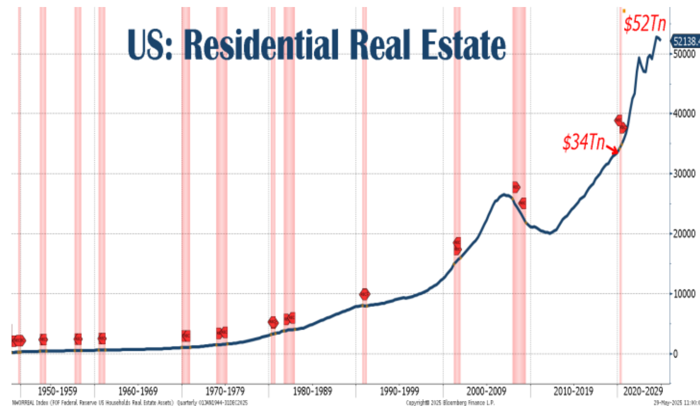
In addition, we are witnessing rising inventory in the once super-tight resale market. According to Redfin data, there are 500,000 more house sellers than buyers on the market, the most in at least 12 years, likely since the 2006 housing bubble. In other words, there are 34% more sellers than buyers, up from 6% in 2024.



As the Fed has kept mortgage rates at punitive levels, the income needed to qualify for an entry-level home has more than doubled since 2020 to $100,000. First-time buyers have been crowded out to such an extent that the builders and developers have no choice but to discount their units aggressively. This is a key reason why the homebuilding stocks are locked in a severe bear market.

With this backdrop, it should not be surprising that home values are now declining in 27 of 50 states on a month-over-month basis, and they're dropping in seven states on a year-over-year basis. These declines will accelerate in the back half of 2025 due to the big build-up of inventory.

Bottom line: Air is now coming out of the ~$52 trillion balloon of residential real estate, which has risen by a mind-blowing 52% since the pandemic.



There is no mistaking that deflation is starting to rear its head in the heart of the consumer and banking sector balance sheets. At some point, Powell and company will be forced to shift their attention.

This is good news for wannabe buyers but less so for existing owners who are no longer benefiting from the wealth effect. This is another reason to be cautious on the consumer spending outlook, even at the high end.

TROUBLE WITH TOURISM

“Whether fair or not, a perception is taking hold that more people are being detained, more devices [are] being searched, and legal travelers are being deported back to their origin country….That creates a great deal of fear.” — Geoff Freeman, President and CEO, U.S. Travel Association

Governments can sit and talk and negotiate, but it seems to me as though the populations around the world are taking matters in their own hand and voting with their wallets and with their feet. And you're seeing evidence in terms of people are boycotting, voluntarily, U.S. goods. That has an impact on U.S. exports.

And you're seeing a lot of evidence of people around the world canceling their trips or redirecting their vacations away from the United States. And travel and tourism, with all the multipliers, touches $2 trillion GDP in a $30 trillion economy and supports about 20 million jobs.

Consider the following:

- Tourism Economics sees an -8.7% drop in international arrivals to the U.S. Europeans are planning -10% fewer trips to America this summer and there has been a huge -33% plunge in flight bookings from Canada to south of the border in the May-July period.
- According to Oxford Economics, spending from foreign visitors to the U.S. is poised to fall 9% or by $8.5 billion this year as negative beliefs tied to trade and immigration policy lead overseas tourists to look elsewhere.

Other estimates suggest the potential economic loss may be even larger.

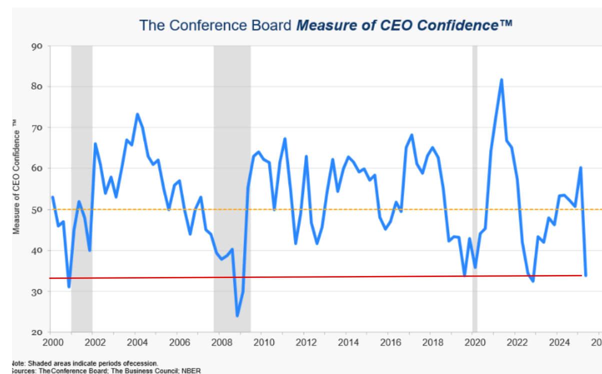
- The World Travel and Tourism Council said it expects the U.S. economy to lose a "staggering" $12.5 billion in spending from international visitors in 2025 and a "direct blow to the U.S. economy overall, impacting communities, jobs and businesses from coast to coast."
- The U.S. Travel Association projects the U.S. will lose $21 billion in travel-related revenue in 2025 if current trends continue.

