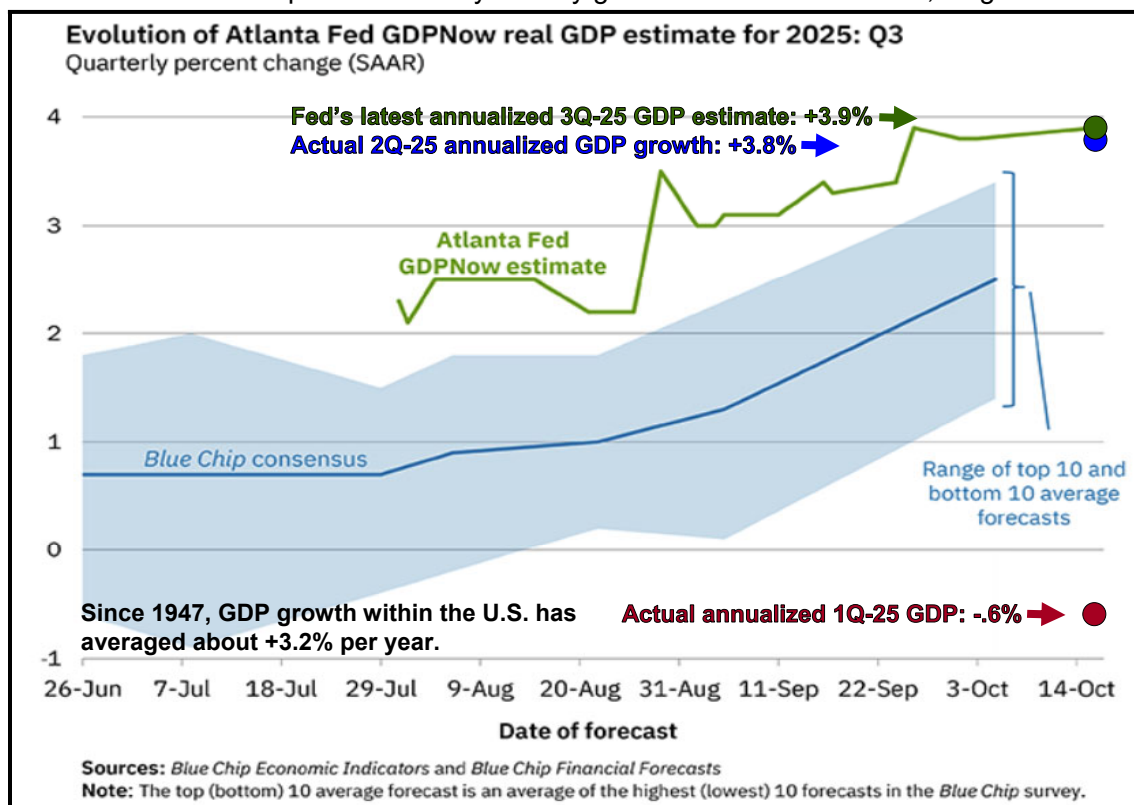


ECONOMY BEGINS TO SAG AS EARNINGS REMAIN STRONG

FED'S 3Q GDP GROWTH ESTIMATE HAS RISEN STEADILY ...

On July 31st, the Federal Reserve Bank of Atlanta estimated that U.S. GDP (economic output) would grow at an annual rate of 2.3% during the 3rd quarter of the year (green line). **As of October 16th, the Fed's growth estimate had improved to a relatively robust 3.9%.** If this estimate proves accurate, it would mark a slight improvement from the second quarter's already healthy growth rate of 3.8%. So far, so good.

