

ECONOMIC OUTLOOK

Summary

The U.S. economy currently presents two different perspectives. Sentiment indicators—the “soft data” that measures how people feel—are trending cautious. For example, the University of Michigan Consumer Sentiment Index declined to 52.2 in April, reaching its lowest level since July 2022. Many consumers are expressing concern about potential price increases related to new tariffs. Business sentiment shows similar hesitation regarding trade policies, which could potentially increase costs and influence spending decisions.

Meanwhile, the concrete economic metrics—the “hard data” tracking employment, consumer spending and production—paint a more reassuring picture. Job gains during April exceeded expectations by 39,000, lifting the three-month average job growth higher from its March levels. The unemployment rate held steady at 4.2% while the labor force grew slightly more than expected. First-quarter GDP showed a modest 0.3% decline, which may appear concerning on the surface, but the underlying reasons are not particularly troubling. This decrease resulted from a substantial increase in imports as businesses attempted to stockpile ahead of anticipated tariffs. Net exports feed directly into the GDP calculation and since the U.S. imported substantially more than it exported, it decreased GDP by a staggering 4.83 percentage points. Rather than indicating economic weakness, it suggests proactive planning by businesses. Consumer spending continued to grow at 1.8%—slower than the prior quarter, but still healthy despite tariff concerns.

The timing of economic activity may have also contributed to the slight GDP decline. Imports are recorded in GDP as soon as the goods enter the economy, typically at ports. However, those same goods must be physically received and processed by business to count as inventory. It is likely that second-quarter GDP will benefit as inventory growth catches up to the level of imports we saw during the first quarter.

The overall disconnect between sentiment “soft data” and economic “hard data” highlights a perception versus reality dynamic. For investors, this mixed environment should be met with cautious optimism. The labor market is still solid and there is reason to believe second-quarter GDP may well rebound as inventory benefits materialize and import surges normalize. However, continued tariff implementation, or complications in trade negotiations, could create additional challenges as the year progresses. While current economic indicators point to stability, sentiment data encourages attention to policy developments.

Positives

Headline CPI declined to a low of 2.4% for just the second time since 2021

Retail sales growth jumped to its highest level since January 2023

Personal consumption during the first quarter beat expectations (1.8% vs. 1.2% est.)

Negatives

Average Hourly Earnings in April came in slightly lower than expected (0.2% vs. 0.3% est.)

University of Michigan Consumer Sentiment Index has dropped by ~22 points since year-end (74 to 52.2)

NFIB Small Business Optimism Index has decreased for four consecutive months (97.4)

EQUITY OUTLOOK

Summary

In April, U.S. and global equity markets experienced significant volatility, primarily driven by U.S. policy uncertainty surrounding trade tariffs. The S&P 500 Index declined by approximately 19% from its February peak, entering correction territory, while the Nasdaq index crossed into bear market territory. This downturn was largely triggered by President Trump's April 2 announcement of sweeping tariffs, which caused a rapid, two-day selloff. Sectors reliant upon supply chains, such as information technology and consumer discretionary, were hit hardest. Equity markets rallied off the April lows and the S&P finished the month down just 0.8%.

Looking ahead, the near-term outlook for U.S. and global equity markets remains cautious but with opportunities for select investments. Market volatility is expected to persist due to ongoing trade policy uncertainty, particularly as tariff negotiations with countries like China and Mexico evolve. Recent softening in U.S. rhetoric and hopes for de-escalation have spurred hope for a market recovery.

Equity markets will continue to wrestle with the impact of this uncertainty and the lingering effect on fragile consumer confidence and corporate disposition. Investors will be closely watching company guidance in the coming quarter with the market looking for clues from management regarding inflation, slowing activity and other pressure points. This heightened state likely means company results will be closely scrutinized and stock prices punished for suboptimal results or guidance.

Equity markets are likely to remain volatile as we muddle through the next several months. Even if U.S. trade policy settles it will take some time to assess the damage. Still, when the rules of the game are finally set, corporations will learn the new rules and find ways to evolve and be successful. Capitalism will survive and prosper, investors will be rewarded, it may just take some patience.

Positives

Trump's course change

Corporate balance sheets

Higher productivity from technological investment

Negatives

Potential for trade war escalation remain

Consumer confidence is declining

Unknowns

Federal Reserve bracing for more challenging decisions

FIXED INCOME OUTLOOK

Summary

After a relatively quiet March, bond market volatility returned following the April 2 “Liberation Day,” where President Trump announced broad new tariffs with all our trading partners. Larger than expected, it is widely believed they will result in more inflation and slower growth than previously expected, at least in the near term. Consistent with the plunge in equity prices, Treasury yields moved sharply lower and investment-grade corporate bond spreads materially wider. Focusing on the economic embroglio, the futures market quickly priced in a fourth rate cut for this calendar year. The 10-year Treasury note hit an intraday low of 3.85% a few days after the announcement but then rose sharply over the next five trading days to almost 4.60% as investors focused on the inflationary impact and concerns about global demand for U.S. debt. While monthly ranges more than 40 basis points (bps) or more are not unusual (half of the months during the past two years), the ferocity of the whipsaw over a 10-day period was. The Merrill Lynch Option Volatility Estimate (MOVE) index, a measure of volatility calculated from option contracts, reached previous levels associated with extreme uncertainty. By the end of the month, yields then moved lower again as surveys of economic activity and sentiment polls indicated troubling times ahead. These “soft” data points were at odds with the “hard” actual economic data, which remained firm. By the end of the month, the 10-year Treasury note was at 4.16%, 4 bps lower than it started. The 2-year Treasury note followed a similar pattern, but reflecting an additional Fed rate cut, it closed the month 28 bps lower at 3.60%. The 2 to 10 yield curve increased to 56 bps, which is still only about half of its 25-year average.

Given the uncertainty and volatility, the new issuance of corporate bonds was paralyzed early in the month but returned to normal function in the last week or so. Overall, the issuance was about \$105 billion. This level was about 40% less than the previous three-month average, but slightly above the April issuance of the past two years. Investment-grade corporate bond spreads increased 25 to 30 bps early in the month as equity markets plunged but then rallied to close April about 13 bps wider. For the third consecutive month intermediate

Treasury notes outperformed intermediate investment-grade corporate bonds. At 0.93%, the Bloomberg Intermediate Government/Credit Index delivered a return that was in the top third of monthly observations over the past 50 years.

April ended with the release of the first quarter’s GDP report which showed the economy contracted for the first time in three years. While much of the decline can be attributed to the surge in imports in anticipation of tariffs, it will still put Jerome Powell and the Fed in a tough situation as they try to navigate a softening economy with the expectation of rising prices due to the tariffs. With uncertainty abound, we continue to recommend a neutral duration policy and will be using the increase in credit spreads to increase the duration of our credit position and therefore add more exposure without increasing out percentage allocation.

Positives

Tariffs are likely to continue to create economic disruptions

The U.S. economy may have entered a recession as many business decisions are paralyzed

Efforts to cut government spending should reduce borrowings at the margin

Negatives

Inflationary pressures are likely to increase in the near term

Foreign investors could reduce purchases of U.S. Treasury debt

Unknowns

DOGE’s ability to reduce budget deficit by a meaningful amount

Resolutions of Israeli conflict and Russia/Ukraine war

Simplifying Life