

The Great Inflation Comeback Of 2025

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Executive Summary

Insufficient Tightening Of Monetary Policy



Insufficient tightening of monetary policy, immigration, and reshoring helped the U.S. side-step a 2024 recession and S&P 500 earnings contraction. The 100bps of easing against an economy running just below peak cyclical capacity suggests stronger growth and inflation in 2025.

“Inflationary” Green Shoots



The underlying drivers and leading indicators of inflation suggest that it has not been tamed. The output gap, labor markets, and credit growth likely work to push prices higher in 2025. The Fed remains in wait-and-see mode in the near term before ultimately reversing course later this year.

Policy Proposals Could Exacerbate Inflation



The primary policy proposals of the incoming Administration have the potential to exacerbate the upward trend in inflation. The macro headwinds from tariffs and reduced labor supply likely prove more consequential to the direction of equity markets than austerity measures.

Five Concerns For 2025



Apart from inflation, risks to U.S. equities stem largely from fiscal policy and the debt/deficit driving bond yields to levels inconsistent with current equity market valuations. A global economic recovery could also spark a rotation out of the domestic “safety” trade and the USD.

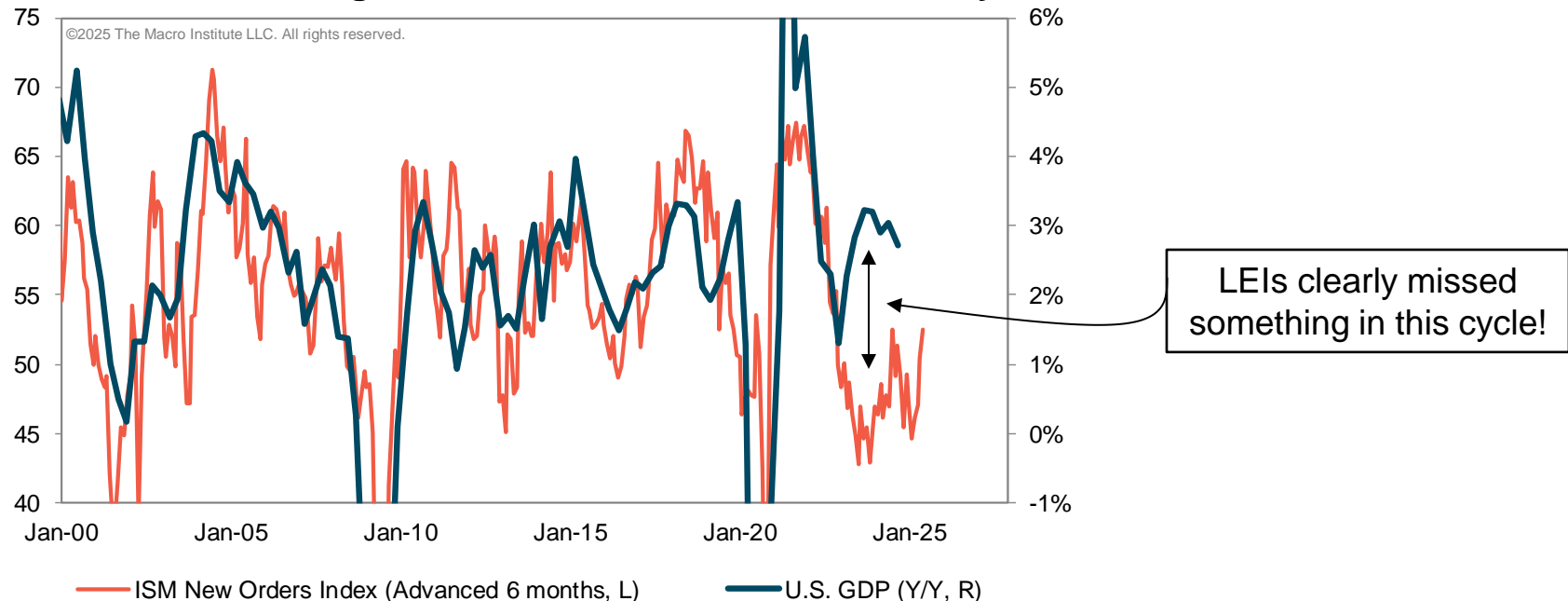
Long: Small Cap, Cyclical, & Pricing Power



Many anticipatory and leading indicators of the global economy suggest growth and inflation move higher in 2025. Under this backdrop, we favor Small Cap, Cyclical and businesses with Pricing Power. We expect higher bond yields and further Fed tightening.

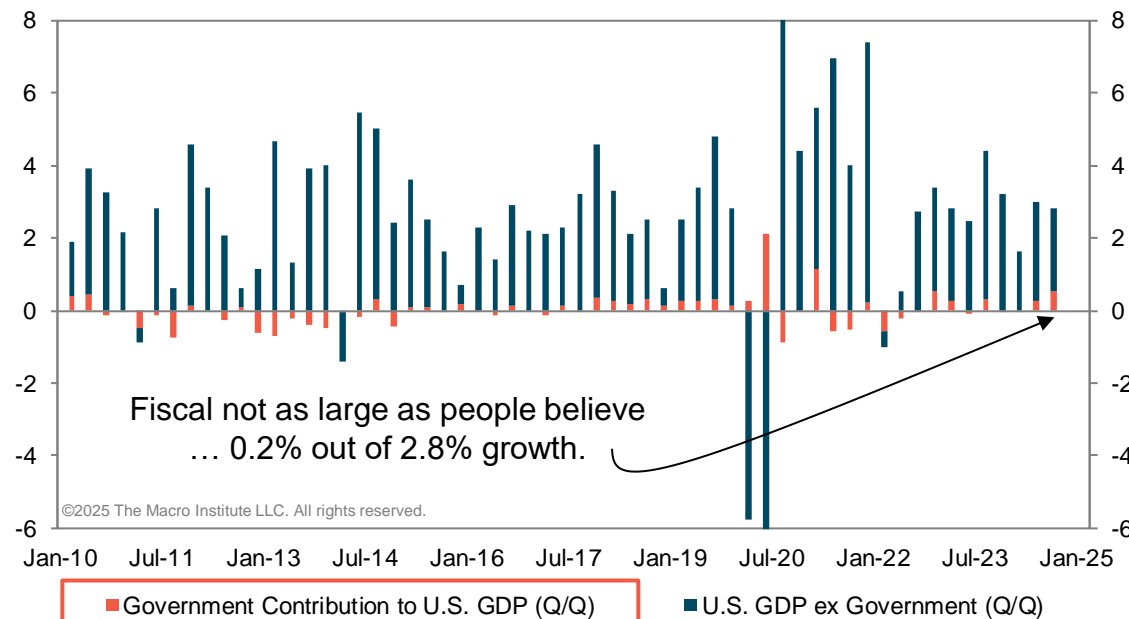
U.S. GDP Growth Usually Follows The Path Of Leading Indicators

An Unusual Divergence Between LEIs And The Economy



Consensus Mostly Points To Fiscal Policy As Source Of Economic Momentum

Fiscal Policy Not Adding As Much To GDP As Investors Believe

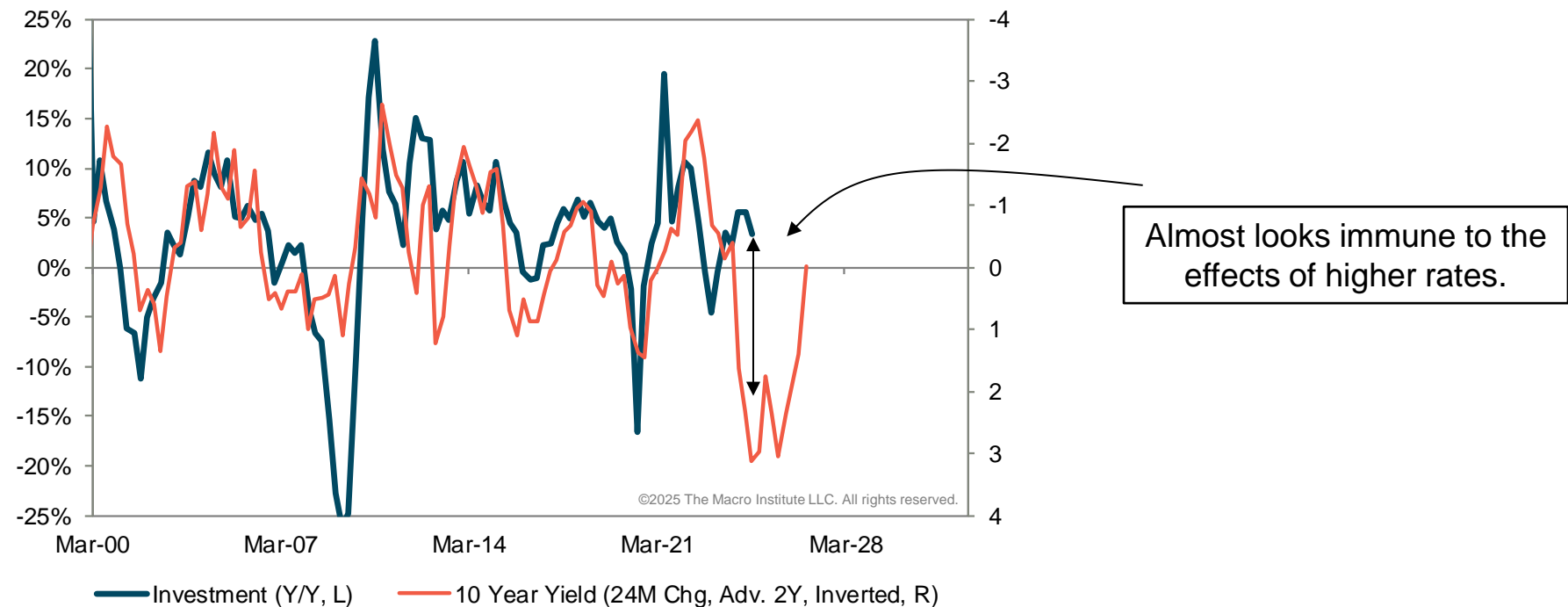


Unusual Forces At Play In 2024

1. Investments (Reshoring)
2. Consumption (Immigration)
3. Fed Not Restrictive Enough

Investments: A Truly Unprecedented Cycle For U.S. Investment Spending

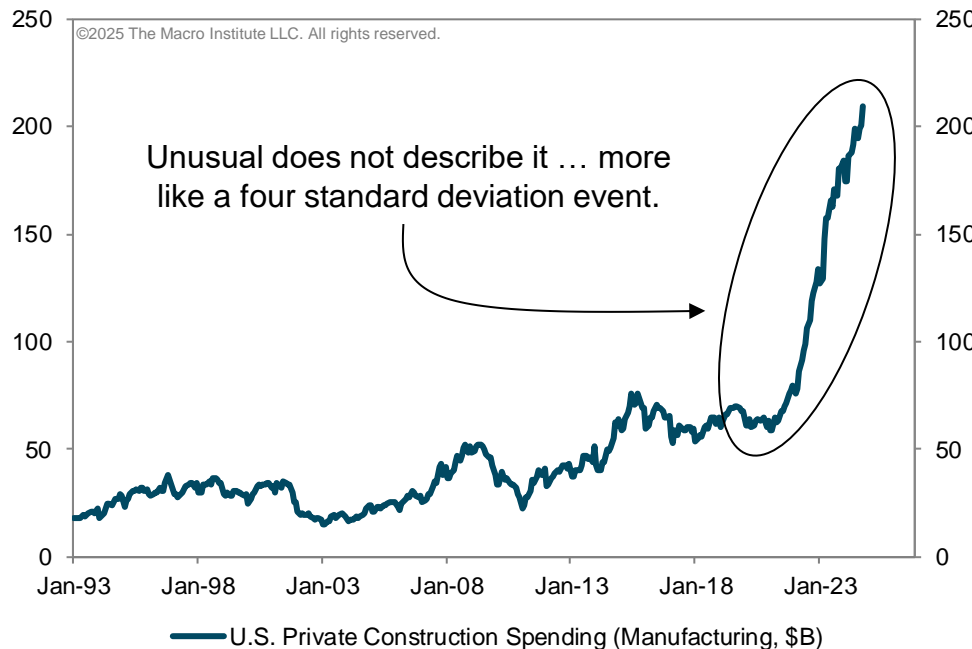
Investments Still Growing Despite Headwind From Interest Rates



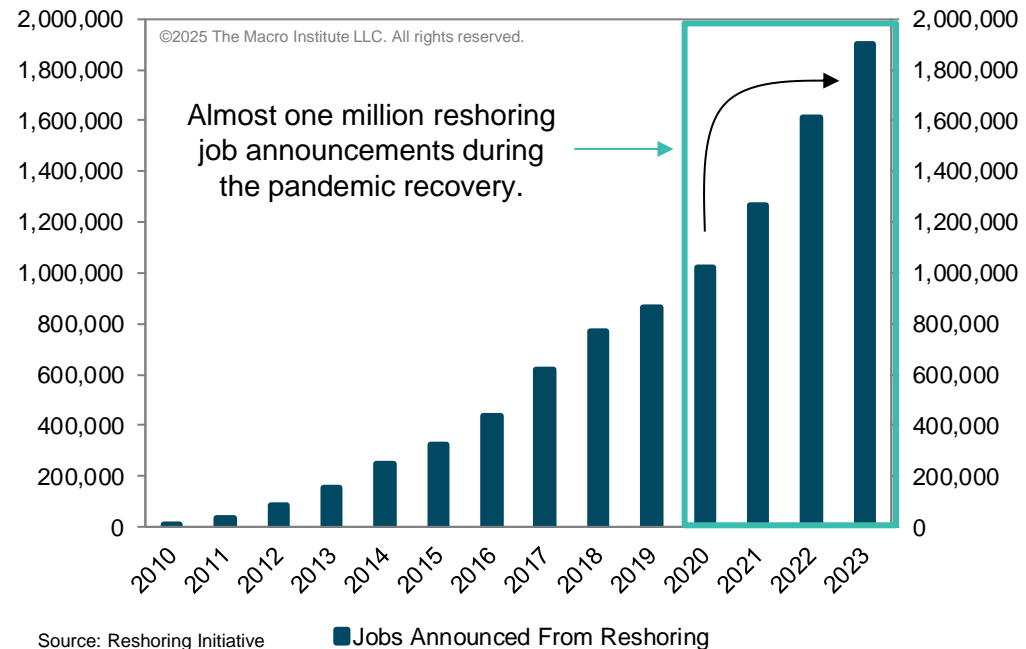
Introduction: An Unusual And Problematic Economic Cycle

Reshoring: A Structural Phenomena With Cyclical Implications

Robust Manufacturing Spend Amidst Tightening

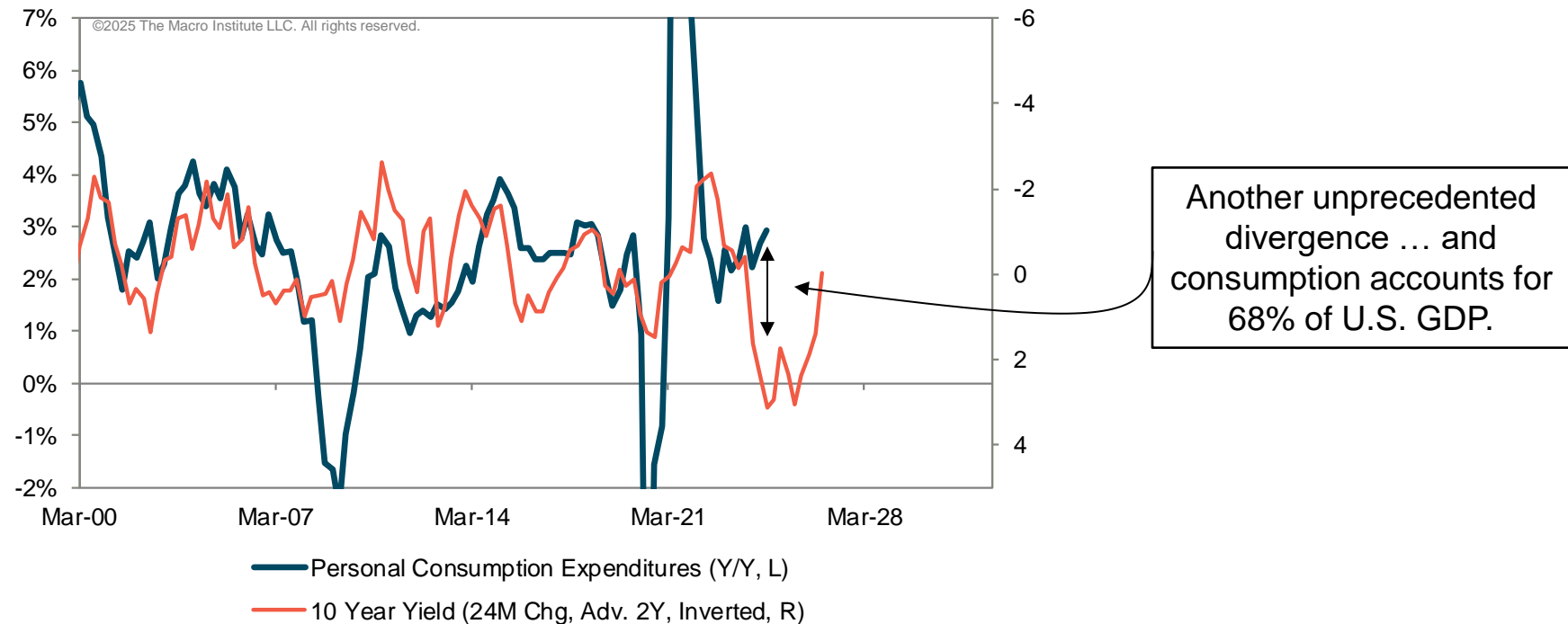


Cumulative Reshoring Jobs Announced



Consumption: Almost Looks Immune To The Effects Of Higher Interest Rates

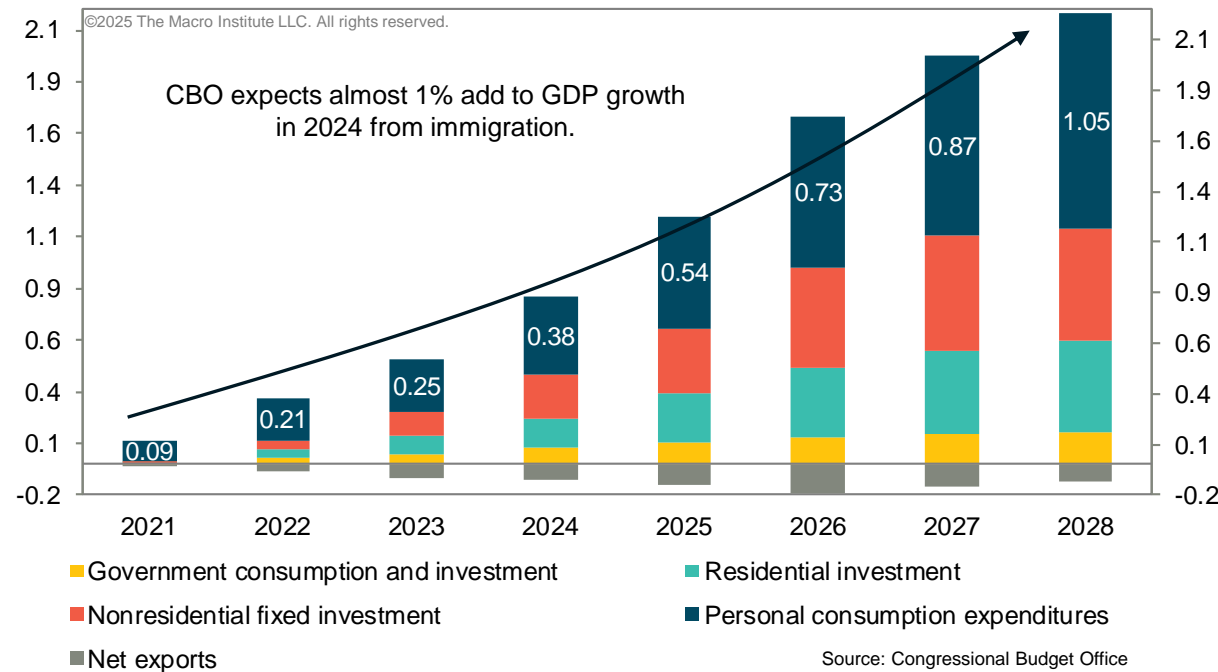
Consumption Still Growing Despite Headwind From Interest Rates



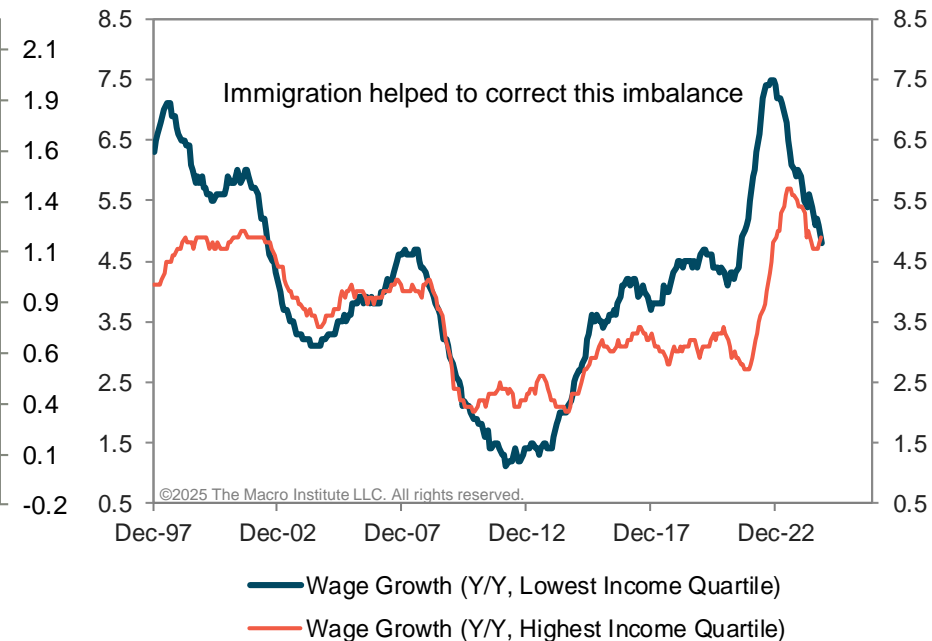
Introduction: An Unusual And Problematic Economic Cycle

Immigration: Added To Consumption And Weighed On Wage Inflation

GDP Tailwinds From Immigration Largely Consumption Driven

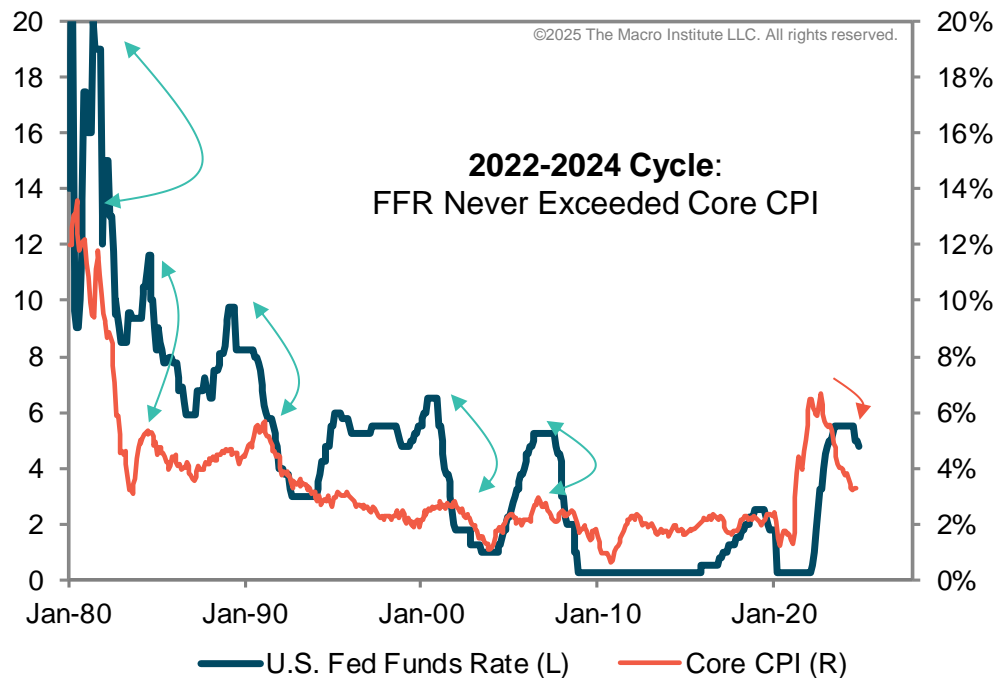


Immigration Also Helped Fed's Inflation Fight



Monetary Policy's Relationship With Inflation Very Different Than In The Past

Behavior Of Fed Very Different This Time Around



FFR Peak Usually > Core CPI Peak

Period	FFR Peak		Core CPI Peak	Ratio
2022-24	5.50%	<	6.6%	0.83
2006	5.25%	>	2.9%	1.81
1999	6.50%	>	2.8%	2.32
1989-91	9.75%	>	5.7%	1.71
1984	11.63%	>	5.3%	2.19
1980	20.00%	>	13.6%	1.47

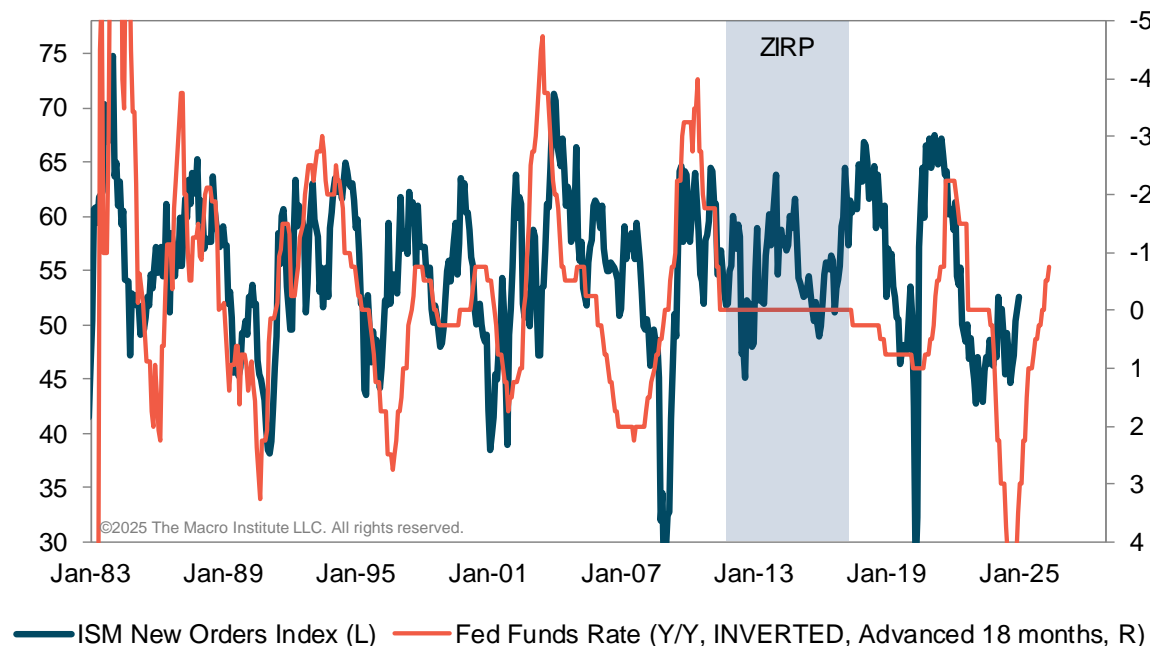
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Powell is different than his predecessors.

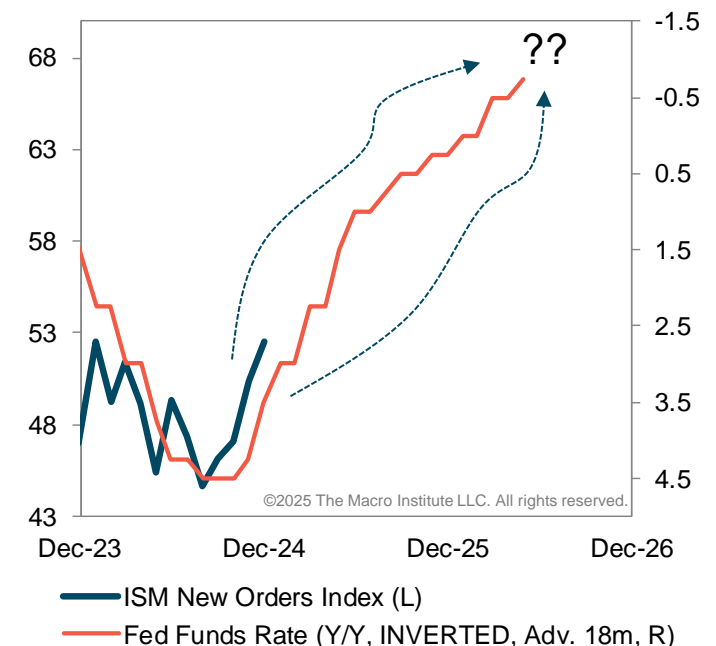
Introduction: An Unusual And Problematic Economic Cycle

Monetary Policy: Now A Tailwind For Economic Prospects (LEIs)

LEIs Usually Start To Recover ~18 Months After Last Rate Hike

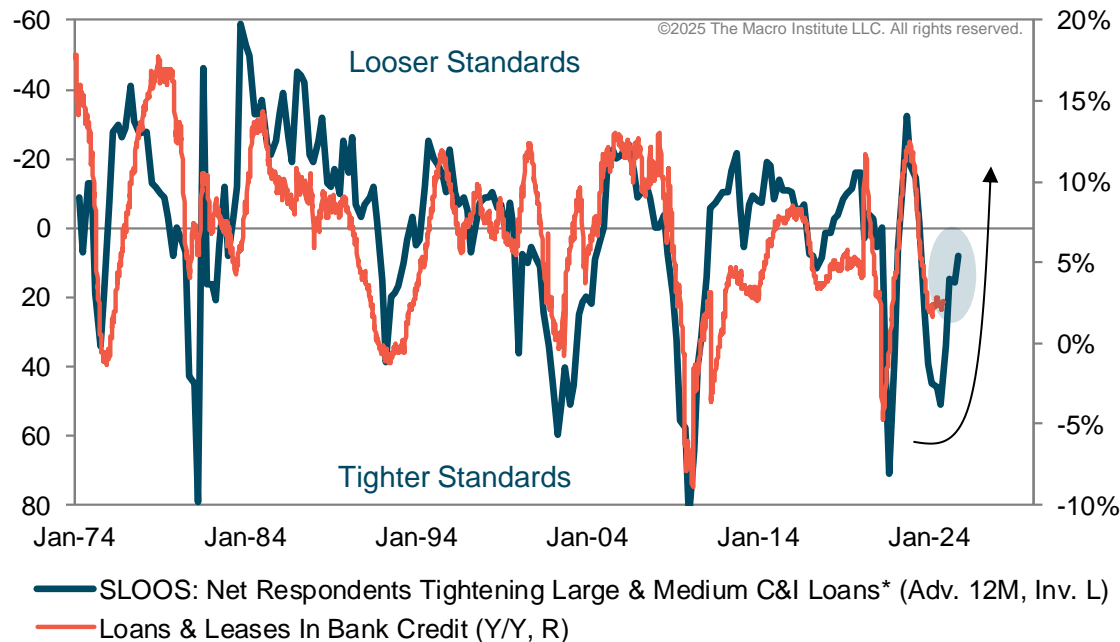


Higher LEIs In 2025?!?



