INVESTMENT SERVICES

Weekly Relative Value

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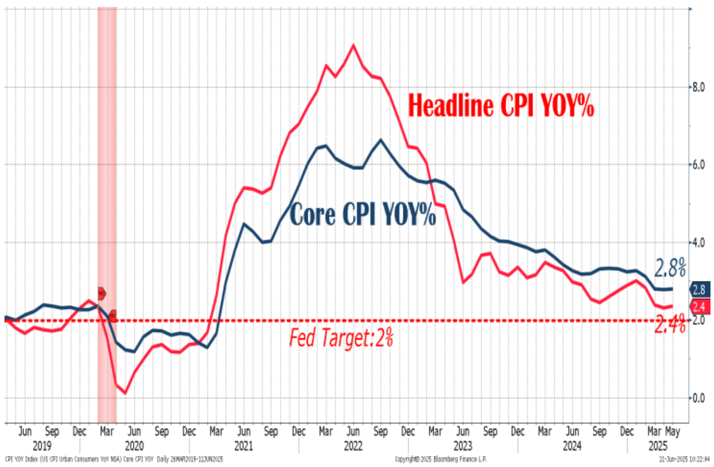
WEEK OF JUNE 16, 2025

The Calm Before the Storm?

"I mean, it's one banana, Michael. What could it cost? $10 plus shipping?"
— Line from Arrested Development

The May Consumer Price Index (CPI) report released last week was considered the first inflation gauge to show how tariffs are impacting prices. For the fourth consecutive month, the CPI was below Wall Street estimates. Both the headline and core indices came in at +0.1% month over month apiece. Base effects took the year-over-year headline inflation rate up to an as expected +2.4% from +2.3% in April; the core year-over-year rate remained at +2.8%.



Amazingly, over the past three months, the CPI has edged up at a grand total of a +1.0% annual rate. The core is now below target on this basis at +1.7% annualized and well below the Fed's 2.00% target. At least it is encouraging to see that, heading into the tariff file, inflation pressures were back into cooling-off mode.

Core goods, the most affected by tariffs, saw inflation tick up, but not to a level that's discernible. Goods where inventory is held for longer (like autos) avoided tariff effects for now. Interestingly, new car prices fell by 0.3% and used car prices declined by 0.4%.

This suggests that companies are finding ways to limit the pass-through of higher costs resulting from tariffs. Might profit margins be weaker than expected in the coming earnings reports for companies in these industries?

THIS WEEK

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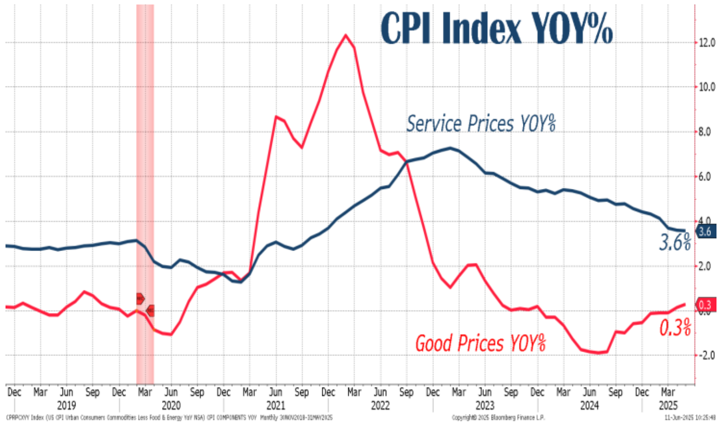
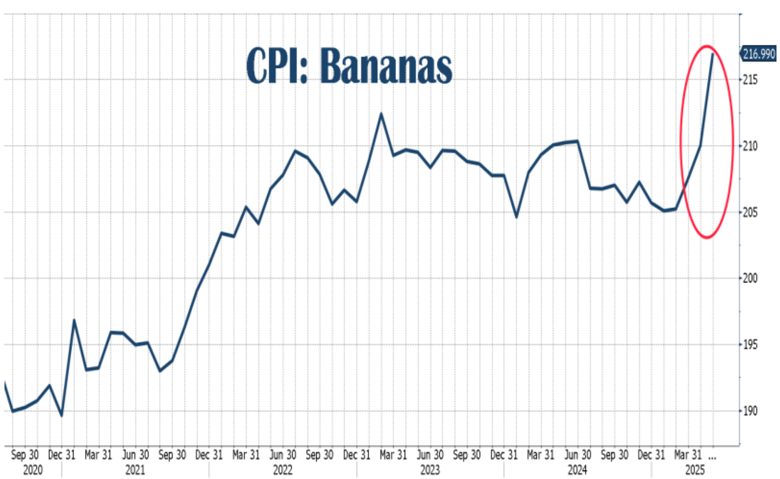


Imported goods with shorter inventory times — like bananas — saw price surges.

