May 23, 2025

MarketDesk

The Weekly Note

U.S. Debt Downgrade, Congress Debates Tax Cut Bill, & Fed Speakers Urge Patience

Weekly Market Recap

Stocks edged lower this week, with the S&P 500 declining less than -1%. Smaller companies underperformed, while the Nasdaq Index remained a relative outperformer. The Low Volatility, Growth, and Momentum factors were relative outperformers, while the Equal Weight and High Beta factors lagged. Defensive sectors slightly outperformed, while Energy and Real Estate led to the downside. The bond market saw the most notable development, as the U.S. debt downgrade and deficit-funded tax cut bill pushed Treasury yields higher (see below). Long Duration Treasury and corporate bonds underperformed while shorter-duration bond proxies were unaffected. Volatility picked up modestly, with both equity (VIX) and bond (MOVE) gauges rising after recent declines. Meanwhile, the U.S. dollar weakened amid growing fiscal concerns.

Key Takeaways

1. Moody's downgraded the U.S. credit rating by one notch, stripping the U.S. of its last AAA rating among the three major credit agencies (S&P downgraded in 2011, Fitch in 2023). Moody's cited unsustainable fiscal deficits, rising interest expenses, and increasing national debt as reasons for the downgrade. It also pointed to political dysfunction, including repeated debt ceiling standoffs and a lack of a credible long-term fiscal plan. *Implication – The downgrade wasn't a surprise, but it comes amid mounting concerns about the country's fiscal health .*

2. The downgrade comes as Congress debates the Trump administration's tax cut bill, which seeks to extend the 2017 tax cuts. Supporters argue it could boost investment and economic growth, but estimates suggest it could add $3–5 trillion to the national debt over the next decade, raising concerns about fiscal responsibility. *Implication – The House passed its version of the bill, but it's fate remains uncertain as some Republican Senators push for significant changes.*

3. Fed officials continue to signal a cautious and data-dependent approach to rate cuts. Several speakers this week emphasized the need for patience, citing ongoing policy uncertainty and inflation risks tied to tariffs. While rate cuts are still expected later this year, officials stressed that any decision will depend on incoming economic data. *Implication – Absent a significant economic shock, the Fed is now likely to keep interest rates unchanged over the summer months.*

4. Markets are scaling back rate cut expectations in response to the Fed's messaging. In the three weeks since the May Monthly Roundup, the number of projected cuts has dropped from four to two, and the anticipated timing of the first cut has shifted from June or July to September (Figure 1). *Implication – Forecasts for Fed policy are likely to remain volatile as the market and the central bank navigate an uncertain macroeconomic and policy environment.*

5. The combination of fiscal concerns and fewer rate cuts is weighing on long duration Treasury bonds. The 30-year Treasury yield rose above 5% this week, touching levels last seen in early 2007 (Figure 3). The catalyst: a lackluster auction of 20-year U.S. Treasury bonds. *Implication – Bonds are facing selling pressure as investors sentiment turns deeply negative.*

6. It's important to distinguish why yields are rising. When yields rise due to stronger growth expectations, that's typically a positive signal. However, when they rise due to policy and fiscal concerns, it's more worrisome. While tax cuts would boost growth, the market is instead focusing on the deficit. *Implication – Higher yields can impact markets in several ways: stocks can selloff as bonds become more attractive, and economic growth can slow as financial conditions tighten.*

7. Last week's Weekly Note highlighted the unusual nature of the market rebound. The QQQ ETF has staged a COVID-like recovery, but one group has posted an even stronger rebound: meme stocks. Coreweave has gained +180% since its late-March IPO, when it struggled to attract investor interest and Nvidia stepped in as an anchor investor. MicroStrategy, known for its Bitcoin holdings, is up +70%. Tesla has climbed +58% following Elon Musk's return, Hims & Hers Health, a telehealth provider, has gained +112%, and Robinhood has rallied +88%. Even SPACs are back after earning a bad reputation in 2021-2022. *Implication – This is not a normal market.*

