

KEY TAKEAWAYS

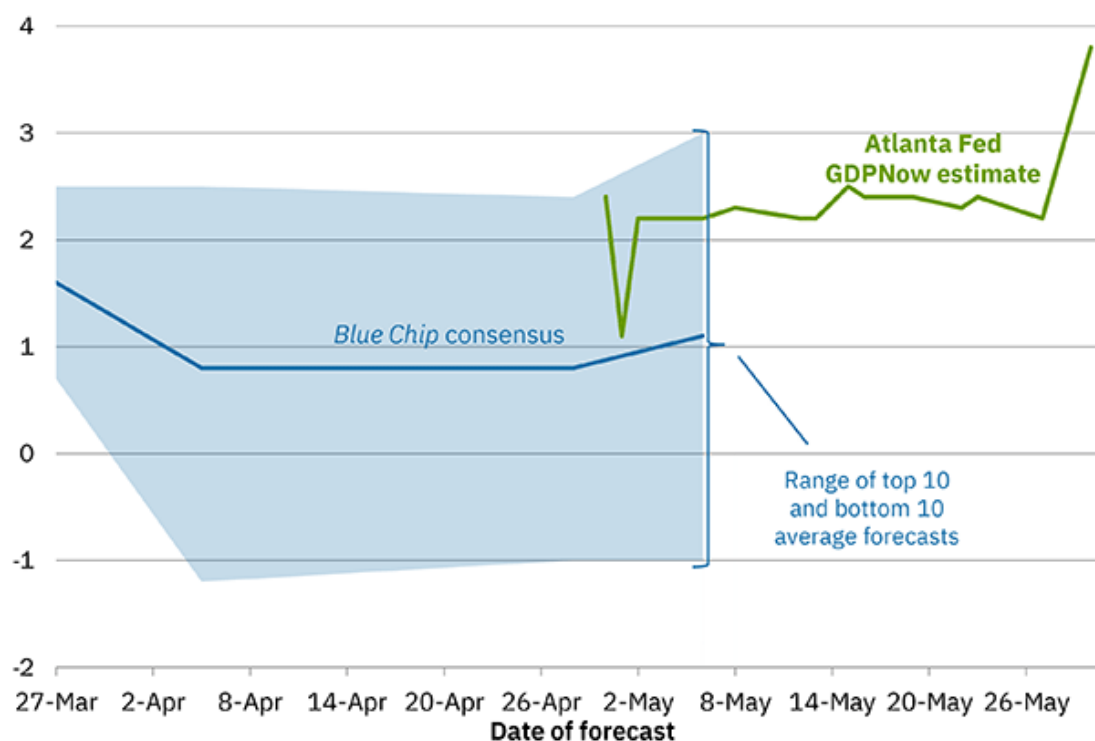
- The equity markets started the month strong and then spent the last two weeks digesting the gains with no additional advance.
- The U.S. 10-year Treasury Yields sprinted higher the first 3 weeks and then settled down near the middle of the range around 4.40%.
- Crude oil stabilized, hovering around the \$60 mark.

The U.S. Economy

The second read for 1st quarter GDP came in at -0.2%, slightly better than the initial reading of -0.3%. Core PCE, the imbedded inflation measure, came in slightly lower at 3.4% vs. 3.5% initially reported. The expected whipsaw for estimates of 2nd quarter GDP, GDPNow, is occurring, with expectations at 3.8%, the Blue-Chip consensus forecast is holding around +1.0%, as shown in the chart below. Economic reports have firmed up though the PCE deflator remains elevated and is well above the Fed's sweet spot of "2%" inflation. The trade war/tariffs continue to cause a lot of distortions in the data and now the two-quarter look is for reasonable growth.

Evolution of Atlanta Fed GDPNow real GDP estimate for 2025: Q2

Quarterly percent change (SAAR)



