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Market Insights

JUNE 2025

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SUMMARY OUTLINE AND KEY POINTS:

Tariff Update: *The times they 'keep' a-changin'*

- Adding to uncertainty, the U.S. Court of International Trade ruled that Trump tariffs imposed under IEEPA were invalid
- But the Federal Appeals court has put that ruling on pause with an administrative stay – Trump's trade war moves to a court battle

Fiscal in Focus: Groundhog Day or Potential Longer-Term Risks? Yes and Yes.

- The debt ceiling debate and Moody's recent downgrade of U.S. debt both pose fiscal policy concerns
- But these are not causal factors, per se, rather symptomatic of debt and deficit issues that have been building up for years

One Big Beautiful Bill: The Trump Administration's Budget Bill Comes Under More Scrutiny With Tariff Policy Uncertainty

- Tariff policy uncertainty highlights tariff revenue uncertainty to a key to paying for the spending packages in the budget bill
- This is prompting fears of further widening deficits, albeit it could also prove somewhat stimulative/offsetting if passed

Implications for Inflation, U.S. Dollar, and Interest Rates Pose Potential Increases in Longer-Term Risks

- The ultimate landing spot of tariffs will be a key driver of inflationary impulse, but the risks skew towards higher from here
- We believe reports of the "death of the dollar" are greatly exaggerated, but on the margin, it may become a "Gentler Giant"
- Higher inflation and a "Gentler Giant" dollar could both keep upward pressure on interest rates, so "higher for longer" still stands

U.S. Court of International Trade strikes down majority of Trump tariffs, but Federal Appeals court issues an administrative stay that keeps the tariffs in place until it can hear further legal arguments – the Trump 2.0 trade war continues

- The court of International Trade ruled that tariffs imposed under IEEPA (International Emergency Economic Powers Act) were invalid, which includes the baseline 10% tariffs and reciprocal tariffs announced in April, but the Federal Appeals court has put that ruling on pause
- Even if the appeals court were to uphold the lower courts ruling, the Trump administration would still have other legal means to impose tariffs:
    - **First,** existing **Section 301** (country-specific) tariffs to raise tariffs on China or new investigations via **Section 232** (sector-specific) tariffs
    - **Second,** new **Section 122** tariffs, which gives the President explicit power to impose tariffs of up to 15% for up to 150 days to address trade deficits
    - **Third,** new **Section 338** tariffs, allowing up to 50% tariffs on countries found to discriminate against U.S. commerce through unfair practices, which could be a likely choice given much of the pre-reciprocal research the US Trade Representative did would be argued to back this up

This ruling in debate would reduce tariff revenues by around 80%, or down to around $40 billion, from $200+ billion prior

- Importantly, this ruling would still leave in place Section 232 sectoral tariffs on steel, aluminum, and autos, with additionally already in process Section 232 tariffs on pharmaceuticals and semiconductors still expecting to come in short-order
- A key question is: If (a big IF) upheld, will this provoke Trump to double-down on tariffs or use this as a de-escalation opportunity, without appearing to back down and still claiming to be tough on tariffs – it's not binary, and we could end up seeing a bit of both as Trump pushes through some targeted tariffs as a means to keep his tariff focus/narrative in force, but ultimately ends up at a lower than current average effective tariff rate

If (a big IF) tariff levels fell to even marginally lower levels, it would be incrementally positive for economic growth and inflation, thus earnings and equities, but fiscal deficits concerns, thus rate concerns, could remain elevated

- The tariff drag on GDP would be reduced and we could see upside in earnings, but the S&P 500 trades near 22x NTM PE, so at risk if tariffs remain
- Bond yields must balance the positives of lower economic and inflationary risks with the negative of deficits potentially widening to around 7%, which could keep risks skewed to the upside on rates, so we would remain cautious longer-duration bonds

The range of outcomes remains wide, with low confidence in predicting the near-term path, so keep your head on a swivel…

Source: Evercore ISI, Strategas Research. FactSet.

FISCAL IN FOCUS: GROUNDHOG DAY OR POTENTIAL LONGER-TERM RISKS? YES AND YES.

The pending debt ceiling debate and Moody's recent U.S. debt downgrade are not new causal issues, per se, rather symptomatic of broader fiscal concerns that have been building up and are back in focus in light of trade policy uncertainty and the fiscal budget.

DEBT CEILING

- On January 2, 2025, the federal debt ceiling was reinstated at $36.1 trillion after its suspension under the Fiscal Responsibility Act of 2023
- Treasury Secretary Scott Bessent has employed extraordinary measures—such as suspending federal retirement fund investments—to stay under the limit
- In a letter to House Speaker Johnson, Bessent projected these measures will be exhausted by August 2025—during Congress' recess—setting up a high-stakes debate in the months ahead
- Since 1917, Congress has raised the ceiling 78 times, often under duress
- We expect to see the 79th time, but note the risk of waiting for an 11th hour deal
- **Groundhog Day…**

MOODY'S DOWNGRADE

- On May 16, Moody's downgraded the U.S. from Aaa to Aa1, citing rising debt, persistently elevated fiscal deficits, higher interest costs, and policy uncertainty
- This marks the first time all three major credit agencies—S&P (2011), Fitch (2023), and now Moody's—have stripped the U.S. of its top rating
- The agency shifted its outlook to stable from negative, suggesting a belief that immediate further deterioration is unlikely but that long-term fiscal trends remain concerning
- Again, this is not new information, rather symptomatic of a broader issue
- **Groundhog Day…**

