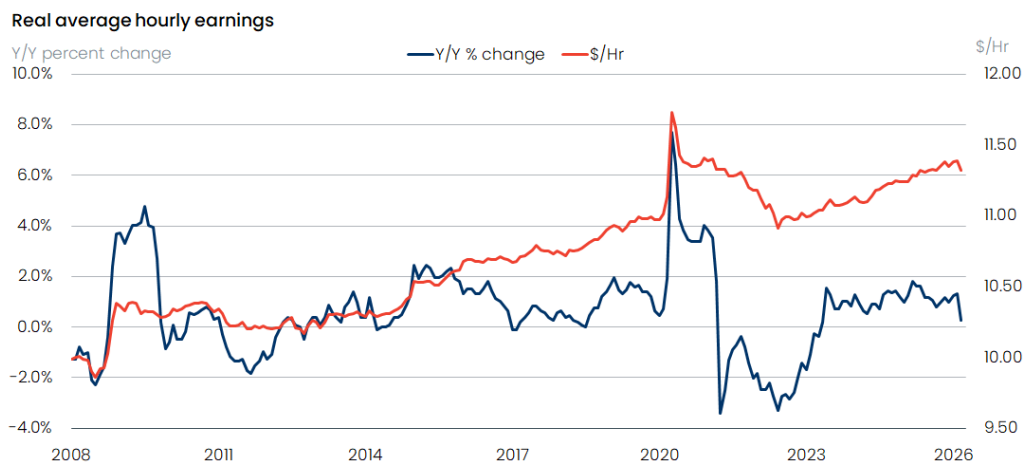
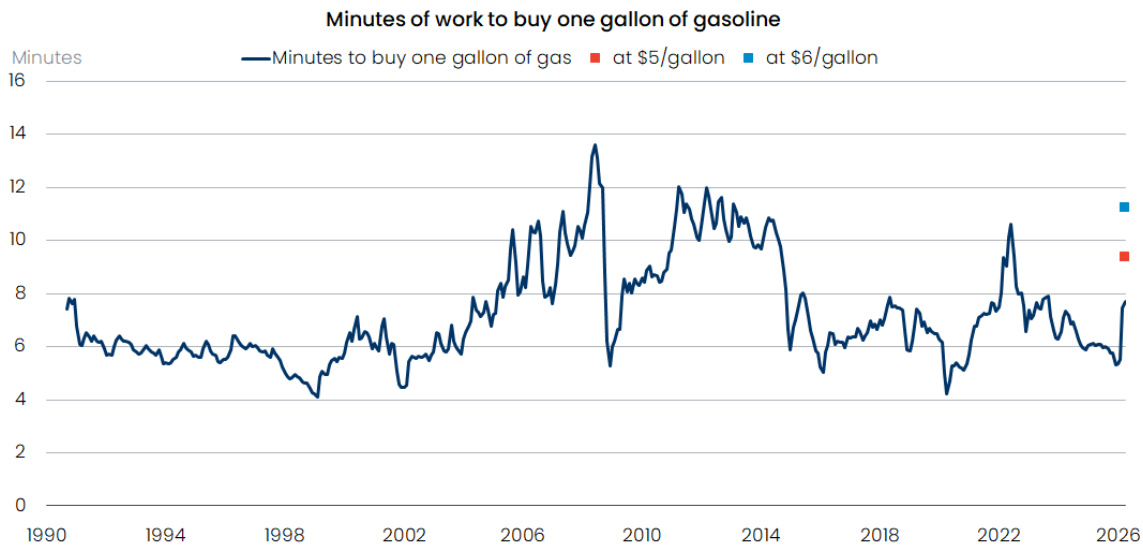


Reports that Iran has reopened the Strait of Hormuz on Friday morning is clearly good news for the financial markets and global economy, as it would arrest the oil-induced inflationary surge linked to the Mideast conflict. It remains to be seen if the gesture holds and the U.S. responds by removing its naval blockade of Iranian ships. President Trump declared that the blockade would remain in effect until a full peace accord is signed. Unsurprisingly, crude prices plunged following the report on Friday morning and, if that trend holds, prices at the pump will follow. However, the response at service stations will not be immediate nor aligned dollar for dollar with the crude price drop. It takes time for oil production to fully recover and for the lower priced crude to replace the more expensive product currently filling up gas tanks. Even if the truce is sustained, retail gas prices could rise further before retreating.

