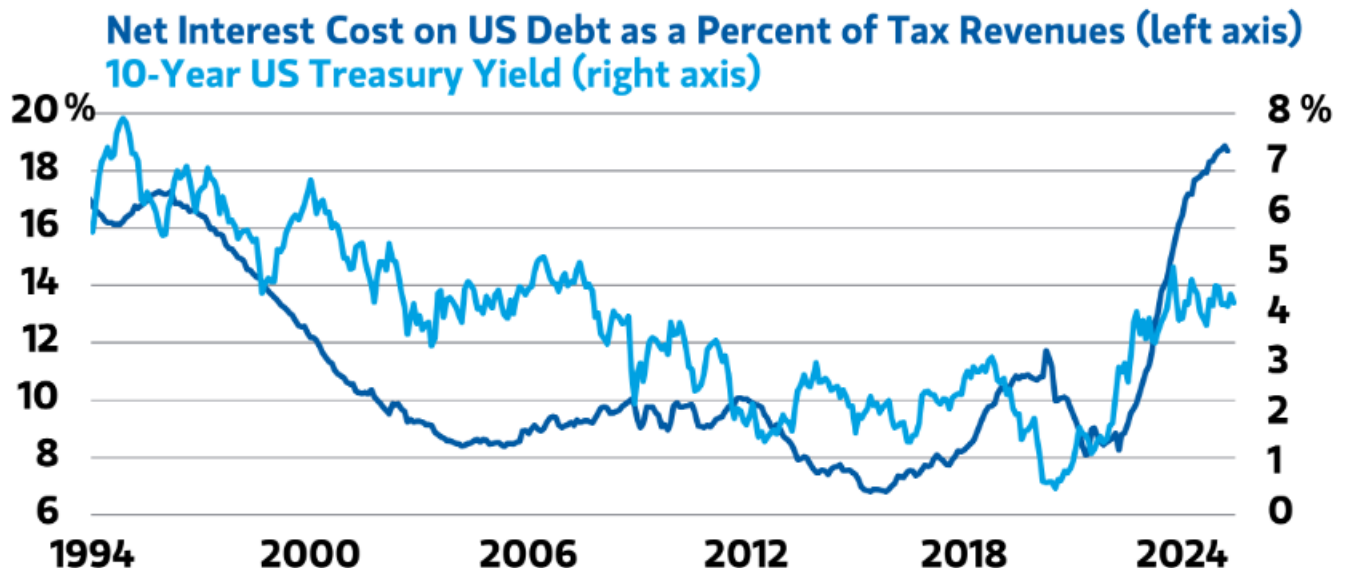




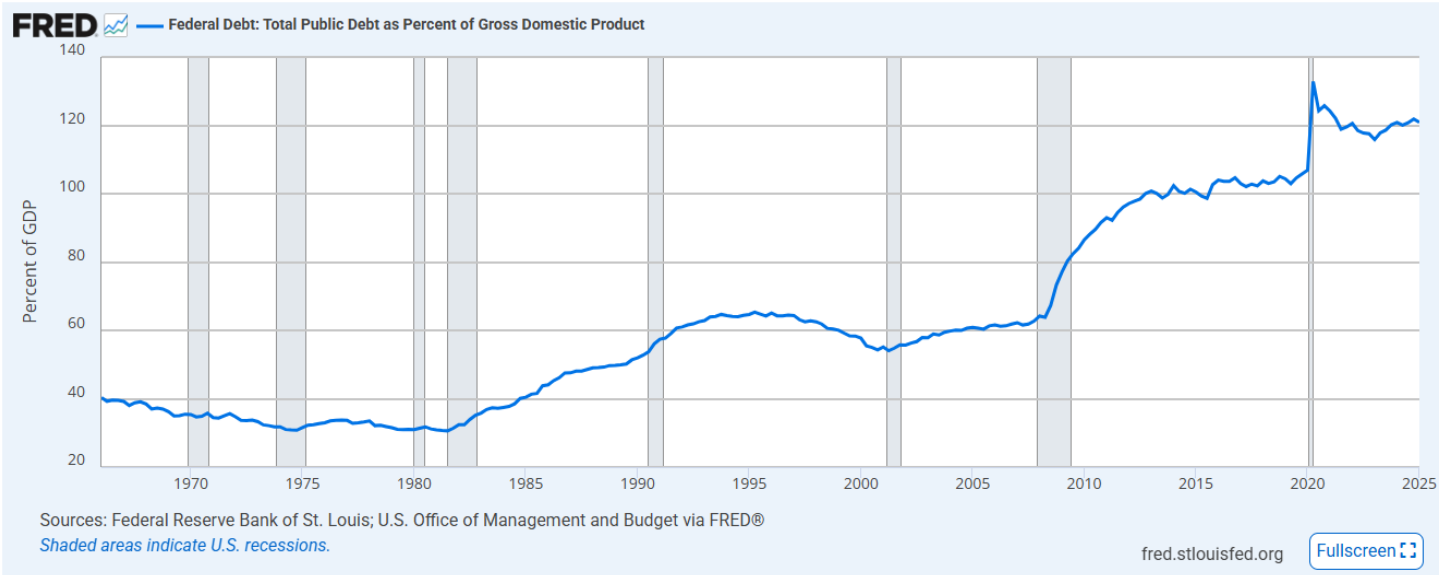
## Capital Markets Commentary ~ August 2025

Most of the folks who read this letter, probably all of you, regularly pen checks to the US Treasury for a disconcerting amount of money. For the sake of easy math, let's pretend you're mailing a check to the IRS today for \$10,000. Back in 2015, just ten years ago, 6.9%, or \$690, of that payment was needed to offset interest payments on the national debt.<sup>i</sup> By 2026, the percentage of your tax dollars required to pay interest (and only interest) on the national debt will have risen to 20% or \$2,000.