Summary

Economic data was highlighted by consumer price inflation that came in hotter than expected, as did producer price inflation. Positive results were seen in industrial production, while retail sales fell back for the month, with perhaps weather and turn of the year seasonal effects skewing several of these measures.

Equities saw gains globally, as markets celebrated what appeared to be a less dramatic and broad tariff policy. Bonds were up slightly although yields were little changed, with foreign bonds helped by a weaker dollar. Commodities were up across the board.

Economic Notes

(-) **Retail sales** fell by -0.9% in January, a reversal of December's 0.7% increase, and below the -0.2% median forecast. Removing autos improved the decline to -0.4%, while core/control retail sales fell -0.8%. By segment, auto sales fell by -3%, offset by gasoline station and food service sales up nearly 1%. Otherwise, gains in department stores and misc. retail were offset by declines in sporting goods (-5%), non-store/online retail (-2%), and furniture (-2%). It appeared that especially cold weather in the month played a negative role, as did perhaps the Southern California wildfires, and normal seasonality issues around the Dec./Jan. timeframe, which can skew the monthly figures more dramatically than normal, especially as a high proportion of some retailers' revenues are earned during the Holidays. Year-over-year, retail sales were up over 4%, which accounts for some 'real' gain after inflation is accounted for.

(+) **Industrial production** rose 0.5% in January, exceeding the 0.3% expected, but half the pace of December's revised 1.0% rise. Manufacturing production fell by -0.1% in the month, pulled down by auto assemblies, which declined by -8%, while business equipment rose by 2% and aircraft/parts up along with catch-up effects after the Boeing strike last year. While mining production fell by -1%, utilities rose by a substantial 7%, helped by especially-cold winter weather conditions during the month. Year-over-year, industrial production is up 2%, with 6-7% gains in utilities and high-tech equipment offset by a -6% drop in auto production, and a minor drop in business equipment. **Capacity utilization** ticked up by 0.3% to 77.8%.

(-) The **Consumer Price Index** rose more sharply than expected in January, up 0.5% on a monthly seasonally-adjusted basis, and 0.4% for core, removing food and energy—each were above the 0.3% increases expected. The headline figure was the highest rate in over a year, with a 2% gain in energy commodities. In core, shelter costs rose another 0.4%, which represented 30% of the total monthly all items increase, per the BLS. Other items that experienced gains included car insurance (2.0%), recreation, hotels, used cars/trucks (2.2%), medical care, communication, and airline fares (1.2%). Price declines were seen in apparel (-1.4%), personal care, and household furnishings/operations. Additionally, it was observed that the impact of the recent Los Angeles wildfires did not result in an uptick in costs from that region.

On a year-over-year basis, headline and core inflation rose by 3.0% and 3.3%, respectively. As was the case last year, some residual seasonality snuck through based on new calendar year price adjustments. This is common in a variety of industries, including insurance premiums of various types, which has caused the January price bump to be a bit stronger than in other months. In looking at alternative measures of inflation, the "all items less shelter" showed a far more tempered year-over-year rise of 2.2%, and the more expansive "all items less food, shelter, and energy" up 2.3%. Overall, financial markets were not enthused by the report, mostly because of the ramifications on the Federal Reserve's easing plans. But, while frustrating for policymakers, the differences between 2.0%, 2.5%, and 3.0% inflation in the short term likely aren't enough to throw the economy off-track.

(0/-) The **Producer Price Index** rose 0.4% in January, a tenth of a percent above expectations. Removing food and energy, core PPI rose 0.3%. For the month, this included a 2% rise in energy prices and 1% for food, with final demand goods up 0.6%, while final demand services were up 0.3%. Government-purchased goods and transportation of goods generally saw the strongest gains, while transportation of passengers' costs fell slightly in cost. On a year-over-year basis, headline PPI rose 3.5%, while core PPI gained 3.6%. By segment, goods rose 2.3%, and service increased 4.1%. This can also be calculated in different ways, but the majority of methods, including or excluding certain goods and services, ended with PPI in the 3-4% range for the past 12 months.

(0) **Initial jobless claims** for the Feb. 8 ending week fell by -7k to 213k, just under the median forecast of 216k. Continuing claims for the Feb. 1 week fell by a sharper -36k to 1.850 mil., well below the expected 1.882 mil. Activity was mixed by state, with rises in CA and FL, while those in OH and MI declined, with the spike in continuing claims the prior week reversing back down. Conditions remain strong, with no apparent layoff activity.

