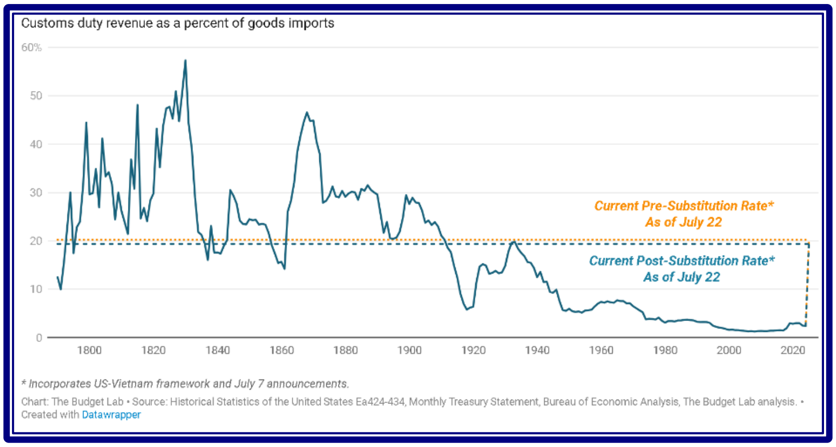
MARKET PERSPECTIVE

AUGUST 2025

IN FOCUS:

Markets in the first half of this year have been celebrating, despite tariffs that are well above levels at start of 2025, and choosing instead to focus on the fact that levels are not as high as initially proposed on "Liberation Day". It's worth noting that the overall current tariff rate of 18.6% is at its highest level since 1911. According to The Budget Lab at Yale, a non-partisan policy research center, price levels from 2025 tariffs are due to rise 1.8% in the short run, excluding action from the Fed, in which case the estimate could be modestly lower. Clothing and textiles would feel the brunt of the tariffs with 37-40% increases in the short term.

U.S. Effective Tariff Rate at Highest Level Since 1911



The Consumer Price Index (CPI) edged up 2.7% on an annual basis, up from a 2.4% reading the prior month. Personal Consumption Expenditures (PCE) prices, the Fed's preferred measure of inflation, also advanced at an annual rate of 2.6%, higher than expected. The modest uptick in price levels is no cause for alarm just yet, and investors remain optimistic that the Fed will raise interest rates at some point before year end. According to Bloomberg Economics' chief U.S. economist, price levels since "Liberation Day" have primarily been reflected in discretionary items such as household appliances and audio equipment which account for only about 10% of the CPI. On the other hand, the effect on consumer sentiment has negatively impacted services and discretionary spending, such as travel and hotels, and has more than offset the tariff passthroughs so far. However, let us remind ourselves that after the initial tariff announcement in April, companies rushed to front end imports to beat the tariff surge. Until now, they have used this inventory in the interim as a buffer to hiking prices. So far, companies are mostly absorbing the higher costs in order to protect their market share. Data points over the next few months should shed more light as to just how inflationary or not the imposed tariffs will be.

Data on the U.S. consumer remains mixed. The Conference Board reported an uptick in confidence during the month of July, but this was in conjunction with a weakening view of available jobs on the horizon. Forward-looking expectations also increased; however, the overall level remains relatively low, indicating pressures on growth lie ahead. The differential between percentage of consumers who believe *jobs are plentiful* and those who believe *jobs are hard-to-get* shrank by a little over one point, further adding to weakening sentiment. Most recently, the jobs report showed hiring slowed in July, accompanied by downward revisions to the prior two months. The current administration felt compelled "to shoot the messenger" in response to the traditionally nonpartisan Bureau of Labor Statistics Commissioner report on the employment coincident indicators. There are in fact several reasons that could account for recent softness and subsequent revisions. To name a few, some culprits could range from declining business survey results, basic statistical modeling assumptions and limitations, and an overall hiring slowdown from uncertainty surrounding tariff and immigration policies.

The first estimate for Q2 GDP growth exceeded expectations, climbing 3.0% for the 2nd quarter. On its face this looks strong, however taking into consideration the -0.5% decline in Q1, economic growth is running at less than half the growth rate in 2024. Personal consumption expenditures grew 1.2%, recovering somewhat off Q1 lows. In addition, tariff policies continue to cause tremendous uncertainty amongst businesses, and it is reflected in the -15.6% drop in private domestic investment. Final sales to private domestic purchasers, a good indicator of underlying demand, remains positive - but the growth rate has slowed for a third consecutive quarter. Imports fell sharply by -30.3% this past quarter, following a surge in Q1, as companies scrambled to stock up ahead of tariffs.

Leading Economic Indicators (LEI) declined -2.8% during the first half of this year. The index also came in below expectations for the month of June, as higher stock prices only partially offset weakening manufacturing and softening consumer expectations. The second half of the year should reveal more about the full impact of tariffs on corporate strategies and consumer demand as they work their way through the system. Like the Conference Board, we are not predicting a recession but do expect economic growth to slow in 2025, as consumer spending in the second half begins to respond to higher price levels.

After considering all the new data thus far, Fed Chaiman Powell summarized his remarks after the July Fed meeting stating "the unemployment rate remains low, and labor market conditions remain solid. Inflation remains somewhat elevated,". The result was that the committee left interest rates unchanged. Economic viewpoints are split as to whether the Fed's actions or inactions are the correct ones - and only time will tell. Thus, the debate continues. Some economists believe pressures could be short-lived interpreting tariffs to be a one-time price adjustment upwards that will be absorbed in stride by both businesses and consumers. Tax relief from the One Big Beautiful Bill (OBBB) will then kick in with stimuli that offsets tariffs and other pressures, restoring growth in 2026. Economists who are more skeptical believe economic growth is slowing. This viewpoint focuses more on the historically high level of tariffs and the cuts included in the OBBB that are strategically scheduled to roll out overtime. The next few months will begin to highlight just how impactful (or not) the combined effect from policy changes are on price levels and employment trends.

Our view is that real growth as reflected in the U.S. GDP will slow in the back half of the year as the trade wars drag on. We remain cautiously optimistic that trade risks do not increase meaningfully from current levels and reaccelerate U.S. GDP growth above 2-2.5% in 2026. Investors will work through the near-term economic stress associated with tariffs this year and digest weaker economic activity as the tariff effects settle down.

We are expecting new job growth to cool down as companies turn more cautious and defer hiring amid the uncertainty. Recent data in July highlights the downside risk to the economy. However, the U.S. trade court recently ruled that the Trump administration exceeded its authority in imposing sweeping tariffs under the International Emergency Economic Powers Act. That decision was immediately appealed, and it is widely expected this case could reach the Supreme Court before any final ruling is made. We conclude that unless the trade war ramps up from current levels, a repeat of the contraction in job growth in May and June will not be replicated. The employment picture is also clouded by immigration flows and deportations. In addition, the dip in government employment has been amplified by the DOGE (Department of Government Efficiency) as well as seasonal factors relating to employment in the education sector. The bottom line is that the U.S. economy remains in a "low hiring", "low firing" mode. The current slowdown in hiring is occurring at a time when the more positive fiscal response has yet to kick in and is pending in anticipation of a rate cut this fall.

We conclude that unless layoffs pickup meaningfully, following a slowdown this year, U.S. economic growth will resume above 2-2.5% in 2026. This assumes stimulative tax policies, monetary policy, and sequentially smaller headwinds from trade policies. We remain cautiously optimistic that the U.S. economy remains resilient, despite market concentration, persistent volatility, and a backdrop of mixed economic indicators.

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