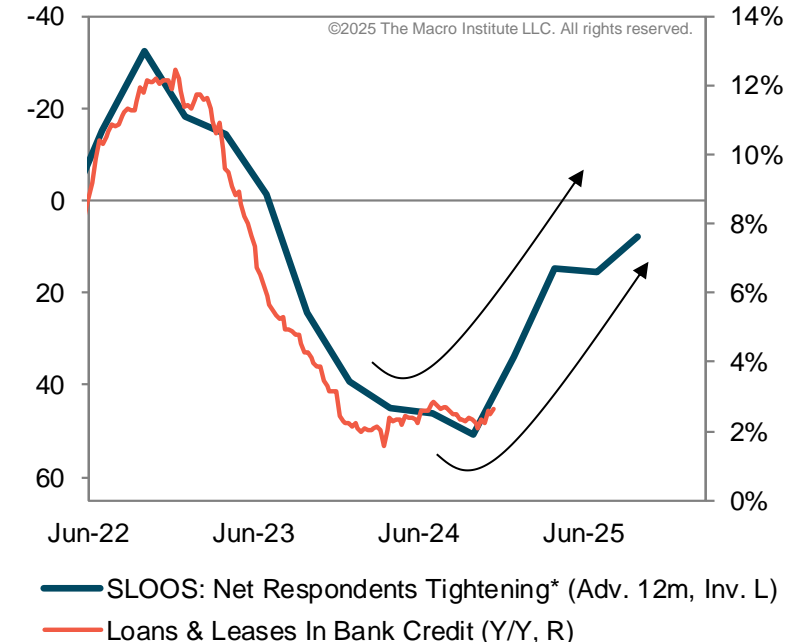
Easier Lending Standards: Also Supportive Of Economic Activity In 2025

Loosening Credit Standards Suggest Higher Loan Growth



*Spliced with Consumer Loans Pre-1990)

Loan Growth Accelerating Into 2025?

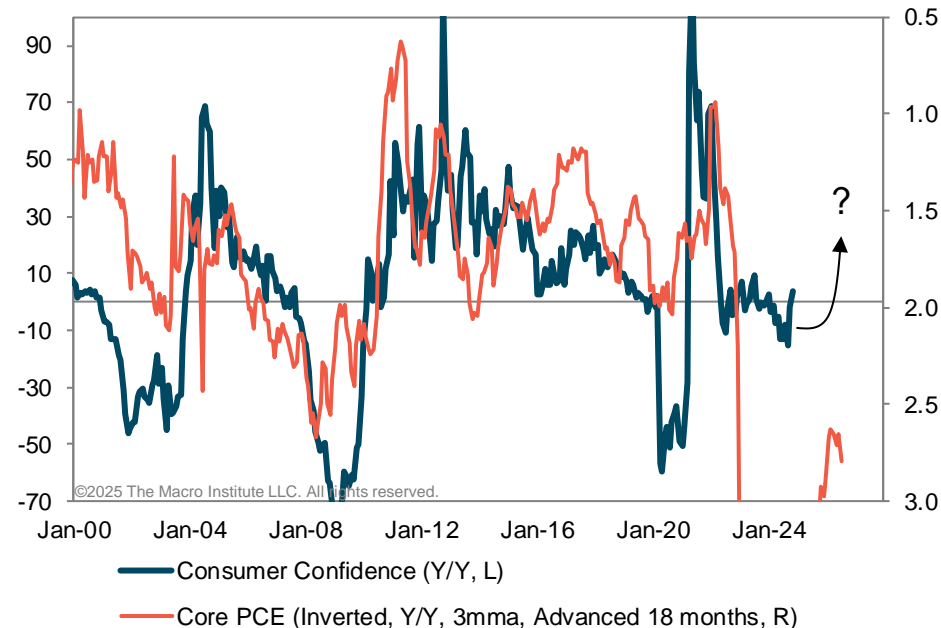


*Spliced with Consumer Loans Pre-1990)

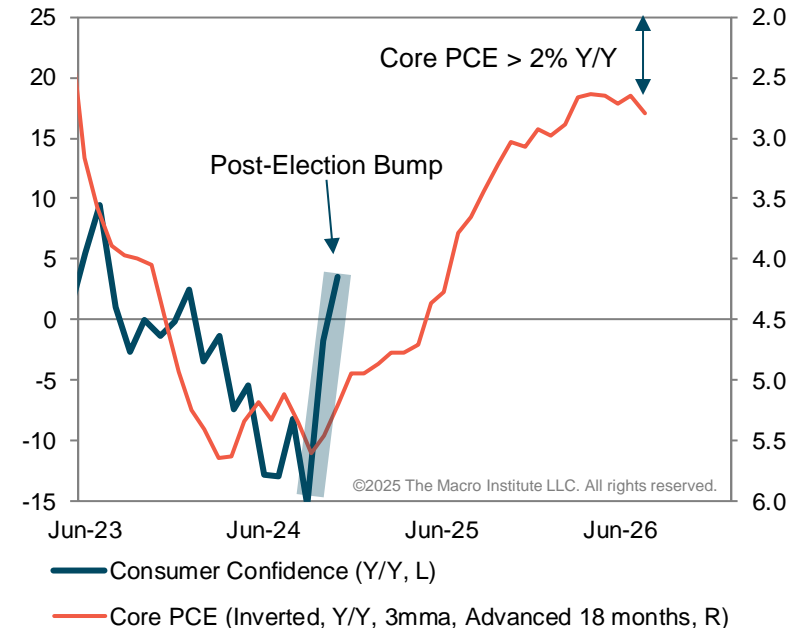
Introduction: An Unusual And Problematic Economic Cycle

Lower Inflation: Also Supportive Of Economic Activity In 2025

Consumer Confidence Follows The Path Of Inflation

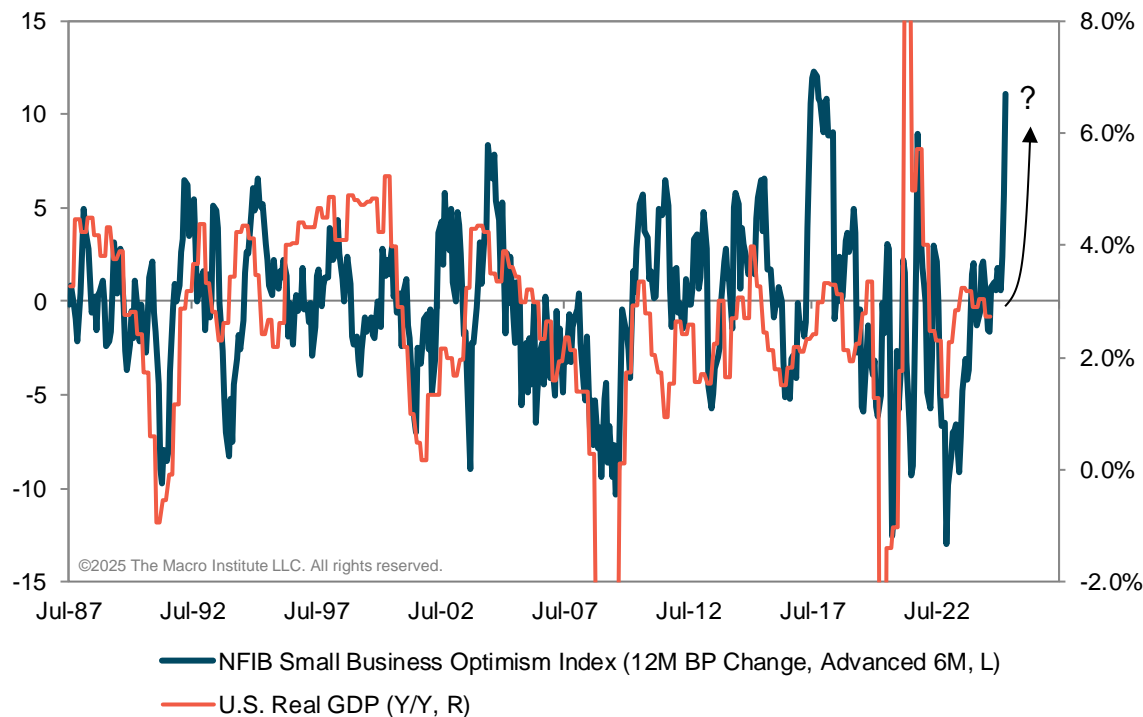


Disinflation Trends To Support Consumers

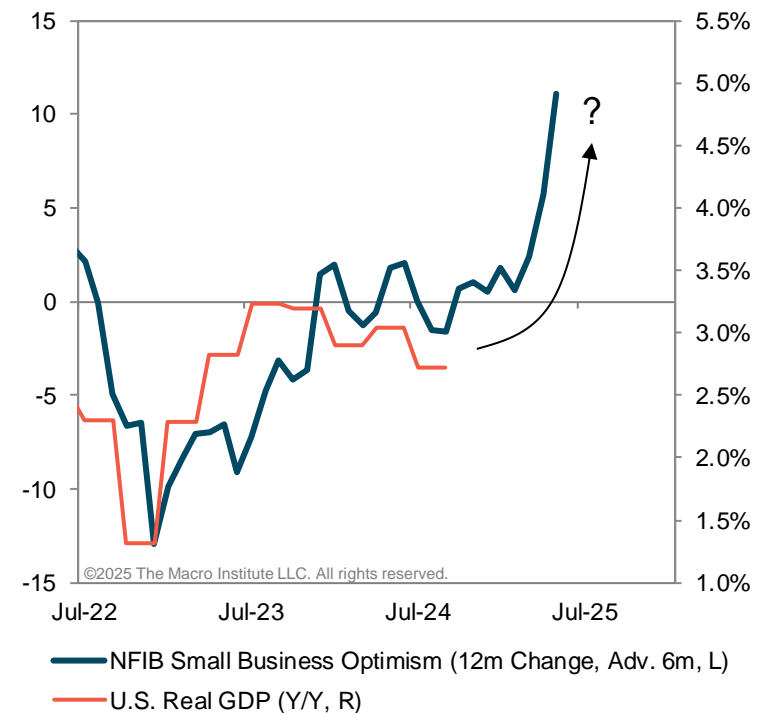


NFIB's Small Business Optimism Points To Even Stronger Economy In 2025

↑ Small Business Optimism = ↑ GDP Growth Ahead?

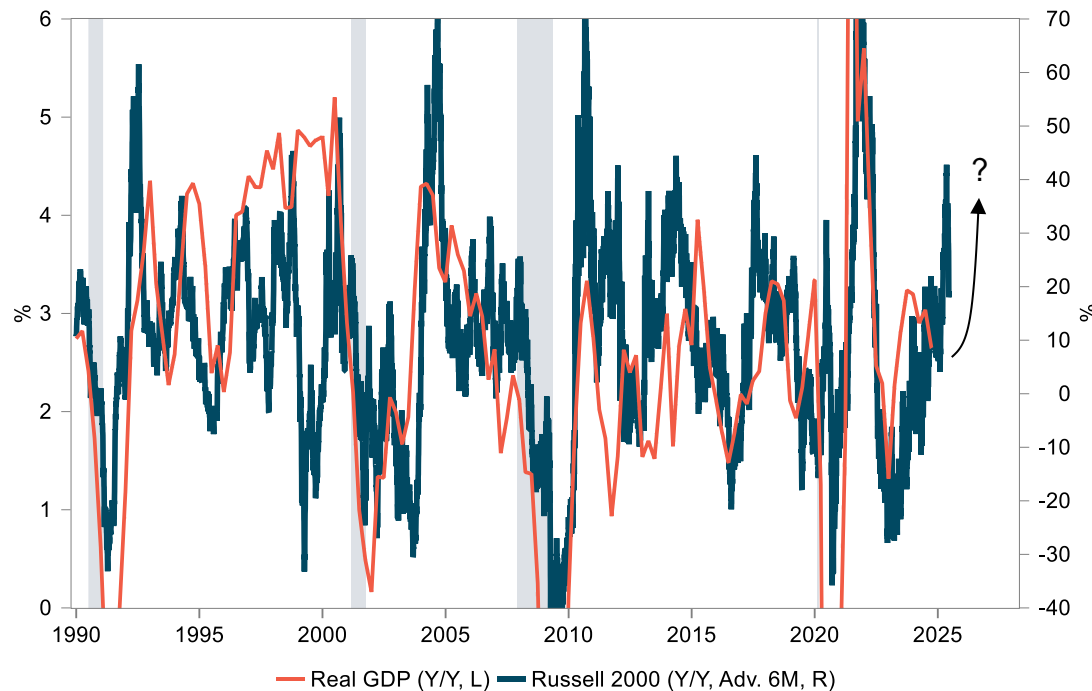


Accelerating Growth In 2025?



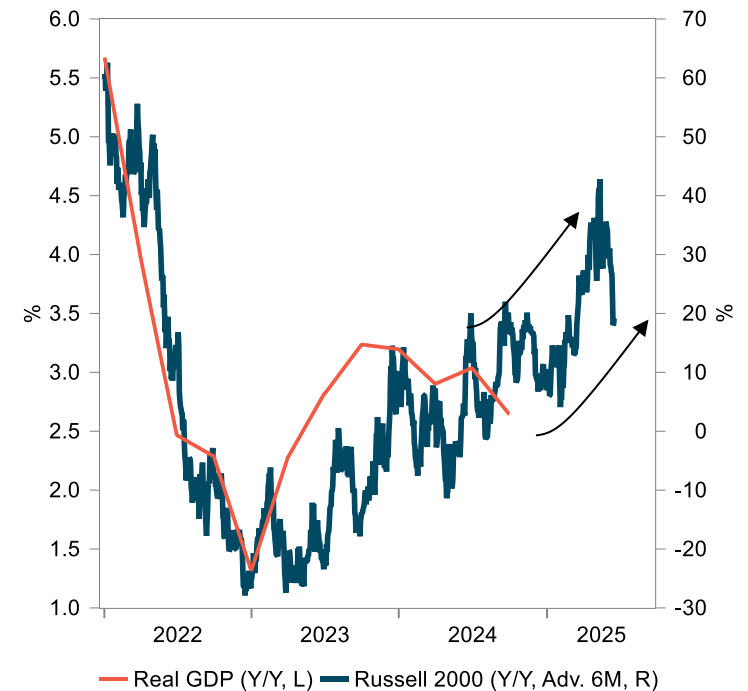
Small-Cap Equities Point To Even Stronger Economy In 2025

Small-Cap Equities Suggest Strong Growth Ahead



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Accelerating Growth In 2025?

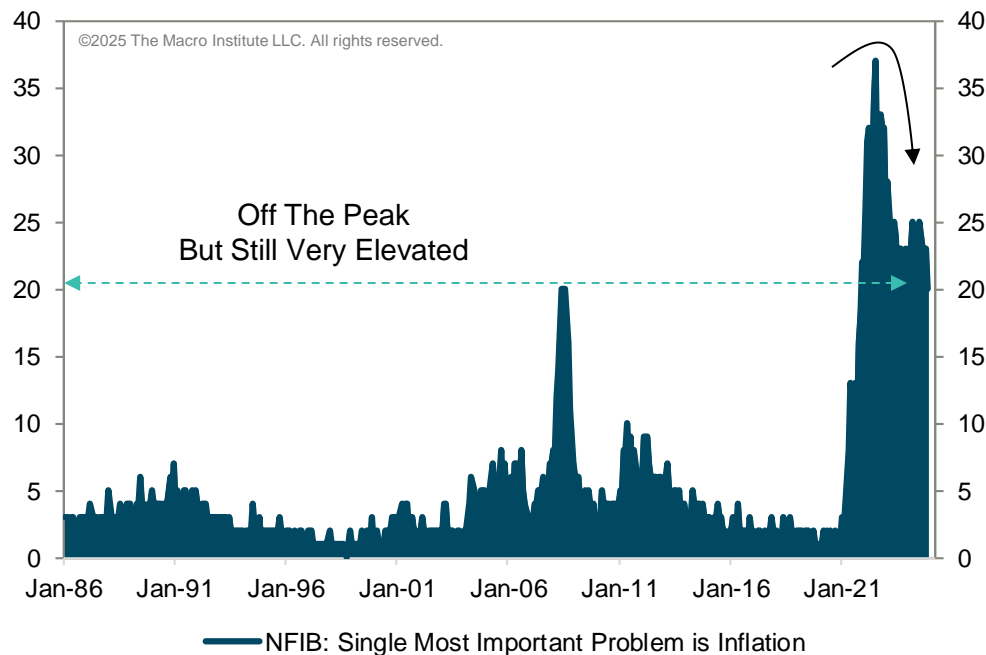


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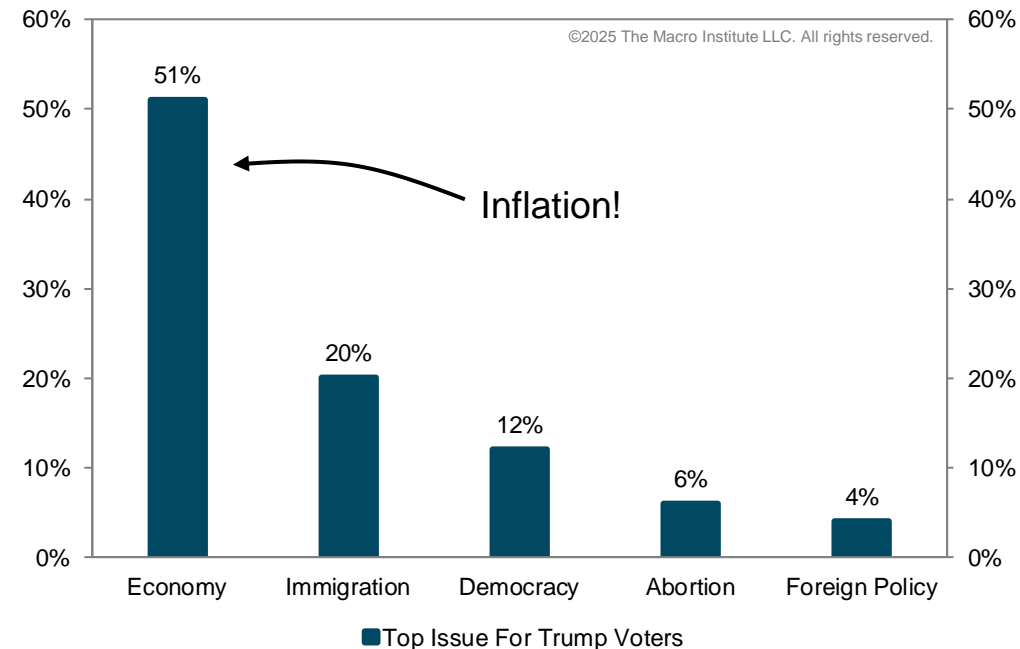
Introduction: An Unusual And Problematic Economic Cycle

Bottom Line: New Cycle Is About To Start When Inflation Is Still An Issue

Inflation Still A Problem For Small Businesses

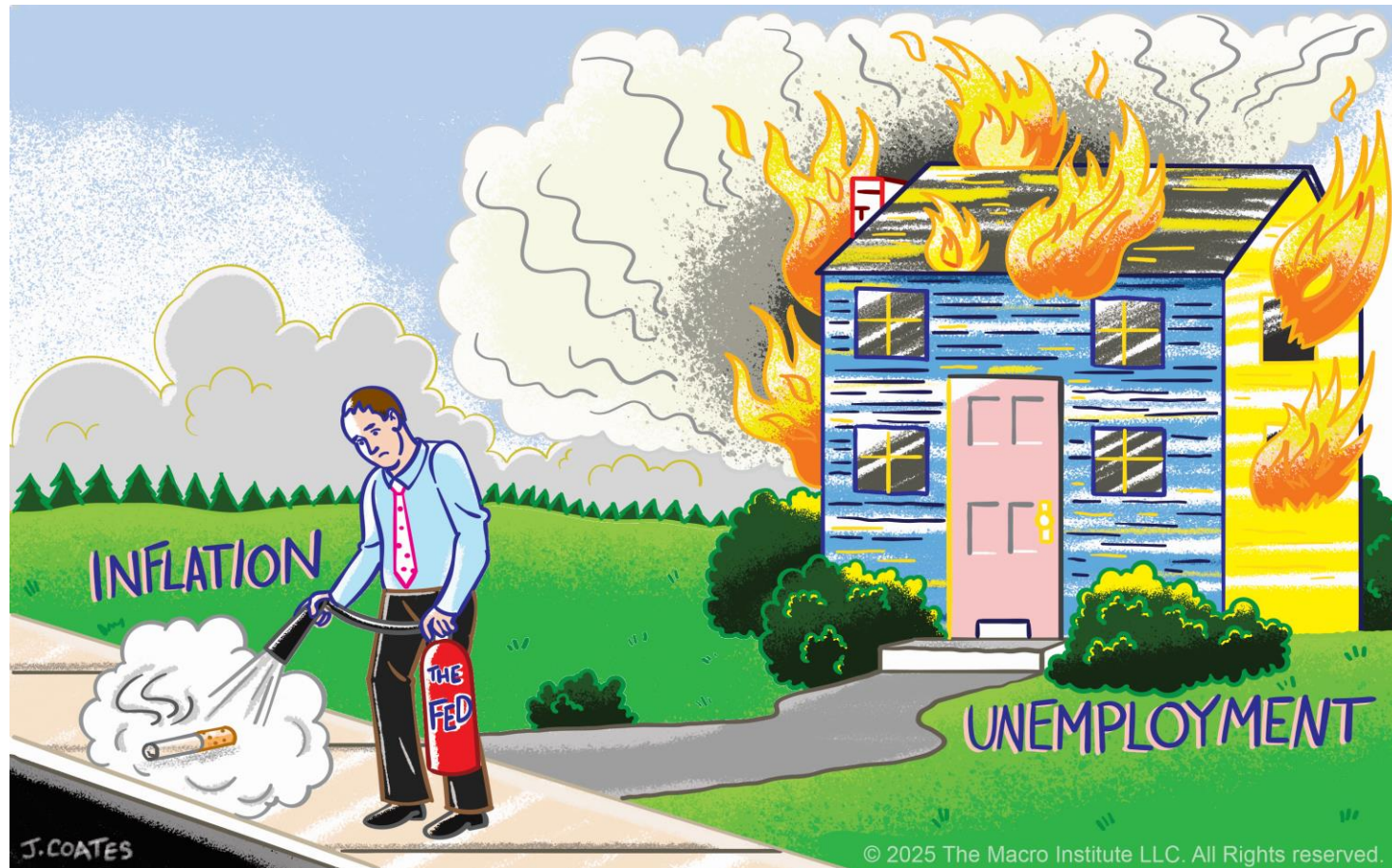


Inflation Still An Issue For Consumers



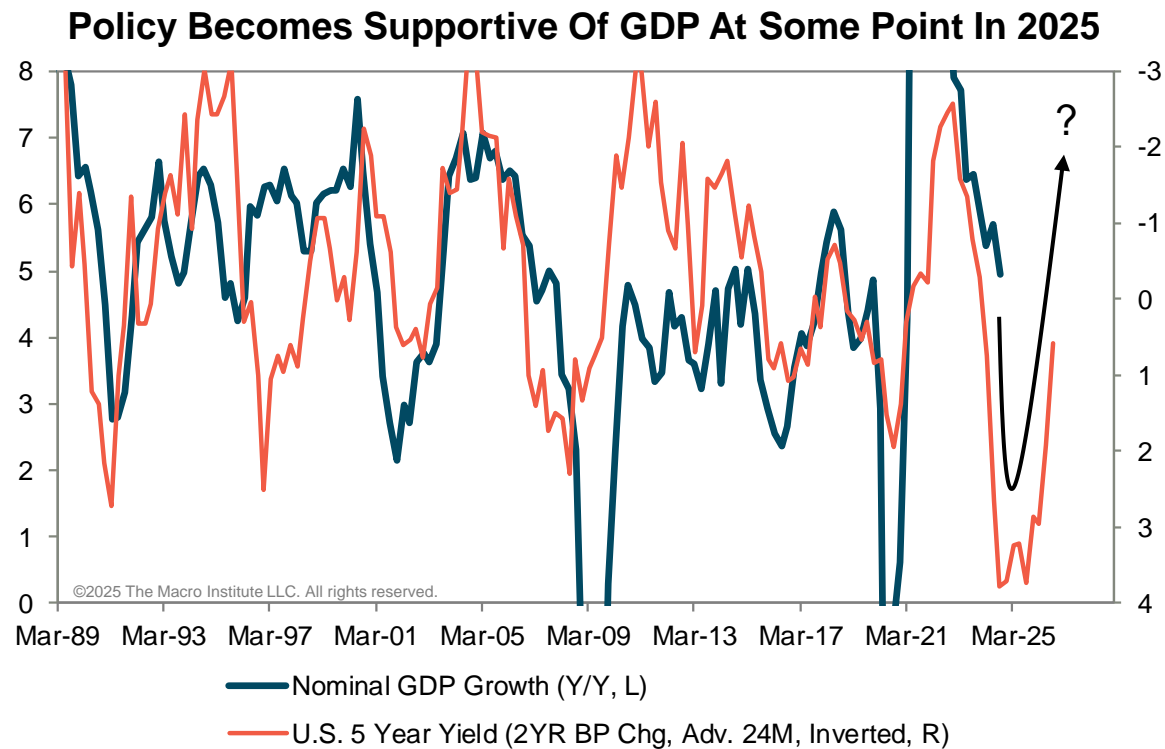
Source: NBC News Exit Poll

Section 1: An Inflationary Recovery In The Making



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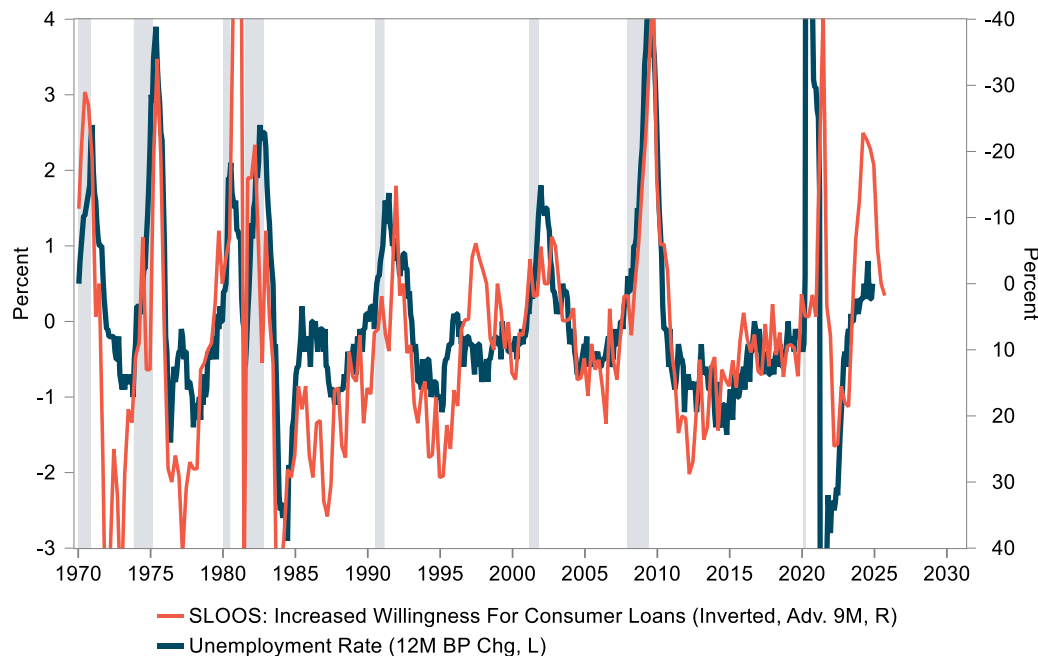
Fed Stimulus Set To Intensify Economic Growth In 2025



Section 1: An Inflationary Recovery In The Making

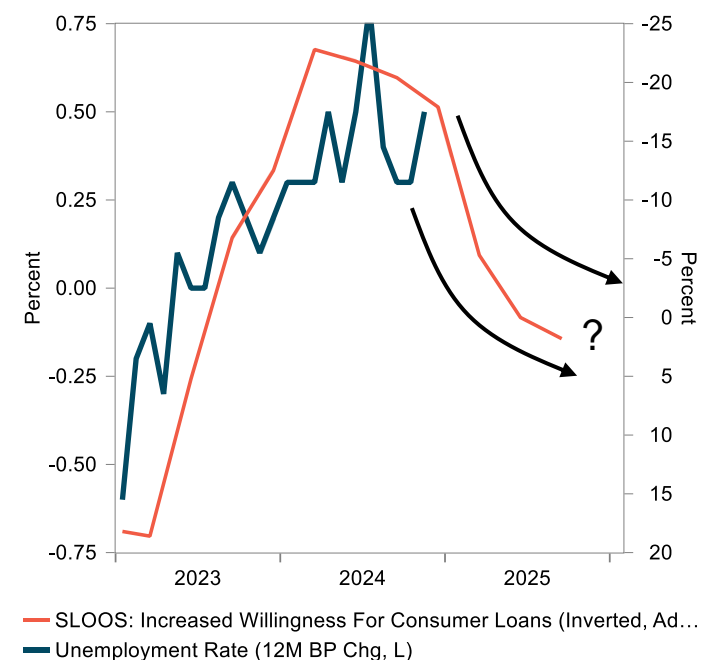
Lending Standards Argue Labor Market Recovery Already Underway

Lending Standards Point To Tighter Labor Markets



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Lower Unemployment In 2025?