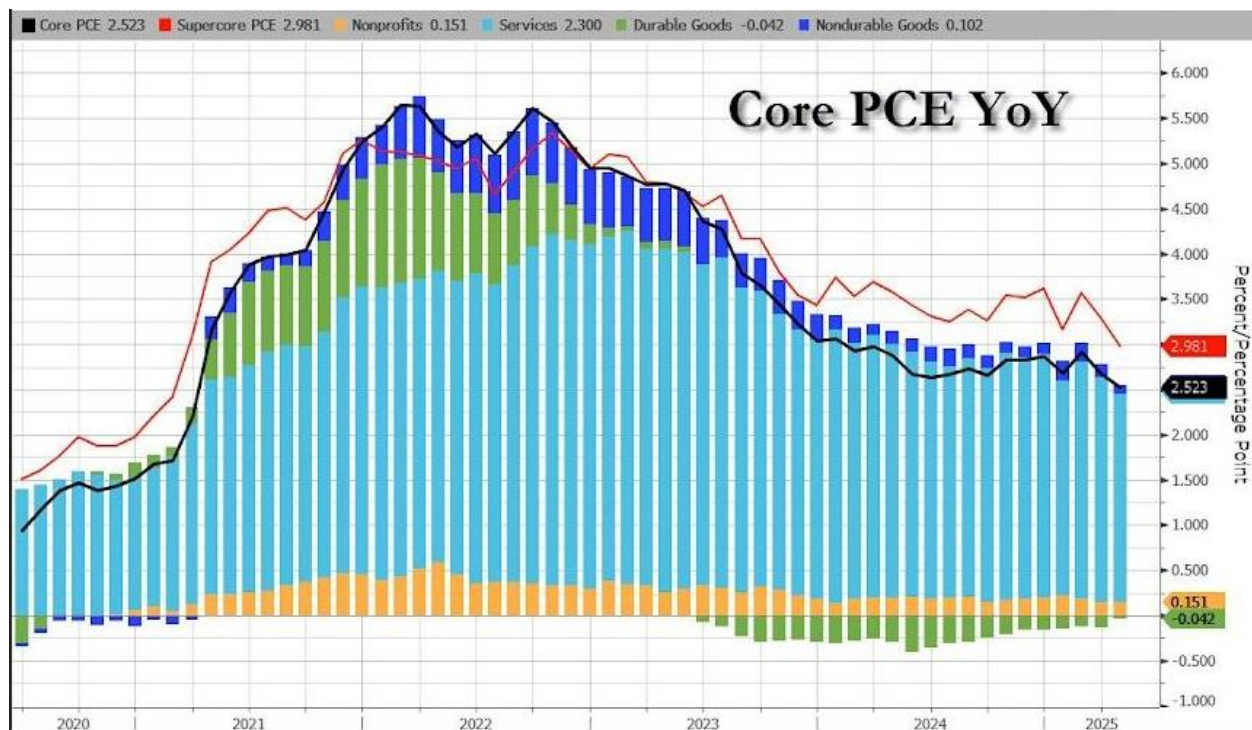
Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

Source : <https://www.frbatlanta.org/cqer/research/gdpnow>

Stocks and Bonds

The U.S. 10-year Treasury yield started the month at 4.18% and was mostly a one-way trade to 4.63% 3 weeks into the month. But then “panic” from the Japanese Central Bank, as their long duration bonds were going up even faster, created a reprieve for global longer duration bonds and yields settled near the middle of the range at 4.42%. The rise in yields really was more a function of international activities though tariffs are always an easy boogeyman. But as the saying goes, “the market stops panicking when central banks start panicking”. In this case, the Japanese were issuing more bonds than the market was comfortable digesting. Late in the month the Japanese Central Bank said they would reduce issuance which provided some comfort to the markets and yields started to retrace. The Fed met early in the month and as expected, left rates unchanged, even though inflation has moved lower the last 6 to 9 months and employment is softening, the Fed continues to stand by their, “we are scared of tariffs”. Interestingly, several other central banks have cut interest rates and specifically called out the slowing economic activity because of tariffs... The Fed continues to tout the strong economy and high uncertainty as the reasons not to cut rates for the foreseeable, and the markets are adjusting to just 2 rate cuts this year and 2 more in 2026. The Fed meets again mid-month, will they soften their hawkish tone? The chart below shows that the Fed's favorite indicator for inflation has trended down meaningfully. The move up in yields was a head wind for High Quality fixed income, which as measured by the iShares US Aggregate Bond ETF fell -0.72% for the month. The U.S. 10-year Treasury bond yield ended the month at 4.42%, up from April's close of 4.18%.



Source: <https://www.zerohedge.com/markets/despite-tariff-flation-fearmongering-feds-favorite-inflation-indicator-tumbles-four-year>

The Dow Jones Industrial Average climbed +3.94%, the S&P 500 jumped +6.15%, and the small cap iShares Russell 2000 ETF popped +5.33%. The international markets traded in line with the U.S. markets. The MSCI EAFE iShares Core International Developed Markets ETF Index rallied +4.75%, and the MSCI Emerging Markets iShares Core ETF Index rose +4.37%.