Question of the Week

What should we make of all this tariff talk? How do today's current/proposed tariffs compare with those of the past?

Tariffs continue to be newsworthy, with the prior Sunday's announcement of 25% rates on all steel and aluminum imports. These would be in addition to the earlier, but later postponed for at least a month, tariffs of 25% on all goods from Canada and Mexico, 10% on Canadian energy, and 10% on China. A variety of other ideas have been suggested, with 'reciprocal' tariffs being announced in concept later last week on all trading partners. In that case, 'reciprocal' implies that any tariffs (and other barriers, such as onerous regulations, subsidies, and exchange rate policies) imposed on the U.S. would be matched one for one. Though, there hasn't been a set timeline other than somewhere between April and August. Per comments from the administration, such a plan would take the place of an across-the-board tariff discussed extensively during the campaign, which is the part that likely provided financial markets the biggest sigh of relief, at least for the time being.

While dramatic and newsworthy, the mainstream economist community continues to assume that final tariff levels will be far lower and less problematic than historic peaks. While they will likely raise the weighted average tariff rate from recent levels, this rate has been hovering near 5%. That is well within the low range of where they've fallen since around 1980—a period of historically-low tariffs as well a robust economic growth, tied in with rising globalization.

Since America's founding, tariffs and excise taxes have been used either exclusively or sporadically as a revenue generator. In the 18th and 19th centuries, tariffs of 20-60% were regularly imposed, in a period when trade was far less efficient and integrated. At the same time, tariff policy in the period was fraught with contentious political battles, as individual tariffs helped/hurt some products/regions of the country more than others. In the 20th century, the introduction of the U.S. income tax in 1913 reduced the reliance on tariff income, as average rates were lowered under 10% for a time. However, the last major bout of punitive trade, with the Smoot-Hawley Act of 1930, where tariffs again peaked at around 20%, was thought to have been a partial cause of exacerbating and lengthening the Great Depression. In a reversal to undo some of that damage, the Reciprocal Trade Agreements Act of 1934 (RTAA) set the stage for a gradual lowering of high tariffs. This ushered in an age of globalization after World War II, which continued with the General Agreement on Tariffs and Trade (GATT) in 1947 and World Trade Organization (WTO) in 1994.

Per statistics from Deutsche Bank, the U.S. accounts for 29% of global consumption, but only 15% of goods production. China provides the reverse, at only 12% of consumption, and 32% of global manufacturing. By contrast, Europe is more balanced, at just under 15% in each. While these tendencies have created a natural trade relationship over the last 20+ years, after China's WTO entry, the imbalances have created some negative side effects, which the current U.S. administration has implied they're trying to correct. China's entry into the WTO in 2001 is looked at in hindsight as a major catalyst by many for an era of cheap goods production and the fatal blow for a variety of U.S. manufacturing sectors, which had been in decline for decades. That decline in mainstream U.S. manufacturing has been blamed by some observers as a catalyst for not only economic but also social deterioration in some regions of the country, including job loss, poverty, substance abuse, and other negative societal outcomes—with the accompanying frustration at least partially behind recent political shifts. (Ironically, this is not dissimilar to the populist movement of the late 1800s-early 1900s during the President McKinley era.) While economists don't expect levels in the current administration to return to the earlier type of isolationist and restrictive policies, the global environment could become more uncertain than we've become used to, perhaps as that era of 'peak globalization' has evolved toward a variety of nations deciding to 're-shore' manufacturing and structure more advantageous trade relationships for themselves.

While these trade policy announcements are cheered by some and denounced by others, it's probably helpful to take a step back and look at the big picture. These appear to be a political attempt at a negotiation starting point, by sounding the alarm, so to speak, that the U.S. is interested in renegotiating and resetting trade relationships around the world—especially agreements that don't appear to work in favor of U.S. interests. Despite the sometimes-dramatic news announcements, any renegotiations will no doubt take more time than a weekend to fully unfold.

Financial markets seem to have become less fazed as time has gone on, with the assumption these are indeed negotiation starting points, as opposed to opening rounds of an all-out trade war. (Although more extreme global tariff policy always remains a tail risk.) The lack of clarity is no doubt intentional, as it allows open-ended discussion and other nations to save face. At the very least, the path to getting there continues to heighten general uncertainty. In the end, the global sectors most likely targeted in the near-term include 'critical imports' like pharmaceuticals and semiconductors, as well as European autos. Technology, and especially that related to artificial intelligence, has been of growing concern as a commercial but also a national security issue, which has support from both political parties.

