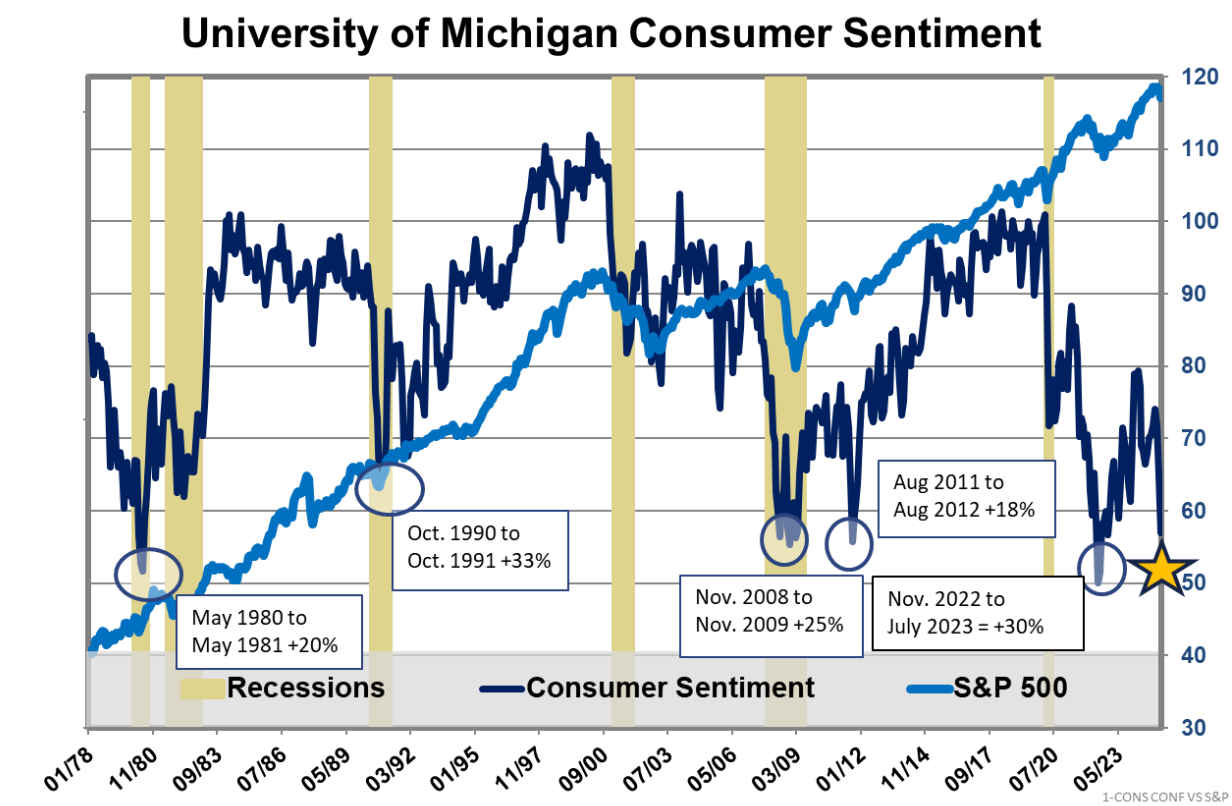
Extraordinary Uncertainty

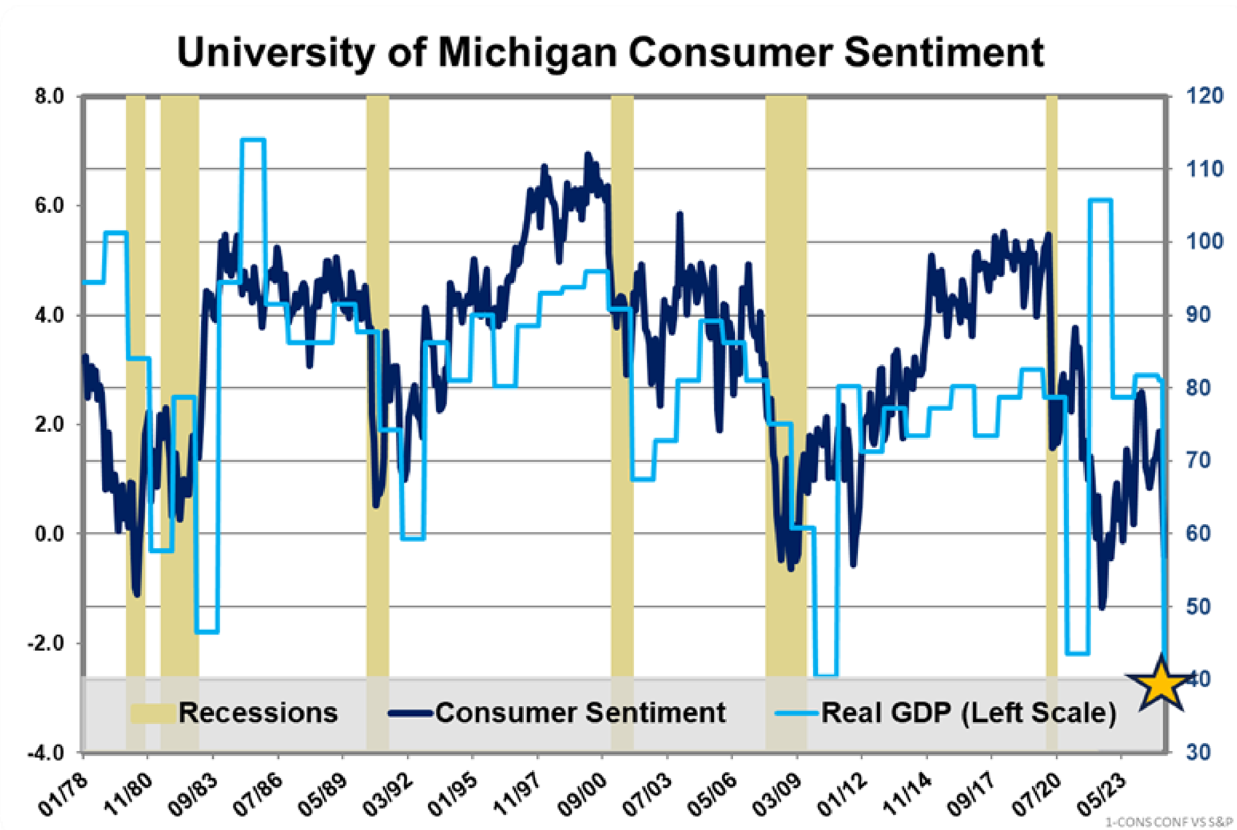
Some uncertainty is a normal part of life, both personally and professionally. The extreme uncertainty caused by President Trump's daily tariff decisions makes decision-making difficult, leading to inaction. The Trump administration's tariff motives are multifaceted but have the same goal, to tip the scales in the United States favor. They aim to reduce our trade and budget deficits by raising taxes on imports while reducing taxes on incomes. Additionally, the tariffs are intended to create negotiating leverage on other priorities, such as border security, to curb illegal immigration and fentanyl trafficking. The application and implementation of US tariffs, whether promised or imposed on China, Canada, Mexico, Europe, and other nations, could have significant