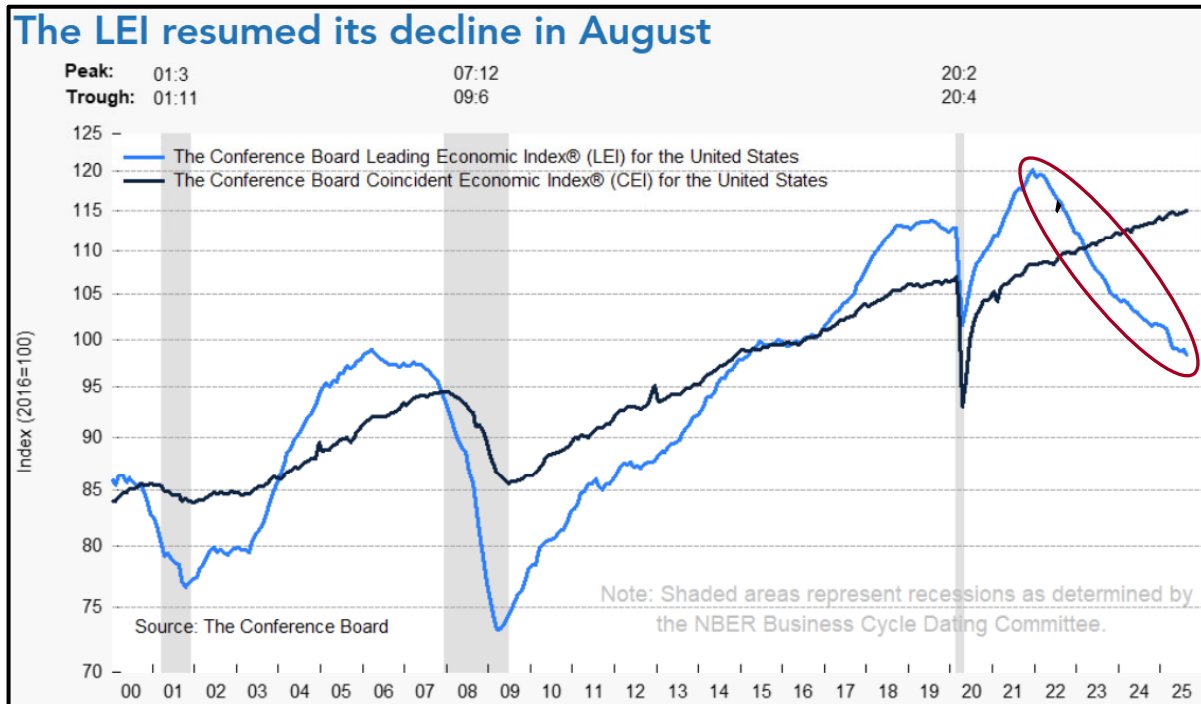


BUT THE LEADING ECONOMIC INDEX® WARNS OF RECESSION

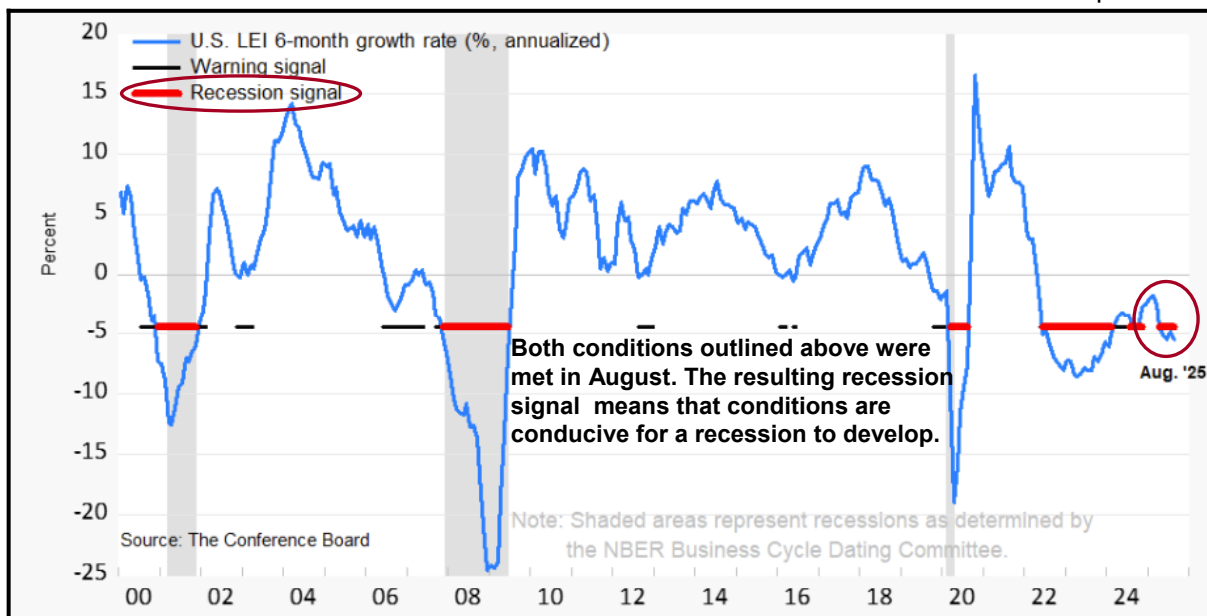
Published by The Conference Board, the Leading Economic Index (LEI) provides an early indication of significant turning points in the economic environment. In a September 18th press release, the Conference Board announced that the LEI declined by 2.8% during the six-month period ending this August, and that this rate of deterioration far exceeded the 0.9% rate of contraction over the previous six-month period. The press release also indicated that in August, “the US LEI registered its largest monthly decline since April 2025, signaling more headwinds ahead.”