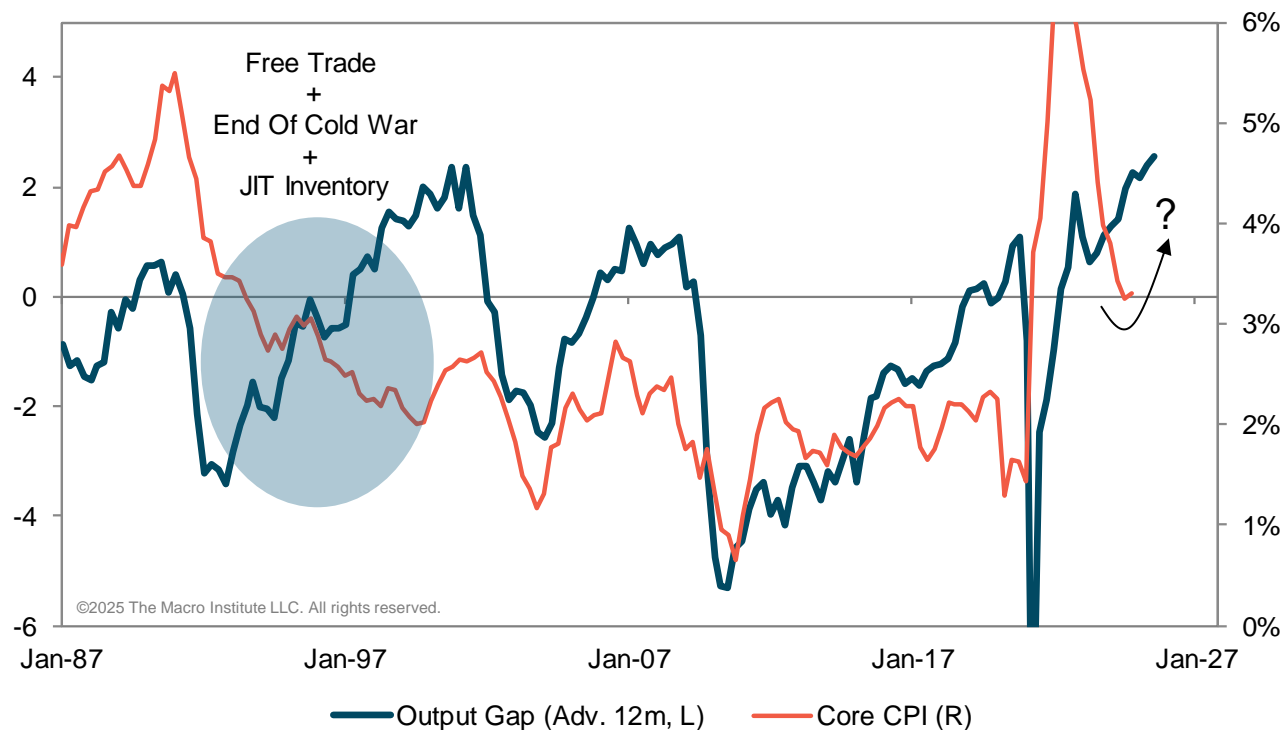


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Section 1: An Inflationary Recovery In The Making

U.S. Economy Already Running With Little Excess Capacity

Output Gap At Its Most Inflationary In Almost 40 Years

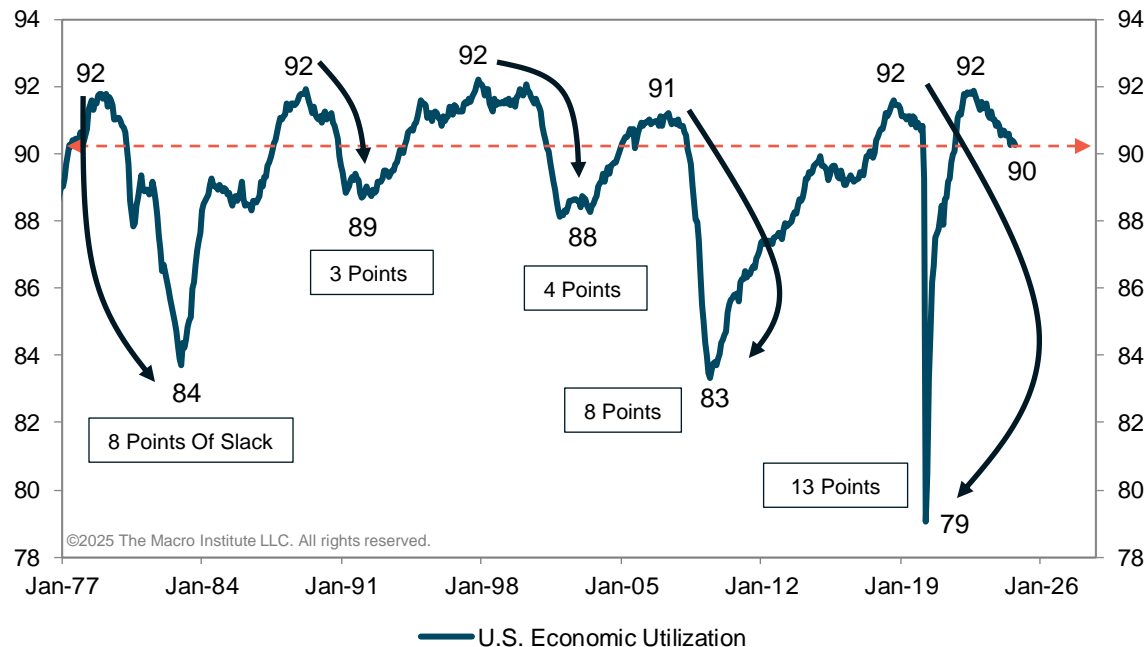


The **output gap** is the difference between an economy's actual output and its potential output.

Section 1: An Inflationary Recovery In The Making

Dearth Of Excess Capacity Set To Alter Economic Recovery Playbook

Lack Of Excess Capacity Already Inflationary



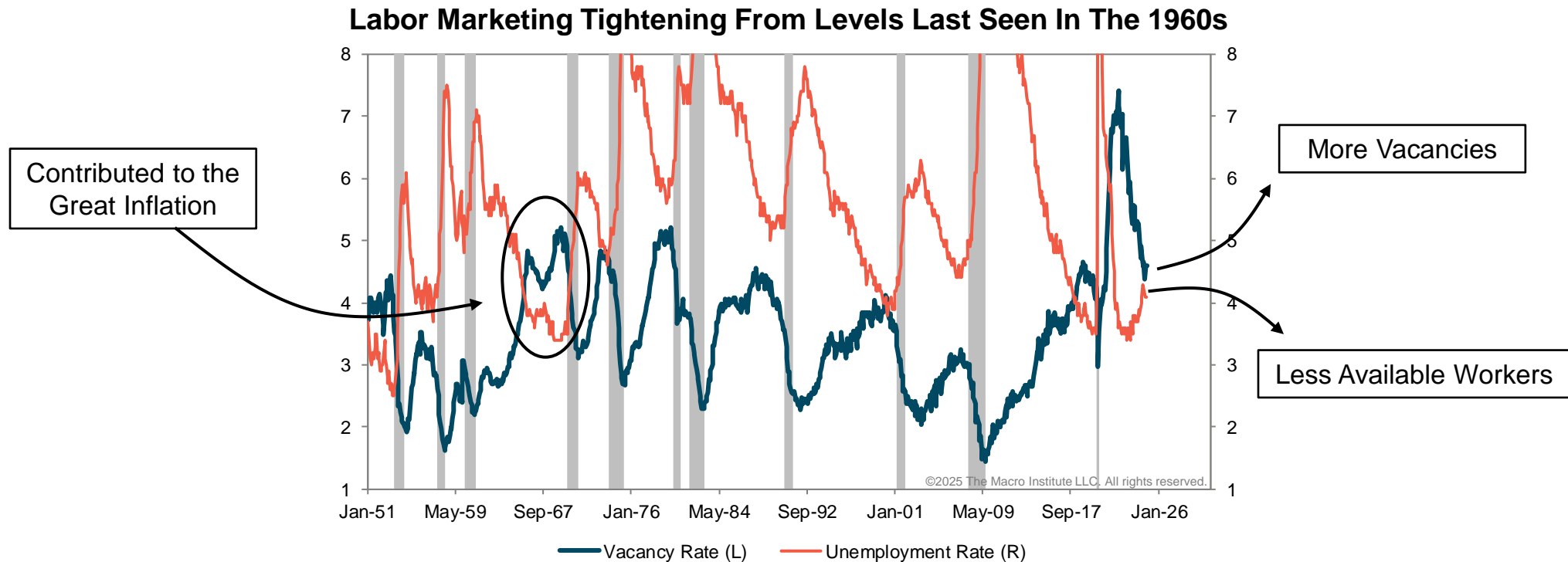
Regime	Description	Avg. Change In Core CPI
1	EU Above 90	+1.0%
2	EU Below 90	-1.3%

$$\text{U.S. Eco Utilization} = \frac{(\text{Manufacturing \% of GDP}) \times (\text{Capacity Utilization})}{(\text{Services \% of GDP}) \times (\text{Employment Rate})} +$$

Economic utilization is the extent to which an economy is being used relative to its maximum potential.

Section 1: An Inflationary Recovery In The Making

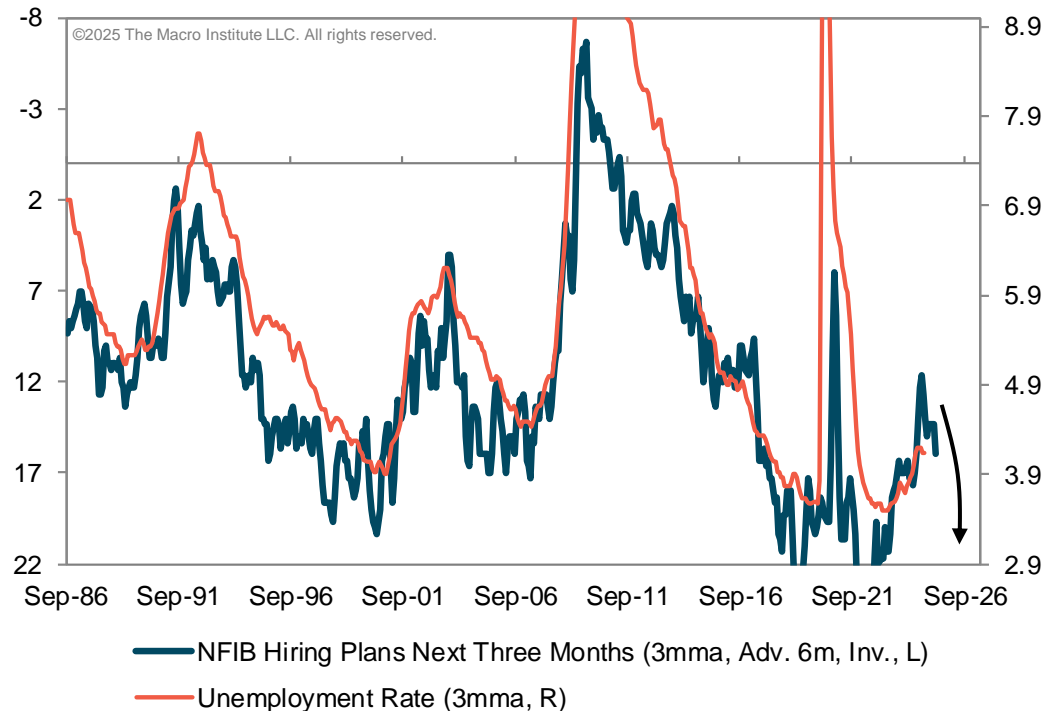
An Unprecedented Labor Market For Today's Investors



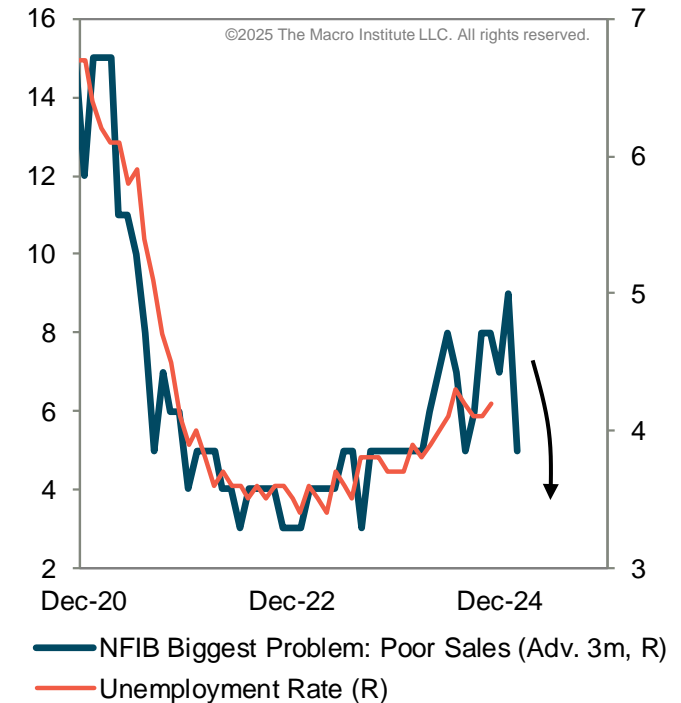
Section 1: An Inflationary Recovery In The Making

Small Business NFIB Survey Points To Even Tighter Labor Markets Ahead

Hiring Intentions On The Rise ...



... And Sales Visibility Improving



Section 1: An Inflationary Recovery In The Making

Improving Labor Markets A Sign Of Stronger Economic Activity

Labor Markets Set To Reinvigorate Economy ...



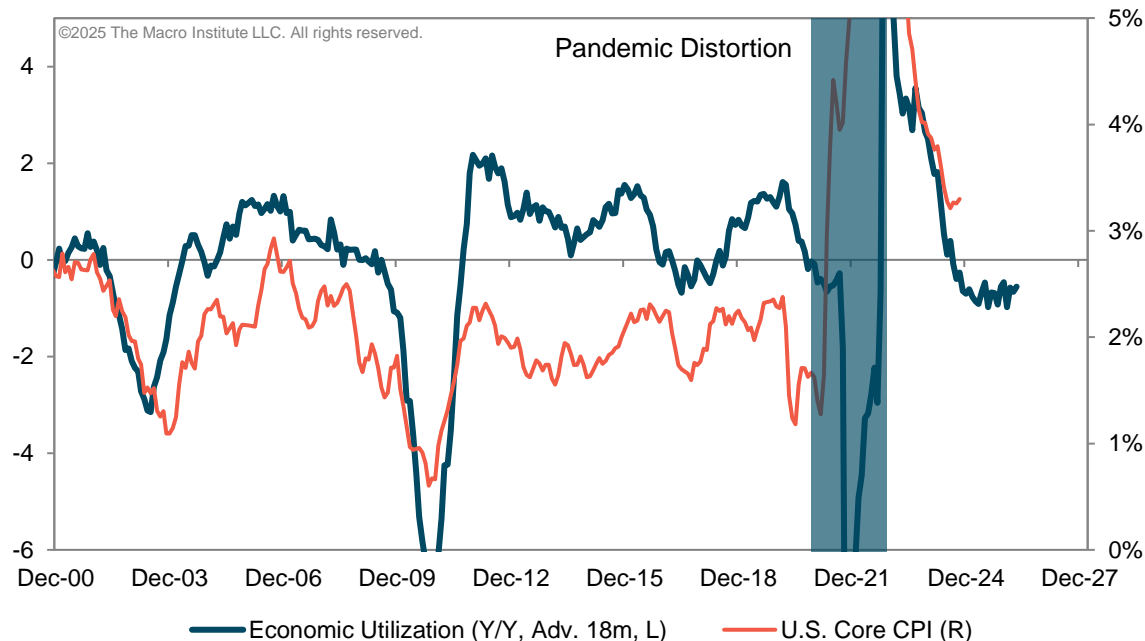
... Starting In Q1?!?



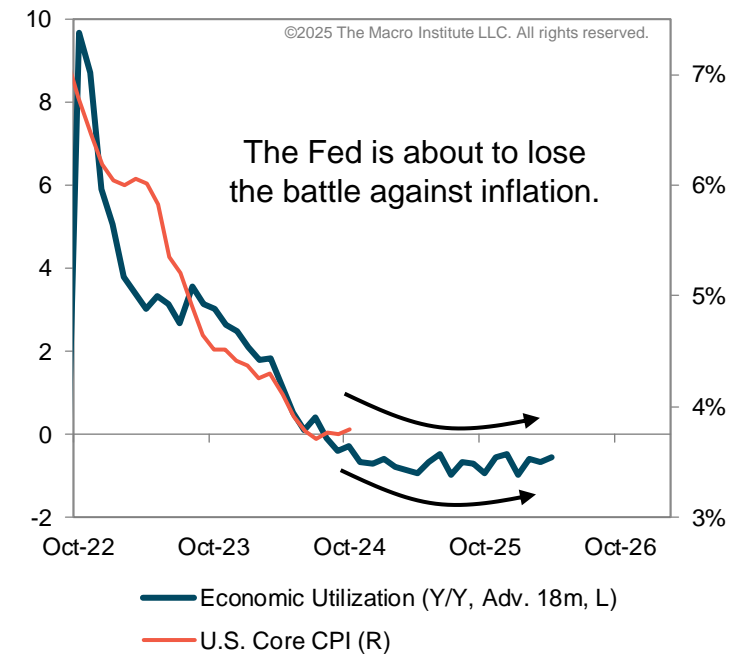
Section 1: An Inflationary Recovery In The Making

Dearth Of Capacity + Fed Stimulus = Return Of Inflation

Economic Utilization Already Troughing ...



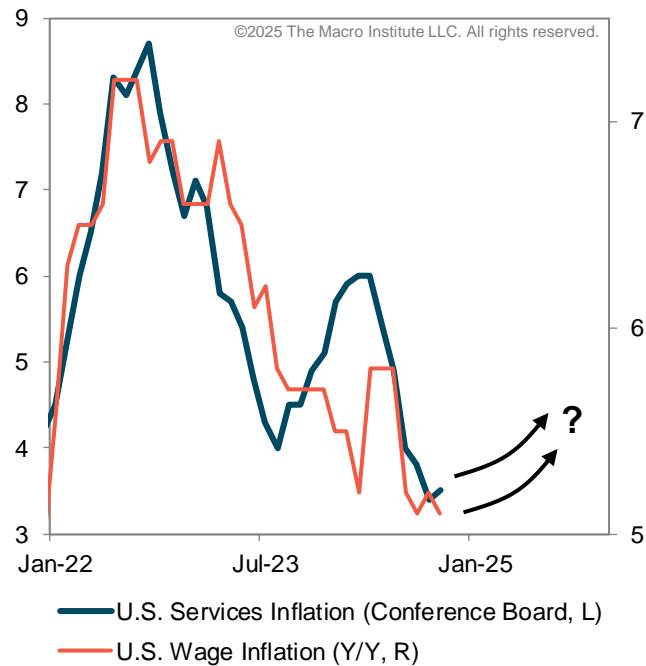
... Setting The Stage For ↑ Inflation



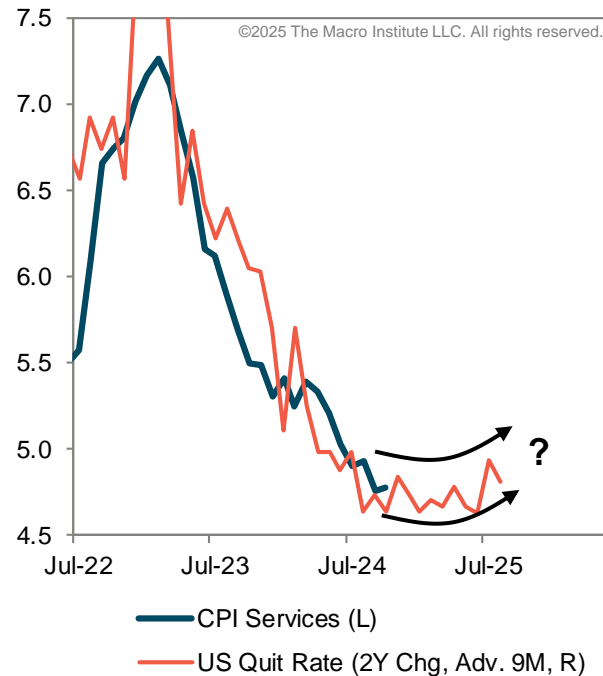
Section 1: An Inflationary Recovery In The Making

Several Different Sources Of Data ALL Pointing To Higher Inflation Ahead

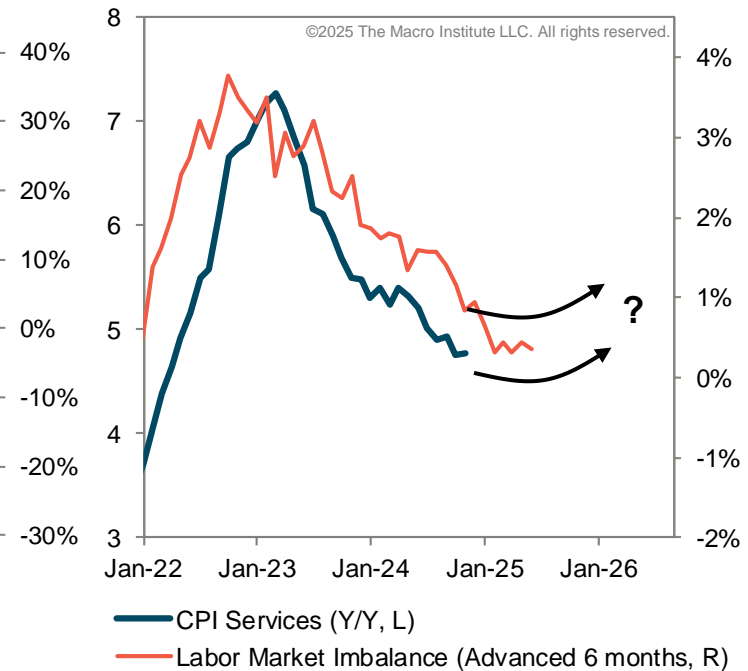
Higher Wage Inflation Ahead?



↑ Quit Rate = ↑ Core Inflation



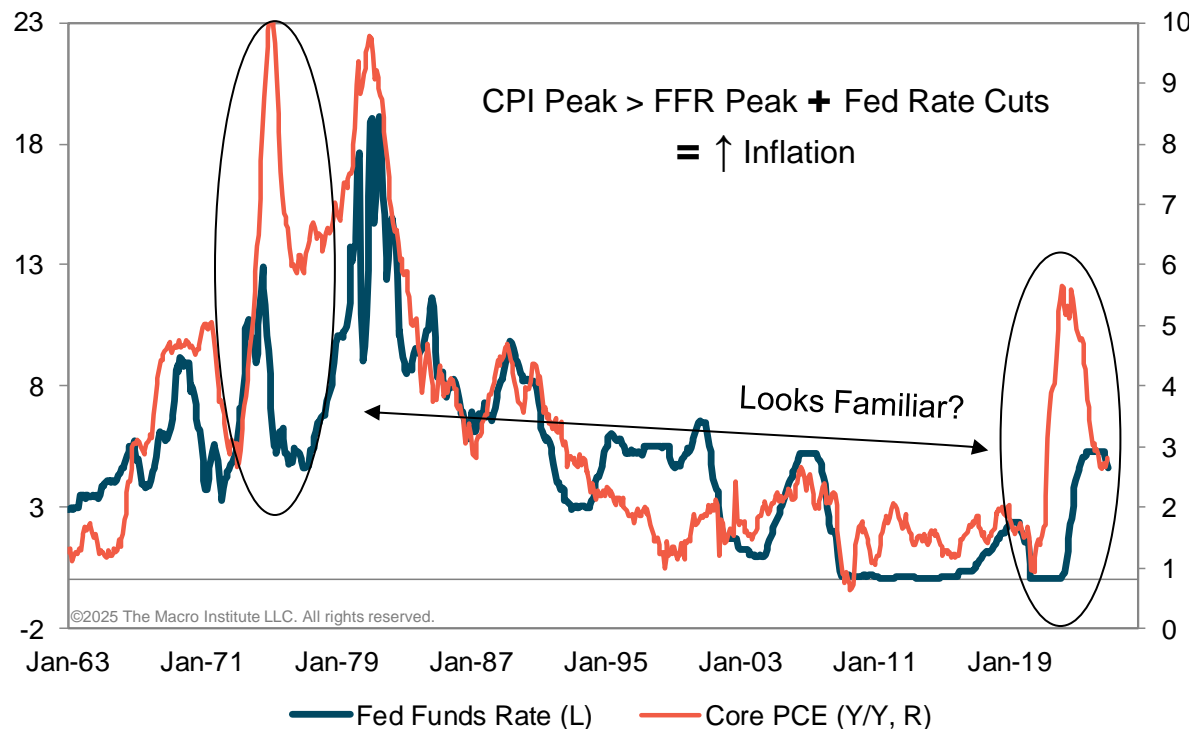
↑ Labor Market = ↑ Core Inflation



Section 1: An Inflationary Recovery In The Making

On Deck: Fed Turns Hawkish And Tightens Policy Again In 2025

Higher Inflation \cong Fed Tightening Ahead



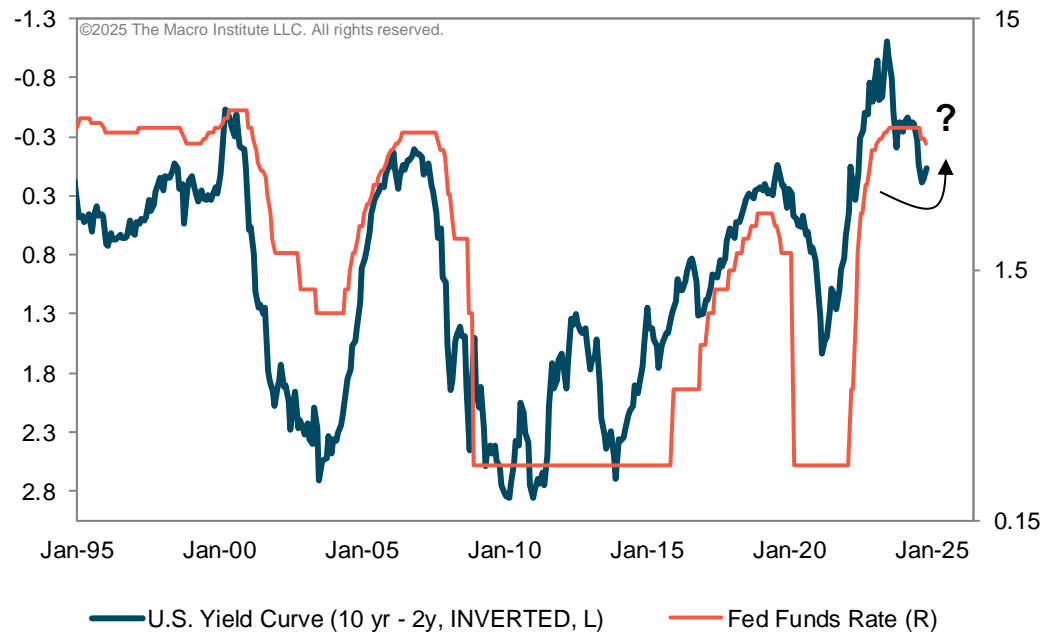
“Supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation.”
- FOMC Statement, Dec. 15, 2021

Expect a similar statement from the Fed again in 2025.

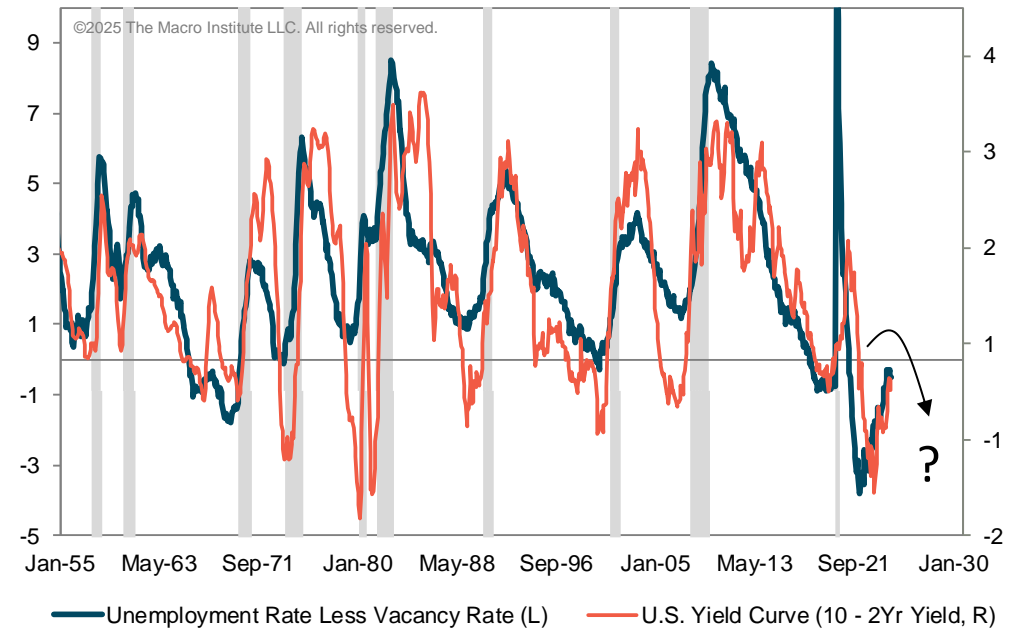
Section 1: An Inflationary Recovery In The Making

Yield Curve Likely Remains Inverted For Foreseeable Future

Further Fed Tightening = Flatter Yield Curve



Tighter Labor Markets = Flatter Yield Curve

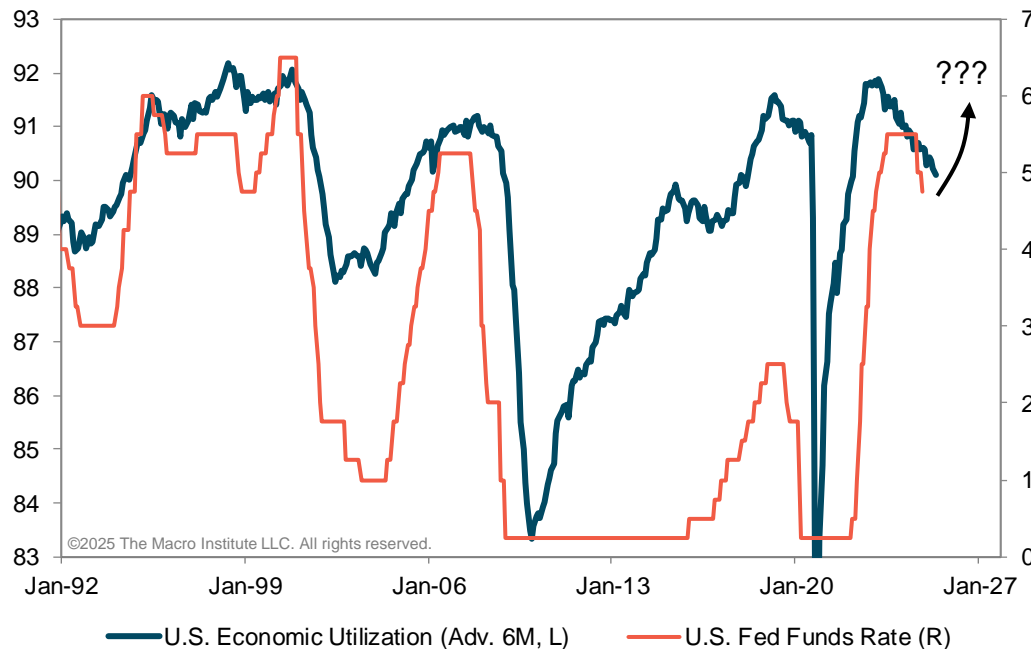


Excess capacity proxy
for labor markets.

