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PEAK CAPITAL MANAGEMENT

A Big, Beautiful Market?

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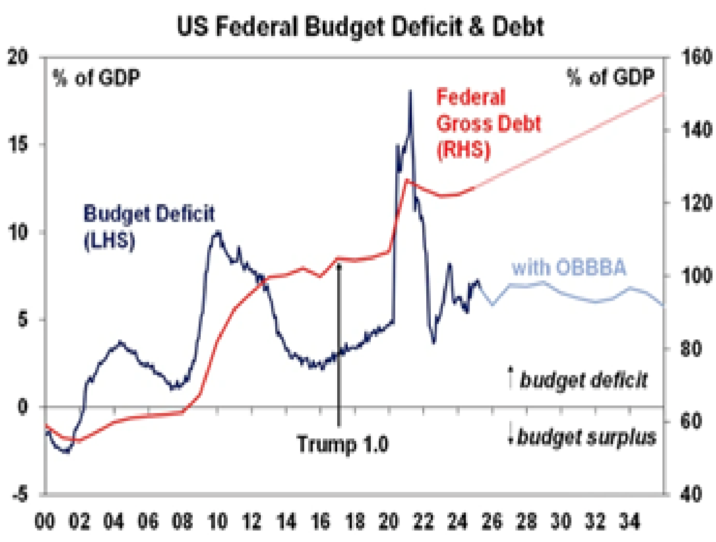
The much-heralded Budget Reconciliation Bill, A Big, Beautiful Bill, has passed the first hurdle in the House and heads to the Senate where changes are almost certain to occur leading to a reconciliation process. The Bill passed the House on a party-line vote 215-214, with descriptions ranging from 'A new day in America' to 'A Debt Bomb' depending on who your media source is. The Bill is definitely pro-growth as tax rates, slated to move higher next year, will remain at current levels and tax incentives for spending on R&D and equipment by companies remains in place.

As you might expect, the Bill is filled with plenty of election promises including tax breaks for tips, overtime, and lower income Social Security recipients that should increase discretionary spending for those benefitting from lower taxes. Budget Reconciliation bills are required to be 'revenue neutral' so any cost of tax cuts must be paid for with spending cuts. The cuts in this Bill come mostly from eliminating subsidies for green energy, credits on electric vehicle (EV) and solar panel purchases. There are also cuts to some safety net programs like SNAP (formerly food stamps) and Medicaid that are surely to be hot-button items in the reconciliation process.



Source: Bloomberg, AMP

How the Bill will help or hurt economic growth and the markets is of primary concern for most of the readers of this analysis. Corporate tax rates have a direct impact on earnings and market valuations as demonstrated by Trump's first time in office. This Bill aims to keep corporate rates constant at 21%, which combined with the accelerated depreciation for R&D and Capex, should provide a positive tailwind for earnings. There is concern that the Bill could add to already sky high debt levels, causing some in the GOP like Rand Paul of KY to oppose, that would put upward pressure on interest rates, potentially stifling future growth.

> **"Finalizing tariff discussions with our major trading partners should be priority number one ...".**

The market response to House passage has been relatively muted thus far as analysts largely expect many changes before the final Bill is passed. It has been a bumpy road for equities in 2025. The S&P 500 and Nasdaq had gained 3-4% through mid-February before pulling back around 20% and hitting a short-term bottom in mid-April. Market's have rallied and sit around breakeven for the year and it is anyone's guess where we go from here. Jamie Dimon, CEO of the largest bank in the US, JP Morgan, recently updated their investors by referring to investors as overly complacent. Dimon does not believe the market has priced in the impact of stagflation, rising inflation and flat or negative economic growth, in equity prices and expects markets to come under pressure this Summer. He raised alarm bells by forecasting earnings growth for 2025 at 0% compared to prior consensus of 12% growth. If earnings are flat compared to 2024, equity markets are likely significantly overvalued.