Supporting data reveals that only two of the index's 10 components (stock prices and credit conditions) provided positive support to the LEI during the six-month period ending August 31st. **Whereas the Fed's healthy GDP estimate concerns a calendar quarter that is already in the books, The Conference Board's LEI is presumably more relevant since it is forward looking.**

The following image shows the disparity between The Conference Board's Leading Economic Index (LEI), and its Coincident Economic Index® (CEI). Whereas the LEI is intended to signal future economic conditions, the CEI is designed to measure conditions as they presently exist. **A deteriorating LEI does not, by itself, signal the onset of a recession, but it does** illustrate a widening disparity between economic conditions as they now exist and how they may exist in the near future, and it does **portend a slowing economy**.



The Conference Board will warn of a potential recession only if the LEI's annualized rate of change over the most recent six-month period is a) worse than a statistically significant threshold of negative 4.1% and b) the overall deterioration in the LEI is the result of weakness in more than half of the LEI's subcomponents.

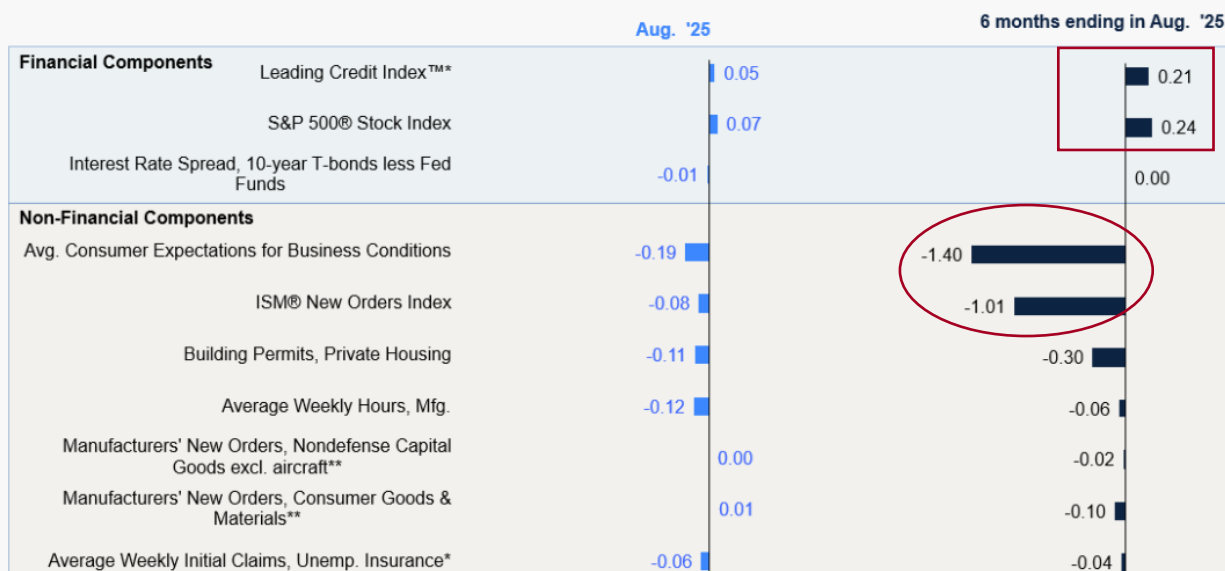


WHAT'S CAUSING THE LEI TO FLASH A RECESSION SIGNAL?

Rising stock prices and easing credit conditions, each of which tends to stimulate the economy via increased spending, were the only positive contributors to the LEI over the past six months (boxed). **The two components primarily responsible for the LEI's latest recession signal are a precipitous decline in new orders and an even greater deterioration in consumer expectations for business conditions (circled).**

LEI's decline in August

The Conference Board Leading Economic Index® and Component Contributions (Percent)



Source: The Conference Board

* Inverted series; a negative change in this component makes a positive contribution.

** Statistical Imputation

LEI change might not equal sum of its contributions due to application of trend adjustment factor

WORLD TRADE ORGANIZATION ALSO EXPECTS A SLOWING

Global trade was resilient earlier in 2025, but the World Trade organization (WTO) attributes that to purchases being accelerated to occur ahead of the imposition of various tariffs. The WTO expects a slowdown to materialize as inventories are drawn down and uncertainty impacts business and consumer confidence.

In a Reuters article published October 17th, the **head of the WTO warned that the decoupling of the U.S. from China could reduce global economic output by 7% over the longer term and characterized the recent spate of tariffs as “the most severe policy shock in eight decades.”** This policy shock has begun to manifest as a slowdown in the New Orders data, shown above.

GENEVA REPORT SEES THREAT TO RULES-BASED WORLD ORDER