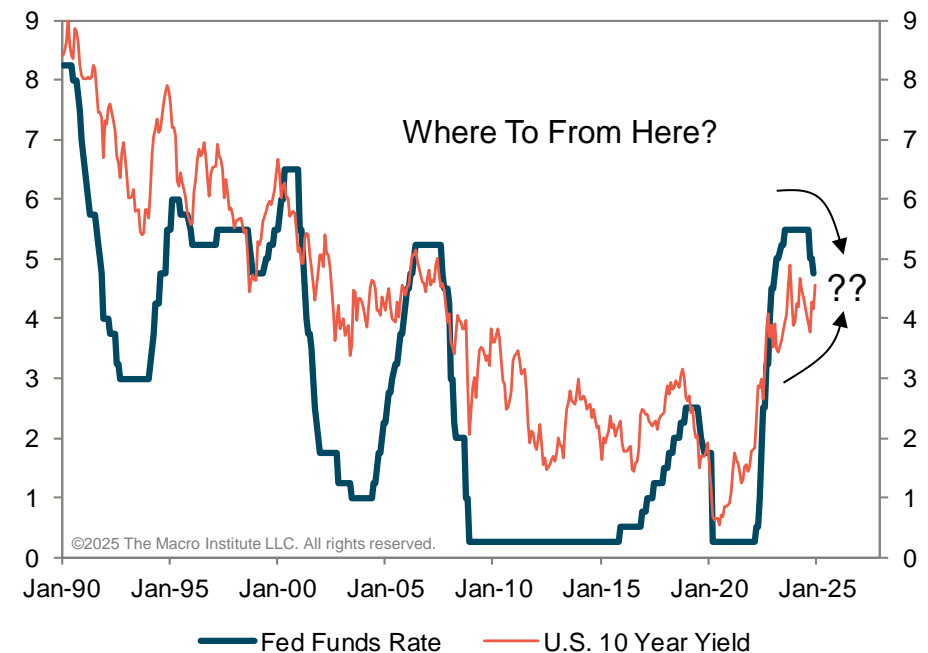
Section 1: An Inflationary Recovery In The Making

Countdown To The Fed's Change In Policy Stance

Economic Utilization At the Heart Of The Fed's Efforts



Interest Rates Usually Follow Fed Policy Stance

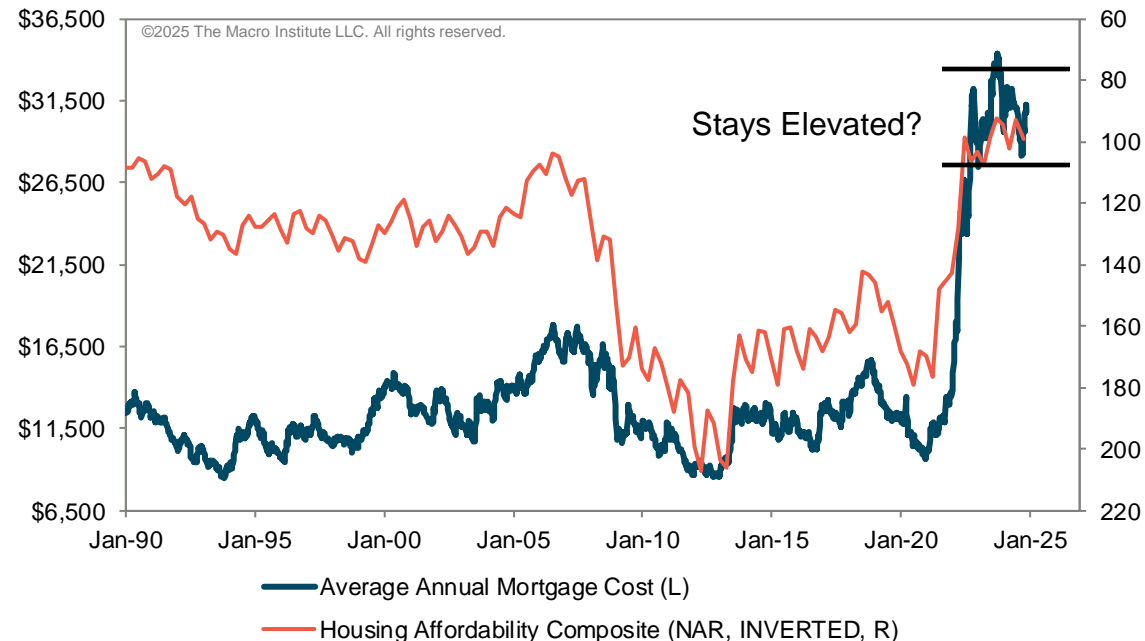


Next Fed meeting on January 29th, 2025

Section 1: An Inflationary Recovery In The Making

High Inflation Likely Pushes Fed Funds Rate And Mortgage Rates Higher

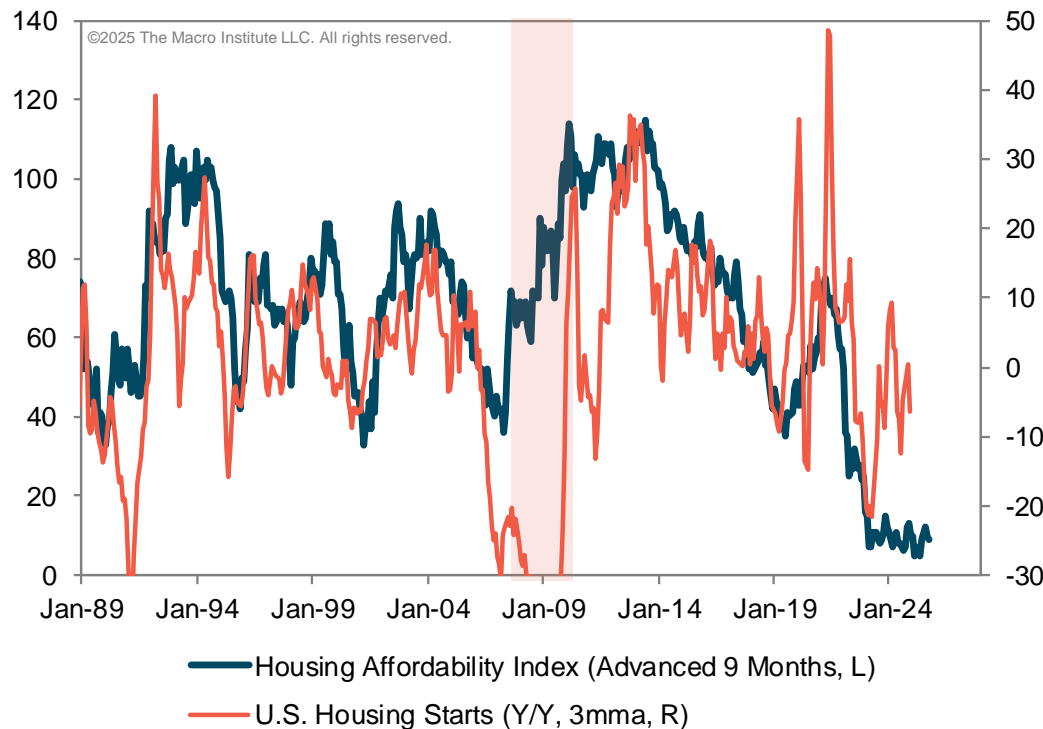
Mortgage Rates Not Headed Lower In 2025?



Section 1: An Inflationary Recovery In The Making

U.S. Housing Market STILL In The Early Stages Of A Slowdown

Housing Affordability Leads Housing Activity



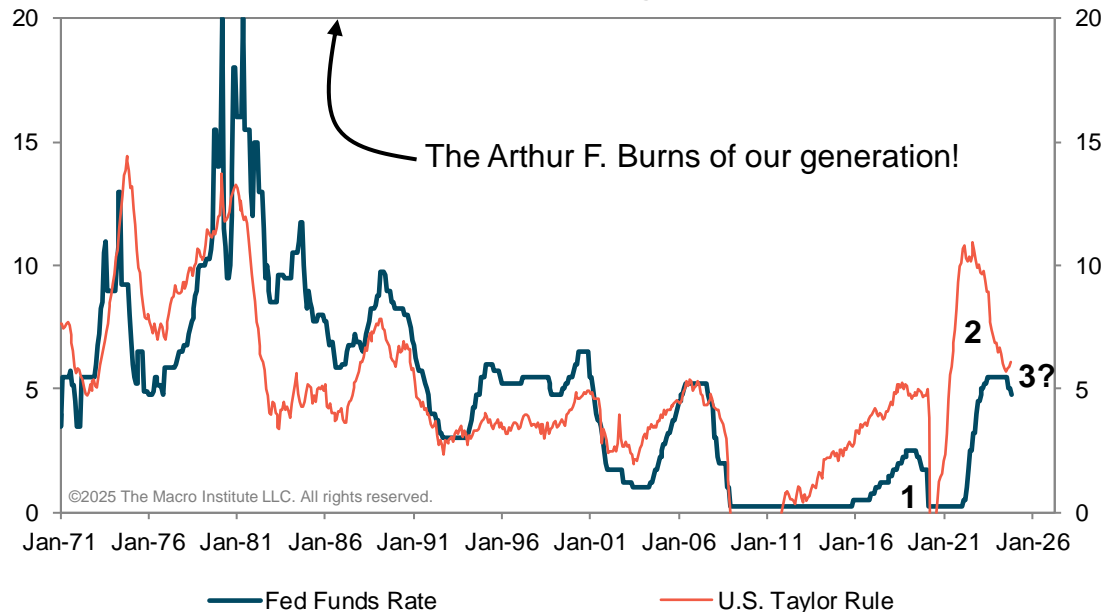
Slowdown In Starts Has A Way To Go



Section 1: An Inflationary Recovery In The Making

Chairman Powell's Soft Landing Victory Lap Sours In 2025

Is Fed Chairman Powell Making His Third Mistake?



Mistake	Description
1	Hiking Too Late
2	Not Hiking Enough
3	Cutting Instead Of Tightening

Section 2: Protectionist Policies Set To Fuel Inflation Further

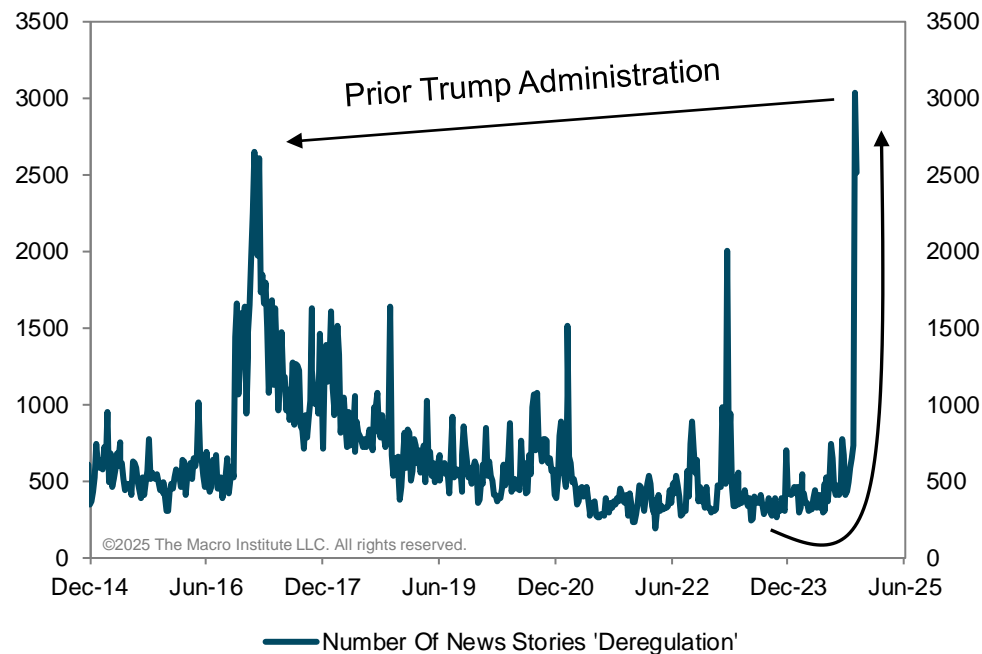


Section 2: Protectionist Policies Set To Fuel Inflation Further

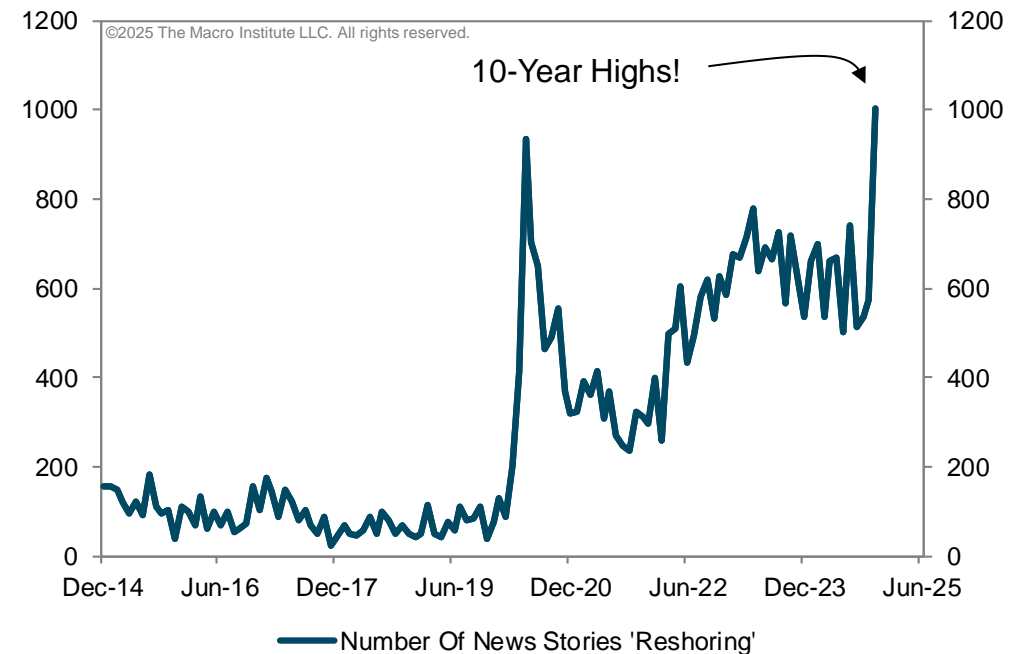
U.S. Elections Revive Interest in Deregulation AND Reshoring

↖ Twin Forces Supporting Economy In 2025 ↗

Deregulation Has Never Been More Popular



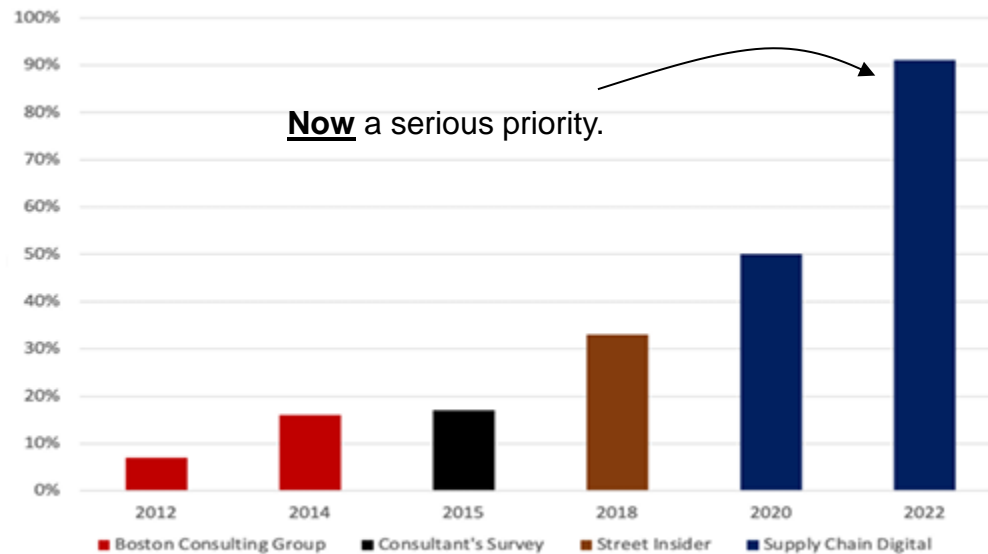
Interest In Reshoring Has Never Been Higher



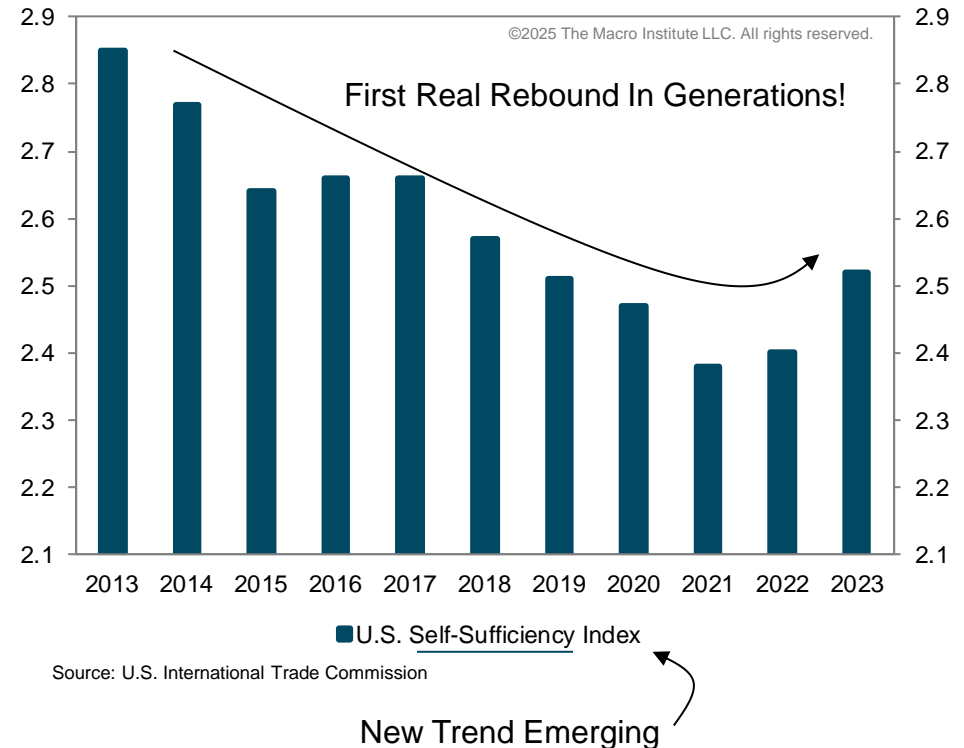
Section 2: Protectionist Policies Set To Fuel Inflation Further

Reshoring Also A Pro-Growth Phenomenon For U.S. Economy

On The Radar For A Full Decade At This Point



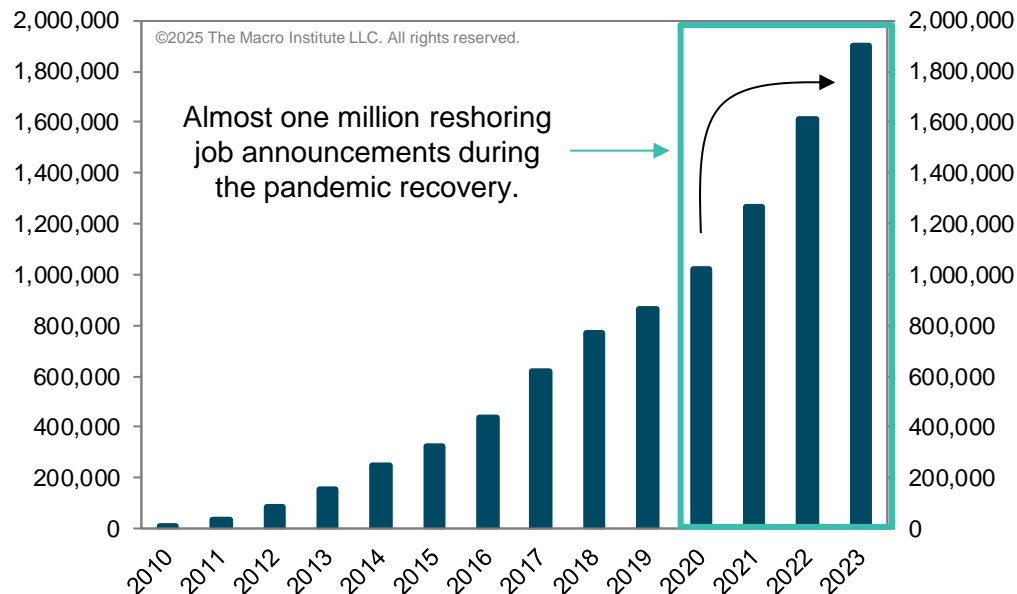
Gained Momentum During Pandemic Recovery



Section 2: Protectionist Policies Set To Fuel Inflation Further

The Real Economic Impact Of Reshoring ... Job Creation!

Cumulative Reshoring Jobs Announced



Source: Reshoring Initiative

■ Jobs Announced From Reshoring

Areas Losing U.S.-Bound Jobs

Rank	Country	% of Total Jobs
1	Asia	87%
2	Western Europe	5%
3	North America	5%
4	South & Central America	2%
5	Oceania & Eastern Europe	0%
6	Middle East & Africa	0%

Source: Reshoring Initiative

Section 2: Protectionist Policies Set To Fuel Inflation Further

On Paper: Trump Administration's Proposed Policies Would Add A Lot Of Debt

The Proposed Trump Plan

Policy Proposals	Trump Plan (Billions)
Extend TCJA	-\$5,350
Exempt Overtime Income From Tax	-\$2,000
Exempt Social Security From Tax	-\$1,300
Lower Corporate Tax Rate To 15%	-\$200
Exempt Tips From Tax	-\$300
Strengthen Military	-\$400
Secure Border And <u>Deportations</u> ^{#2}	-\$350
Housing Reforms	-\$150
Boost Support For Health Care	-\$150
^{#1} <u>Revenue & Spending Reductions</u> ^{#3}	+\$3,700
Total Estimated Budget Impact	-\$7,500

Source: Committee for a Responsible Federal Budget

Need revenue offsets for this priority.

#1 Tariffs

#2 Deportations

#3 Austerity

Tailwind for
inflation?

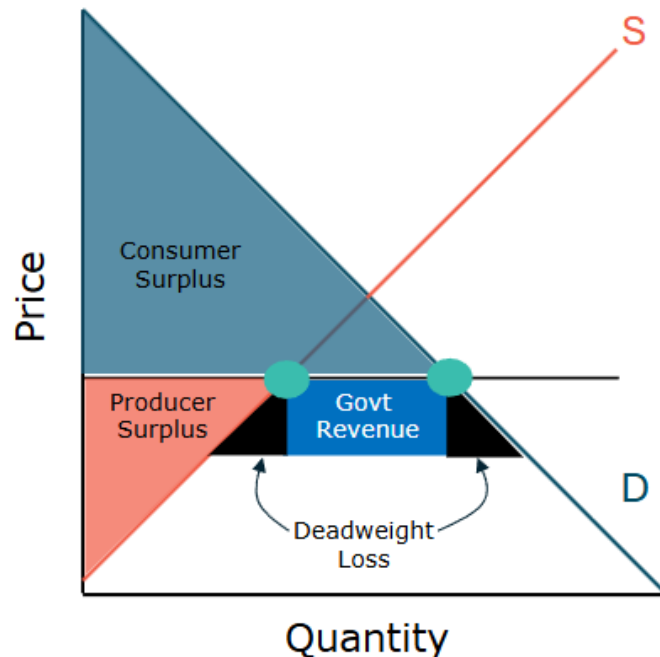
Headwind for
economy?

Section 2: Protectionist Policies Set To Fuel Inflation Further

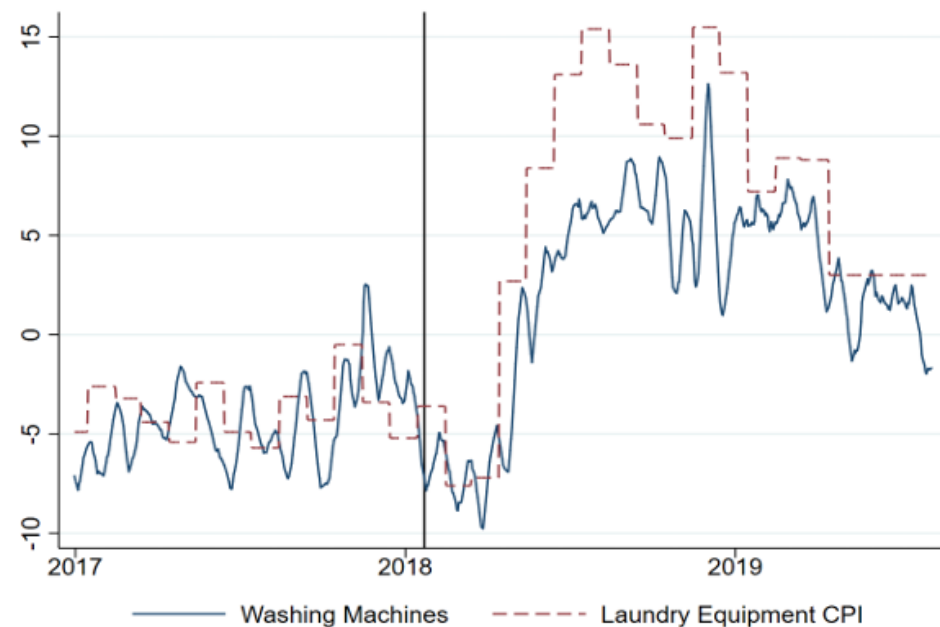
#1 Tariffs

Tariffs Help Fiscal Policy At The Expense Of U.S. Consumers

2018 Experience Confirms Tariff Theory And Their Inflationary Consequences



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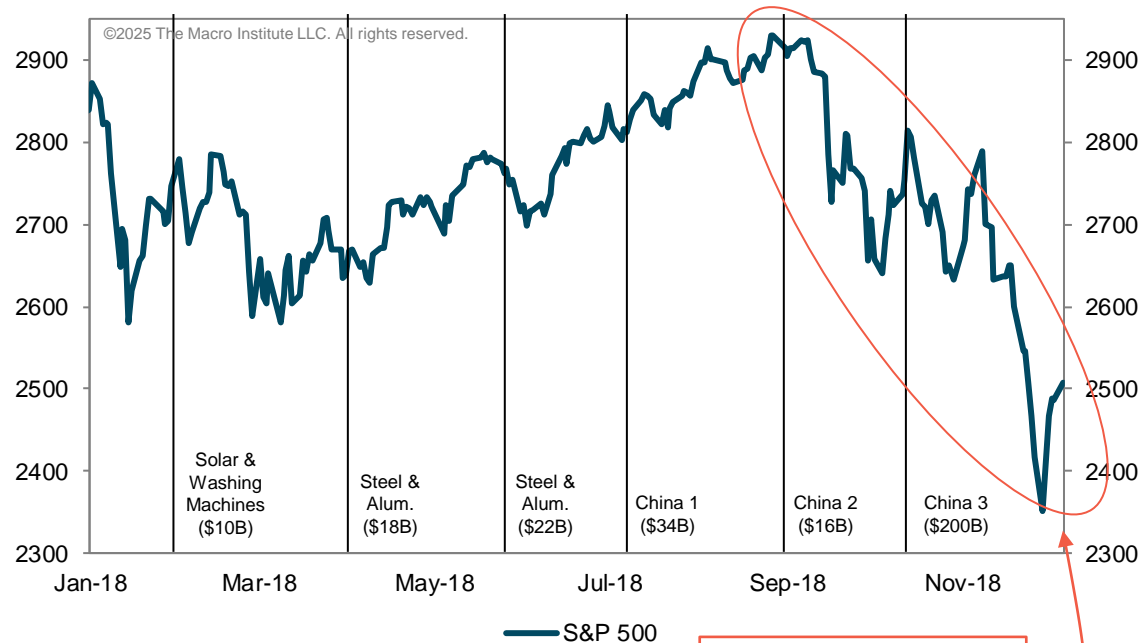
Source: Cavallo, Alberto, *Tariff Passthrough At The Border And At The Store: Evidence From US Trade Policy*, 2019.

Section 2: Protectionist Policies Set To Fuel Inflation Further

#1 Tariffs

U.S. Stock Market Did NOT Like Trade Retaliation In 2018

Wall Street Was Eventually Spooked By 2018 Tariffs



The S&P 500 fell 20% in Q4 2018!

Tariffs Are A Two-Way Street

Panel A: Tariffs on U.S. Imports Enacted by U.S. in 2018						
Tariff Wave	Date Enacted	Products	2017 Imports	Tariff (%)		
		(# HS-10)	(mil USD)	(%)*	2017	2018
Solar Panels	Feb 7, 2018	8	5,782	0.2	0.0	30.0
Washing Machines	Feb 7, 2018	8	2,105	0.1	1.3	32.2
Aluminum	Mar-Jun, 2018	67	17,685	0.7	2.0	12.0
Iron and Steel	Mar-Jun, 2018	753	30,523	1.3	0.0	25.0
China 1	Jul 6, 2018	1,672	33,510	1.4	1.3	26.2
China 2	Aug 23, 2018	433	14,101	0.6	2.7	27.0
China 3	Sep 24, 2018	9,102	199,264	8.3	3.3	12.9
Total		12,043	302,970	12.7	2.6	16.6

Panel B: Retaliatory Tariffs on U.S. Exports Enacted by Trading Partners in 2018						
Retaliating Country	Date Enacted	Products	2017 Exports	Tariff (%)		
		(# HS-10)	(mil USD)	(%)*	2017	2018
China	Apr-Sep, 2018	7,474	92,518	6.0	8.4	18.9
Mexico	Jun 5, 2018	232	6,746	0.4	9.6	28.0
Turkey	Jun 21, 2018	244	1,554	0.1	9.7	31.8
European Union	Jun 22, 2018	303	8,244	0.5	3.9	29.2
Canada	Jul 1, 2018	325	17,818	1.2	2.1	20.2
Russia	Aug 6, 2018	163	268	0.0	5.2	36.8
Total		8,073	127,149	8.2	7.3	20.4

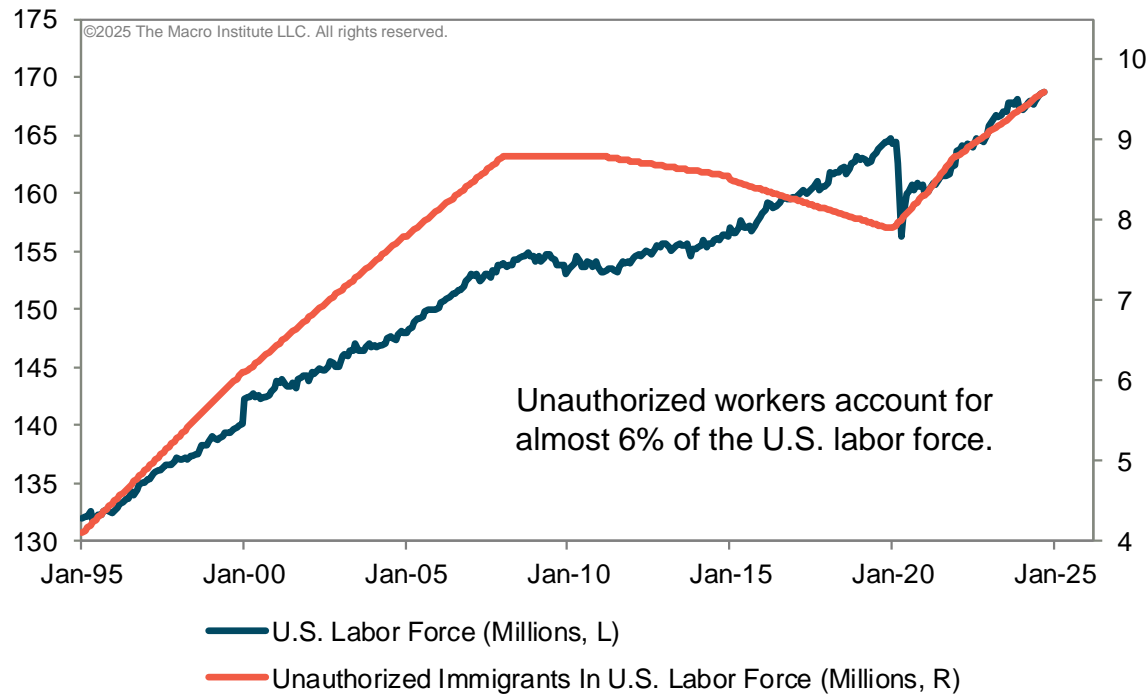
Source: UCLA

Section 2: Protectionist Policies Set To Fuel Inflation Further

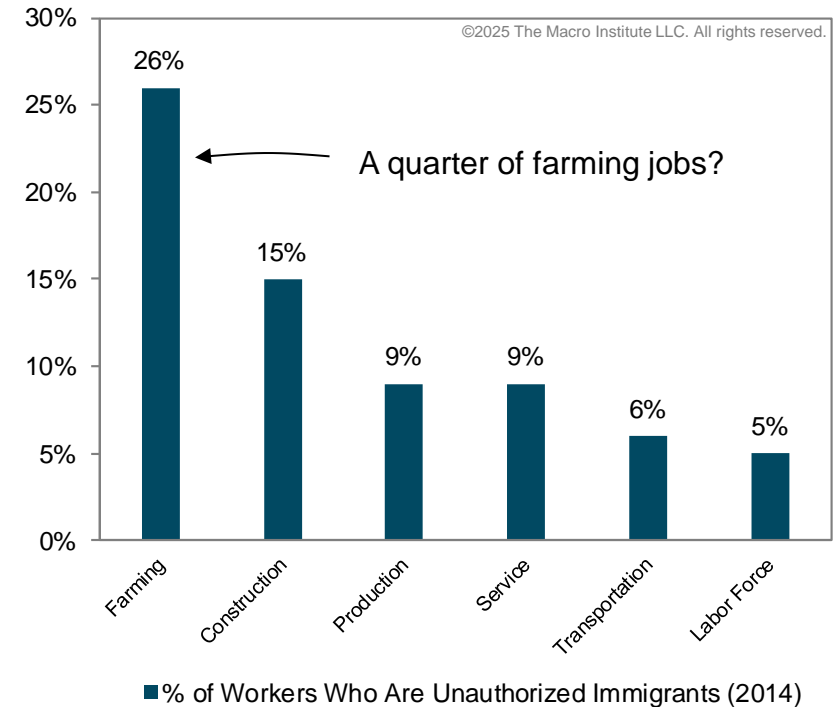
#2 Immigration

Undocumented Workers Have Been A Relief Valve For Tight Labor Markets

Unauthorized Workers In The U.S. Number Almost 10 Million



A Real Problem In Some Industries!

