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THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

Our dearly beloved, venerable, and somewhat flawed indicator of the general direction of the U.S. stock market values, the S&P 500 Stock Index (SPX), had a good week. The Index was up 1.47% for the week, closing at 6114.63, after taking a dip mid-week as traders tried to figure out whose ox would be gored by what tariff. The SPX is almost 4% higher this year, up about 22% from last year at this time, and nearly 39% higher than three years ago. The other stock index we follow, the CRSP US Mid-Cap Value Index, as it seems to us to provide a better indicator of what the mainstream U.S. stock values are doing, was up 0.11% to 2849.68 at Friday's close, 1.87% higher than when the year began, and about 15% higher than a year ago.

The benchmark 10-year U.S. Treasury rate fell about half a percent to end the week at 4.47% but remains about 5% higher than last year at this time when it was yielding 4.27%, and the yield is an astonishing 126% higher from three years ago when the yield was 1.96%. Fortunately for those who own U.S. Treasury money market funds, the very short-term Treasury obligations remained around 4.4%. The Treasury yield curve remained positive, with the 20-year bond yielding 4.75%. The price of a barrel of West Texas Intermediate crude oil (WTI) showed little change for the week as the price was $70.62 at the close of U.S. trading, but that one-week view missed the rise to $73.61 mid-day Tuesday, and a second price spike that occurred mid-day Friday. International traders in commodities are spooked.

The Economy

We have to pour over the data in some weeks to find the most relevant economic data. In other weeks, it is clear that one data point is significant. This week was one of the latter.

For the past couple of years, inflation, as measured by the Labor Department's Consumer Price Index (CPI), has gradually declined, with the annual one-year trailing rate falling to around 2.5% late last year. The release of the January 2025 report indicates a reversal in that trend. The 12-month trailing CPI rose to 3.0%, but perhaps the more alarming statistic is that the last two months have seen a substantial increase, with January's one-month CPI hitting 0.5%, an annualized increase of 6%. If we pull the highly volatile food and fuel numbers out of the tally, revealing the "core" CPI, the picture doesn't improve as the so-called "core CPI" has risen 3.3% in the last 12 months.

So what caused this, and what is it likely to mean? A lot has been and is being written about this, but it is clear that prices started to climb as soon as the election results were finalized. Why? First, it seems logical to us that if a President is elected who has promised to impose high-level tariffs, there will be a rush to purchase things that may be subject to those tariffs. The law of supply and demand states that prices will rise if there is a sudden rise in demand with no accompanying increase in supply. The problem with that explanation is that commercial goods inventories declined in January, suggesting that commercial hoarding has not occurred. If businesses were accelerating purchases to avoid tariffs, one would think that their unsold inventory would rise. Another flaw in that logic is that the most significant price increase among commodities was a 2.2% rise in the price of used cars and small trucks.

Inflation is the prime factor in short-term interest rates because anyone loaning money wants to receive back a little more than inflation in short-term, high-quality loans. It is also a significant factor in intermediate rates for the same

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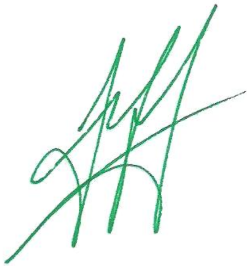
reason. However, inflation is primarily driven by consumer expectations, at least in the United States, and collectively, the U.S. consumer sometimes appears to be surprisingly sophisticated. For example, because of the average quantity of steel and aluminum used in a typical car or small truck, a careful analysis of what a 25% tariff on steel and aluminum would do to the price of the average car reveals that it will increase the U.S. sales price by about 3%. In the end, an import tariff is a federal sales tax. Since our experience has shown that a tariff will raise the cost of imported goods and domestic manufacturers will raise their prices by the same amount, 3% inflation suddenly looks rational. With more tariffs in the works, combined with a reduction in the number of people available to perform manual labor, we consider it very likely that inflation will continue to be higher than the Fed's target and that interest rates will remain higher than we have seen in the past couple of decades.

Meanwhile, U.S. economic growth still appears to be healthy. However, given the ongoing interest rate environment and limited infrastructure capacity in the U.S., we may be near capacity in some areas. We can confidently state that we are in uncharted territory as international trade adjusts to a new tariff regime from the world's largest purchaser.

Until next week, we remain diligently on duty, always ready to serve, answer your questions, and provide fiduciary advice and portfolio management for you, our sole employers and reason for existence.

Your obedient servants,



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