The Centre for Economic Policy Research and the International Center for Monetary and Banking Studies issue a series of influential economic reports that, together, form the annual *Geneva Reports on the World Economy*.

Citing Russia's invasion of Ukraine, the sanctions imposed in response, an intensifying strategic competition between China and the West, and a trend toward rising protectionism, including the imposition of sweeping U.S. tariffs on allies and competitors alike, **the latest Geneva Report (Report 28) concludes that the world is now experiencing a reversal of decade's worth of financial integration as it becomes more geoeconomically fragmented. The report further concludes that rising geopolitical tensions now threaten the rules-based world order that has governed the functioning of the international monetary system since WWII.**

Disclaimer: I am aware that the political environment has become relatively polarized. Therefore, I would like to stress that nothing in this note is intended to be political commentary or criticism. My aim is to assess the investment environment as it now exists and as it may reasonably be expected to exist in the months ahead rather than to pass judgment as to whether a particular policy may have merit now or over the longer term.

CONSUMER EXPECTATIONS FOR BUSINESS CONDITIONS

As shown on page 3, **the index that captures average consumer expectations has deteriorated precipitously due to an overall lack of optimism about future business conditions**, a weakening job market, tariff concerns, and inflation remaining above the Fed's target. The ongoing shutdown of the federal government is further exacerbating the general level of wariness about future business conditions.

WEAKENING JOB MARKET

According to an October 13th Associated Press article, **a senior vice-president from recruiting firm Challenger, Gray & Christmas said, "We saw real strong signals that there's been a cooling in the labor market, even beyond what our expectations were in the first nine months of the year."** In a September 25th press release, **this same recruiting firm expects seasonal/holiday hiring in the retail sector to fall to its lowest level since 2009.** In general, non-farm payroll growth has slowed significantly, the overall unemployment rate has risen as has initial jobless claims, and layoffs **are at their highest level since 2020 ... and 55% higher than they were a year ago.**

TARIFF CONCERNS

Tariff-related revenues rose by \$118 billion through the September close of the U.S. fiscal year to a record \$195 billion. This resulted in the fiscal 2025 budget deficit declining by about 2.2% versus fiscal 2024 to a still worrisome \$1.78 trillion. However, the incremental revenue also represents an internal tax on U.S. importers and consumers. All else being equal, higher tax burdens tend to suppress economic growth.

