TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

On Our Radar – May 2025

April brought extreme volatility across global financial markets, with sharp swings in stocks, bonds, currencies, and commodities. Much of the turmoil was sparked by President Trump's unexpected implementation of "Liberation Day" tariffs, which marked a sharp departure from the initially discussed reciprocal and parity-based proposals.

The S&P 500 plunged more than 11 percent over a three-day span, only to rebound 9.5 percent in a single day following news of a 90-day pause on the tariffs—excluding China. For the month, the index ended down 0.76 percent.

Bond markets also experienced significant disruption. The yield on the 10-year U.S. Treasury surged from 4.01 percent on April 4 to 4.59 percent just five days later, reportedly driven by aggressive selling from Japan. By month-end, yields had eased to 4.17 percent.

Commodities were not immune. West Texas Intermediate crude oil fell 18 percent, closing near $59 per barrel. Gold briefly hit an all-time high of $3,500 per ounce before settling at approximately $3,318.

The volatility was set in motion on April 2, when President Trump issued an Executive Order declaring a national emergency. The order cited "a lack of reciprocity in our bilateral trade relationships, disparate tariff rates, and non-tariff barriers." One example: the U.S. imposes a 2.5 percent tariff on imported gasoline-powered passenger vehicles, while the European Union levies a 10 percent tariff.

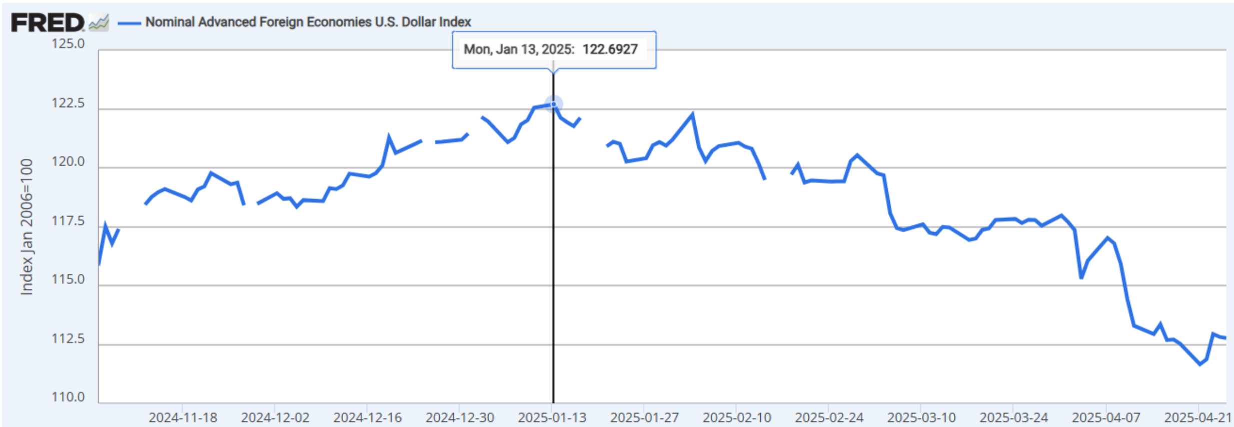
While the idea of reciprocal tariffs resonated with many, the administration's initial actions went well beyond parity. The tariff hikes also targeted non-tariff barriers—such as currency manipulation, regulatory hurdles, government subsidies, and persistent trade deficits—taking markets by surprise.

Historically, sharp sell-offs are often followed by equally strong rebounds. The real question now is: where do we go from here?

TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

In early January 2025, a trade-weighted index tracking the value of the U.S. dollar against a basket of advanced economy currencies stood above 122, as shown in the accompanying chart. By late April, the index had fallen sharply to 112.77 — an 8 percent decline over a matter of months — driven by growing concerns about a possible escalation in the trade war.



In a recent speech, Federal Reserve Chair Jerome Powell acknowledged that tariffs are likely to increase inflation while slowing economic growth. However, he emphasized that the Federal Open Market Committee (FOMC) would wait for greater clarity before making any changes to interest rates. That stance provoked a sharp rebuke from President Trump, who on April 21 publicly called Powell a “major loser” and accused the Fed of playing politics. Markets reacted swiftly, with the S&P 500 dropping 2.3 percent that day.

