On Our Radar – July 2025

Over the past few months, markets have been roiled by a series of extraordinary and unusual events—many of which might only occur once in a decade. Amid heightened uncertainty stemming from protracted tariff negotiations, geopolitical tensions in the Middle East surged as conflict escalated between Israel and Iran. In a dramatic development, the U.S. deployed B-2 bombers over a weekend to strike Iran's nuclear facilities, prompting a swift decline in equity market futures.

Oil prices surged to approximately $78 per barrel on concerns that Iran might retaliate by disrupting the oil supply route through the Strait of Hormuz. However, as fears eased, equity futures recovered, and oil ultimately ended the month of June near $65 per barrel.

A tentative ceasefire agreement between Israel and Iran—fragile though it may be—provided further relief, helping markets rally. For the month of June, the S&P 500 rose 4.96 percent, while the yield on the 10-year Treasury fell roughly 17 basis points (0.17%) to 4.24 percent.

To underscore just how extreme this market environment has been: the NASDAQ Composite posted its worst start to a year through mid-April since its inception, only to reach an all-time high by the end of June—a remarkable reversal.

Despite market enthusiasm surrounding tariff developments, the actual substance behind the headlines has been minimal. Much of the optimism is based on pauses or vague assurances rather than concrete agreements. For instance, Commerce Secretary Lutnick claimed that a trade deal with China had been completed, a statement echoed by President Trump, who then acknowledged a signed trade "truce" with China—a notable improvement when contrasted with the earlier threat of 145 percent tariffs. Still, significant challenges remain. China has reportedly imposed a six-month limit on rare-earth exports, and many semiconductor firms remain in the dark about what trade rules with China will ultimately look like.

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)

The Federal Open Market Committee (FOMC) voted unanimously to maintain the target range for the federal funds rate at 4.25 percent to 4.50 percent, noting that inflation remains "somewhat above" its longer-run 2 percent objective. Fed Chair Jerome Powell cited "elevated uncertainty… largely reflecting trade policy concerns" as a primary reason for maintaining a cautious policy stance.

The Fed's preferred inflation gauge—Core Personal Consumption Expenditures (PCE)—rose 2.7 percent year-over-year, down meaningfully from its peak above 5.5 percent. Despite this notable progress, the Fed chose not to cut rates, drawing sharp criticism from President Trump. The President has repeatedly blamed Powell's leadership for holding rates near zero even as inflation soared to 40-year highs.

While the FOMC's decision to hold rates steady was unanimous, two committee members—Christopher Waller and Michelle Bowman—later stated publicly that they would support a rate adjustment at the upcoming July 30, 2025, meeting. With Powell's term as Chair set to expire in May 2026, these remarks have fueled speculation that both Waller and Bowman may be positioning themselves as potential successors.

President Trump has been particularly outspoken in his disapproval of Powell. In a recently released letter, he accused the Fed Chair of acting "too late, as usual," and claimed Powell has cost the country a fortune in interest payments on the national debt by failing to lower rates more aggressively.

While we've been critical of the Powell-led Fed—particularly for abandoning decades of sound monetary policy that helped keep inflation under control in favor of an unproven "inflation makeup" strategy—we also acknowledge the difficult circumstances he currently faces. With President Trump threatening new tariffs on select countries, including revisiting those announced on April 2, 2025, even the possibility of retaliatory trade measures adds considerable uncertainty to the inflation outlook.

Looking ahead, a vacancy on the FOMC is expected in January, and President Trump is likely to announce a nominee well in advance—potentially increasing political pressure on the Fed as it navigates an already challenging policy environment.