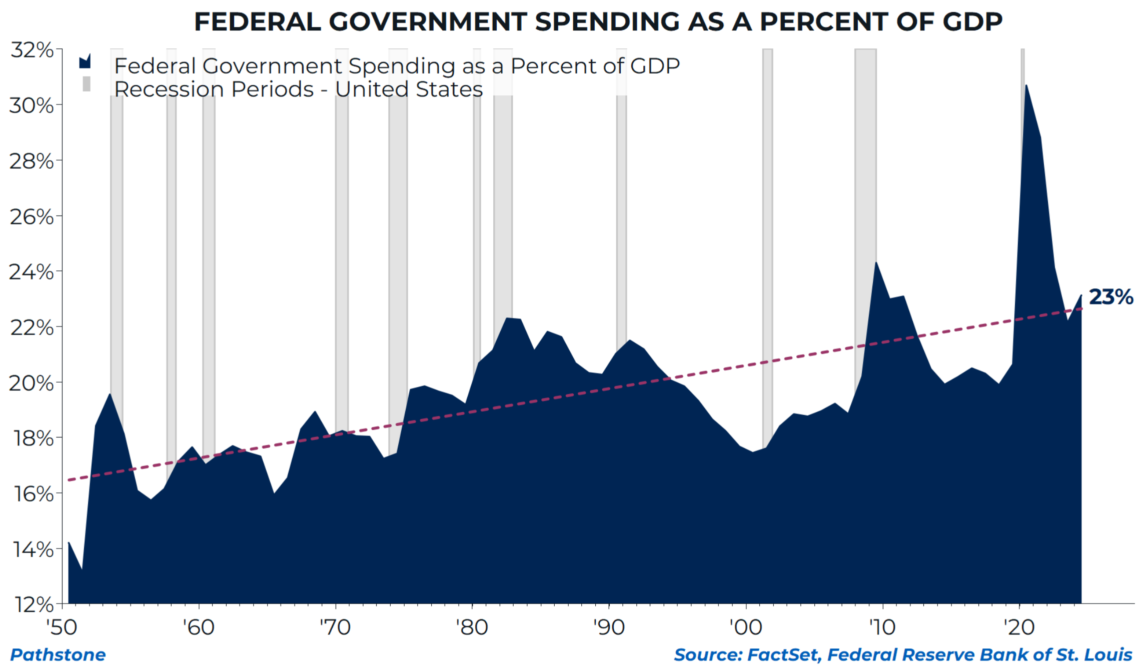
ONE BIG BEAUTIFUL BILL

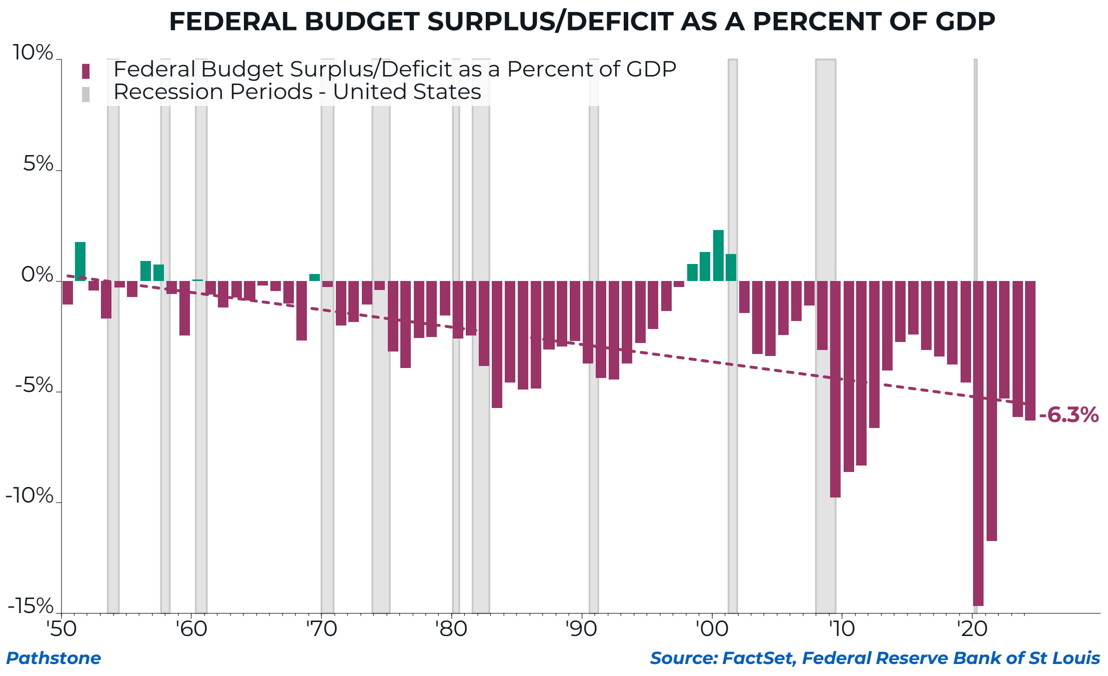
- The court battle over Trump tariffs puts further scrutiny on the budget bill and it's potential to now further widen the deficit
- Trump tariffs were supposed to be a major 'pay-for' for tax cut extensions, but that is more in question now, causing deficit hawks to push back on the budget bill
- The net deficit cost of the bill is estimated to add $2.3 trillion over 10-years, while the latest tariff revenue estimate was $2.1 trillion over 10-years
- Without tariff revenue, the deficit could breach 7%, but without tariff tax, we could also see lower inflation and higher growth
- This prompts concerns around pressure on Treasury yields and the U.S. Dollar
- **Fiscal concerns have been Groundhog Day for 40+ years, but potential longer-term risks are increasing…**

Source: Committee for a Responsible Federal Budget, Reuters, Strategas Research.

Federal spending as a percentage of GDP has reached 23% of GDP, while deficits have and are expected to exceed 6% of GDP

- The debt ceiling debate and downgrade are symptomatic of strained government finances: broadly speaking, recession stimulus spending coupled with growing spending on entitlements like health care and social security, defense, discretionary, and interest costs are outpacing tax revenue
- Nearly 75% of federal spending is mandatory (mandated by existing law), in areas difficult to cut or modify, like health care and social security, or interest expense, leaving limited room to cut deficits without significant legal changes or above trend growth (outgrow the deficit)
- The deficit reached -6.3% of GDP in the early 2020s, driven by noted pandemic spending and structural issues, which is especially noteworthy given we had wider than average deficits during a period of above trend GDP growth, where we would typically expect to see deficits narrow
- Current estimates are that the fiscal deficit will remain greater than 6% from 2026-2028, and only gradually declining from there
- This is well above Secretary Bessent's goal of sub-3% deficits by 2028, but it's important to note that he believes we can get there by achieving closer to 3% GDP growth, i.e. growing our way to a smaller deficit, but this would be no small feat and would require a meaningful increase in labor productivity





