TJT CAPITAL GROUP
REGISTERED INVESTMENT ADVISOR

On Our Radar – August 2025

Despite months of trade tariff turmoil, the S&P 500 gained roughly 2.1 percent in July, reaching a new all-time high. Yields on the 10-year U.S. Treasury rose to 4.37 percent, up from 4.24 percent at the end of June, while crude oil climbed about 6 percent to nearly $69.70 a barrel.

The Federal Reserve left interest rates unchanged, maintaining its target range for the federal funds rate at 4¼ to 4½ percent. Corporate earnings have generally been solid, but markets were rattled by a sharp downward revision to recent U.S. job growth data.

The United States and the European Union have reached an agreement imposing a 15 percent tariff on most goods imported from the EU—down from the threatened 30 percent rate but still a substantial increase from the near-zero tariffs that existed previously. The key question now is who will ultimately bear the cost of these tariffs. If European companies absorb the expense, they may face reduced profit margins, potentially leading to job cuts. If the costs are passed on to consumers, higher prices could trigger secondary and even tertiary economic effects.

The U.S. also reached a parallel deal with Japan, setting a 15 percent baseline tariff on Japanese imports and securing a pledge of $550 billion in Japanese investment in the U.S. economy. However, shortly after the announcement, Japanese officials stated that Washington's public description of the deal differed from their understanding of the terms, raising concerns about possible disputes down the road.

Separately, the U.S. and China agreed to a temporary trade truce. Under the arrangement, the U.S. will maintain 30 percent tariffs on Chinese goods, while China will continue retaliatory tariffs of 10 percent on U.S. exports. The truce is currently set to expire on August 12, 2025, but expectations are high that it will be extended.

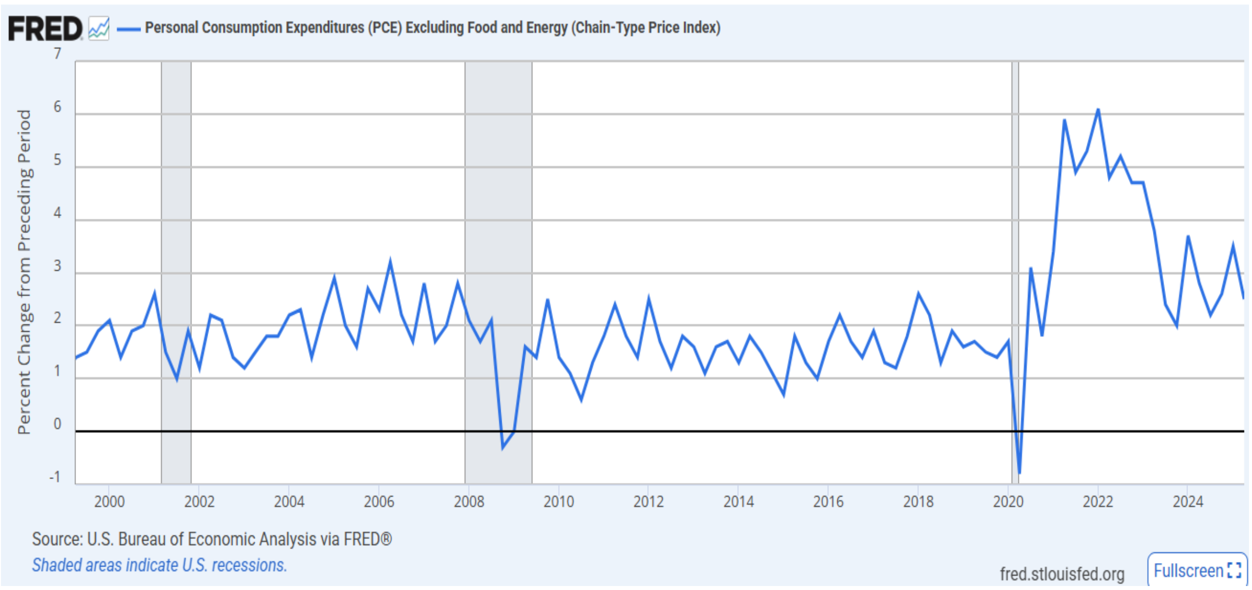
TJT Capital Group's InVEST Risk Model ® has helped our clients participate in bull markets and protect capital from the devastation of bear markets by focusing on 5 indicators that really matter when it comes to determining the health and direction of markets. The following is the most recent update.

Interest Rates (Monetary Policy)

President Trump has been openly criticizing Federal Reserve Chair Jerome Powell for the Fed's reluctance to cut interest rates. Although there have been reports suggesting Trump might fire Powell, it appears more likely that the president will continue applying public pressure in hopes that Powell steps down before his term ends in May 2026.

While the president's approach is debatable, his criticism touches on a deeper issue: the Powell-led Fed's adoption of an untested and controversial policy known as flexible average inflation targeting (FAIT). This strategy—intended to allow inflation to temporarily run above the 2 percent target to offset prior periods of low inflation—ultimately contributed to inflation reaching a 40-year high before the Fed reversed course. In embracing FAIT, the Fed abandoned decades of proven monetary discipline based on the assumption that inflation was too low.

As the chart below shows, Core PCE inflation averaged 1.7 percent annually over the 20 years preceding the policy shift. When Powell announced the change in August 2020, he assured that "if excessive inflationary pressures were to ratchet up above levels consistent with our [2 percent] goal, we would not hesitate to act." Yet in 2022, a Fed governor admitted they had "bet the farm" on inflation receding—an outcome that still has not materialized, with Core PCE remaining above 2 percent years later.