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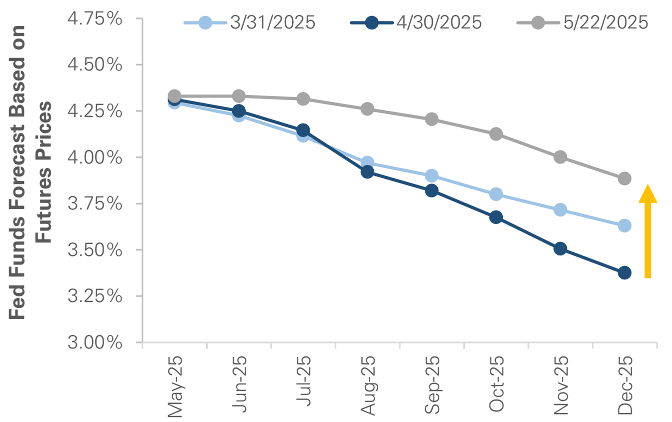
Markets	1-Week	YTD
S&P 500	-1.0%	-0.4%
R.2000	-1.9%	-7.4%
Nasdaq	-0.5%	+1.2%
Dow Jones	-0.6%	-0.6%
Bond Agg.	-0.6%	+1.5%
WTI Oil	-0.2%	-11.4%

Next Week's Economic Releases

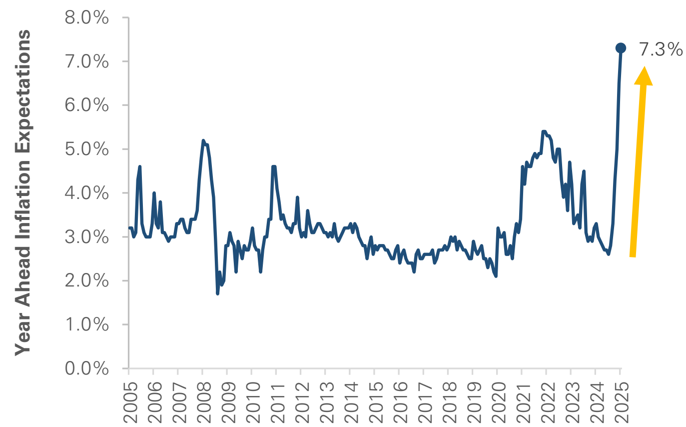
Consumer Confidence Index (5/27)
Dallas Fed Index (5/27)
S&P 20-City Home Price Index (5/27)
Richmond Fed Index (5/28)
Pending Home Sales (5/29)
PCE (Inflation) (5/30)
Michigan Consumer Sentiment (5/30)
Domestic Auto Sales (5/30)
Domestic Total Vehicle Sales (5/30)

Figure 1: Rate Cut Expectations Fall as Fed Urges Patience



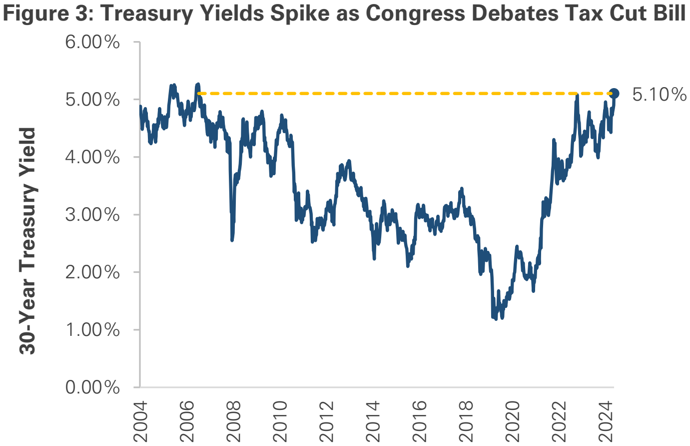
Source: MarketDesk, CME. Based on Fed Funds futures pricing.

