Commerce Trust Market Brief with Scott Colbert

Stocks, Bonds, and the Economic Outlook

June 2, 2025

Scott Colbert: Good morning. It's Monday, June 2nd. We're five months into the year and the markets have been trending positive lately as the tariff worries have receded a bit. The S&P 500 (Index) now has clawed it's way back to a positive return up a little over 1% now year-to-date. Smaller cap (capitalization) stocks (as measured by the Russell 2000 Index) though are still negative.

International stocks have been the big winner. Large cap international stocks actually up over 16% (as measured by the MSCI EAFE Index) now year-to-date. And the emerging markets getting pulled along, up 8.7+% (as measured by the MSCI Emerging Market Index) so far this year.

And even bonds are in positive territory with the broad investment grade bond market, as measured by the Bloomberg Aggregate (Index), up 2.45% so far. Muni (municipal) bonds, though, have not quite participated. Their spreads have widened a little bit relative to taxable bonds, mostly because of the implications for the potential of having some of their tax exemption reduced with the budget deficit as large as it is. Total return for the municipal market is still a -0.96 basis points, as measured by the Bloomberg Municipal Bond Market Index.

Beneath the 1% positive return to the stock market, though, has been a very bouncy year. The market started out in positive territory, was pushed down by all the tariffs basically into almost bear market territory, and it's bounced back significantly since early April as the tariff worries began to dissipate a bit.

And while we know the underlying market has been bouncy, small cap stocks still have not participated much here in the United States. And while we had been seeing some type of broadening in the market, the recovery from the market's bottom on April 8th has been one of those narrow, tech-driven recoveries again. In fact, over 50% of the recovery has been driven by just nine stocks, including those familiar NVIDIA (NVIDIA Corporation), Microsoft (Microsoft Corporation), Tesla (Tesla, Inc.), Alphabet (Alphabet Inc.), et cetera.

And we mentioned that international stocks are up. Helping propel the international markets, of course, has been the rather dramatic decline in the (U.S.) dollar so far this year. Year-to-date, the dollar against a trade-weighted basket of currencies is down 8.4%. This, of course, then translates to any international currencies being worth more relative to the U.S. dollar.

And of course, with this decline in the dollar has meant the improvement in the overseas markets. But the overseas markets have even outperformed the decline in the dollar, driven largely by two things. Number one, they've been bringing their interest rates down in Europe. In fact, the CPI (Consumer Price Index) in Europe is only about 2% on a year-over-year basis. Plus, the added spark to some potential deficit spending, particularly in the defensive sector.

And of course, then we mentioned the bond markets had a positive return. Interest rates have fallen a bit this year. The two-year Treasury started out the year at about 4.25%, and is now about 3.9%, down 35 basis points. And even the ten-year Treasury has recovered from its initial start of about 4.5+% and is now closer to 4.4% on a year-to-date basis. As interest rates come down, of course, that pushes bond prices up. Thus, the total rate of return of the market of close to 2.5% so far, year-to-date.

Now let's talk inflation for just a second. We've been seeing some material improvement in inflation, particularly from those post-pandemic peaks that we saw several years ago. On a year-over-year basis, the core CPI now has fallen to just 2.8%. And the core PCE (Personal Consumption Expenditures), the Fed's (Federal Reserve's) favorite measure of inflation, is down to 2.5%. Unfortunately, these are likely to be the low prints in inflation for the near term because, of course, now all of the negatives of the tariffs and the price increases are likely to start accumulating going forward.

You can see here that basically we think inflation is likely bottoming and likely to rise near term. How much? Perhaps as much as 3.5% to 4% by the end of the year. But by the end of the year, most of these tariff's impacts will have likely been absorbed. And then we'll begin to see a rollover in inflation once again. Effectively, the tariffs have simply delayed the improvement that we've been seeing in inflation and pushed it out a bit. This is why the Fed has been on hold, will likely remain on hold in June, and why the market is not discounting nearly as many Fed rate cuts this year as it was in the beginning of the year.

Now, as the market has been bouncing around, so too has the implied probability of a likely recession this year. We would point out that since World War II, you get a recession on average once in every seven years. And since 1980, it's been about once in every nine years. So effectively, basically there's always a one in ten to one in seven shot of a recession in any given year.

But you can see that the probabilities increased, particularly with peak tariff enthusiasm, but have come down materially now. The betting markets have the odds of a recession over the next year down to 31%. We've been fairly consistent in thinking that we could work through the tariff thunderstorm, that it wouldn't be enough to knock down our economic momentum, but it would certainly slow it, add to inflation and, of course, postpone those likely Fed rate cuts that we don't really see coming until the end of the year.

Finally, I'd like to touch a little bit on demographics. We all know the country is aging, and in fact, the whole world is aging. And of course, as we are aging, there are going to be fewer workers on a relative basis supporting more and more Social Security recipients. This is likely to have implications for both the job market going forward and the financial markets.

We're going to be producing several pieces on demographics, the job market, and its implication for the markets going forward. Look forward to those, and then we'll be back in several weeks also to discuss how the recent financial news are impacting your portfolios.

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