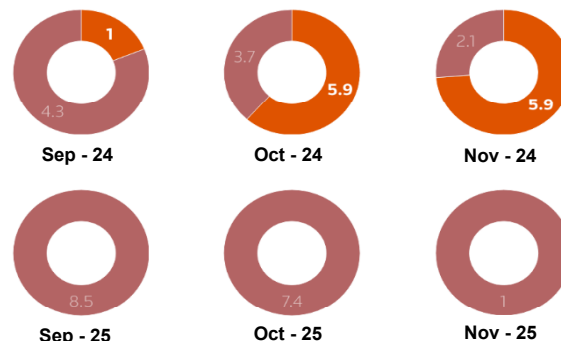
Whether or not tariffs result in the reshoring of business and industry to the U.S. in the long run, the legality of their imposition under the International Emergency Economic Powers Act remains in question. A U.S. Court of Appeals ruled their implementation to be illegal and the issue is currently under review by the U.S. Supreme

Court. In exchange for the protection tariffs provide to domestic industry, near-term tariff concerns include the risk of retaliatory damage to U.S. export markets and inflation as a result of higher prices on raw manufacturing inputs such as crude oil, mineral fuels, metals, and on finished goods such as pharmaceuticals, vehicles, apparel, and coffee.

A primary concern pertaining to the U.S. imposition of tariffs is retaliatory damage to U.S. export markets. For example, the image to the right comes from a September 10th Reuters' article which depicts **the complete loss of China as an export market for U.S. soybeans**. During September, October and November of 2024, the U.S. sold 12.8 million metric tons of soybeans to China. During the same three months of 2025, China has not yet bought any U.S. soybeans. Based on a value of \$404 per metric ton of beans, U.S. farmers have lost over \$5 billion worth of soybean demand from China.

China Ditches U.S. Soybeans Amid Trade Tensions

Chinese soybean purchases for September through November shipments from the U.S. and South America (millions metric tons)



● United States

● Brazil / Argentina / Uruguay

Source: Traders

This image shows China's soybean purchases from the U.S. and South America for shipments from September to November in 2024 and 2025. All figures are in million metric tons.

The table that appears below illustrates why corn and bean farmers are hoping to receive additional farm subsidies from the U.S. government. In Southern Illinois, for example, *farmdocDAILY* estimates that farmers will lose \$70 for each acre of corn and \$71 for each acre of soybeans brought to market this year. Illinois plants approximately 22 million acres of corn and soybeans, so these estimates suggest a combined loss to corn and soy farmers on the order of \$1.5 billion for this particular state for the year.

Table 1. 2025 Corn and Soybean Budgets for Northern, Central, and Southern Illinois

	Northern		Central-High		Central-Low		Southern	
	Corn	Beans	Corn	Beans	Corn	Beans	Corn	Beans
Yield per acre	228	69	236	75	222	68	195	61
Price per bu	\$4.25	\$10.25	\$4.25	\$10.25	\$4.25	\$10.25	\$4.25	\$10.25
Farmer return	-\$73	-\$43	-\$73	-\$50	-\$72	-\$59	-\$70	-\$71
Breakeven price to cover:								
Non-land costs	\$3.32	\$6.74	\$3.17	\$6.53	\$3.37	\$7.21	\$3.66	\$8.38
Total costs ¹	\$4.61	\$11.01	\$4.60	\$11.05	\$4.61	\$11.25	\$4.66	\$11.56

¹ Equals non-land costs plus land costs.