economic impacts across various sectors in the U.S., affecting labor costs, inflation, corporate earnings, equity performance, and GDP.

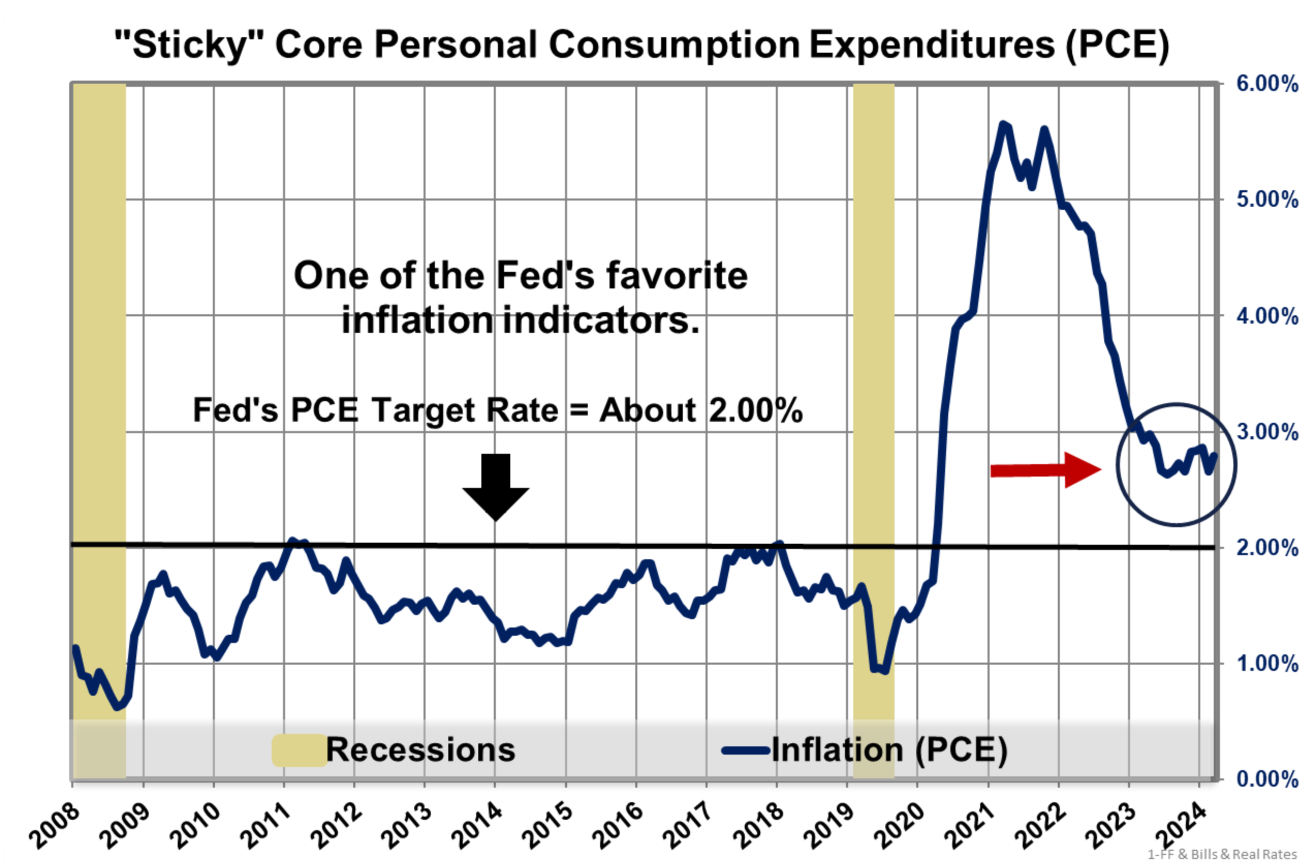
Higher labor and material costs could sharply curtail automobile companies' profits. U.S. steel and aluminum producers might benefit from tariffs. However, they would likely pass on increased production costs to buyers, including automobile and other industrial companies, and eventually to consumers. This would fuel inflation. Companies like Apple and Home Depot could face higher supply chain costs. Additionally, tariffs on Canadian energy imports could reduce Canadian producers' margins, increase costs for U.S. refiners, and ultimately harm U.S. consumers. Retailers will likely absorb some of the cost of tariffs on imported goods and even small price increases will reduce some demand.

