

Good morning,

What's in this week's Report:

- Why Are Markets Ignoring Scary Headlines?
- Weekly Market Preview: Does the Fed Signal Rate Cuts Ahead?
- Weekly Economic Cheat Sheet: Is Consumer Spending Losing Momentum?
- What Is the Shadow Fed and How Could It Impact Markets?

Futures are modestly higher as geopolitical risks didn't rise substantially over the weekend, while Chinese economic data was stronger than expected.

Geopolitically, the Israel/Iran conflict escalated as the two countries exchanged attacks over the weekend. Still, there are no signs it's spiraling into a broader regional conflict, and that's keeping geopolitical concerns anchored.

Economically, Chinese retail sales rose 6.4% year-over-year, surpassing expectations of 4.9%, which helped alleviate concerns about a dramatic slowdown.

Today, the focus will remain on geopolitical headlines, but as long as the conflict stays limited between Israel and Iran, it's unlikely to have a materially significant impact on the markets. Outside of geopolitics, the notable report today is the June Empire Manufacturing Survey (-7.3), and markets will want to see stable data and declining prices (further pushing back on stagflation fears).

Market	Level	Change	% Change
S&P 500 Futures	6,076.00	44.50	0.74%
U.S. Dollar (DXY)	98.00	-0.18	-0.18%
Gold	3,434.55	-18.25	-0.53%
WTI	69.86	-1.43	-2.01%
10 Year	4.430%	0.006	0.14%

## Stocks

### Last Week (Needed Context as We Start a New Week)

Stocks were higher for most of last week thanks to optimism surrounding U.S.-China trade talks and mostly Goldilocks domestic economic data. However, a resurgence in geopolitical tensions in the Middle East triggered a spike in volatility into the weekend, leaving the S&P 500 down 0.36% on the week.

Equity markets began last week with a slight rally on Monday as U.S.-China trade talks commenced in London, spurring optimism for some progress towards a deal. The S&P 500 drifted higher by 0.09%.

The rally continued on Tuesday, despite the lack of a conclusion to the trade talks in London. However, a consistent optimistic tone from Trump and cabinet members involved kept the sense of optimism present among investors, and subsequently maintained a bid under the market. The S&P 500 added 0.55% to its week-to-date advance.

Stocks sprinted to fresh multi-month highs in early trade Wednesday as both headline and Core U.S. CPI figures for May came in “cooler” than estimates, prompting dovish money flows across asset classes that kept the aforementioned risk-on bid under equity markets and helped investors shrug off reports of escalating tensions between Israel and Iran. The “framework” U.S.-China trade deal, as opposed to a concrete written agreement, sparked a sell-the-news reaction, and the S&P 500 ended the day down 0.27%.

The market bounced back on Thursday as the U.S. PPI came in below estimates, following CPI’s lead, while jobless claims data revealed signs of more pronounced weakness emerging in the U.S. labor market. The continued dovish money flows and increasing hopes for a sooner-than-later Fed rate cut helped offset the simmering geopolitical tensions in the Middle East, allowing for another 0.38% gain in the S&P 500 through the close.

Volatility returned Friday as Israel launched a massive attack on Iranian nuclear and military infrastructure. The surprise action prompted an initial 7% rally in oil, which boosted yields and weighed on stocks. The declines weren’t as bad as feared, however, as the market views the chances of the conflict spreading as relatively low. The S&P 500 ended down 1.13%.

#### Why Are Markets Ignoring Scary Headlines?

Since mid-April, the stock market has confounded the bears, steadily rallying and turning positive year-to-date despite a consistent stream of decidedly negative headlines, risks, and threats not just to the markets but to the U.S. economy. That continued last week with markets largely ignoring the attack on Iran by Israel (a situation global powers have been trying to prevent for 10+ years).

The gap between what we are reading daily in the mainstream and financial media is wide and getting wider. I wanted to take a moment to explain why none of these headlines have materially impacted stocks, so that we can 1) Explain this market resilience and 2) Know why markets are ignoring these risks, so that if something changes and markets can’t ignore them anymore, we’ll know about it.

