Commerce Trust Market Brief with Scott Colbert

Federal Reserve Balancing Inflation and a Slowing Economy

July 14, 2025

Scott Colbert: Good morning. It's Monday, July 14th, and the markets are open and trending sideways after this weekend's tariff news. So far this year, of course, stock prices are falling into positive territory. Domestically, the S&P 500 (Index) kind of leads the way still, with a 7.18% return through last Friday. On the smaller-cap (capitalization) side, though, they're barely positive. The Russell 2000 (Index) about 94 basis points of positive performance. And almost every other index, mid-cap stocks, the Dow (Dow Jones Industrial Average), the Nasdaq (Nasdaq Composite Index), somewhere in between the S&P 500 and the Russell 2000.

International stocks have broadly done better. Large-cap international stocks (as measured by the MSCI EAFE Index) are up almost 20%, 19.18% with dividends so far this year. And the emerging markets have come close, up about 16% so far as measured by the emerging market indexes (MSCI Emerging Market Index). Those emerging market and international stocks have been propelled along by about a 10% decline in the trade-weighted dollar, which, of course, makes foreign assets more valuable.

Bond returns have generally been positive too. The broadest measure of the bond market, the Bloomberg Aggregate (Index), shows that investment-grade securities are up a bit over 3%. And even municipal bonds, which grossly outperformed taxable bonds last year, have nearly caught up and are just barely negative, as measured by most of the indexes (Bloomberg Municipal Index).

Behind these positive bond market returns, of course, have been a slight decline in interest rates. The (U.S.) 2-year Treasury began the year at about 4.25%, and it's fallen to about 3.9% and generally has been trending downward this year as economic growth has slowed. In contrast, the (U.S) 10-year Treasury has been relatively steady at about 4.4% so far this year, not making as much progress as the 2-year, primarily because of the worry about the inflationary impact of the tariffs that have lessened in the number of rate cuts likely to accrue this year.

And we don't talk much about credit spreads, but the BBB corporate bond sector is kind of a harbinger for economic activity. And it's remained relatively steady this year, starting out at about 1% over (U.S.) Treasuries. And it's currently about 1% over (U.S.) Treasuries today.

Most of the market's forecasts going forward are likely to be on tariffs and the impact or pass-through of the tariffs into inflation. Inflation, of course, has made dramatic progress from its peak several years ago. We show you a chart there where inflation peaked at 9.1% as measured by the CPI (Consumer Price Index), and fell to a low just several months ago of 2.3%. But we've been seeing a little slight uptick in inflation going forward. And this week we're going to get both the CPI prints and the producer price index (PPI) print.

We think about a third of this inflationary uptick in the inflationary rate will be driven, finally, by the increase in tariffs that are rapidly coming at us. While the effects of the tariffs on inflation have been relatively benign, with Goldman Sachs (Goldman Sachs Group, Inc.) and Barclays (Barclays PLC) estimating it's probably been less than one tenth of a percent so far, most of the impacts are likely still to come.

You can see how impactful these tariffs are likely to be in the automotive sector, where we show you a chart of how much automakers would have to increase their prices to fully pass through the tariff rates currently outstanding. The least impacted, of course, are the domestic car companies with Ford (Ford Motor Company), General Motors (General Motors Company), and Stellantis (Stellantis N.V.), that's Chrysler, probably having to increase their prices less than 3% to fully pass on the impact of the tariffs.

But when you get into the foreign car markets like Honda (Honda Motor Co. Ltd.), BMW (BMW AG), Mercedes (Mercedes-Benz Group), and Toyota (Toyota Motor Corporation), you see a material uptick in the likely pass through. And then if you're after an exotic car like a Porsche or a Ferrari, you're looking at 17% to 20% increases in prices if those tariffs are fully passed through.

So all of this leaves the Fed (Federal Reserve) in a bit of a conundrum. They know that there's going to be some inflationary impact of the tariffs, but they're just not sure how sharp or how long they're going to be.

Secondly, the economy is cooling, but it hasn't cooled materially to the point where the Fed knows that it needs to start cutting rates. The market still is betting that there will be two rate cuts coming this year, now having been pushed back to basically October and December, and then a gradual two rate cuts next year. But all of this will likely depend upon the push and pull. The push of inflation versus the pull downward as the economy slows, as it adjusts to the higher tariff regime.

We'll be back in several weeks to discuss how all these events are impacting the financial markets.

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