Weekly Relative Value

Tom Slefinger
Market Strategist

WEEK OF JULY 21, 2025

Don't Bet on TACO

"It still requires a leap of faith to assume Trump will back away from implementing tariffs on August 1… Right now, U.S. stocks appear priced for the most optimistic of outcomes." — Financial Times Editorial Board, July 15, 2025

When President Donald Trump announced reciprocal tariffs on April 2, markets tanked within a few days. This time around, the tariff problem isn't the same, it's worse: Planned August 1 tariff rates are now at, or above, "Liberation Day" levels for major countries.

Average tariff rates against China now total 40%, a level sufficient to stall trade flows. Canada is now 35% versus 25% on Liberation Day. The Mexico and EU rate is 30% versus 20%. Also, as a reminder, Canada and Mexico were initially exempted back on Liberation Day. Brazil is now 50% (versus 10%). For Japan, South Korea, Indonesia, Thailand and the Philippines, the August 1 rates are as high or higher than the Liberation Day rates, but this is a completely different, more emboldened and dare I say, complacent market than we had on our hands just over three months ago.

The non-partisan Yale Budget Lab estimates that the net effective U.S. tariff rate has risen to 20.6% from 2.5%, which would be the highest since 1910. The U.S. government has already raised $108 billion of tariff revenue in the first nine months of this fiscal year (since October 1, 2024), nearly double the intake in the comparable period a year ago. That either comes out of profits or it gets passed on to the consumer, impeding personal income and

THIS WEEK

- PRICED FOR PERFECTION
- STALL SPEED
- WHY THE BOND MARKET IS NOT RALLYING
- TAME CPI FOR NOW
- PPI DELIVERS A GOOSE EGG
- RETAIL SALES SURPRISE HIGHER
- CONSUMER CREDIT CONTRACTS
- NOT SO GREAT EXPECTATIONS
- CLINICALLY DEPRESSED
- A FIRE "PURCHASE"
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

SUBSCRIBE

spending growth. The Budget Lab has upped its tariff estimate on real spending power in the average household to $2,800 per year. That is a big squeeze. In fact, a -0.8 % drag on real gross domestic product (GDP) growth.

The next round of uncertainty will come from retaliation — likely to come on August 1 if the announced tariffs all go into effect. Canadian Prime Minister Mark Carney has already stated that there is not going to be any trade deal with the White House that will not include steep tariffs. In particular, the EU has numerous options for retaliation, including soybeans, motorcycles and orange juice, among other exports, but will delay some of them while they negotiate. At some point, one of those countries does something that provokes a new threat from President Trump, and the cycle restarts.

Bottom line: Markets keep imagining a world where the tariff question is “settled.” Either we have high tariffs, or we have low tariffs as the result of “deals.” But that does not seem to be happening as tariff uncertainty shows no sign of abating. While the markets are seemingly betting that Trump will TACO (an acronym standing for “Trump always chickens out”), what if he doesn’t?

In the meantime, an economy needs predictability. Investors won’t invest, consumers won’t buy and producers won’t produce if economic policies change on a whim.

PRICED FOR PERFECTION

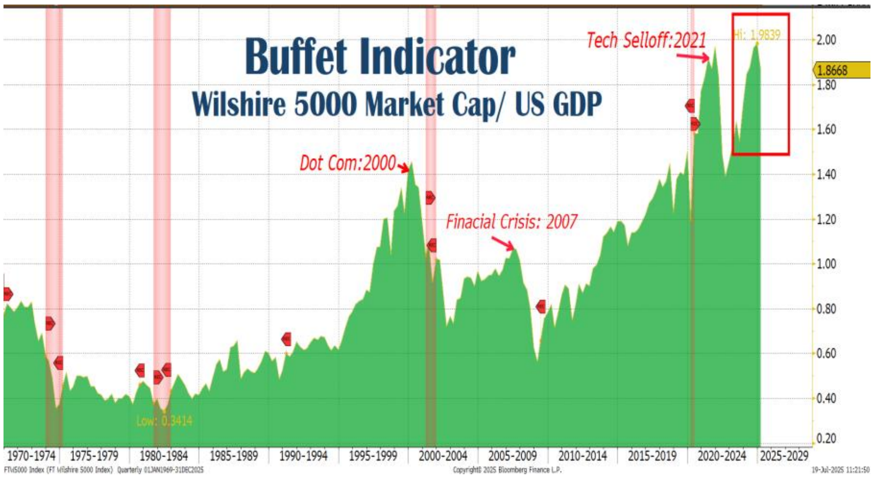
“Probably the best single measure of where valuations stand.”
— Warren Buffett, Chairman & Chief Executive Officer, Berkshire Hathaway

Despite the uncertainty surrounding the tariff policy, stocks continued to march higher.

Warren Buffett once said that the ratio of the stock market to GDP is “probably the best single measure of where valuations stand.”