*Scary Headline 1: Iran-Israel Military Conflict.* This is the latest scary headline to confront investors as Israel launched a direct and comprehensive attack on Iran, targeting Iran’s nuclear facility and senior military leadership. This campaign is likely to last for several more days and weeks, essentially putting the two countries in a de facto state of war. On its surface, this situation is potentially extremely negative as it risks plunging the Middle East into a regional war if more countries get involved and raises the risk Iran attacks U.S. assets in the region, potentially leading to a direct U.S./Iran conflict. *Why don’t investors care?* There are two reasons this event didn’t elicit a more negative reaction. First, Iran’s military capabilities have been materially degraded, likely limiting their ability to wage war against Israel, given Iran’s weakened state (which is the result of years of sanctions and targeted military operations). Second, given existing sanctions, Iran is not a major global oil player right now, and given likely OPEC production increases and Saudi Arabia’s dominant market share, the conflict is unlikely to increase oil prices dramatically. If either of those assumptions changes (that a broader war will occur or oil prices will sustainably rise), then the market will care about this conflict (and it will be negative for stocks).

*Scary Headline 2: Never-ending tariff threats.* The beat goes on with President Trump's tariff threats, as the administration sent letters to trading partners warning them of the July 9 expiration of reciprocal tariffs. Therefore, there remains a significant risk that we will face higher tariffs on major trading partners, which could exacerbate inflation and hinder growth. *Why don't investors care?* TACO. The markets have become extremely complacent about tariff and trade risks. They are now largely ignoring every tariff threat or trade utterance, dismissing it as bluster and comfortable in the idea that none of it will happen. Tariff rates won't move higher than they are now (at least not on the things that matter to the U.S. economy). TACO has become a de facto "mute" button for most of Trump's most dramatic or absurd threats. Markets will care (a lot) about this if/when TACO is proven false. The next chance for that to occur is ahead of the July 9 reciprocal tariff deadline. But at this point, markets are so convinced in TACO that it's going to take a sustained tariff increase to shake the belief that, before too long, Trump will back down.

*Scary Headline 3: U.S. debt and deficit crisis.* The U.S. fiscal situation continues to deteriorate, and the "Big, Beautiful Bill" threatens to exacerbate it with intense spending increases, tax cut extensions, and minimal spending reductions to offset them. Given that, we may see a "Liz Truss" moment in global markets once investors have an idea what the final bill will look like (as a reminder, UK PM Truss proposed an absurd UK budget and UK GILT yields spiked horribly, the pound and UK stocks plunged and Truss was voted out within a few weeks, although that last part obviously won't happen here). *Why don't investors care?* The 10-year Treasury yield. That's the barometer for the global bond market's worries about the U.S. fiscal situation and for all the angst and concern in the mainstream media, the bottom line is the global bond markets are not yet concerned about the U.S. fiscal situation, and that's an important and clear signal to investors that they don't need to be worried about it either right now. If the 10-year yield begins to creep towards and through 5.00%, that will be a signal that global bond markets are starting to worry about the U.S. fiscal situation. At that point, markets will care about deficits and debt a lot. (and we should expect stocks to be sharply lower).

*Scary Headline 4: Economic slowdown.* There is a growing body of economic data suggesting that the U.S. economy is losing momentum, including jobless claims, the ISM PMIs (which are both below 50), and the monthly jobs report. This is reasonable, considering two factors: 1) Still-high interest rates and 2) Still-elevated tariff uncertainty and policy volatility. *Why don't investors care?* Because it's not bad enough yet. The U.S. economy has twice proved more resilient than expected over the past five years (first with Covid and then with the Fed rate hike campaign), and the result is that investors have given it the benefit of the doubt. Meanwhile, none of the data is yet bad enough to reasonably raise concerns about a slowdown. Instead, it still could all just be pointing to a soft landing. If economic data deteriorates further, however, that will change. As the summer progresses, we will increasingly see the impact of policy chaos and tariff whiplash. If the ISM PMIs remain below 50, jobless claims rise above 260k and approach (or exceed) 300k, and monthly job growth turns negative, we will see economic concerns intensify.