For a bit of comic relief, see the following conversation between Commerce Secretary Howard Lutnick and Representative Madeleine Dean:

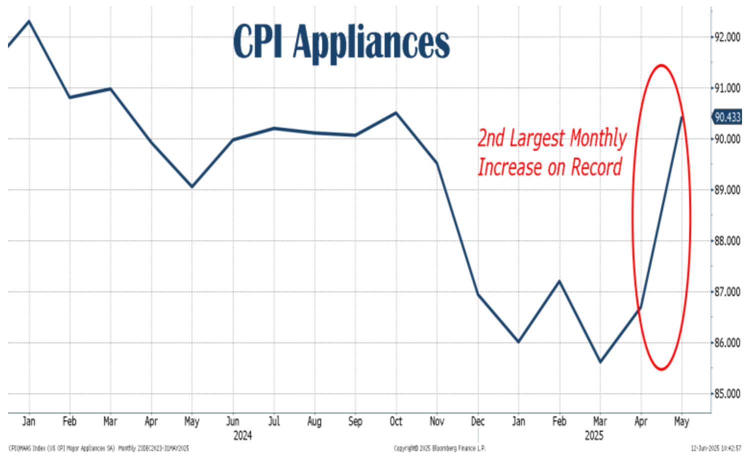
DEAN: *What's the tariff on bananas?*
LUTNICK*: Generally, 10%.*
DEAN*: Walmart has already increased the cost of bananas by 8%.*
LUTNICK*: If you build in America, there is no tariff.*
DEAN*: We cannot build bananas in America.*



Moving on. There was no inventory buildup of appliances in anticipation of the trade tariffs. As a result of the lack of inventory, consumer appliance prices surged 4.3% in May, the second largest monthly increase ever. (The largest was a post-lockdown August 2020 spike.) Appliance importers seem to be making their customers pay. This is a possible sign of how tariffs might change prices for U.S. shoppers in the future.

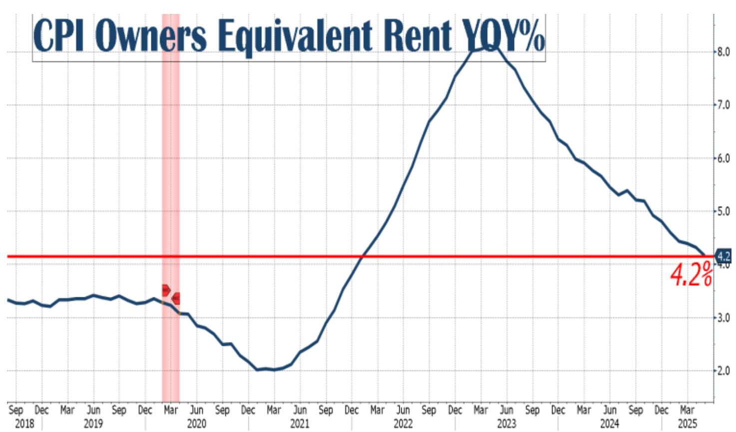
One other thing: The Commerce Department just announced that washing machines, refrigerators and other common household appliances made with steel parts will soon be subject to an expanded 50% tariff (the current level for all other steel and aluminum imports). Nice to see where all these trade deals and reprieves have led us.

The message to the consumer is *don't delay buying appliances*. If you want that toaster or microwave — get it now, as prices could soar in the next few months. Likewise, it may be too late to buy video and audio equipment, as tariffs already showed up briskly there. Wait for a recession.

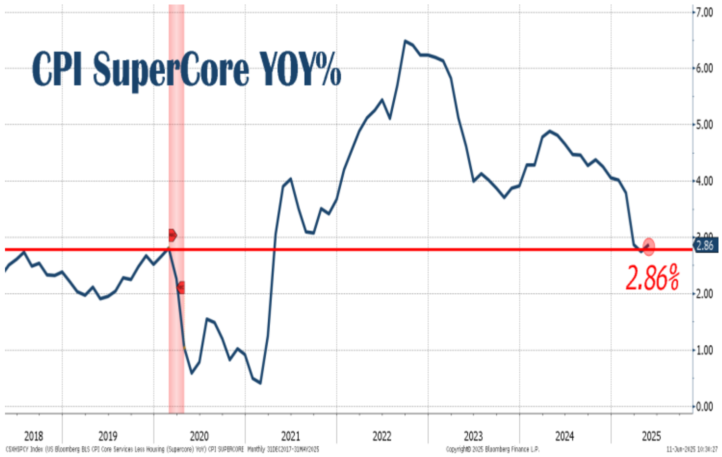


In the non-tariff categories, Owners' Equivalent Rent (OER) is the single largest component of the CPI with a current weight of ~26 %. OER is the price one would pay to rent one's own home, unfurnished, without utilities. The Bureau of Labor Statistics (BLS) reported a decline in OER from 0.4 % to 0.3%. On a year-over-year basis, OER has steadily declined from the pandemic peak of ~8% in March 2023 to 4.2%.