The Buffett Indicator is a straightforward way to measure if the stock market is overvalued. It compares the total value of all U.S. stocks to the size of the U.S. economy. Most versions of the Buffett Indicator use the Wilshire 5000 Index to represent the U.S. market because it is the broadest, most accurate snapshot of the entire stock market.

As shown below, the U.S. stock market capitalization (Wilshire 5000) to GDP ratio hit a new RECORD high. Higher than 2000. Higher than 2007. Higher than 2021. The ratio has risen a whopping 45% over the last three months. In other words, stocks are currently worth twice as much as the entire U.S. economy produces in a year.



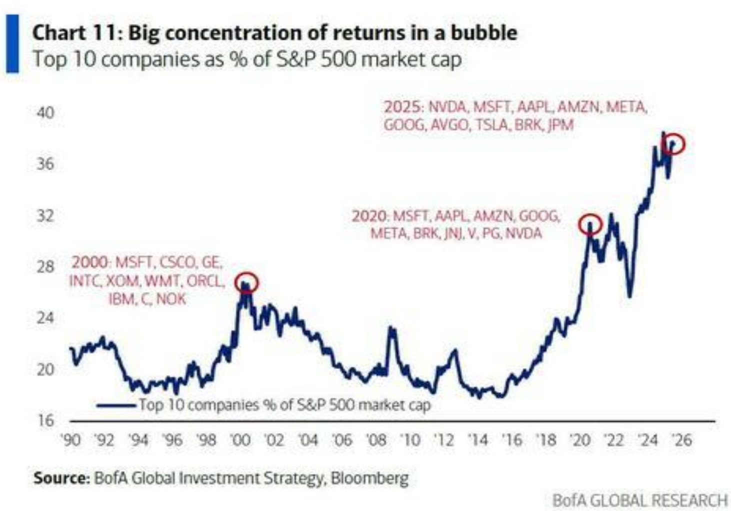
In essence, this indicator shows that investor enthusiasm, sentiment and greed are running far ahead of real-world output. And when that number gets too high, it's a sign that the market may be in bubble territory.

Indeed, each time this ratio soared, major corrections followed.

• 2000 – Buffett Indicator spiked → Dot-com crash
• 2007 – Spiked again → Financial crisis
• 2021 – Spiked again → Tech lost $10 trillion in 2022

I should also stress that just five companies — Apple, Microsoft, Nvidia, Amazon and Google — make up over 22% of the entire U.S. market. Nvidia alone added $2 trillion in value in under two years. That kind of growth has never happened before. So, this isn't about an economic boom. It's about a market boom concentrated in a few mega-cap stocks.

For the tell, look at the concentration of the top 10 S&P 500 companies: It was 27% of market cap at the dot-com bubble top, and is a staggering **38% of market cap today!**



Some may say: "AI is going to change everything."

Maybe, but in 1999, people said the internet would change everything. They were right, and the Nasdaq still crashed 78% when the hype got ahead of earnings.

Today, the risk is even greater because of interest rates. In 2021, rates were at 0%. Stocks had no competition. Today you can earn 4.5-5% on U.S. Treasuries or money market funds.

Bottom line: The Buffet Indicator is NOT a timing model, and it is ever so true that valuations only matter when they do. Indeed, momentum and animal spirits could continue to drive the markets to higher highs.

But investors in the equity market should understand that stocks are NOT cheap. In fact, they are priced to perfection. Eventually, valuations matter. Forewarned is forearmed!

STALL SPEED

"Nonauto consumer spending declined in most Districts, softening slightly overall. Auto sales receded modestly on average, after consumers had rushed to buy vehicles earlier this year to avoid tariffs."
— The Fed Beige Book, July 16

The just-released Fed Beige Book described the national economy as "increasing slightly." But that is no ringing endorsement for the economic backdrop. Indeed, seven of the twelve Districts are flat to contracting versus nine at the time of the prior Beige Book.

Out of the twelve Federal Reserve Board Districts, only three saw retail sales gains in the past six weeks (Richmond, Kansas City and San Francisco). One was flat (Chicago). And the other eight, or two-thirds of the country, posted sales contraction — particularly New York, Boston, Cleveland and Dallas (which reported that "retail sales declined notably").

The commentary was borderline recessionary:

"<u>Uncertainty remained elevated</u>, contributing to ongoing caution by businesses. <u>Nonauto consumer spending declined in most Districts</u> […] auto sales receded modestly on average […] tourism activity was mixed, manufacturing activity edged lower*, and nonfinancial services activity was little changed on average […] <u>construction activity slowed somewhat</u> […] <u>home sales were flat or little changed in most Districts</u> […] <u>energy sector activity declined slightly, and transportation activity was mixed</u> […] <u>the outlook was neutral to slightly pessimistic, as only two Districts expected activity to increase, and others foresaw flat or slightly weaker activity."</u>*

Aside from that, Mrs. Lincoln, how was the play?

Bottom line: The Fed's own Beige Book shows that the economy is at stall speed.