Still, the enhanced prospect that the gasoline price spiral is nearing an end promises to relieve motorists of a major budget squeeze less than a month away from the peak driving season. True, things would be much worse if the squeeze took place amid large scale unemployment, depriving workers with paychecks and the means to fill up their tanks. With the unemployment rate hovering at historically low levels and wages still outpacing inflation, that is not the case now. But hiring is stagnant, and wage growth is slowing even as the cost of energy, as well as most everything else, keeps on rising. Hence, worker purchasing power is weakening, as the annual growth in real average earnings virtually stagnated in March at levels no higher than last May.



That means jobholders have to work longer just to fill up Old Betsy. At the latest nationwide average retail price of gasoline -- \$4.23 a gallon as of mid-April – nonmanagement employees are devoting 7.7 working minutes towards the cost of a service station visit, based on average earnings in March. That’s well above the time worked during the 1990s but exceeded several times over the past twenty years. However, should tensions flare up again and undercut the tenuous ceasefire, reigniting the oil price climb, things would get dicey. At \$5 a gallon – which was widely considered approachable before Friday’s news – the gas-time spent on the job would rise to 9.34 minutes. At \$6/gallon, more than 11 minutes would be needed, which exceeds the peak reached following Russia’s invasion of Ukraine in 2022. Importantly, a robust job market and strong worker bargaining power enabled the economy to weather that headwind. That’s not the case now.



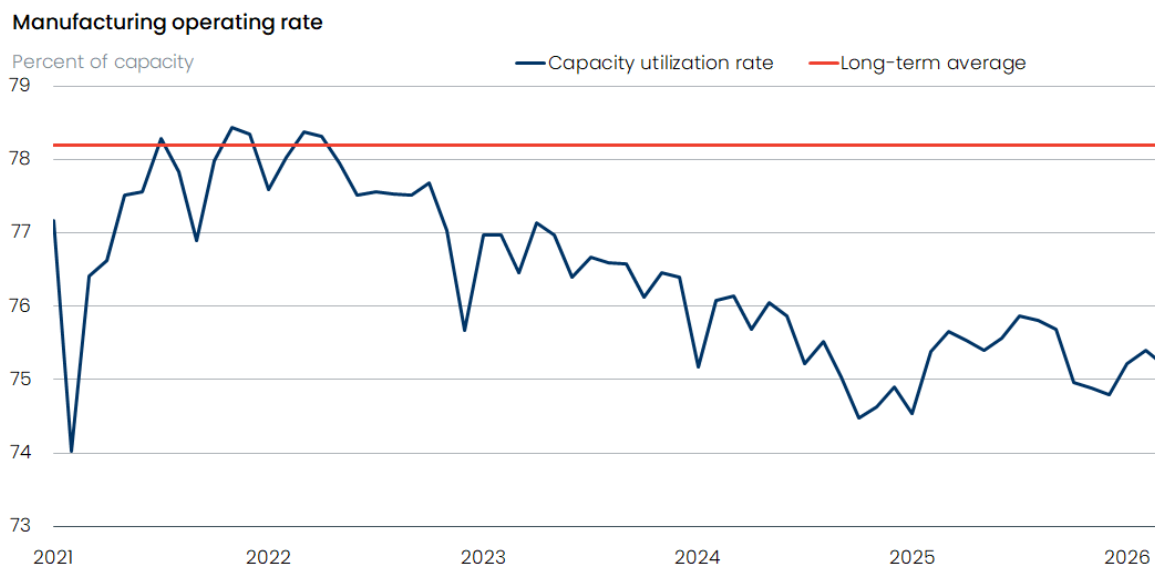
To be sure, the disruption in the oil markets has contributed to the economy’s recent weakness, not only by juicing inflation but also via its influence on driving up market interest rates. That added another headwind to an already beleaguered housing market and put a dent on auto sales. It also further complicated the job of Federal Reserve officials, who are gingerly navigating the mounting tension between its dual mandate of promoting stable inflation and maximum employment. Walking that tightrope has put policy on hold, drawing consternation of both the doves and an increasing minority of inflation hawks.

