

## Week in review and ahead (vol.21)



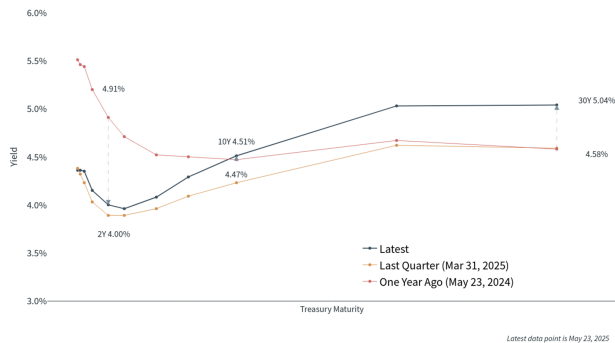
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May 26, 2025

Equity markets in the US retraced as long-term bond yields rose following the house narrowly passing the proposed tax bill (by one vote) and sending it on to the US Senate. Bond markets in the US reacted to concerns that much of the bill's increased spending is frontloaded adding (initially) to the federal deficit, while cuts are expected to occur in the outer years. The 30-year and 10-year treasury yields spiked well above key levels of 5% and 4.5%, respectively, as the bill passed the house vote, moderating somewhat to end the week just above those levels. The steepening of the yield curve in three (3) months' time has been significant with many market participants expecting it to continue. Accordingly, market pricing for credit default swaps for the US sovereign debt has risen as of late to levels reflecting pricing that is at odds with the current credit rating of the US. Similarly, should the bear steepening progress, as some market participants are predicting, it could raise questions about equity valuations which have significantly rebounded as of late yielding a price-earnings ('P/E') ratio of approximately 23.7x on the S&P. As reference, over the last five (5) years the P/E ratio ranged between 19.4x and 24.3x

## Treasury Yield Curve

The shape of the U.S. Treasury curve last year versus today



Latest data point is May 23, 2025

Sources: Clearnomics, Federal Reserve  
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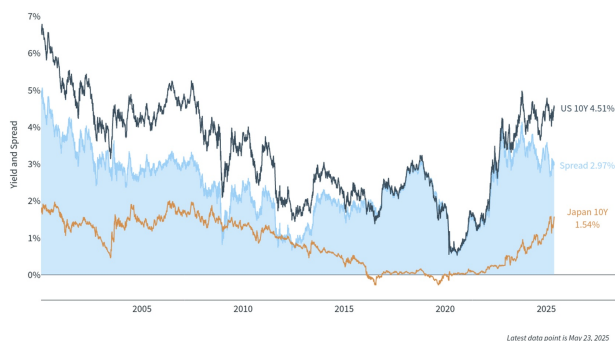
Simultaneously, long-term yields globally, but particularly in the UK and Japan experienced notable steepening as well. In the UK that saw inflation surprise markets by increasing to 3.5% in April, up from 2.6% in March, increasing concerns that the Bank of England's monetary policy may be disconnected with UK's economic and fiscal outlook added to the selloff in gilts, elevating long-term yields, with the 30-year gilt yields reaching levels not seen since 1988. The Bank of England had been easing its monetary policy, cutting the Bank Rate by 100 basis-points (bps) from 5.25% to 4.25% since August 2024. In Japan, meanwhile, markets are reassessing the country's fiscal sustainability and

inflationary risks after years of flat or inverted yield curve.

While the steepening of the yield curve arguably reflects a general re-evaluation of sovereign risks and long-term fiscal stability globally, the rate at which the steepening, particularly the rising of long-term maturities is occurring, is somewhat of a concern. Specifically, Japan's movements are disconcerting to some market participants, as the unwind of the "yen carry trade" last August triggered a global selloff in equities, with the S&P declining 3% on a single day. JP Morgan at the time (on or about October 2024) had estimated, with exact figures difficult to assert, that about 65-75% of the global carry trade had effectively been unwound.