Source: Strategas Research.
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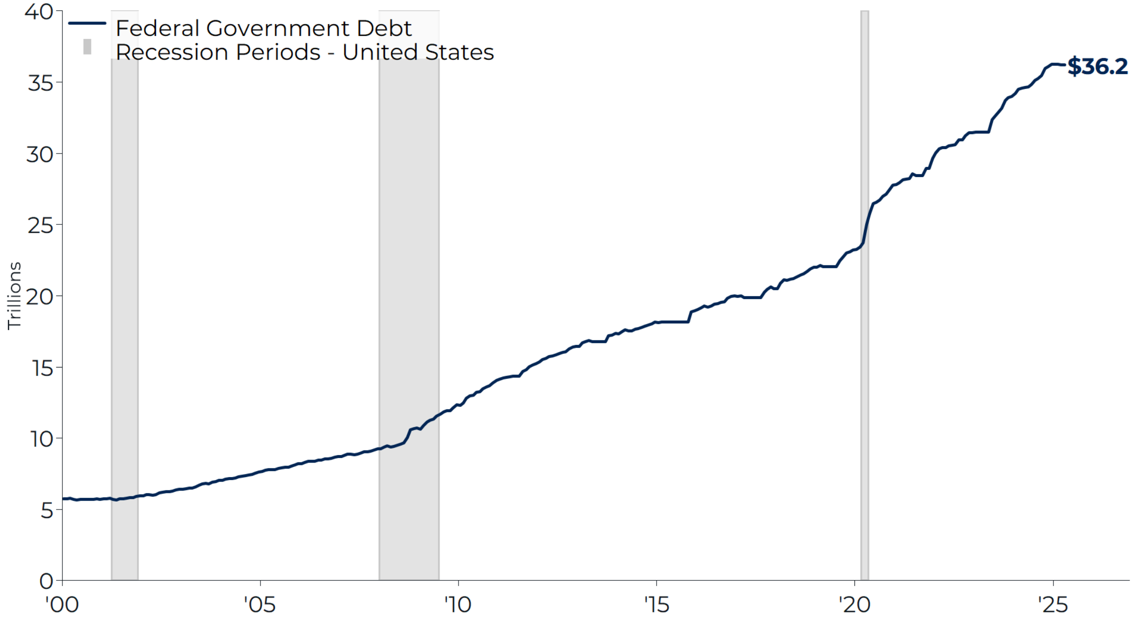
Deficits have run higher than economic growth, thus driving debt-to-GDP ratios to near all-time highs

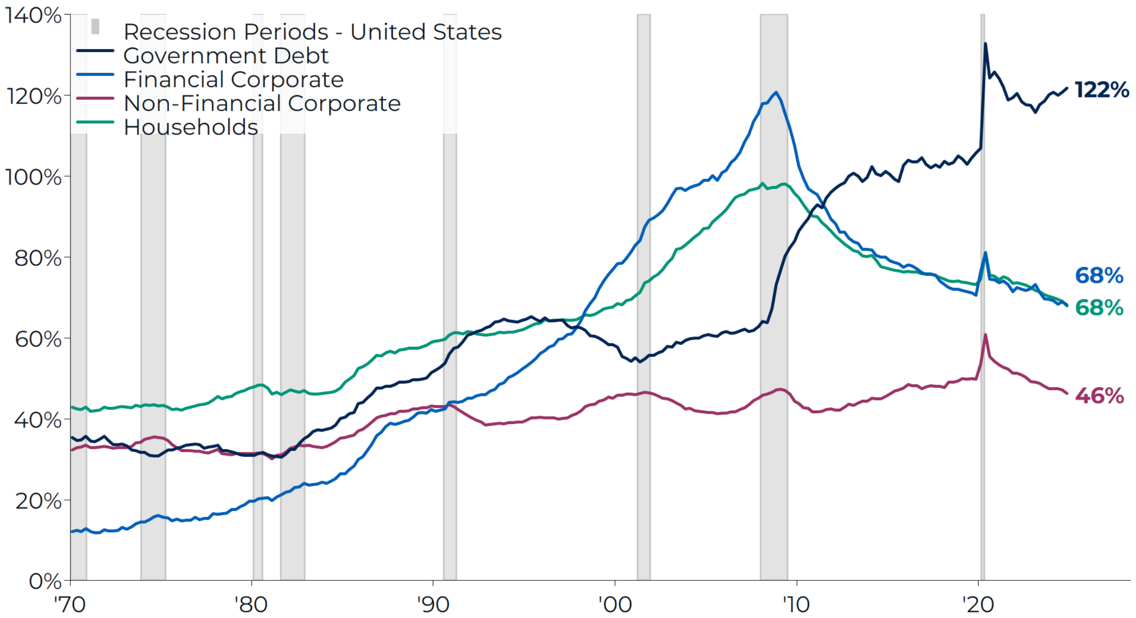
- The absolute debt level matters less than the relative total debt-to-GDP ratio, a measure of fiscal sustainability, where a debt-to-GDP ratio above 100% is considered high by international standards, raising concerns about long-term affordability, especially with higher interest rates
- Notably, this increase in government spending has coincided with a decade plus period of private sector (households and corporates) deleveraging, following the over-leveraged period leading up to the 2008 financial crisis, offsetting what could have otherwise been slower growth
- We will never "pay off" the debt, rather we need to be able to refinance the debt in a way that is feasibly sustainable, without stoking persistent inflation or causing loss of confidence in the value and stability of the U.S. Dollar that could cause devaluation in a disruptive way
- We don't have to run budget surpluses to reduce debt-to-GDP, we just need deficits lower than GDP growth to keep the debt manageable long-term

FEDERAL GOVERNMENT DEBT



Pathstone *Source: FactSet, US Department of Treasury*

DEBT LEVELS AS A PERCENT OF GDP

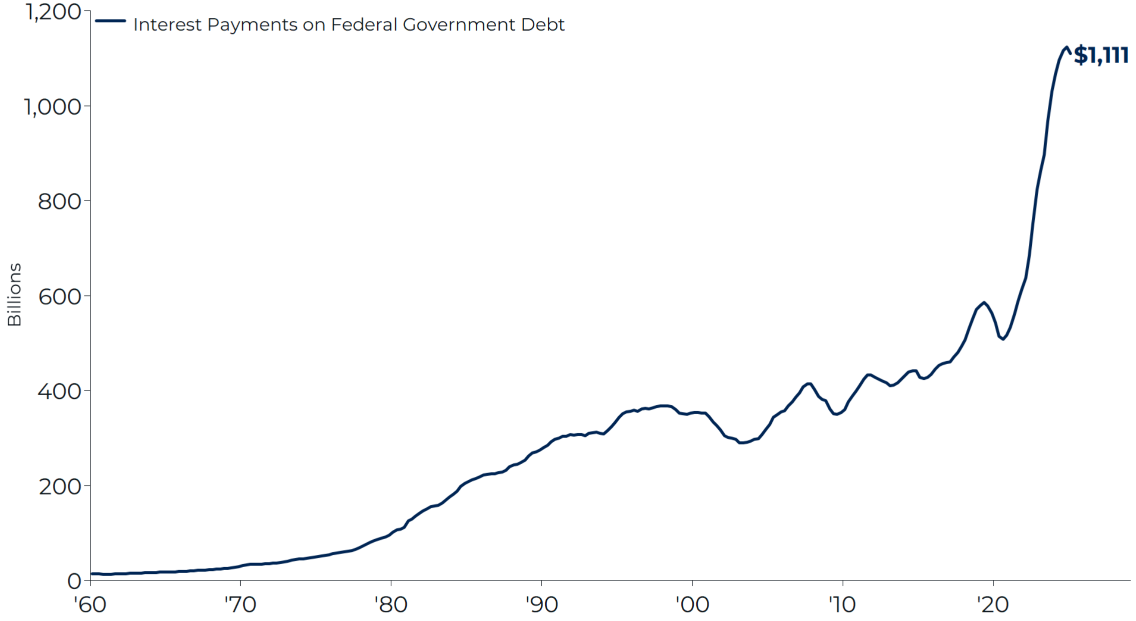


Pathstone *Source: FactSet, Federal Reserve*

Post-covid inflation brought about higher rates, which brought about higher refinancing costs on Treasuries