Following the latest jobs report, the 2-year U.S. Treasury yield fell to 3.69 percent. With the effective federal funds rate at 4.33 percent, that implies the rate is roughly 60 basis points (0.60%) above what the bond market views as appropriate. As of Friday, August 1, 2025, the U.S. Treasury yield curve was inverted—meaning short-term rates exceeded long-term rates. Specifically, the 3-month Treasury bill yielded 4.35 percent, compared to 4.23 percent for the 10-year Treasury note.

Historically, an inverted yield curve has been a warning sign that underlying economic conditions may be deteriorating.

Valuation

Operating earnings estimates for the S&P 500 have slipped in recent months, falling from around $265 to roughly $257. With the index trading above 6,300, this places the current price-to-earnings (P/E) ratio above 24—above historical averages, suggesting that U.S. equities are far from inexpensive.

At the same time, consumer spending is showing signs of slowing, and many small businesses are grappling with how new tariffs might affect their operations. Against this backdrop, investors may be anticipating future interest rate cuts from the Federal Reserve. However, such easing is far from certain if the latest tariff hikes remain in place.

Economic Cycle

On August 1, the Bureau of Labor Statistics reported that non-farm payrolls rose by 73,000 in July. However, job growth figures for May and June were revised down by a staggering 258,000. May's initial report of 144,000 new jobs was cut to just 19,000, while June's 147,000 estimate dropped to only 14,000. This was one of the largest downward revisions in years. Just two days earlier, Fed Chair Jerome Powell had described the labor market as "solid," citing average job gains of 150,000 per month over the past three months. In reality, the average was closer to 35,000.

While the stock market has rallied sharply since President Trump's "Liberation Day" sell-off, several economic indicators appear distorted. Second-quarter GDP grew at an estimated 3.0 percent, but that figure may have been inflated by companies "front-running" tariffs—stockpiling goods before price increases took effect. If so, growth could slow meaningfully in the second half of the year.

For the first half of 2025, GDP expanded by 1.2 percent, down from 2.5 percent over the same period last year, largely due to weaker consumer spending despite an uptick in consumer confidence. The Fed's preferred inflation gauge, Core PCE, rose 2.8 percent year-over-year, and ongoing tariff uncertainty is adding to policymakers' caution.

Other data point to cracks beneath the surface. The ISM Manufacturing Index fell to 48, its lowest level in nine months, signaling contraction. Pending home sales dropped 2.8 percent from a year earlier, and both credit card and auto loan delinquencies are on the rise. Beneath the record highs in equity markets, the economic picture remains far more complex.

Sentiment

While bullish investor sentiment has rebounded since the "Liberation Day" lows, business sentiment may prove even more telling, offering valuable insight into the broader economic outlook. Recent responses from the ISM Manufacturing survey highlight the challenges companies are facing:

- "It's been very difficult to forecast what we will pay in duties"
- "tariff policies are uncertain, which slows down our investment in new projects"
- "higher tariffs on costs of raw materials and components both sourced domestically and from overseas…will be higher in the third and fourth quarters."

These comments underscore a key point: the uncertainty surrounding tariffs remains a significant headwind for businesses, and that drag is likely to persist until the trade situation is resolved.

Technical Factors

The percentage of stocks trading above their 50-day moving average has fallen to below 50 percent, down from nearly 80 percent just a couple of weeks ago. At the same time, the number of new 52-week highs has contracted, while new 52-week lows have increased—indicating that market gains are being driven by a shrinking group of companies.

While narrowing breadth is not necessarily alarming—since participation could broaden again—it may signal that the strong rally off the April lows is due for a period of consolidation.

Outlook

U.S. markets have staged a dramatic reversal in recent months amid a fast-changing and often unpredictable tariff landscape. While there have been carveouts, exceptions, pauses, and trade deals, many of the details remain undisclosed—and, in some cases, appear subject to change without warning.

One example came when President Trump announced a 50 percent tariff on copper, triggering a 13 percent surge in futures prices—the largest intraday gain in decades. Weeks later, he confirmed that refined copper products would be exempt, sending copper futures tumbling roughly 19 percent within minutes.

Effective August 1, 2025, the U.S. imposed a 35 percent tariff on Canadian imports, excluding goods covered under the U.S.–Mexico–Canada Agreement (USMCA). Despite the market's overall advance, the CEO of one of the nation's largest aluminum companies— which imports aluminum from Canada—noted, "Our customers are paying significantly higher prices for aluminum in the United States than they would pay anywhere else in the world."

The takeaway is clear: behind the headlines, the tariff environment remains highly fluid, creating uncertainty that may prompt some businesses to delay or cancel projects. At present—though this is subject to change—average U.S. import tariffs are estimated at roughly 15 percent, up sharply from about 2.3 percent a year ago.

While higher tariffs are expected to boost government revenues, the U.S. Treasury has also raised its third-quarter borrowing estimate to $1 trillion, well above the prior $554 billion projection. Meanwhile, fiscal policy seems to still be operating as if we were in a pandemic, with an estimated $1.9 trillion federal budget deficit for fiscal year 2025—reflecting economist Milton Friedman's statement that there is nothing so permanent as a temporary government program.

On the geopolitical front, tensions may be building. President Trump has pledged to escalate pressure on Russia, promising tougher sanctions and warning that any country purchasing Russian oil could face U.S. penalties. Several nations have pushed back, citing their sovereign right to make independent policy decisions without U.S. interference.

Despite these challenges, markets have demonstrated resilience. However, equity valuations are stretched: the S&P 500 now trades at more than 24 times projected 2025 earnings, investment-grade credit spreads are the tightest since the late 1990s, and margin debt has reached a record $1.01 trillion—driven by the largest monthly increase in history, $87 billion.

While opportunities remain, elevated valuations bring elevated expectations—and leave markets more vulnerable to disappointment if bullish sentiment shifts. (8.4.25)

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