Figure 2: Inflation Expectations Spike as Tariffs Take Effect



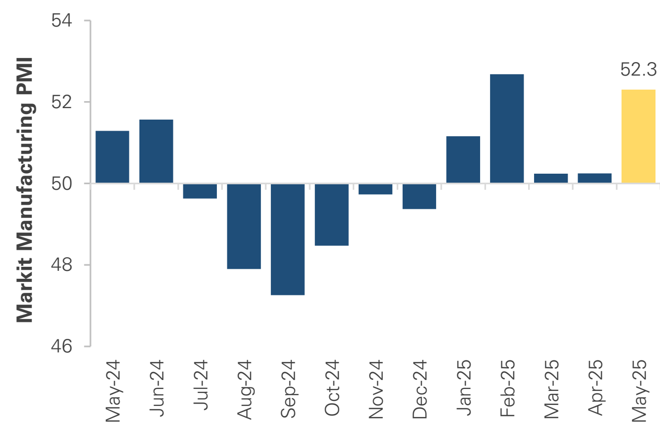
Source: MarketDesk, University of Michigan

Figure 3: Treasury Yields Spike as Congress Debates Tax Cut Bill



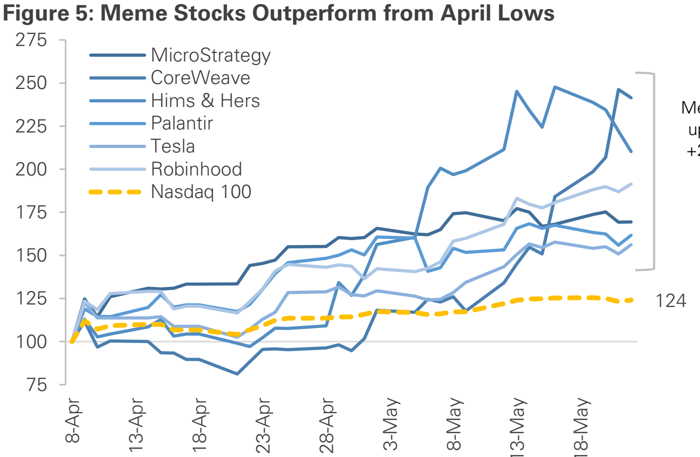
Source: MarketDesk, U.S. Treasury

Figure 4: Soft Data Rebounds as Trade Tensions Ease



Source: MarketDesk, Markit

Figure 5: Meme Stocks Outperform from April Lows



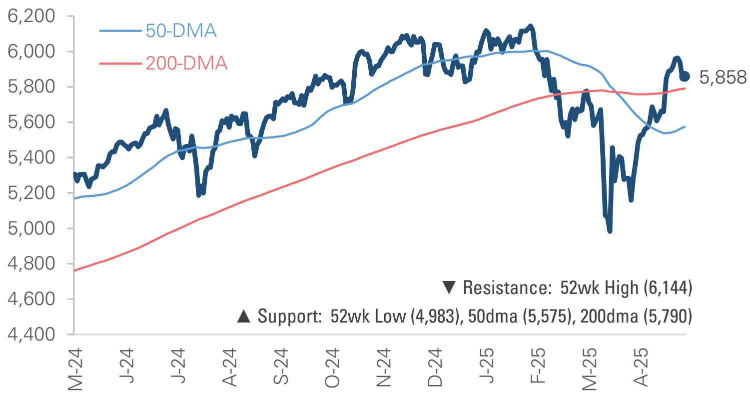
Source: MarketDesk

Figure 6: Bitcoin Trades Above $110,000 for the First Time

Source: MarketDesk, Coindesk

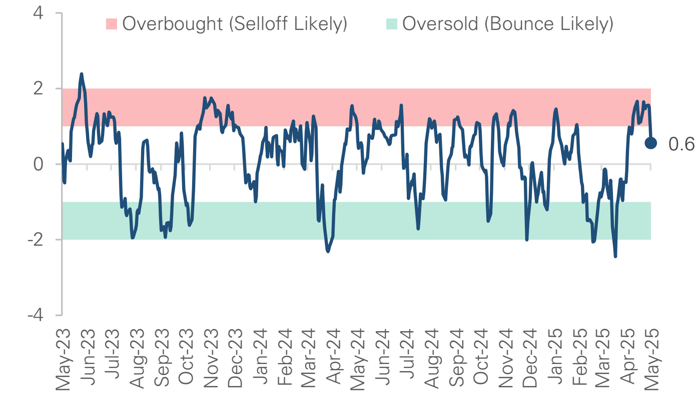
Asset Class Performance

Figure 7: S&P 500 Index (Last 12 Months)



Source: MarketDesk

Figure 8: S&P 500 Technical Composite (Last 24 Months)



Source: MarketDesk. Based on a composite of technical breadth measures.