As I have written previously, nobody actually pays OER. Those with a mortgage pay a fixed amount every month. Many argue that because the mortgage payment is constant, the monthly increase is zero. So, for all practical purposes, this number is a flawed input. Nevertheless, this component of the CPI has been the primary culprit to the recent rise in inflation.



The Powell "supercore" index (services excluding shelter and energy) came in at less than +0.1%, which is exactly the three-month trend at an annual rate! The six-month pace is at +2.4%, and the year-over-year trend is at +2.9%, which highlights the level of disinflation momentum that not too long ago was near and dear to the Fed Chairman's heart.



Finally, strip out shelter, which is cooling off, consumer prices are now running at -0.2% annual rate over the three months to May. The core CPI (excluding shelter) came in flat as a pancake and has shown no net change since February. Indeed, over 60% of the CPI deflated (NOT a typo) slightly over the past three months! What more does anyone need to know about how inflation looked before this tariff war?

Have a look at the items that actually experienced DEFLATION month over month:

- Airline fares: -2.7% (deflating in each of the past four months)
- Financial services: -1.4% (ending a three-month run-up)
- Energy: -1.0% (down in two of the past three months)
- Furniture: -0.8% (biggest decline of 2025 to date)
- Recreation services: -0.1% (on top of a -0.3% falloff in April)
- Used cars/trucks: -0.5% (down in each of the past three months)
- Apparel: -0.4% (after dipping by -0.2% in April)
- New vehicles: -0.3% (after a flat April and the steepest decline in a year)
- Hotels/motels: -0.1% (slipping in each of the past three months)
- Motor vehicle repair: -0.1% (first decline of the year)
- Tech hardware and software: -0.1% (after being down -0.7% the prior month)

This data tells you a thing or two about the consumer and shape of the economy too. Powell needs to find a replacement for “solid.”

Bottom line: This latest inflation report is undeniably good news. If it were not for trade and tariff uncertainty and the Fed’s obsession with its credibility, the Fed would be cutting rates, and the Treasury market would be rallying right alongside.

That said, it doesn’t disprove the threat that higher prices may come. In fact, this may be the calm before the storm. It should not be lost on anyone that products out of China are costlier now than was the case a year ago. Consumers haven’t felt the squeeze yet, as evidenced by the tame CPI reports because the inventory being sold today is pre-tariff inventory. It will take two to three months of inflation reports before claiming the coast is clear, if not longer. This makes the Fed’s job that much tougher because the price shock is not a matter of “if” but a matter of “when.”

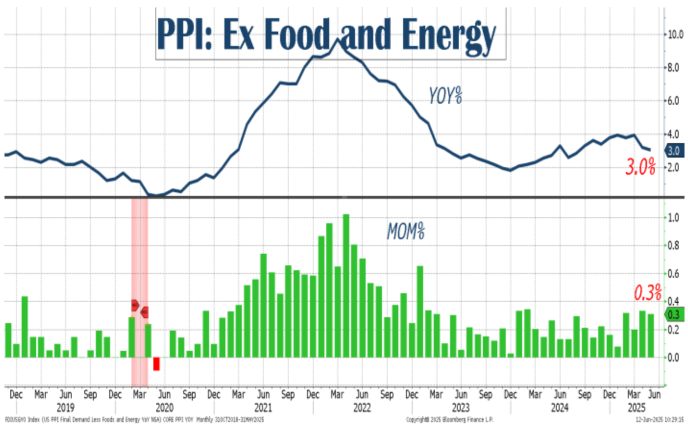
The good news is that the majority of the CPI is not influenced by tariffs, and the easing in price pressures across many of the services like airfares, recreation and residential rents is highly encouraging.

PPI FOLLOWS CPI LOWER

First came the CPI with another "lame and tame" reading of 0.1% in the headline and core CPI data for May. Then came a tepid +0.1% month-over-month readings in the May Producer Price Index (PPI).

The headline PPI inflation rate ticked up on base effects to +2.6% year over year from +2.5%, but what is more important is that the core (excluding energy and food) eased to +3.0% year over year from +3.2%. So far, the tariff-led inflation has yet to rear its ugly head, though these are still early days. Also, the tariffs may exert a greater impact on profit compression than on final pricing.

While the tariffs should be hitting the goods sector hard, even prices here were held to a tame +0.2% month-over-month gain, and there has been almost no net change since the turn of the year. Rather incredible.