WHY THE BOND MARKET IS NOT RALLYING

The Beige Book also explained why the bond market has failed to rally much, if at all, from the benign set of June core Consumer Price Index (CPI) and Producer Price Index (PPI) data last week.

The survey revealed that the low inflation readings are lagging as businesses continue to work off their current low-cost inventory; however, the future looks quite a bit different. The Beige Book was awash of examples of what lies ahead over the next three months, in terms of where inflation in the products sector is concerned.

Read on:

"Contacts in a wide range of industries expected cost pressures to remain elevated in the coming months, increasing the likelihood that consumer prices will start to rise more rapidly by late summer."

"Several contacts noted they were still working through pre-tariff inventories, thus delaying price adjustments."

"One retail industry analyst said that they expected tariffs to be felt broadly at the consumer level in late July and early August although they were not yet materially impacting retail prices."

"Some contacts reported absorbing higher costs, but many contacts reported passing along these costs to customers."

"Consumer packaged goods companies reported increasing prices, which will raise costs for grocery stores over the next 90 days."

Bottom line: If this survey proves prescient, we should brace for some ugly inflation readings in the next few months. And with a Fed that still feels that its credibility was damaged in the 2021-2023 period and is now fighting the White House over its independence, it is hardly likely to be cutting rates any time soon — barring a collapse in the jobs market.

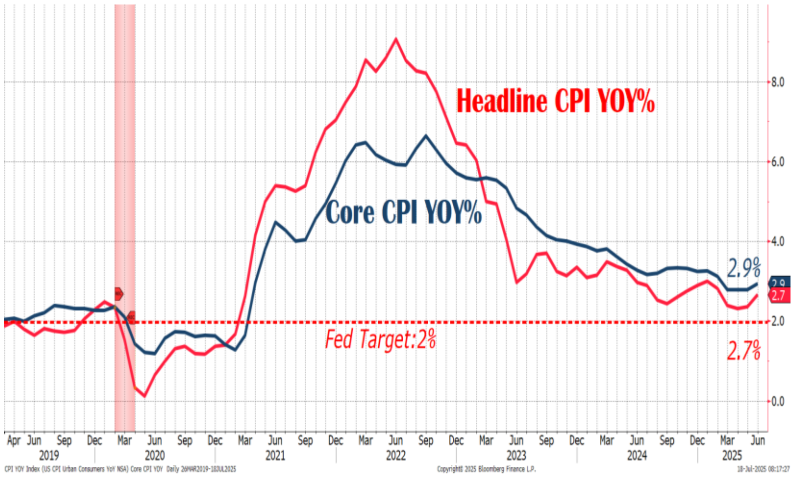
TAME CPI FOR NOW

"We've had goods inflation just moving up a bit, and, of course, we expect — as you — as you point out, we, we do expect to see more of that over the course of the summer. It takes some time for tariffs to work their way through the chain of distribution to the end consumer.

*A good example of that would be, goods being sold at retailers today may have been imported several months ago — before tariffs were imposed — so we're beginning to see some effects. And we do expect to see more of them over coming months … every outside forecaster and the Fed is saying is that **we expect a meaningful amount of inflation to arrive in coming months**, and we have to take that into account."*
— Jerome Powell, Chair of the Federal Reserve

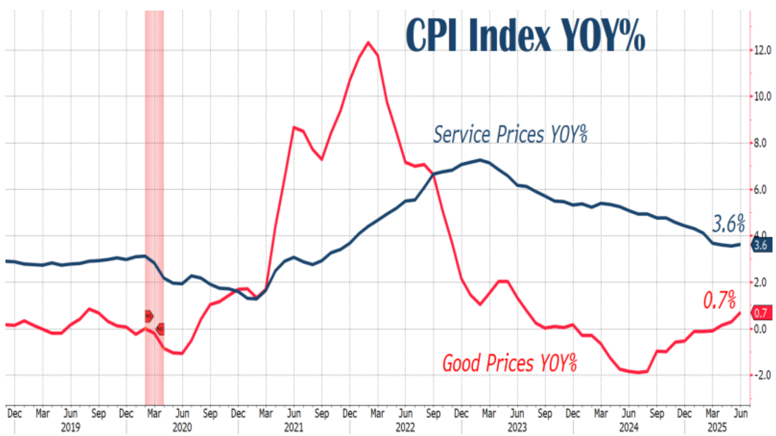
The June CPI was up +0.3% month over month, and the core rose 0.2% and below consensus expectations of 0.3%. (The core is important for the bond market. At this point, all the bond market sees is the tariff effect starting to percolate through the goods sector — and more is to come.

As highlighted in the quote below, Jay Powell, after the Federal Open Market Committee meeting on June 18, said that he views the current inflation data as stale because businesses have been working down their prior low-cost inventory, so the tariffs have yet to show through in goods prices. In essence, the Fed Chair clearly expects a big spike in inflation over the near-term and is bracing for it.