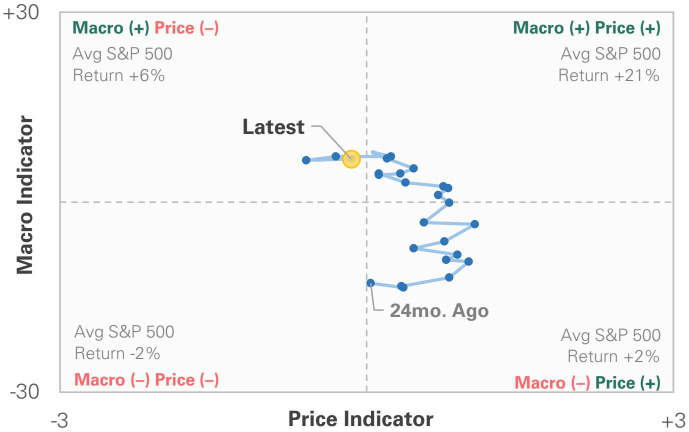
Figure 9: Key Performance, Valuation, and Technical Details

Category	Market Areas	Yield	Total Returns (%)						NTM P/E (vs 10 Years)				Technical Composite			
			1wk	1mo	3mo	6mo	YTD	12mo	5th	Current		95th	RSI	10wk Price	TC Reading	
MDR Focused Indices [1]	U.S. Dividend	3.4%	-1.7	2.0	-4.6	-7.4	-3.2	-2.0	11x	15.7x	31%	29x	53		0.3	-
	U.S. Large Cap	1.5%	-1.3	3.2	-6.2	-5.0	-3.1	2.4	14x	17.5x	18%	44x	55		0.6	-
	U.S. Small Cap	0.8%	-1.9	7.9	-4.0	-8.0	-2.9	-1.3	13x	18.8x	23%	52x	60		0.9	-
	U.S. Sector Rotation	1.1%	-1.7	5.0	-2.0	-2.8	0.1	4.2	14x	17.8x	17%	48x	59		0.7	-
	U.S. Momentum	1.2%	0.7	3.1	-12.6	-11.4	-7.0	3.8	14x	22.9x	58%	28x	50		-0.1	-
Major Indices	S&P 500	1.3%	-1.0	6.8	-4.2	-1.5	-0.4	11.2	15x	21.2x	79%	24x	65		0.6	-
	Russell 2000	1.2%	-1.9	5.2	-8.8	-12.5	-7.4	1.6	17x	23.1x	53%	58x	56		0.3	-
	NASDAQ	0.6%	-0.5	10.5	-3.7	2.6	1.2	14.5	17x	26.1x	74%	31x	73		0.8	-
	MSCI EAFE	2.8%	1.2	5.2	7.3	15.6	16.5	13.0	11x	14.7x	65%	18x	69		0.9	-
	MSCI EM	2.2%	-0.4	5.9	2.4	8.4	10.2	10.0	10x	12.5x	72%	15x	67		0.6	-
U.S. Factors	Equal Weight	1.6%	-1.4	4.9	-3.1	-3.7	0.8	8.4	13x	16.8x	64%	22x	61		0.3	-
	Growth	0.5%	-0.7	10.3	-4.1	1.0	-1.1	16.2	17x	25.6x	65%	32x	71		1.5	-
	Value	2.0%	-1.1	3.7	-3.7	-3.6	1.7	8.9	12x	16.1x	71%	18x	57		0.3	-
	Momentum	0.8%	-0.7	11.0	1.3	7.0	10.2	21.7	13x	25.9x	88%	39x	71		0.7	-
	Low Volatility	1.6%	-0.1	2.3	-0.5	0.8	5.1	14.0	16x	19.6x	75%	22x	51		0.1	-
	High Beta	0.7%	-2.0	12.2	-6.4	-3.7	-0.7	5.9	-186x	19.4x	82%	51x	69		0.6	-
U.S. Sectors	Technology	0.7%	-1.7	12.2	-4.3	-0.9	-0.7	8.8	14x	26.2x	81%	29x	72		1.0	-