Markets are clearing finding direction in the tariff discussions that are ongoing. Pauses to announced tariff's, like recently announced with the EU, are immediately bullish and puts a strong bid in stock prices. Trump's negotiating style is disruptive at best for traders and will make it difficult for any trend to take hold. Long term victories to create more fair and open trade are often accompanied by short-term pain and spikes in volatility. Patient investors can find value in today's market but are unlikely to see steady gains. Utilities and Energy are both trading at extremely attractive valuations and yields but face increasing interest rate risk as they tend to carry heavy debt loads. Healthcare and Pharmaceuticals are equally compelling in terms of valuation but investors need to navigate political risk as the Administration takes steps to reduce the US government's spending on healthcare and prescriptions. Technology valuations remain closer to the level of 'priced for perfection' and I anticipate divergent paths between the technologies of tomorrow and the technologies of yesterday. Understanding which companies belong in each group is the primary challenge for tech investors.

On balance, I think this Bill could be very good for future economic growth and corporate profits, supporting equity prices and facilitating modest gains. Budget hawks in the Senate are likely to reign in some of the tax provisions and insist on more spending cuts to be budget neutral and that would probably be good for the long-term health of the American economy. Finalizing tariff discussions with our major trading partners should be priority number one as that has the potential to unleash investment in the US, creating jobs and increasing government revenue to move deficits into surpluses. I am not sure this would avert a mild recession later this year, but it would set the stage for a massive new bull market to start next year.

Bond Market Naysayers

The popular Wall Street adage, Sell in May and Go Away, typically refers to the equity markets and the market's proclivity to decline, or underperform, during the May through October period. With stocks rallying off of April lows, it appears it is the bond market, not the stock market, giving signals that investors may be wise to heed. The current fixed income environment would suggest falling yields as the risk of recession remains elevated and equities are rallying. Naysayers among bond traders, however, are keeping yields near the April highs for the year and hinting that even with a slowing economy, yields may break out to the upside, likely quashing the equity market rally. A rising bond market risk premium should be getting the attention of all investors.

- At the top of the list for bond traders is concern over what some view as trade protectionism with Trump's tariff negotiations and the expectation that it will cause inflation to remain elevated.
- The bond market is very sensitive to government deficits and debt and there is concern that Trump's Big, Beautiful Bill will ultimately fund tax cuts with an increase in government debt.
- The 30-year Treasury recently hit the important 5% level that many analysts believe is a turning point for servicing US debt. Yields have retreated back to 4.95% but should be watched closely.

Bitcoin Surges

Against a backdrop of uncertainty surrounding trade wars, credit downgrades and a weakening dollar, bitcoin has surged to record highs. The token has surged to over $110,000 (as of May 22nd) after trading at roughly $76,000 around the Liberation Day tariff announcement in early April. The higher move could be attributable to the recent spike in Treasury yields, which has seen the benchmark 10-year rate creep above 4.5%. Many investors consider the crypto currency as a hedge against inflation given its fixed supply. Furthermore, the recent downgrade of U.S. debt by Moody's has reinforced alternative stores of value such as bitcoin.

- Relative to previous moves higher, the current bitcoin rally has been more gradual as institutional investors and corporations are adopting the cryptocurrency on a broader scale. According to Bitcoin Treasuries, the amount of bitcoin held by public companies has grown to roughly $349 billion, or roughly 15% of total bitcoin supply.
- Likewise, bitcoin ETFs has seen consistent and steady inflows throughout the year amid wider adoption of crypto as a legitimate asset class. Furthermore, there is promise of future crypto legislation which could help legitimize crypto through a regulatory and legal framework. The Trump administration has been pro-crypto while Congress has approved legislation to regulate stablecoins.

Markets Tariff Yo-Yo

President Donald Trump announced last Sunday that he has granted the European Union a deadline extension on his proposed 50% tariff, moving the implementation date from June 1 to July 9, 2025. The move followed a request from European Commission President Ursula von der Leyen, who emphasized the importance of securing a mutually beneficial trade agreement. While the extension signals a temporary de-escalation, it follows weeks of mounting tension, with Trump sharply criticizing EU negotiation efforts and threatening a sweeping tariff hike. Trump previously implemented a 20% tariff in April as part of his broader "reciprocal tariffs" strategy, later reducing it to 10% for 90 days. Despite recent signals of openness to dialogue, Trump remains publicly skeptical about the EU's willingness to negotiate in good faith.