<sup>ii</sup> Let that sink in for a sec. Of your \$10,000 payment, \$2,000 goes toward interest on the national credit card. Here's a chart that shows, over time, interest costs as a percentage of federal revenue:



Source: Strategas, Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of July 8, 2025

And another that shows debt service as a percentage of GDP over time:



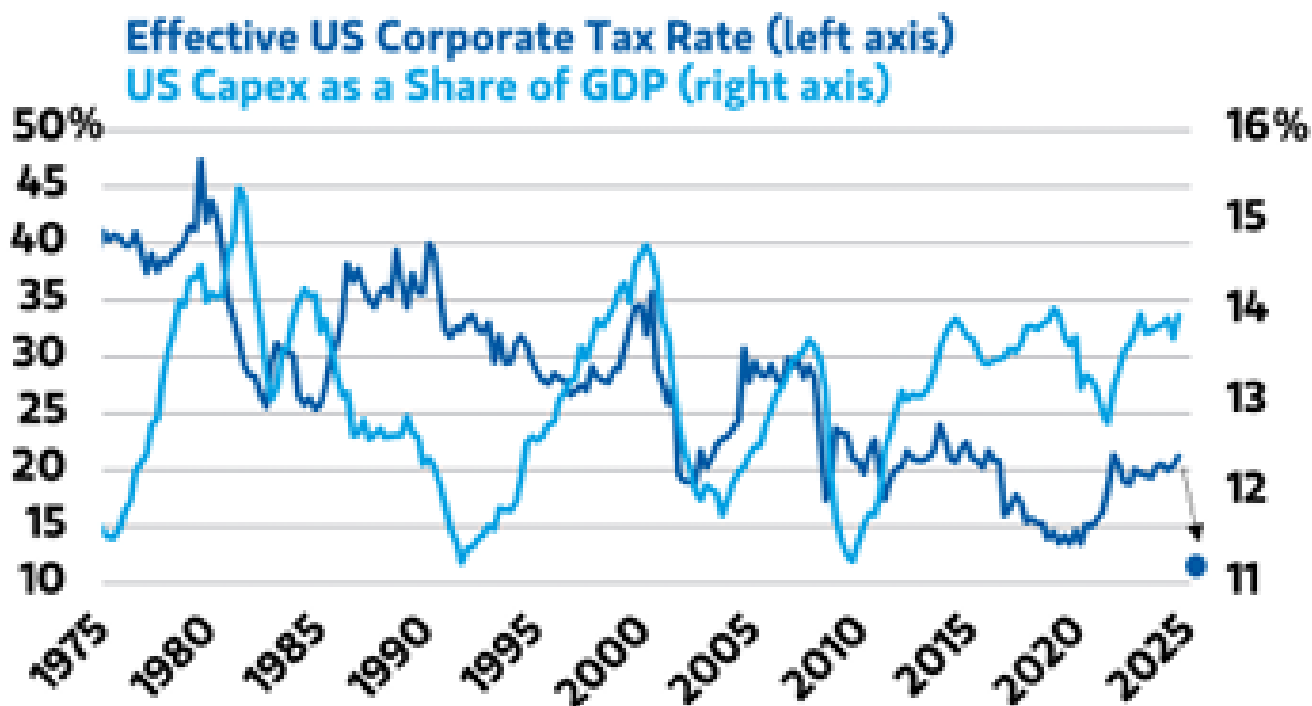
The exponential increase in the percentage of your hard-earned cash that services the national debt is a problem that has **very** many mothers, but the recently enacted One Big Beautiful Bill Act, or the OBBBA isn't going to reverse that trend.