Tariff uncertainty alone can slow economic growth and cause a stock market correction. The Atlanta Federal Reserve bank predicts real GDP growth at -3.67% this quarter. U.S. equity markets fell about 14% in the fourth quarter of 2018 when tariffs were last implemented. The stock market rebounded in 2019, rising over 30%. The U.S. equity markets corrected between 10% and 14% between mid-February 2025 and April 3, 2025. Jay Powell believes that any tariff-induced inflation will be transitory, but tariffs still pose a risk of causing immediate higher inflation and a slowdown in economic growth. This could lead to the “worst of all worlds” scenario: near-term economic stagflation.

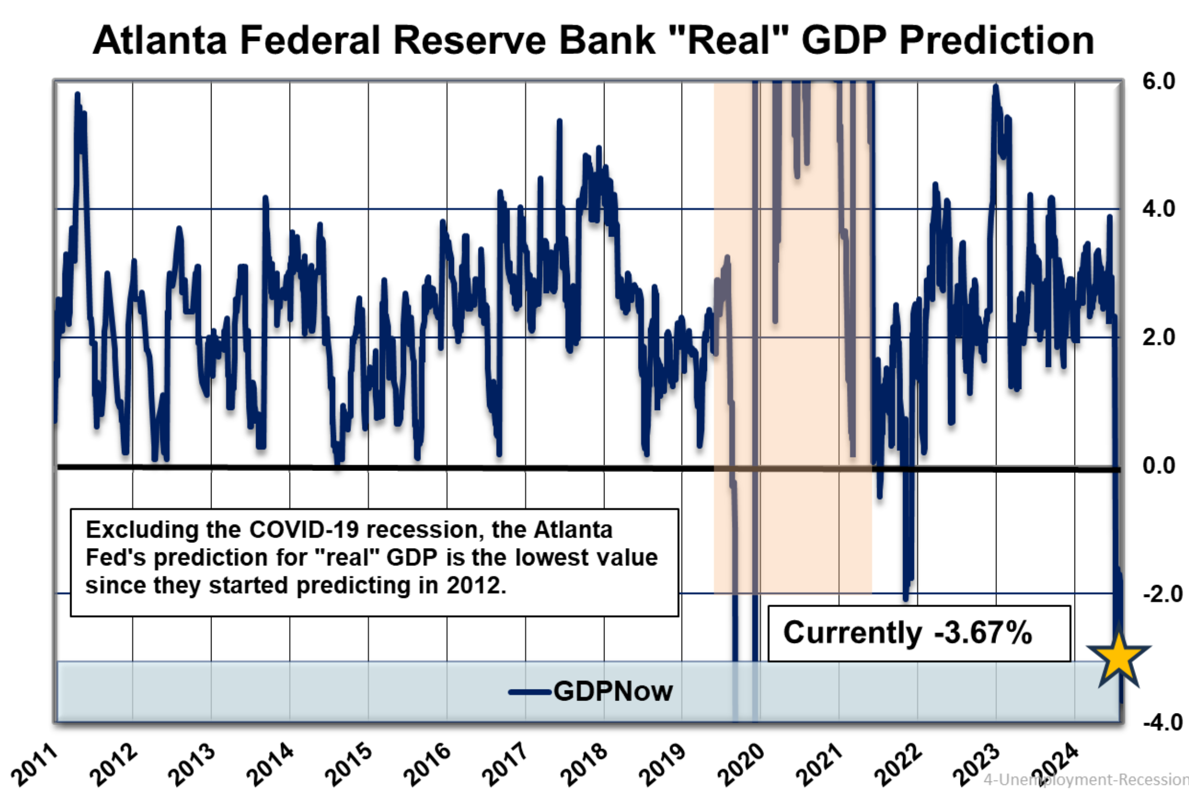


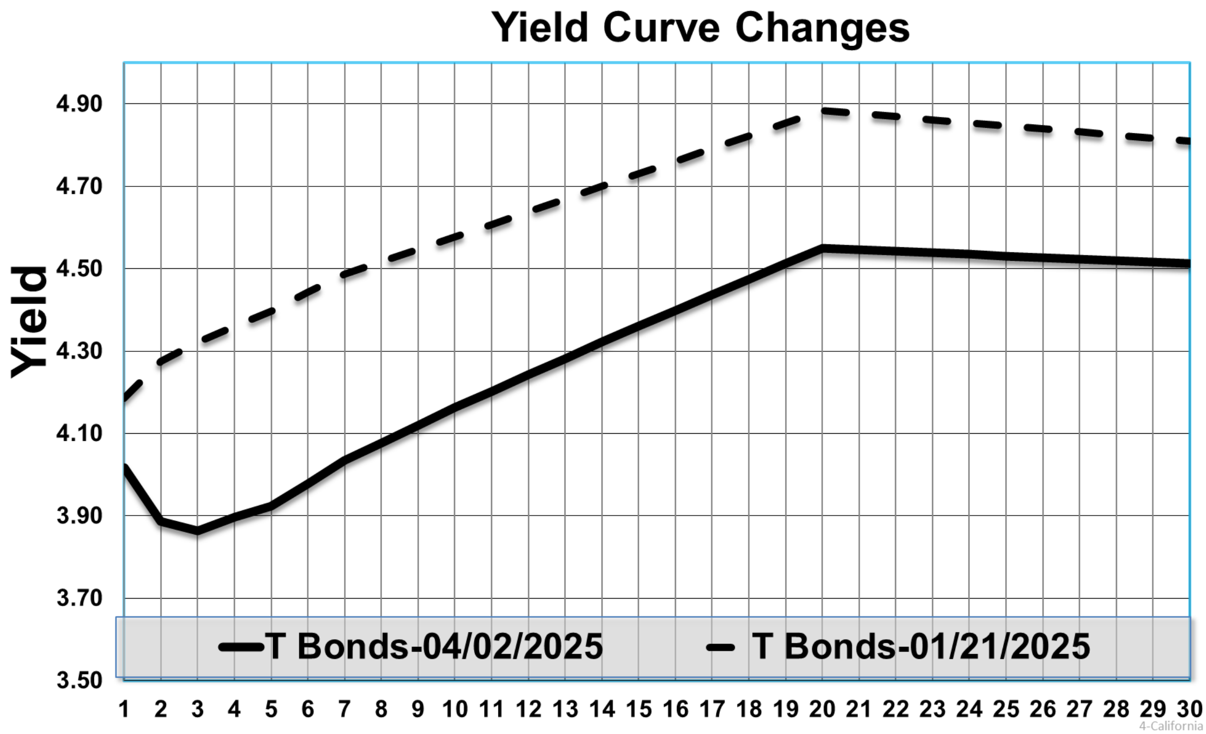
Consumer sentiment, a gauge of the prevailing attitude of consumers regarding the health of the economy and their personal financial well-being, is often considered a vital sign for economic activity. There is a correlation between today's consumer sentiment level and levels seen during recessions, **stock market bottoms** and the growth of real Gross Domestic Product (GDP).