- Trump agreed to push the 50% tariff deadline on EU imports to July 9, following a direct request from EU Commission President Ursula von der Leyen.
- The proposed tariff escalation reflects Trump's frustration with what he described as stalled talks, stating, "Our discussions with them are going nowhere!"
- Earlier in April, Trump reduced initial 20% EU tariffs to 10% for a 90-day period, which now coincides with the extended deadline for finalizing a deal.

Quinn VandeKoppel

Macro View – Consumer Confidence Surges

Consumer sentiment rebounded sharply in May, driven by growing optimism around U.S.-China trade relations. The Conference Board's Consumer Confidence Index jumped to 98.0, up 12.3 points from April and significantly beating expectations of 86.0. The surge followed President Trump's decision on May 12 to halt further tariff escalations, which helped ease market fears and reverse five consecutive months of declining confidence. Improvements were seen across key indicators: the present situation index rose to 135.9, while the expectations index climbed 17.4 points to 72.8. Investor outlook also improved, with 44% now anticipating stock gains over the next year. Labor market sentiment strengthened modestly, particularly among Republican respondents, who registered the largest boost in optimism.

Fixed Income – Japanese Bond Troubles

Global financial markets turned their attention to Japan on last Wednesday, as a lackluster auction of 40-year Japanese government bonds raised alarm across bond markets. The auction's bid-to-cover ratio fell to 2.21—its weakest since July 2024—signaling deteriorating investor confidence amid growing fiscal concerns in Japan. This follows an even weaker auction on May 20, adding momentum to rising yields on "superlong" bonds and prompting speculation that the Ministry of Finance may curtail such issuances. With Japan holding the largest stock of U.S. Treasurys, the ripple effect extended to American bond markets, pushing the U.S. 10-year Treasury yield up by five basis points. Investors also reacted to broader debt sustainability issues, as both Japan and the U.S. face mounting debt-to-GDP burdens. Analysts warn that elevated yields, persistent inflation, and geopolitical uncertainties—including U.S. tariffs—may further complicate monetary policy decisions for both economies.

Taking Stock – U.S. Retains Control in U.S. Steel-Nippon Deal

Investor confidence grew this past week as details emerged about the U.S. government's conditions for approving Nippon Steel's $14.9 billion acquisition of U.S. Steel. Under a pending national security agreement, the U.S. will maintain significant oversight through a "golden share" structure, giving it veto power over critical decisions, including board appointments and production levels. The agreement ensures a U.S.-based CEO, a majority-U.S. board, and U.S.-approved independent directors—key stipulations aimed at protecting domestic steel capacity and jobs. Despite previous opposition from both President Trump and President Biden, the deal now appears likely to move forward following Trump's recent endorsement highlighting its economic impact.

Technical – Eyes on Small Caps

Small-cap stocks have noticeably lagged their large-cap counterparts in recent years, weighed down in part by rising interest rates that have challenged the growth prospects of smaller, more rate-sensitive companies. However, with markets predicating a potential 50 basis point rate cut before year-end by the Federal Reserve, small caps may be poised for a rebound. The chart below highlights the performance of the iShares Russell 2000 ETF (IWM) over the past year. Notably, the ETF has recently formed an ascending triangle pattern—a bullish technical formation characterized by a rising support line and a horizontal resistance line. This pattern typically suggests increasing buying pressure and the potential for a breakout above resistance, signaling a possible continuation of the current uptrend.

Watching the Ten-Year Treasury

Clint Pekrul, CFA

Most headlines reference the S&P 500 or the Dow Jones Industrial Average to gauge investor sentiment and the overall pulse of the economy. After achieving new all-time highs earlier this year, equity markets took a nosedive in April when President Trump announced his tariff policy on Liberation Day.

Investors were spooked by the prospect of a global trade war and what that could mean for the U.S. economy, the dollar's standing as the world's reserve currency and corporate earnings. But just as quickly as Trump announced the tariffs, he backtracked on his proposal and implemented a 90-day reprieve to further analyze the situation.