Bottom line: What's the Fed to do? It fears the future, but the real-time inflation data says that rate cuts now are perfectly appropriate.

THE LAYOFF CYCLE IS GAINING TRACTION

As I highlighted in last week's *WRV*, "Jobs Market Is Weaker than Advertised," the headline payroll report was a bit of a ruse.

In the same vein and to further highlight the labor market weakness, initial jobless claims came in at an elevated 248,000 in the week of June 7 — the consensus was 242,000. This is tied for the highest in over eight months! While this level of jobless claims remains relatively low from a long-term perspective, it is also widely believed that fewer people are making claims, as they can earn more freelancing in gig economy jobs like Uber and DoorDash.

More importantly, the four-week moving average of 240,000 compared to 223,000 at the end of Q1 is classified as a breakout. The four-week moving average, at 240,000, is the highest since August 2023.

The backlog of continuing claims, which comes out with a one-week lag, jumped to 1.956 million from 1.902 million. That is a big move and takes the level to its highest since November 13, 2021, when Powell was still pinning the funds rate at the zero bound.

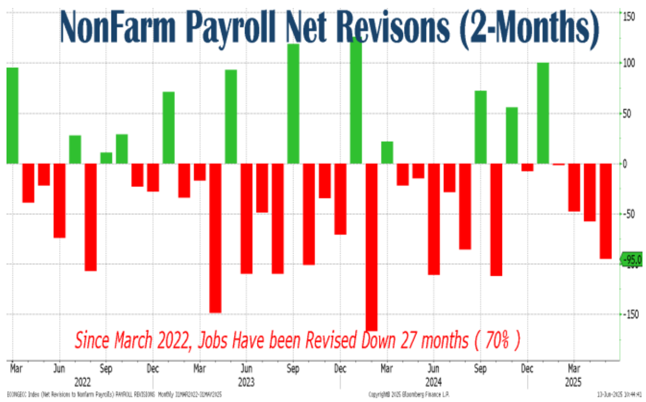
Bottom line: Two things jump out of this report: The layoff cycle is accelerating, and it is becoming increasingly difficult for the ranks of the unemployed to land a job. At the current trajectory, we are within two months away from seeing the first decline in non-farm payrolls since December 2020. When that happens, look out for Wall Street economists to lift their recession odds.

BE PREPARED FOR BIG DOWNWARD JOB REVISIONS

On June 6, 2025, the BLS reported May's employment at 139,000 jobs, slightly above expectations, fueling optimism. However, prior months' revisions reveal a weaker labor market:

- February 2025: Revised down 15,000, from 117,000 to 102,000.
- March 2025: Revised down 108,000, from 228,000 to 120,000.
- April 2025: Revised down 30,000, from 177,000 to 147,000.

The graph below shows that non-farm payroll payrolls since April 2022 have been revised downwards 27 out of 39 times (70%). These downward adjustments highlight that the labor market has been much weaker than the initial nonfarm payrolls have indicated.



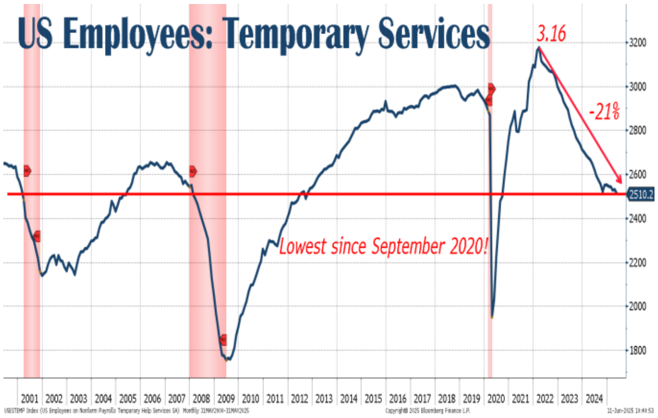
Also, as I have highlighted previously, the preliminary Quarterly Census of Employment and Wages (QCEW) estimates suggest that job gains were overstated by around 75,000 per month (857,000) in the final three quarters of 2024. If recent history is a reliable guide, this overcount could increase to anywhere from 1.0-1.3 million jobs when initial Q1 2025 estimates are folded in for the preliminary benchmark adjustment. This would likely reflect the lower labor supply from slowed immigration. And that's before the trade war went into overdrive.

Bottom line: Be prepared for a big downward benchmark revision to the job estimates in the upcoming employment benchmark adjustment this September.

TEMPORARY HELP DECLINES

Historically, temporary job numbers have been seen as a forward-looking economic indicator. When businesses are confident and expanding, they often hire temporary workers initially before committing to full-time staff. Conversely, if economic conditions soften or they anticipate a slowdown, businesses tend to reduce or eliminate temporary positions first, as these workers can be more easily released without incurring the costs associated.