## U.S. and Japan Interest Rates

Yields and spread between U.S. 10Y Treasury and Japan 10Y Government Bond



Latest data point is May 23, 2025

Sources: Clearnomics, U.S. Treasury, LSEG  
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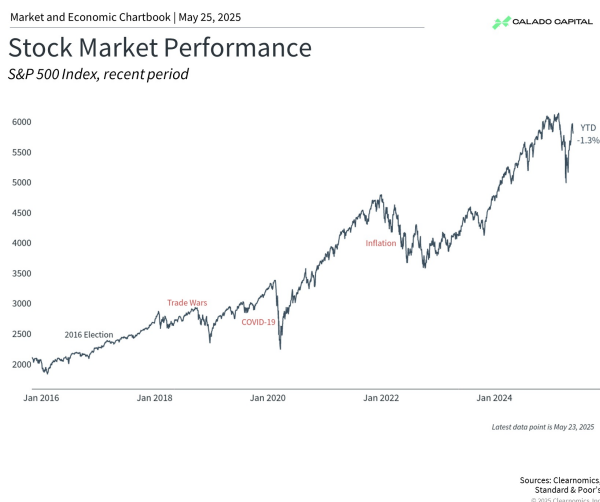
The S&P500 retraced 2.6% for the week with the Dow Jones and tech-heavy Nasdaq seeing similar declines for the week of 2.5%, respectively. The declines impacted all the S&P sectors lead by energy with a weekly decline of 4.4% followed by tech, real estate and consumer discretionary declining by -3.5%, -3.3% and -3.1%, respectively.

With yet another weekly decline, all major US indices turned negative again for the year after a weeklong rally that saw the S&P rebound nearly 20% from the lows on April 8th. Concerns about increased deficits, reflected in the steepening of the yield curve, and renewed tariff risks to

nations (with POTUS looking to impose 50% tariffs on the EU effective June 1st, only to retract it Sunday) and specific companies (by threatening removal of current exemptions to Apple and subsequently extending it to Samsung covering a large share of the smartphone market) led to the markets selling off towards the end of the week.

Globally, all major indices declined following the rise in long-term yields, except for London and

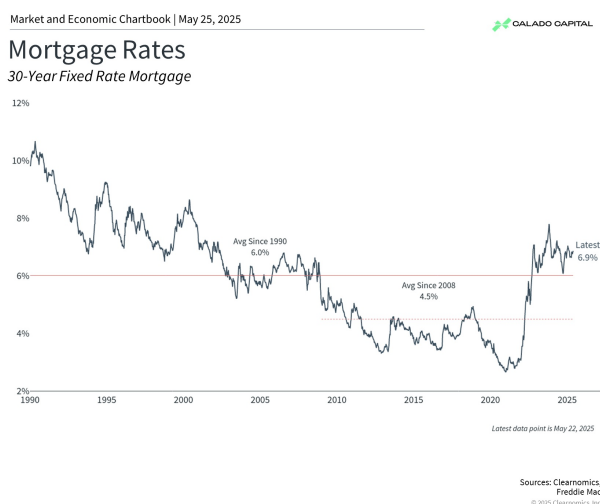
Hong Kong that showed gains of 0.4% and 1.1%, respectively.



With little macroeconomic data reported last week, markets focused on the tax bill that narrowly passed the house and its now making its way to the Senate where changes (to the current bill) are expected. Leading economic indicators continued to deteriorate, coming in at -1.0% for April compared to -0.9% expected and -0.8% in March. The labor market, however, continues to be resilient, with initial jobless claims of 227K just below the 230K expected and the 229K reported the week prior. Continuing claims did surpass 1.9M for the second time in four (4) weeks and are projected to climb higher in the coming weeks. If confirmed, this may indicate some cooling in the labor market as finding

employment (after a layoff) may become more challenging.

The S&P flash PMI readings (or preliminary readings) for the US service and manufacturing sectors did surprise with both showing a (preliminary) reading of 52.3 for May, well above expectations and the prior month, or in expansionary territory. With respect to the housing market, data reported last week was mixed that saw existing home sales unexpectedly fall to 4M, the slowest April since 2009 and signaling a weak start to the spring selling season, while new home sales increased to 743K the highest in more than three (3) years. Home builders do have the ability to offer discounted financing rates which attract buyers particularly in periods when US 30-year mortgage rates jump above 7%.



This week begins with markets in the US closed to observe Memorial Day. Thereafter, markets will focus on the Fed's FOMC meeting minutes due on Wednesday as well as inflation in general with the Fed's closely watched PCE inflation index for April due on Friday that may reflect some initial tariff impact. Estimates for April remain moderate, with month-over-month ('MoM') and year-over-year ('YoY') core PCE inflation index expected to increase by 0.1% and 2.6%, respectively, moderately up from March.

Prior to, markets will focus on the first revision to Q1 GDP on Thursday, which is expected to confirm the preliminary

decline of -0.3% for the quarter as well as initial jobless claims to be reported on the same day with little changes of 228K expected. On Tuesday, durable goods orders for April are expected to retreat

significantly, by -7.8%, after March had shown a significant increase of 9.2% as many may have processed orders ahead of tariffs. The upcoming week will also provide an update on consumer sentiment with the survey conducted by the University of Michigan expected to show a further decline in sentiment.

If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at [claudio@caladocapital.com](mailto:claudio@caladocapital.com).

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