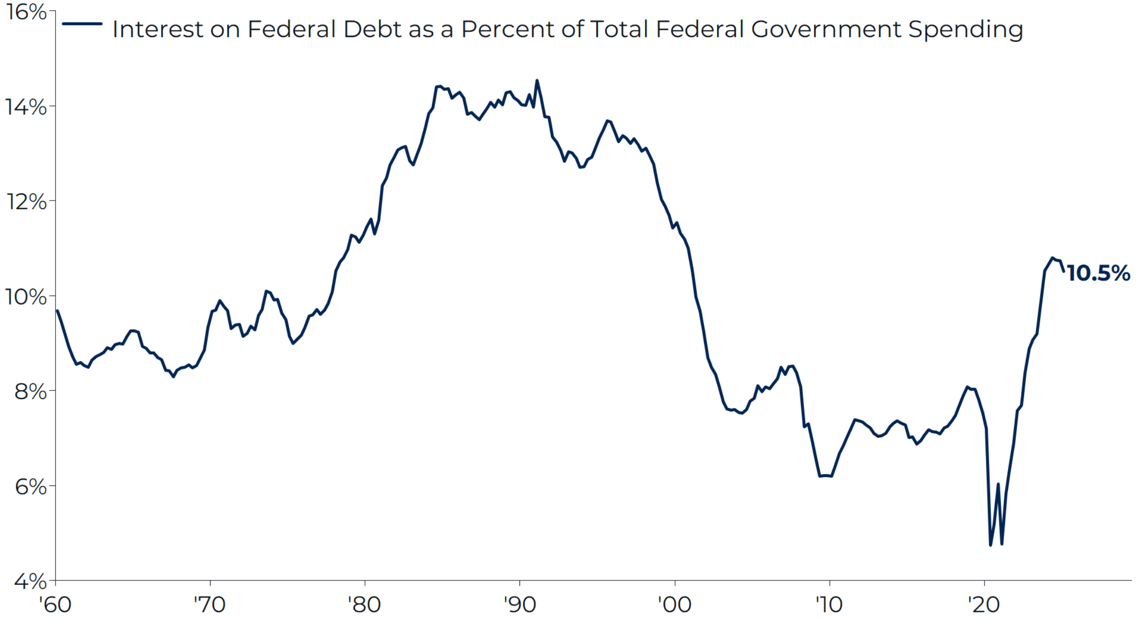
- For context, interest payments on the debt now exceed annual spending on national defense, which was $997 billion in 2024
- Driving down overall interest rates, but especially the 10-year rates, is a top priority for Treasury Secretary Bessent to both:
  a) Lower the absolute and relative levels of Treasury interest payments
  b) Lower the base rate for private sector borrowing, which is viewed as pro-growth for the economy, an important offset to tariffs and spending
- Failure to contain higher interest rates coupled with growing debt-to-GDP could lead to fiscal dominance, which would limit the Fed's ability to effectively control inflation through monetary policy – an increasing risk perceived by markets, albeit one that has been around for some time

INTEREST PAYMENTS ON FEDERAL GOVERNMENT DEBT



Pathstone *Source: FactSet, US Bureau of Economic Analysis*

INTEREST ON FEDERAL DEBT AS A PERCENT OF TOTAL SPENDING



Pathstone *Source: FactSet, US Bureau of Economic Analysis*

Source: Peterson Foundation.
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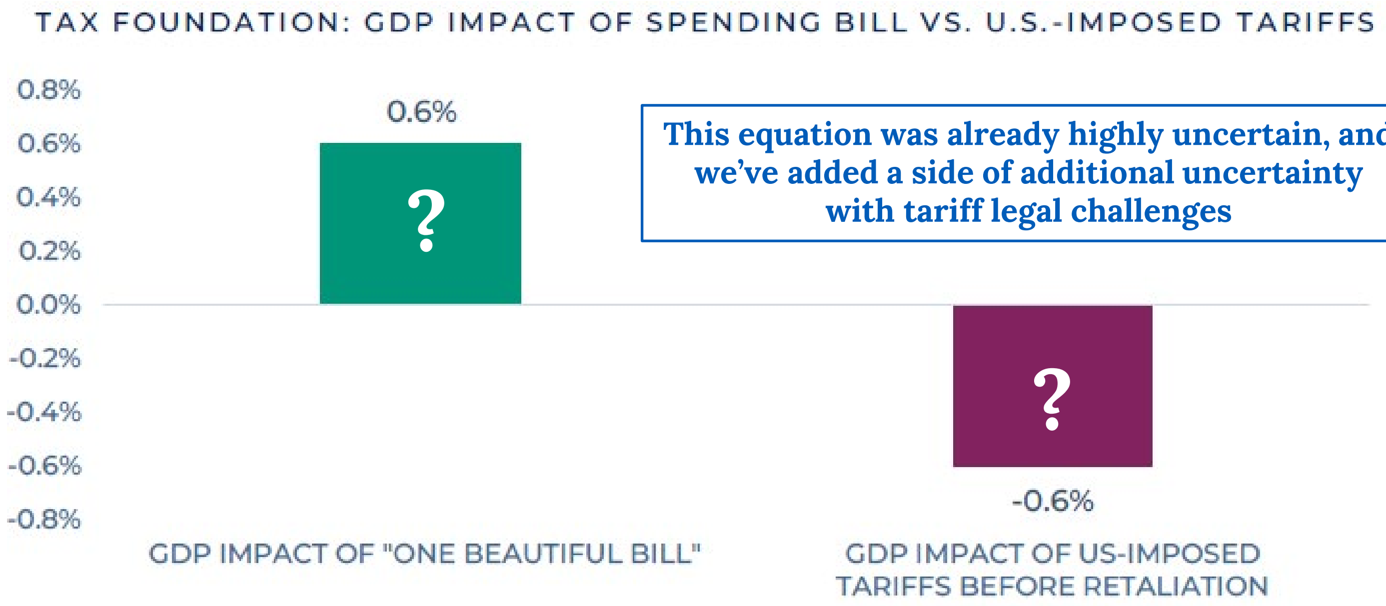
The pending debt ceiling debate and Moody's U.S. debt downgrade are not new causal issues, rather symptomatic of broader fiscal concerns, of which was culminating in Trump's "One Big Beautiful Bill" and the potential impact it could have on fiscal deficits