Keep an eye on temporary help services employment, which has dropped 666,000, or 21%, since the peak to 2.5 million, the lowest since September 2020. Such a drawdown has never occurred outside of recessions.

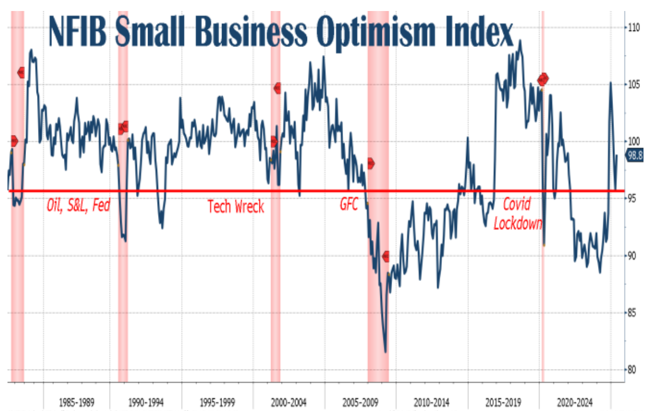


Bottom line: Temporary services is a leading indicator for the U.S. job market, and the trend is a bit worrisome.

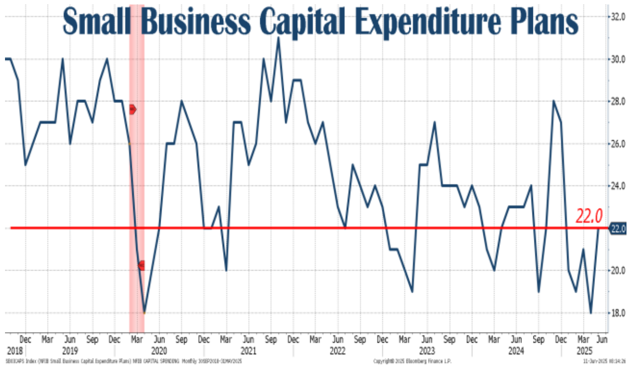
GOOD THINGS COME IN SMALL PACKAGES

Wall Street and the financial media focus on the high-profile companies such as the Magnificent 7, but there is little exposure to the small businesses in America. Yet there are ~35 million small businesses compared to 20,000 large businesses. In other words, small businesses represent over 99% of all businesses in the U.S. They account for 43.5% of economic activity in the U.S. These small firms also employ 59.0 million people, or 46% of all private-sector employees and are responsible for 61% of overall job growth since 1995.

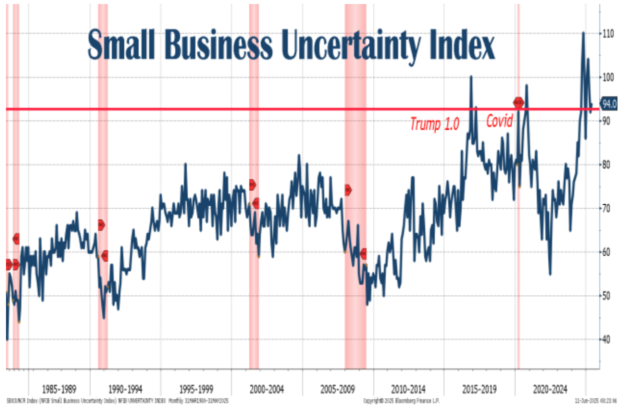
So, what happens in the small business community has a significant impact on the overall economic profile. To that end, the latest National Federation of Independent Business (NFIB) Small-Business Optimism Index rose an impressive +3-points to a three-month high of 98.8 in May, which is a big move for this typically slow-moving confidence measure. At the same time, there is still work left to be done to get back to the year-end level of 2024, when it was prettier at 105.1.



Notably, capital expenditures plans also hooked up to +22 in May from +18, which is the best reading in five months, while business expansion plans ticked higher to a three-month high of +10 from +9. Real sales expectations also swung sharply from -1 to +10, also a three-month high.

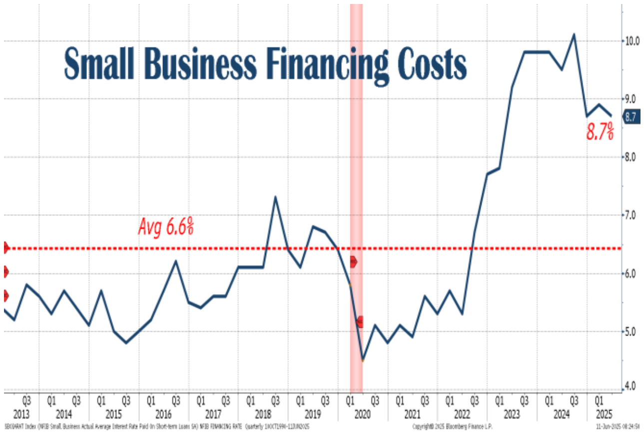


What is interesting, and perhaps just a small case of cognitive dissonance, is that the companion "uncertainty" index ticked back up to 94 from 92 in April.