Last month, we did see the impact of tariffs. To wit: appliances (+1.9% month over month), toys (+1.8%), sporting goods (+1.4%), footwear (+0.7%), video-audio equipment (+0.4%) and furniture (+0.4%) were all up.

As we move forward, the question is whether the moderation of the service inflation will continue to provide an offset to goods inflation. Regardless, the Fed isn't going to be taking any chances, and the swaps curve is in the process of pricing out the prospect of seeing anything more than one rate cut by year-end.



Bottom line: Was the fact that the CPI held to a +0.3% month-over-month increase in June and +0.2% for the core merely a reflection of the fact that businesses are still working off their lower cost imported inventory bulge in the opening months of the year? In other words, is the tariff effect still in the pipeline as the new, higher-priced inventory is sold off?

What will win the tug-of-war between decelerating service sector inflation (not affected by tariffs) and the onset of goods sector inflation (which was evident across a range of tariff-affected products in June)?

That said, September rate cuts are increasingly in doubt, barring more evidence that the labor market is cooling off (but that must be a "meaningful" cooling off). This is what is nagging the bond market.

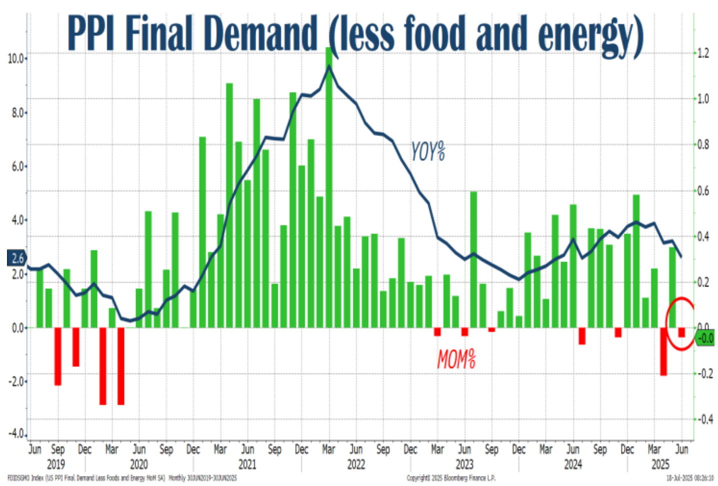
PPI DELIVERS A GOOSE EGG

If there was a report that should have reflected the tariff hikes to date (not to mention the dollar weakness), it would be June's PPI report.

Instead, the headline came in flat. The index excluding food and energy was also flat (consensus was +0.2%), and the index excluding food, energy and trade was flat (again, undercutting the consensus estimate of +0.2%).

The headline PPI inflation rate cooled off to +2.3% year over year from +2.7% year over year in May (consensus was +2.5%) and to +2.6% from +3.2% for the index excluding food and energy. The PPI has now shown no net change at all in the January-June time frame.

As was the case with the CPI, there was some pass-through on producer goods prices, which rose by +0.3% month over month (the biggest print since February) but was offset by weakness in the services sector — which deflated by -0.1% month over month and is down in two of the past three months.



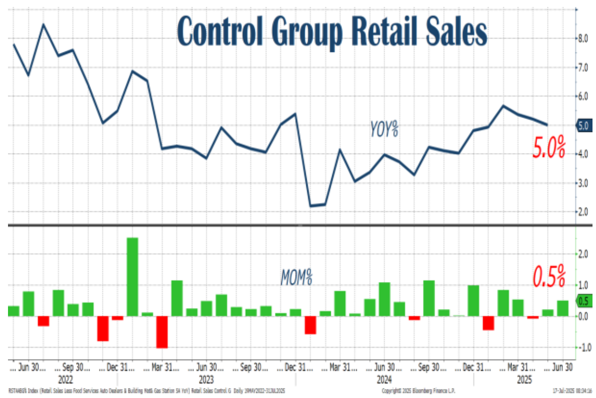
Bottom line: Despite back-to-back low readings on the core CPI and PPI, the bond market does not believe that these numbers will be sustained. Bond markets also responded to remarks from New York Fed President Williams that the Fed's restrictive stance is appropriate. This is a major source of support for Jay Powell (will Trump fire the whole Committee?) and a signal to investors that the central bank may in fact not end up cutting rates at all this year.

There is little doubt that the Fed would be cutting rates if not for the tariff issue, but it doesn't help much to deal with the counterfactual. Even with a benign +0.2% month-over-month print on the core CPI and 0.0% on the core PPI, the Fed has made it clear that they are not giving much weight to the current data. They are erring on the side of restraint based on the belief that between now and autumn, the probability is that prices are going to spike.

