



HIGHLIGHTS

- Where Do We Stand with Tariffs and How Important Are They for Markets?
- **Economic Preview:** ISM Data and May Jobs Report in Focus
- Assessing the Market's Performance Since the April Lows
- What is the TACO Trade? (And Why It Matters to You)
- Credit Spreads: Some Deterioration Warrants Attention

STOCKS

S&P 500

- Technical View: The trend in the S&P 500 shifted from bearish to neutral in mid-May after the index broke above the March highs and approached its records.
- Dow Theory: **Bearish since the week-ending March 14, 2025**
- Key Resistance Levels: 5969, 6025, 6115
- Key Support Levels: 5803, 5687, 5561



“Stocks rose modestly last week thanks to several positive trade-war headlines, including President Trump delaying increased tariffs on the EU and after a court ruling invalidated many of the 2025 tariffs.”

SOURCE: Factset and Vann Equity Management Research Team

- ✓ **What is Outperforming:** Defensive sector, minimum volatility, and sectors linked to higher rates have relatively outperformed recently as markets have become more volatile.
- ✓ **What is Underperforming:** Tech/growth and high valuation stocks have lagged as yields have risen.

Where Do We Stand with Tariffs and How Important Are They for Markets?

Last week, the landscape surrounding tariffs was abruptly upended when the Court of International Trade blocked most of the administration's 2025 tariffs. The court ruled that the legal foundation for those tariffs, the International Emergency Economic Powers Act (IEEPA), does not grant the president the authority to impose such measures. However, less than 24 hours later, the U.S. Court of Appeals for the Federal Circuit issued a stay on that ruling during the appeals process. As a result, the tariffs remain in effect until a final decision is made, likely in the coming weeks, and possibly by the Supreme Court.



From a market perspective, our investment team believes the development has bullish implications on the surface. Most analysts concur that, despite these tariffs, equity markets would likely be trading near all-time highs. However, this court decision does not constitute a materially bullish shift, and it does not meaningfully alter the outlook for equality. ***Our investment committee continues to maintain a constructive long-term view, but the near-term environment remains highly uncertain.***

Above all else, financial markets and broader economies require clarity in order to function efficiently. By their nature, tariffs create friction and uncertainty, both of which weigh on growth and earnings. The central issue now is not whether tariffs are a headwind, but rather the extent of that headwind.

In recent weeks, investors and businesses have largely come to terms with the likelihood of a 10% global tariff regime, with elevated rates in specific sectors such as steel and Chinese imports. The prevailing consensus was that, while not ideal, such a structure was manageable and would not pose a significant threat to economic momentum. The recent court decision, while increasing the chances of temporary tariff relief, simultaneously reintroduces legal and policy uncertainty, which markets tend to view as inherently negative. Put simply, uncertainty leads to caution, and excessive caution can ultimately stall economic growth.

Few expect the tariffs to disappear entirely, even if the courts ultimately rule against the administration. What is more likely is a rotating legal justification, as the administration pivots from one statute to another in an effort to maintain its trade agenda. This could result in a prolonged cycle of litigation and shifting enforcement mechanisms. In this scenario, expect to hear more about Section 122 and Section 301 tariffs in the news, which are the next likely tools if IEEPA is invalidated.

In absolute terms, this week's legal development can be considered a modest positive for growth, as it reduces the probability of the most extreme tariff outcomes. However, it is not an unqualified win. It has likely set off a chain reaction in which the administration simply reaches for another legal basis to reimpose similar measures. It is important to recognize that the administration remains committed to these tariffs as a matter of policy and is unlikely to retreat from them without exhausting every legal option.

This dynamic is not inherently negative, but it does disrupt what appears to be an emerging consensus around trade expectations. Just as businesses and consumers began to believe there was some level of predictability, they now face what could be several months of renewed trade uncertainty. That uncertainty is, at best, a moderate drag on growth and corporate performance.

In summary, ***our investment team continues to maintain a cautious stance on the market. While tariff headlines will capture media attention, we believe the focus should remain squarely on the underlying economic data.*** This is a crucial week for macroeconomic releases. If the data confirms the soft patches we observed last week, then tariff developments will take a back seat to rising concerns about a broader slowdown. Should that occur, markets are vulnerable to a meaningful pullback. In our view, equities are not currently priced to reflect the risk of a true economic downturn, a 5% decline would barely scratch the surface.