Bottom line: Tourism is a key sector of the U.S. economy, and unless perceptions and actions change soon, the hotel leisure sector of the economy will end in a recession, if it is not already there.

CEO CONFIDENCE PLUNGES

"The percentage of CEOs planning to reduce capital expenditures over the next 12 months doubled to 26."
— The Conference Board

The Conference Board said its latest measure of CEO confidence revealed an abysmal 26-point decline in the second quarter, the biggest since the survey started in 1976. Here is the CEO confidence, visualized, since 2000.



The survey showed that the vast majority of CEOs (83%) predicts a recession in the next 12 to 18 months. But virtually no one on Wall Street is calling for recession (as usual).

Bottom line: Suffice it to say, the person in the C-suite will be unlikely to open the purse strings to invest or hire until there is greater clarity.

RECESSION ODDS AT 50%?

In the latest Federal Open Market Committee (FOMC) minutes in early May, Fed staffers stated the odds of the economy slipping into recession were as high as the base-case forecast. While it is tough to know at this point if those FOMC minutes released yesterday are stale or not, it was interesting to hear what the Fed staffers had to say:

- "The staff projection for real GDP growth in 2025 and 2026 was weaker than the one prepared for the March meeting."
- "The staff viewed the possibility that the economy would enter a recession to be almost as likely as the baseline forecast."
- "With the drag on demand expected to start earlier and to be larger than the supply response, the output gap was projected to widen significantly over the forecast period. The labor market was expected to weaken substantially, with the unemployment rate forecast moving above the staff's estimate of its natural rate by the end of this year and remaining above the natural rate through 2027."

The Fed staff is saying the odds of a recession are now 50/50!

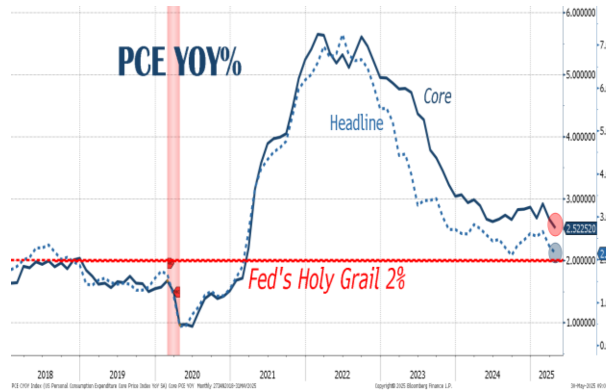
Even if there is no downturn, the output gap (the difference between what businesses actually produce and what they would produce when the economy is in balance) is seen widening through 2027 and "significantly" so, with the unemployment rate climbing above its estimated natural level.

This is disinflationary, and if prescient, will surely be incredibly positive for the Treasury market. How the Fed can sit on their hands indefinitely with this narrative is anybody's guess. Note the swaps market is down to fully pricing in just one rate cut this year.

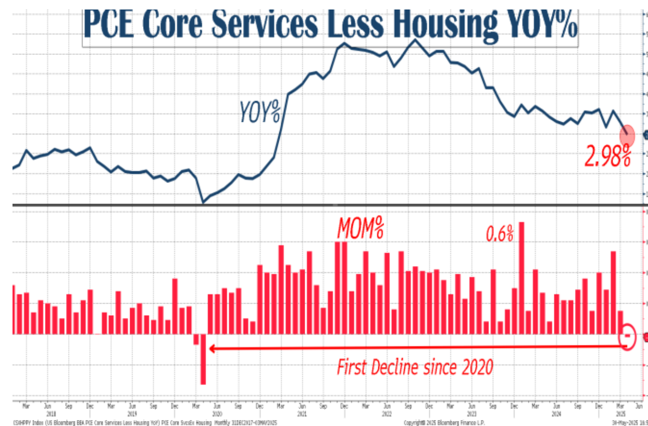
Bottom line: The fate of the economy remains precarious even if we avert a recession. However, the Fed can't act and cut rates until it can assess the effect of tariffs on prices.

PCE ON TARGET

The headline and core PCE indices came in light at +0.1%. This allowed the year-over-year core trend to recede to +2.5% from +2.7% in March (compared to +2.9% a year ago); the headline PCE inflation rate eased to +2.2% from +2.3% (compared to +2.7% a year ago).



What should be important to Fed Chairman Jay Powell is his own super-core inflation number — PCE services excluding energy and housing — which actually dipped to the second decimal place (-0.02% month over month), which has not been seen since April 2020. Then again, he doesn't really talk about it any longer as he dreams up new reasons for staying deliberately restrictive.



Bottom line: Last week Trump told Powell it was a "mistake" not to lower rates. The irony is that if it weren't for the inflation threat from the tariffs and the possible impairment of global supply chains, the Fed would likely be trimming interest rates right now!

