
# ECONOMIC & INVESTMENT PERSPECTIVES

June 2, 2025

## MAY: EQUITIES REBOUND, BONDS WEAKEN
US DEBT, DEFICITS & SPENDING

**Figure 1: 5/31/2025 Returns** (source: FactSet)
*Conditional formatting: green (high) to red (low) for each time period*

| Bonds | ETF | Month | YTD | 1YR | vs. 52-wk High | vs. 52-wk Low |
|---|---|---|---|---|---|---|
| US Aggregate Fixed Income | AGG | -0.6% | 2.6% | 5.9% | -3.9% | 2.5% |
| Investment Grade Corp Bonds | LQD | 0.2% | 2.4% | 5.8% | -5.5% | 4.2% |
| U.S. 20+ YR Treasuries | TLT | -3.2% | 0.2% | 0.1% | -15.1% | 3.6% |
| Muni Bonds | MUB | -0.6% | -1.5% | 1.4% | -4.6% | 3.5% |
| US High Yield | HYG | 1.8% | 3.1% | 9.8% | -1.0% | 6.0% |
| Non-US Corp Bonds | IBND | 0.8% | 11.6% | 11.2% | -0.8% | 13.4% |
| Emerging Markets Bond LC | EMLC | 1.4% | 9.0% | 8.5% | -3.4% | 7.6% |
| **Global Equity** | | | | | | |
| ACWI Global Equity | ACWI | 5.7% | 5.2% | 14.0% | -0.7% | 22.1% |
| ACWI Global Equity ex US | ACWX | 4.4% | 14.0% | 13.5% | -1.0% | 21.4% |
| International Developed | EFA | 4.8% | 17.5% | 13.9% | -0.7% | 23.1% |
| Emerging Markets | IEMG | 4.7% | 8.6% | 10.3% | -3.9% | 19.9% |
| **Global Equity by Region** | | | | | | |
| United States | VTI | 6.3% | 0.4% | 13.7% | -4.5% | 22.6% |
| Europe | IEUR | 5.0% | 21.7% | 14.3% | -0.8% | 23.6% |
| Asia ex-Japan | AAXJ | 4.9% | 7.3% | 11.3% | -5.8% | 20.4% |
| China | MCHI | 2.2% | 12.7% | 21.1% | -11.7% | 32.2% |
| Japan | BBJP | 3.7% | 10.6% | 11.4% | -1.1% | 23.8% |
| Latin America | ILF | 1.5% | 20.9% | -0.6% | -6.9% | 21.4% |
| **US Equity** | | | | | | |
| US S&P 500 | IVV | 6.1% | 0.9% | 14.3% | -3.9% | 22.3% |
| NASDAQ 100 QQQ | QQQ | 9.2% | 1.7% | 15.7% | -4.0% | 29.0% |
| US Large Growth | IWF | 8.9% | -0.4% | 17.6% | -4.8% | 29.4% |
| US Large Value | IWD | 3.5% | 2.3% | 10.2% | -5.9% | 15.6% |
| US Eqwt S&P 500 | RSP | 4.3% | 1.2% | 9.6% | -6.2% | 17.3% |
| US Mid Cap | IJH | 5.5% | -3.4% | 3.3% | -12.1% | 19.7% |
| US Small Cap | VTWO | 5.4% | -6.8% | 1.9% | -16.3% | 19.6% |