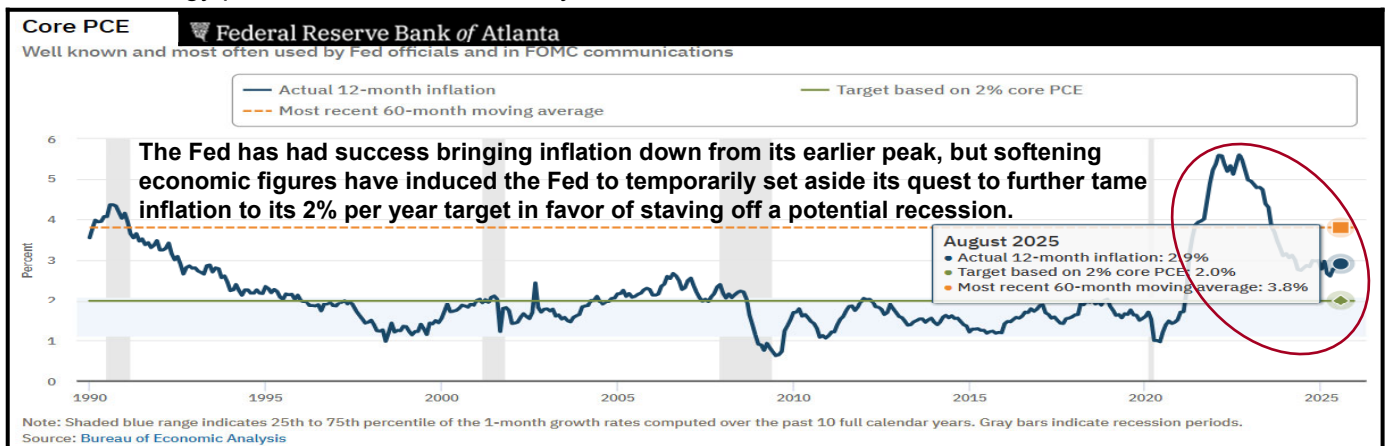
farmdocDAILY

During the second quarter of the year, exports of whiskey, bourbon, and other American spirits to Canada declined by 85%, largely as a result of Canadian boycotts. The overall reduction in foreign demand for American spirits is not as severe as the Canadian response but, to the extent demand remains subdued, related employment reductions within this and other U.S. industries is the probable result.

INFLATION REMAINS ABOVE THE FED'S 2% TARGET

For most of 2025 the Fed faced the dilemma of either raising its benchmark interest rate to quell inflation at the risk of exacerbating recession risk, or reducing its benchmark interest rate to bolster sagging employment numbers at the risk of exacerbating inflation. **On September 17, 2025, the Fed determined that tepid employment figures and the risk of recession represent a more acute threat to the U.S. economy than does inflation** remaining modestly above the Fed's target of 2% per year. As such, it implemented its first rate reduction since December of 2024.

The image that appears below is the **Core Personal Consumption Expenditures Index**, which is the Fed's preferred measure of inflation. The "Core" qualifier indicates that the index excludes the impact of changes in food and energy prices due to their inherently volatile nature.



The image that appears to the right shows how manufacturing and service firms have adjusted to higher tariffs.