Valuation

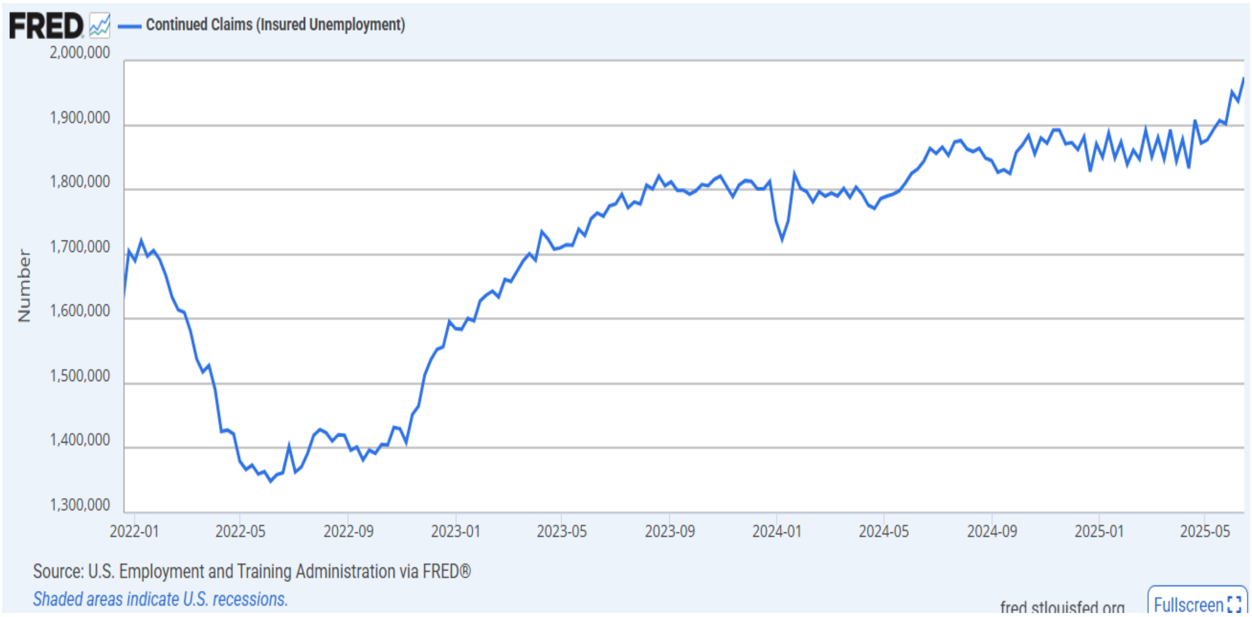
Over the past few months, earnings estimates for the S&P 500 in calendar year 2025 have declined from approximately $265 to around $255. Despite this, equity markets have rallied as concerns over tariffs have eased—suggesting that, at least in the short term, relief over trade tensions has outweighed the impact of lower earnings projections.

Based on a $255 estimate, the S&P 500 is now trading at a forward price-to-earnings (P/E) ratio exceeding 24-times, a level generally considered rich by historical standards.

Economic Cycle

On the economic front, the final reading of first-quarter Gross Domestic Product (GDP) was revised downward to minus 0.5 percent from the previously reported minus 0.2 percent, largely due to a sharp downgrade in consumer spending. While the initial round of tariffs implemented on "Liberation Day" has clearly contributed to recent economic weakness, the data suggests additional headwinds are at play. A broader softening in activity is becoming increasingly evident across housing, labor, and consumer-related indicators.

For example, continuing unemployment claims have climbed to their highest level since late 2021, signaling a slowdown in the labor market as layoffs begin to outpace new hires. Consumer confidence fell sharply in June to 93.0—down more than five points from May and marking the second-lowest reading since February 2021. Major credit card issuers are also reporting a pullback in customer spending, consistent with the 0.1 percent decline in overall consumer spending last month.



In housing, new home sales dropped more than 13 percent in May compared to April—the largest monthly decline in three years. Manufacturing data also paint a weak picture: the ISM Manufacturing Index registered 49 in June, remaining below the growth threshold of 50 for the fourth straight month. Notably, the New Orders sub-index declined further to 46.4 from 47.6, indicating continued deterioration in demand.

While much of this economic softness can be attributed to uncertainty surrounding tariffs, it's becoming increasingly clear that tariffs may not be the only factor weighing on growth.

Sentiment

As we've frequently noted, investor sentiment often reflects the market's recent trajectory. However, the most meaningful signals—typically contrarian indicators—emerge when sentiment reaches extreme levels.

In early April, following President Trump's announcement of "Liberation Day" tariffs, the S&P 500 fell nearly 10 percent over the span of two days. At that low point, bearish advisors outnumbered bullish ones by more than 11 percentage points. Sentiment at such deeply negative levels is typically considered extreme—and historically, that has often signaled a favorable entry point for investors.