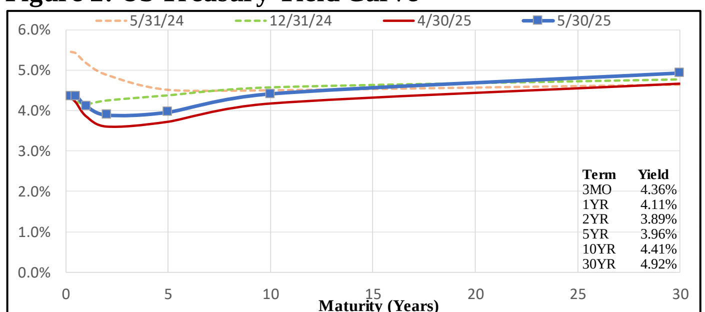
Equities continued to rebound in May as tariff implementation and trade wars remained substantially paused. The S&P 500 has rallied 22% from the 4/8 low but is still 4% below all-time highs. Bond yields rose and the US dollar continued to weaken amid growing concerns about US debt and deficits. Performance highlights for May and year-to-date (YTD) are below.

- **Bonds:** The US Aggregate index (AGG) fell 0.6% (+2.6% YTD) as yields rose. Long-term Treasuries (TLT) are most sensitive to interest rates, falling 3.2% (+0.2% YTD). Corporate bonds (LQD) and high yield (HYG) rose as credit spreads narrowed. Non-US bonds outperformed amid US dollar weakness.
- **Global equity:** ACWI +5.7% in May (+5.2% YTD).
- **US Equity:** The broad market (VTI) rose 6.3% (+0.4% YTD); the S&P 500 (IVV) gained 6.1% (+0.9% YTD) and is now 3.9% below all-time highs set in mid-February. Small stocks (VTWO), which are highly sensitive to US economic growth, were up 5.4% (-6.8% YTD) but are more than 16% below all-time highs. Most sectors were up for the month, but health care stocks (XLV) were down almost 6% in the wake of weakness at United Health and uncertainty around changing US policy.
- **Non-US Equity:** Stocks outside of the US continue to perform well. Developed markets (EFA) gained 4.8% (+17.5% YTD), with solid gains across Europe (IEUR) and in Japan (BBJP), partially due to currency strength versus the weak US dollar. Emerging market stocks (IEMG) gained 4.7% (+8.6% YTD), led by gains of more than 5% in Korea (EWY) and Mexico (EWW); after falling 5% in April, China (MCHI) gained 2.2% (+12.7% YTD) amid temporary tariff reductions.

## Interest Rates and the Economy

Interest rates rose with uncertainty about the impact of tariffs and fiscal spending on inflation, US debt and deficits. The Federal Reserve (Fed) held short-term rates steady in May and are expected to remain paused for the near future, but bond yields increased as investors priced in concerns about rising US debt as Congress considers tax cuts that are not offset by material spending cuts. Investors foresee rising debt issuance amid declining global demand as the US continues down an unsustainable fiscal path. The yield curve (Figure 2) plots the interest rates for various US Treasury maturities. US 10-year Treasuries yield 4.41%.

**Figure 2: US Treasury Yield Curve**

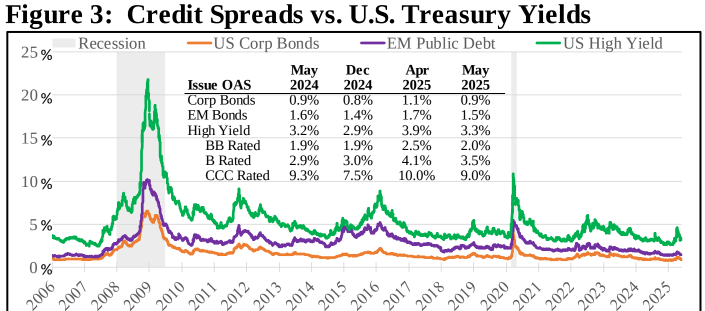



*Source: Board of Governers of the Federal Reserve System via St. Louis Fed (FRED)*

For bonds other than US Treasuries, we track the option-adjusted spread (OAS) between their yields and Treasuries of comparable maturities (Figure 3). Low or narrowing spreads signal optimism; high or widening spreads signal fear. Spreads narrowed in May, as the tariff-related angst eased, at least temporarily.