	Consumer Staples	2.5%	0.5	0.6	0.9	1.9	4.3	8.8	16x	19.9x	61%	22x	50		0.8	-
	Consumer Discr.	0.8%	-0.9	10.1	-4.5	-0.2	-4.5	24.0	17x	26.0x	82%	39x	69		0.8	-
	Utilities	2.8%	-0.9	2.3	0.7	-0.5	6.8	16.8	15x	18.3x	64%	21x	53		0.2	-
	Health Care	1.8%	0.5	-4.6	-10.6	-8.2	-4.3	-8.1	14x	16.3x	52%	20x	37		-0.2	-
	Real Estate	4.2%	-2.0	0.3	-4.6	-6.7	-0.9	11.2	14x	16.5x	55%	22x	38		-0.6	-
	Financials	1.4%	-1.6	4.6	-1.4	1.4	4.8	23.9	9x	16.9x	98%	18x	57		0.2	-
	Comm Svcs	1.1%	0.3	9.5	-4.2	4.1	2.6	21.4	-169x	19.1x	28%	72x	76		0.8	-
	Energy	3.5%	-4.1	-0.5	-10.9	-14.1	-3.4	-7.1	-251x	14.9x	47%	85x	51		-0.7	-
	Industrials	1.4%	-0.1	10.1	3.3	1.8	8.1	16.4	14x	23.9x	92%	26x	72		0.8	-
	Materials	2.0%	0.0	3.5	-3.5	-7.0	2.9	-3.1	12x	19.6x	81%	22x	56		0.7	-
U.S. Credit	U.S. Corp HY	5.9%	-0.4	0.9	0.4	2.3	2.4	9.0					59		0.5	-
	U.S. Corp IG	4.5%	-0.7	-0.8	-0.4	0.2	0.9	4.0					42		-1.1	-
	UST (1-3Y)	4.0%	0.0	-0.1	1.4	2.5	1.8	5.4					44		-1.0	-
	UST (7-10Y)	4.6%	-0.5	-1.1	1.3	1.8	2.4	4.6					36		-1.7	OS
	UST (+20Y)	5.1%	-2.1	-4.1	-3.8	-4.7	-2.1	-3.6					28		-1.9	OS
Volatility	CBOE VIX	-	3.0	-5.6	5.2	4.0	3.5	8.1					44		-0.5	-
	MOVE (Bond VIX)	-	3.5	-6.2	15.8	0.2	3.3	15.9					51		-0.5	-
FX	U.S. Dollar Index	-	-0.9	0.6	-6.1	-6.6	-7.9	-4.9					49		-0.1	-
Oil	WTI Oil	-	-0.2	-2.0	-14.0	-8.8	-11.4	-11.3					63		0.0	-

Source: MarketDesk. All data as of Thursday's close. 1-week returns are calculated Thursday to Thursday. See page 6 for definitions. (1) MarketDesk Focused S&P 500 Index based on the "Monthly Rebalance" model index version. Refer to each index's monthly PDF for additional information and disclosures.