Some have speculated that, behind closed doors, the president was advised by members of his senior staff, and perhaps some large donors, about how damaging his tariff policies could be to our country's standing as the world's premier economy.

Regardless, all Trump had to do was look at the bond market after his Liberation Day announcement to appreciate the gravity of the situation. Prior to the tariff plan, the yield on the 10-year Treasury bond hovered around 3.9% after peaking at roughly 4.7% in January. A full one percent move lower perhaps led the president to believe that his tariff plan would be welcome news.

Afterall, the market knew tariffs were likely coming based on campaign promises and Trump's use of tariffs in his first term in office. The window was open, so Trump went all-in and announced hefty tariffs across the board. His blanket approach was not well received. While equities sold off the yield on the 10-year benchmark Treasury spiked in short order. The yield went from approximately 3.9% to roughly 4.5% in just a matter of days.

While not reclaiming the previous year-to-date high set in January, the spike in yields likely set off alarm bells within the Trump administration. Perhaps realizing they had gone too far too fast with an overly aggressive tariff plan, Trump pivoted and helped calm the markets. Indeed, the benchmark 10-year yield eased back closer to the four percent level by the end of April and stock markets rallied.

However, what we have seen throughout May is interest rates creeping steadily higher. After the pullback down to the lower four percent range in late April, the 10-year Treasury yield now stands at roughly 4.6% (as of May 22nd) and is approaching its earlier January level. President Trump responded by engaging Federal Reserve chairman Jerome Powell to lower interest rates.

It appears that Trump envisions that a swift and meaningful cut would provide the sugar high we needed to assuage fears of a possible recession and support the markets overall. However, chairman Powell thought otherwise and has held rates steady in opposition to the president's demands.

The Federal Reserve is in a precarious position and although he won't say it publicly, chairman Powell may despise Trump's tariffs, or at least the president's approach to implementing them. One possible scenario that is particularly problematic for the central bank is inflationary tariffs that prohibit chairman Powell from lowering the Fed funds rate or at least curtail the size of a potential cut.

Businesses will be faced with what is essentially a new tax imposed by the Trump administration, and they have two choices – either absorb the tax and accept lower profit margins or pass the tax along to the consumer in the form of higher prices. The latter is a tricky option as consumers have pricing power and can alter their spending behavior.

Either way, higher unemployment is a potential outcome. Wages are often the largest expense for businesses and when margins are squeezed layoffs are inevitable. One of the Federal Reserve's mandates is to support full employment by adjusting interest rates. In a recession, aggregate demand falls and inflationary pressures ease.

In the present situation, however, tariffs are akin to a dark cloud full of uncertainty. Will the Federal Reserve be able to cut interest rates to support full employment if CPI is well above the central bank's 2% target? If not, then chairman Powell faces a dilemma, and the bond market knows it. Without deep interest rate cuts and potential stagflation, the U.S. debt burden, credit downgrades and deficits come to the forefront. The global appetite for U.S. Treasuries could wane, sending the 10-year yield even higher.

Ultimately, we may come through this volatility relatively unscathed. Businesses could manage the tariffs sufficiently, retain their margins and avoid significant price increases. The consumer could prove resilient, and the economy could continue to expand, albeit at a relatively modest pace. The central bank could leave its policy rate more-or-less unchanged.

But for now, the bond market seems to be pricing in a stagflation scenario. Investors will demand a higher yield because of perceived risks to a slowing economy, rising unemployment and a Federal Reserve that will be hamstrung with respect to monetary policy.

Q: How do we trade the US credit downgrade?

The recent downgrade by Moody's of US government debt has been treated mostly as a non-issue and for good reason. Moody's was simply the latest after S&P downgraded US debt in 2011 and Fitch downgraded in 2021. The issues identified by Moody's are the same, the trajectory of US national debt and the failure of Congress to reign in deficits. Pending action by Congress to increase the debt ceiling has also been a concern of ratings agencies. The government will spend 18% of its revenues on interest this year and the CBO forecasts a rise to 30% by 2035.

