Financial HARTbeat

US Treasury downgrade?
May 20th 2025

Good Morning,

Finance leaders of the G7 meeting in Canada today to discuss tarrifs and many other pressing global financial issues to contend with the remainder of this year..

Musk said he is committed to lead Tesla well past current tenure…5 years +

US Treasury downgrades getting some headlines…does it really matter? Presently the answer is a resounding no…

Catch the playback of our Weekly Roundup ***[Click here]***

Chart of the Day: Odds of cut increasing again in Canada in June..

		Bank of Canada	Federal Reserve	European Central Bank
Rates	President / Chair	Tiff Macklem	Jerome Powell	Christine Lagarde
	Policy rate	Overnight rate	Fed Funds rate	Deposit facility rate
	Current policy rate	2.75%	4.50%	2.25%
Next meeting	Next meeting date	June 4, 2025	June 18, 2025	June 5, 2025
	Market-implied policy rate*	2.59%	4.48%	2.01%
	Spread vs. current rate	-16 bp	-2 bp	-24 bp
	Probability of…			
	… hike	0%	0%	0%
	… hold	36%	92%	6%
	… cut	64%	8%	94%
Rate cuts	25bps cuts priced in over...			
	... next 3 months	1.1	0.4	1.2
	... next 6 months	-	1.4	1.9
	... next 12 months	-	3.1	-

*Derived from OIS (Bank of Canada, European Central Bank) and Fed Funds Futures (Federal Reserve).

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Top News

U.S. stock index futures are trading slightly lower today as investors awaited commentary from Federal Reserve officials through the day to assess the impact of U.S. President Donald Trump's tariff policies into the second half of 2025. At least seven Fed officials including St. Louis Fed President Alberto Musalem are expected to speak later in the day.

Fed officials on Monday flagged the ramifications of the latest downgrade of the U.S. government's sovereign credit rating and uneasy market conditions. Treasury Secretary Scott Bessent commented that Friday's decision by Moody's to strip America of its remaining AAA sovereign credit rating was out of date, coming 14 years after S&P Global shocked investors by downgrading Uncle Sam. What's more, the move was well telegraphed. Moody's placed the U.S. Treasury on watch for downgrade as far back as November 2023. Little has changed to address fiscal concerns since then. Indeed, the major policy changes this year include plans to roll over tax cuts, only making the situation worse. And then there's the long-standing argument that marginal shifts in the U.S. credit rating are not particularly material as long as an actual U.S. default remains improbable. In addition, there's no sufficiently large and liquid global savings alternative to Treasuries and strict AAA mandates among big institutional investors are largely a thing of the past.

On Monday, the 30-year Treasury yield popped briefly above 5% early in the day, its highest since 2023, but then quickly erased the move. The dollar and U.S. stocks also clawed back most early losses. However, despite the modest reaction in markets, concerns around mounting U.S. debt will remain in focus, with a vote on Trump's sweeping tax-cut bill in the House of Representatives expected sometime this week. In Canada, the main stock index rose following data that showed that annual inflation rate eased to 1.7% in April as energy prices dropped sharply after the removal of a federal consumer carbon tax, but core inflation edged up. Two of the three core measures of inflation, which are closely watched by the Bank of Canada, hit 13- month highs on underlying price pressures.

Analysts had forecast the annual rate would ease to 1.6% in April from 2.3% in March. Overall energy prices plunged 12.7% last month as gasoline prices fell by 18.1% from a year earlier while year-over-year prices for natural gas dropped 14.1%. Consumers, though, paid 3.8% more for groceries than they had done a year previously, up from 3.2% in March. Year over year, prices for travel tours rose 6.7% in April. On a month-by-month basis, inflation dipped by 0.1% compared to analysts' forecasts of a 0.2% drop.

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The currency swap market bets showed that the odds for a rate cut dipped to 48% from 65% before the release.

Later today, finance leaders from the Group of Seven industrialized democracies will meet in Canada. They will strive for unity on non-tariff issues, but may have trouble reaching consensus with a Trump administration intent on pushing allies to serve U.S. interests.