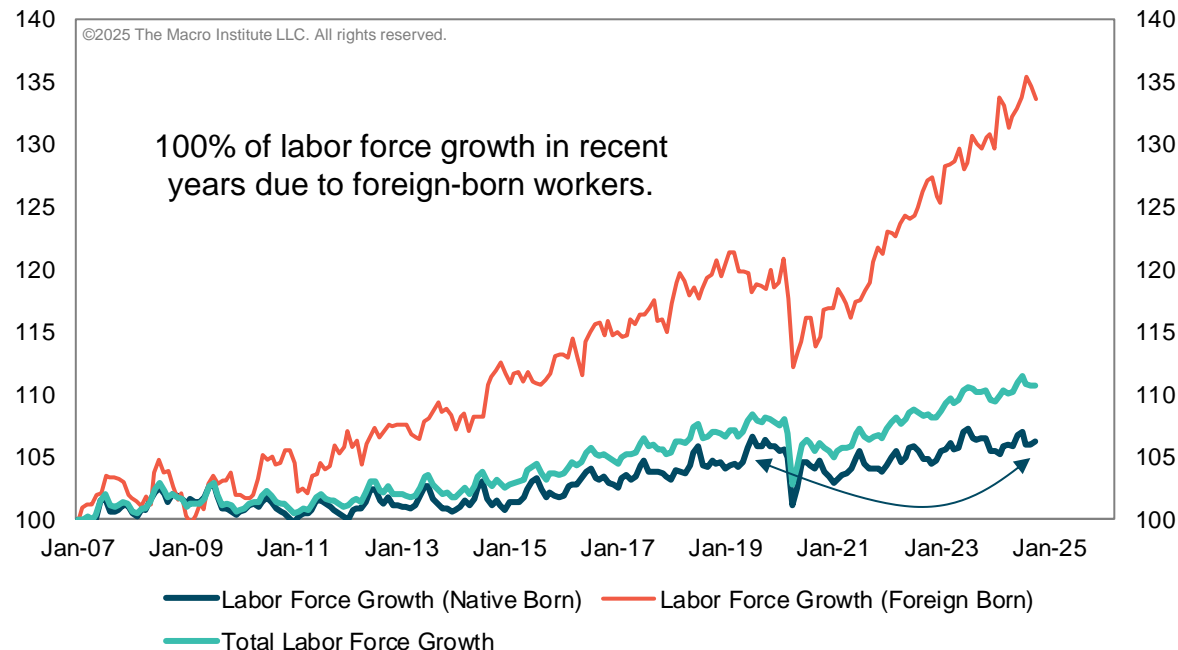


Section 2: Protectionist Policies Set To Fuel Inflation Further

#2 Immigration

U.S. Labor Markets Inflationary **DESPITE** Foreign Workers

Foreign-Born Workers Explain Bulk of Growth In Labor Force



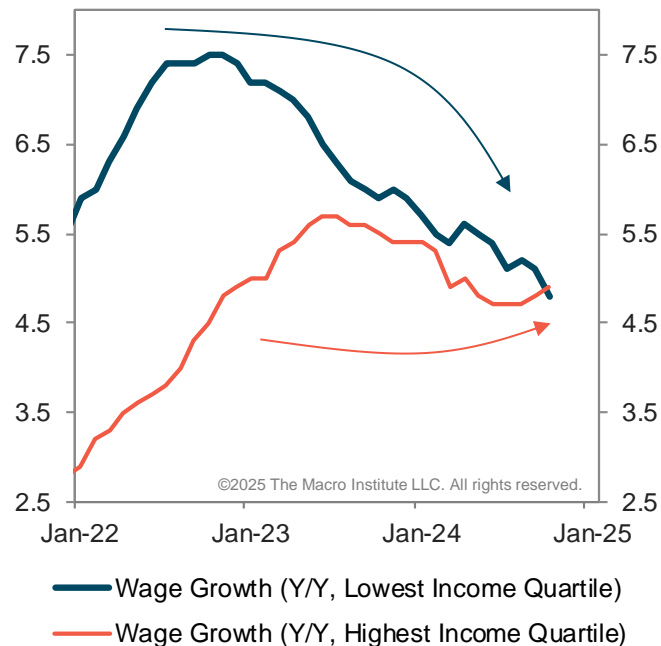
No gains in native born labor force!

Section 2: Protectionist Policies Set To Fuel Inflation Further

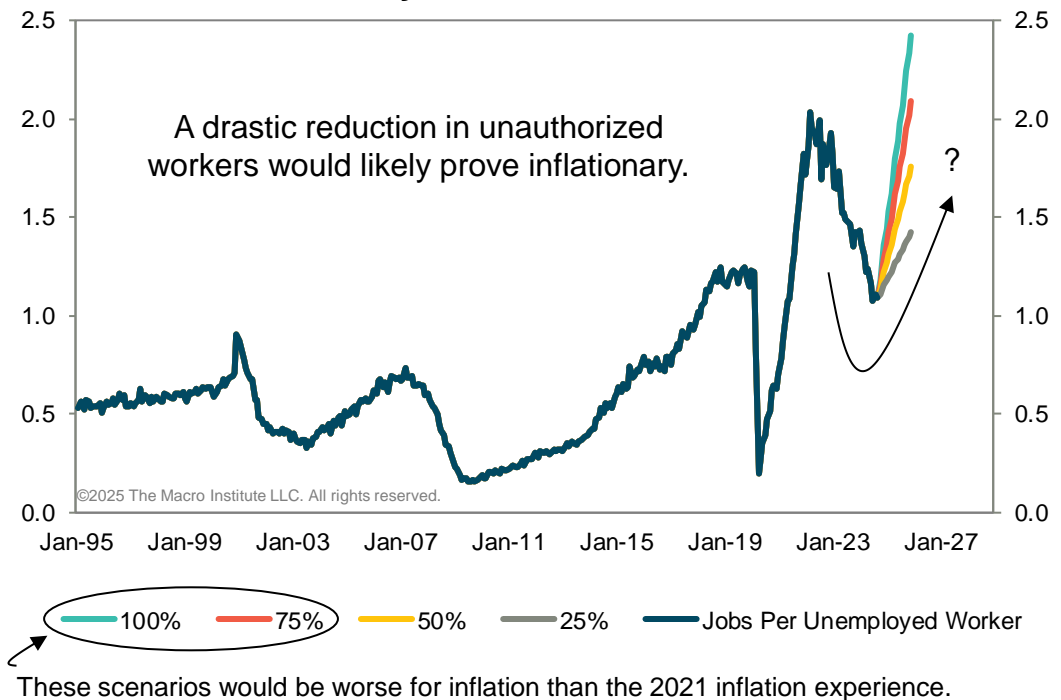
#2 Immigration

Deportation Would Reverse Fed's Inflation Fight Very Quickly

Earlier/Faster Slowdown!



Labor Market Key Driver Of U.S. Inflation Trends

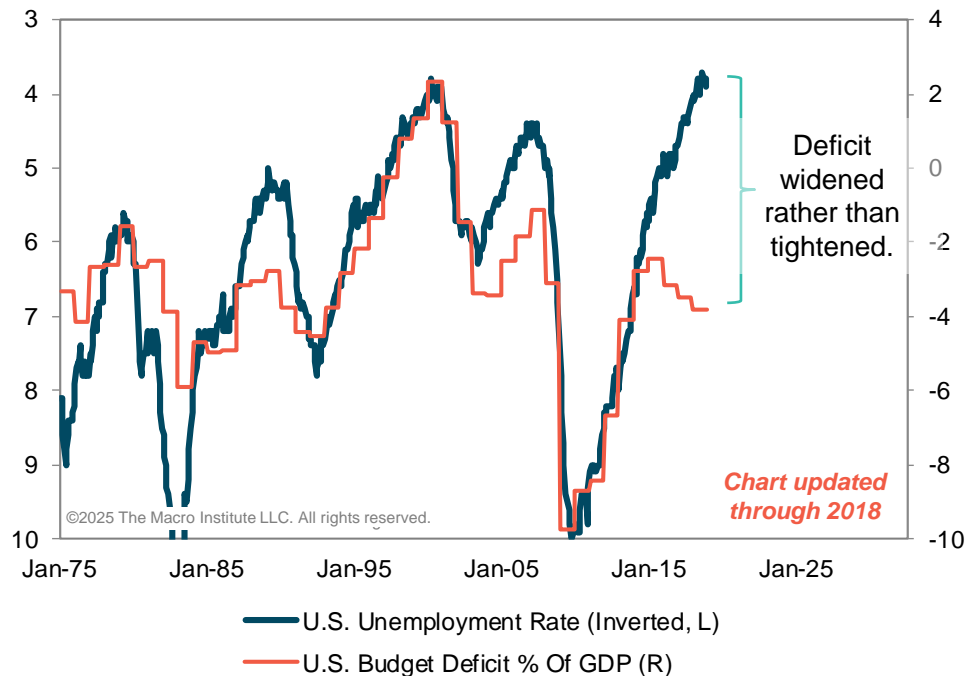


Section 2: Protectionist Policies Set To Fuel Inflation Further

#3 Austerity

A Structural Deficit In Dire Need Of A Solution

2017 Tax Cuts Contributed To Structural Deficit



Revenue Loss Outweighed Economic Growth

	2016	2017	2018
Revenues:			
Income Taxes	\$ 1,546	\$ 1,587	\$ 1,684
Payroll Taxes	\$ 1,115	\$ 1,162	\$ 1,171
Corp. Income Taxes	\$ 300	\$ 297	\$ 205
Other	\$ 307	\$ 270	\$ 271
Total	\$ 3,268	\$ 3,316	\$ 3,330
Expenditures:			
Discretionary	\$ 1,185	\$ 1,200	\$ 1,262
Mandatory	\$ 2,427	\$ 2,519	\$ 2,522
Interest	\$ 240	\$ 263	\$ 325
Total	\$ 3,853	\$ 3,982	\$ 4,109
Deficit	\$ (585)	\$ (665)	\$ (779)
% GDP	-3.1%	-3.4%	-3.8%
Unemployment Rate	4.7%	4.1%	3.9%

Source: CBO

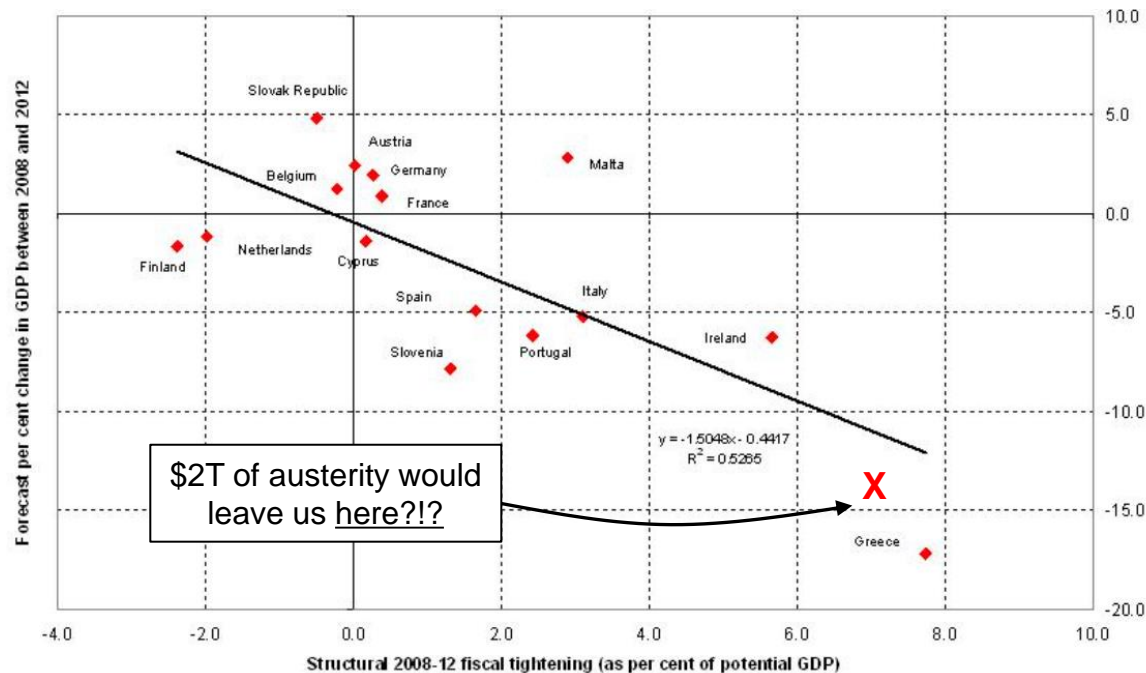
↓ Tax cuts led to only 1.9% revenue growth while expenditures grew 6.7%.

Section 2: Protectionist Policies Set To Fuel Inflation Further

#3 Austerity

Addressing U.S. Fiscal Imbalance Will Not Be Pain Free

Europe's Experience With Austerity = Economic Headwind



Total Government Spending In The U.S.

Outlays (Billions)	2024
<u>Discretionary Programs:</u>	
Defense	880
Non-Defense	992
Total Discretionary	1,872
<u>Mandatory Programs:</u>	
Social Security	1,459
Medicare	842
Medicaid	556
Other	1,060
Total Mandatory	3,916
Net Interest	796
Total Outlays	6,584

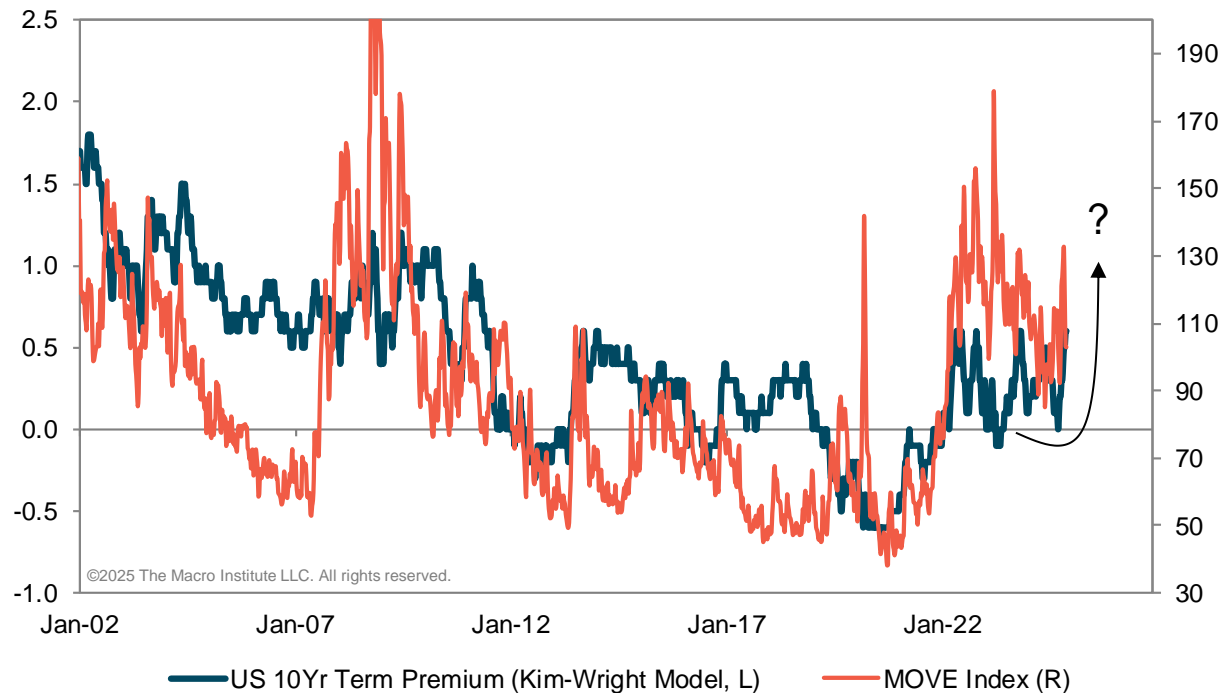
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Section 2: Protectionist Policies Set To Fuel Inflation Further

#3 Austerity

Election Uncertainty & Policy Proposals Certainly Played A Role In Higher Bond Yields

Economic Uncertainty Raises The Term Premium In Bond Yields



Kim Wright Model

	10-Yr Yield Chg (bps)	=	Growth Outlook	+	Inflation Component	+	Term Premium
Since Fed Cut	66		3		25		38
	100%		4%		39%		57%

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Interesting

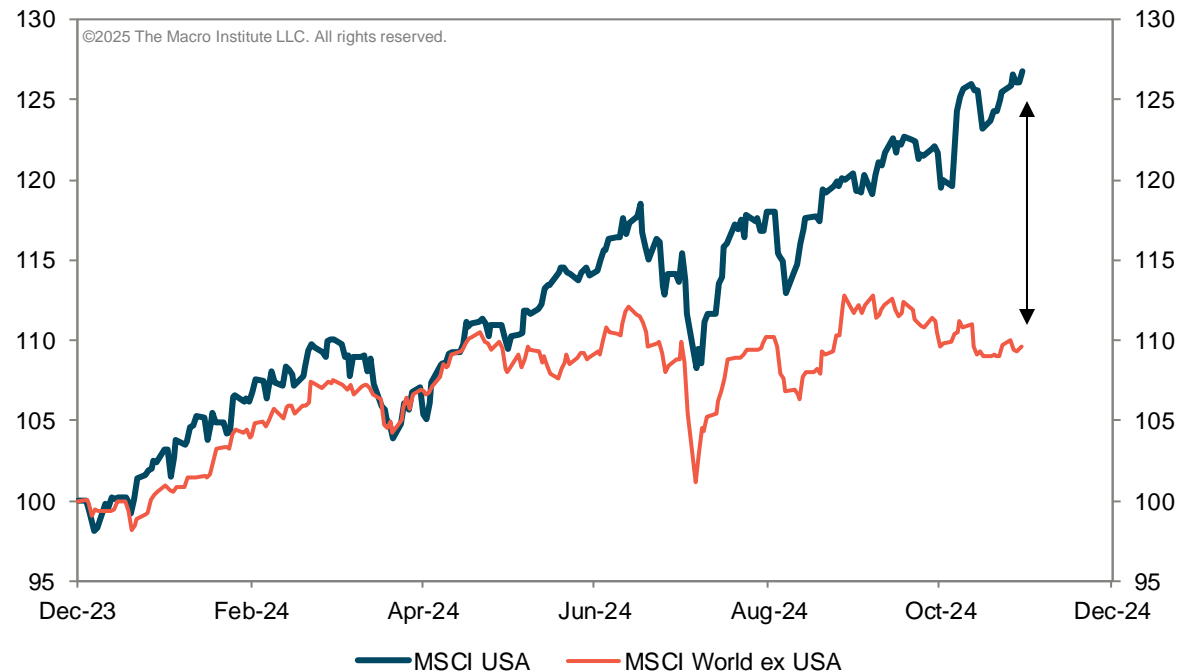
Section 3: Top Five Concerns On Our Minds For 2025



Section 3: Top Five Concerns On Our Minds For 2025

Risk #1: The Proposed Policies Of The Incoming Administration

The U.S. Has Significantly Outpaced The RoW In 2024



Section 3: Top Five Concerns On Our Minds For 2025

Risk #2: An Out-Of-Control Fiscal Backdrop In The U.S.

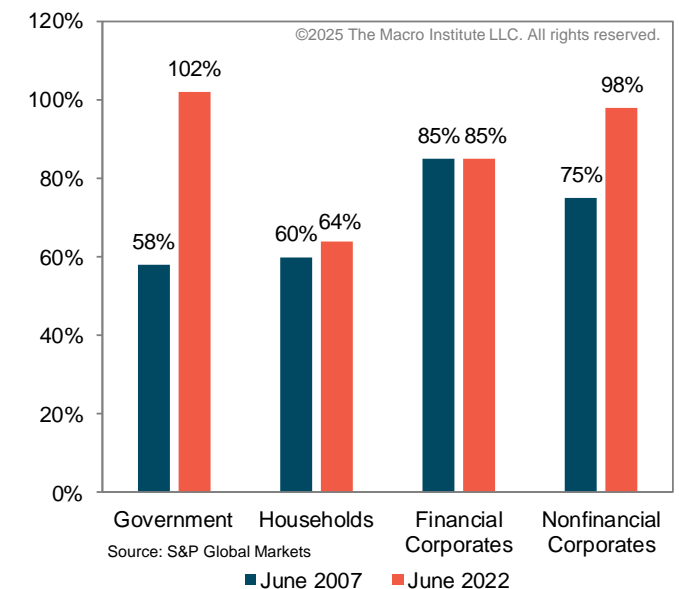
U.S. Loses Top AAA Credit Rating From Fitch

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Fitch	AAA, Stable Outlook	AAA, Negative Outlook	AAA, Negative Outlook	AAA, Negative Watch	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Negative Outlook	AAA, Negative Outlook	AAA, Stable Outlook	AA+
Moody's	AAA, Stable Outlook	AAA, Negative Outlook	AAA, Negative Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook	AAA, Stable Outlook
S&P	AAA, Stable Outlook	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AA+

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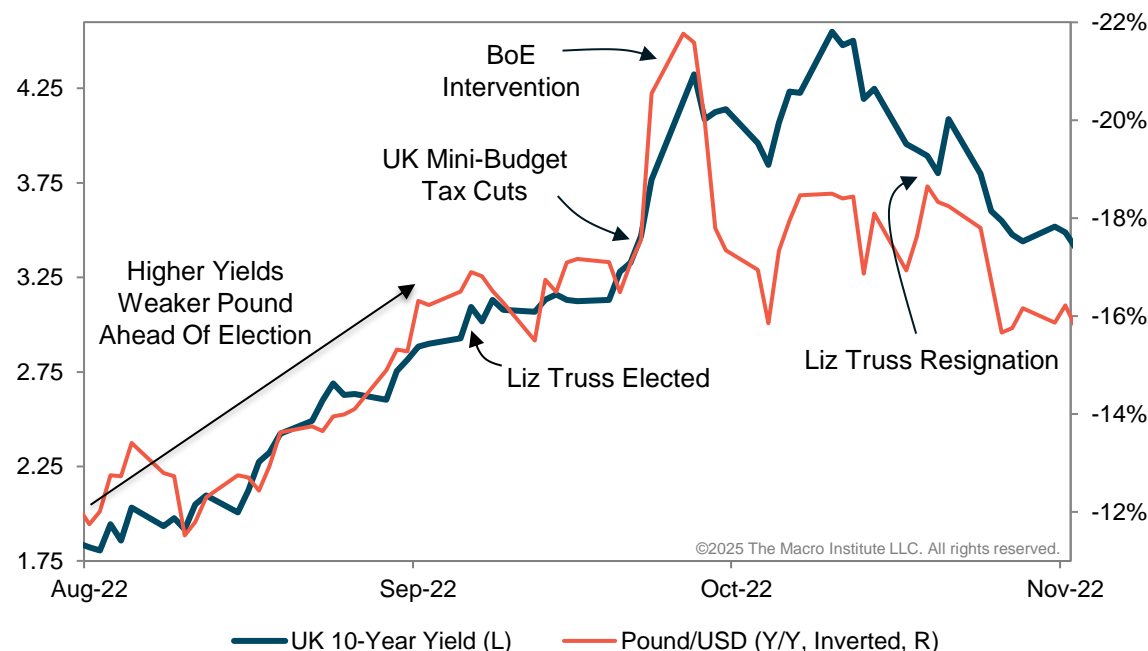
Debt Elevated Across All Segments



Section 3: Top Five Concerns On Our Minds For 2025

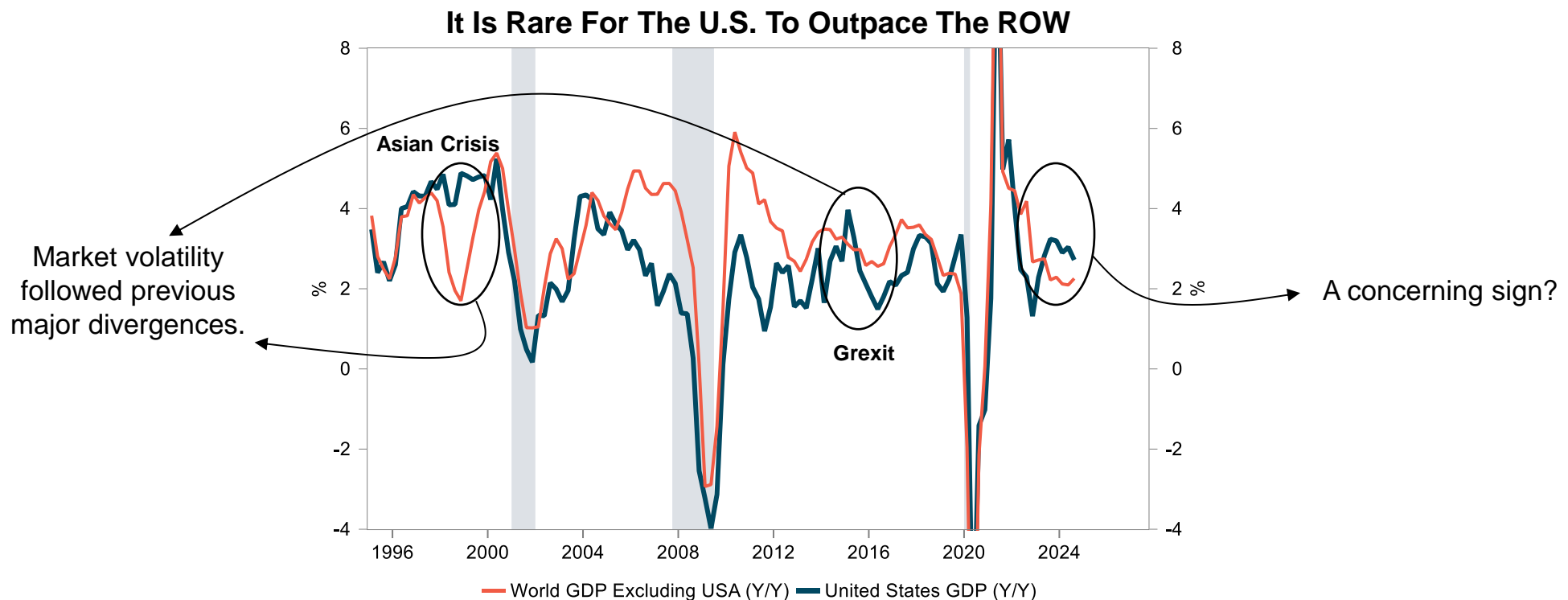
Risk #3: Could The Bond Vigilantes Force The Government's Hand?

U.S. Policy Makers Should Heed Lessons From U.K.'s 2022 Experience



Section 3: Top Five Concerns On Our Minds For 2025

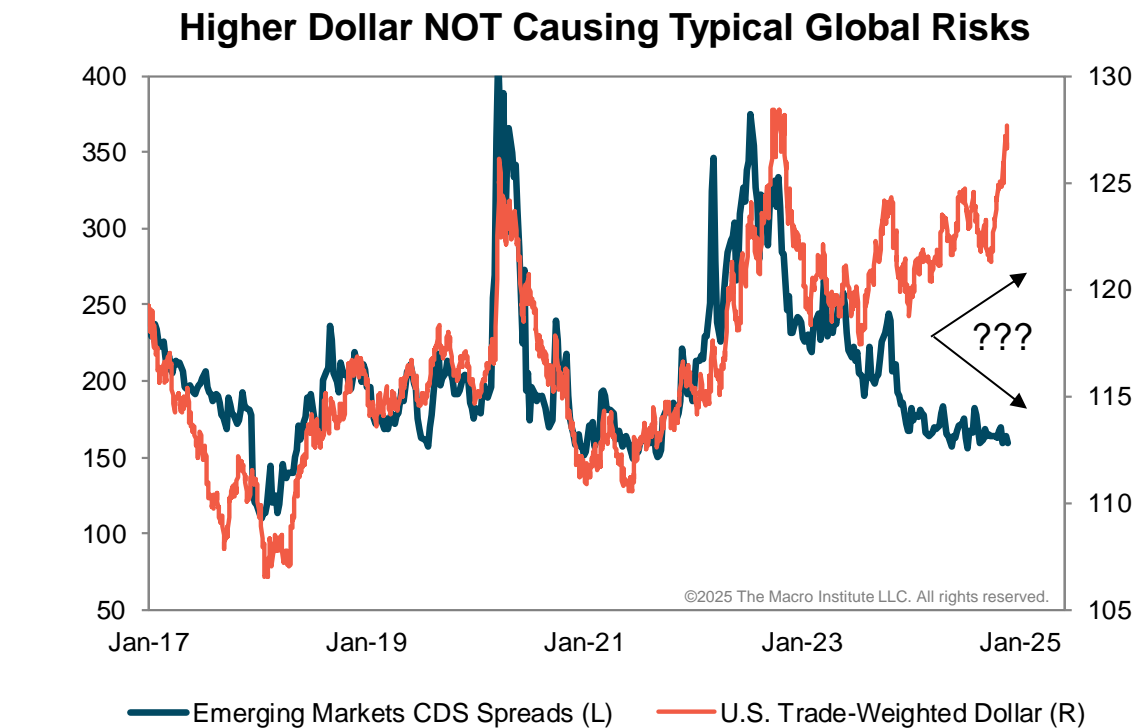
Risk #4: An Already Shaky Backdrop In The Rest Of The World (Think China!)



