MACRO COMMENTARY | August 2025

# Charts and Smarts®

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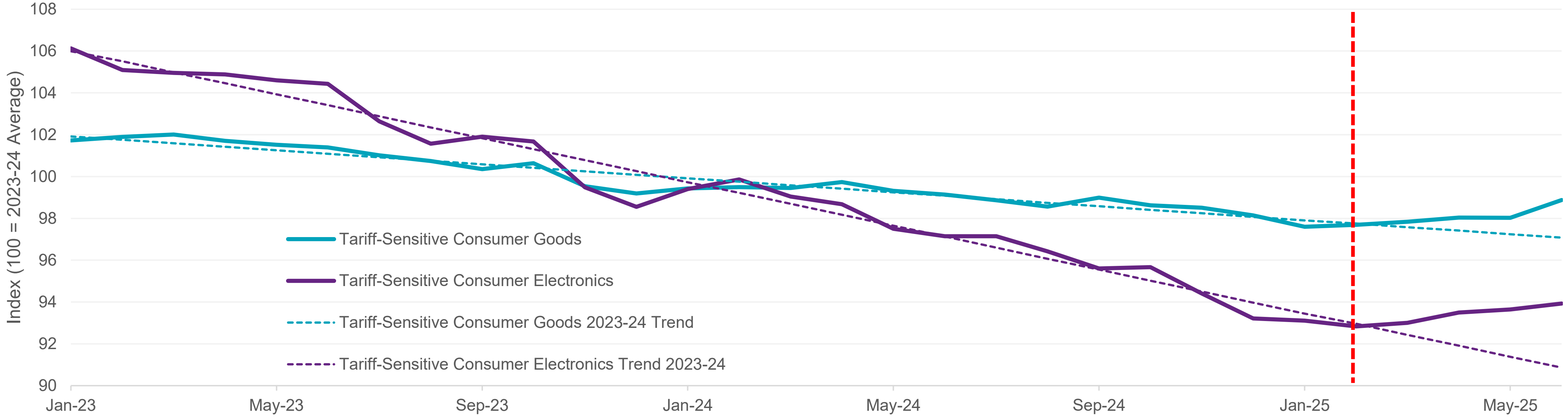
# Fee

