

ECONOMIC OUTLOOK

Summary

The U.S. economy continues to navigate a complex landscape shaped by persistent trade tensions and policy uncertainty under the Trump administration. Nonfarm payrolls for May rose by 139,000, surpassing the consensus estimate of 125,000, though moderating from April's revised 147,000. The unemployment rate held steady at 4.2%, reflecting a resilient labor market in the face of significant economic uncertainty. However, consumer and business sentiment remain well below historical norms, driven by fears of tariff-driven price increases.

While still early in this policy cycle, those inflationary fears have yet to materialize in the data. Since the official tariff announcement in early April, Headline CPI has declined from 2.8% to 2.3% year-over-year, while Core PCE, the Fed's preferred inflation metric, has fallen from 2.9% to 2.5%. Admittedly, this represents a very short timeframe, as the 10% universal tariff has only been in force for roughly two months. Still, pass-through effects would be expected to begin appearing in upcoming data releases if they haven't already.

Despite these encouraging inflation trends, the Organization for Economic Co-operation and Development (OECD) materially reduced its U.S. growth forecast to 1.6% for 2025, down from 2.2%, citing tariffs as a primary economic drag. This revision follows first-quarter GDP contraction of 0.2%, though the Atlanta Fed's latest GDPNow estimate indicates a nearly 4% second-quarter growth. Should this materialize, it would represent a solid rebound from first-quarter's weakness, which was largely driven by trade flow adjustments as businesses front-loaded imports ahead of anticipated tariff implementation.

Policy uncertainty continues to weigh on business confidence, with the ISM services index declining to 49.9, signaling slight contractionary conditions in the services sector. Similarly, the NFIB Small Business Optimism Index dropped to 95.8, marking its fourth consecutive monthly decline as companies grapple with supply chain disruptions and elevated input costs. The

manufacturing sector has also been impacted, as indicated by April's durable goods new orders declining by the largest amount in 15 months.

With resolution to these significant policy adjustments still likely months away, investors should maintain a cautious stance while balancing labor market strength against tariff-induced uncertainties. The Federal Reserve will almost certainly hold rates steady at its June meeting, remaining vigilant for potential inflation pressures while buying time to wait for further policy certainty. As always, we will pay close attention to policy developments and their transmission through the economy as markets adjust to this evolving landscape.

Positives

Inflation data continues to improve as CPI, PPI and Core PCE all decreased year-over-year

Average Hourly Earnings (year-over-year) jumped more than expected (3.9% vs. 3.7% est.)

Though still negative, first-quarter GDP was revised slightly higher (-0.2% vs. -0.3% prior)

Negatives

The Labor Force Participation Rate unexpected declined to 62.4% (62.6% prior)

Both ISM manufacturing and service are in contractionary territory (48.5 and 49.9 respectively)

Factory and durable goods new orders were both negative for the first time in five months

EQUITY OUTLOOK

Summary

U.S. equity markets rebounded notably in May with the S&P 500 Index rallying 6.3% during the month and propelling back into positive territory for the year. The recovery, which began in April, was fueled by a cooling of trade tensions and hopes negotiations will continue to progress between the Trump administration and U.S. trade partners. Gains in equity markets were led by growth stocks with the Russell 1000 Growth Index climbing 8.8%, outpacing the 3.5% gain for the Russell 1000 Value Index. The Russell Midcap Index and small-cap Russell 2000 Index returned 5.7% and 5.3% respectively.

Investor and consumer sentiment has been oscillating due to the ever-changing landscape. At this point it is hard to imagine any sustainable momentum in that regard. “Buy the dip” has been a pervasive theme within the equity markets for the past several years and that trend still seems to have legs despite the challenging and uncertain start to the year. Significant corporate share buybacks are partly responsible for this pattern.

Corporate earnings have been resilient, but it is unclear how much demand was pulled forward from buyers looking to accelerate purchases ahead of tariff implementation. Given higher equity valuations, potential setbacks are likely to continue jostling equity markets in the months ahead.

Global equity markets will likely continue to be influenced largely by policy uncertainty, including tariffs and immigration

restrictions, which could drive inflation higher and limit Federal Reserve rate cuts. However, prospects for lower tax rates and deregulation offer investors reason for optimism. We remain optimistic as long-term investors but will proceed cautiously in the near term, advocating for diversification particularly in the current environment.

Positives

Recession appears avoidable

Corporate balance sheets

Revolutionary new technologies wave

Negatives

Competition from other asset classes, in particular higher-yielding bonds

Equity valuations are lofty

Unknowns

Federal Reserve bracing for more challenging decisions

Trade deals being negotiated but many road bumps lie ahead

FIXED INCOME OUTLOOK

Summary

Coming into May, tariff uncertainty continued to be the primary source of volatility for investors. Bond yields whipsawed as the outlook for the economy and inflation changed with each on-again, off-again media post. With a temporary pause in their implementation, tariffs took a backseat to the federal budget and the rising debt levels as the “Big Beautiful Bill” made its way through the House of Representatives and on to the Senate. With little in terms of spending cuts to offset significant reductions in taxes, investors are rightfully concerned about the size of the budget deficit as well as the associated level of federal debt.

Economic data continued stronger than expected even with sentiment indicators showing weakness. Second-quarter GDP estimates now show a sharp rebound from the slight first-quarter contraction. As anticipated, another Federal Reserve Open Market Committee (FOMC) meeting came and went with no change in the overnight rate. Investors are now looking for only two rate cuts this year as opposed to the four they were forecasting at the end of April. While no change in policy is expected at the June meeting of the FOMC, they will release new consensus forecasts for growth, employment and the path for the overnight rate. Given the lack of clarity on tariffs and the budget bill, there will be significant skepticism regarding any outlook and Chairman Powell will likely reiterate the inability to be confident in any forecast at the current time. In May, yields moved higher across the curve in a fairly parallel fashion. The 2-year note increased by 30 basis points (bps) to end the month at 3.90%. The 5, 10 and 30-year bonds increased by about 24 bps to end at 3.96%, 4.40% and 4.93%, respectively.

With the exclusion of the pandemic-fueled issuance of 2020, the level of new investment-grade corporate bonds brought to market was the highest ever for the month of May at \$155 billion. But the level of maturities was also elevated at \$95 billion which left \$62 billion of net new supply. Credit spreads narrowed by 18 bps leading to significant relative

outperformance for the sector. While the corporate bond market was able to squeeze out a small positive return, the broad bond market indices delivered a negative return for the first month of this year.

Given the vast uncertainty, we continue to keep our neutral duration policy but are using the increase in Treasury yields to extend when portfolios age and become short of the benchmark duration. We continue to favor corporate credit, but the recent contraction in spreads is making it tougher to find attractive valuations. We are likely to pause our progress on adding additional credit exposure.

Positives

Tariffs are likely to continue to create economic disruptions

Inflationary pressures have eased even in the face of new tariffs

Rates are at the upper end of recent ranges which is attracting buyers

Negatives

GDP likely to bounce back from negative first quarter based on frontloading to avoid tariffs

The budget bill could increase deficits requiring more Treasury issuance

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

Unknowns

Escalation of tensions with China

Resolutions of Israeli conflict and Russia/Ukraine war