- The net deficit cost of the bill is estimated to add $2.3 trillion over 10-years, while the latest tariff revenue estimate was $2.1 trillion over 10-years
- Estimates vary, but the above estimate and chart below estimate from the Tax Foundation highlight a key point, which is that the GDP impact from tariffs and spending have an offsetting impact, both in terms of the deficit and drag/impulse to GDP growth
- However, complicating matters is the active court battle over Trump tariffs, an important "pay-for" in keeping the deficit from growing even faster
- Without tariff revenue, the deficit could breach 7% … but without the tariff tax, we could also see lower inflation and higher growth via the near-term fiscal impulse of the higher spending being a boost to GDP growth



Source: Tax Foundation.
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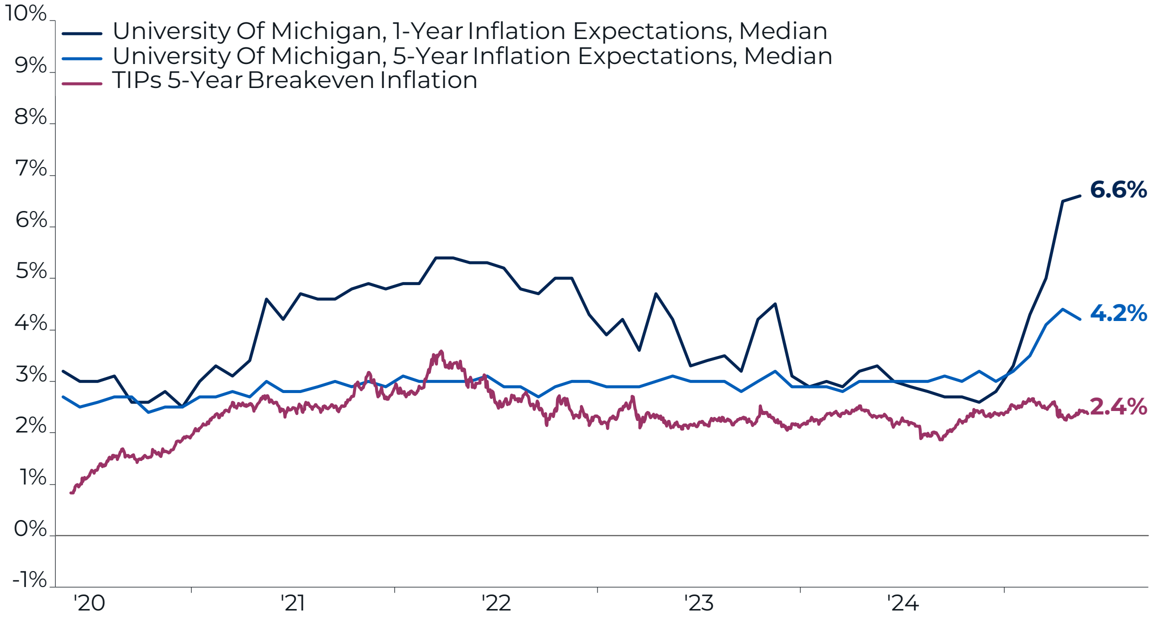
Tariffs plus wider deficits both stoke consumer inflation concerns, albeit market-based inflation expectations have remained more sanguine, while simultaneously seeing yields higher and dollar lower challenges the typical "flight to quality" aspects of each

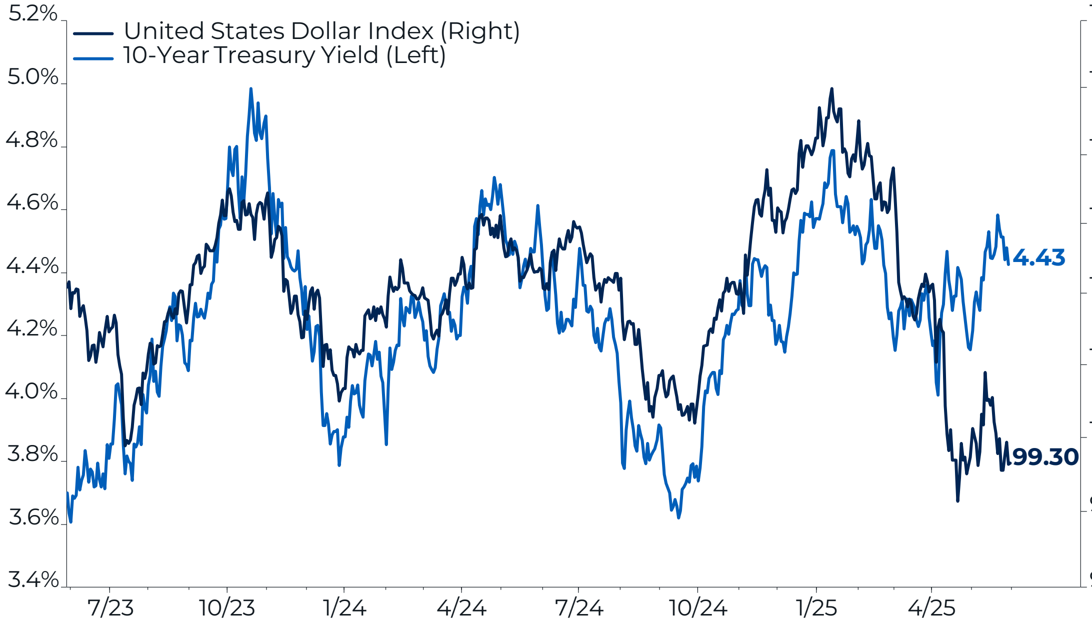
- Inflation expectations are a key variable for the Fed to watch, and thus, increasing inflation concerns has biased the Fed towards a more "wait and see" approach on further adjustments to monetary policy, with the pace of cuts near-term expected slow and be pushed out
- The term "bond vigilantes" re-entered the chat in 2025, pushing rates higher – the term, coined by Ed Yardeni in the 1980's, refers to bond market investors who protest against monetary or fiscal policies considered inflationary by selling bonds, thus increasing yields
- Noteworthy, again, is the fact that this term has been around since the 1980's, highlighting that fiscal concerns are not a new phenomenon, and hence the reference to this being a little bit like Groundhog Day for 40+ years, but also acknowledging that the market is telling us that today's levels are concerning given fiscal expansion in recent years (and projected) and warrants a prudent lens on risk management of duration