Given this outlook, we continue to favor a defensive positioning within portfolios. Our preference is to remain long, as we believe the intermediate to long-term backdrop remains supportive. In this environment, defensive positioning offers participation in potential upside while mitigating exposure to the kind of volatility that could accompany a deeper



economic contraction. A 10% drop in the S&P 500 remains a very real possibility should macro conditions deteriorate further, and that risk must be respected.

Economic Data (What You Need to Know in Plain English)

After several weeks of quiet on the economic front, this June kicks off with several potentially important economic reports and will provide a lot more insight into just how much damage the tariffs and policy volatility have done to the economy. From a market standpoint, the better the data, the better for stocks, especially given the suspension of the tariffs late last week, as the potential elimination of tariffs makes an economic slowdown less likely.

The key prints this week is Friday's jobs report. This data is especially important because continued solid job growth will push back on slowdown fears, and that will be positive for stocks. However, ***if job growth slows materially, that will dramatically increase concerns about economic growth***, and while the tariff suspension could cushion the blow somewhat from a weak number, the bottom line is that economic anxiety will rise. ***The unemployment rate (currently 4.3%) is now one of the most important, if not the most important, economic reports in the market.***

The next most important economic reports this week are the ISM Manufacturing PMI (today, Monday 06/02/2025) and the ISM Services PMI (Wednesday). The critical level for both remains 50, and, positively, the ISM Services PMI moved further above that level last month. The manufacturing PMI did not, as it remains below 50. However, the last few years have shown us that, by itself, this is not a clearly negative signal on the economy (the manufacturing PMI was under 50 for months, and growth held up just fine). ***The key here is the Services PMI. If it drops below 50 for a few months (one to three), that is a very negative signal of growth***, and as such, the stronger this number, the better for markets.

In addition to the jobs report, there are several other labor market indicators next week, including JOLTS on Tuesday, ADP on Wednesday, and jobless claims on Thursday (which rose modestly last week). Bottom line, the totality of the data should give us a pretty good look at the state of the labor market as we move into the summer.

Bottom line: Whether the economy can hold on is the key question for markets beyond the short term. And while bears will dismiss solid data as still not having enough time to reflect the impact of the tariffs (and to a point that is fair, although it has been two solid months of tariff chaos), the reality is that if the totality of the labor market is solid, the chances for an economic slowdown near term will remain low.

Special Reports and Editorial

Assessing the Market's Performance Since the April Lows

We recently received a press inquiry regarding the strong performance in "riskier" and "lower quality" stocks since the April lows were established, and specifically, if that strength in riskier corners of the market suggested a new leg of the bull market had commenced. The short answer is "no," as the outperformance of growth-focused and technology-oriented equities since April is masking the deeper drawdowns those names suffered during the late-Q1/early-Q2 market rout. We are simply seeing high-beta stocks live up to that label as they underperformed on the way down and have since



outperformed on the way up.

To confirm this idea, we can simply look at YTD returns for different investment styles, sectors, and indexes, which reveals that historically stable, value-oriented corners of the market with defensive qualities continue to outperform in 2025.

Starting with investment styles, it is true that growth has handily outperformed value since the April lows as the former has enjoyed a trough-to-peak rally of more than 30%, while the latter is up just 13% since the YTD lows. However, in YTD terms, value (VTV: +1.22% YTD) is still modestly outperforming growth (VUG: +0.95% YTD). Furthermore, the more economically sensitive equity benchmarks, the small-cap Russell 2000 and Dow Jones Transportation Average, are down 7.03% and 6.81%, respectively, YTD compared to the S&P 500's modest 0.74% gain in 2025.