Downgrades typically cause problems for borrowers in three ways:

1. Higher borrowing costs. Debt with greater risk of repayment pay higher rates to attract borrowers. When S&P lowered the US government rating in 2011, that was not an issue. One year after the downgrade, the 10-year Treasury had a lower yield.
2. Confidence of investors. Again, looking back at data following the 2011 downgrade, the coverage ratios of Treasury auctions were unchanged, and the assumption remains that the US government debt market is the largest and most liquid in the world.
3. Steeper yield curve. A higher risk premium should cause long-duration bonds to rise disproportionately with short-term debt which is something we may experience.

The S&P 500 was 20% higher one year after the 2011 downgrade suggesting to me the Moody's downgrade is not going to be much of a factor for investors.

The latest downgrade from Moody's is a continuation of previous downgrades in 2011 (Standard and Poor's) and 2023 (Fitch). From a historical context, the equity market, as measured by the S&P 500, experienced a highly volatile year in 2011 but that was mainly due to the Eurozone crisis overseas and fears of another 2008 style meltdown. In 2023, the equity market returned over 20% on the back of the Magnificent 7 rally while the credit downgrade took a backseat to the AI boom. From a tactical standpoint, there was really nothing to trade based on the previous downgrades.

In 2011 we had near zero interest rates and a Federal Reserve that was implementing a QE program to keep rates low. While our debt was growing the cost of service it was manageable. In 2023, inflation expectations peaked, and the central bank was poised to cut rates. Likewise, in 2011 and 2023 the U.S. was not at odds with every trading partner vis-a-vis tariffs. We're in a situation now where inflation is on the horizon and the demand for Treasuries could wane, which would send rates higher. A simple strategy could be to raise cash and wait. You're currently getting paid 4-5% in money market funds which could very well outpace many risk assets this year.

Q: Will Trump's Middle East trip move the needle with the economy?

I have read summaries of Trump's visit to Saudi Arabia, Qatar and the UAE ranging from economically transforming to nothing but a PR stunt. As with most issues debated today, the reality is very likely somewhere in the middle. More than $2 trillion of deals were announced during the 3 country visit by the President. The $200 billion in new commercial deals with the UAE is on top of more than $1.4 trillion of previously announced investments planned by the Emirates. While the investments are scheduled to occur over several years, it does represent almost 15% of US GDP suggesting a strong boost to growth. One way to measure the success of these negotiations is with expected job creation as that tends to have the greatest long-term positive impact. Qatar's deal to purchase Boeing aircraft is estimated to add 400,000 jobs across supply chains to fulfill. In total, the White House estimates more than 2 million new jobs will be created as a result of the announced deals. The focus of new jobs will be technology (specifically with AI investments), defense (new weapon sales and military aircraft), and energy (both clean and fossil-fuel).

It was also clear that Trump intends to leverage the commercial deals into wins he wants to secure with international policy. Trump is a non-interventionalist but is attempting to use trade deals to resolve tensions in the region, specifically with Iran, Syria and the conflict with Israel and Gaza. If he succeeds, lower geopolitical tensions may result in stronger global economic growth benefitting all countries.

The president boasted that his trip to the Middle East could secure deals totaling roughly $2 trillion for the American economy, including the addition of over 150,000 new jobs. For example, the United Arab Emirates (UAE) pledged to invest $1.4 trillion with the U.S. over the next decade and Qatar made a pledge to purchase planes from Boeing. Both Saudi Arabia and the UAE are building out large scale AI data centers that will partner with American chip makers such as Nvidia. The trip was highlighted by a series of business deals which were struck not contractually but in good faith with business leaders in the region. Furthermore, Trump pushed for an end to the war in Gaza and for the UAE to normalize relations with Israel via the Abraham Accords, which if accomplished could provide stability to the region.

Much of these commitments, however, have major contingencies, the most significant of which is the price of oil. WTI is currently trading at its lowest level (roughly $61/barrel) since 2021. Will these nations follow through on their commitments if the price of crude stagnates or trades lower in the coming years? Likewise, are the Arab nations genuine about normalizing relations with Israel, or simply playing lip service to President Trump? There were no doubt many handshake deals behind closed doors that might ultimately come to fruition. Only time will tell.

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