- Investment grade corporate bond spreads narrowed to +0.9% and have been relatively stable over the past year.
- High yield (non-investment grade) spreads narrowed from +3.9% to 3.3% last month and have widened over the past year. Spreads of the riskiest bonds (rated CCC & below) narrowed to +9.0% and are below the +9.3% spreads one year ago.
- Emerging market spreads narrowed to +1.5% and have been stable over the past year; investors see low risk in EM debt.

**Figure 3: Credit Spreads vs. U.S. Treasury Yields**

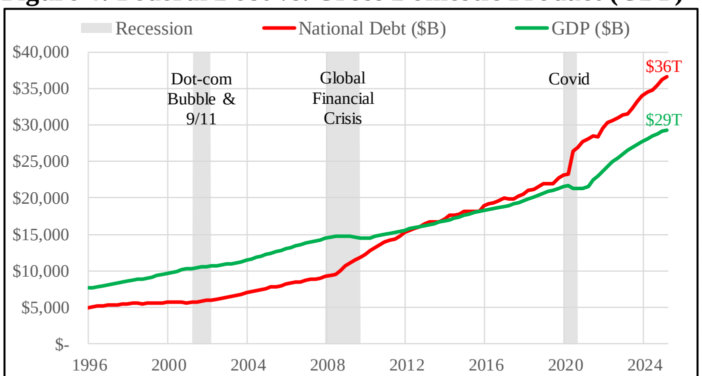



*Source: Ice Data Indices, LLC via St. Louis Fed (FRED)*

## Federal Debt, Deficits and Spending

While US stocks have staged an impressive relief rally as tariff tensions temporarily eased, US bond yields have continued to rise with uncertainty regarding tariff-related inflation and the on-going budget reconciliation negotiations in Congress. Higher interest rates have refocused attention on the unsustainability of large federal budget deficits and an ever-increasing federal debt burden (currently $36 trillion or 125% of US Gross Domestic Product – i.e., GDP, the value of all final goods and services produced annually). This has led to the recent downgrade of the US credit rating by Moody's and rancorous debate and brinksmanship in Congress. Given that this drama is likely to continue well into the summer, we have gathered some data to help frame our thoughts on government spending, taxes and debt, beginning with a summary of US federal debt in the context of GDP (Figure 4).

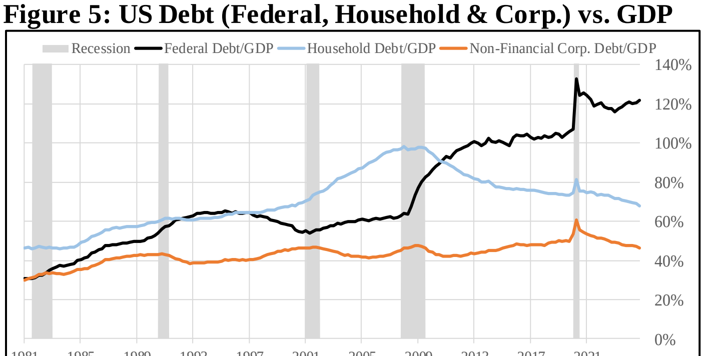
**Figure 4: Federal Debt vs. Gross Domestic Product (GDP)**




*Source: Dept. of Treasury, US Bureau of Economic Analysis, Federal Reserve*

Over the last 30 years, the US economy (GDP) has nearly quadrupled in size from less than $8 trillion to $29 trillion annually. Over the same period, our national debt has grown seven-fold from $5 trillion to roughly $36 trillion today. The dramatic increase in debt has been steady but has accelerated episodically in response to recessions and significant threats to the economy. Prior to the Global Financial Crisis (GFC) the debt-to-GDP ratio was fairly stable around 60%, but the massive fiscal response to the GFC (government spending, bailouts, etc.) greatly increased the US debt load. By 2012, our debt increased to more than 100% of GDP for the first time since WW II, surging to approximately 130% in 2020 as the government and the Fed used fiscal and monetary policy aggressively to avert economic calamity in the wake of the pandemic. Today, the debt-to-GDP ratio is roughly 125%. While household debt (now $20 trillion) and corporate debt (now $14 trillion) have continued to rise as well, they have declined to historically normal levels relative to GDP as shown in Figure 5.

