

## What the Market is Focusing on and What it Could Be Missing

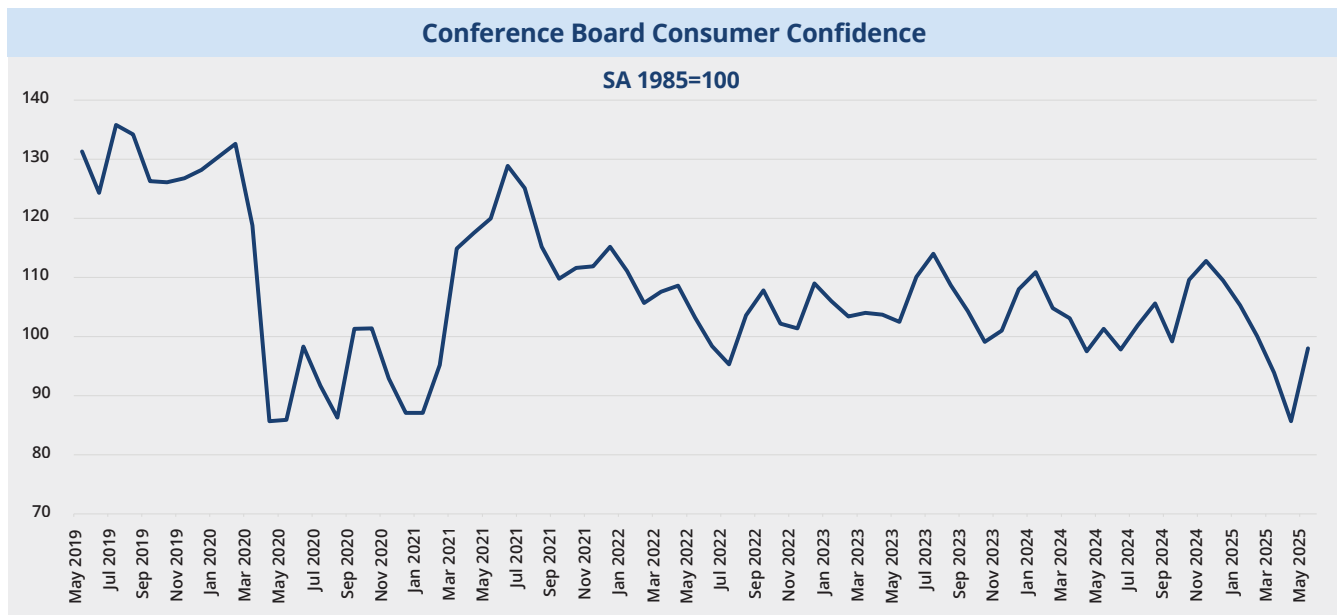
From conflicting economic signals to shifting trade policy and the still-unfolding impact of AI, markets are juggling multiple crosscurrents. Five themes emerge as we monitor how investors are sizing up risks and the dynamics that may impact investor sentiment in the second half of the year.

### 1. What the Market is Telling Us

Current equity valuations and corporate credit spreads suggest markets see little risk of recession or meaningful economic slowdown. Credit spreads have tightened while equity valuations have expanded beyond levels seen just prior to “Liberation Day.” President Trump listened to the market’s forceful reaction to his April 2nd tariff announcement and quickly pivoted to a more conciliatory stance. By pausing the threatened tariffs, the administration has removed—at least temporarily—the risk of an imminent recession. Market consensus now views left-tail outcomes as largely off the table.

