



BLUE GRANITE CAPITAL, LLC

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US Government Shutdown: Economic Disruption

With Washington already deeply divided, a government shutdown adds another layer of uncertainty to an environment already marked by political tension, tariff disputes, and record-high equity markets. The shutdown, now entering its second week, has furloughed roughly 800,000 federal workers and disrupted essential public services. Each added week could trim as much as 0.2% from GDP growth, according to economists. While mandatory programs like Social Security continue, the broader impact on confidence and consumer spending grows more pronounced as the standoff drags on.

Tariff Uncertainty Rattles Businesses

At the same time, escalating trade tensions are adding further strain. The administration's recent tariff measures—lifting average rates from below 2.5% to nearly 18%—have unsettled businesses and complicated investment planning. Rising import costs are beginning to pass through to consumers, pressuring their finances, and threatening to keep inflation elevated and delaying a return to the Federal Reserve's 2% target. More worrisome may be the current hostility between the U.S. and China that seems to be deteriorating rather than progressing toward a common trade goal.

Inflation: Progress, but Pressure Persists

Inflation remains stubbornly high, with annual readings near 2.9%. While lower than post-pandemic peaks, persistent pressures in energy, food, and housing continue to weigh on households. In response, the Federal Reserve has shifted its focus toward supporting employment as growth slows. After cutting rates in September to a range of 4.00%–4.25%, the Fed is widely expected to ease further before year-end as policymakers try to balance elevated inflation against weakening labor market conditions.

Federal Reserve Policy: Shifting Focus Amid Twin Risks

The Federal Reserve executed its first rate cut in nine months in September, reducing the benchmark rate to 4.00%–4.25%. Another cut to 3.75%–4% is widely expected in October in response to mounting risks in the labor market and economic growth trajectory. The central bank is now prioritizing employment stability as hiring has slowed sharply, even as inflation hovers above target. Several Fed officials favor further easing, and markets have currently priced in more rate cuts by year-end.

Slowing Economic Growth and weakening Labor Market

Economic momentum is indeed softening. Following a robust rebound in mid-2025, growth has slowed noticeably, with fourth-quarter GDP expected to decelerate to around 1%. Hiring activity

has cooled, job postings have declined, and unemployment claims are edging higher. Signs that businesses are turning cautious amid increasingly uncertain tariff policy and a slowing economic backdrop.

AI's Outsize Economic and Market Influence

One bright spot is still the ongoing investment boom in artificial intelligence. AI-related spending continues to drive productivity gains and capital investment, providing a partial offset to broader economic headwinds. However, this rapid innovation is also reshaping the labor market and concentrating market leadership within a small group of mega-cap technology firms as domestic hiring slows.

Record Stock Market and Valuation Concerns

The stock market has reflected both the optimism and the risks of this transformation. Major indices have reached record highs, rising more than 17% over the past year and valuations now sit above historical averages, which do not seem sustainable. Since the April stock market low just after global tariffs were broadly announced, the S&P 500 has rallied more than 33%. The 3-year performance for the S&P 500 bull market that began in October 2022 has now totaled more than 80%. Nearly 40% of total market capitalization is concentrated in just 10 AI-focused companies, leaving equities increasingly vulnerable to shifts in sentiment or disappointment in growth expectations. We are increasingly concerned that long-term investment strategies cannot be built on just 10 stocks or one investment theme, as such we continue to endorse our broadly diversified portfolio strategy focused on value-oriented, dividend-paying stocks, blended with high quality bonds.

Investment Takeaway

In this environment of political gridlock, persistent inflation, and slowing growth, investors face a delicate balance between opportunity and risk. While the long-term potential of AI and innovation is incredibly compelling, the margin for error is thin. A disciplined, diversified approach focused on quality and adaptability is essential as markets navigate this uncertain landscape.

Please let us know if there is anything you would like to discuss or have any questions. Our best to your families during the upcoming holiday season.

Warmest regards,

Scott, John & Dave