Yardeni Research

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Morning Briefing

Meltup In Stocks
Or Meltdown In Bonds?

Check out the accompanying chart collection.

Executive Summary: Two scenarios to put on your radar: Bond prices might melt down if the Bond Vigilantes are roused by the downgrading of the US's sovereign debt rating and/or the prospect that Trump's tax-cut bill worsens the federal budget deficit outlook and/or tariff-related inflation. But a bond market meltdown could force Washington to set the US onto a more sustainable fiscal path—a positive end result for bonds and stocks. … The stock market might already be melting up again. … Also: Consumers are worried about tariff-related inflation coming, sentiment surveys suggest, but they're spending apace nonetheless. And that's not just spending on stuff in advance of anticipated tariff-related price hikes; they've been eating out a lot too.

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US Financial Markets: On the Edge of a Meltup or a Meltdown? It's time to think ahead. Are stocks on the verge of a meltup? They might be unless bonds are on the verge of a meltdown. So, which will it be? We can make the case for both scenarios. Let's do so:

(1) *Bond market meltdown*. Since the start of the year, we've opined that the 10-year US Treasury bond yield is likely to trade between 4.25% and 4.75% this year. That has been a good call so far (*Fig. 1*). Since the end of last year, we predicted that the Fed won't change the federal funds rate (FFR) this year. So far, so good (*Fig. 2*).

We disagreed with the Fed's decision to cut the FFR by 100bps in three steps, down to 4.33% from September 18 through December 18 last year. We argued that the bond yield might rise instead of fall because the economy was resilient and didn't need lower rates. That's what happened as the yield bottomed last year at 3.63% on September 16, 2024 and rose to a high of 4.79% so far this year on January 13. The bond yield has been mostly fluctuating around the FFR rate so far this year.

Expectations for rate cuts this year have diminished as President Donald Trump has de-escalated his trade war (*Fig. 3*). This de-escalation is reducing the odds of a recession and Fed rate cutting. According to Polymarket.com, the odds of a recession was 37% on Friday, the lowest since March 28 (*Fig. 4*). That's just before Trump's April 2 Liberation Day, which was followed by four Annihilation Days in the stock market (*Fig. 5*). Those odds peaked at 66% on May 1 and fell sharply after Trump postponed on April 9 the reciprocal tariffs he had imposed on all trading partners except China and postponed on May 12 those on China.

Through all this turmoil, the 10-year Treasury bond yield remained mostly in our projected trading range. Its correlation with the Citigroup Economic Surprise Index remains intact, because the latter hasn't done much so far this year (*Fig. 6*). The bid-to-cover ratio during this year's 10-year Treasury auctions fluctuated around its historical average since the start of this year (*Fig. 7*).

So where's the potential meltdown in bond prices among all this calm? On Friday, Moody's downgraded the US sovereign credit rating due to concerns about the nation's growing $36 trillion-and-growing debt pile. Moody's first gave the United States its pristine "Aaa" rating in 1919 and is the last of the three major credit agencies to downgrade it.

Is Moody's expecting an imminent US government debt crisis? That's possible, we suppose, given that Trump's "Big Beautiful Bill" is facing significant challenges in Congress. The bill—which includes major tax cuts, spending reductions, and enhanced border security measures—was blocked from advancing out of the House Budget Committee on May 16, due to opposition from a group of conservative Republicans, often referred to as "fiscal hawks." These lawmakers, including Representative Chip Roy, argue that the bill does not include sufficient spending cuts, expressing concerns about its impact on the federal deficit.

The Bond Vigilantes might weigh in on the subject if Trump manages to ram a bill through Congress that they consider to be ugly for the deficit outlook rather than beautiful. Increasing the odds of a spike in the bond yield would be higher-than-expected inflation readings in coming months resulting from Trump's tariffs.

(2) *Stock market meltup*. It is somewhat easier to make the case for a stock market meltup than a bond market (price) meltdown. That's because the rebound in stock prices since April 8 has pushed valuation multiples almost back up to where they were before the correction from February 19 through April 8. The S&P 500 forward price-to-sales ratio jumped back up to 2.9 during the May 16 week (*Fig. 8*). It peaked at a record high of 3.0 during the week of February 18. The S&P 500 forward P/E rebounded to 21.3 during the

same week. Both are historically high.

Meanwhile, the collective forward P/E of the Magnificent-7 stocks has soared from 21.6 on April 8 to 27.5 on Friday (*Fig. 9*). Excluding them, the forward P/E of the remaining "S&P 493" is 18.5. Arguably, the market is already back in meltup territory, making it more vulnerable to a meltdown in the bond market.