RETAIL SALES SURPRISE HIGHER

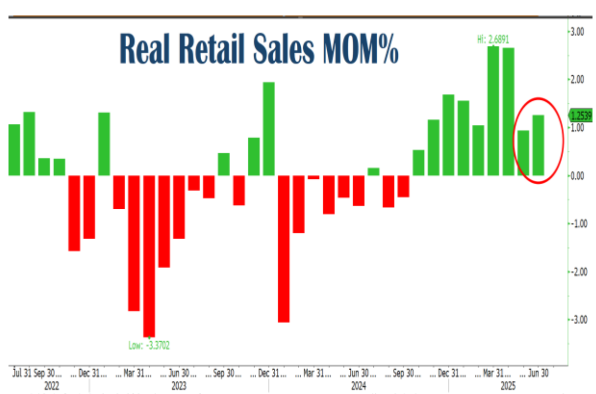
While the Beige Book showed retail spending declining throughout the country, the hard data that came out last week showed the complete opposite.

Amazingly, retail sales jumped by +0.6% month over month in June, which smashed the +0.1% consensus estimate. After two months of decline, this was a big rebound. Sales excluding autos came in at +0.5% month over month, and that also was above market views of +0.3%. Excluding autos and gas, at +0.6%, sequentially, was double the consensus estimate. The key "control" group that feeds directly into the consumer segment of the GDP accounts spiked by +0.5% (consensus was +0.3%), but one blemish was the downward revision in May to +0.2% from +0.4%.



In real or inflation-adjusted terms, sales rebounded by +0.4% month over month but only after recording steep declines in April and May — and in four of the past six months. The three-month trend in sales volumes is running at -3.7% annual rate, and the six-month pace is running at -1.7% pace. The year-over-year trend is barely running above +1.0%. That helps provide a better picture of the state of the consumer than the noise inherent in one data point.

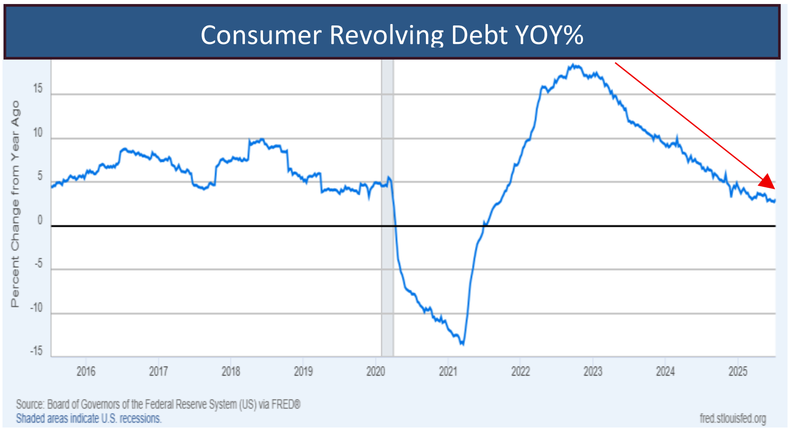
I am not into conspiracy theories, but there is also a wide divide between what the government data releases are telling us and the statistics that are flowing out of the private sector. We were told in the June retail sales report last week that auto sector receipts jumped by +1.2% month over month, even though we know from the industry data that unit sales had fallen by -1.7% month over month. We were also told by the government that ex-auto sales expanded by +0.5% month over month, even though the Johnson Redbook survey of same-store sales was down by -0.4%. Suffice it to say, I am cynical of the strength in the retail sales data.



Bottom line: The Beige Book suggests that consumers are hunkering down, yet the most recent retail sales data does not reflect this sentiment. That said, I would not extrapolate on months' worth of data. Regardless, the Fed will need to see more evidence that the consumer is weakening before moving on rates.

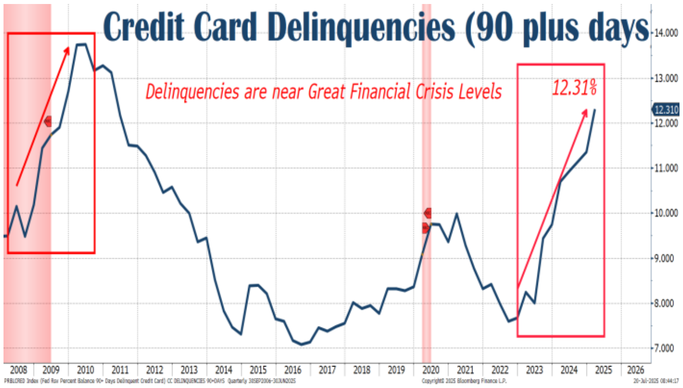
CONSUMER CREDIT CONTRACTS

Also another problem with the supposed retail sales data is that over the past month, there was a -$3.5 billion decline in outstanding credit card balances. From October 2024 to May 2025, outstanding credit card balances have declined some -$50 billion!



What's going on? Consumers are struggling with maxed out borrowing limits, using cash flow to other priorities and increasing credit card delinquency rates.

As shown below, serious credit card delinquencies (90+ days) are approaching the levels seen in the Great Financial Crisis. For the lowest-income Americans, credit card debt that was seriously delinquent was over 20% in Q1 2025.