WHY SUBSCRIBE TO THE WRV?

There is a lot of noise in the financial world and social media about the markets and the economy. I do what I always do, block out the noise, rhetoric and bullish biases (that point to the rewards without discussing the risks) that dominate Wall Street research and, most of all, try to keep investors out of trouble. This constant analysis goes through the noise, debunks misleading headlines and makes deep dives into the financial markets and economic reality.

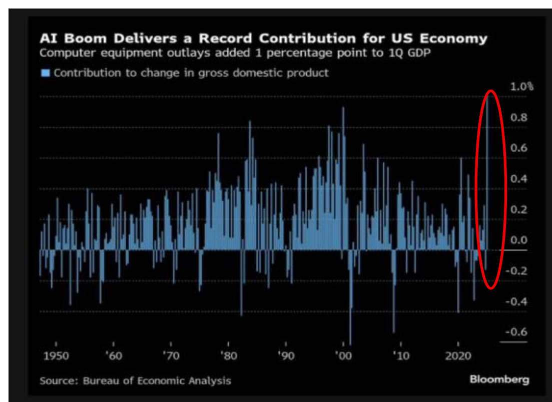
Call me a "permabear" if you will, but I see myself more as the car mechanic who fixes your brake lights and makes sure your side-view mirrors are okay. Risks should never be ignored, and I focus on identifying them. It's what makes the *Weekly Relative Value (WRV)* unique in the marketplace**.**

By subscribing, you will always be up to date with the most relevant economic and market trends, and most importantly, you will be aware of the key risks. To receive future issues of *WRV* in your inbox, subscribe here.

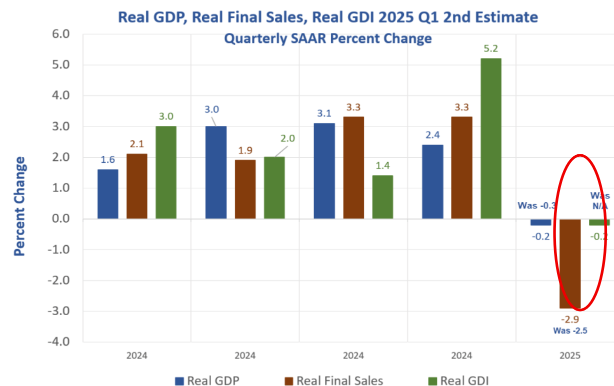
MARKET OUTLOOK AND PORTFOLIO STRATEGY

"I don't want to be the one to stand in front of the steamroller right now… "I'll let somebody else help stabilize the long end. I'm concerned that it's going to get worse before it gets better."
— Bob Michele, Global Head of Fixed Income, JPMorgan Asset Management

The Bureau of Economic Analysis (BEA) reported that Q1 GDP declined 0.2% in the first quarter of 2025. Purchases of computer equipment (the AI boom) added a full percentage point to GDP in Q1 2025.



While the bottom-line GDP declined by -0.2%, Real Final Sales (RFS) is the bottom-line estimate for the economy. The rest is inventory adjustment that nets to zero over time. From Q4 2024, RFS was a whopping -2.9%. This will have a much bigger impact on the National Bureau of Economic Research's recession determination than the top line report of -0.2%



Inventories added a massive 2.64% points to Q1 GDP. Subtract that out and the bottom-line GDP estimate is -2.9%. We now have the second largest inventory surge in history at a time when the economy is clearly slowing. The inventory build occurred because corporations front-ran Trump's reciprocal tariffs.

The BEA Q1 GDP report also showed a decline in corporate profits. Profits swing substantially, but -2.95 % is a big move. It's the largest decline since -8.64% in Q4 2020 coming out of the pandemic.

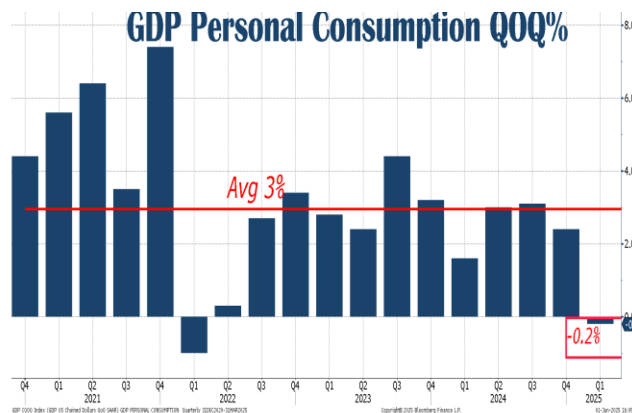
The delinquency rates on auto, credit cards and even mortgages are at the highest level since 2011.