### 2. Our Consumer Confidence Has Yet To Dampen Demand

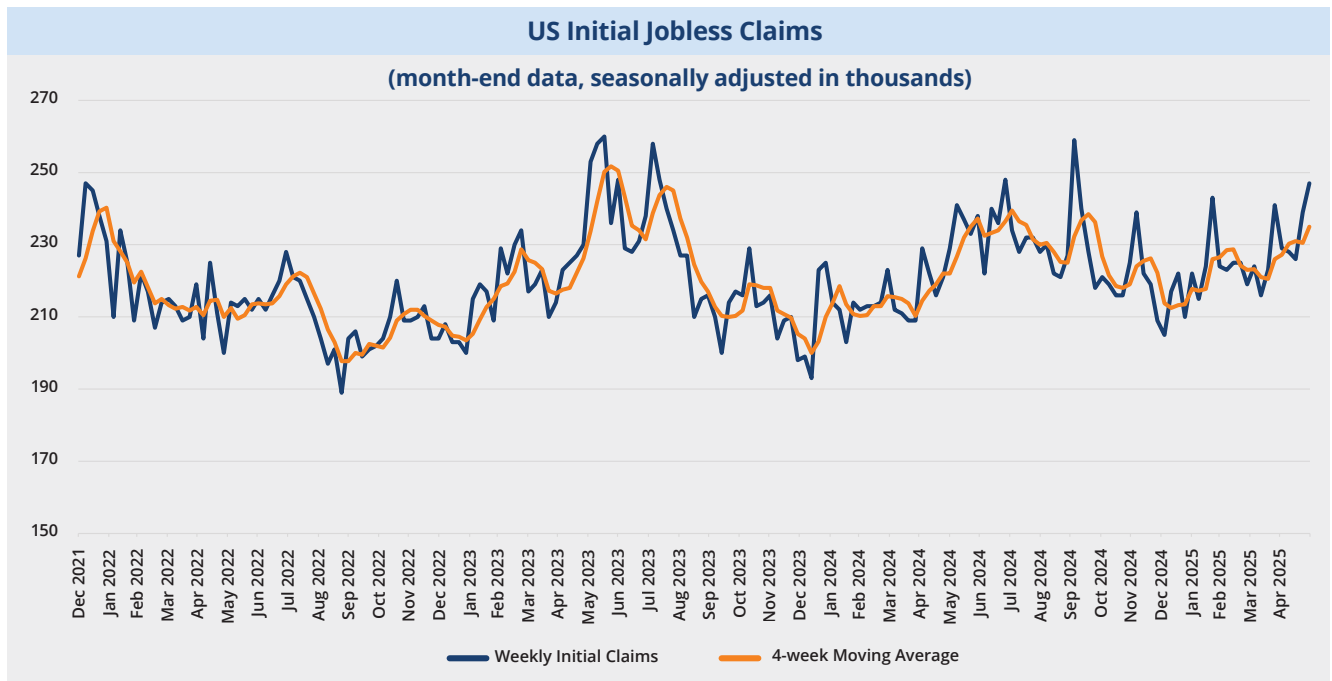
While consumer sentiment readings have strengthened in reaction to the trade war cease fire, they remain weak. So far, this has not translated to a significant pullback in spending. Much like 2022, when consumer sentiment was under pressure from rising interest rates and surging inflation, consumer behavior has yet to be reconciled with their feelings. The critical question is, will this last? The answer depends on the two major pillars of consumer willingness to spend: housing and jobs. Significant deterioration in the labor or housing markets would be the catalyst for a meaningful downshift in spending. With two-thirds of the US economy dependent on consumer spending, a recession hinges on consumer resiliency.