## Economic Data (What You Need to Know in Plain English)

### Last Week

The focus of economic data last week was inflation, and the news was positive, as all the key inflation metrics showed stable inflationary pressures. This continued to push back against fears of a tariff-driven inflation surge, and the positive reports helped support stocks last week.

The most important report was the CPI report, and despite fears of a tariff-driven spike in inflation, it has not yet materialized in the data. Both headline CPI (0.1% vs. (E) 0.2% m/m and 2.4% vs. (E) 2.5% y/y) and Core CPI (0.1% vs. 0.3% m/m and 2.8% vs. (E) 2.9% y/y) were lower than expected and headline CPI remains close to the Fed's 2.0% target. Confirming those tame readings was the PPI, which rose 0.1% vs. (E) 0.2% m/m and 3.0% vs. (E) 3.1% y/y. Further

reinforcing that inflation is not seeing dramatic upward pressure (yet) was the fact that many categories that should be most sensitive to tariffs (cars, apparel, footwear) saw declines in May. Bottom line, last week's CPI and PPI don't mean we will not see a tariff-driven spike in inflation (price increases are just now starting to spread throughout the economy). Still, it does mean fears of it hitting soon have been misplaced, and that is a near-term positive, supporting markets amidst geopolitical angst.

The other notable economic report last week was the weekly jobless claims, which continued to slowly tick higher, with claims rising to 248k versus (E) 243k. That's not a number that should worry about the labor market, but the four-week moving average of claims moved above 240k, and that's the highest level since last August. And if we consider this number in conjunction with JOLTS and the jobs report, there is clear evidence that the labor market is cooling. Now, that's not a bad thing by itself (and it could mean a soft landing), but this is something we have to watch closely (and we are). If claims continue to rise and the four-week moving average surpasses 260k, that will likely be a wake-up call that the labor market may be starting to deteriorate significantly, and if that happens, concerns about economic contraction will intensify (and impact stocks).

### **Important Economic Data This Week**

The most significant event this week is the FOMC decision on Wednesday. The focus of this meeting won't be on whether the Fed cuts rates (no one expects them to cut), but instead what the "dots" show about how many cuts Fed officials expect this year. Currently, markets are anticipating two 25-basis-point cuts in 2025. If the dots show less than that, it'll boost yields and be a potential market negative.

Looking at this week's data, the most important economic report is tomorrow's Retail Sales report. Retail sales are the engine of growth for the U.S. economy, and as long as retail sales remain solid and unemployment isn't rising, the chances of an economic slowdown are low. That said, we're aware that we're seeing some cooling in the labor market (not enough to warrant concern, but it's present), so if we see a similar trend emerge in retail sales, that will only further confirm that the U.S. economy is losing momentum.

### **Special Reports and Editorial**

#### **What Is the Shadow Fed and How Could It Impact Markets?**

The next Fed meeting is this week, and the focus could shift to a new avenue in the Trump vs. Fed debate: the shadow Fed.

The shadow Fed is a concept brought up by Treasury Secretary Bessent in late 2024 and, if implemented, it could 1) Complicate the market's outlook on monetary policy (and increase some market volatility) and 2) Ultimately, have policy take a dovish turn but also undermine the independence of the Fed (which would be negative for U.S. assets such as Treasuries and the dollar). Because of these potential impacts, I wanted to cover 1) What the Shadow Fed is? 2) Why is it being discussed? and 3) How could it impact markets?

*What Is the Shadow Fed?* As mentioned, Bessent brought up the idea of a shadow Fed in late 2024, and it'd serve one purpose: To undermine the credibility of the current Fed. Essentially, the idea is this: President Trump appoints Fed Chair Powell's successor very, very early (like in the next few weeks or months). Now, Fed Chair Powell's current term doesn't end until May 2026, but the appointment of a new Fed chair would essentially make Powell a "lame duck." Additionally, this new Fed chair could then hit the speech circuit and, presumably, discuss how, when he's chair, the Fed will cut interest rates.

So, even if the current Fed doesn't cut interest rates, the "shadow" Fed chair would issue dovish forward guidance to the markets, and they would pull forward those expected rate cuts, and that, presumably, would boost markets and economic growth.

