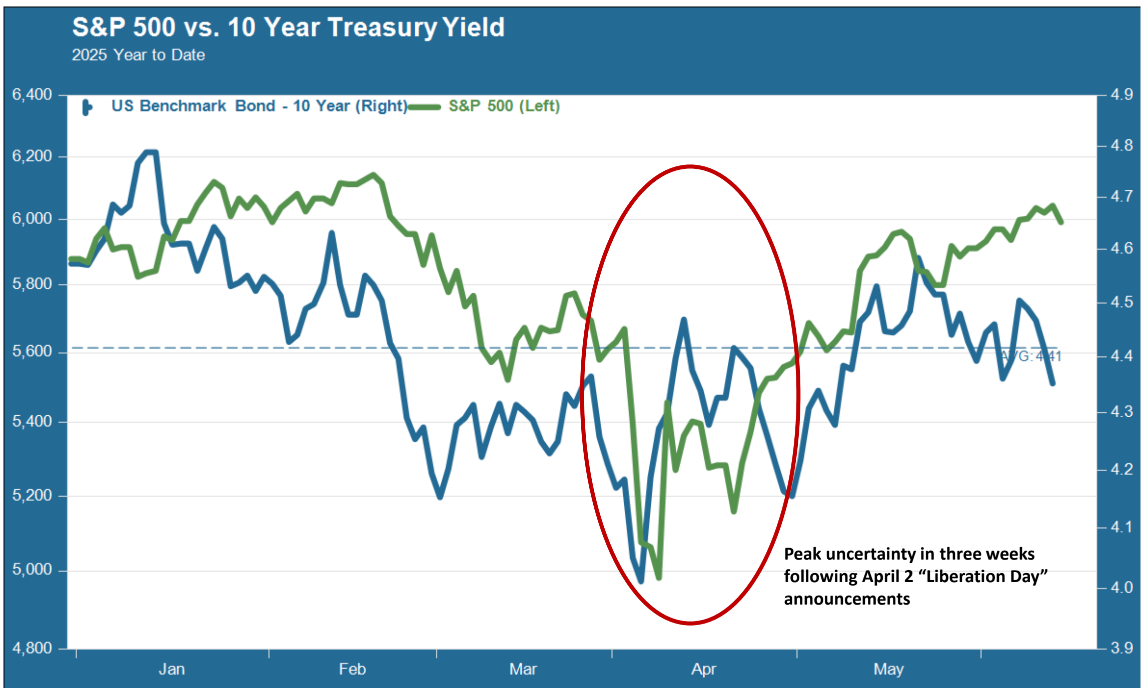
MV CAPITAL MANAGEMENT

Weekly Market Flash

Can the Markets Maintain Their Cool?

June 13, 2025

If you exclude that three-week period in April when the most draconian tariff regime since the beginning of the twentieth century was announced and then promptly reversed (technically put on hold, but does anyone really believe that 46 percent tariffs are coming to Vietnam on July 2?), the first six months of 2025 have actually been pretty humdrum. The S&P 500 is up about two percent from where it was at the beginning of January, while the 10-year Treasury note is hovering right around its average yield of 4.4 percent for this period.



Source: MVF Research, FactSet

Both stocks and bonds, in other words, seem to be registering a conviction that the worst of the potential economic hit is behind us, with a resumption of something like the cyclical trend that was prevailing prior to the whole tariff kerfuffle: a "soft landing" with growth slowing but remaining positive while inflation settles back to its two percent target. Are the markets correct in their composure, or are they premature in their assumption that all is well and back to the brandy?

Hard and Soft Converge

The optimists have a pretty good case to make simply on the basis of the available data. A few weeks ago we were writing about the divergence between so-called hard and soft data. Surveys such as the Consumer Confidence index, the Michigan consumer sentiment report and the NFIB small business sentiment index all plummeted amid economic uncertainty among households and businesses. The question we asked back then was whether the hard data, headlined by GDP growth, inflation and unemployment, was going to "catch up" with the doom and gloom vibes of the surveys. Now it seems like the trend might be going the other way. The latest Consumer Price Index report came out this week, and it showed core CPI (excluding the volatile categories of food and energy) at 2.77 percent, its lowest level in four years (headline inflation, which includes food and energy, was even closer to the two percent target at 2.8 percent). Last week's employment report was also mostly fine, with payroll gains a bit better than expected and overall unemployment stable at 4.2 percent (though, as we noted in our report last week, the unemployment rate for recent college graduates is a potential source of concern). Meanwhile, the surveys have been trending up. The latest Michigan sentiment report, fresh off the presses this morning, registered a significant increase from last month and was well ahead of economists' forecasts. The convergence, in other words, seems to be going in a positive direction.

Where's the Inflation?

Is it surprising that higher inflation isn't showing up? After all, despite the administration's repeated backtracks from the direst of tariff threats, the overall tariff rate for US consumers is still, at around 20 percent give or take, higher than it has ever been since 1934. The rational expectation would be that the higher tariffs beget higher prices. Yet the month-to-month increase in prices from April to May was just 0.1 percent for both headline and core CPI.

The most likely explanation for the non-event of higher inflation to date is that many businesses ramped up inventories before the new tariffs took effect, and thus are able to sell their goods without undue price increases while maintaining stable profit margins. Evidence for this can be seen in the massive drop in imports recently – a 16.3 decrease in April from the previous month. But inventories run out in due time. That is why many economists believe that inflationary pressures won't really kick in for another month or two, but that consumer-facing prices are likely to be higher towards the end of the summer. Maybe it's a good idea to get your back-to-school shopping done well in advance of Labor Day weekend.

Another Geopolitical Wild Card

The news this morning of Israel's large-scale attacks on Iran, targeting nuclear facilities, military sites and the residences of prominent leaders adds another variable to the equation. Generally speaking, markets are quick to regain equilibrium after unexpected geopolitical news breaks – witness for example the resumption in calm of commodity markets within days of Russia's invasion of Ukraine in 2022. The immediate market reaction today is within the usual bounds – stocks down but not dramatically so, bond yields steady, and oil prices up sharply but retreating a bit from their overnight highs.

We don't know yet the extent to which Israel intends to continue its attacks, or what its planned end game might be, but there is the potential that it could be a significantly destabilizing event. The World Bank has already projected that global growth will slow in 2025 to 2.3 percent, which is half a percent lower than what the Bank forecasted at the beginning of the year. That forecast is based on an assumption of oil at an average of $66 per barrel – so the implications of structurally higher prices for oil and other commodities do matter.

While we are impressed with the markets' ability to remain cool, calm and collected in the face of all the first half uncertainty, there is still a long way to go before the end of the year, and plenty of challenges awaiting us around the next bend. This is not a time for relaxing one's guard.

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