## Tariff-Sensitive Consumer Goods Price Index (1/31/23–6/30/25)

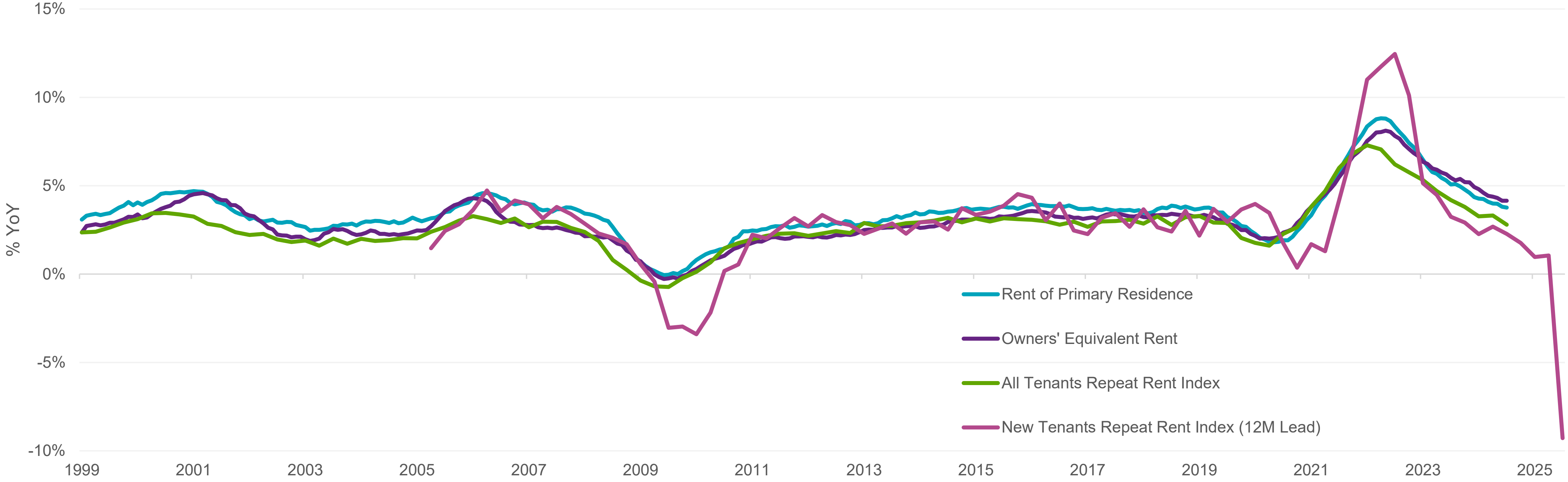



Inflation is very much back in the ranks of top-tier data as investors, who have grown largely indifferent to tariff rhetoric, scan for evidence of its fingerprints in the macro and the June CPI print was arguably the first print where those fingerprints were fairly visible. Despite the downside surprise on the core print, the fifth consecutive downside surprise, core goods inflation jumped notably in the report from modest deflation in the May release to a nearly 20 basis point increase in June, led by the most tariff-sensitive line items. Stripping out auto prices, which deflated in June, in large part thanks to the pull forward of demand to front-run tariffs, core goods rose 3.9% in annualized terms, good for the fastest pace since February 2023. And while June was the first month when tariff effects really shined through in the report, the trend change has been notable for several months now. Aggregating the most tariff-sensitive categories of consumer electronics, furniture, appliances, toys, apparel, sporting goods, and other household equipment and furnishings reveals a notable deviation from the trend of disinflation we've witnessed in those goods for the past few years, starting in February and accelerating in recent months. That deviation from trend is even more notable when looking exclusively at tariff-sensitive consumer electronics. While it's taken some time for the effects of tariffs to show up in the price data, they are visible if you know where to look and those are likely to increase as not only has the effective tariff rate continued to rise, but, as pre-tariff, low-cost inventories are depleted, corporates broadly have stated they intend to pass along a portion of those increased costs to consumers. June may have been the first month those effects were plainly visible, but the price level shift has been showing up in the data for some time now.

Source: Portfolio Analysis & Consulting, Bloomberg. Tariff-Sensitive Consumer Goods composed of furniture, appliances, toys, apparel, sporting goods, and other household equipment and furnishings. Tariff-Sensitive Consumer Electronics composed of computers & smartphones, televisions and cameras.

# Heavy Things

## Shelter CPI vs Tenant Repeat Rent Indices (12/31/99–6/30/25)

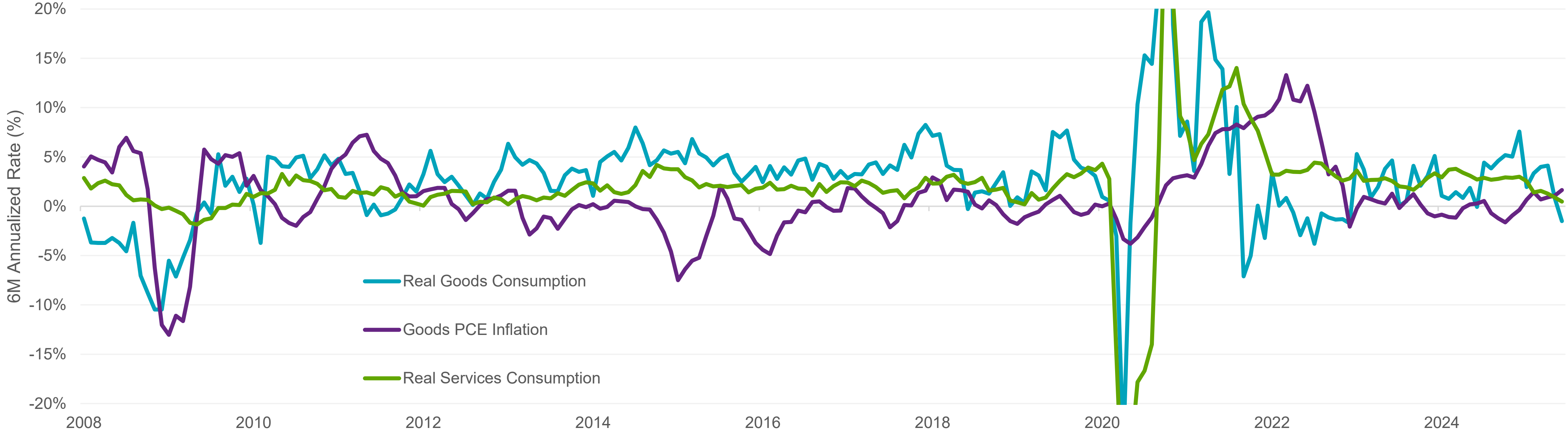



While tariff-sensitive core goods inflation is now clearly on the rise, price changes for those items are only one part of the equation when it comes to changes in the aggregate price level. Core goods represent just 19% of the CPI basket and only 24% of core CPI, which means that the price changes need to be large enough to overcome the smaller weighting in the inflation basket to offset the disinflationary trends that remain underway within services components. And while we're on the topic of component weights, as we've discussed repeatedly over the years, housing costs represent a massive weight within not only core services CPI, but in the headline and top-line core CPI. Rent of primary residence and owners' equivalent rent, the two components of housing CPI, represent 33.6% of CPI and 42% of core CPI, and the trend of disinflation in these line items remains very much alive and well. Housing inflation follows market rents with a lag of about 12 months, and continuing weakness in both market rents, as well as home prices themselves, provides plenty of runway for further cooling over the coming year in one of the largest components of the CPI basket. Two points can be concurrently true: tariff-sensitive goods prices are indeed on the rise, but the impact of price increases in goods that represent just 7.5% of the core CPI basket are being offset by the broader disinflationary process, particularly in the larger weights of housing and supercore services, that remains underway.