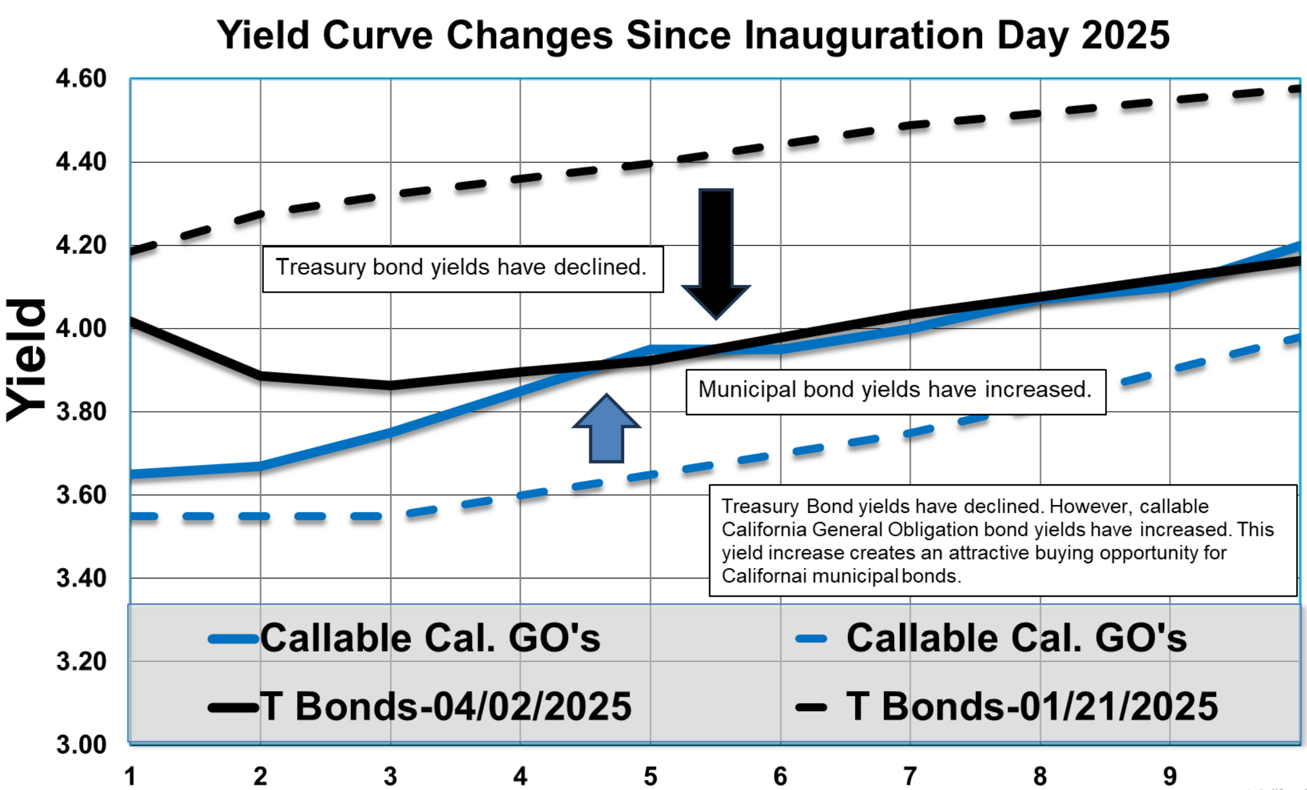


Inflation, as indicated by one of the Federal Reserve's preferred measures, remains persistently above the central bank's target of 2.0% (see above), and tariffs may exert further upward pressure. Simultaneously, the Atlanta Federal Reserve Bank is predicting a significant economic slowdown (see below). Rising inflation and an economic slowdown can lead to unwanted economic stagflation.





The current macroeconomic environment presents a seemingly paradoxical situation: while inflation remains persistently above the central bank's target of 2.0%, yields on U.S. Treasury bonds have declined since President Trump took office in January 2025 (see above). This divergence suggests that investors are currently more concerned about the potential for an economic slowdown than the ongoing stickiness of inflation. Conversely, callable municipal bond yields have increased, reflecting a seasonal increase in supply and creating an attractive buying opportunity (see below).



Wrapping Up:

Low consumer sentiment can be a valuable indicator for potential stock market rebounds

Consumer sentiment, a gauge of the prevailing attitude of consumers regarding the health of the economy and their personal financial well-being, is often considered a vital sign for economic activity. There is a correlation between today's consumer sentiment level and levels seen during recessions, stock market bottoms and the growth of real Gross Domestic Product (GDP). The graphs on page two point to the historical trend of the stock market and real GDP experiencing strong rallies following periods of depressed consumer sentiment, indicating a contrarian predictive power. This suggests that when consumers feel the most pessimistic, it might represent an opportune time for investors, as the market may have already priced in these negative sentiments.

The current macroeconomic environment presents a seemingly paradoxical situation

The current economic environment presents a complex picture characterized by persistent inflation, as measured by the Federal Reserve's preferred PCE Price Index, remaining above the central bank's 2% target. Despite this stickiness in inflation and shockingly high tariffs to exacerbate price pressures, U.S. Treasury bond yields have exhibited a declining trend since President Trump took office in January 2025. This seemingly contradictory behavior in the bond market strongly suggests that investors are currently more concerned about the possibility of an economic slowdown than the ongoing challenges posed by inflation.