Source: Conference Board, May 31, 2025

### 3. Mixed Labor Market Signals

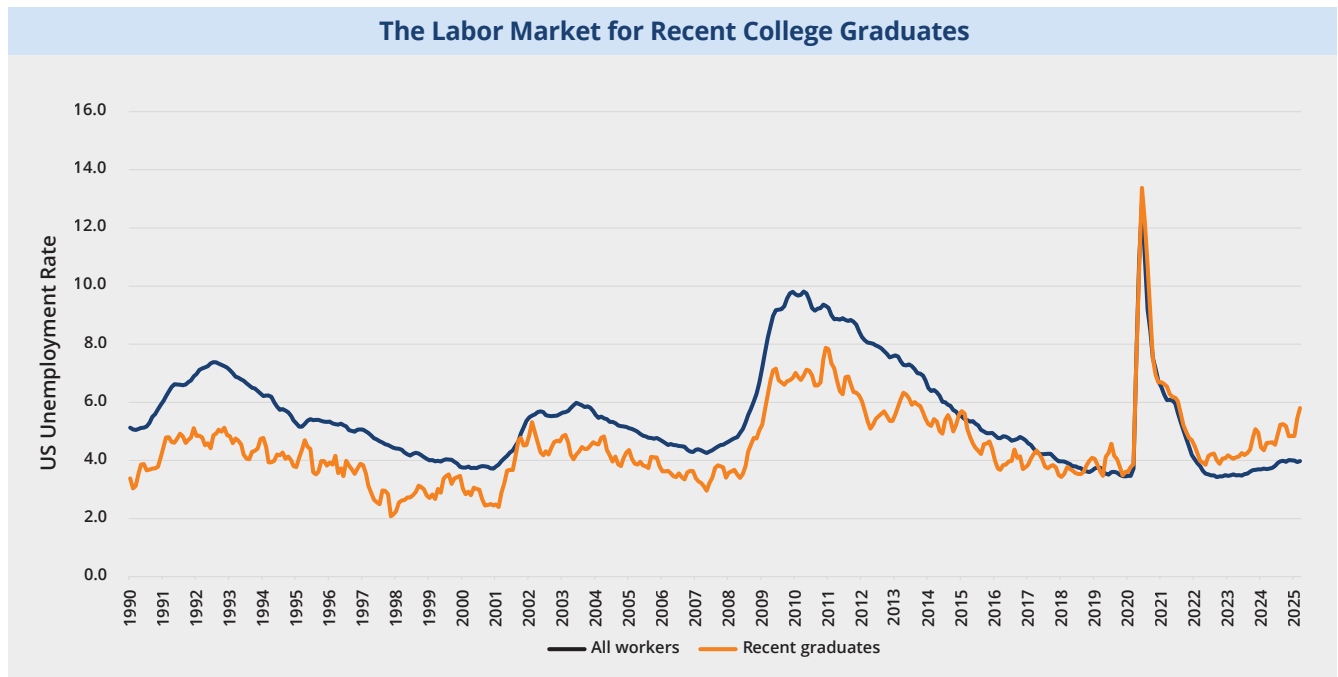
Gradual labor market softening is underway. Hiring has slowed, making jobs harder to find. The total number of workers receiving unemployment has been climbing since June 2022 but has yet to set off major alarm bells for investors. Weekly initial claims have been on an upswing in 2025. If this trend continues, we expect investors may start to rethink the Pollyannaish economic outlook currently priced into risk assets. The challenge of hiring workers in the post-pandemic expansion has often been cited as the reason behind employer's reluctance to reduce headcount in the face of economic uncertainty. The question is: how long will this mindset last? Anecdotes from sources like the Fed's Beige Book may offer an early warning sign of a paradigm shift.



Source: US Department of Labor, May 30, 2025

#### 4. AI's Cunundrum

Implications of the Artificial Intelligence revolution is the dominate secular theme of the global economy. The potential for productivity enhancement is a clear positive for corporate earnings power. Yet, the potential for labor displacement both in terms of scope and speed is an offset that is difficult to predict with confidence. Anthropic's CEO Dario Amodei's recent comment that AI could "wipe out" half of all entry-level white-collar jobs in the next one to five years is not just a wild assumption—it may already be happening. According to the NY Fed, the recent college graduate unemployment rate is currently 1.8% higher than the overall unemployment rate, suggesting that AI is removing the first rung of the white-collar employment ladder.



Sources:  
Federal Reserve Bank of New York interactive web feature: The Labor Market for Recent College Graduates;  
U.S. Census Bureau and U.S. Bureau of Labor Statistics, Current Population Survey (IPUMS) April 22, 2025

#### 5. Trade Policy Uncertainty and The Fed's Dry Powder

Uncertainty over potential trade wars continues to weigh on investor sentiment and elevate recession risks. However, markets are taking comfort in the Federal Reserve's ability to provide stimulus by cutting rates from current restrictive levels if economic conditions deteriorate. In our view, this confidence may be misplaced. Tariffs create inflationary pressures that could constrain the Fed's ability to ease policy aggressively, creating a policy dilemma between supporting growth and containing price pressures. Markets may be overestimating the reliability of the traditional 'Fed Put.' How policymakers navigate this tension between trade-induced inflation and recession risks will likely determine whether the current economic expansion can be sustained.



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