Seelaus Asset Management
Market Update

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ASSET MANAGEMENT

Current Market Environment

It's official, at least in our opinion, the Fed is off the table for the near term and maybe for the remainder of 2025. As expected, the Fed kept Fed funds unchanged at their January 29th meeting. The hawkish tilt from the December meeting that took 2025 Fed cut expectations from 3 to 2, remains intact. In fact, as we mentioned last month, we argue that despite the recent Fed funds cuts, the Fed continues to operate in an economically restrictive manner due to their continued decrease of their balance sheet. So much so, that we believe that economic data will continue to show a healthy enough U.S. economy that warrants no cuts this year. In addition, should inflation not continue to decline as the Fed expects, the currently restrictive positioning of the Fed suggests to us that unless there is a large shock to inflation, we do not expect the Fed to need to raise rates either. We believe this continues to support a relatively favorable environment for risk assets. We recognize this view is not necessarily in line with what the market is pricing at the moment, so we note a few reasons as to how we came to this conclusion:

- As of today, the market is currently pricing 50bps of cuts for 2025. The Fed continues to focus on the data, not the new administration, to determine their policy. (Best wishes to J. Powell to be able to withstand the social media barrage he is likely to experience from the President!) To support a view of not needing any cuts near term, initial jobless claims numbers in 2025 have been in-line to below expectations so far and ultimately at levels below long-term averages. In addition, from an economic growth perspective, ~17% of U.S. companies have reported Q4 earnings, and they have outperformed earnings expectations by ~6.5% according to Bloomberg.
- Since the election, the yield curve has continued to steepen. Not only does it potentially speak to the expectation of future inflation but it more importantly, in our mind, signifies an expectation of future growth for the U.S. economy. Again, the Fed will continue to focus on the data, and we believe the health of the consumer and economy will remain in-line to maintain current Fed policy. The Feds comments on inflation and employment state that, for now, both economic components appear balanced enough to leave the Fed at bay. Although they did remove from their statement that "inflation has made progress to the Committee's 2 percent objective." As noted on the chart on the next page, PCE and CPI both have been trending higher the last few reporting periods although it is important to note those data points have at least been in-line to below expectations which gives us hope that the Fed will not need to take additional actions.
- We have stated for a number of commentaries that the health of the consumer had become the new focus for the Fed, but it appears, as we just highlighted above, the focus is now back on inflation. The dominant inflation concern is the impact of tariffs which, if implemented at a particular level and left unchanged, should be a one-time impact that may not necessarily lead to consistently higher inflation. In addition, from an equity market perspective, when you isolate companies with Trump tariff exposure, as noted by an Index created by UBS shown on the next page, it is possible that the impact of tariffs may already be priced in. What may be more worrisome could be the result of mass deportations, and potentially self deportations, that may have a larger impact on inflation as jobs that are typically not desirable for U.S. residents (construction, etc.) that leads to certain industries having to pay higher wages to attract the U.S. resident worker.
- So, this brings us to the next topic. If the Fed is on hold that means that 4.5%-5% on the U.S. 10-year Treasury may define our risk-free rate for the year, but that is not necessarily a bad thing.

Can the economy grow and markets continue to rally if rates are so "high"? Yes!

- First, let's put some of this into context. The 10-year Treasury yield has been below 4% since the beginning of 2008 after the Fed started cutting at the end of 2007 as we headed into the Global Financial Crisis. More recently, the 10-year was below 2% for ~2.5 years from the end of 2019 until early 2022 with a low of ~0.50% coinciding with the Fed's final cut to a 0%-0.25% Fed funds rate to offset the impact of the COVID pandemic. 10-year yields only rebounded above 2% after the Fed started raising rates again in March 2022. We have only consistently been above 4% since the end of 2023 so it is understandable to have the impression that 4%+ yields seem "high" which could give pause to some trying to understand if the economy can survive and grow at these levels.
- According to Bloomberg, 10-year yields over the life of U.S. Treasury issuance from the early 1960s to today, have ranged from a low of 50bps during the pandemic to a high of ~16% in 1981. Over this lifespan the 10-year yield averaged ~5.8%. Now granted there a number of periods of growth and recession throughout that timeframe, but we can all agree that in that time period from early 1961 to today, the U.S. has grown substantially with an average GDP rate of 3.1% and 7.5% annualized growth for the S&P 500! So, are 4.5% yields high? No, not historically and the U.S. economy can absolutely function and grow in this environment. As much as this is an oversimplification, we still believe the point is valid.
- Just two weeks ago on January 14th, the 10-year hit a high of ~4.8% only to correct back to today's level of 4.52%. As much as there were a lot of concerns around Trump policies, specifically tariffs, as the new administration has communicated more about their intentions, the markets seems to have agreed the worst-case scenario will not be a reality and has adjusted as such.
- In addition, we believe that current levels signify some hope that DOGE can bring some optimization to the Federal deficit and although it likely will not get fixed, the market seems to be saying that it is not necessarily worried about the expected continued issuance and is satisfied that someone is at least paying attention again.
- Finally, a much scarier environment is a Fed with no cards left to play such as in the Global Financial Crisis and the pandemic when they took Fed Funds rates to zero. As of today, with a 4.25%-4.5% target Fed funds rate and a shrinking Fed balance sheet, we believe the Fed is in a much more nimble position to adjust to employment or inflation shocks. With near-term history as a precedent, the Fed will continue to adjust, as will the new administration, to ensure a positive experience for risk assets and ultimately financial market investors.