(3) *Our subjective probabilities*. So what are the odds of a stock market meltup and/or a bond market meltdown?

On May 4 and again on May 13, we lowered our odds of a recession this year from 45% to 25%. So the odds of our Roaring 2020s scenario is back up to 75%. In this scenario, the S&P 500 rises to 6500 by the end of this year. It could keep going to 7000 in a meltup.

A bond market meltdown would be included in our 25% bucket of risks. In our opinion, it would force the Republicans to agree on a more conservative budget bill that would put the US government on a more sustainable fiscal path. The end result would be positive for both bonds and stocks.

US Consumers I: Americans Are Depressed… Consumers were extremely depressed in early May, according to the Consumer Sentiment Index survey conducted by the Surveys of Consumers (SOC) at the University of Michigan. Apparently, they are fretting that tariffs will boost inflation. The SOC notes: "Tariffs were spontaneously mentioned by nearly three-quarters of consumers, up from almost 60% in April; uncertainty over trade policy continues to dominate consumers' thinking about the economy." The interviews for the latest survey were conducted between April 22 and May 13, closing just two days after the announcement of a pause on some tariffs on imports from China. So the final May results might show an uptick in the CSI and a downtick in expected inflation.

Here's more:

(1) *Consumer Sentiment Index.* The CSI dropped to 50.8 in the preliminary reading for May, down from 52.2 in April (*Fig. 10*). That is the second-lowest reading on record (behind that for June 2022) and down almost 30% since January 2025. While most index components were little changed, current assessments of personal finances sank nearly 10% based on weakening incomes. The current conditions index was much more depressed than during Covid and just as bad as during the Great Financial Crisis! The expectations component matched or fell well below previous recession lows.

The CSI current conditions index has been well below that of the Consumer Confidence Index (CCI) survey over the past 10 years (*Fig. 11*). There have been times in the past when the former was above the latter, usually coming out of recession. The CSI and CCI expectations indexes tend to track one another more closely (*Fig. 12*).

(2) *Expected inflation.* According to the SOC, year-ahead inflation expectations surged from 6.5% in April to 7.3% so far in May (*Fig. 13*). This month's rise was seen among Democrats and Republicans alike. Long-run inflation expectations lifted from 4.4% in April to 4.6% in May, reflecting a particularly large monthly jump among Republicans. The final release for May will reveal the extent to which the May 12 pause on some China tariffs leads consumers to update their expectations.

The year-ahead inflation expectations measures of the CSI survey closely tracked the comparable series compiled by the Federal Reserve Bank of New York monthly consumer survey (*Fig. 14*). They've diverged significantly recently over the past couple of months. During April, the former was 7.3%, while the latter was 3.6%.

Oddly, the CSI survey's year-ahead inflation expectations, which closely following the retail price of gasoline in the past, have diverged significantly, with the latter soaring as described above even though the pump price has remained subdued in recent months (*Fig. 15*).

(3) *Partisanship.* Joanne Hsu, the director of SOC posted an April 11 report titled "*Partisan Perceptions and Sentiment Measurement*." She observes, "Partisan differences in consumer attitudes and expectations are well documented and date back to at least the Reagan administration. The data consistently showed that consumers affiliated with the political party in the White House tend to have higher levels of sentiment and more favorable expectations than those whose party is not."

Historically, the SOC asked about political affiliation a few times per administration, increasing to a monthly frequency starting in February 2017. In her report, she investigated "how partisan differences in consumer attitudes and expectations evolved since 2017, and whether these patterns distort survey measurements of changes of over time." She concludes that her findings confirm that the SOC's methodology remains valid because it continues "to reach a nationally representative sample of Americans across the political spectrum."

Maybe so, but we aren't convinced that's so currently. Our hunch is that Democrats are much more depressed than Republicans.

US Consumers II: …But Not Too Depressed To Go Shopping. April retail and food services sales edged up just 0.1% m/m during April (*Fig. 16*). That's a preliminary number that is often revised. Indeed, the March increase was revised higher from 1.4% m/m to 1.7%.

That's why the Atlanta Fed's *GDPNow* tracking model increased Q2's real GDP growth rate to 2.4% (q/q, saar) from 2.5% (*Fig. 17*). Real personal consumption spending is tracking at a growth rate of 3.7% q/q, up from 3.3% earlier in May.