Source: Portfolio Analysis & Consulting, Bloomberg.

# Down with Disease

## Real Durable Goods Consumption vs Inflation (1/31/08–6/30/25)

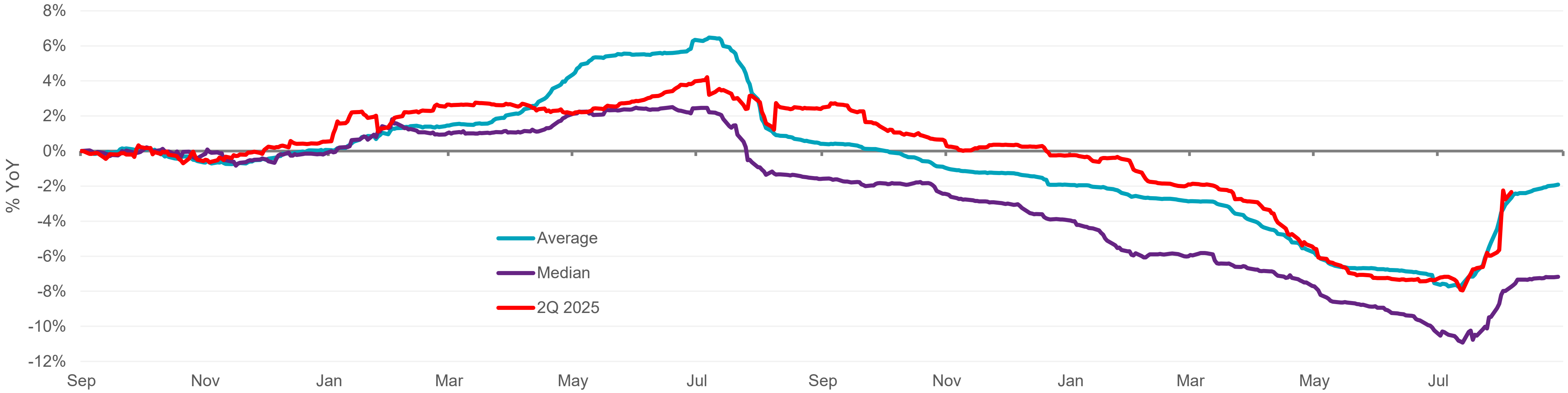



Rising goods prices won't just be fighting the weight and price trends of shelter, but also the potential demand destructive effects of those higher prices. Over the past few years, we've consistently pointed to the fact that nominal growth is slowly slowing and now sits at just 4.1% through the first half of 2025. With labor market slack continuing to build, aggregate income growth is likely to continue softening, further weighing on nominal incomes, the fuel behind consumer spending. And that softening nominal engine is likely to serve as a self-governing mechanism on how much inflation can durably rise. Without a tight labor market to guide both wage growth and nominal growth higher, any increase in core goods prices will erode disposable income for consumption in other categories, notably services. To the extent that corporates intend to pass along tariff costs to consumers via higher goods prices, any increase in prices simply weighs on quantity and real growth. This dynamic is already showing through in the divergence that is growing between durable goods prices and real durable goods consumption. Through the first six months of 2025, core goods PCE inflation has risen 1.65% annualized, while real goods consumption has fallen 1.5% annualized and real services consumption has tumbled to just 0.5% annualized growth. Yes, trade uncertainty has likely contributed to the slowdown and may open the door to a recovery in coming months, but the bigger point is that with nominal consumption growing just 2.7% annualized so far this year as nominal income growth continues to slow, not only may corporates find it hard to pass tariff costs on to consumers (but should they try), the greater threat to the economy lies on the labor side of the Fed's dual mandate.

Source: Portfolio Analysis & Consulting, Bloomberg.

