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Economic & Market Summary
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Following the Presidential election, there was wide-spread optimism about the incoming administration's pro-growth deregulation and tax agenda. That ebullience has been replaced by concerns over the economic fallout from tariffs and a trade war. Tariffs are essentially a tax on imports. While benefiting certain domestic industries, tariffs tend to raise prices and curtail economic growth. Compared to the previous Trump administration, the tariff agenda is broader and larger, and the chaotic rollout has created significant uncertainty. Uncertainty potentially hinders growth because businesses and consumers could delay investments and spending until there is greater clarity on the level of tariffs and how they will be implemented.

Economic data up to this point have generally been stable. The labor market is neither booming nor collapsing. The unemployment rate has oscillated between 4.0% and 4.2% since May 2024. Claims for unemployment insurance do not suggest an imminent increase. Growth in payrolls has been reasonable. After-tax income and consumption are ahead of inflation. Debt service payments remain manageable relative to income levels. However, there's evidence of weakness beneath the surface which tariffs could exacerbate. Reports from several airlines and consumer companies warn of softer spending. Credit card and auto loan delinquencies continue to rise. High income consumers increasingly account for a larger portion of spending which suggests that low-income consumers still struggle with higher prices. We'll likely see distortions in near-term economic data as businesses and consumers anticipate or adjust to tariffs. For example, Q1 annualized economic growth could be very soft as imports rise significantly ahead of tariffs. One real-time, albeit volatile, estimate of real GDP even suggests negative growth in the first quarter. Actions from the Department of Government Efficiency (DOGE), may impact near-term growth by pressuring the labor market. However, a reduction in government spending accompanied with deregulation would be positive long-term for the economy. A potential policy tailwind might come from an extension of the Tax Cuts and Jobs Act (TCJA). Many businesses and consumers will face higher taxes if parts of the TCJA expire at the end of this year. Extending or making the TCJA permanent removes a potential tax hike and reduces uncertainty.

Since the summer of 2024, inflation measures have been around 2.5% to 3.5%, which is above the Federal Reserve's 2% target. While we continue to believe inflation will trend downward, that progress may be slowed by tariffs. Large, broad-based tariffs could be inflationary near-term as ripple effects potentially drive price hikes across supply chains. A tit-for-tat trade war would be even worse for inflation. Tariffs could also reduce corporate profit margins if the tariff cannot be passed on via price increases. The Federal Reserve is being cautious, waiting to see how tariffs impact the economy and inflation before further reducing interest rates. Independent projections from Fed policymakers suggest that most officials foresee two rate cuts this year. However, with inflation flattening out above 2% and potentially ticking higher near-term from tariffs, we think the Fed will only reduce rates if the economy falters.

It's not surprising that an exogenous shock like tariffs has produced a market selloff. Entering the year, equity valuations were elevated leaving the S&P 500 vulnerable to bad news. The Trump administration walking back tariffs or interest rate cuts by the Federal Reserve could be catalysts for a near-term reversal. In the meantime, we expect additional market volatility on trade news or signs of consumer weakness. Our investment philosophy emphasizes owning a broadly diversified portfolio of high-quality companies. Prices of those companies fluctuate far more than the intrinsic values, which is why remaining focused on long-term investment objectives is critical during periods of extreme uncertainty.

Mark J. Sprtel, CFA

If your financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.