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Section 3: Top Five Concerns On Our Minds For 2025

An Already Shaky Backdrop In Some Parts Of The World

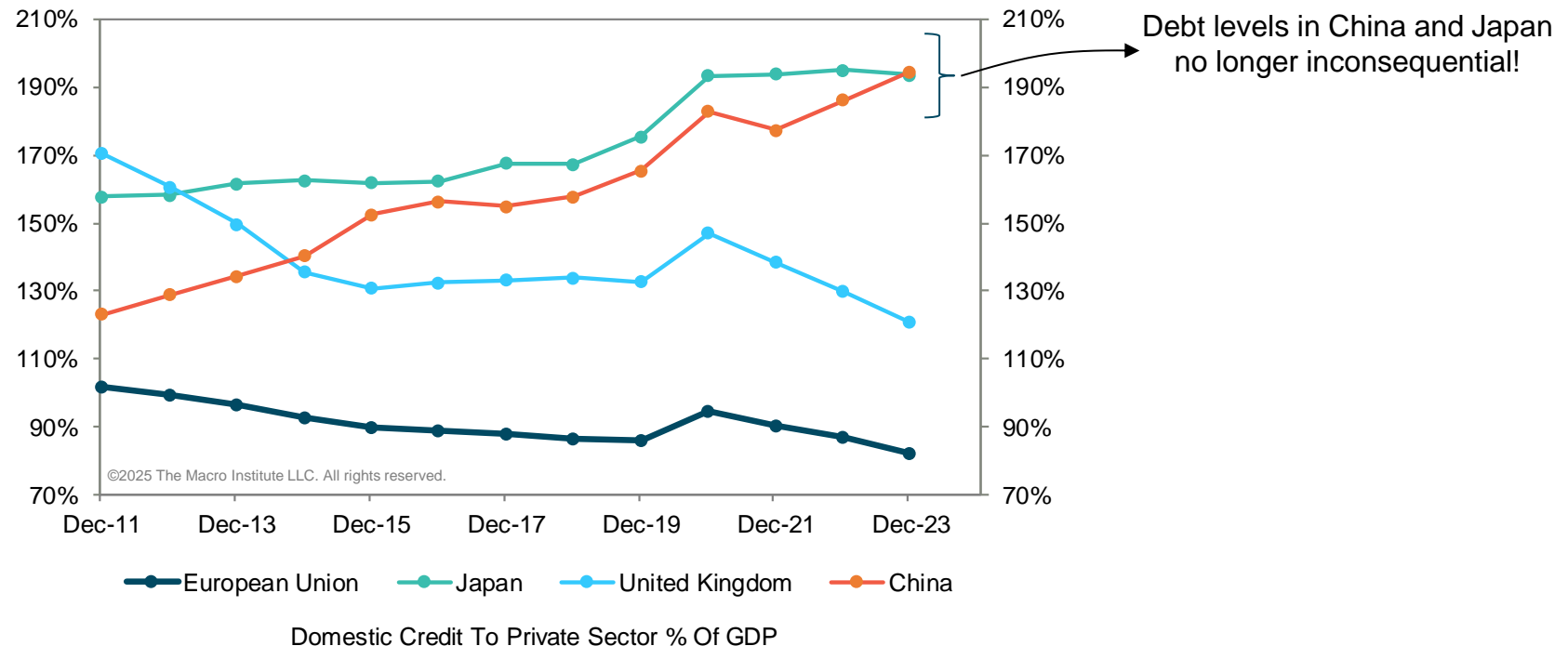


Holding Up! →

Section 3: Top Five Concerns On Our Minds For 2025

Systemic Risk Mostly About Larger Economies In 2025

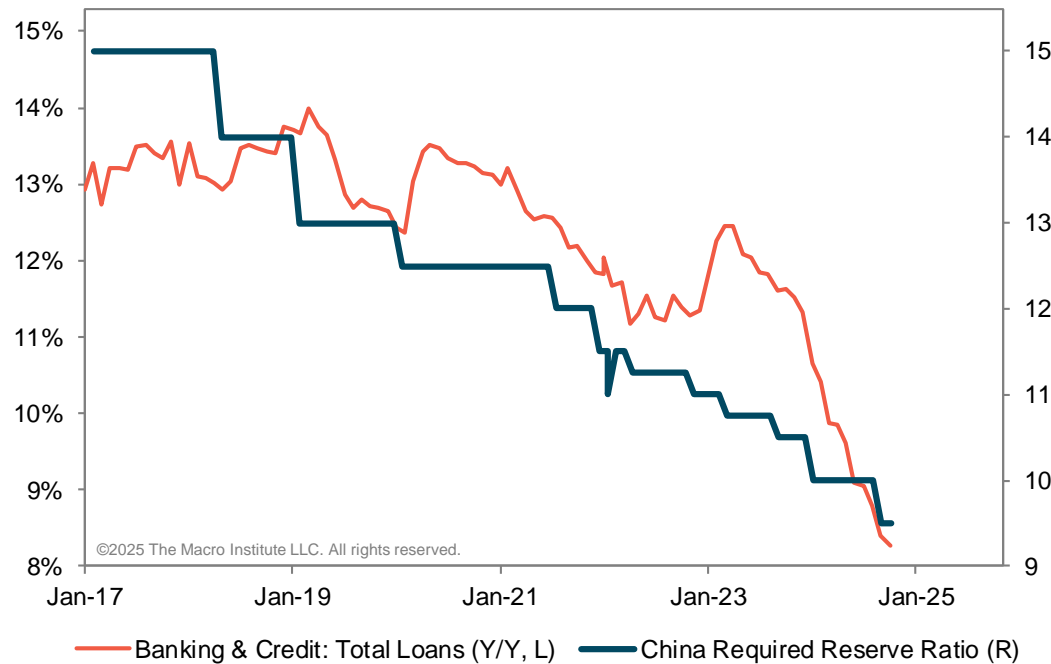
Japan And China Most Likely To Have To Support Private Sector



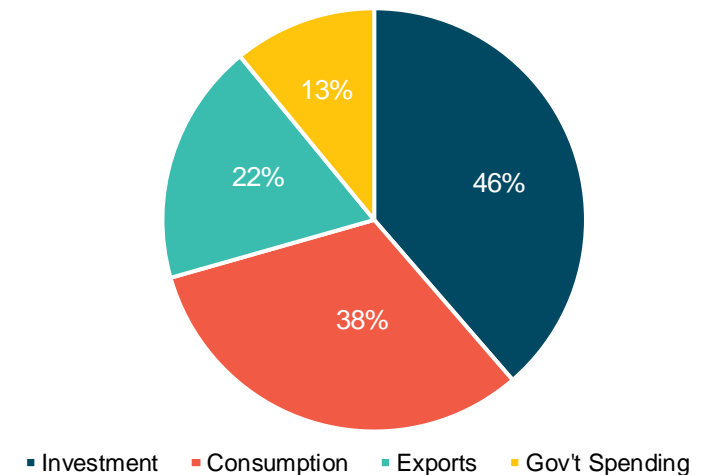
Section 3: Top Five Concerns On Our Minds For 2025

China's Investment Woes Leave The Country Vulnerable

A Classic Liquidity Trap In China?!?



Components Of China's GDP



Section 3: Top Five Concerns On Our Minds For 2025

China's Recent Stimulus Not Enough To Revive Optimism

China STILL A Driver Of Commodity Prices!

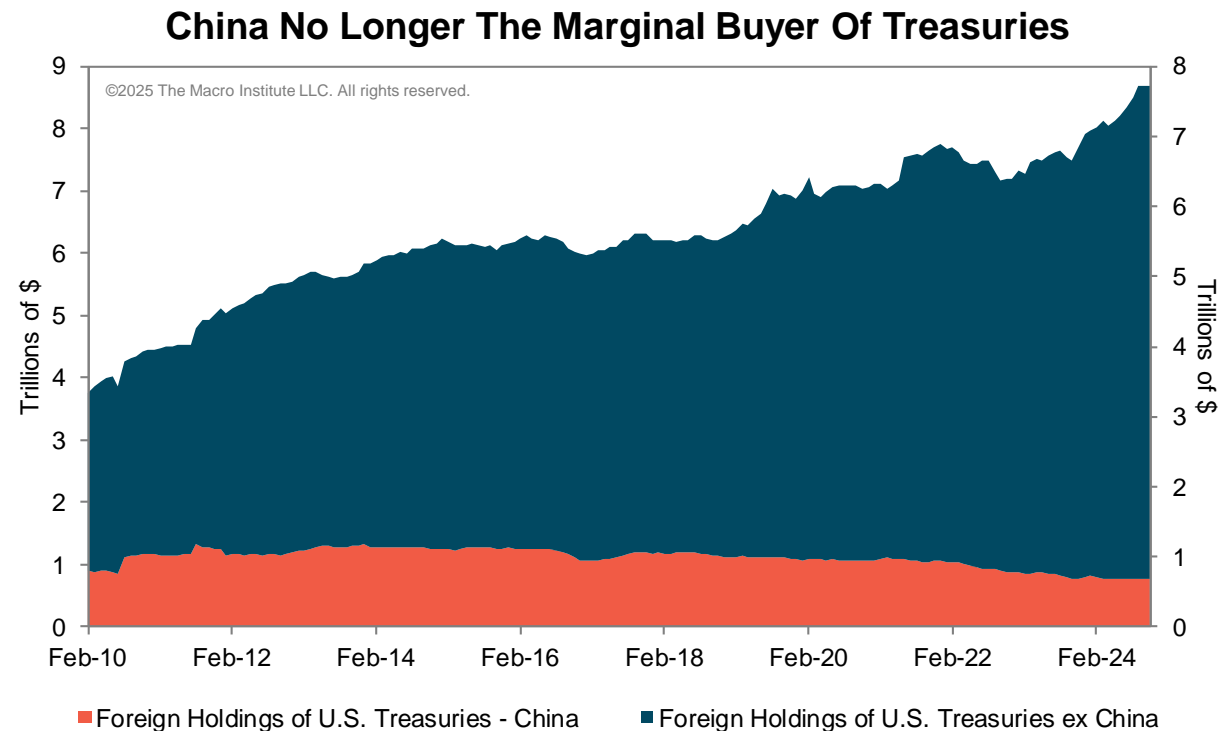


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“China bond yields hit record low after Beijing vows ‘vigorous’ effort to boost consumption.”
- Financial Times, Dec. 12, 2024

Section 3: Top Five Concerns On Our Minds For 2025

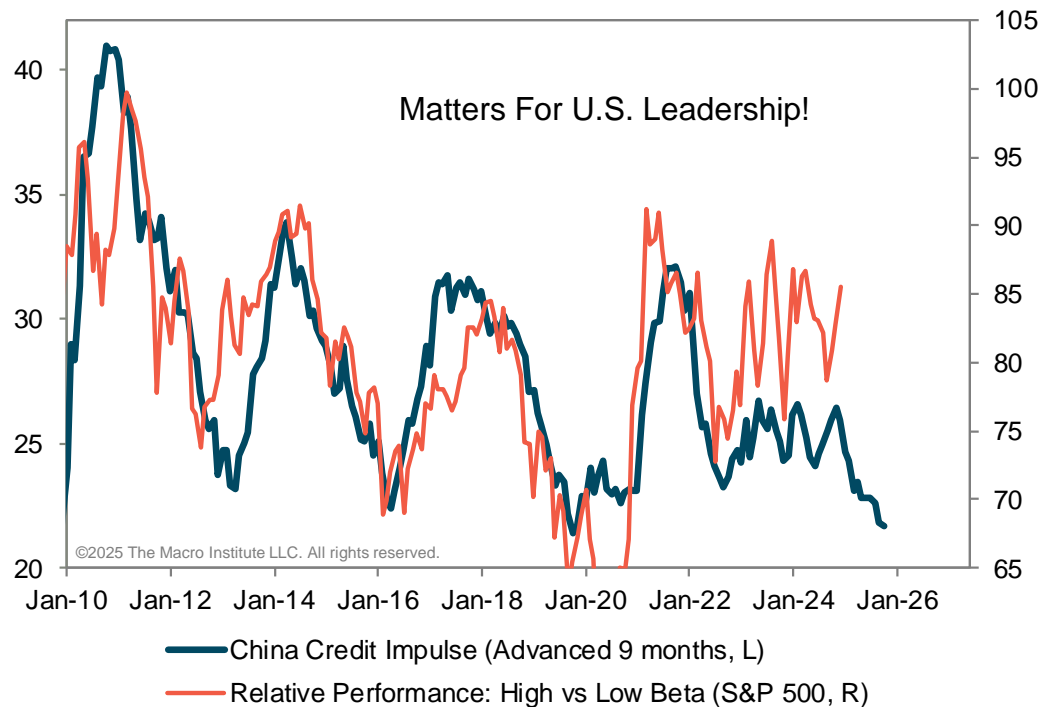
China And U.S. Treasuries Much Ado About Nothing?



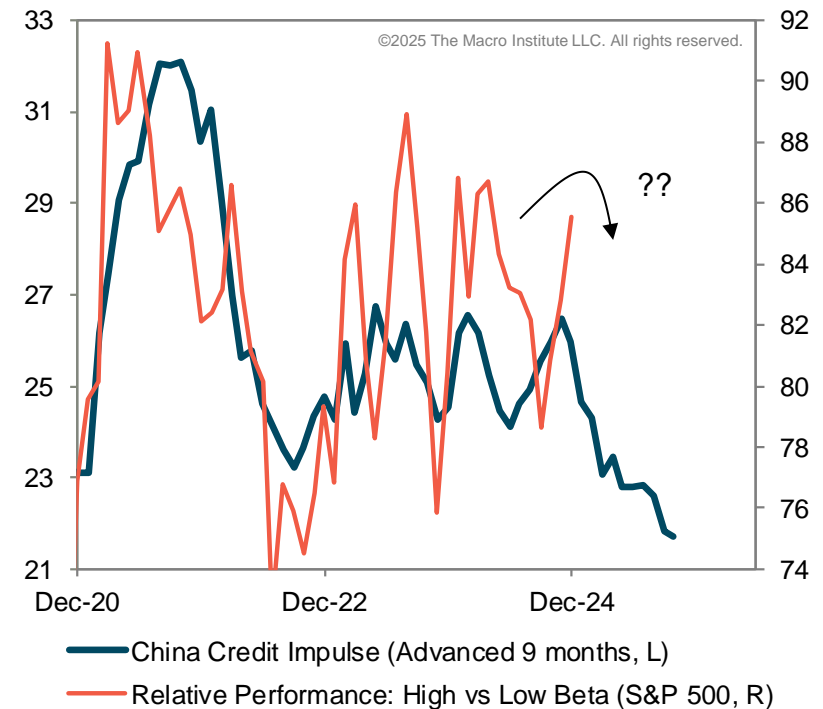
Section 3: Top Five Concerns On Our Minds For 2025

Could China's Woes Catch Up To U.S. Equity Markets?

China's Policies And Their Influence On U.S. Equities

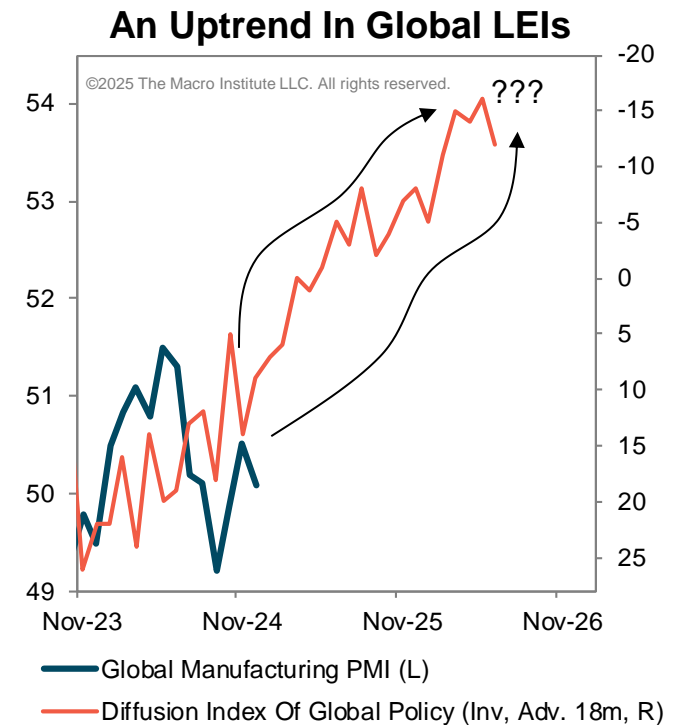
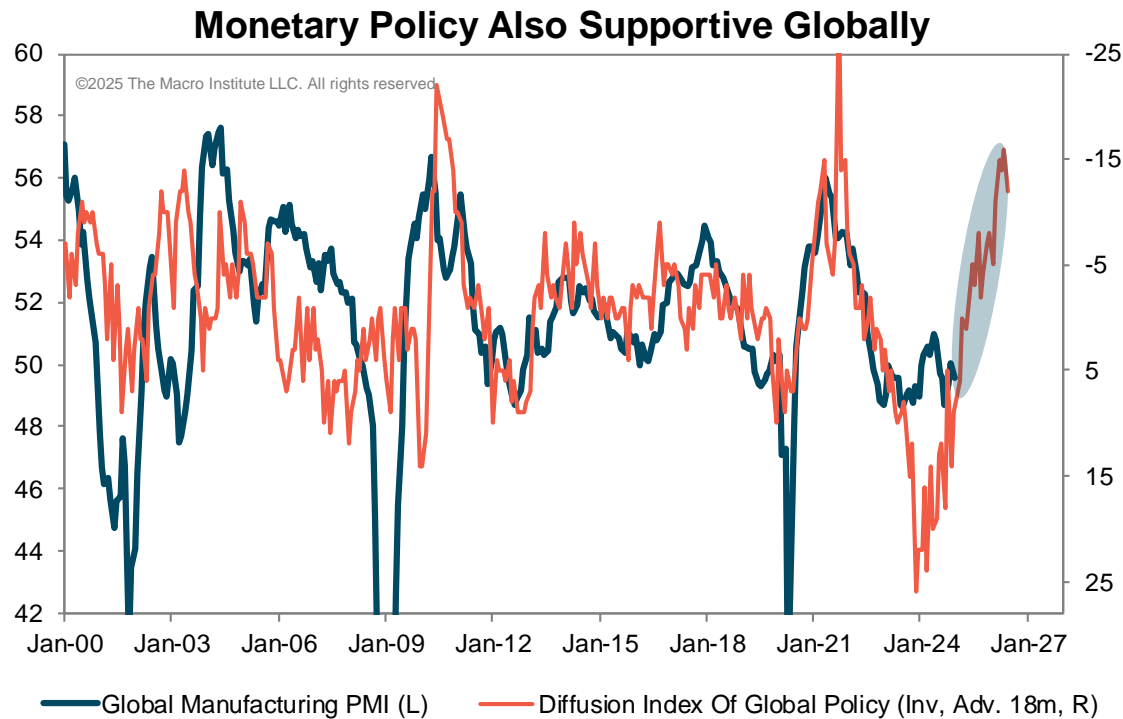


One To Keep An Eye On



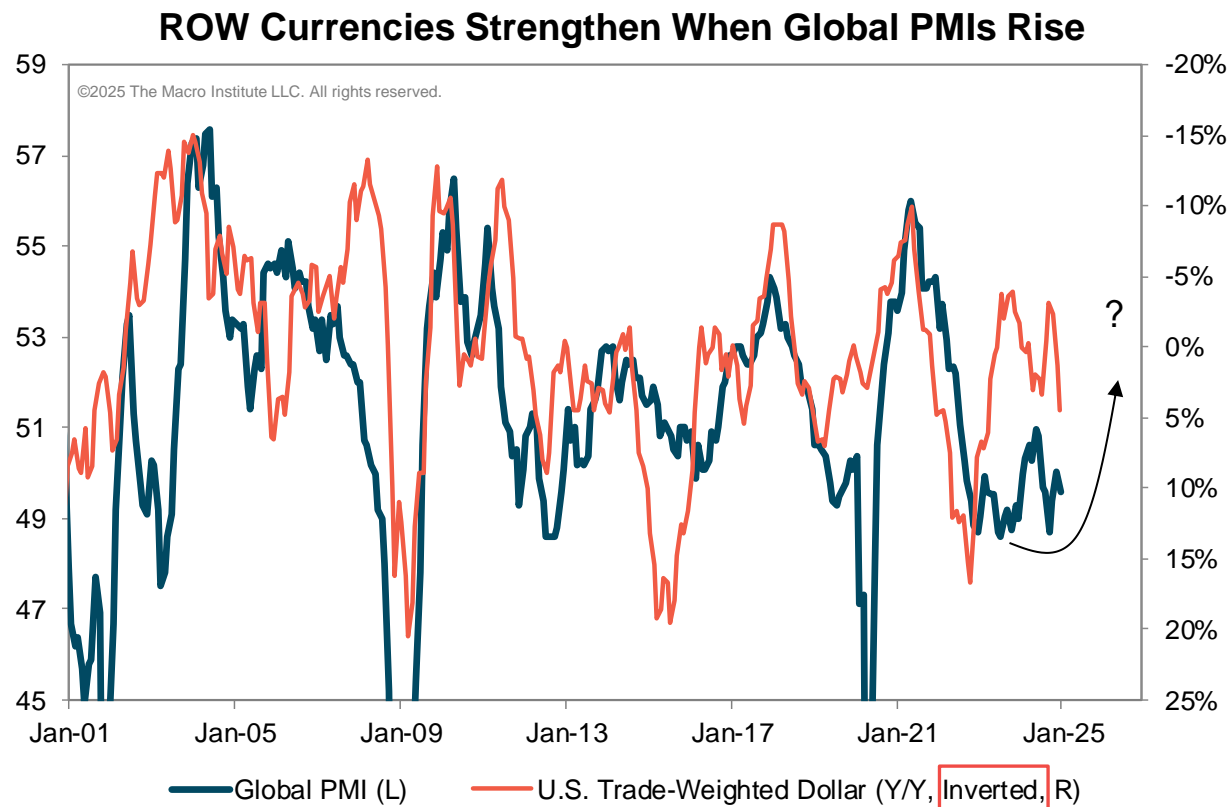
Section 3: Top Five Concerns On Our Minds For 2025

Risk #5: A Global Recovery Would Accentuate U.S. Inflation Trends



Section 3: Top Five Concerns On Our Minds For 2025

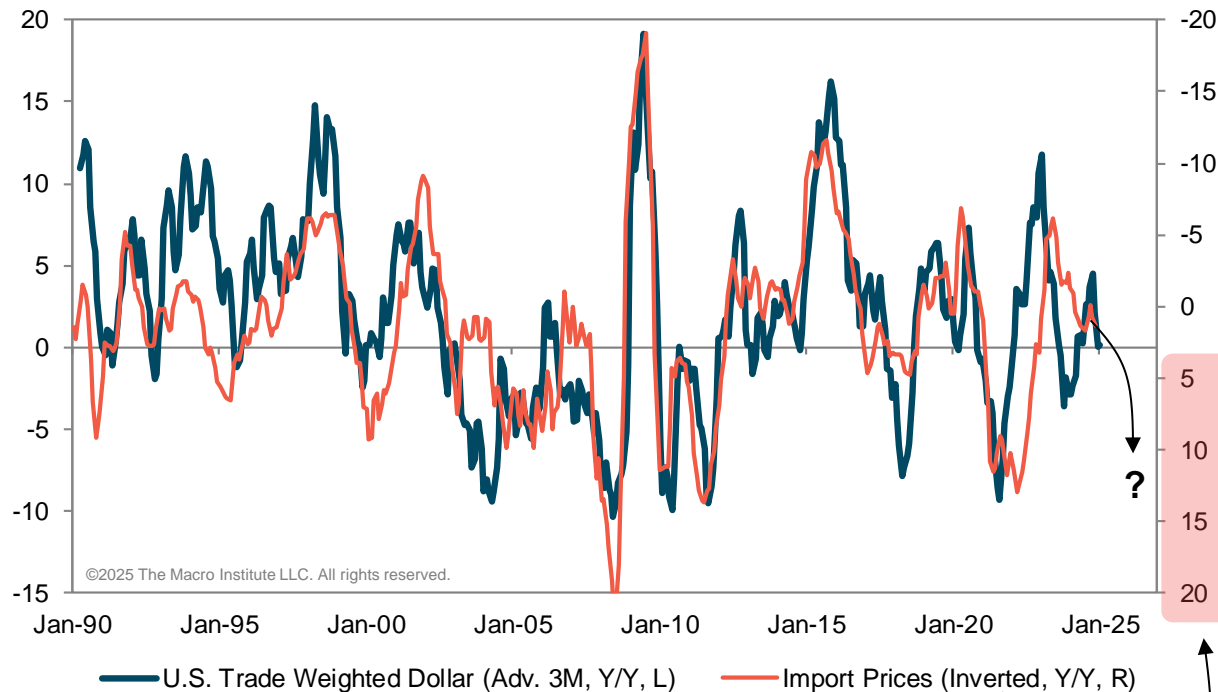
A Global Recovery Would Likely Weigh On The U.S. Dollar



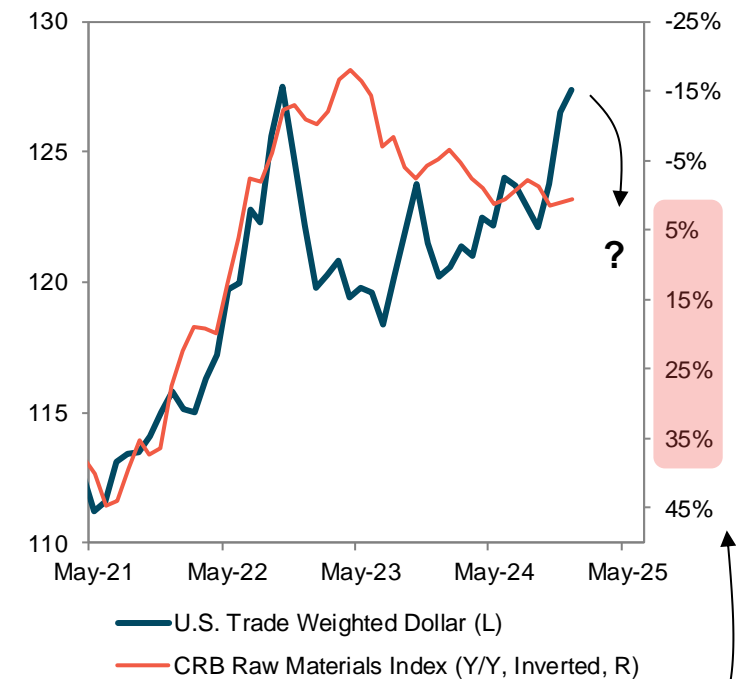
Section 3: Top Five Concerns On Our Minds For 2025

A Weaker USD Could Accentuate Inflationary Pressures

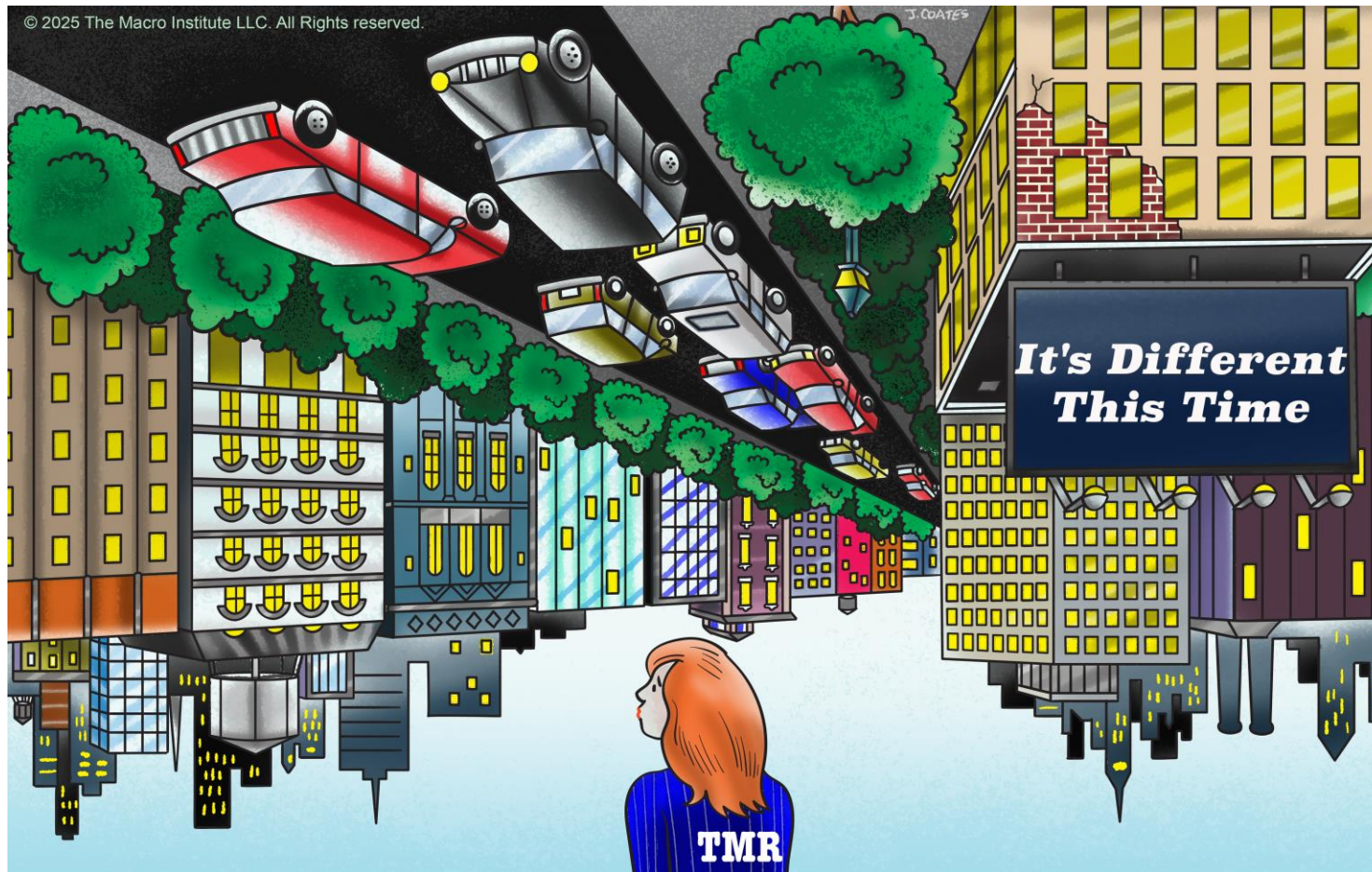
An Appreciating Currency Usually Leads To Weaker Import Prices



USD vs. CRB Raw Materials Index



Conclusion: Opportunities In A Complicated Macro Backdrop



It always is ...
a little bit !!!