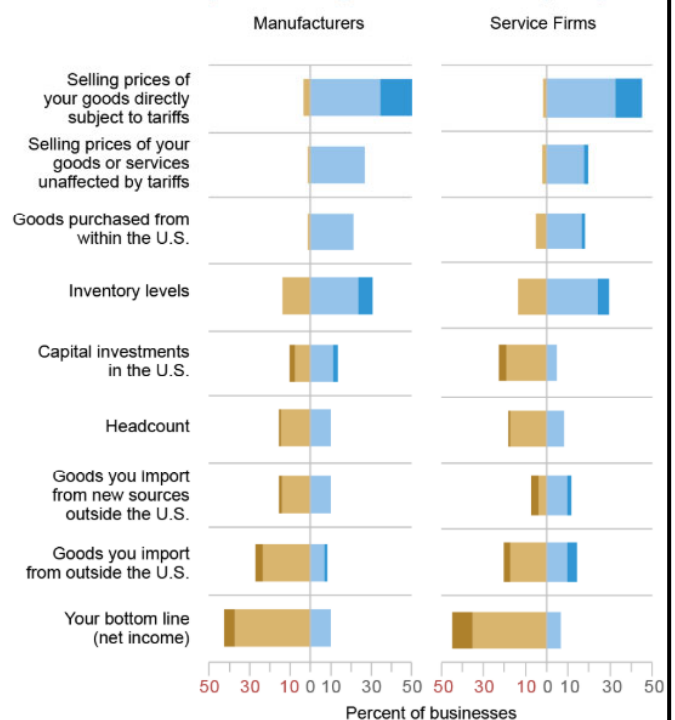


I offer you a few general observations:

- 1) Prices of tariff-impacted goods and services have risen more than prices have as a whole.
- 2) Inventory levels are more likely to have increased ahead of tariff-related price increases.
- 3) Headcounts are more likely to have decreased.
- 4) Imported goods and net income are far more likely to have declined.

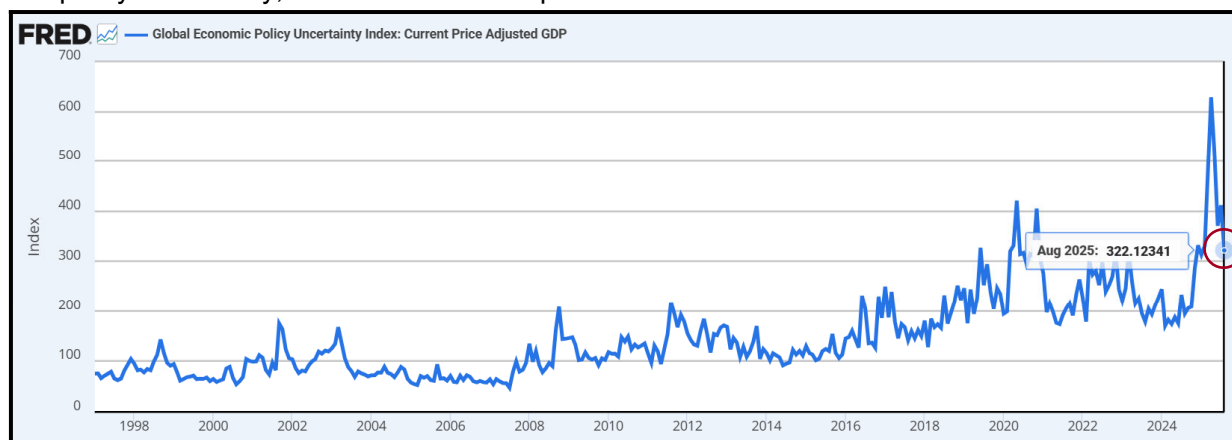
Note that this graph was created by the Federal Reserve Bank of New York in May, before the U.S. tariffs were fully implemented in early August.