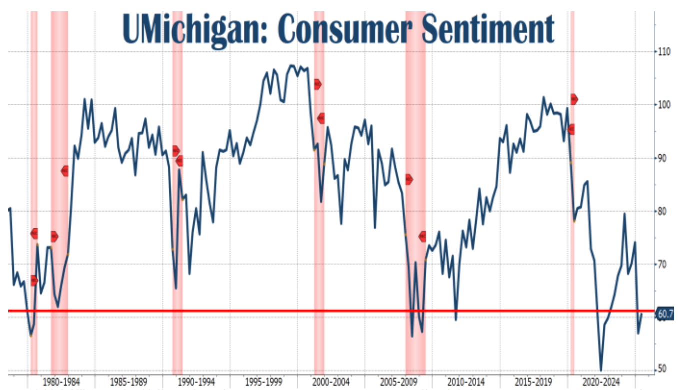
Bottom line: Regardless of the retail sales data, declines in credit are a major contractionary force for the economy. While we will likely see a near-term bump in the Fed's preferred inflation metric (Personal Consumption Expenditures deflator) as the goods segment kicks into gear from the tariffs, the bigger picture is that consumer credit contraction will ensure that the inflation we do see unfold in coming months will be swamped by cyclical disinflationary pressures from contracting credit.

NOT SO GREAT EXPECTATIONS

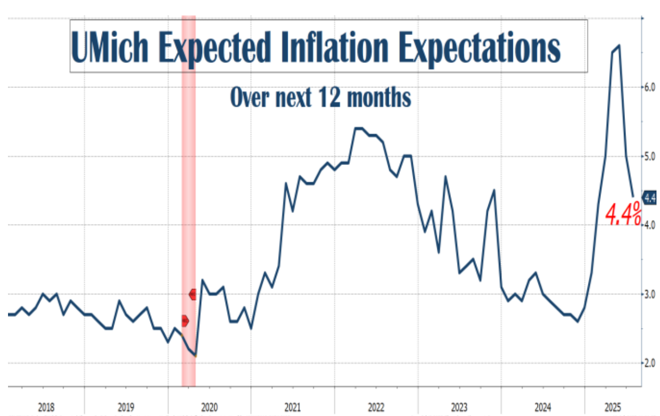
"Consumers' expectations over business conditions, labor markets and even their own incomes continue to be weaker than a year ago… That said, the recent two-month lift in sentiment suggests that consumers believe that the risk of the worst-case scenarios they expected in April and May has eased.''
— Joanne Hsu, Director of the Survey of Consumers, Institute for Social Research at the University of Michigan

The Headline Sentiment Index rose from 60.7 to 61.8 (above the 61.5 expected). Better than better. Now, let's put the 61.8 headline into some perspective. The long-run mean going back to 1952 is 85. And it really says something when consumer confidence today is lower than the levels that defined the past nine recessions dating back to 1960, including 9/11, the onset of the Great Financial Crisis and the 2020 global pandemic. But investors seem to believe that the U.S. economy has "swagger." The "flat earth society" has grabbed control of the narrative, that much is for sure.

Meanwhile, consumer spending plans across the board remained at depressed levels that, in the past, we only saw in recessions (which nobody believes we will ever see again). Don't expect to hear that on the financial news channels or other corners of Wall Street.



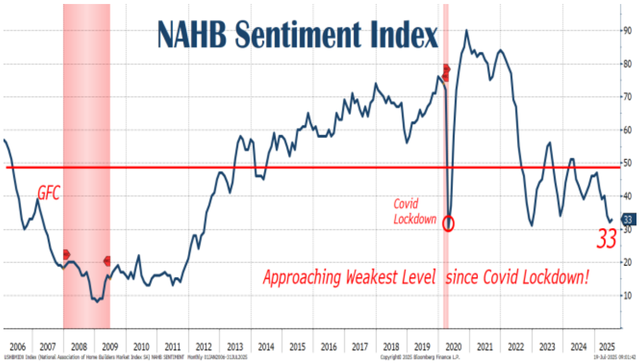
What really stood out, and should be comforting for the Fed and the Treasury market, were one-year median inflation expectations that receded to a five-month low of 4.4% from 5.0%.



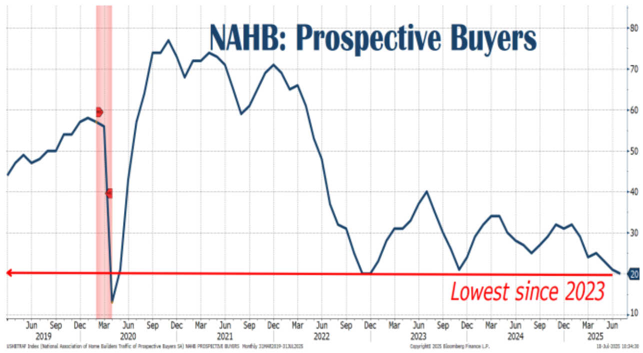
Bottom line: The University of Michigan Consumer Sentiment Index was comforting for the Fed, with one-year median inflation expectations receding to a five-month low. Nonetheless, a July cut won't happen. Money markets still assign near-zero odds of a cut on July 30. They price in about 45 basis points of easing by year-end.