Student loan delinquencies are another issue. What former students spent on goods and services will now go to debt paydowns. In isolation, this is deflationary. The delinquency rate jumped from 0.7% in Q4 to 8% in Q1.

The labor market is clearly weakening. Initial claims and continuing claims have trended higher, and that trend is likely to continue.

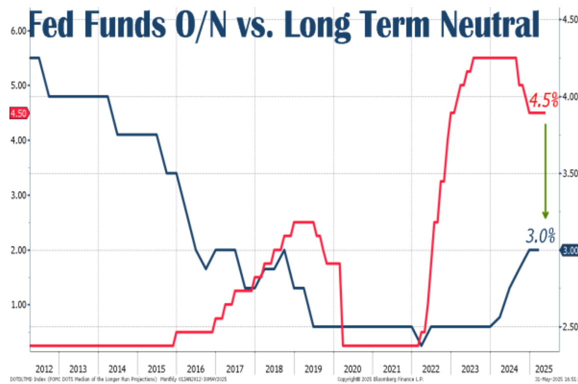
Finally, if the stock market tanks, that will be another drain on factors supporting consumption.

As depicted in the graph below, personal consumption in the latest GDP report fell into negative territory for the first time since Q1 2022 and is well below the average personal consumption rate of 3%!



The economy appears more unstable than many realize. I believe that growth is weak and will likely weaken further. Aside from the AI craze, I don't see any signs of vitality coming to the rescue. With the pending home sales numbers coming out lower than the worst points we experienced during the Great Recession in 2008-2009, consumption slowing and capex coming to a standstill, don't be surprised to see near-negative GDP growth between now and the end of the year.

As the following graph shows the Fed restrictive relative to where they believe the long-term "neutral" fed funds rate (the theoretical rate which is neither stimulative nor restrictive to the economy) should be. In other words, the Fed could lower rates by 150 basis points to 3% and still not be stimulative.



Despite my view on the economy and Fed policy, San Francisco Federal Reserve Board President Mary Daly and her Dallas counterpart, Lorie Logan, stated last week that it is going to be quite some time before the Fed starts to step on the policy gas pedal again. Meanwhile, the market is now expecting the Fed to hold rates steady at the FOMC meetings on June 18 and July 30 at 4.25-4.50% but then cut rates 25 basis points at the Sep 17 meeting.

Concerns around the potential inflationary impact of President Donald Trump's tariffs along with the Moody's downgrade shifted the focus back to the fiscal outlook and a tax bill in Congress that stands to boost the deficit by around $3.3 trillion over the coming 10 years, according to the Committee for a Responsible Federal Budget.

As investors fretted about the prospect of increased bond issuance to plug deficits, the 30-year yield reached 5.15% last month, approaching levels last seen in 2007. Note the U.S. 30-year real rate is now close to 3% (highest since November 2008.

Meanwhile the tariff file is not going away, and tensions with the EU, China and others will likely stay at elevated levels. I have to wonder how wise these policies are considering that the U.S. government faces an epic $10 trillion of Treasury refinancing needs over the course of the next year. Being able to do this at lower interest rates may prove difficult if foreign investors don't show up at the Treasury auctions. (I thought Scott Bessent was attempting to target the 10-year Treasury yield — but did he mean higher? He should probably hand in his resignation at this point, especially after the obvious degree of discomfort he displayed last week in his Bloomberg interview.)

Yields on the long bond have risen, while those on 2-, 5-and 10-year notes have fallen. This sort of divergence is rare — the last time it happened over a full year was in 2001 —underscoring the pressure on the long bond as investors demand added compensation to lend to the U.S. government for such a long period.

Despite the recent underperformance of the long end of the Treasury curve, the market is giving us some vital information, which is that buyers are willing to step into the Treasury market when the 10-year hits 4.5%, and the long bond breaches the 5.0% threshold. It was rather impressive actually to have seen the 10-year Treasury yield manage to decline -11 basis points last week to 4.40%. That is incredible when you consider the very negative comments Jamie Dimon made last week on the bond market — ready to "crack" at some point — and many at the FOMC pushing back on the notion that there will be any policy shifts coming before the end of the summer.

Moreover, at current levels there is a ton of coupon protection, and real rates are high by the standards of the past several decades. However, for the big rally to occur, it is a waiting game — waiting for the weak soft data to morph into the hard data to convince investors that recession risks are more elevated than commonly perceived. At this point, that likely will take a few months of negative prints in the non-farm payroll data. That, and the unemployment rate, are really what matters most right now as far as market interest rates are concerned.

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

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