Profit Margins Widening (May 20, 2025) (Argus)

First-quarter earnings season is winding down, as the retailers wrap up with their reports. The overall growth rate is set to land in the mid-teens range, which is above our forecast for 10%-12% growth. Yes, earnings typically do beat expectations, but let's take a closer look. There are three drivers to EPS growth: higher sales, a wider operating margin, and a reduced share count. A decline in shares outstanding, which is the result of corporate share buybacks, is the lowest quality driver of EPS growth. Higher sales -- as customers demand and pay for more products and services -- is the highest quality, especially when those sales totals are driven by an increase in volume. (First-quarter revenue growth has been about 5%, or about 300 basis points above long-term U.S. GDP growth, which is healthy.) Margin management is in the middle. Consistently wider margins, quarter after quarter, are often a sign of a good management team, which should, over time, be able to grow revenues faster than it grows costs. That's a tall order in periods of high inflation, which raises the prices of Cost of Goods Sold, and of high interest rates, which result in higher financing costs. What's more, there's a cap to and they don't rise indefinitely. (This is one of those statistics for which the concept "reversion to the mean" is relevant.)

In 4Q, the S&P 500 operating margin widened by more than 100 basis points year over year to 12.0%, which means there's still room before margins peak at around 13.5-14.0%. This trend fits into our outlook for a modest widening for the S&P 500 operating margin in 2025, taking into account an expected negative drag from tariffs, and for EPS growth in the 12% range for the year.

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Gold in Demand (May 19, 2025) (Argus)

When global economic conditions become uncertain or unpredictable, investors often flock to gold. According to Trading Economics, the yellow metal is currently trading above $3,200 per ounce, up 25% for the year and near the high end of its five-year range of $1,660-$3,325. Essentially, gold has been on an upward arc since the start of the pandemic. During the first phase of the unanticipated global health crisis, the spot price for an ounce of gold jumped 33% in six months and broke through the $2,000 level. Gold also spiked in 2022 due to the war in Ukraine. Over the past year, gold has jumped another 40%, driven in part by global uncertainty over tariffs and trade wars. The current price of gold reflects the perceived safety of hard assets amid the global conflicts, as well as expectations for lower U.S. interest rates, which tend to weaken the dollar (the currency in which gold is priced). The outlook for Federal Reserve rate cuts also helps gold, as lower rates reduce the risk for a global economic recession and thus a potential decline in gold purchased for jewelry.

Looking ahead, our forecast trading range for gold in 2025 is $2,500-$3,500 and our average price forecast for the year is $3,000. This compares to average gold prices of $2,450 in 2024, $1,960 in 2023, $1,873 in 2022, $1,806 in 2021, $1781 in 2020, $1,400 in 2019, $1,265 in 2018, $1,277 in 2017, $1,258 in 2016, and $1,155 in 2015. As long as geopolitics are flaring and the global economy is wobbling, gold is likely to remain at elevated levels.

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Bond Yields (bps (basis points) negative means prices up and positive means prices down)

Figure 1: Key Interest Rates (Canada & U.S.)

Canadian Key Rate	Last	Change bps	Canadian Key Rate	Last	Change bps
CDA o/n	2.75%	0.0	CDA 5 year	2.79%	1.4
CDA Prime	4.95%	0.0	CDA 10 year	3.20%	2.5
CDA 3 month T-Bill	2.59%	-1.5	CDA 20 year	3.44%	3.1
CDA 6 month T-Bill	2.56%	0.0	CDA 30 year	3.52%	3.1
CDA 1 Year	2.53%	0.0			
CDA 2 year	2.53%	-0.7			
US Key Rate	**Last**	**Change bps**	**US Key Rate**	**Last**	**Change bps**
US FED Funds	4.25-4.50%	0.0	US 5 year	4.06%	-1.6
US Prime	7.50%	0.0	US 10 year	4.47%	-0.8
US 3 month T-Bill	4.27%	2.1	US 30 year	4.93%	-0.6
US 6 month T-Bill	4.28%	0.0	5YR Sovereign CDS	53.00	
US 1 Year	4.12%	-0.3	10YR Sovereign CDS	55.95	
US 2 year	3.97%	-1.5			

Preferred Shares Indicators	Last	Daily %	YTD
S&P Preferred Share Index	640.38	-0.01%	0.78%
BMO Laddered Preferred Shares (ETF)	11.07	-0.09%	1.10%

Source: LSEG

Things are looking up! Have a great day!

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