CLINICALLY DEPRESSED

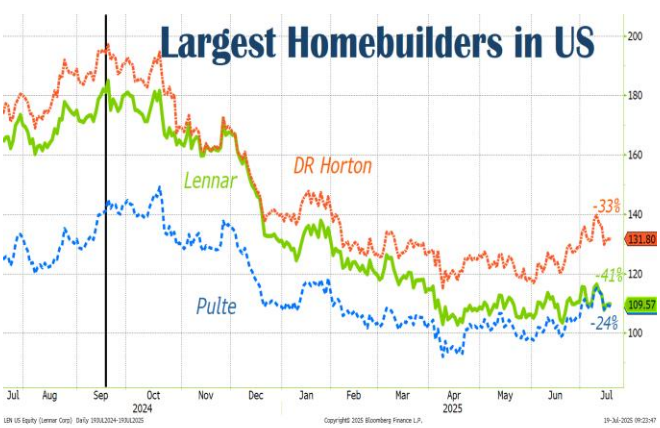
The National Association of Home Builder Sentiment Index remained very depressed in July at 33.



The most important segment of this report is the index that measures "prospective buyer traffic," and it has eroded to 21 in June and tied for the most depressed reading since April 2020.



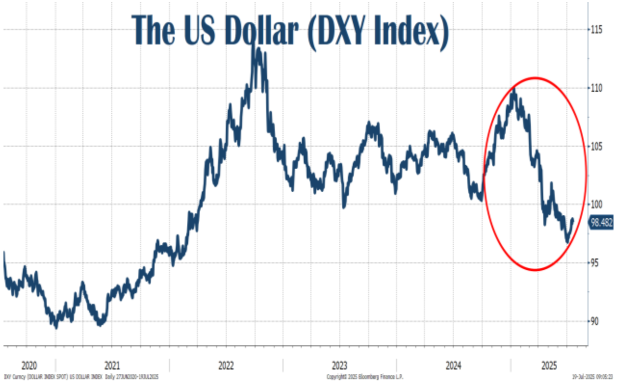
Obviously, this is not welcome news for the three largest homebuilders in America who have seen their respective share price declining -24% to 33% since September 2024.



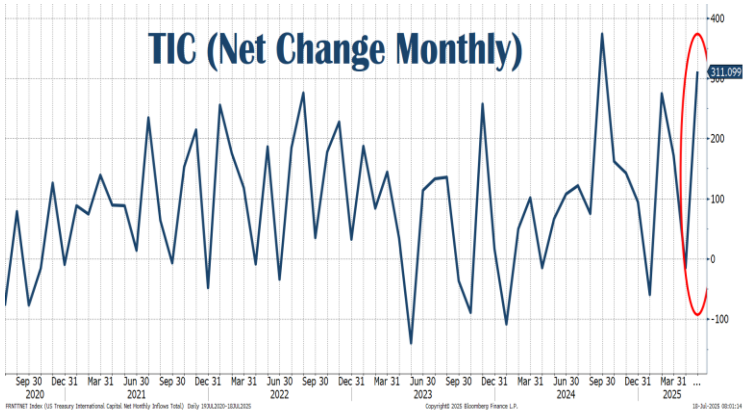
Bottom line: Housing remains floored. Until interest rates decline and affordability improves, real estate activity is likely to remain clinically depressed. I believe it's only a matter of time before the Fed will have no choice but to slice rates and lower the entire yield curve. By doing so, they will provide the necessary relief to the contractionary state of residential real estate. This is a big reason why I remain constructive on the bond market.

A FIRE "PURCHASE"

The U.S. dollar may have hit the skids in recent months, but there is one thing for sure: There never was a foreign "fire sale" on U.S. assets.



The Treasury International Capital Survey (TICS) data for May showed net foreign inflows totaling +$311 billion, the third most on record. And all of it from private investors, not central banks. Global investors gobbled up U.S. equities in the aftermath of the tariff reprieve — +$104 billion net inflow, the fourth highest ever. Net private buying of Treasuries? Try +$120 billion — the fifth most on record. And they added a further +$32 billion to their cache of corporate bonds. This was no fire sale — rather, it was a fire purchase!