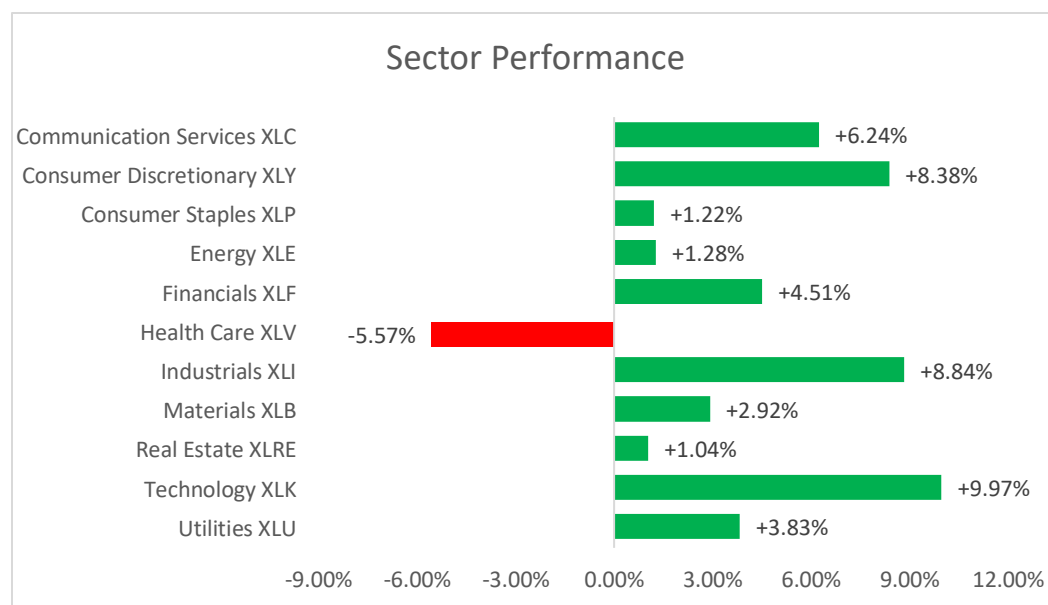
May's sector performance was generally positive except for Healthcare.

The best performers were...

- Technology: +9.97%
- Industrials: +8.84%
- Consumer Discretionary: +8.38%

The worst performers were...

- Healthcare: -5.57%
- Real Estate: +1.04%
- Consumer Staples: +1.22%



Source: <https://www.morningstar.com>

Oil Report

Crude Oil was pretty quiet this month, stabilizing after last month's steep losses and generally hugged the \$60 level. The pausing of tariffs on China was supportive for Crude Oil, OPEC+ agreeing to increase supply quotas weighed on Crude. The end result was a modest bounce in Crude prices. The current NYMEX WTI Crude Oil futures settled at \$60.79, gaining over 4% from the prior month's close of \$58.21 a barrel. RBOB gasoline was more volatile than Crude, rallying almost 10% before rolling over and giving back all the gains. RBOB gasoline fell by -0% vs. April's close. Well, this statement proved inaccurate, "The tariffs and their impact on the economy will likely be the center of attention next month.". Maybe the start of summer driving season will gather attention this month.

The Rest of the Data

The April ISM Manufacturing Index eased to 48.7 from March's reading of 49.0, remaining below 50 after a couple of months above. The ISM Services Index increased to 51.6 in April, from March's print of 50.8. Any reading below 50 generally indicates deteriorating conditions. Any reading above 50 generally indicates improving conditions. The prices paid component for Manufacturing remained high in the elevated range and Services' prices moved higher into elevated levels. Consumer confidence surged to 98.0 in May, which compared to a downwardly revised 85.7 in April. The unemployment rate remained at 4.2%, while the number of jobs added came in at 177,000 in April, beating expectations of 138,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) increased +0.2% in April, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index rate eased further to +2.3% on a non-seasonally adjusted basis. The CPI ex Food and Energy held at 2.8% over the last year. The general theme seems to be reasonable to slowing economic growth, stable employment and noisy inflation data with some showing firming and others showing continued abatement. The Fed seems to be solely focused on the data points of positive economic and employment and tariffs are scary with inflation waiting to pounce any minute. Though their favorite indicator, current PCE and the 2-year Treasury Note suggest the Fed is behind the curve as usual. We will continue to monitor economic activity, policy announcements, and inflation reports for potential shifts.

Summary

The market seems to be settling into the turmoil of the Trump Tweet mania. The reactions have been more muted as time has continued, though the 4-months of his term has already felt like 4-years of news. 🤖 The markets will start the new month with a test of that thesis as Trump announced additional steel tariffs. The budget process is working its way through the snake, and it appears that while the deck chairs may get rearranged that we will continue to see deficit spending. Thus, the government stimulus makes it unlikely that we see recessionary prints. If the market gets comfortable that a recession is likely far off in the distance, prices are likely to move higher on better-than-expected economic activity. The items to keep an eye on are do we see any meaningful trade agreements or do we see a renewed escalation of tariffs. Does the Fed remain focused on tariffs, or do they lift their heads and look at other measures that suggest they are behind the curve? Even though prices have moved up a lot from the depths of the early April lows, there seems to be a lot of participants focused on the negatives and if those don't come to pass, they likely trigger additional buying pressure.

More than ever, the markets can be emotional, so we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/tariffs vs. growth and interest rates, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. The recovery in broader markets has reversed most of the defense mechanisms with U.S. Large cap, International and High Yield have moved back to risk on positions. The lone exception is U.S. Mid cap which remains 100% T-Bills.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.



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