(Data noted above as of 1/30/25 per Bloomberg)

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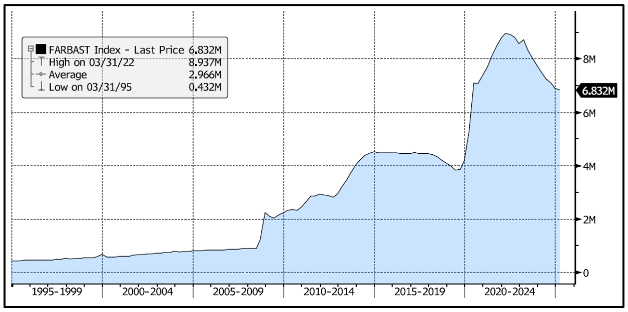
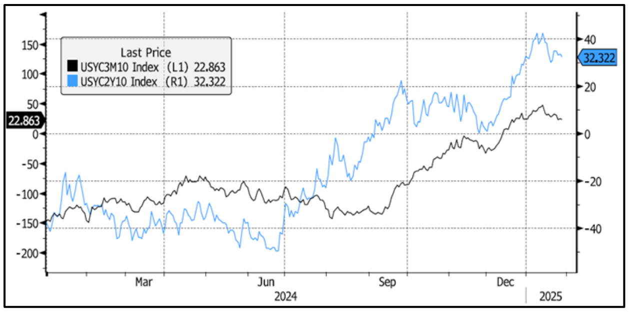
Visual Context

Federal Reserve Bank Assets

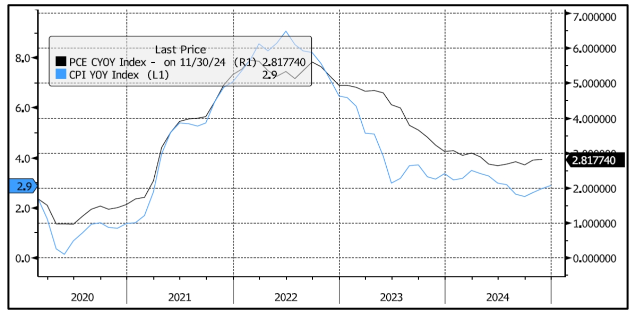


Implied Overnight Rate for the US

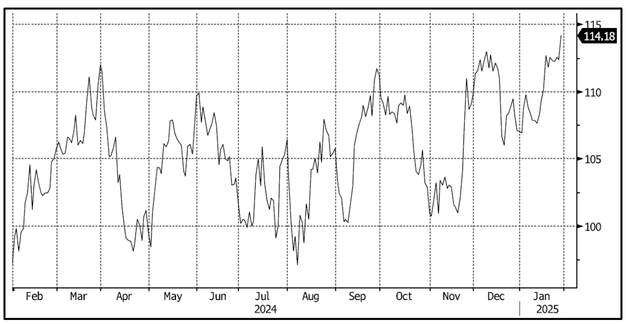
UST 3mo-10yr spread vs. UST 2yr-10yr spread



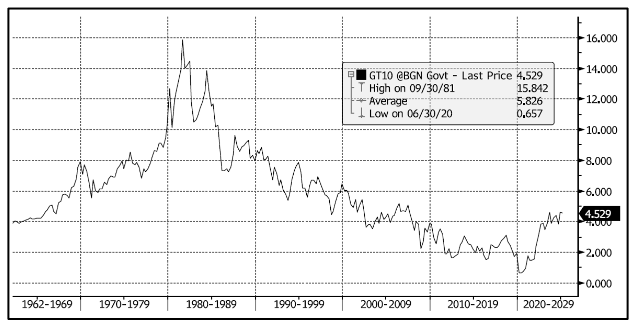
PCE vs CPI



UBS Trump Tariff Losers (UBXXTTL)



U.S. 10-year Treasury Yield



(Data and charts as of 1/30/25 per Bloomberg)

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