At Graystone Charleston, we look at our children and grandchildren (as well as your children and grandchildren) and despair over the ballooning debt they'll inherit ten, twenty, or thirty years in the future. Markets, on the other hand, aren't looking so far ahead. Markets are pretty much rooted in the right now (or at least the next couple of years) and if we can set aside our trepidation over the future for a moment, the OBBBA does come with some juicy tidbits for equity investors. Bond investors, on the other hand, aren't so sure. Obviously, it isn't possible to thoroughly vet a 900-page bill in this limited space, so the précis will have to do, but first, let's look at the numbers for July.

July was a decent month, if not a barn burner. August 1<sup>st</sup> was a rough day for a number of reasons, but for now, we'll focus on the positive. In the US, the leader was the tech-heavy NASDAQ which was up 3.7% for the month, followed by the S&P 500 which gained 2.2% and the Dow which eked out a teeny gain of 0.2%. Europe, on the other hand, gave up ground with the Eurozone STOXX 50 losing 2.4%. Asia was mixed with China's Shenzhen gaining 4.5% versus Japan's Nikkei 225 losing 2.9%. Bond yields, as measured by the US ten-year, rose for the month. The benchmark bond ended June yielding 4.23%, adding 13 bps to close July at a yield of 4.36%. We should note that the ten-year yield plunged amidst the market rout on August 1<sup>st</sup> and as of this writing stands at just 4.2%.<sup>iii</sup> Rather than expend ink on a one-day event, we'll table that topic until next month (one day does not qualify as a trend). Now, on to the OBBBA.

When economies are in need of a boost, deficit spending, and tax cuts, can be just the ticket. That boost, though, can come with unpleasant side effects ~ much like indulging in retail therapy with an already overburdened credit card (but we digress). Most of the tax cuts in the OBBBA are simply an extension of the 2017 tax cuts that were set to expire at the end of the year, so they're not "new" stimulus. Other cuts, like the no-tax-on-tips or overtime provisions are new. The bill is also structured so that the tax cuts begin immediately, but the revenue cuts don't kick in until after the 2026 midterms, meaning the stimulative effects start now and may be amplified due to the lag in offsetting cuts.<sup>iv</sup>