*Why Is the Shadow Fed Being Discussed?* There are two reasons this concept is being openly discussed. First, the administration (not just President Trump but also Treasury Secretary Bessent) wants Powell to cut interest rates to support the economy. Second, they can't fire Powell and replace him with someone who will do that. So, their solution could be the shadow Fed, whereby Powell's successor provides dovish forward guidance and undermines the Fed's still-high interest rates.

*How Would This Impact Markets?* Initially, we could see a "dovish is bullish" response as markets embrace a more dovish Fed, and shorter-term interest rates are likely to decline in anticipation of those cuts. However, while shorter-term rates could drop due to the expected decline in the fed funds rate, the key to the market's reaction would be at the long end of the yield curve, specifically the 10- and 30-year Treasury yields.

Essentially, a move to undermine the Fed could be akin to playing with the "third rail" of a subway line from a market standpoint. Perceived Fed independence is a critical pillar of American economic exceptionalism. If Trump's shadow Fed chair is seen as being an instrument of the administration, then that could seriously undermine the inflation-fighting reputation of the Fed and further reduce the appeal of U.S. assets globally (most notably U.S. Treasuries).

The positive outcome, should it occur, is that the market views the shadow Fed chair as independent, but also more dovish than Powell. That's the best case, and it should lower rates and send stocks higher.

The negative outcome from this would be that longer-dated Treasury yields rise sharply, undermining the economic benefits of a lower fed funds rate and creating a more significant headwind for the economy. Those rising yields would pressure equity market multiples (which leaves this market very vulnerable to a sharp decline, given the 20X+ forward valuation) and hit earnings expectations as well. Finally, higher rates would increase concerns about an economic slowdown. This outcome would be considerably negative for stocks (easily a 10% decline).

Bottom line, this would be a high-risk move for the administration in its bid to provide dovish forward guidance and support the U.S. economy, as undermining the Fed could have serious consequences for foundational assets such as the dollar and U.S. Treasuries.

**Disclaimer:** The Weekly Advisory Update is provided to clients on an informational basis only and is not intended to be considered investment advice or recommendations to buy or sell any security or a solicitation to buy or sell any security. Information contained in The Weekly Advisory Update is compiled from various sources and is not necessarily complete, and its accuracy is not guaranteed. Neither the information contained in The Weekly Advisory Update or any opinion expressed in The Weekly Advisory Update constitutes a solicitation for the purchase of any future or security referred to in the Newsletter. The Newsletter is strictly an informational publication and does not provide individual, customized investment or trading advice to its clients. CLIENTS SHOULD VERIFY ALL CLAIMS AND COMPLETE THEIR OWN RESEARCH AND CONSULT A REGISTERED FINANCIAL PROFESSIONAL BEFORE INVESTING IN ANY INVESTMENTS MENTIONED IN THE PUBLICATION. INVESTING IN SECURITIES, OPTIONS AND FUTURES IS SPECULATIVE AND CARRIES A HIGH DEGREE OF RISK, AND SUBSCRIBERS MAY LOSE MONEY TRADING AND INVESTING IN SUCH INVESTMENTS.

REPRESENTATIVES ARE REGISTERED THROUGH, AND SECURITIES ARE SOLD THROUGH NATIONWIDE PLANNING ASSOCIATES, INC., MEMBER FINRA/SIPC, LOCATED AT 32-16 BROADWAY, 2<sup>ND</sup> FLOOR, FAIR LAWN NJ 07410. INVESTMENT ADVISORY SERVICES ARE OFFERED THROUGH NPA ASSET MANAGEMENT, LLC. INSURANCE SOLD THROUGH LICENSED NPA INSURANCE AGENCY, INC. NON-DEPOSIT INVESTMENT PRODUCTS ARE NOT FEDERALLY INSURED, INVOLVE INVESTMENT RISK, MAY LOSE VALUE, AND ARE NOT OBLIGATIONS OF OR GUARANTEED BY THE BROKER/DEALER. NATIONWIDE PLANNING ASSOCIATES, INC. IS A REGISTERED BROKER/DEALER.