Conclusion: Opportunities In A Complicated Macro Backdrop

The Three Most Important Macro Trends In The Coming Year



Stronger Economic Prospects

An opportunity for small caps and cyclicals



Recovery In Inflation

Favors companies with pricing power



Fed Tightening/ Higher Interest Rates

A problem for growth stocks and early cyclical sectors

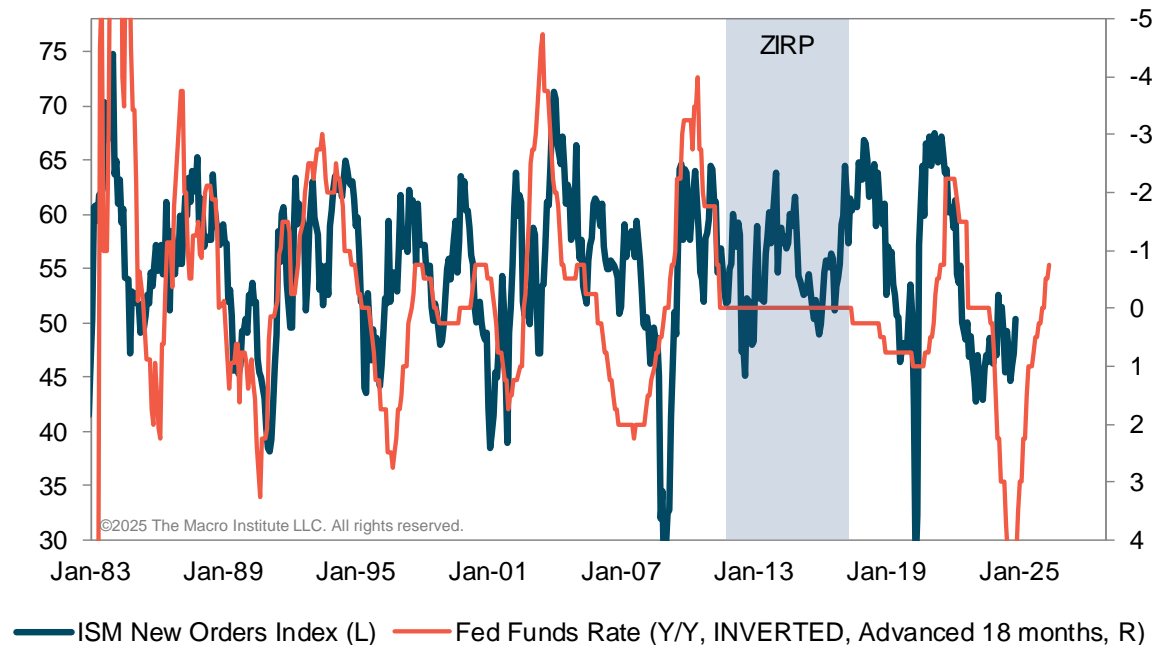
Three Key Macro Influences For 2025

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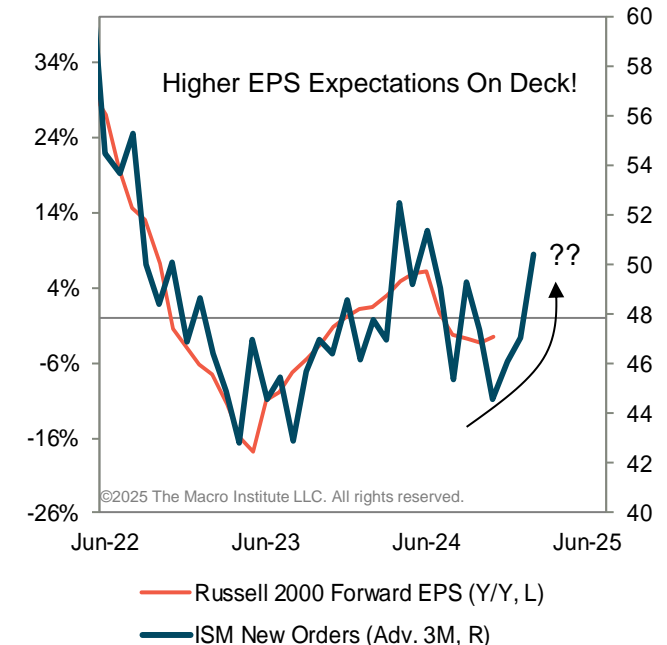
Conclusion: Opportunities In A Complicated Macro Backdrop

Monetary Policy Becomes Supportive Of The Economy In 2025

LEIs Usually Start To Recover ~18 Months After Last Rate Hike



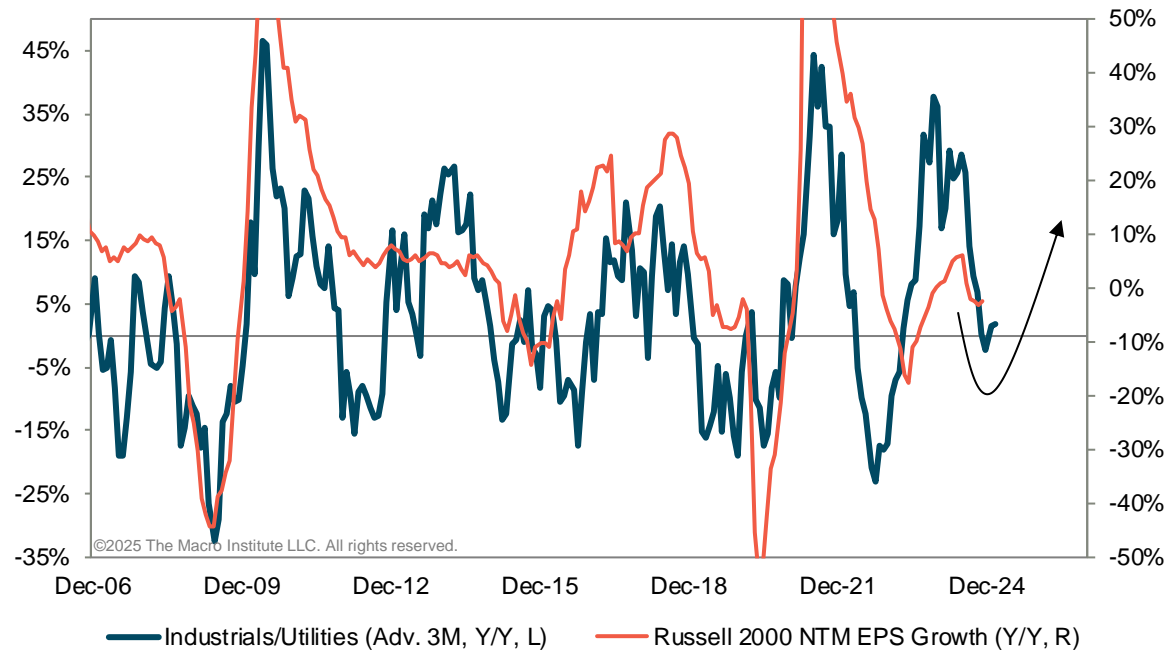
Rising LEI's Should Benefit EPS



Conclusion: Opportunities In A Complicated Macro Backdrop

An “Unusual” Risk-On Backdrop For Equities In 2025

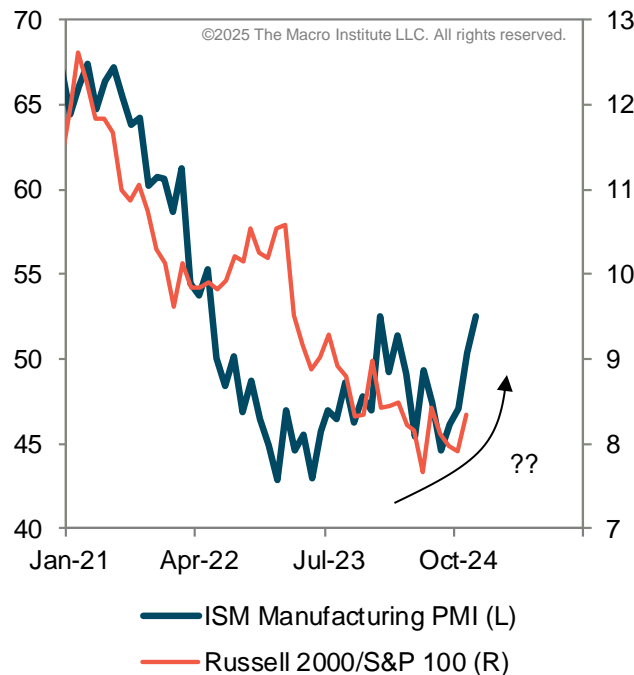
2025 In A Nutshell – Cyclical > Defensives Amidst Rising EPS



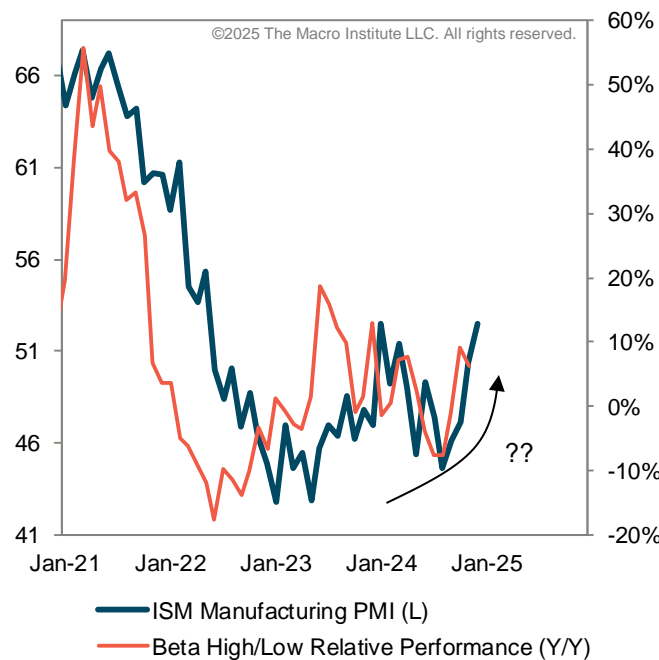
Conclusion: Opportunities In A Complicated Macro Backdrop

A Pro-Cyclical Or Risk-On Equity Backdrop For 2025

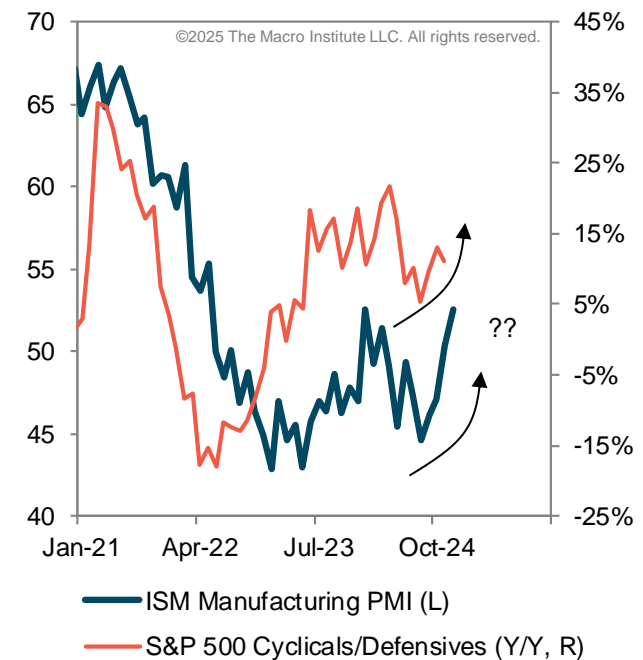
Small Cap > Large Cap



High Beta > Low Beta



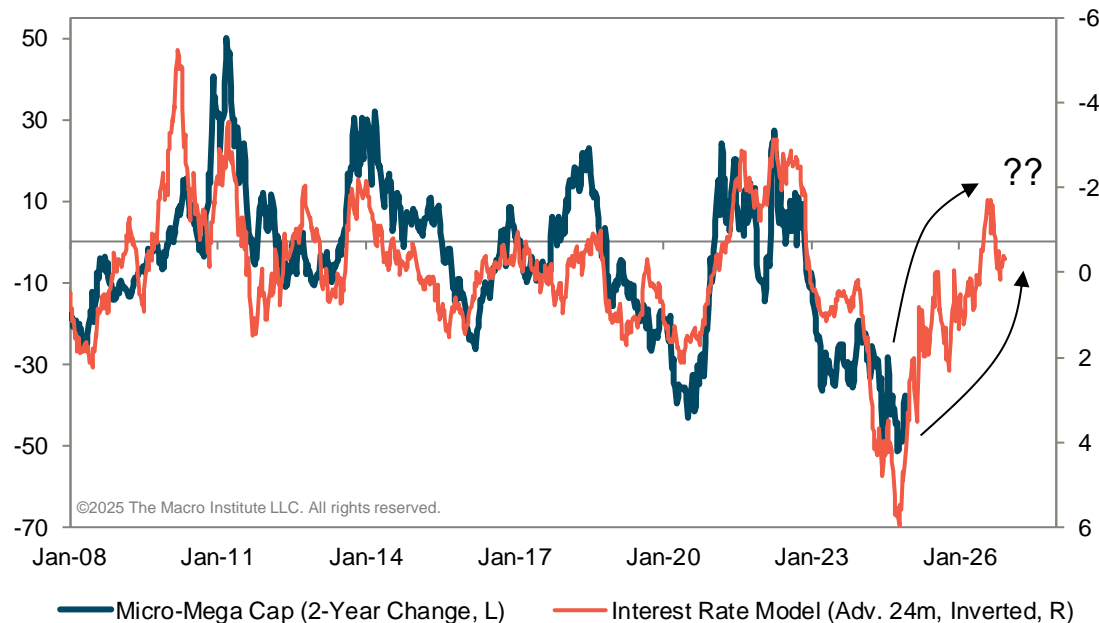
Cyclicals > Defensives



Conclusion: Opportunities In A Complicated Macro Backdrop

The Size Trade - Small Over Large ... And The End Of Mag 7?

Rates Favor Small Caps Over Large Caps Going Into 2025



Not All Indices Are Created Equal

Index	Beta	P/E	Cyclical Weight
Nasdaq 100	1.18	34.83	6.14%
S&P 500	1.00	27.21	26.42%
Russell 2000	1.12	17.18	43.56%

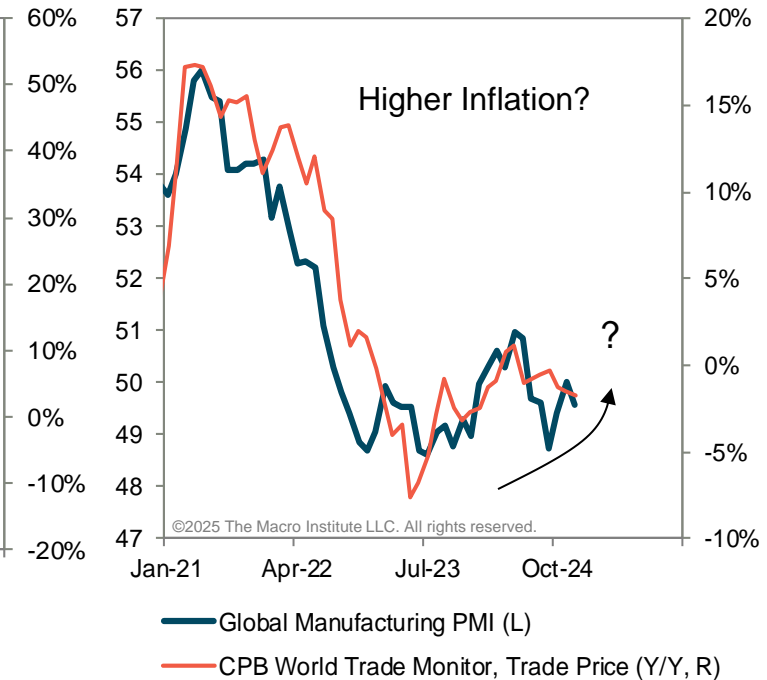
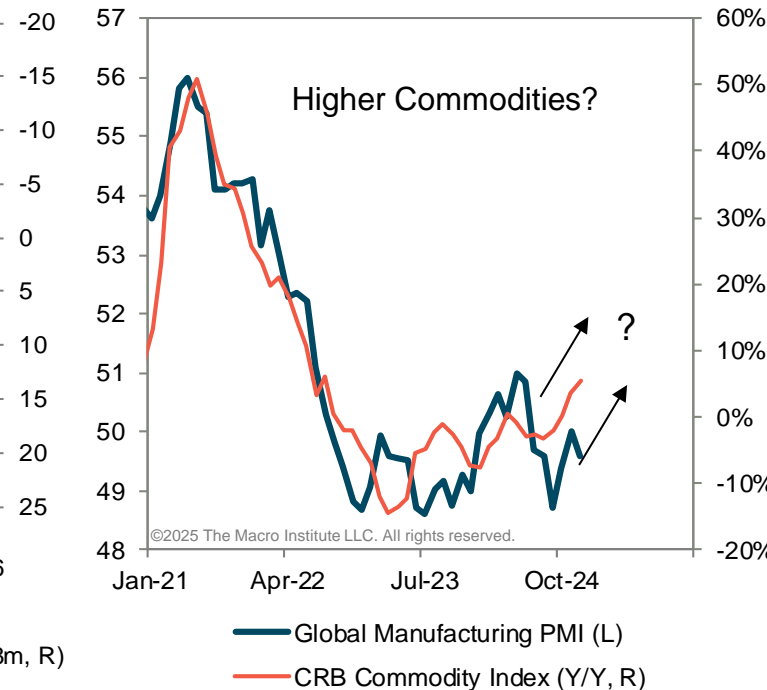
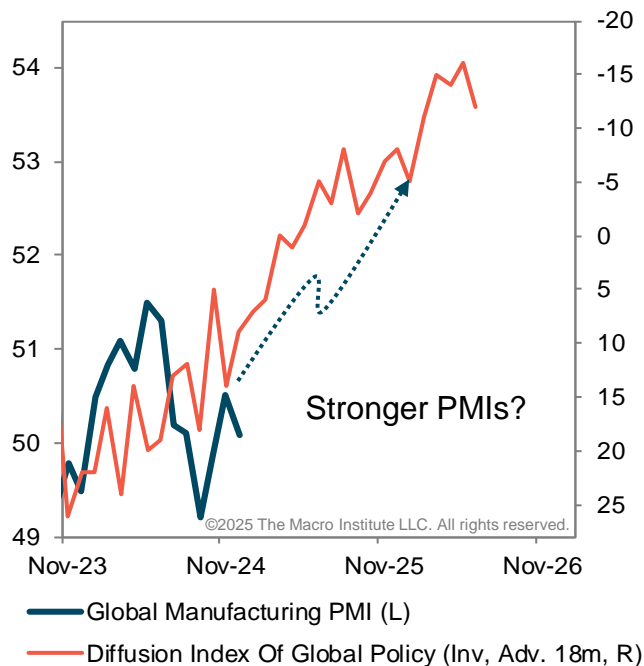
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The TMI rate model is constructive on cyclical-heavy indices in 2025.

Conclusion: Opportunities In A Complicated Macro Backdrop

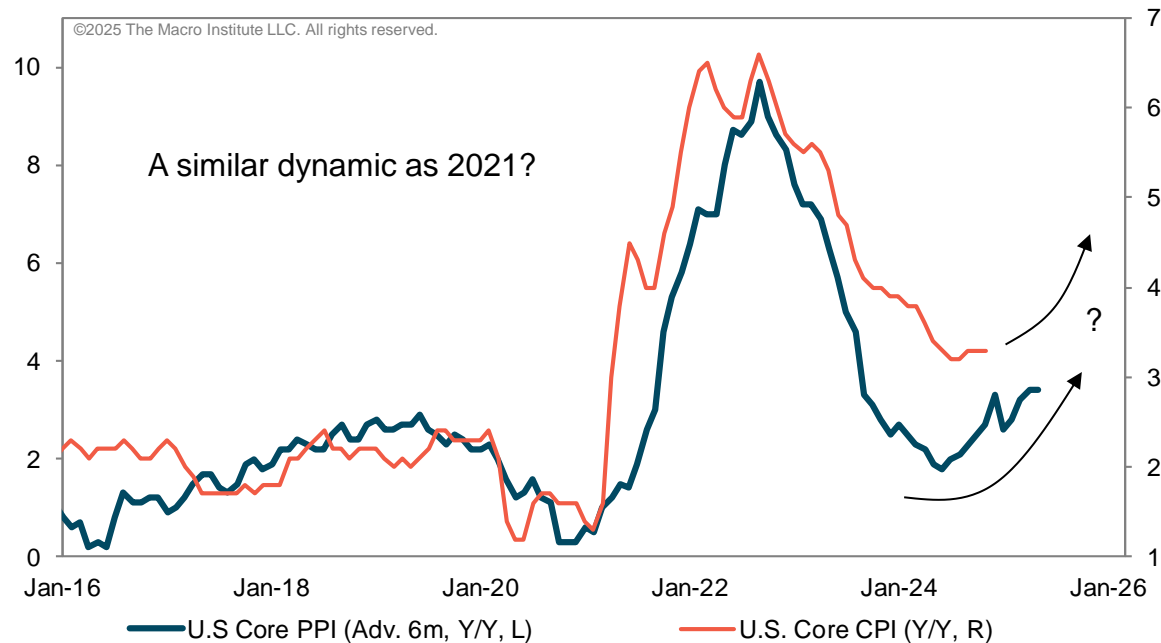
Global Recovery on Track ... Barring Restrictive U.S. Policy

The Economic Recovery Story Is Not Limited To The United States



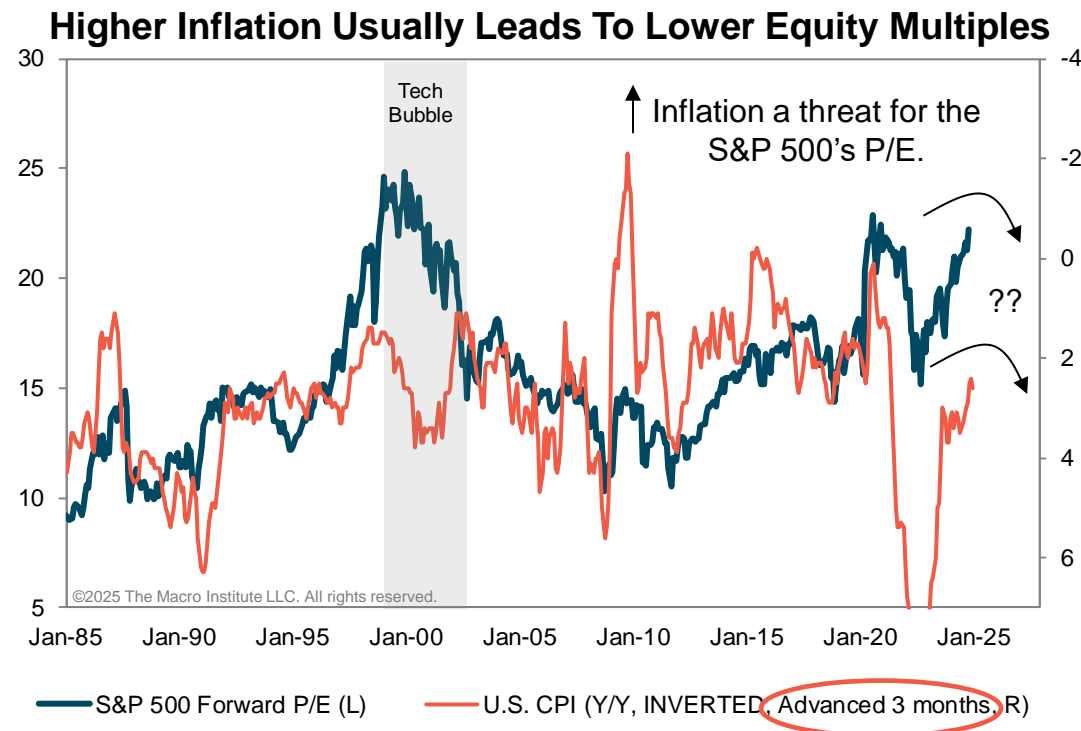
A Gradual Recovery In Inflationary Pressures In 2025

Producer Prices Already Pointing To Higher CPI Ahead



Conclusion: Opportunities In A Complicated Macro Backdrop

P/Es And Inflation Usually Have An Inverse Correlation

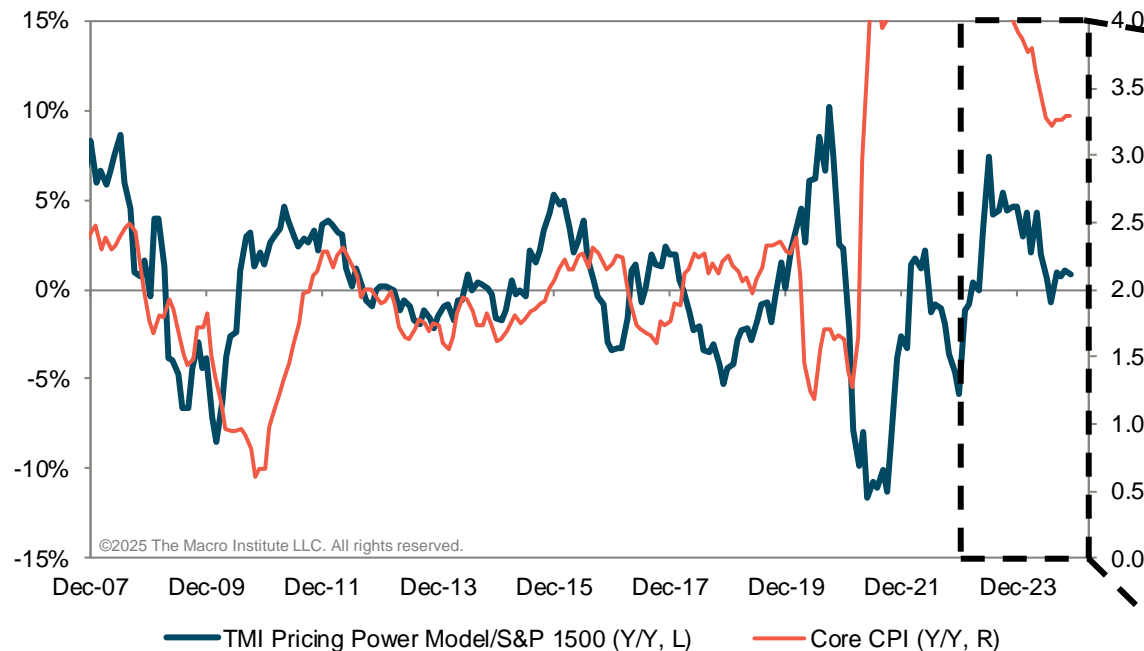


Conclusion: Opportunities In A Complicated Macro Backdrop

Recovery In Inflation

A Stock Selection Tool For An Inflationary Backdrop

Emphasize Stocks With High-Pricing Power As Inflation Climbs

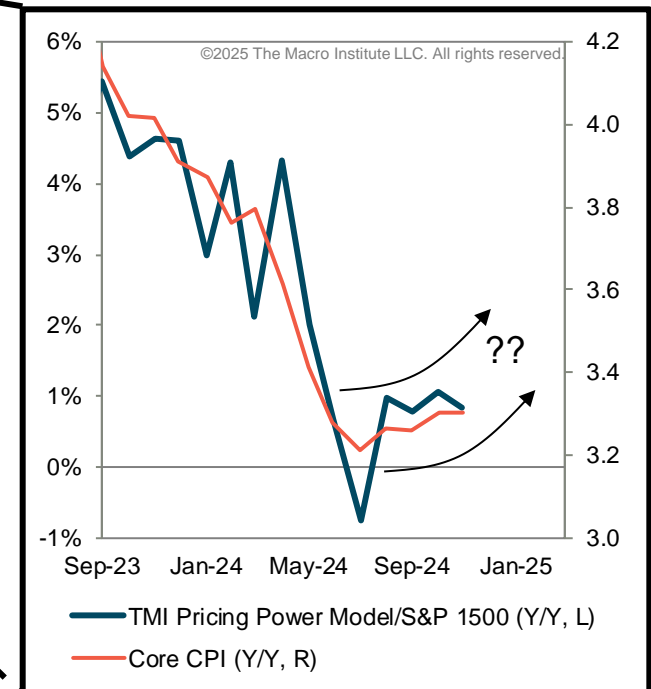


Strong Pricing Power:

Δ Gross Margins + Δ Market Share

Higher Gross Margins (Y/Y)

Higher Market Share (Over Past 2 Years)