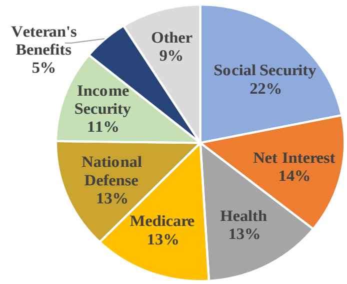
**Figure 5: US Debt (Federal, Household & Corp.) vs. GDP**




*Source: US Bureau of Economic Analysis, US Office of Management & Budget, Federal Reserve*

The US government is expected to spend over $7 trillion in fiscal year 2025. Figure 6 breaks down this spending, which is the starting point for the current budget negotiations in Congress.

**Figure 6: US Federal Government Spending (fiscal 2025 est.)**




**Federal Government Spending (est. FY 2025)**

| Category | $Billions | % |
|---|---|---|
| Social Security | $ 1,555 | 22% |
| Net Interest | $ 993 | 14% |
| Health | $ 951 | 13% |
| Medicare | $ 943 | 13% |
| National Defense | $ 922 | 13% |
| Income Security | $ 768 | 11% |
| Veteran's Benefits | $ 365 | 5% |
| Other | $ 636 | 9% |
| **Total Gov't Spending** | **$ 7,133** | **100%** |

*Source: treasury.gov*

- Note: Fiscal 2025 expenditures are estimated using actual data through April grossed up for the remainer of the fiscal year.
- Nearly two-thirds of expenditures are defined by prior law; this mandatory spending is dominated by Social Security, Medicare and Medicaid but includes income security programs (food/nutrition, child and family support, veterans' programs, etc.).
- Net interest payments on US debt are expected to be nearly $1 trillion this year (14% of federal spending) and have now surpassed the amount we spend on national defense annually!
- "Other" spending represents 9% of total government outlays and includes a wide variety of programs (health, education, training, employment, social services, transportation, international affairs, justice, environmental, community & regional development, science, space, technology, etc.).
- The budget deficit for 2025 is expected to be $1.8 trillion.

It is clear from Figure 6 that significant spending cuts will be difficult to achieve. If all discretionary non-defense programs were eliminated (not going to happen), we would still have a deficit. Real progress can only be made through mandatory spending reform (social security, Medicare, Medicaid, etc.) and/or tax increases, but these politically perilous topics are not likely to be resolved soon, especially with mid-term elections looming.

## Bottom Line

Stocks were strong in May as tariff tensions eased, at least temporarily, but bonds weakened as interest rates continued to move higher, reflecting concerns about the future impact of US economic and fiscal policy (tariffs, tax cuts, debt and deficits). Uncertainty remains high as Congress debates a comprehensive budget package. As it currently stands, the Big Beautiful Bill passed by the House extends the 2017 TCJA tax cuts, only partially offset by spending cuts and tariff revenue; most economic experts agree with the Congressional Budget Office (CBO) that the bill will actually increase budget deficits by nearly $4 trillion over the next 10 years. The federal debt problem is getting worse.

While the Fed sets short-term rates, the market sets longer-term rates. It is a function of supply and demand: Higher deficits require additional bond issuance; meanwhile, the global demand for US bonds seems to be decreasing, evidenced by rising yields and falling US dollar. Higher rates are accelerating concerns about the sustainability of large federal deficits and the growing federal debt burden. It is impossible to predict the future, but it is unlikely that our divided government will be willing and able to solve the debt problem by tackling the hard issues (mandatory spending and tax increases). Uncertainty lingers; diversification is critical.

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