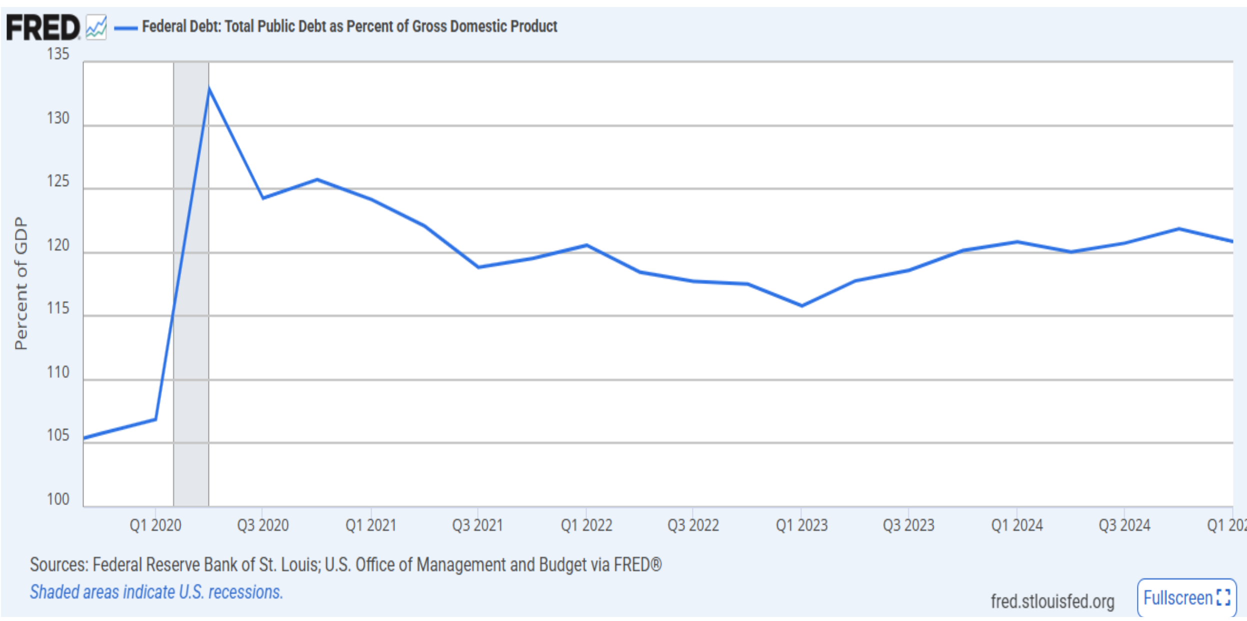
Since then, the market has rebounded, and bullish sentiment has climbed above the 50% threshold, now outpacing bearish sentiment by nearly 30 percentage points.

Technical Factors

From a technical perspective, the percentage of stocks trading above their 50-day moving averages has also rebounded sharply—from oversold levels in the low 30s to over 78 recently. Historically, barring unusual circumstances, this measure rarely exceeds the low 80s, and when it does, it typically remains elevated for no more than a few weeks.

Outlook

At the time of writing, the U.S. Senate has passed the budget reconciliation bill, placing the next move in the hands of the House of Representatives. If enacted, this legislation is expected to add trillions to the national debt and push the federal deficit-to-GDP ratio to between 6 percent and 7 percent in fiscal year 2026. That trajectory would likely keep the federal debt above 120 percent of GDP through at least 2032. The Trump administration has pushed back strongly on these projections, arguing that they are overly pessimistic.



Here lies the dilemma: with the national debt already at $37 trillion, any significant reduction in government spending could risk slowing the economy and triggering deflation. That scenario could result in asset values falling below their underlying debts—similar to the 2008 housing crisis, when home prices dropped below mortgage balances. Central banks are keen to avoid this outcome, so their preferred strategy is to allow the economy to grow while gradually inflating away the real value of the debt.

But the larger the debt load becomes, the harder it is to “thread the needle.” There are increasing second- and third-order effects to consider. For example, the U.S. dollar has fallen to its lowest level in over three years, pressured by growing expectations for interest rate cuts. Foreign central banks are also reassessing their U.S. dollar exposure, citing concerns over trade policy and the potential weaponization of the currency.
Trade uncertainty further complicates the picture. Negotiations remain unpredictable, with the administration frequently shifting its goals. As the 90-day trade extension nears expiration,

President Trump has threatened to impose 35 percent tariffs on Japan and India. In response, some U.S. officials have reportedly begun pursuing phased trade agreements rather than comprehensive deals.

Historically, nations have managed high debt-to-GDP ratios by maintaining low interest rates—even at the risk of rising inflation—in the hope that strong economic growth will eventually help reduce the debt burden. If and when the Federal Reserve does cut rates, the federal government's interest expense would decline over time. But that also assumes continued foreign demand for U.S. debt, even as the dollar weakens relative to other major currencies. Treasury Secretary Scott Bessent has outlined three key objectives: grow GDP at a 3 percent annual pace, reduce the federal deficit to 3 percent of GDP, and boost domestic oil production by 3 million barrels per day. While ambitious, these goals will take time to achieve—and are not without risks.

Given the current backdrop—including ongoing geopolitical conflicts, the need to refinance trillions in U.S. Treasury debt over the next 12 months, a weakening dollar, early signs of softening consumer spending, and equity valuations hovering near 23-times forward earnings on the S&P 500—a pause in the market, or even a more significant pullback, would not be unexpected. (7.3.25)