Missing in the good news was the labor market: Hiring plans dipped to +12 from +13 (was +19 at the end of last year). As the graph below depicts, the hiring level in small businesses is at recessionary levels.

Despite the tariff hysteria, it was interesting that ONLY 14% of the 485 businesses taking part in the survey stated that "inflation" is their top constraint — tied for the lowest reading since September 2021. But while the percentage of firms lamenting "inflation" has declined of late, interest rate concerns have risen. Not entirely a surprise seeing as the average interest rate that the small business sector is paying remains at a punishingly high level of 8.7%.



Bottom line: The small business community has become a tad more optimistic, but overall sentiment levels remain quite depressed.

NO DEAL!

March 2, 2018*: Trump tweets, “Trade Wars are Good and Easy to Win”*

Seven years later…

June 4, 2025: *Trump tweets, “I like President XI of China, always have, and always will, but he is VERY TOUGH, AND EXTREMELY HARD TO MAKE A DEAL WITH!!!”*

What a hoot.

After the so-called “deal” was made in London, we find out that an agenda was reached whereby China will ease up on some shipments of rare earth materials while the U.S. will allow for some Chinese tech exports and permit some Chinese students to attend U.S. universities.

“The remarkable thing about this "deal" is that it just restores things to the pre-Liberation-Day status quo, except both sides have imposed an extra 10% tariff on each other (which is not good). So all that blather about "isolating China" turned out to be just empty talk.” — Posted on X, James Surowiecki, American Journalist

The reality is that the U.S. gets those magnets and prevented a complete shutdown of the auto industry. (Like a double-negative, averting a horrible outcome is a good thing.)

And while the so-called London agreement included some easing of U.S. companies’ access to these rare earth materials, it is a fair bet that China will keep them on a tight leash to prevent stockpiling and maintain maximum leverage.

Simply put, there was NO “trade agreement.” Tariff schedules didn’t move a single basis point.

The reality is that the 30% duty is still being applied to Chinese-made exports to the U.S. remain in place. Two days of meetings in London for this when a phone call would have sufficed. I suggest that everyone take a few minutes to read: “Trump Has No China Trade Strategy” in *The Wall Street Journal’s* op ed section. Here's a snippet from the piece:

> *“This gets to the larger problem with Mr. Trump’s tariff strategy — that is, he doesn’t have one. His latest walk-back shows he can’t bully China as he tried to do in his first term. China has leverage of its own.”*

Meanwhile, there have been no trade deals signed with other trading partners. And it doesn’t appear that and deals are forthcoming as the European Union, Japan and India have begun to dig in their heels, with the July 9 deadline for the reciprocal reprieve around the corner (though the president said it would be extended again for “serious” trading partners).

Bottom line: No one wins trade wars. Uncertainty is on steroids. For now, we are walking back from the brink, but Trump has a lot more backing down to do on tariff percentages and/or export controls.

THE 3-D ECONOMY

Because of tariffs, the world has inflation on its brain. But the Trump tariffs on goods imports aren't inflationary in a sustainable sense. There is a big difference between a one-time price shock and a sustainable inflationary cycle. What tariffs actually do is create an extended period of uncertainty, which is the enemy of business and household decision making.

Meanwhile, the U.S. economy is stuck in 3-D: debt, demographics and deflation.

The total all-economy debt-to-gross-domestic-product (GDP) ratio is at 330% (that's right, more than triple the GDP), and baby boomers are retiring at 10,000 per day (spending less as a result). Thus, tariffs are a side-show compared to these long-term secular deflationary forces.

Tariffs will also squeeze corporate margins. And overleveraged companies don't raise prices — they can't. These companies cut costs, slash payrolls and build liquidity to service their debts and hopefully survive. Not inflationary!

At the same time, households are choking on excessive debt, and it is showing through in the ever-rising auto loan, student debt and consumer credit card delinquency rates.

Have a read of: "Consumers Are Financing Their Groceries. What Does It Say About the Economy?" (*The New York Times*)

"Increased use of "buy now, pay later" loans may signal shifting consumer habits, but could also be a troubling sign of financial stress."

"Nearly a quarter of consumers using buy now, pay later loans finance groceries, up from 14 percent a year ago, according to a recent LendingTree survey. And it's not just groceries; more Americans are using these loans to pay for recurring monthly bills, such as electricity, heat, internet and streaming services like Hulu."