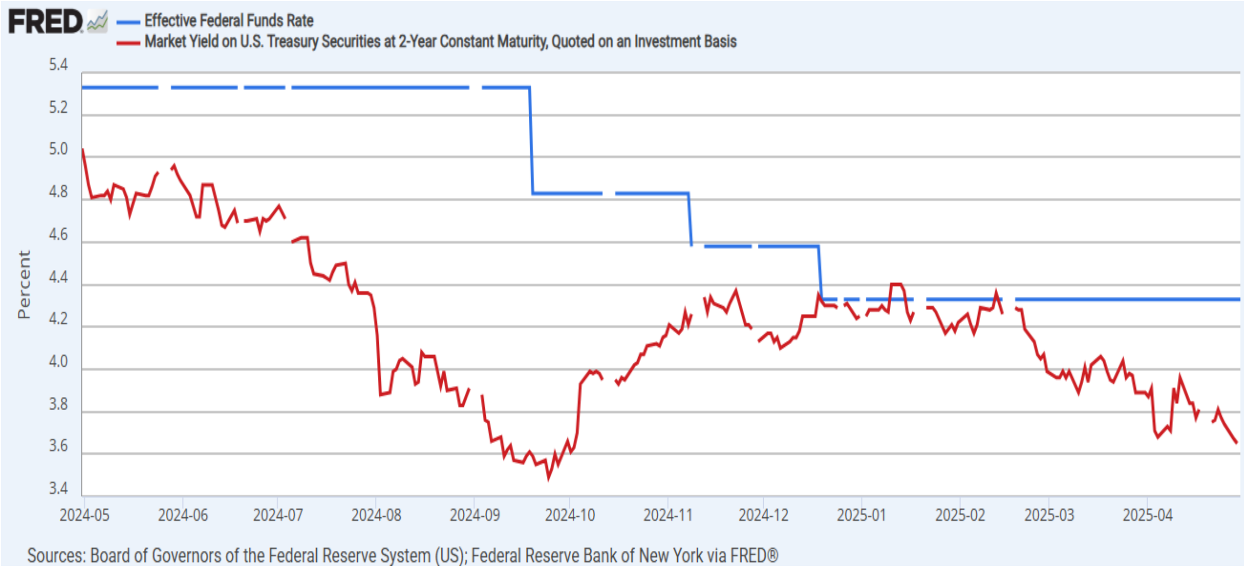
A day later, on April 22, President Trump clarified that he had "no intention" of removing Powell from his position. Markets bounced back, and the S&P 500 rose 2.5 percent.

Beyond the headlines, the broader issue is the growing uncertainty created by these developments. The U.S. relies heavily on foreign demand — particularly from allies — for financing its large and growing debt. The assumption that U.S. Treasury securities and the dollar are reliable safe havens during times of stress may no longer hold if trust erodes. Attempting to fund massive deficits while simultaneously reshaping global trade through aggressive tariffs could prompt affected countries to reconsider their support.

Chair Powell has reiterated that the Fed cannot preemptively counteract the effects of trade disruptions, noting that tariffs pose a dual threat to the central bank’s mandate—raising inflation while weakening growth and employment.

We have been highly critical of the Powell Fed, especially following its decision to abandon decades of sound monetary discipline in favor of an experimental inflation "makeup" strategy. That approach allowed inflation to surge to a 40-year high before the Fed took action by raising interest rates.

Historically, the relationship between the 2-year Treasury yield and the federal funds rate has been a reliable guide for policy. A persistent gap between the two often signals that the fed funds rate is misaligned—either too high or too low. As shown in the adjacent chart, current market conditions suggest the Fed should consider cutting rates.



Yet Powell has resisted such calls. It is worth noting that the Fed previously ignored actual inflation data, despite having promised to act if inflation rose modestly above 2 percent. Now, however, it appears the Fed is prepared to base policy decisions on expected inflation — an approach that raises further questions about the consistency and credibility of its framework.

Valuation

As of early May, the S&P 500 was trading at a Price-to-Earnings (P/E) ratio of approximately 21, indicating the index was valued at about 21 times projected calendar-year earnings. This places the market firmly on the high side of fair value. However, when valuations are elevated, even modest negative surprises can have outsized impacts — a dynamic we've already seen play out with several individual companies.

The key concern is whether the tariff dispute persists. If it does, many companies may be forced to lower their earnings guidance. Additionally, the evolving nature of the situation raises broader questions about both tariff and regulatory effects on specific sectors — pharmaceuticals, for instance — which could weigh further on future earnings prospects.

Economic Cycle

The U.S. economy contracted by 0.3% in the first quarter of 2025, driven largely by a 4.8% decline in net exports. However, the headline figure was skewed by significant front-loading of activity ahead of anticipated tariff increases. According to the Commerce Department, the U.S. trade deficit widened to $162 billion as companies rushed to import goods before new tariffs took effect. Retail sales rose 1.4% month-over-month, with much of the increase attributed to a surge in auto purchases under the same pre-tariff dynamic.

Despite these temporary boosts, forward-looking indicators point to growing economic concern. Consumer sentiment continued to slide amid rising worries about inflation and job security. The Conference Board's Leading Economic Index (LEI) declined 0.7% in March, while its Consumer

Confidence Index dropped nearly 8 points—the lowest level since May 2020. This marked the fifth consecutive monthly decline, the longest such streak since the 2008 financial crisis.

At the same time, manufacturing activity showed further signs of weakness. The Institute for Supply Management's (ISM) Manufacturing Index fell to 48.7 from 49, with any reading below 50 indicating contraction.

