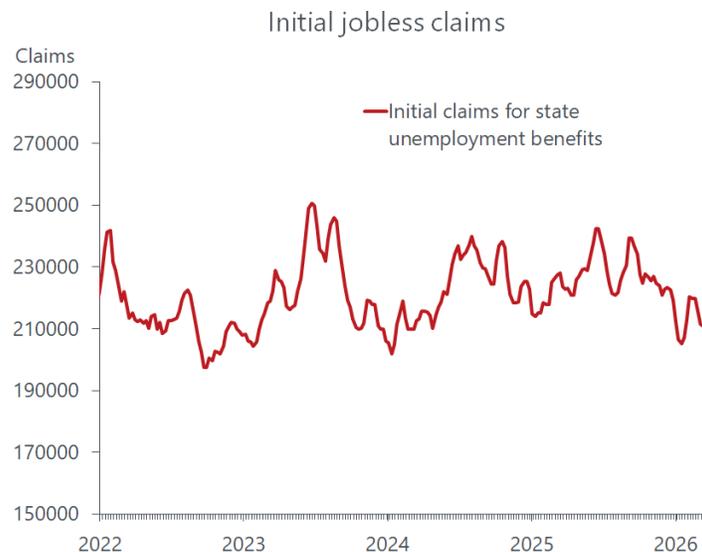


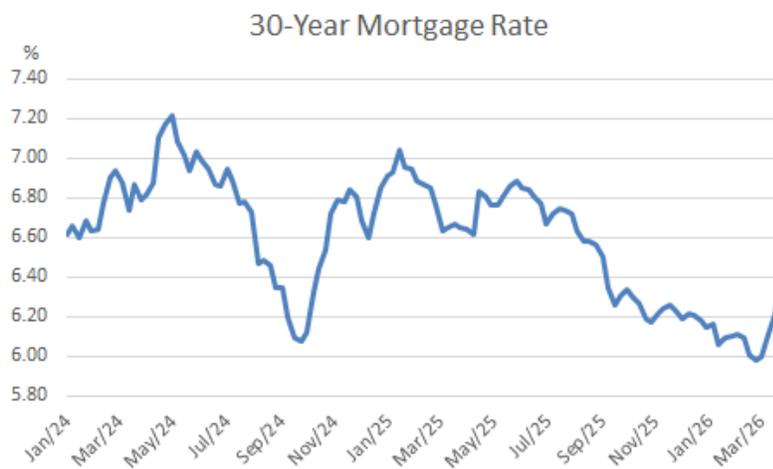
Despite President Trump’s decision to postpone the deadline for Iran to open the Strait of Hormuz -- and delay bombing of Iran’s power plants – for another 10 days, the turmoil in the financial markets has not subsided – and likely won’t until visible signs the Mideast war is ending, and the oil spigot reopens. Stocks tumbled again this week, and the tech-laden Nasdaq index has entered correction territory. As the war drags on, its ramifications are bleeding into both inflation and growth, amplifying stagflation and complicating the rate-setting decision of the Federal Reserve. At its last meeting in mid-March, a planned rate cut this year was still in the books. But since then, adverse portents on the price front have intensified. Oil prices have continued to rise, import prices have surged and the prevention of Gulf States from transporting industrial materials through the Strait of Hormuz is sending aluminum and other commodity prices up the same ladder as oil prices.

Unsurprisingly, these inflationary impulses have altered the mindset on Wall Street, which has thrown in the towel on rate cuts this year and is pricing in a growing probability of a rate hike. One reason: even as inflation has become more visible, signs of economic distress are still not showing up in the data. That’s particularly true of the main barometer of economic health – the job market. It’s true that anecdotal evidence of worker layoffs abounds, particularly in the tech sector; but until that evidence is mirrored on the unemployment lines, it is hard to believe that companies in the aggregate are drastically reducing headcount. If massive layoffs were underway, you would see a bump up in first-time claims for unemployment benefits. But that’s simply not happening; indeed, initial applications for jobless benefits continue to hover around historical lows.



That's not to say that the job market is in good shape. Even as companies in the aggregate are holding on to workers, they are not hiring new ones as evidenced by the lowest hiring rate since 2003. True, weak hiring is less alarming than it would otherwise be, because it's accompanied by a slowdown in labor-force growth due to a plunge in immigration and aging demographics. However, as Fed Chair Powell has noted, the balance in the demand and supply for workers is a precarious one, as it leaves the labor market vulnerable to significant job losses if the shock from the oil crisis intensifies and its impact spreads more broadly throughout the economy. It may well be that employers have the same mindset as the Fed, namely that the oil-driven inflation surge is a temporary supply shock that will fade when a ceasefire occurs, and conditions return to normal. That sentiment leaves both the Fed and employers in a holding position until the fog of uncertainty lifts.