# Stash

## S&P 500® Q2 Earnings Evolution (2011–2025)

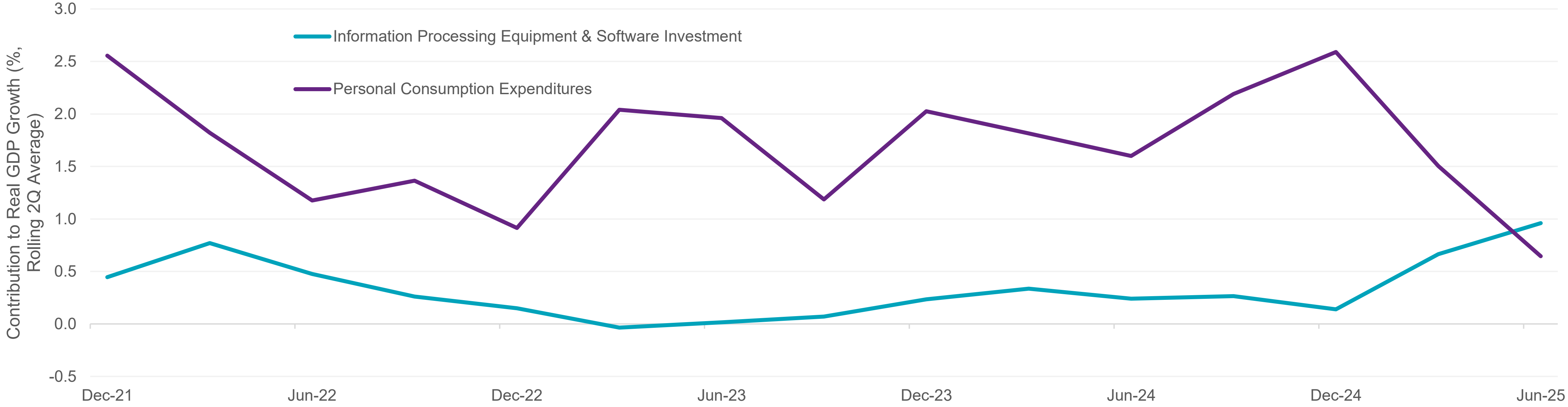



It's a tale as old as time. Consensus earnings estimates begin lofty and grind higher before reality begins to set in and the bar gets steadily lowered only for estimates to fall too far and actuals surprise to the upside. We call it the earnings fishhook effect and we see it play out quarter after quarter. The second quarter was no different as consensus estimates fell as low as 3.2% before the beats started to roll in fast and furious. As we sit today, now more than 75% through the earnings season and past the majority of the key bellwethers, second quarter earnings have grown close to 9% year over year as 77% of reports have beat on the top line and 75% have beat on the bottom line, as compared to the long-term medians of 60% and 71%, respectively. Perhaps even more surprising is the 61% of firms that have beat both top- and bottom-line estimates, well ahead of the long-term median of 53%. In short, it's been a strong quarter headlined by continued optimism around the durability of the AI investment boom. But when it comes to markets, the reaction to the news is more important than the news itself, and in that regard, the market reaction around earnings demonstrates just how discerning investors have become. The median one-day outperformance of double beats, relative to the S&P 500® Index, has been underwhelming, to say the least, with double beats being rewarded by a modest 1.1% median outperformance, in line with the historical median, while double misses, though rare this quarter, have been punished with 8.9% underperformance, more than three times the historical median. Once again, despite the slowing consumer backdrop, earnings have been not only better than feared, but outright strong, as management teams demonstrate an impressive ability to adapt to changing policies and continue delivering results. But the price reaction is illustrative of a market that has priced in much of that dynamism and is showing increasing evidence that perhaps a breather is in store, particularly as the narrative around growth and resilient labor markets begins to shift.

Source: Portfolio Analysis & Consulting, FactSet. As of 8/6/25.

# The Divided Sky

## AI Investment vs Consumer Spending (12/31/21–6/30/25)




While the second quarter earnings season continued to confirm that the AI boom is alive and well, it's proving to be a key driver, not only for corporate earnings, but for the broader macro economy as well. Throughout this year, we've repeatedly highlighted that the breadth of economic growth has been steadily declining as government spending retrenches at both the federal and state and local levels, housing remains mired in stasis, with further slowing in store, and non-AI capex remaining on pause. That has left the economy increasingly sensitive to the consumer, and ultimately, labor market health. As real consumption has slowed materially through the first half of the year, we are beginning to challenge the long true concept that consumption drives the economy. In fact, through the first half of the year, AI capex, defined as investment in information-processing equipment and software, is now contributing more to real GDP growth than consumer spending. AI is not only a critical driver of equity markets but is basically the lone driver of material growth in the economy. While we may see a modest recovery in real consumption during the critical back-to-school and holiday shopping seasons after tariff and trade uncertainty likely weighed on consumer behaviors in the first half of the year, the economy is in many ways firing on just one cylinder: AI spend. Corporate commentary certainly supports the view that this investment boom is likely to continue into 2026, but so far this boom hasn't translated to a meaningful impulse to labor markets and consumption, and, if anything, may pose a risk to employment as AI utilization continues to grow. Bottom line: while the boost to growth from AI investment is encouraging, the risk remains that slowing momentum in the broader economy continues to weigh on labor markets to a degree that offsets the still powerful AI investment boom.

Source: Portfolio Analysis & Consulting. Bloomberg.

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