For example, the bill maintains the 21% corporate tax rate of the 2017 bill but adds something called the “Advanced Manufacturing Investment Tax Credit.” This credit was part of the Inflation Reduction Act which passed in 2022 under the Biden Administration, but back then, it applied only to semiconductor production and renewable energy projects. The OBBBA phases those credits out for some renewable energy businesses such as wind, solar, geothermal, nuclear, electric vehicles, and more, but extends it to a slew of other industries. Building an AI data center? You may be able to fully expense the construction and immediately deduct research and development costs and interest expenses as well. The same goes for traditional energy projects and manufacturing facilities, too. Morgan Stanley estimates that this could push the corporate tax rate to as low as 12% for some payers, which would be the lowest level in US history.<sup>v</sup>



Source: Piper Sandler and Co., Morgan Stanley Wealth Management Global Investment Office as of March 31, 2025

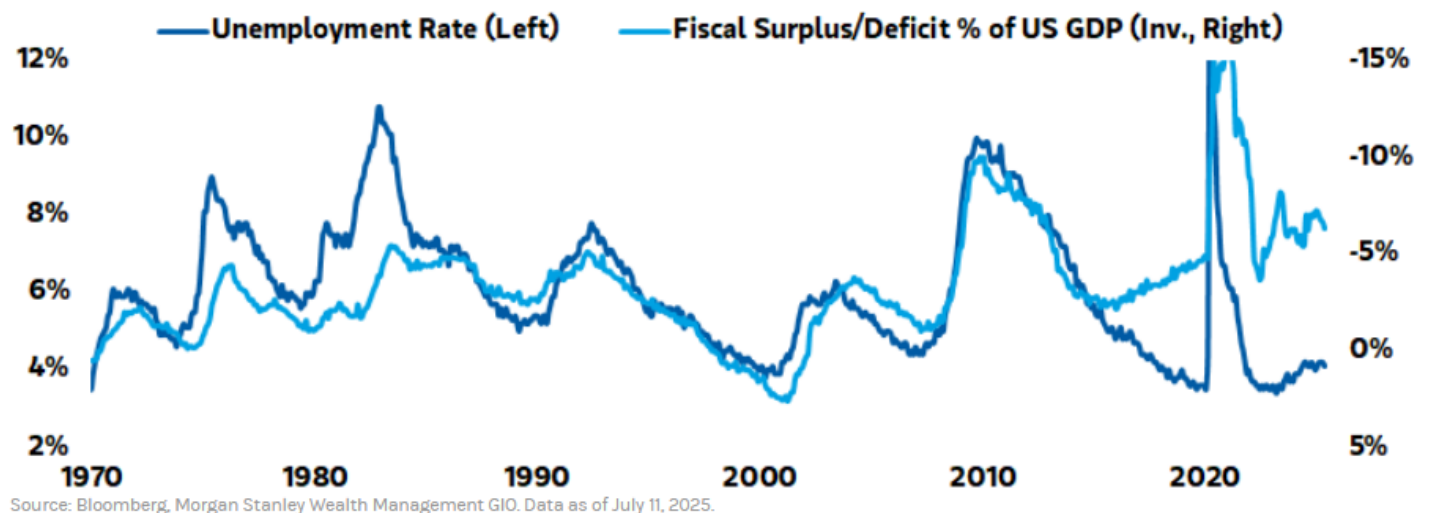
So, it's a great time to build a factory and may be a great time to invest in companies that build factories, but what's the downside? It is estimated that the OBBBA will add a total of \$4.1 trillion to the national debt, which breaks down to \$3.4 trillion of spending that isn't offset by revenue and \$700 billion in additional interest costs. Over time, the Congressional Budget Office estimates that it will reduce federal spending by \$1 trillion (yay!), but at the same time reduce federal revenue by \$4.45 trillion (boo!).<sup>vi</sup> All this spending is like buying something with your credit card. The price of the widget you buy is increased by the amount of interest you pay to the credit card provider, right?

The same principle applies to the national debt. When Treasury yields are low, deficit spending costs less. When Treasury yields rise, deficit spending costs more. This is why we're interested in what impact the OBBBA might have on the Treasury market. It's not only because of how it impacts our bond investments, but also because higher interest rates make servicing the national debt more expensive. It can become a vicious cycle, and the bond market is already taking notice.