Portfolio Strategy

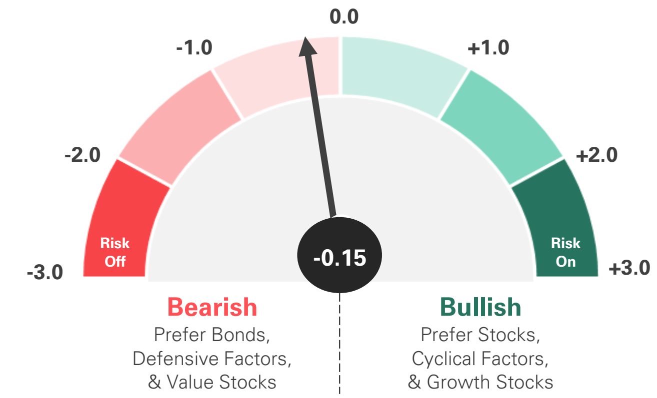
Figure 10: Simple Asset Allocation Framework (SAAF)



Source: MarketDesk. **Click Here** to read more about the SAAF.

Figure 11: MarketDesk U.S. Risk Demand Indicator (USRDI)

Bull / Bear Market Gauge



Source: MarketDesk. **Click Here** to read more about USRDI.

Figure 12: MarketDesk Current Asset Class Ratings

Underweight Ratings (Decrease Exposure)	Overweight Ratings (Increase Exposure)
US Corp High Yield	Quality Factor
Preferreds	Equal Weight Factor
US High Beta Factor	High Dividend Factor
Value Factor	Low Volatility Factor
Industrials	Growth Factor
Financials	Health Care
Materials	Utilities
	Consumer Staples
	MBS
	Long Duration Treasuries
	Mid Duration IG Corporates

Source: MarketDesk. **Click Here** to read the latest Monthly Roundup.

Figure 13: Bullish and Bearish Narratives

Bear Case (Market Headwinds)	Bull Case (Market Tailwinds)
Risk Appetites Fading	Fed Started Cutting Rates
Weak Sentiment / Low Confidence	U.S. Earnings Breadth Rebound
Lagged Impacts of Rate Hike Cycle	Cash Sitting on Sidelines
Inflation Reacceleration Risk	Labor Market Remains Tight
Fed Shrinking Balance Sheet	Consumer Keeps Spending
Interest Coverage Ratios Declining	Housing Market Reaccelerates
Pandemic Savings Depleted	Investment Rises After Election
Disinflation Drag on Sales Growth	"Buy the Dip" Investor Base
Geopolitical Tensions	
Fewer Rate Cuts Than Expected	

Source: MarketDesk

Figure 14: S&P 500 Valuation Matrix

Change in S&P 500 NTM Consensus EPS

NTM P/E Multiple	$249	$263	$268	$277	$285	$291	$304
	-10%	-5%	-3%	0%	+3%	+5%	+10%
19.0x	4733	4996	5101	5259	5417	5522	5785
20.0x	4982	5259	5370	5536	5702	5813	6090
21.2x	5272	5565	5682	**5858**	6034	6151	6444
22.0x	5481	5785	5907	6090	6272	6394	6699
23.0x	5730	6048	6175	6366	6557	6685	7003

NTM = Next 12 Months

Source: MarketDesk. Note: Growth of 0% (center column) is based on the current NTM consensus EPS of $277, which already implies +11% growth vs LTM's actual EPS of $249. Therefore, growth of +10% (far right column) would imply +21% growth vs LTM actual EPS. The S&P 500's NTM P/E multiple is currently 21.2x.