The stunning increase in tariffs on April 2nd is expected to exert upward pressure on inflation while simultaneously posing a downside risk to economic growth. This potential for a stagflationary scenario further complicates the Federal Reserve's monetary policy decisions, making near-term interest rate cuts less likely. The divergence between the signals from elevated inflation and falling bond yields highlights a market sentiment that is currently prioritizing the safety of government bonds in anticipation of potential economic weakness, overriding the typical investor response to inflationary pressures.

Looking ahead, the U.S. economy faces a period of considerable uncertainty. The interplay between persistent inflation, tariff increases, and the bond market's anticipation of a looming slowdown will be crucial factors shaping the economic trajectory. Investors will need to closely monitor incoming economic data, policy developments, and market signals to effectively navigate this complex and evolving landscape.

Investors always overreact to perceived good and bad news

For instance, the dot-com bubble of the early 2000's involved chasing extreme overvaluation which led to a subsequent crash, while the financial crisis, the Great Recession of 2007-2008, led to panic selling at the wrong time. KCM believes it is crucial to cultivate an awareness of one's own behavioral biases, such as the tendency to follow the herd or react emotionally to fear, greed, and tariffs. Developing a disciplined investment strategy based on long-term goals can help mitigate the impact of short-term market noise and emotional responses to news. Understanding the historical context of market reactions to different types of news can provide valuable perspective and help in assessing whether a current market move represents a potential overreaction. By maintaining a long-term perspective, investors can aim to avoid the pitfalls of overreaction and potentially benefit from market inefficiencies created by the emotional responses of others.

The “Magnificent 7”, which comprise approximately 32% of the S&P 500, have the following Year-to-Date (YTD) returns:

- Meta Platforms (META): -6.1%
- Microsoft (MSFT): -10.5%
- Amazon (AMZN): -17%
- Apple (AAPL): -17%
- Alphabet (GOOGL/GOOG): -20%
- Nvidia (NVDA): -23%
- Tesla (TSLA): -33%

From the end of 2015 through 2024, the S&P 500 performed strongly, with an overall return of about 240%. However, according to Gemini AI, this is significantly less than the Magnificent Seven's combined return of 698% over the same period. Year-to-date, the Magnificent 7 returned -18%, while the S&P 500 returned -6.1%.

Stay Flexible

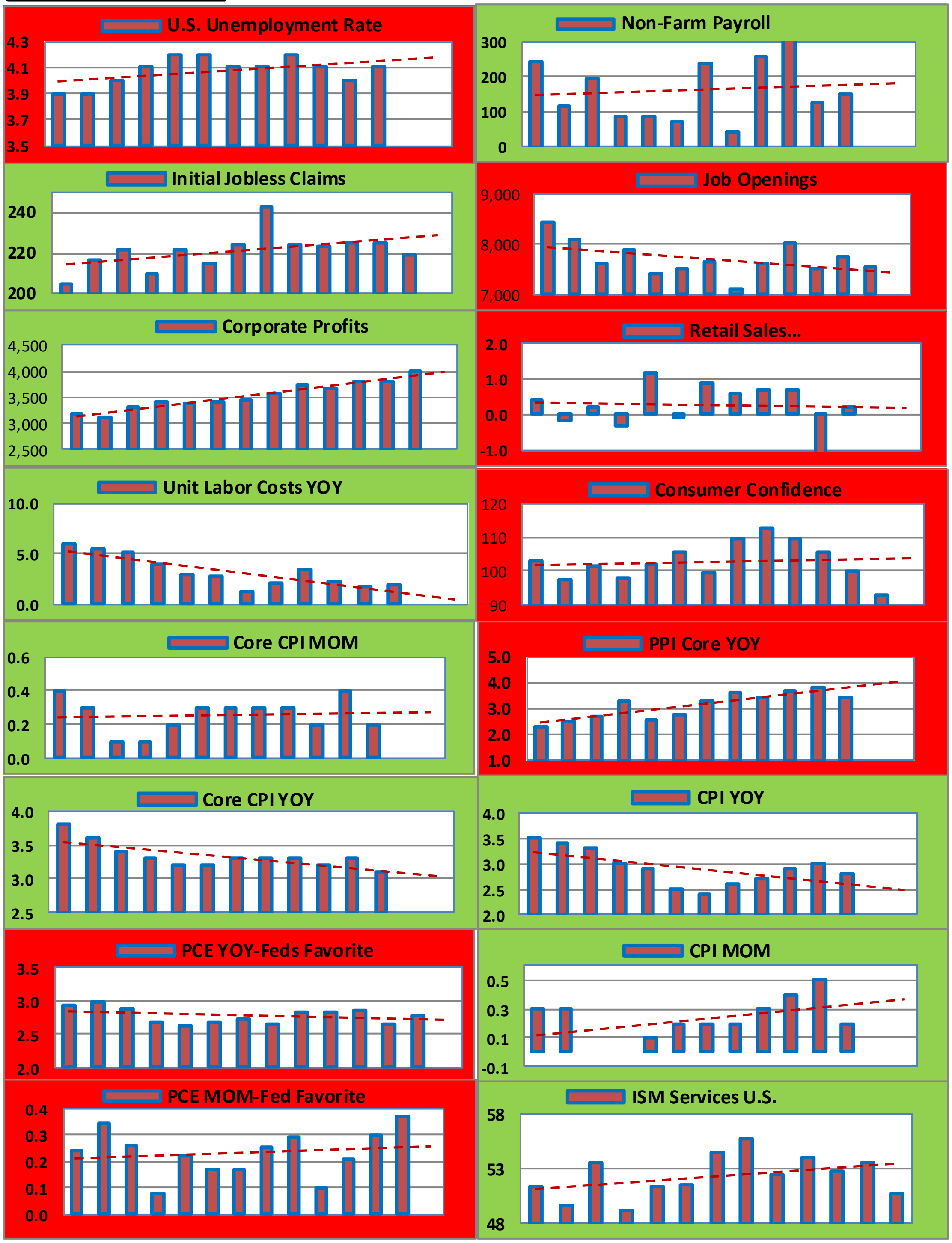
We will closely monitor the evolving landscape, carefully evaluating potential and actual policy outcomes. Initiative-taking observation and strategic adjustments are critical for navigating the inherent uncertainties of the new economic environment.