INFLATION EXPECTATIONS



Pathstone *Source: FactSet, University of Michigan*

10-YEAR TREASURY & U.S. DOLLAR INDEX

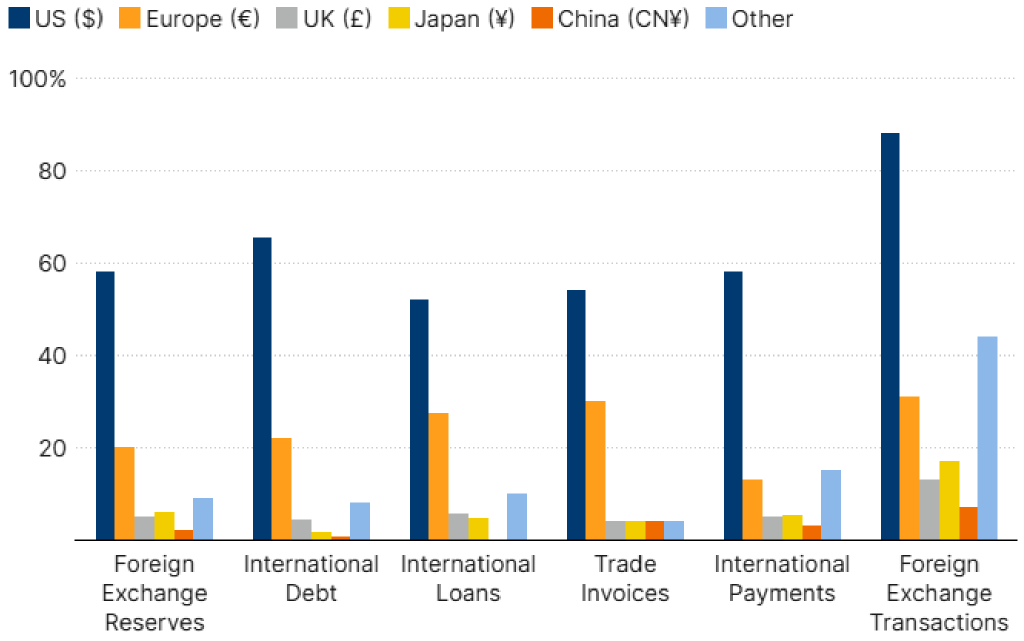


Pathstone *Source: FactSet*

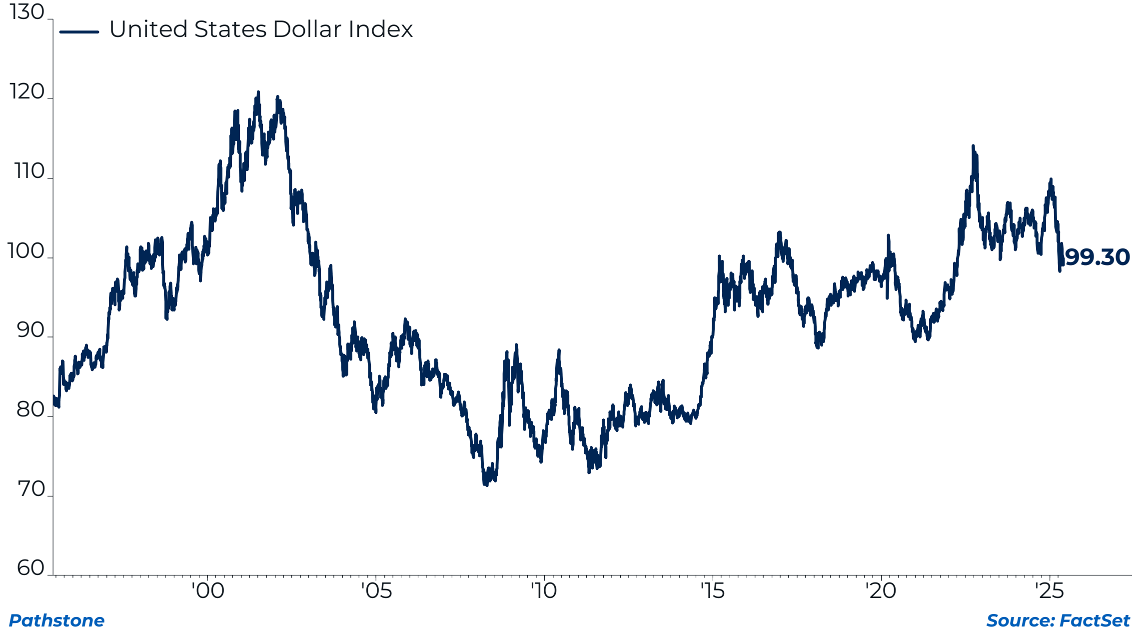
We believe reports of the "death of the dollar" are greatly exaggerated, but on the margin, it may become a "Gentler Giant"

- We will be the first to acknowledge there is a complex matrix of variables at play regarding currency values, and our experience and history remind us to have humility in making predictions around how this could all play out – that said, we can see an incrementally increased risk
- The U.S. Dollar has played a dominant role in international finance contributing to it's longer-term appreciation, and we believe it will continue to do so given it's broad acceptance and stability, the depth and breadth of U.S. capital markets, rule of law, checks and balances, and independent central bank
- While the dollar may not be perfect, it remains the "cleanest dirty shirt", without a clear dominant replacement
- However, on the margin, we could see demand and usage decline from a number of factors including trade policy, rates, and stability concerns
- This does not inherently mean this should be viewed as the base cases, rather an intellectually honest acceptance that the probabilities of these outcomes have increased given the increased range of outcomes amidst evolving and highly uncertain fiscal and monetary policy