Also, some buying in advance of tariff-related price hikes might have boosted March retail sales (excluding food services) to a record high and left April's reading flat at that record high (*Fig. 18*).

On the other hand, sales at food services and drinking places jumped 1.2% m/m in April to a new record high, while sales at food and beverage stores were flat in April at its record high (*Fig. 19*).

The one big negative reason for a consumer retrenchment is the rise in 90-days-plus consumer credit delinquency rates (*Fig. 20*). During Q1, there was a big jump for student loans, as the government required payments to be made again on outstanding balances. Credit card delinquencies rose to 12.3%.

Lower-income consumers are clearly experiencing financial stress. On the other hand, higher-income consumers are still spending. Retired Baby Boomers are likely to bolster consumer spending the most as they spend their considerable nest eggs in coming years and transfer some of their assets to their adult children.

Calendars

US: Mon: Leading Indicators -0.8%; Williams; Jefferson; Bostic; Logan; Kashkari. **Tues:** Daly; Barkin; Bostic; Collins; Musalem; Kugler; Hammack. (FXStreet estimates)

Global: Mon: Eurozone Headline & Core CPI 2.2% & 2.7%y/y; China Retail Sales 5.5%y/y; China Industrial Production 5.5%y/y. **Tues:** Eurozone PPI -0.3%; Eurozone Consumer Confidence Flash -16; G7 Meeting; PBoC Interest Rate Decision 3.0%; RBA Interest Rate Decision 3.85%; Canada CPI 0.2%m/m, 1.6%y/y. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index soared 5.4% last week, and improved to just 3.1% below its January 23 record high. That compares to a 1.5% gain for the AC World ex-US index, which hit a record high on Wednesday for the first time since June 15, 2021. The US MSCI has outperformed the AC World ex-US in just four of the past 17 weeks. EM Asia was the best performing region last week, with a gain of 3.5%, ahead of EM (3.0%) and the AC World ex-US. EMEA was the worst regional performer, albeit with a gain of 0.7%, followed by EAFE (0.8), EMU (1.1), Europe (1.1), and EM Latin America (1.3). The Taiwan and US MSCI indexes performed the best among country indexes last week, with gains of 5.4%, ahead of India (4.8), Korea (2.8), and Spain (2.6). The Japan MSCI index was the worst performer w/w, with a drop of 0.5%, followed by Germany (-0.4), France (0.6), South Africa (0.7), and Switzerland (0.8). In terms of ytd performance rankings, the US MSCI index is still the worst country, with a gain of just 1.4%, and trails the 11.3% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 21.7%, followed by EMU (20.9), Europe (16.5), EAFE (12.7), and the AC World ex-US. EM Asia is the worst ytd performer, albeit with a gain of 7.9%, followed by EM (9.0) and EMEA (9.7). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 34.3%, followed by Germany (25.9%), Mexico (24.9), Brazil (20.7), and South Africa (19.8). The worst performing countries ytd: the US (1.4), Taiwan (2.7), India (3.6), Australia (5.0), and Japan (5.1).

US Stock Indexes (*link*): All of the 48 major US stock indexes that we follow rose during the week ending May 16, up from 23 indexes rising in the prior week. The S&P 500 Transportation and Dow Jones 20 Transports indexes were the best performers, with gains of 8.0%, ahead of S&P 500 LargeCap Pure Growth (7.3%), Nasdaq Composite (7.1), S&P 500 LargeCap Growth (7.1), and Russell 1000 Growth (7.1). The Dow Jones 15 Utilities index, with a gain of 1.1%, was the worst performer, followed by S&P 500 LargeCap Pure Value (3.0), Russell 1000 Value (3.2), Russell 3000 Value (3.2), S&P 500 LargeCap Value (3.3). Twenty-seven of the 48 indexes are now higher so far in 2025, up from just two a week earlier and down from 47 of 48 rising ytd in mid-February. With a gain of 6.4%, the S&P 500 LargeCap Pure Growth index is in the top spot as the best performer so far in 2025, ahead of Dow Jones 15 Utilities (6.1%), Russell MidCap Growth (6.0), S&P 100 Equal Weighted (4.1), and S&P 500 Transportation (3.4). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-9.1), S&P 600 SmallCap Value (-8.8), S&P 600 SmallCap Equal Weighted (-6.9), S&P 600 SmallCap (-6.1), and Russell 2000

Value (-5.8).