We are always available to address any questions or concerns you may have. We sincerely appreciate your trust in KCM and the valuable referrals you may provide. We remain committed to exceeding your expectations in all aspects of our service.

Jay Kellett - Founder and CEO

Economic Trends

Red=Troubling Trends Green=Favorable Trends 4/3/2025



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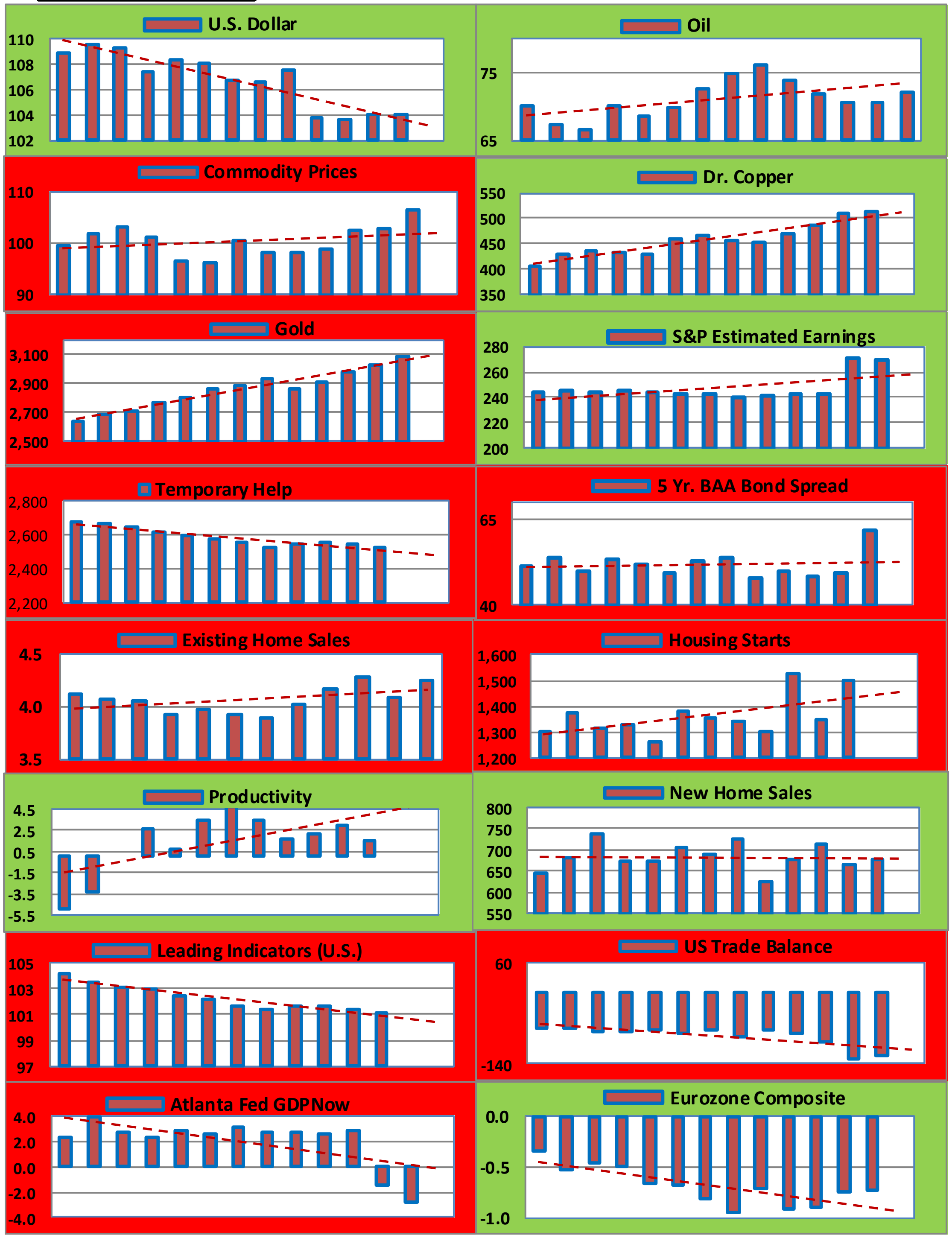