CURRENCY SHARE OF INTERNATIONAL FINANCE METRICS



US DOLLAR INDEX



Source: Brookings Institute, IMF COFER.
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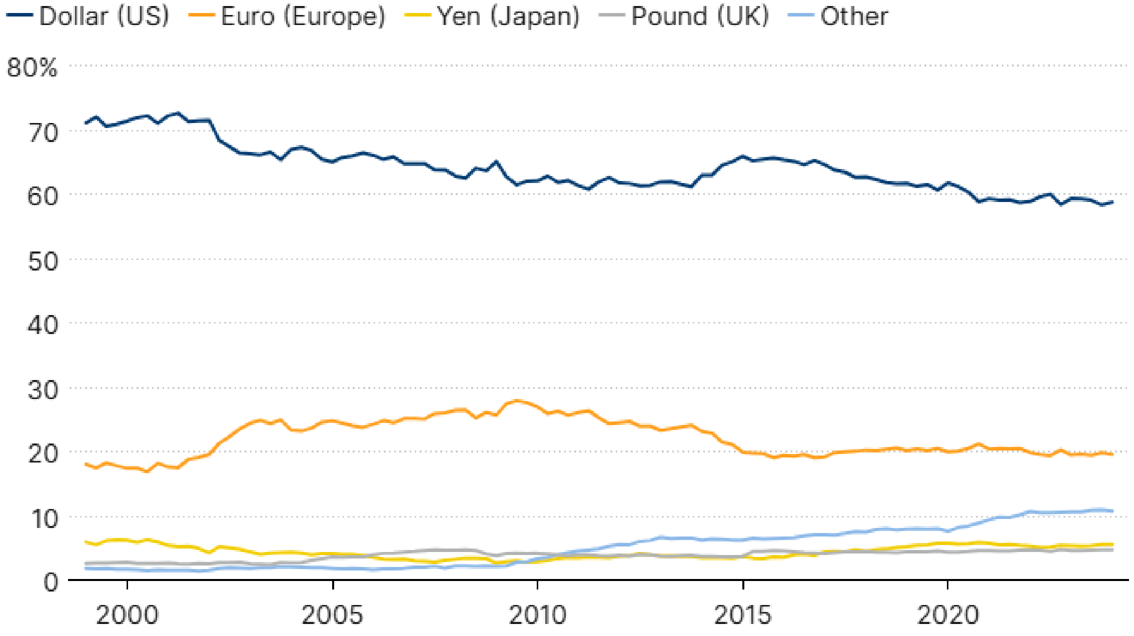
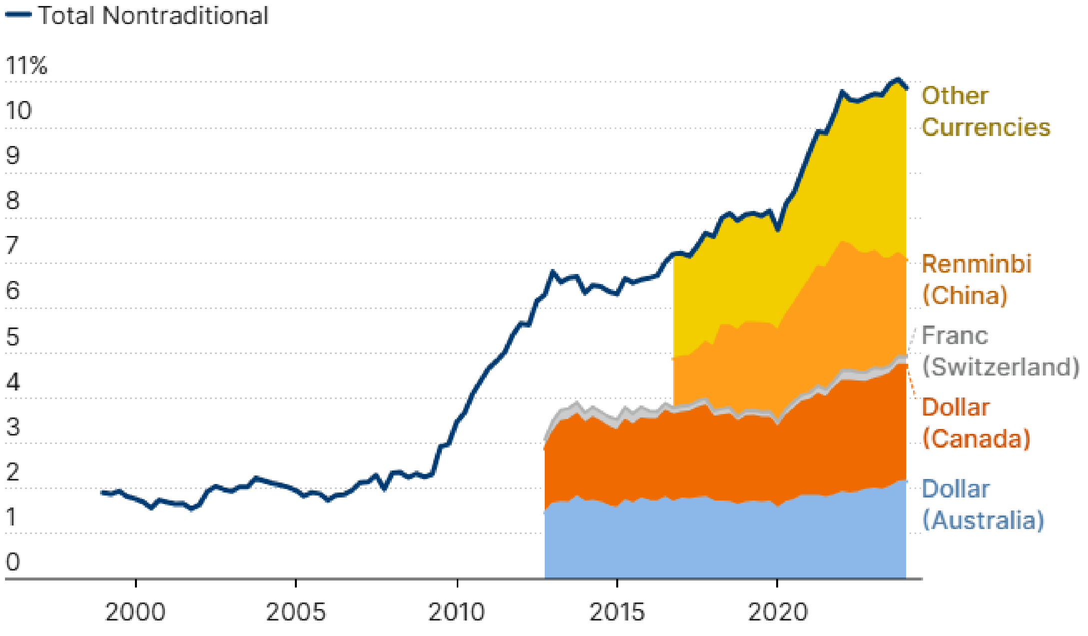
Dollar's declining share of foreign exchange reserves alone clearly is not a single variable driver of a depreciating dollar

- The dollar has appreciated over 35% since the financial crisis low, while other currencies have gained foreign reserve share
- Part of this is increased trade deficits keeping upward demand on dollars, but demand for dollars also stems from U.S. capital markets and U.S. investments more broadly generating high returns on invested capital, again, highlighting that currencies are a complex multi-variable equation
- That said, again, an incremental decline in trade, rotation out of dollar-based assets for reserve, trade, or investment purposes could put incremental downward pressure on the value of the dollar – as preferences for other currencies, or even gold or bitcoin, could grow
- How the economy responds to policy, both in terms of growth and confidence, will play a key role – international investment will ultimately still seek attractive returns, so a continuation of U.S. growth and innovation remain offsetting factors to declining demand for dollars, tailwinds we think persist