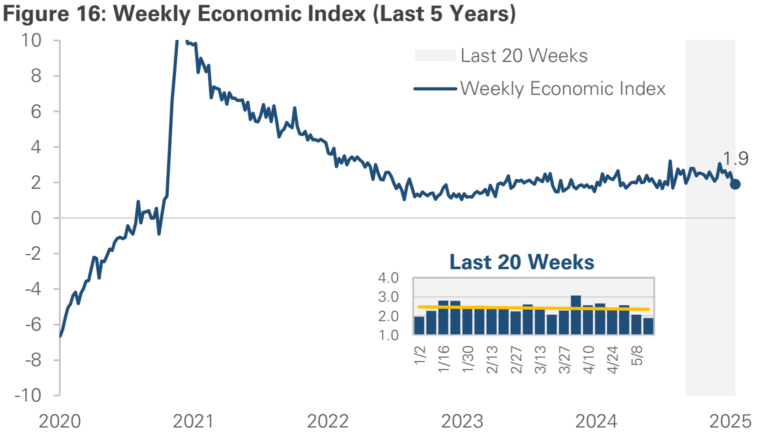
Economics & Interest Rates

Figure 15: U.S. Economic Calendar – Next Three Weeks

Monday	Tuesday	Wednesday	Thursday	Friday
May 26	**May 27**	**May 28**	**May 29**	**May 30**
	Consumer Confidence Index Dallas Fed Index S&P 20-City Home Price Index	Richmond Fed Index	Pending Home Sales	PCE (Inflation) Michigan Consumer Sentiment Domestic Auto Sales Domestic Light Trucks Sales Domestic Total Vehicle Sales
Jun 2	**Jun 3**	**Jun 4**	**Jun 5**	**Jun 6**
Construction Spending Manufacturing PMI	Durable Goods Orders Industrial Orders JOLTS (Job Openings)	Services PMI	Labor Productivity	Unemployment Rate Nonfarm Payrolls Private Payrolls
Jun 9	**Jun 10**	**Jun 11**	**Jun 12**	**Jun 13**
		Consumer Price Inflation (CPI)	Producer Price Inflation (PPI)	

Source: MarketDesk, Federal Reserve, Various U.S. Government Departments and Agencies

Figure 16: Weekly Economic Index (Last 5 Years)



Source: Federal Reserve Bank of New York. WEI is an index of ten real-time economic indicators, such as unemployment claims, railroad traffic, and retail sales.

Figure 17: Interest Rates and U.S. Treasury Yields

UST Duration	Recent Performance (bps)				Last 12-Month Range		
	1wk	2wk	1mo	3mo	Low	Current	High
Fed Funds	-	-	-	-	*4.3%*	**4.33%**	*5.3%*
3-Month	-1	+3	+5	+5	*4.3%*	**4.35%**	*5.4%*
2-Year	+3	+10	+20	-7	*3.5%*	**3.99%**	*5.0%*
5-Year	+2	+9	+16	+0	*3.4%*	**4.09%**	*4.6%*
10-Year	+9	+16	+23	+27	*3.6%*	**4.54%**	*4.8%*
30-Year	+14	+20	+28	+49	*3.9%*	**5.05%**	*5.1%*
Prime Rate	-	-	-	-	*7.5%*	**7.50%**	*8.5%*
30Yr Mtge	+6	+9	+3	+7	*6.6%*	**6.92%**	*7.4%*
US Corp IG	+7	+5	+10	+26	*4.7%*	**5.41%**	*5.7%*
US Corp HY	+7	-14	-21	+48	*7.2%*	**7.80%**	*8.7%*

Source: MarketDesk, Federal Reserve

Asset Class Ratings

Latest as of April, 30 2025

MarketDesk

- **Overweight (OW)** — Favor higher weight than the broad index. Comfortable letting winners run and increasing exposure after selloffs.
- **Marketweight / Neutral (N)** — Market areas offering limited differentiation vs the broad index.
- **Underweight (UW)** — Favor lower weight than the broad index. Potential areas of risk (i.e. underperformance, macro / thematic headwinds).