Businesses Have Adjusted to Higher Tariffs in Many Ways

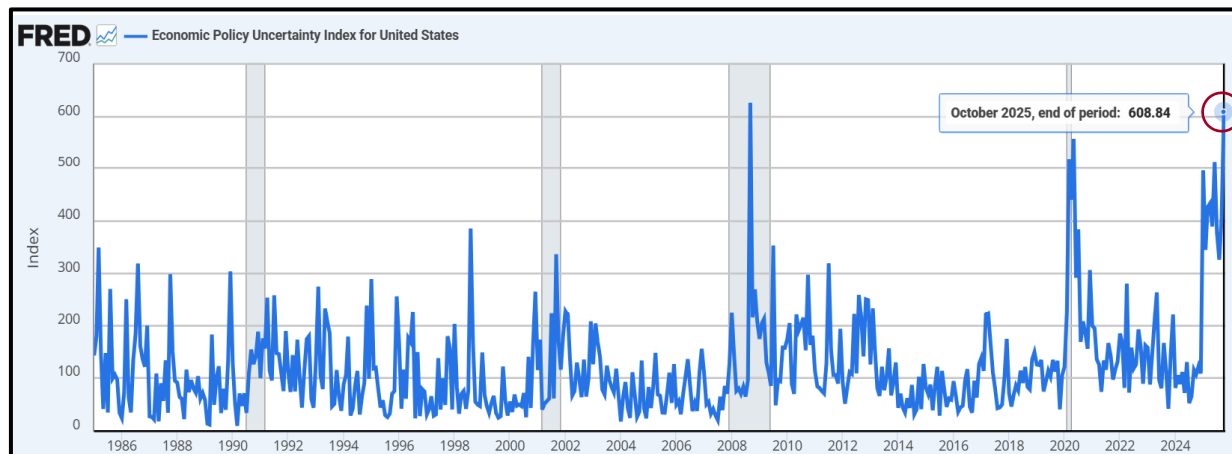


ECONOMIC UNCERTAINTY REMAINS ELEVATED

The Federal Reserve's Global Economic Policy Uncertainty Index spiked to an all-time high of 628 in April, which is when the U.S. announced its revised tariff policies. As of October 20th, this index has relaxed to 323 units of policy uncertainty, but this level is still quite elevated in historical terms.



This next image shows that economic policy uncertainty within the U.S., itself, remains extremely elevated at 608 uncertainty units (circled). **The only time economic uncertainty has been more elevated in the U.S. than it now is, was at the onset of the financial meltdown in September of 2008.** Even then, this uncertainty index was only marginally higher.



ECONOMIC POLICY UNCERTAINTY LEADS TO CAUTION

As you might imagine, economic policy uncertainty tends to lead to cautiousness which often culminates in hiring freezes, layoffs, production cuts, reduced inventories, and a general decline in the willingness to enter into long-term investments and commitments.

As investors become more cautious, they typically react by reducing their exposure to the equities of growth-oriented companies in favor of the shares of companies that operate in more staid industries, or by reducing their overall equity exposure in favor of assets that generate contractually guaranteed interest, such as bonds.

HOWEVER, 3Q EARNINGS ARE OFF TO A STRONG START ...

Only 58 of the 500 companies that form the S&P 500 have reported third quarter results so far but, according to Zacks Investment Research, earnings for these 58 companies are up 15.4% versus the same period last year on revenue growth of 8.0%. Furthermore, 86% of these early reporters have beaten analysts' earnings estimates, 79% have surpassed their revenue estimates, and 74% have done both. This is all very good.

Not only are the companies that have so far reported earnings easily beating analysts' estimates, the commentary and earnings guidance coming from these companies is mostly reassuring and favorable, which could help sustain the trend of positive estimate revisions that has been in place in recent months.

... AND EARNINGS GROWTH LOOKS GOOD THROUGH 2027

If a company can grow its revenues (orange bars) in tandem with inflation, it is exceedingly likely its earnings will satisfy investors by growing at a rate well in excess of inflation. This is so because businesses usually have at least some costs that do not rise with inflation, i.e., costs that are fixed. As shown below, expected revenue growth of approximately 6% per year through 2027 is already twice the rate of recent inflation. If current revenue estimates hold, corporate earnings increases (green bars) over the next couple of years could easily reach into the double digits (circled), far outpacing expected increases in the cost of living.

However, stocks are widely considered to be richly valued. Last month, Fed Chairman Jerome Powell characterized stocks as being “fairly highly



valued.” If the information I covered in the first seven pages of this note were to gain prominence in investors' minds, the premium stock valuations to which Jerome Powell recently alluded could quickly evaporate. If investors' thoughts were to darken beyond that, the premium stock valuations we've been enjoying could morph into sizeable discounts with a few negative strokes of the pen from strategists and analysts.

LIKE HOT AND COLD WATER THAT HAS NOT YET MIXED

I struggle to recall a time where earnings forecasts were as favorable as they now are against a backdrop of elevated policy uncertainty and weakening economic metrics. For any portfolio that does not represent money that can be lost, my current preference is to trim equity exposure to the lower portion of our agreed upon range, hedge away another portion of that equity exposure, and to temporarily favor bonds. — Glenn Wessel