Should the current truce lead to a permanent resolution of the conflict – a big if – and oil once again flows freely, both sides of the dual mandate would benefit. The job market would get a lift from the removal of a major growth-dampening influence and inflation would retreat as oil-induced price pressures ease. On the surface, that points to a standoff for the Fed, keeping it on the sidelines until it assesses the balance of risks that results from these opposing trends. From

our lens, the door would open wider for rate cuts under this scenario, although the lagged response of falling gasoline prices increases the odds that the first cut will come later than sooner. Keep in mind that inflation was sticky, holding well above the Fed's 2 percent target before the outbreak of Mideast hostilities, and a premature rate cut before a sustained disinflation trend takes hold could raise inflationary expectations.

But a rebound in activity should not arouse inflation hawks as it would unfold amid strong disinflationary forces. For one, the economy has plenty of room to run before it strains output capacity. That was illustrated in the latest industrial production report released Friday, which revealed a sizeable 0.5 drop in total industry output in March. The overall decline was led by weakness in Utility usage, thanks to unseasonably warm weather, and in mining, as large cautious oil producers are not swayed by higher oil prices to rev up output. Doing so is costly and vulnerable to the boom-and-bust nature of the oil industry, which burned many aggressive producers in the past.

More important is the slack in manufacturing, which is more sensitive to cyclical forces and has historically aligned with the ebb and flow of inflation. A company running at full capacity has more pricing power than it would if its resources were underutilized. The slim 0.1 percent drop in manufacturing last month was not meaningful and weighed down by a slump in auto assemblies. But it left factories with an ample amount of unused capacity, so it would take a sizzling and sustained rebound in output before they are empowered to flex their pricing muscles. The manufacturing utilization rate stood at 75.2 percent in March, well below its long-term average (from 1972-2025) of 78.2 percent.



To be sure, manufacturing has had a waning influence on the economy and inflation over the years, as an ever-wealthier nation has devoted more of its resources to services. As a result, the major cost pressure on inflation has increasingly come from labor rather than capacity constraints, except for episodes of severe product shortages linked to unusual circumstances, such as a pandemic. But as we noted earlier, worker bargaining power has been weakening and is unlikely to regain the upper hand anytime soon amid the ongoing low hiring/low firing environment. What's more, labor costs have been restrained by stronger productivity growth over the past two years, and the emergence of AI is poised to energize that trend going forward. All told, we don't see a potential economic rebound from a normalized energy sector stoking inflation, nor preventing the Fed from cutting interest rates later this year.

FINANCIAL INDICATORS

INTEREST RATES	April 17	Week Ago	Month Ago	Year Ago
3-month Treasury bill	3.69	3.68	3.71	4.32
6-month Treasury bill	3.68	3.71	3.75	4.20
2-year Treasury note	3.71	3.81	3.91	3.81
5-year Treasury note	3.84	3.95	4.01	3.94
10-year Treasury note	4.25	4.34	4.39	4.33
30-year Treasury bond	3.91	4.92	4.94	4.80
30-year fixed mortgage rate	6.30	6.37	6.22	6.83
15-year fixed mortgage rate	5.65	5.74	5.54	6.03

STOCK MARKET				
Dow Jones Industrial Index	49,447.43	47,916.60	45,577.50	39,142.23
S&P 500	7,126.06	6,816.89	6,506.48	5,282.70
NASDAQ	24,468.48	22,902.89	21,647.61	16,286.45

COMMODITIES				
Gold (\$ per troy ounce)	4,849.40	4,771.0	4,500.7	3,328.4
Oil (\$ per barrel) - Crude Futures (WTI)	85.57	95.63	98.81	64.68

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Producer Price Index (March) - % change	0.5	0.5	0.6	0.5
Existing Home Sales (March) - mlns	4.0	4.1	4.0	4.1
Industrial Production (March) - % change	-0.5	0.7	0.0	0.0
Capacity Utilization (March) - Percent	75.6	76.1	75.7	75.7

DISCLAIMER: This communication has been prepared by Government Portfolio Advisors LLC solely for informational purposes for institutional clients. Sources for this commentary include Bloomberg and Oxford Economic/SMRA. It is not an offer, recommendation, or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.