At the same time, the companies have been slashing new hires.

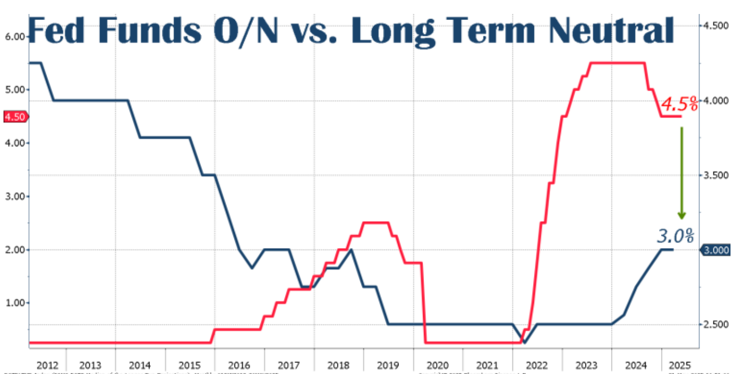
This is not inflationary.

Further, when consumers see prices jump by 10%-25% on imported goods, they don't pay up — they simply stop buying. Moreover, corporate CEOs seeing unprecedented economic uncertainty don't invest and don't hire. They build liquidity. There is nothing at all inflationary about this.

Also, the effects of AI-related technology will likely drive corporate costs substantially lower, not to mention the impact it will have on worker job confidence and wage pressures. Again, no inflation here!

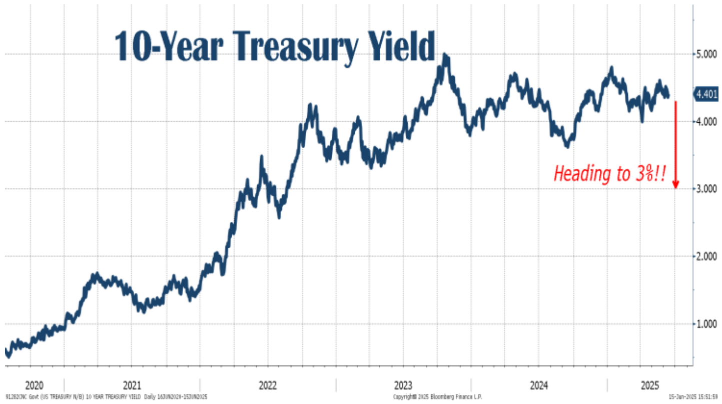
To sum it up: We have massive debt, demographics from hell and now tariffs. This equals DEFLATION, NOT INFLATION!

The U.S. economy is on the cusp of a balance sheet recession, and tariffs coupled with a Fed keeping rates more than +100 basis points above their neutral level as well as the extreme levels of overall economic uncertainty are the catalysts that makes it a higher probability scenario.



Remember, in a deflationary environment, cash is king and bonds are the crown prince. The Fed will panic-cut when unemployment spikes above its projections, but it will be pushing on a string. You can't solve a debt crisis into aging demographics and pinched incomes from tariffs with liquidity. That is an undeniable fact, not an opinion.

When the 10-year Treasury yield hits 3%, remember who told you first.

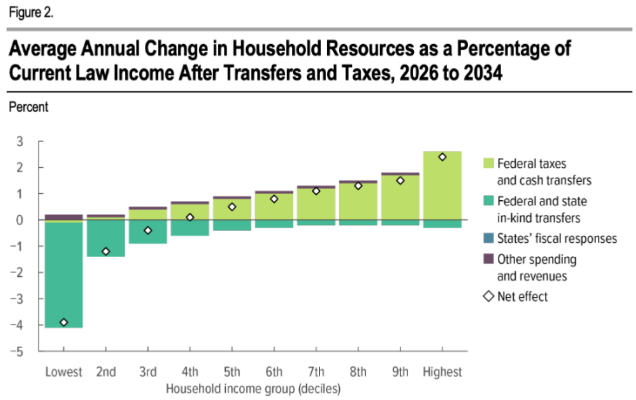


Bottom line: Near term volatility and uncertainty will rule the day. Longer term my view is the combination of aging demographics, excessive debt and the tariffs will lead to a DEFLATIONARY environment. If this comes to fruition, look for yields to eventually decline.