S&P 500 Sectors Performance (*link*): All 11 S&P 500 sectors rose during the week ending May 16, and four were ahead of the S&P 500's 5.3% gain. That compares to six of the 11 S&P 500 sectors rising a week earlier, when seven sectors were ahead of the S&P 500's 0.5% decline. The outperformers last week: Information Technology (8.1%), Consumer Discretionary (7.7), Communication Services (6.6), and Industrials (5.5). The underperformers last week: Health Care (0.3%), Real Estate (0.9), Consumer Staples (1.5), Utilities (2.3), Materials (2.5), Energy (3.1), and Financials (3.5). The S&P 500 is up 1.3% ytd, with seven of the 11 sectors positive ytd and ahead of the index. Industrials now wears the crown as the best ytd performer, with a gain of 8.9%, ahead of Utilities (8.2%), Financials (6.6), Consumer Staples (6.0), Materials (3.3), Real Estate (2.9), and Communication Services (1.7). These three sectors continued to lag the S&P 500 so far in 2025: Consumer Discretionary (-4.8), Health Care (-3.5), Information Technology (-0.7), and Energy (-0.6).

US Economic Indicators

Retail Sales (*link*): Retail sales in April inched up 0.1%—in line with expectations, though considerably slower than March's upwardly revised 1.7% (from 1.4%). Sales were up 5.2% versus a year ago. Sales in the *control group*—which excludes autos, gasoline, building materials, and food services—slipped 0.2% in April, below March's upwardly revised 0.5% gain and weaker than the 0.3% consensus estimate. *Of the 13 nominal retail sales categories*, five rose in April, while seven fell, and sales at food & beverage stores was unchanged. *April sales performance versus that of a year ago*: food services & drinking places (1.2% m/m & 7.8%y/y), building materials & garden equipment (0.8 & 3.2), furniture & home furnishings (0.3 & 7.8), electronics & appliance stores (0.3 & 0.1), non-store retailers (0.2 & 7.5), food & beverage stores (0.0 & 2.7), sporting goods & hobby stores (-2.5 & 1.7), miscellaneous store retailers (-2.1 & 6.0), clothing & accessories stores (-0.4 & 3.5), motor vehicles & parts (-0.1 & 9.4), health & personal care stores (-0.2 & 8.5), general merchandise stores (-0.2 & 2.8), and gasoline stations (-0.5 & -6.8).

Business Sales (*link*): Both nominal and real business sales at record highs. *Nominal business sales* in March rose 0.7% to a record high of $2.30 trillion. Meanwhile, *real business sales* increased 0.9% in February to $1.87 trillion—back at December's record high. These sales hovered at $1.85 trillion from September to November.

Industrial Production (*link*): Industrial production was weak for the second month in April, reflecting uncertainty stemming from tariffs. *Headline production* was flat in April, missing the consensus forecast of a 0.1% gain, after contracting 0.3% in March—which was its first loss since November. In April, declines in manufacturing (-0.4%) and mining (-0.3) output were offset by a rebound in utilities (3.3) output from March's 6.2% plunge. The decline in manufacturing output was the largest in seven months, with *nondurable goods* manufacturing contracting 0.6% and *durable goods* manufacturing slipping 0.2% last month. Motor vehicles & parts production dropped 1.9% in April, after gains of 1.4% and 10.1% the prior two months. *Excluding autos*, headline industrial production contracted 0.3%. *By market group*, *consumer goods* output declined 0.2%, reflecting a 1.3% drop in *durable goods* output, on widespread declines—led by a 1.8% drop in automotive products. *Nondurable goods* output was little changed, ticking up 0.1%, as a 0.9% drop in non-energy goods basically offset a 3.2% jump in energy goods. Energy output was up 3.2%, and non-energy production down nearly 1.0%. Meanwhile, *business equipment* output ticked up 0.2% after posting a sizeable jump the first three months of the year—averaging gains of 1.7% per month. Transit equipment (0.1) production barely budged, following gains of 4.7% and 9.3% the prior two months, while defense & space equipment output also showed little growth in April. Production of information processing equipment sank 1.8%, after a 1.4% jump in March.

Capacity Utilization (*link*): The *headline* capacity utilization rate fell for the second month in April from 78.1% in February to 77.7% by April. April's rate is 1.9ppts below its long-run (1972-2024) average. The *manufacturing* utilization rate slipped from 77.2% in March to 76.8% in April, hovering between 76.1% and 77.2% the past five months, with the rate 1.4ppts below its long-run average. The utilization rate for mining fell from 90.5% to 90.2% in April, while the utilities rate rose from 69.2% to 71.3% in April—1.5% above its rate a year ago.

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