Sentiment

Investor sentiment reached extreme levels in April, with the Bull-to-Bear ratio falling to a negative 11.8 percentage points, according to Investors Intelligence. Historically, periods when bearish sentiment outweighs bullish sentiment have often marked attractive entry points for investors.

As noted earlier, sharp selloffs are frequently followed by strong rebounds. However, the magnitude of these swings underscores the ongoing fragility across equities, bonds, currencies, and commodities.

Technical Factors

Technical indicators in early April also reflected extreme conditions, with the percentage of stocks trading above their 50-day moving averages falling into single digits. Historically, when this measure dips below 15 percent, it has often signaled attractive entry points.

That said, sharp declines are frequently followed by "re-tests," where markets rebound and then pull back again to revisit recent lows. Much of the market's next move will likely hinge on developments related to tariffs and corporate earnings guidance.

Outlook

The United States has imposed sweeping tariffs on Chinese imports, totaling 145 percent. This includes a 125 percent "reciprocal" tariff, plus an additional 20 percent penalty tied to issues surrounding fentanyl. In response, China raised tariffs on U.S. goods to 125 percent, although certain exemptions remain. The U.S. further escalated the standoff by tightening restrictions on the sale of advanced artificial intelligence chips to Chinese buyers.

China, having studied the effects of President Trump's 2018 tariffs, responded with a more strategic countermeasure: export restrictions on key rare earth minerals. These materials are essential to industries ranging from defense and automotive to aerospace and consumer electronics.

For context, the 2018 trade conflict saw the U.S. impose tariffs on steel, aluminum, and technology firms like Huawei. China retaliated by targeting U.S. agricultural exports — especially soybeans — redirecting purchases to Brazil and prompting a $28 billion U.S. farm bailout.

This time, China's approach is more targeted. In addition to sourcing agricultural goods from countries other than the U.S., Beijing is directly pressuring U.S. companies, banning exports of critical materials to defense-related sectors, and restricting the export of equipment used to manufacture advanced components such as high-performance magnets. Given that China processes more than 90 percent of certain rare earth elements, these export controls are being used as a strategic weapon. The materials in question are vital to the production of vehicles, drones, robots, and missile systems.

U.S. Treasury Secretary Scott Bessent has argued that China must reform its export-reliant economic model. He views tariffs as a necessary tool to exert leverage and bring China to the negotiating table. However, achieving such structural changes would require a significant shift in Beijing's policy direction — one it may be reluctant to undertake.

Leading into April 2, 2025, markets were rattled by the unpredictability of President Trump's trade policy. A series of delays, reversals, abrupt threats, carve-outs, exemptions, and floating trial balloons created a climate of deep uncertainty. As a result, the S&P 500 fell 5.75 percent in March alone.

When the actual tariffs were formally announced, markets reacted sharply. The core concern is that decades of structural trade imbalances cannot be resolved in a matter of weeks. The United States has run a trade deficit every year since 1975, and addressing that reality requires a thoughtful, coordinated, and strategic approach. Instead, the abrupt rollout of tariffs alienated key allies and disrupted global supply chains.

According to global logistics firm Flexport, ocean freight bookings from China have fallen by 60% industry-wide — raising the risk of product shortages as early as this summer.
Adding to the confusion, the administration's focus on goods-based trade deficits overlooked key realities — such as services exports (e.g., international Netflix subscriptions) and structural limitations tied to U.S. climate and geography. For example, while 2018 policy encouraged companies to move production out of China, many relocated to countries like Vietnam. Now, those same goods — coffee included — are subject to tariffs, despite the fact that large-scale coffee production is not viable in the U.S.

Businesses are also grappling with policy contradictions. Upgrading the U.S. electric grid is a national priority, yet 80 percent of the transformers required are imported — and now face higher tariffs. Likewise, the machinery needed to expand domestic manufacturing is often imported and similarly affected.

Despite these headwinds, there is a silver lining. Valuations across many sectors have become more attractive, and the early April selloff included forced selling triggered by margin calls — often a sign of a near-term market bottom. However, significant market declines typically unfold in three phases: an initial sharp drop, a reflexive rebound, and a period of choppiness as investors reassess underlying fundamentals. The market's next direction will likely hinge on the duration and intensity of the trade conflict.

For historical context, consider another April 2 — this one in 2007 — when New Century Financial, a major subprime mortgage lender, filed for bankruptcy. At the time, few — including those at the Federal Reserve — recognized it as the spark that would eventually ignite the broader financial crisis. In the months that followed, markets experienced rallies and selloffs, hedge fund failures, and early signs of financial stress. Yet interest rate cuts by the Federal Reserve helped propel the S&P 500 to a new high by October 2007.

We're not suggesting a similar outcome today. Rather, it serves as a reminder that major turning points are often overlooked — even by so-called experts. But if volatility remains elevated, so too will the opportunities it creates. (5.3.25)

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