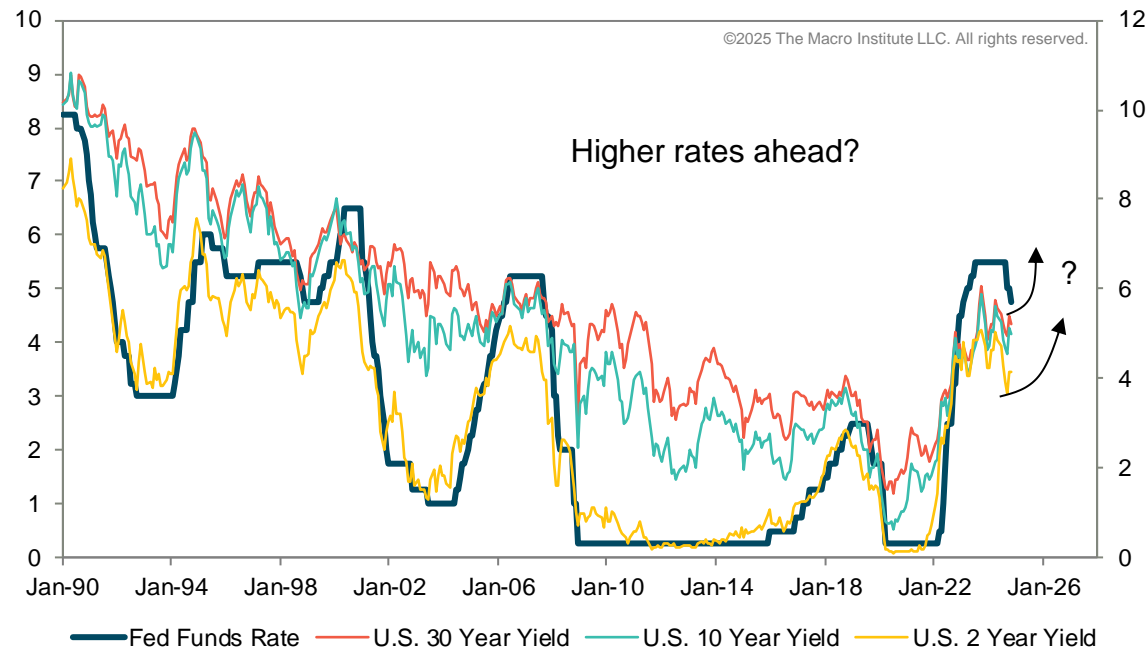


Conclusion: Opportunities In A Complicated Macro Backdrop

Fed Tightening/Higher Rates

Recovery In Inflation Could Reignite Fed Tightening

The Fed Funds Rate Paves The Path For All Market Rates



Conclusion: Opportunities In A Complicated Macro Backdrop

Fed Tightening/Higher Rates

Fed Rate Hikes Typically Associated With Lower P/Es

P/Es Have Contracted During 13 Of The Past 15 Fed Tightening Cycles

Rate Hike Cycle	Start	Nov-54	Jul-58	Jul-61	Oct-67	Feb-71	Feb-72	Feb-74	Nov-76	Mar-81	Apr-83	Nov-86	Jan-94	May-99	May-04	Dec-15	Up
	Stop	Oct-57	Nov-59	Nov-66	Aug-69	Aug-71	Aug-73	Jul-74	Apr-80	May-81	Aug-84	Feb-89	Feb-95	May-00	Jun-06	Dec-18	
Policy Rates	Start	0.83	0.68	1.17	3.88	3.50	3.50	9.00	4.75	16.00	8.50	5.88	3.00	4.75	1.00	0.50	15/15
	Stop	3.50	4.00	5.76	9.19	5.75	11.00	9.25	11.50	20.00	11.75	9.75	6.00	6.50	5.25	2.50	
	Chg Rates	2.67	3.32	4.59	5.31	2.25	7.50	0.25	6.75	4.00	3.25	3.88	3.00	1.75	4.25	2.00	
Oil Prices	Start	2.8	3.1	3.0	3.1	3.6	3.6	10.1	13.9	38.0	30.6	15.2	15.0	17.8	40.3	37.0	13/15
	Stop	3.1	3.0	3.0	3.4	3.6	4.3	10.1	39.5	38.0	29.3	17.8	18.5	28.8	71.0	45.4	
	Chg Oil	8.9%	-3.3%	0.0%	9.1%	0.0%	21.1%	0.0%	184.2%	0.0%	-4.4%	17.2%	23.5%	62.1%	76.2%	22.6%	
Stock Market	Start	34	47	67	94	97	107	96	102	136	164	249	482	1302	1121	2044	12/15
	Stop	41	58	80	96	99	104	79	106	133	167	289	487	1421	1270	2507	
	Chg Stocks	19.9%	23.5%	20.5%	1.7%	2.4%	-2.2%	-17.6%	4.1%	-2.5%	1.4%	15.9%	1.2%	9.1%	13.3%	22.6%	
P/Es	Start	12.6	14.8	21.4	17.9	18.1	19.4	12.2	11.0	9.0	12.5	12.5	14.9	23.5	16.5	16.2	2/15
	Stop	12.4	17.2	14.4	16.4	18.6	15.1	9.9	7.0	8.9	10.7	10.1	12.6	22.2	14.0	14.7	
	Chg P/E	(0.25)	2.31	(7.07)	(1.53)	0.42	(4.29)	(2.30)	(4.06)	(0.14)	(1.85)	(2.38)	(2.36)	(1.31)	(2.48)	(1.57)	
	% Chg P/E	-2.0%	15.6%	-33.0%	-8.5%	2.3%	-22.1%	-18.9%	-36.8%	-1.6%	-14.8%	-19.1%	-15.8%	-5.6%	-15.0%	-9.7%	
U.S. Dollar	Start				99.9	100.3	90.6	85.9	88.6	80.7	102.1	88.3	79.7	85.3	74.2	82.3	4/13
	Stop				103.0	97.1	79.9	83.9	73.5	87.5	117.0	79.2	71.7	90.7	71.0	80.2	
	Chg USD %				3.1%	-3.2%	-11.9%	-2.4%	-17.0%	8.5%	14.7%	-10.4%	-10.1%	6.3%	-4.2%	-2.5%	

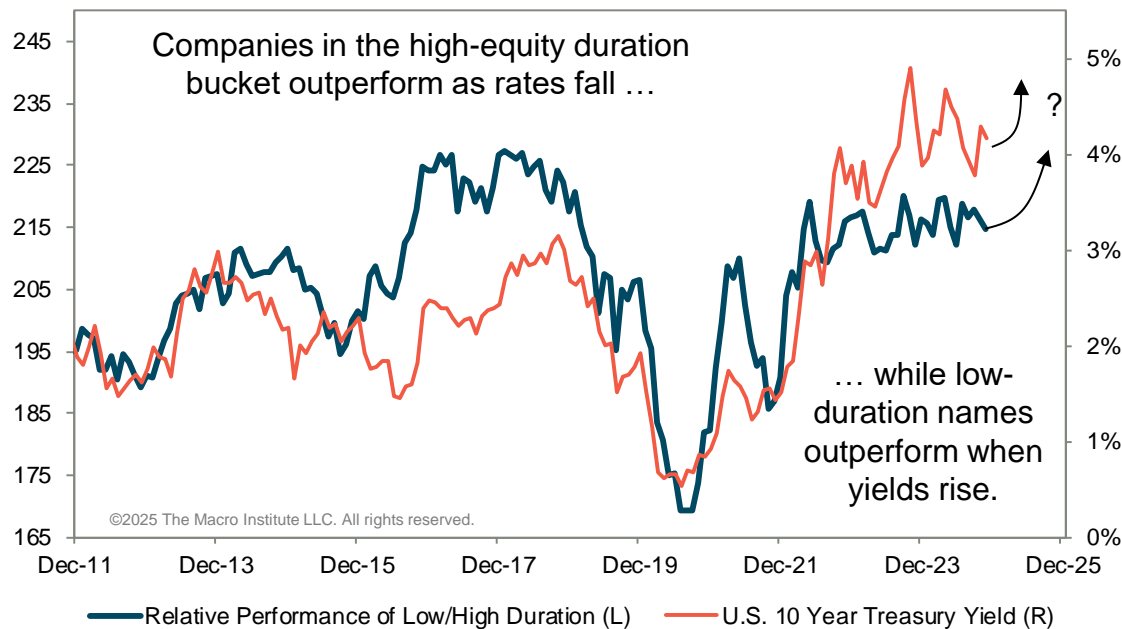
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Conclusion: Opportunities In A Complicated Macro Backdrop

Fed Tightening/Higher Rates

Renewed Inflation Spike Could Expose Lofty Valuations

↑ Interest Rates Makes Valuation Relevant Again



Cyclicals Less Exposed To Rising Rates

Sector	Equity Duration
Energy	20.0
Financials	22.5
Materials	23.6
Comm. Services	24.3
Real Estate	24.4
Health Care	24.5
Industrials	24.5
Cons. Discretionary	24.8
Technology	25.4
Cons. Staples	26.2
Utilities	27.0

↑ Outperforms in rising rate environment

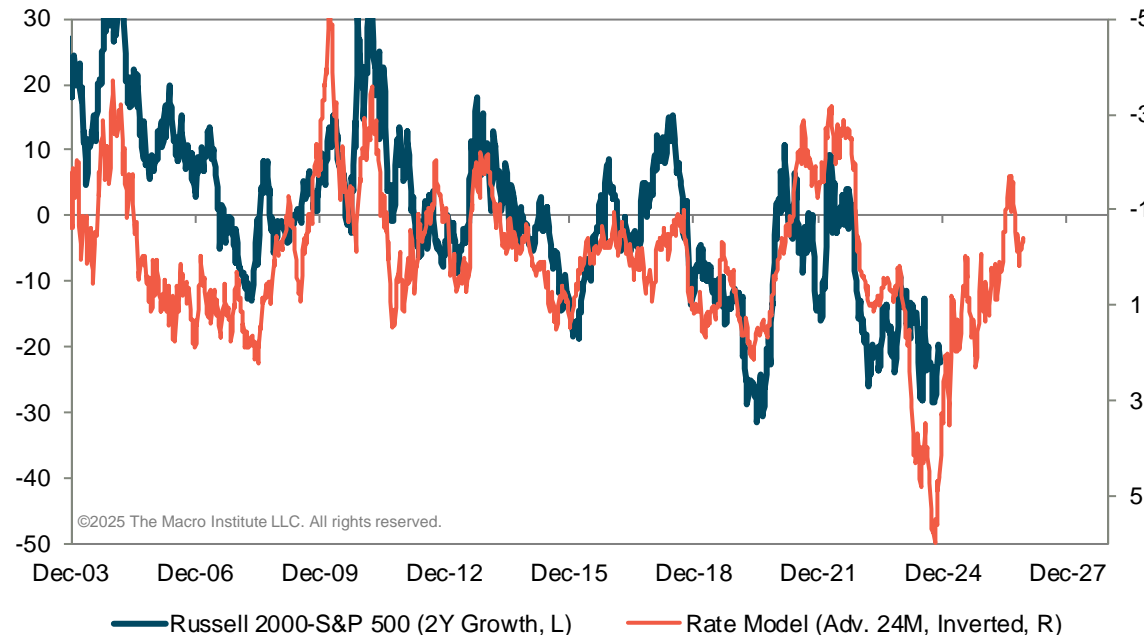
↓ Underperforms in rising rate environment

S&P 1500 12/2024
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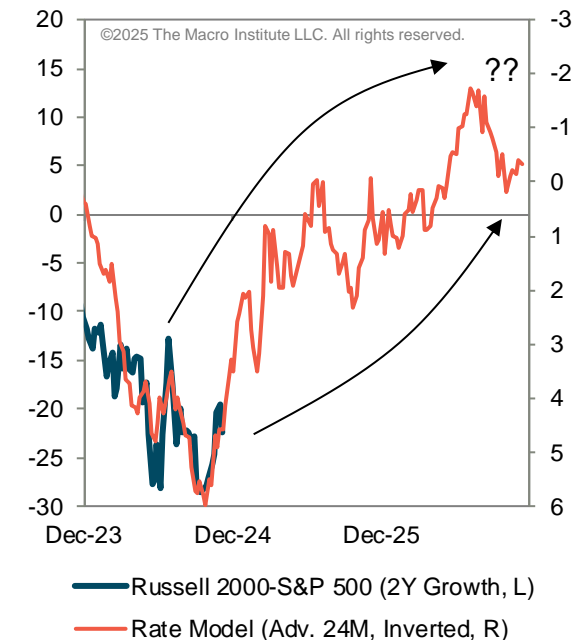
Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: Policy Turns Supportive For Equities (Some!)

A Recovery In Small-Cap Cyclical Stocks ...



... Throughout 2025?!

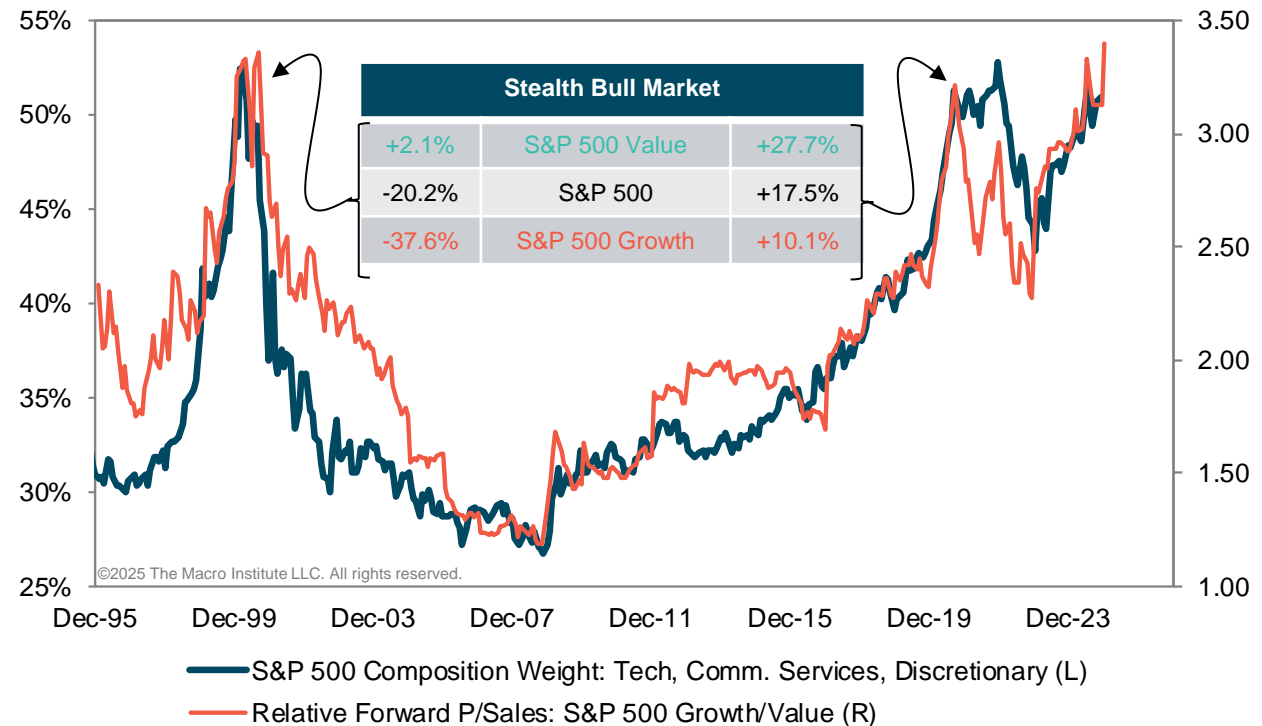


Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: Is The S&P 500 Vulnerable To A *Growth Pullback* ???

-  **Risk #1:**
Cyclical Recovery Leads To
A Pullback In Growth
-  **Risk #2:**
Rising Interest Rates Weigh
On Growth P/Es
-  **Risk #3:**
Crowding Often Triggers
Panic Selling Across History

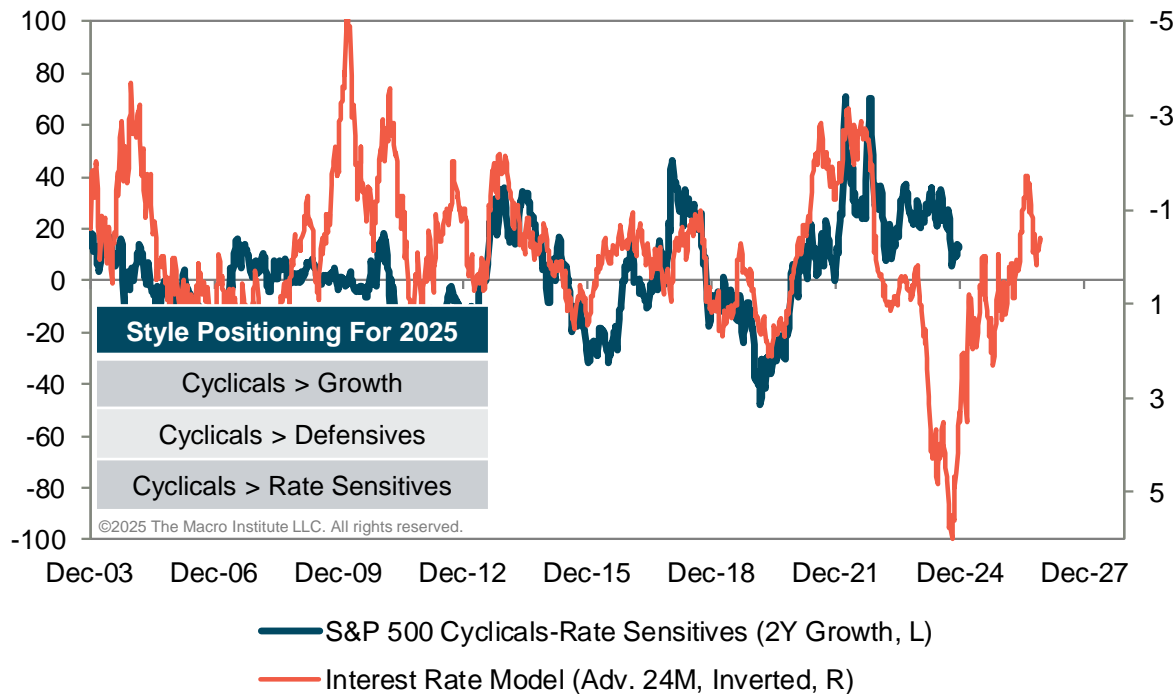
Valuation Disparity At Extremes ... Stealth Bull Market In The Making?



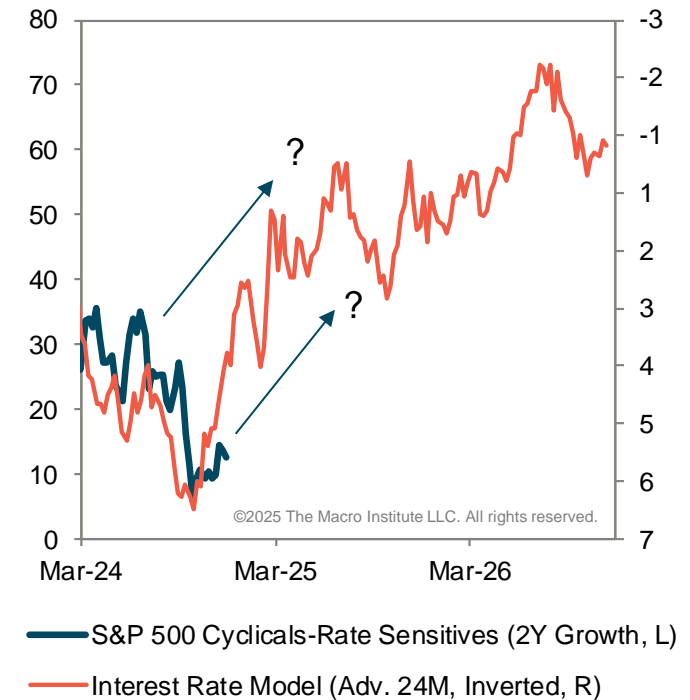
Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: An Opportunity In Cyclical Sectors In 2025

Monetary Policy Finally Turns Supportive Of Cyclical



Cyclicals Set To Outperform



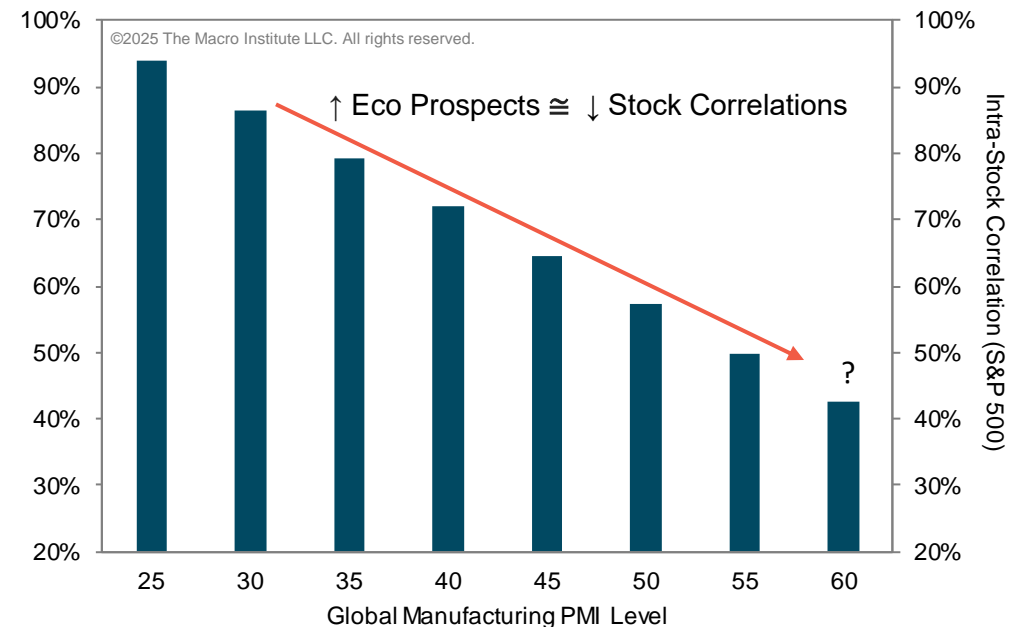
Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: 2025 The Return Of A Stock Pickers Market In 2025

It's Been A Difficult Stretch For Stock Picking



Intra-Stock Correlation Set To Decrease



Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: Macro's Take On Micro Factors In 2025

The 2025 Stock-Selection Playbook

*Emphasize risk-on factors
when PMIs are improving.*

**Operating
Leverage**

**Pricing
Power**

*Focus on firms with pricing
power as inflation re-ignites.*

**TMI 2025
Stock
Selection**

*Avoid long-duration stocks
when rates are rising.*

**Equity
Duration**

**Buyback
Yield**

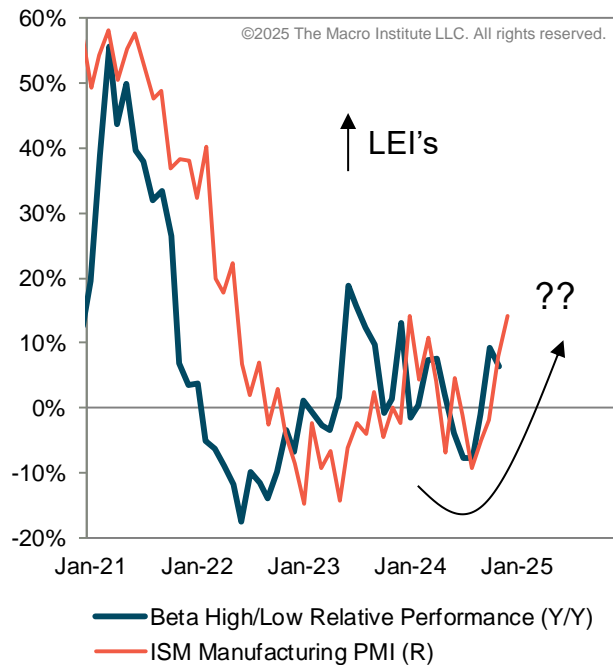
*Emphasize buyback yield when
the Fed is Tightening.*

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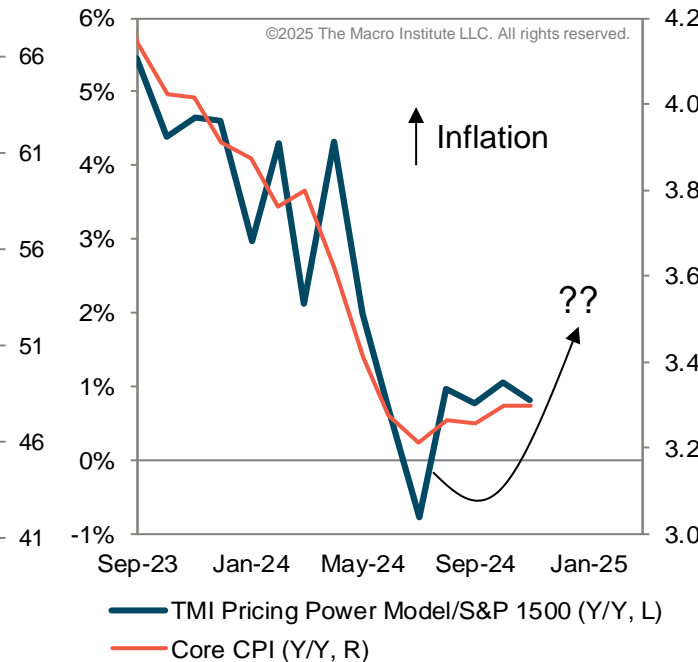
Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: What Does This All Mean For Equity Positioning?

Cyclical Factors!



Pricing Power!



Lower Duration!

Sector	Equity Duration
Energy	20.0
Financials	22.5
Materials	23.6
Comm. Services	24.3
Real Estate	24.4
Health Care	24.5
Industrials	24.5
Cons. Discretionary	24.8
Technology	25.4
Cons. Staples	26.2
Utilities	27.0

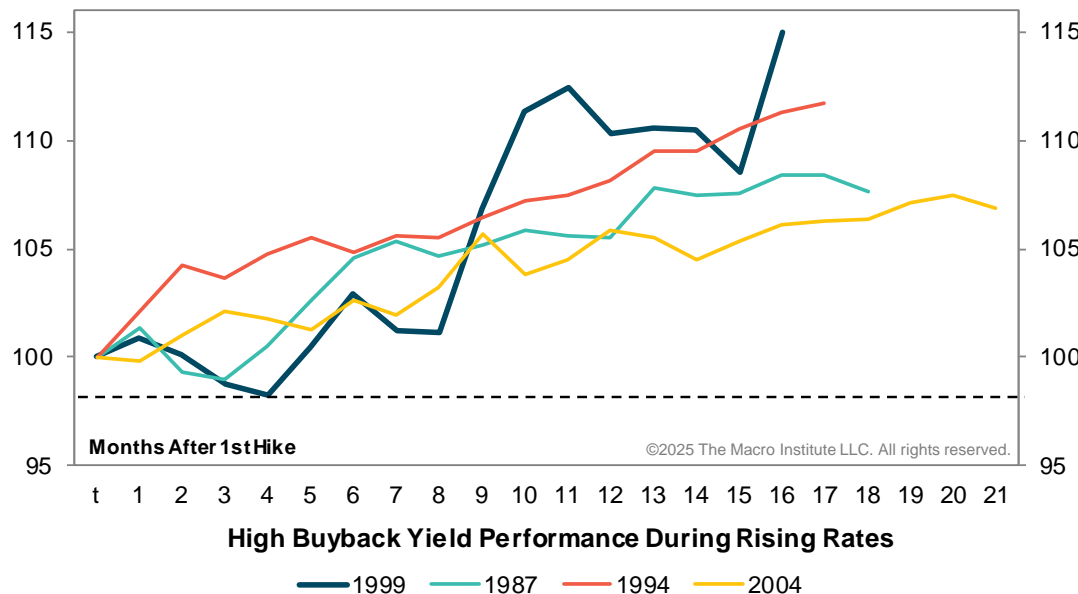
S&P 1500 12/2024
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↑ Outperforms in rising rate environment
↓ Underperforms in rising rate environment

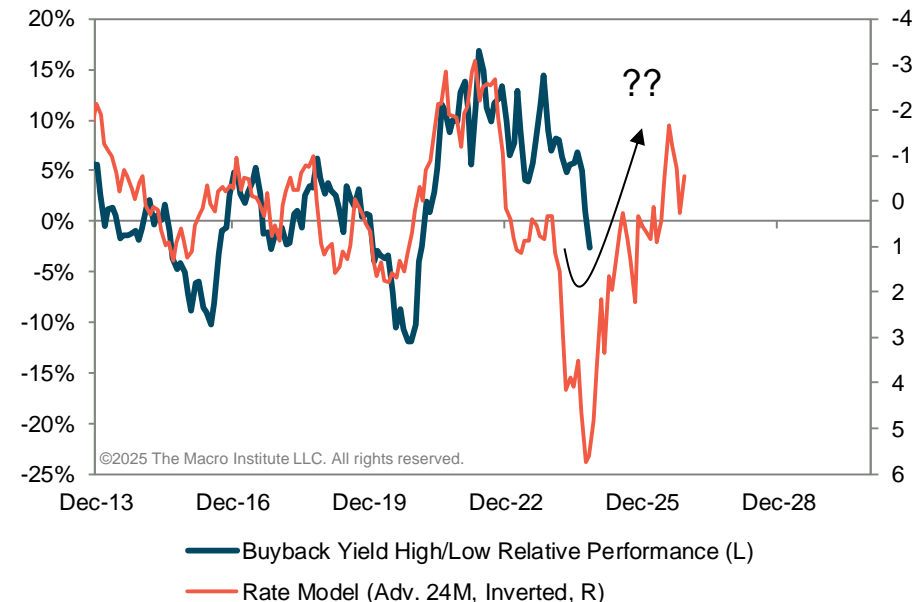
Conclusion: Opportunities In A Complicated Macro Backdrop

In Summary: Fed Tightening Usually Favors Buybacks

High-Buyback Yield For A Rising Rate Environment



Emphasize Buybacks In 2025?



Conclusion: Opportunities In A Complicated Macro Backdrop

A Good Starting Point For Stock Selection

A Sample Of The 2025 Stock-Selection Model

 THE MACRO INSTITUTE		<u>Lower Deciles Rank Better In All Categories</u>							
Universe: S&P 500 TMI 2025 Outlook Portfolio									
Ticker	Name	Equity Duration	Buyback Yield	Pricing Power	Operating Leverage	Price	Market Value	Sector	Industry
TSN	Tyson Foods, Inc. Class A	1	4	1	1	\$ 57.83	20,192.6	Consumer Staples	Food Products
PSX	Phillips 66	1	1	2	1	\$ 110.48	45,627.1	Energy	Oil Gas & Consumable Fuels
ARE	Alexandria Real Estate Equities, Inc.	1	4	2	1	\$ 98.91	17,285.7	Real Estate	Health Care REITs
DHI	D.R. Horton, Inc.	1	2	3	1	\$ 140.09	44,945.0	Consumer Discretionary	Household Durables
JNPR	Juniper Networks, Inc.	1	5	3	1	\$ 37.48	12,409.2	Information Technology	Communications Equipment
PFE	Pfizer Inc.	1	5	3	1	\$ 26.71	151,365.3	Health Care	Pharmaceuticals
EPAM	EPAM Systems, Inc.	1	1	4	1	\$ 243.80	13,828.7	Information Technology	IT Services
FIS	Fidelity National Information Services, Inc.	1	1	4	1	\$ 81.40	43,822.0	Financials	Financial Services
HOLX	Hologic, Inc.	1	1	4	1	\$ 72.50	16,453.2	Health Care	Health Care Equipment & Supplies
PYPL	PayPal Holdings, Inc.	1	1	4	1	\$ 86.90	87,120.6	Financials	Financial Services
BRK.B	Berkshire Hathaway Inc. Class B	1	4	4	1	\$ 454.35	980,027.4	Financials	Financial Services
LYB	LyondellBasell Industries NV	1	4	4	1	\$ 74.01	24,035.3	Materials	Chemicals
CTRA	Coterra Energy Inc.	1	3	5	1	\$ 24.06	17,718.9	Energy	Oil Gas & Consumable Fuels
RVTY	Rewity, Inc.	1	3	5	1	\$ 112.27	13,663.5	Health Care	Life Sciences Tools & Services
TROW	T. Rowe Price Group	1	3	5	1	\$ 110.07	25,786.0	Financials	Capital Markets

For complete list, different benchmark, or
monthly model updates:

Email quant@trahanmacroresearch.com or
visit trahanmacroresearch.com/screens

Executive Summary

Insufficient Tightening Of Monetary Policy



Insufficient tightening of monetary policy, immigration, and reshoring helped the U.S. side-step a 2024 recession and S&P 500 earnings contraction. The 100bps of easing against an economy running just below peak cyclical capacity suggests stronger growth and inflation in 2025.

“Inflationary” Green Shoots



The underlying drivers and leading indicators of inflation suggest that it has not been tamed. The output gap, labor markets, and credit growth likely work to push prices higher in 2025. The Fed remains in wait-and-see mode in the near term before ultimately reversing course later this year.

Policy Proposals Could Exacerbate Inflation



The primary policy proposals of the incoming Administration have the potential to exacerbate the upward trend in inflation. The macro headwinds from tariffs and reduced labor supply likely prove more consequential to the direction of equity markets than austerity measures.

Five Concerns For 2025



Apart from inflation, risks to U.S. equities stem largely from fiscal policy and the debt/deficit driving bond yields to levels inconsistent with current equity market valuations. A global economic recovery could also spark a rotation out of the domestic “safety” trade and the USD.

Long: Small Cap, Cyclical, & Pricing Power



Many anticipatory and leading indicators of the global economy suggest growth and inflation move higher in 2025. Under this backdrop, we favor Small Cap, Cyclical and businesses with Pricing Power. We expect higher bond yields and further Fed tightening.

For any additional questions:
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