However, one sector that is already feeling the pain from the war is housing, where a nascent recovery started before the war due to falling interest rates. That script has been flipped as rates have increased significantly in recent weeks, erasing all the decline that had occurred since



last September. After briefly slipping below the psychological 6% threshold in the last week of February, mortgage rates rebounded to 6.38 % this week and is set to rise further next week. That's because mortgage rates are linked to the 10-year Treasury yield, which rose again this week, reflecting rising inflationary expectations among traders.

The recent increase will make home buying less affordable, which has been a big hurdle for first-time homebuyers. Harsh winter weather contributed importantly to the plunge in new home sales in January to the lowest level since 2022; but that deflating experience captures some of the struggles the industry has been dealing with for some time. Meanwhile, high mortgage rates have long prevented homeowners from putting their homes on the market, unwilling to swap their low-rate mortgages for the higher rates they would incur for trading up to a costlier home. Simply put, the no hire/no fire narrative in the job market is being echoed with a no buying/no selling one in the housing market.

Of course, should the Mideast conflict end soon, rates would no doubt reverse course and erase the impediments punishing housing as well as other industries vulnerable to rising interest rates

and prices on oil-related imports. However, the prospect of a quick ending is looking less likely. Trump's 15-point peace plan was publicly rejected on March 25. Iran, in turn, issued a five-point counteroffer essentially demanding sovereignty over the Strait of Hormuz, war reparations, and binding guarantees against future attacks. These are non-starters.

From our lens, the diplomacy is largely performative thus far. Trump has been using the expectation of diplomacy to jawbone markets into calm, which clearly is not working. Iran is using rejection to signal resolve. The gap between the two sides remains significant, but not hopeless. The fact that Iran responded at all suggests some willingness to engage on terms for ending the war...eventually. Also notable, Iran's outsized demands did not mention anything about its nuclear program being sacrosanct... which could be interpreted as an (unstated) concession.

Depending on how and when the conflict ends, it's reasonable to come up with various outcomes for the economy. The most benign scenario is one in which oil prices have peaked and start to decline in late April as tensions ease. This, of course, would imply that some deal is struck and uncertainty roiling the markets unwinds. Should hostilities continue to unwind, oil prices will drift back below \$80 per barrel over the coming month, triggering a reversal of the steep decline in stock prices and stifling the rise in market yields. Under such a scenario, it would make sense for the Federal Reserve to look through the temporary rise in energy prices as inflation expectations would likely remain well anchored.

Under the most severe scenario, hostilities reaccelerate, global oil prices average around \$140/barrel for two months, financial market turmoil continues, and supply-chain disruptions amplify. Against that backdrop, ignoring oil shocks is no longer viable for the Federal Reserve, as inflation expectations rise and second-round inflation effects on food and other goods take hold. The central bank is likely to raise rates despite slower growth and a weaker labor market, pushing the US into a mild recession in the first half of the year. If we have learned one lesson from the four weeks since the outbreak, it is that the current situation is fluid, and anything can happen. Buckle your seat belts.



## FINANCIAL INDICATORS

INTEREST RATES	March 27	Week Ago	Month Ago	Year Ago
3-month Treasury bill	3.69	3.71	3.67	4.29
6-month Treasury bill	3.72	3.75	3.63	4.22
2-year Treasury note	3.93	3.91	3.39	3.92
5-year Treasury note	4.08	4.01	3.51	3.99
10-year Treasury note	4.44	4.39	3.95	4.24
30-year Treasury bond	4.97	4.94	4.62	4.63
30-year fixed mortgage rate	6.38	6.22	5.98	6.65
15-year fixed mortgage rate	5.75	5.54	5.44	5.89

STOCK MARKET				
Dow Jones Industrial Index	45,166.64	45,577.50	48,977.92	41,583.90
S&P 500	6,368.85	6,506.48	6,878.88	5,580.94
NASDAQ	20,948.36	21,647.61	22,668.21	17,322.99

COMMODITIES				
Gold (\$ per troy ounce)	4,489.70	4,500.7	5,296.5	3,117.9
Oil (\$ per barrel) - Crude Futures (WTI)	101.16	98.81	67.29	69.00

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
No major economic data this week				

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