CURRENCY SHARE OF FOREIGN EXCHANGE RESERVES



CURRENCY SHARE OF FOREIGN EXCHANGE RESERVES



Source: Brookings Institute, IMF COFER.
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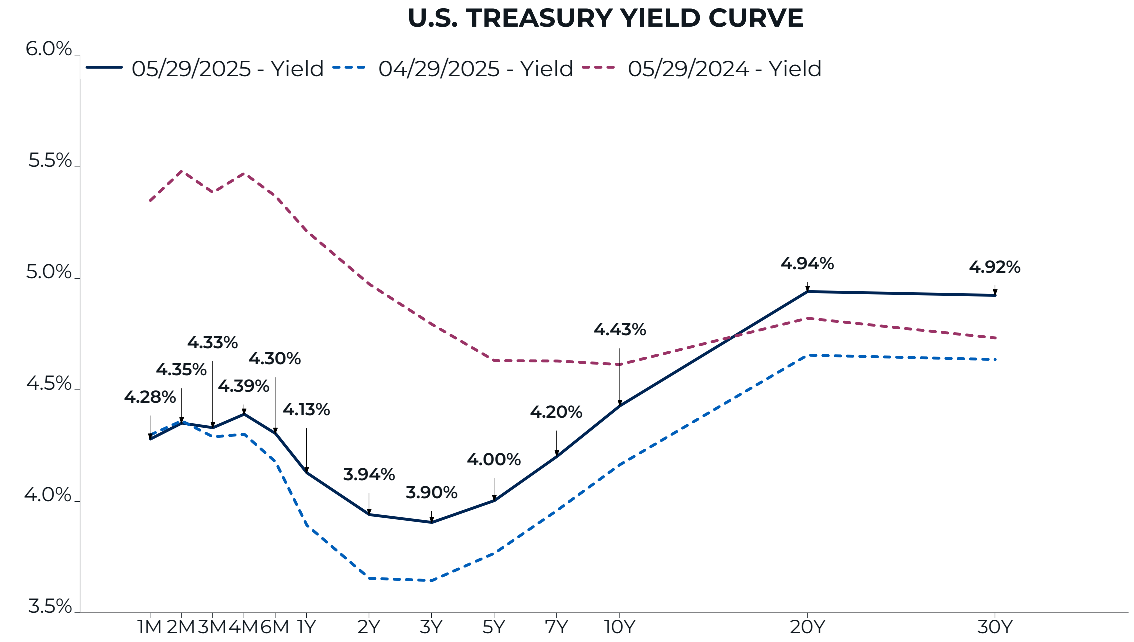
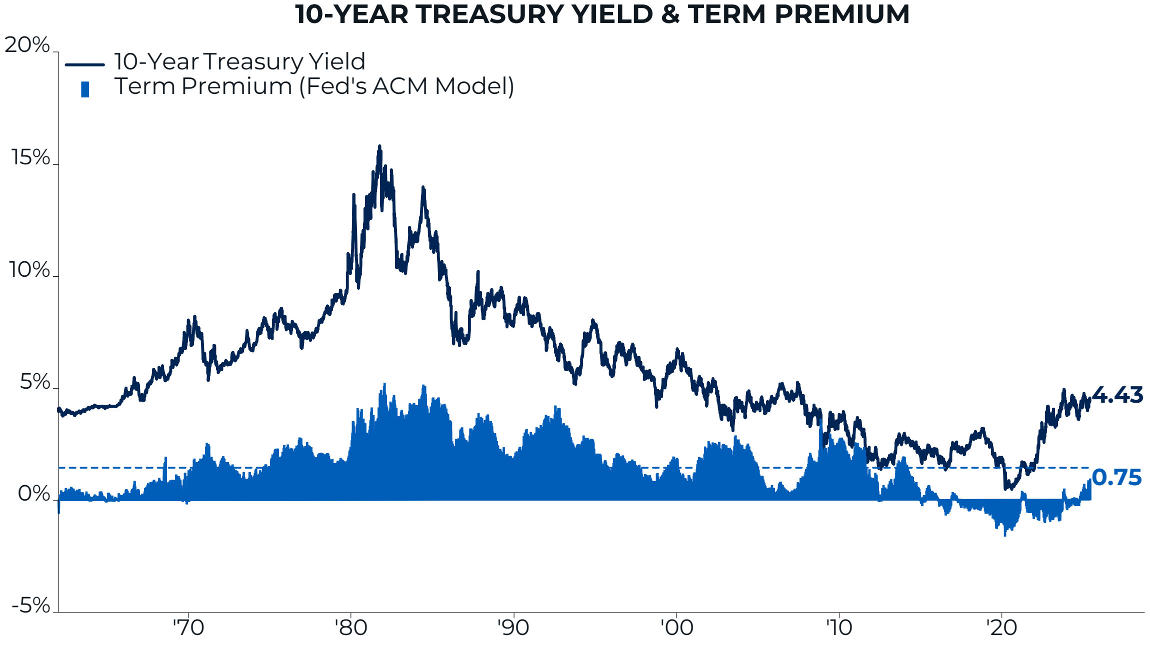
A combination of a higher neutral rate of interest and higher term premium could keep interest rates elevated

- The "ZIRP" (zero interest rate policy) world post financial crisis that was deemed the "new normal" was an extended cycle during a time of private sector deleveraging, but that is no longer the case, and the base policy rate (or neutral rate) is highly unlikely to be anywhere near zero anytime soon
- Combine this with the fact that the premium applied to longer-duration bonds was unusually low during that period (because of high confidence that the Fed could cut rates aggressively in any downturn) has also reverted back higher towards more normal levels, and the formula suggests higher rates
- The longer-term average spread between the Fed funds rate and the 10-year Treasury has been around 1.25-1.50%, so, hypothetically, the Fed cutting the Fed funds rate to 3% could imply a 4.25-4.50% 10-year Treasury, not that much outside the current range of the 10-year Treasury today
- Of course, a risk is that higher inflation and/or increased uncertainty around fiscal policy could keep/push these levels even higher, thus we see an increased level of asymmetric risk (again, even if not the base case) to the upside in rates and remain cautious on longer-duration bonds as a result





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Definitions:

IEEPA (International Emergency Economic Powers Act) – A U.S. law that grants the President authority to regulate commerce and financial transactions during a declared national emergency involving foreign threats.

One Big Beautiful Bill Act (119th Congress) – A legislative proposal aimed at requiring Congress to consider major appropriations, infrastructure, and border security measures as a single comprehensive bill, with the goal of streamlining negotiations and avoiding fragmented legislative standoffs.

GDP (Gross Domestic Product) – The total inflation-adjusted market value of all goods and services produced within a country over a specific period, serving as the primary measure of economic output.

NTM P/E (Next Twelve Months Price-to-Earnings Ratio) – A forward-looking valuation metric comparing a company's or index's current stock price to its projected earnings over the next twelve months.

Federal Budget/Surplus – The annual financial plan of the U.S. government that outlines projected revenues and expenditures; a surplus occurs when revenues exceed spending in a given fiscal year.

Debt-to-GDP Ratio – A measure of a country's total government debt compared to its annual gross domestic product, used to assess fiscal sustainability and borrowing capacity.

University of Michigan Inflation Expectations – A monthly survey component that captures consumers' anticipated inflation over one-year and five-year horizons, offering insight into household sentiment on future price levels.

TIPS 5-Year Breakeven Inflation – The market-implied average inflation rate over the next five years, calculated as the yield difference between 5-year nominal Treasuries and 5-year Treasury Inflation-Protected Securities (TIPS).

U.S. Dollar Index (DXY) – A measure of the U.S. dollar's value relative to a basket of six major foreign currencies, published by ICE, commonly used to track dollar strength in global markets.

U.S. Treasury Yield Curve – A graph that plots the yields of U.S. Treasury securities across different maturities, used to assess interest rate expectations, economic outlook, and market liquidity.

Term Premium (Fed's ACM Model) – An estimate produced by the Federal Reserve's ACM model representing the extra return investors demand to hold long-term Treasuries instead of rolling over short-term securities, reflecting risk and uncertainty about future rates and inflation.