Many mainstream economists, though, continue to find tariffs an outdated and unappealing strategy, with undesired side effects over time, such as slower global economic growth. A direct impact of imposing tariffs has been a stronger U.S. dollar, and weaker foreign currencies, as markets adjust the latter to make them more competitive as a result of the tariff. In broader asset classes, stock markets are focused on the impact on earnings (mixed by sector and company), while bond markets remain watchful of inflation (and Fed) effects.

It's also worth noting that, in the modern age, global trade policies can have a self-correcting element. This implies that any trade policies that end up going 'too far' or tariff rates that end up 'too high' will end up hurting all countries involved—by not only undermining inherent efficiencies that make global trade attractive and cost-effective in the first place but also raising inflation and/or slowing economic growth too much. Those two negative outcomes end up being very apparent to voters soon enough, so usually are the last things an administration wants to end up on the wrong side of. This is one of the reasons why mid-term elections—now only a year and a half away—have been historically prone to leadership reversals if policy effects start to go wrong.

Market Notes

Period ending 2/14/2025	**1 Week %**	**YTD %**
DJIA	0.65	4.89
S&P 500	1.52	4.11
NASDAQ	2.60	3.76
Russell 2000	0.05	2.33
MSCI-EAFE	2.65	8.30
MSCI-EM	1.54	4.79
Bloomberg U.S. Aggregate	0.19	1.12

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2024	4.37	4.25	4.38	4.58	4.78
2/7/2025	4.35	4.29	4.34	4.49	4.69
2/14/2025	4.34	4.26	4.33	4.47	4.69

U.S. stocks saw gains overall, although the week saw its share of uncertainty, mostly on the tariff front. There was a bit of a hiccup mid-week, after the especially hot CPI inflation report, which continues to push out the possibility of further Federal Reserve rate cuts in the near term. Markets turned upward with rising odds of a Ukraine-Russia peace deal, which was reportedly being discussed in Munich. As noted earlier, announcements of tariffs on steel/aluminum and 'reciprocal' tariffs on all countries were seen as less severe than feared, as recent tariff comments have not been reacted to as strongly as they once might have been, and the decision to not introduce full global tariffs provided some relief. Growth stocks broadly outperformed value, and large cap outgained small. By sector, technology gained nearly 4% for the week, followed by the mix of communications, materials, energy, and consumer staples. Healthcare lagged with a decline of over a percent. Real estate saw a small gain.

Fed Chair Powell's prepared testimony to the Senate Banking Committee last week featured no real surprises. He noted that the FOMC did "not need to be in a hurry to adjust our policy stance," with the policy rate "significantly less restrictive than it had been." Also mentioned was that long-term inflation expectations remained well anchored, and that labor wasn't a source of significant inflation at present. Perhaps importantly he noted that the neutral rate was "meaningfully higher" than its very low level pre-pandemic, although it's "very hard to be precise about it." In response to tariff impacts, he reminded that the FOMC ended up cutting rates in 2019, after supposedly inflationary tariffs were implemented the last time.

Foreign stocks fared generally better than domestic, with help from a roughly one percent drop in the U.S. dollar for the week. Europe led the way, up over 3% in U.S. terms, although the U.K. and emerging markets also saw decent gains. European equities were led by stronger earnings reports in addition to potential diplomatic signs of an end to the Ukraine-Russia conflict, which has weighed on sentiment to a large extent there for several years. In EM, Chinese stocks rose over 7%, followed by Mexico and South Korea, with some apparent relief that the U.S. administration's early tariff options weren't more damaging.

Bonds saw minor gains, despite little change in the yield curve, as credit spreads tightened a bit. High yield corporates outperformed investment grade debt slightly, while foreign bonds benefited from a weaker dollar.

Commodities saw gains overall, along with the weaker dollar. Agricultural prices rose by several percent, led by wheat and sugar. Crude oil prices were down a fraction of a percent last week to $71/barrel, while natural gas prices spiked by over 12% along with cold weather heating needs around the country (this offset some rumors about an early-stage Ukraine-Russia peace deal, that could lower gas costs in Europe significantly). Not often in the spotlight, 'soft' commodities like coffee and cocoa have seen upward price pressures over the last three months, due to a weather mix in key growing regions of not enough rain in Brazil and too much in West Africa.

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, Univ. of Michigan, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

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Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.