Asset Class	Allocation View				Rationale
	Chg.	UW	N	OW	
U.S. Factors					
Quality		•	•	●	Attractive factor exposure given the uncertain macro environment and delayed impact of Fed tightening
Equal Weight		•	•	●	Increases exposure to smaller S&P 500 companies; Underweight Magnificent 7 valuation premium
Growth		•	•	●	Companies with superior growth profiles historically outperform after first rate cut; Prefer to own Growth outside of mega cap AI
Minimum Volatility		•	•	●	Top performing equity factor in USRDI risk off regimes; Can gain exposure to low beta stocks via factors or sectors
High Dividend		•	•	●	Favor active security selection with emphasis on quality dividend payers; Trades at extreme valuation discount vs history
Large Caps		•	●	•	Mega Cap Growth trades expensive & now needs EPS growth to meet high expectations; Index concentration = risk
Small Caps		•	●	•	Potential to outperform after underperforming in recent mega cap rally, but historically underperforms early in USRDI risk off regimes
Momentum		•	●	•	Currently provides OW exposure to Large Caps, Financials, & Tech; Prefer strategies with shorter signals that are more nimble
Value		●	•	•	Expensive vs its own history = no clear valuation edge; Slower earnings growth than Growth factor; More cyclical than defensive
High Beta		●	•	•	S&P 500 now in year 3 of the bull market & USRDI below 0; Risk/reward unattractive with high economic & earnings expectations
U.S. Sectors					
Health Care		•	•	●	Top performing sector in USRDI risk off regimes due to it low beta exposure; Limited exposure to slowing growth & tariffs
Utilities		•	•	●	Top performing sector in USRDI risk off regimes due to it low beta exposure; Limited exposure to slowing growth & tariffs
Consumer Staples		•	•	●	Top performing sector in USRDI risk off regimes due to it low beta exposure; Attractive valuations relative to market
Consumer Disc		•	●	•	Historically outperforms after end of tightening cycle, but consumer showing signs of spending slowdown as sentiment weakens
Energy		•	●	•	Capturing gains from past 6 months; Can trade higher in USRDI risk off regimes, but win rate is low & volatile
Comm Services		•	●	•	Barbell exposure to the Growth-factor with additional exposure to the defensive Telecom industry to protect against risk of sell-off
Real Estate		•	●	•	Risk of property valuations falling further & owners unable to refinance due to tighter lending standards
Technology		•	●	•	Trades with AI valuation premium; Expensive vs history & relative to S&P 500; Needs EPS growth to meet high expectations
Industrials		●	•	•	Tariffs pose a significant risk to the manufacturing industry; Risk that earnings estimates don't factor in extended economic slowdown
Financials		●	•	•	Worst performing sector in USRDI risk off regimes; Trades at expensive valuations vs history; Increasing loan loss provisions are a risk
Materials		●	•	•	Falling inflation = potential headwind for revenue growth; Potential upgrade if economy gains momentum in 2025
Fixed Income					
MBS		•	•	●	Higher risk free yield than U.S. Treasuries, with extension risk already priced into bonds; Benefits from decreased rate volatility
Investment Grade		•	•	●	Lower credit risk vs HY = Less risk of credit spread expansion; Favor neutral duration stance due to risk that spreads widen
Long Duration		•	•	●	Potential that yields move higher, but elevated growth expectations + risk/growth scare = bonds now look more attractive
Bank Loans/CLOs		•	●	•	Fed rate-cutting cycle will cause floating yields to steadily decline; Extremely low duration provides no benefit if yields decline
EM Sovereign		•	●	•	Concerned about spreads widening due to slower global growth & risk of liquidity crunch; USD has been a headwind
Municipals		•	●	•	Tax benefit is more valuable when rates are higher; Property valuations may lower tax revenue, while interest expense is rising
TIPS		•	●	•	Inflation continues to ease, albeit at a slower pace; Suggests the benefit of owning TIPS is fading
Preferreds		●	•	•	Banks are a large issuer of preferreds & bank stress could weigh on group; Higher equity beta = potential headwind
High Yield		●	•	•	Tighter lending standards = increased refinancing & default risk; Current credit spreads leave little room for further tightening
International Regions					
Emerging		•	●	•	Slow global growth = risk, but EM banks have more room to cut; Historically early in USRDI risk off regimes
ACWI ex U.S.		•	●	•	Rate hikes have had a bigger economic impact outside of U.S; International will trade lower along with U.S. in bear market
Developed		•	●	•	Data indicates rate hikes having a bigger impact in non-U.S. countries; Favor Quality & Dividend factors
FX					
U.S. Dollar	▼	•	●	•	Informed by MarketDesk USD Technical Indicator (USDTI); Historically strengthens during USRDI risk off regimes

Note: The ratings represent our asset allocation views for the next 6-12 months. Arrows indicate a positive (▲) or negative (▼) recent change in our view. Over / Under / Market weight is in context to the benchmark for each market area (i.e. S&P 500 weights for Sectors).

Disclosures

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