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Macro Memo

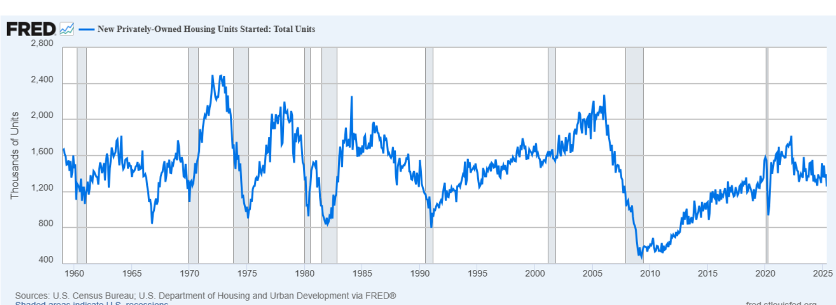
2025 Outlook: Midyear Update

Sloppy Summer Ahead?

Our mission at Cairns Wealth Management is to help our clients navigate the highly dynamic and complex macroeconomic and geopolitical landscape in pursuit of their most important financial goals. This year has certainly highlighted the nature of that landscape. Using a roller coaster analogy, we cautioned in our *2025 Outlook: Buckle Up*, that financial markets appeared vulnerable to increased volatility. In late February the stock market began a slide that was punctuated by the "Tariff Tantrum" in April, since then it has regained almost all its losses. Remaining with the rollercoaster analogy, it seems unlikely the ride has run its course. In fact, another "thrilling" dip may be in the near offing. This Macro Memo will address various factors collectively contributing to that viewpoint.

Housing Starts Signal a Slowdown

New housing starts have historically been a useful indicator of future economic activity. This statistic shows homebuilders' confidence in both the strength of the economy and in potential buyers' ability to purchase a new home. New housing construction stimulates demand for materials, labor, and related services, influencing sectors like manufacturing, construction, and finance. The most recent report on new housing starts, for May 2025, shows activity has dropped to its lowest level since before COVID pointing to potentially slower economic growth ahead.

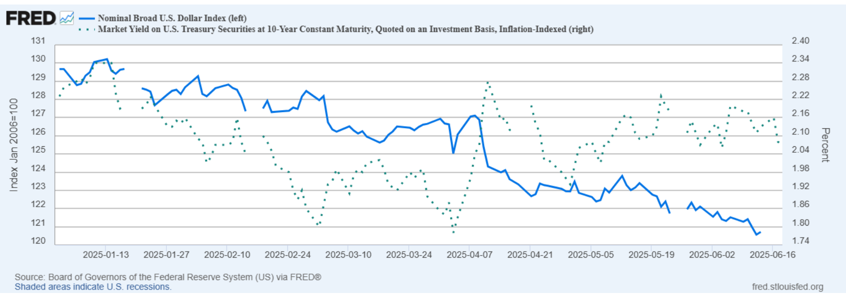


Interest Rates Remain Disruptive

A key variable influencing housing starts is the level of interest rates. It's no surprise that higher rates contribute to a slowdown in construction activity. However, what is surprising is that since the Fed began lowering short-term rates at their September 2024 meeting longer-term rates have run counter to those moves and have actually increased. Prior to that Fed meeting the 10-Year US Treasury bond traded at a yield of 3.6%. Since that meeting the Fed has cut its key interest rate by a full 100 basis points, and yet the yield of the 10-year Treasury bond has increased by 80 points to its current yield of 4.4%. The bond market is clearly not buying the message the Fed is selling. The bond market seems to believe lower short-term rates will exacerbate inflation and therefore requires a higher yield in order to compensate for that risk. These higher yields on longer-term bonds are spilling over into mortgage rates and contributing to the slowdown in housing starts.

Foreign Exchange Markets, US Dollar, And Gold

There is also a disconnect in foreign exchange markets. Normally a higher 10-year Treasury yield would strengthen the value of the US dollar. This makes sense as a higher yielding currency would attract capital flows from other currencies, thus boosting the dollar's price relative to other currencies. However, the opposite is occurring. The chart below shows the value of the dollar (solid blue line) tracking the inflation adjusted 10-year Treasury yield until the April "Tariff Tantrum". Not only does the correlation of rates and the dollar breakdown, but gold continues its counterintuitive move from $3000/ounce to $3400/ ounce (not pictured in the graph). Gold typically moves opposite to interest rates, when interest rates move higher the price of gold struggles. Because physical gold pays no interest or dividends, assets that do are competition to it for investment dollars. As interest rates move higher, historically bonds have become more attractive relative to gold.



Why is that different this time around? The dollar and Treasury bonds (simply dollars paying an interest rate) are no longer acting as the flight to safety assets they have been for decades. Gold appears to be taking that mantle. This is consistent with an inflationary outlook, not one of price stability. And when combined with the potential for a slowing economy as initially discussed in this report, the overall outlook for the economy becomes stagflationary.

Geopolitics and Policy Gridlock

Other factors to consider include President Trump's "One Big Beautiful Bill" which appears to be stalled in Congress. Failure to pass this bill increases the risk of a substantial increase in personal income tax rates, something Treasury Secretary Bessent has suggested would be "cataclysmic" to the economy and lead to a financial crisis[1]. Also included in the bill is the national debt ceiling. If that is not resolved before Labor Day, a government shutdown becomes a possibility.

In addition to these policy gridlock issues are the current military conflicts between Russia and Ukraine as well as Israel and Iran. The possibility of the US entering these conflicts on a larger scale casts a considerable shadow of uncertainty. The bombing of Iran's largest nuclear facilities – Fordow, Natanz and Isfahan – by the US Military elevates the risk of greater involvement by the US.

What is the Bottom Line?

When all these factors are thrown into the mix, the possibility of near-term volatility in the financial markets increases, especially as stock market valuations remain priced for perfection[2]. Any actual outcome short of optimal could trigger the next "thrilling" dip in the roller coaster ride that is 2025. We caution investors to remain "buckled up" for more volatility in the second half of the year and prepare for opportunities that may come your way rather quickly.

As always, if you would like to discuss any of these ideas in more detail and what they might mean for your specific situation, we'd welcome the conversation.

[1]https://nypost.com/2025/06/11/us-news/bessent-warns-that-failure-to-pass-trumps-big-beautiful-bill-would-trigger-financial-crisis/

[2]Stock prices represent the future expectations for corporate earnings. Currently those valuations are near historical records, suggesting the market is overlooking the risks we have discussed in this report.

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