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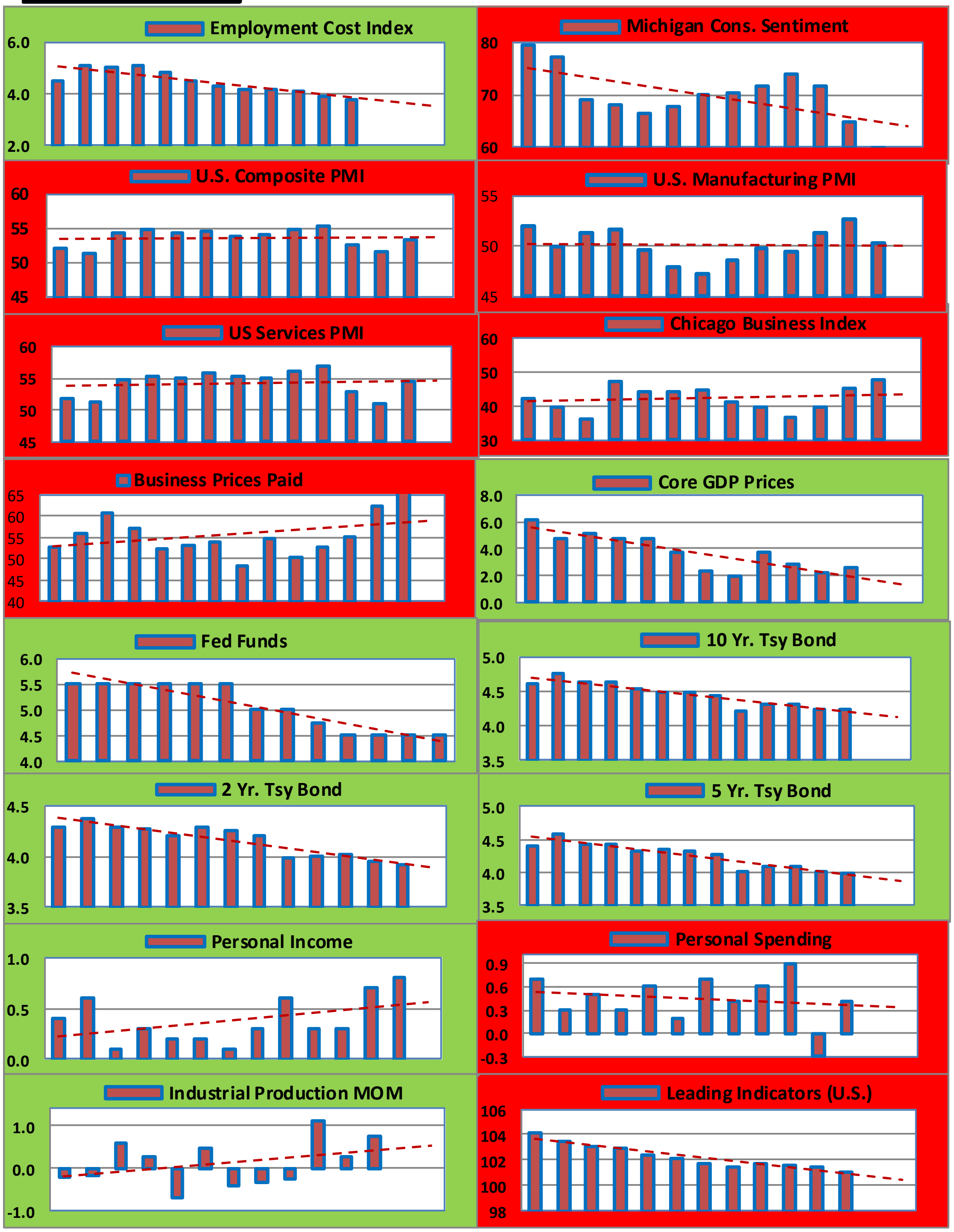

Note: All graphs were produced by KCM using data from Bloomberg. Bloomberg is also the source of the stated economic data.