Bond people talk about a thing called the “term premium.” This is the compensation a bond buyer demands for the added risk of owning a very long bond versus a short bond. The higher the term premium, the higher the yield is on a long Treasury bond. This premium started creeping up in Q4 2024, crept higher when Moody’s downgraded the Treasury’s credit rating, and crept higher still as the OBBBA moved through Congress. Today, the term premium is near a ten year high.<sup>vii</sup> Furthermore, increased deficit spending will necessitate the increased issuance of Treasury debt into a landscape where the Fed isn’t adding to its balance sheet by buying Treasuries, and where foreign governments are less likely to be the voracious buyers they once were. More supply + less demand = higher interest rates, which in turn can add even more to the national debt.

These higher Treasury yields may translate into higher interest rates for borrowers, both people and businesses. Last month we discussed in some detail why Federal Reserve rate cuts don’t necessarily translate into lower borrowing costs and cutting the fed funds rate can do nothing to bring down the higher long-term rates that can result from massive deficit spending. Short rates might fall, but longer rates might rise, and those higher borrowing costs can lead to less consumer spending and weaker employment.

### The US’s Pro-Cyclical Fiscal Policy May Challenge the Fed’s Dual Mandate—And Limit the Capacity for Counter-Cyclical Stimulus in the Event of Recession



So near term, the OBBBA comes packed with freebies that could be net positives for businesses and, by extension, stocks. We might even get some multiple expansion from the stimulative, tax-cutting provisions of the OBBBA which take effect now. This could bode well for equity markets and while total return on our bond portfolios might suffer, our income investors might appreciate the higher yields that come with higher rates. Longer term, though, the hangover could feel as bad as Sunday morning after a raucous football Saturday in college (not that any of us at Graystone Charleston ever suffered one of those, but hey, people talk).

And yet, today, the S&P 500’s PE multiple is 26.71x<sup>viii</sup>, well above the historic median, which might mean that investors expect earnings to grow like crab grass on Miracle-Gro®. OR, investors could simply be riding the wave of momentum as long as they can before booking gains and banking cash. We’re concerned that investors are making a near-term momentum bet here more than an earnings growth bet. Between the uncertainty surrounding

tariffs, the challenge to an independent Federal Reserve and a myriad of geopolitical challenges, we worry that the market may be getting ahead of itself as opposed to reflecting the immediate benefits of the OBBBA.

Simply put, this is no time to be complacent. Lots of things can indeed go right and it is certainly possible that none of the events that concern us come to fruition. Markets can go higher from here, but valuations, as we have seen, are not cheap – far from it – and when markets aren't cheap, negative events can have an outsized impact. Rather than trying to make a market call in an extremely turbulent environment, we suggest allocating based upon your long-term objectives. Actually, this would be our advice in a less chaotic environment, too. Any (and every) time you want to talk about risk, we'll be right here. We always look forward to hearing from you.

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<sup>i</sup> Source: Congressional Budget Office and Office of Management and Budget

<sup>ii</sup> Source: Morgan Stanley Wealth Management US Policy Pulse 07/10/2025, Monica Guerra and Daniel Kohen

<sup>iii</sup> Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet

<sup>iv</sup> Source: Morgan Stanley Wealth Management US Policy Pulse, Monica Guerra and Daniel Kohen, 07/10/2025

<sup>v</sup> Source: Morgan Stanley Wealth Management US Policy Pulse, Monica Guerra and Daniel Kohen, 07/10/2025

<sup>vi</sup> Source: Congressional Budget Office, July 21, 2025, <https://www.cbo.gov/publication/61570> "Estimated Budgetary Effects of Public Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline"

<sup>vii</sup> Source: Federal Reserve Bank of St. Louis, "The FRED® Blog."

<sup>viii</sup> Source: [worldperatio.com/index/sp-500](https://worldperatio.com/index/sp-500)

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NIKKEI 225 Index: This price-weighted index is comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

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