Looking at individual market sector performance so far this year furthers the point as traditional defensives are maintaining solid outperformance over their cyclical peers YTD, despite giving up some ground since the April lows. The more-than-8% performance gap between Consumer Discretionary (XLY: -4.22% YTD) and Consumer Staples (XLP: +4.03% YTD) points to clear defensive positioning and highlights investor concerns about the outlook for consumer spending and the economy more broadly in H2'25, while the strength in Utilities (XLU: +6.39% YTD) and weakness in Tech stocks (XLK: -0.55% YTD) more deeply underpin the fact that risk appetites remain suppressed despite the risk-on rally we have seen off the early Q2 lows. And without renewed leadership from mega-cap tech, other growth-focused segments, and inherently riskier corners of the market, it will be hard for the major indexes to mount a sustainable advance to new highs in 2025.

What is the TACO Trade? (And Why It Matters to You)

The five years seem to have produced the never-ending acronyms traders come up with to describe the markets, and they have done it again with the newly coined "TACO" trade. To that point, the TACO trade is being bounced around by the bulls to help explain why they remain bullish despite tariffs and more trade uncertainty.

What is the TACO trade? The TACO trade is this: Tump Always Chickens Out. The trade is based on the idea that Trump makes an outlandish and significant tariff proposal on a major U.S. trading partner (China, the EU, Mexico and Canada), but within a matter of days, backtracks and either delays the implementation or exempts enough goods that the tariff itself loses much of its bite.

Does Trump always chicken out? So far, yes (at least compared to his tariff threats). Trump exempted USMCA goods from additional Mexico/Canada tariffs, dramatically reducing the impact. Trump postponed all "reciprocal" tariffs against U.S. trading partners just a week after the "Liberation Day" announcement. Trump reduced exorbitant Chinese tariffs a few weeks after implementation, and Trump backed off his threat of 50% tariffs on the EU (they were delayed till July 9, which is the expiration date for the rest of the reciprocal tariff exemptions).

So, has the TACO trade worked? Yes. The thesis behind the TACO trade is: Buy the Trump tariff dip. Essentially, Trump has proven to investors that he won't actually follow through with draconian tariffs. As such, any sell-off following a dramatic tariff threat should be bought. And buying the Trump tariff dip has worked:

- The S&P 500 has gained 2% since the March 4 tariffs on China and Mexico.
- The S&P 500 has rallied nearly 10% from the April 2 "Liberation Day" declines and 11% from the date Trump announced 145% tariffs on China (April 11).
- Finally, the index is higher than it was prior to Friday's 50% tariff threat against the EU.



So, the returns are somewhat conclusive: The TACO trade has worked, and buying stocks on extreme tariff-related threats has worked.

Will it continue to work? Probably. Traders and investors may need to be a bit more cautious when they buy because the existence of the TACO trade means tariff-related declines should be more shallow than before. That said, history does suggest that Trump will not follow through on tariff threats that are destabilizing or extreme. Instead, they appear to be part of his negotiation strategy: *Threaten an absurdity to achieve a more moderate goal (and that negotiation strategy is working).*

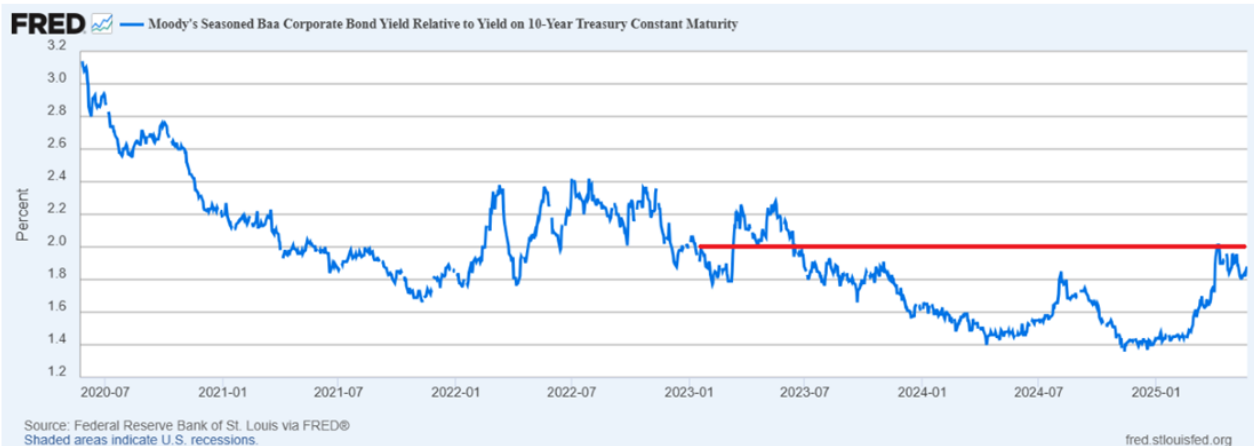
Does the TACO trade mean we do not need to worry about tariffs or the trade war? Absolutely not. Just because Trump appears to consistently back off the most extreme tariff threats, more times than not, he moves the needle. Consider: There are 10% tariffs in place for all U.S. trading partners, with 35% tariffs on Chinese imports and 25% tariffs on steel and non-USMCA products from Canada and Mexico (energy products are tariffed at 10%). None of these are as intense as the original threats, but they are all still much, much higher than they were pre-Trump. And we do not know what those tariffs will do to the economy or inflation. ***The TACO trade should not make us complacent about tariff/trade-war risks for this simple reason: Just because something is not as bad as feared, it does not mean it is not bad.***