ROBIN HOOD IN REVERSE

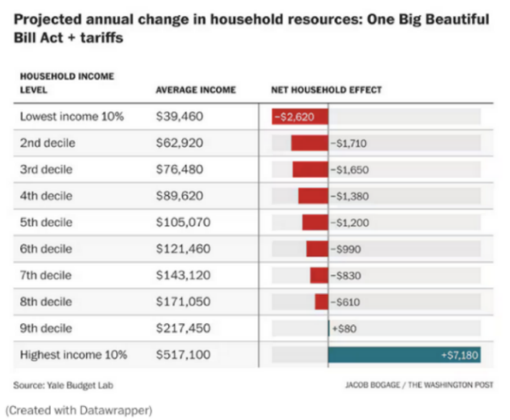
Last week, the non-partisan Congressional Budget Office (CBO) confirmed in detail just how regressive the OBBA will be if passed in its current form. The graph below shows the percentage change in households' purchasing power by decile of the income distribution caused by the OBBA:

The poorest 10% of Americans will experience a 4% decline. Remember, the benefit cuts for those in the bottom decile of the income distribution are being paired with tax cuts at the top of the income distribution. So, the net effect will be a large *increase* in the U.S. budget deficit.



Making matters worse, the CBO's analysis doesn't consider the effect of the Trump tariffs on household incomes. This is important because tariffs are regressive taxes, which fall more heavily on lower-income families than higher-income families.

The graph below from the non-partisan Yale Budget Lab shows the combined impact of the tariffs and the OBBA on U.S. household incomes. Overall, the bottom 80% of households suffer a loss of income from the combined effects of the tariffs and the OBBA. Only the top 10% are clearly better off from a bill that increases the budget deficit. That's quite a trick.



Projected annual change in household resources: One Big Beautiful Bill Act + tariffs

HOUSEHOLD INCOME LEVEL	AVERAGE INCOME	NET HOUSEHOLD EFFECT
Lowest income 10%	$39,460	−$2,620
2nd decile	$62,920	−$1,710
3rd decile	$76,480	−$1,650
4th decile	$89,620	−$1,380
5th decile	$105,070	−$1,200
6th decile	$121,460	−$990
7th decile	$143,120	−$830
8th decile	$171,050	−$610
9th decile	$217,450	+$80
Highest income 10%	$517,100	+$7,180

Source: Yale Budget Lab JACOB BOGAGE / THE WASHINGTON POST

(Created with Datawrapper)

Republicans claim the CBO's estimates are fake. They claim, as they always do, that tax cuts for the rich will trickle down and supercharge economic growth — a claim that has been debunked repeatedly. Frankly, it has NEVER been proven true. Ronald Reagan's own economic advisor, David Stockman, (who coined the term "trickle-down theory") later admitted that it sounds great, but the only issue is that we don't do trickle-down economics**.**

Bottom line: Unless you believe that math has a "liberal" bias, there is no reasonable way to dispute the basic conclusion of the non-partisan CBO and Yale Budget Lab analysis. The One Big, Beautiful Bill Act comes down to taking resources away from those who need them and giving the money to the already rich while driving up the deficit, increasing interest rates and crowding out investment.

Sadly, I sense that something will end up getting passed in Congress. The number of GOP holdouts in the past week has gone from ten to four. The fiscal hawks are starting to cave. At the end of the day, look for the so called "hawks" to hold their nose and end up voting for a bill that will add even more to the bloated deficit and further exacerbate the growing wealth and income inequality in the U.S.

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

"CPI JUST OUT. GREAT NUMBERS! FED SHOULD LOWER ONE FULL POINT. WOULD PAY MUCH LESS INTEREST ON DEBT COMING DUE. SO IMPORTANT!!!"— President Donald Trump, June 11, 2025

The World Bank just cut its global GDP forecast to +2.3% for 2025 from +2.7%. For the U.S., the new estimate is +1.4%, half of last year's pace and nearly a full point below January's prediction. Yet markets focus on the plus sign, not the downgrade. Nothing is priced for recession, even though Fed staff at the May Federal Open Market Committe (FOMC) meeting raised recession odds to 50-50 and cut their own growth outlook.

Nevertheless, this coming week, the FOMC will likely keep policy rates unchanged at 4.25-4.50% as it awaits greater clarity on the evolution of the economy in coming months in the face of elevated economic and policy uncertainty, especially about tariffs. I expect the June FOMC statement to be little changed.

I also expect the new Summary of Economic Projections (SEP) to show higher projections for inflation and to a lesser extent for unemployment alongside lower GDP growth. With participants balancing tensions on both sides of the mandate and inflation revising up relatively more than unemployment, I think participants will deem it appropriate to show delayed rate cuts, despite calls from the administration to lower rates by a full percentage point immediately.

From my lens, considering all the unknowns, not just geopolitically but also the fact that there have been no trade deals signed, the Fed should consider pulling its dot plots and economic forecasts on Wednesday. These numbers are meaningless, carry no weight, and are a colossal waste of time under these extremely uncertain circumstances.

From a portfolio perspective, in this headline driven, extremely volatile and uncertain environment, credit unions should stick to the tried-and-true approach of managing a risk-appropriate ladder strategy. This is no time to be a hero.

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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