Bottom line: Despite the sharp weakness in the U.S. dollar year to date, there was never a "fire sale" of U.S. assets. In fact, it was a "fire purchase." Indeed, the foreign appetite for U.S. assets remains robust. This is a welcome sign for the beleaguered Treasury market.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

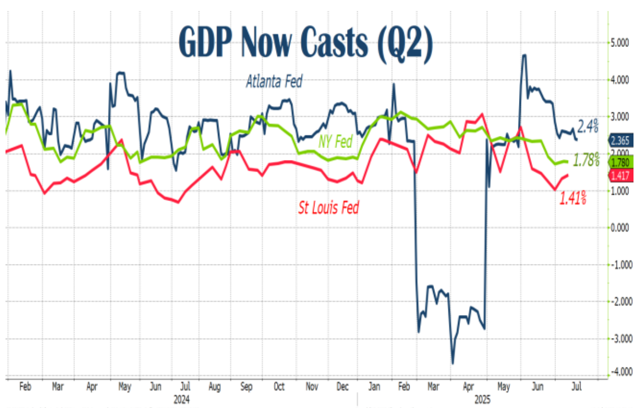
"The private sector is not doing as well as everybody thinks it is …Most of the employment growth we saw last month was in the public sector, and that means the private sector is not doing particularly well."
— Christopher Waller, American Economist

The bullish economic narrative received a shot in the arm from a *New York Times* article titled, "The Economy Seems Healthy. Were the Warnings About Tariffs Overblown?"

Yet, while perception is one thing, reality is another. The incoming monthly data show that nominal GDP growth (real economy plus inflation) has receded from +5.7% a year ago to +3.5% currently.

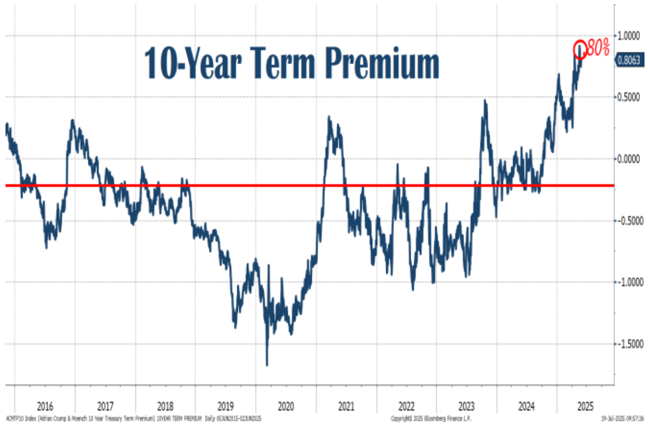
When you average out the Nowcast models from the Atlanta, New York and St. Louis Fed, it comes to +1.9% annualized real GDP growth for Q2. That follows the -0.5% actual print for Q1. That leaves growth at +0.7% for the first half of this year. That compares to +2.3% this time in 2024 and +2.6% in the first half of 2023.

The consensus is at barely more than +1% growth in both Q3 and Q4, which would be a performance that leaves average annual real GDP growth at around +1.0% in 2025, down from +2.8% in 2024 and even weaker than the "recession-scare" year of 2022 when the economy managed to expand +2.5% on average. Before 2020, you have to go back to 2009 to see the last time the economy sputtered so badly. Yet, the narrative is one of a strong economy. Perception and reality are at odds with each other.



As has been the case for a long while, 4.5% on the 10-year Treasury and 5% on the long bond are proving to be ceilings and attractive re-entry points. The impediment has mostly been shifting Fed expectations, as the swaps market has gone (so far this month) from pricing in -65 basis points of rate cuts by year-end to -45 currently.

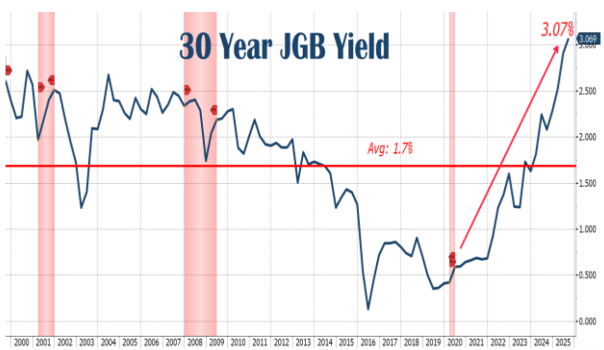
Normally yields will eventually gravitate toward the trend in the 10-year nominal GDP. So, at 4.5%, the 10-year yield is +100 basis points higher than macro fundamentals would warrant. But the "term premium" — representing the fears of the unknown when it comes to the tariff shock and the extent to which inflation becomes unhinged — has taken over.



So as Jay Powell faces increasing pressure from all corners of the White House to cut interest rates, the Fed is dealing with inflation uncertainty, and it is unclear how long it will take before the fog lifts. This is a problem for a central bank that is still licking its wounds from sticking to the "transitory" theme for too long in 2021 and early 2022.

In addition to the uncertainty surrounding tariffs, the U.S. bond market has been impacted by what has been a global bond selloff, especially what has been happening with the Japanese Government Bond market, a key anchor for global bonds.

Japan's 30-year government bond yields are trading near their highest since their debut in 1999.



Despite the uncertainties from trade policy to monetary policy, from a portfolio perspective, nothing has changed. Credit unions with excess cash should continue to average into the bond market while maintaining a risk- appropriate ladder approach. Be ready to pounce on a selloff in Treasuries in the event of any overreaction in the bond market.

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.