As such, while the TACO trade has worked and likely will continue to work in the short term when Trump makes bold tariff threats, it doesn't eliminate the reality that the tariff burden for the U.S. economy and globally is at a multi-decade high and that will 1) Slow growth and 2) Boost inflation. What will determine a rally or decline in stocks is how much of an impact there will be.

Credit Spreads: Some Deterioration Warrants Attention

In volatile and headline-driven markets that are characterized by extreme swings in sentiment, applying a cross-asset approach to confirm opinions or interpret data can be essential in identifying the dominant market trend and filtering out the day-to-day noise. That principle has proven especially relevant so far in 2025, and it is one of the reasons our investment team is closely monitoring the continued deterioration in credit spreads. If this trend persists, it may begin to signal rising risks to economic growth.

As a refresher, credit spreads represent the difference in yields between two bonds of similar maturities but differing credit qualities. For example, the spread between the yield on a 10-year Treasury bond, which remains the benchmark for a risk-free rate, and the yield on a 10-year corporate bond, or more commonly, an index of similarly dated corporate bonds. Analysts track credit spreads because they reflect bond investors' expectations for future economic conditions.



Credit Spreads: The bond market has quietly shown increased concerns about future U.S. growth. While this isn't a "warning sign" yet from credit spreads, it shouldn't be ignored.

Currently, the Baa spread stands at 1.88%. While this is not as elevated as it was immediately following what has become known as "Liberation Day," it remains significantly higher than the levels observed throughout much of the past year. This suggests that the bond market is becoming increasingly aware of downside risks to growth.

The Baa spread initially surged above 2.00 % in the wake of Liberation Day, driven by reciprocal tariff announcements that increased concerns about an economic slowdown. Since then, a temporary easing and partial reversal of those tariffs caused the spread to pull back, although it only fell to 1.80% before beginning to rise again.

To understand the significance of the current 1.88% level, it is useful to recall that the last time this spread reached that height prior to April was in November 2023. At that time, the Federal Reserve was still actively increasing interest rates, and the fed funds rate was materially higher than it is today. In other words, the market's concerns about a slowdown were more justifiable then. That makes the current rise in credit spreads all the more noteworthy.

This increase in spreads is beginning to create a divergence between the bond and equity markets. The S&P 500 has returned to levels last seen in early March, prior to the latest tariff escalation. However, back in March, the Baa spread was closer to 1.60%, which indicated a more neutral outlook from the bond market.

At this stage, a spread of 1.88 % is not yet a clear warning signal, but it is evidence that bond investors are becoming more cautious regarding economic risks. If the spread over Treasuries were to move consistently above 2.00%, that would represent a more serious warning that markets are beginning to price in the increasing probability of a hard landing.

Should that occur, and depending on the catalysts behind the move, we would need to evaluate and potentially implement a more defensive positioning within our equity strategies. Given the recent rise in spreads, we intend to continue monitoring this metric very closely. Credit spreads have historically served as a reliable early indicator of economic stress, and this is one warning that our investment team does not intend to overlook.



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