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# Trump 2.0

In our last letter [10/31/24] we had a little fun recalling the Goldilocks and the Three Bears porridge discussion: it's not too hot, it’s not too cold, it’s just about right. That was used metaphorically in reference to our views regarding the outlook for the economy and the stock market in 2025. As mentioned in several communications, David Lefkowitz, our senior Strategist, has held a positive perspective for quite some time. Our friends and clients will remember that we too have been very constructive about the equity markets through much of the last couple of years. And we continue to maintain that positive overview, notwithstanding possible challenges ahead. One example, if the 2017 Tax Cuts and Jobs Act were to be extended for another ten years (which would likely find broad support) it would cost about $5 trillion. Compare that to our total GDP of around $30 trillion. It begs the question, who’s going to pay for that? You already know.

Nevertheless, if you take a look at the objectives that our strategists have outlined in the January 29th edition of the UBS “House View” you’ll note their belief that the S&P 500 could exceed their target of about 6600 this year, leaving an outside possibility of reaching even 7000, should some of their more bullish scenarios be achieved. As a reminder, these are not static views, they are based upon many factors which include “US political changes, falling interest rates, and transformational innovation in artificial intelligence, power, and resources.”

Global growth is expected to provide a positive backdrop this year. It is forecast to generate around 3% overall with results in the Eurozone coming in near 0.9%. We see GDP growth in the US at 2.1% this year with the possibility that it could hit at a run rate of 2.8% in one of the quarters.

Most of our business clients are relatively optimistic about the outlook for 2025. Although, we do hear from many of them that while business has improved from the COVID constrained environment of a few years back it is nevertheless a little spotty. And it is difficult to find individuals who have the appropriate skills and attitude (flexibility?). We feel that a little caution may be advisable at this point. Nevertheless, looking over the balance of the year, we believe conditions will remain positive enough to allow equity markets to move higher.

Our investment strategy folks, as mentioned above, look for the S&P 500 to reach 6600 (currently 6068) this year based on the expectation that earnings will come in in around 270 up from 248 last year.

And further, that the positive secular backdrop will remain in place supported by the "new world's" so called "Five Ds: deglobalization, demographics, digitalization, decarbonization and debt."

Did we mention that we have a new President at the helm? His name is Donald Trump. We'd understand if you somehow missed that given his shy, retiring and understated mien. Thus far, in sharp contrast to his predecessor, he has demonstrated a high level of energy (no naps) and a passion for getting things done; since his inauguration on January 20$^{th}$, he has crafted no fewer than 53 executive orders according to the American Presidency Project at UC Santa Barbara and signed 20 of them on his first half- day in the office, the afternoon of his inauguration. He has ordered the creation of an American Iron Dome to protect the US against missile attack, declared a national border emergency and a national energy emergency.

He's proposed tariffs on goods from Mexico and Canada which take effect in thirty days and is expected to consider reciprocal tariffs on a broader range of countries. Tariffs on Chinese goods became effective as of midnight on February 4$^{th}$. It is not yet clear what the impact of tariffs will be on global trade or the level of inflation. It would seem logical that goods whose prices have been marked up as a result of tariffs are likely to become part of the initial brew that could reignite inflationary pressures. Tariffs are generally a one-time event. If a $1 pen became subject to a 10% tariff, assuming the underlying domestic price of $1 doesn't change, it would cost you the equivalent of $1.10. It's not a cumulative effect. The price in, say 2 years, should still be $1.10.

President Trump has announced a 25% tariff on all steel and aluminum imports into the US with "no exceptions or exemptions available." The US has tended not to purchase aluminum and steel from China, one of the largest producers of steel globally. While we recognize the potential benefits of utilizing tariffs in trade negotiations, we also need to be aware of how tariffs (or currency devaluations) can develop into "beggar thy neighbor" policies which can lead to undesirable outcomes. Leaders of many nations have already pushed back on the proposed tariffs saying that they will impose reciprocal tariffs if the US imposes them.

Placing tariffs on an expanding list of goods, particularly consumer goods can, at some point, have the potential to impact general price levels. There can be a lot of confusion in the early stages. It is not always clear where and when these increased prices are likely to impact existing consumer price levels. It may be more of an issue for companies, particularly manufacturers, whose profit margins could be impacted should they choose to absorb some of the increases internally to protect market share. All of these will need to be determined as the data becomes available adding a level of risk that cannot be fully quantified upfront.

Is there is a little bit of Liars' Poker going on? Negotiators don't put all their cards on the table up front. They may not attempt to dissuade the folks on the other side of the table from carrying certain assumptions if it can benefit them. However, we don't believe that President Trump is interested in "sinking the ship" in the first few months of his term. He's still a proud growth guy who wants to see our economy stronger, but he has stated publicly that he wants to make sure the United States is not getting "ripped off" by foreign counterparts. Hence, he may use the tariff threat more liberally than he might otherwise where he judges our leverage is strong. It can be uncomfortable to observe from the outside. Although he has shown that he will modify his position if it leads to an acceptable agreement at close to his objectives. There is, of course, a risk that his bombastic style could create insurmountable impediments in dealing with some foreign partners for whom saving face is a significant factor. It's too early to say but at 78 years old, he's been through a few negotiations. As the old expression goes, "it's not his first rodeo." A client asked us before the election, "who would you rather have negotiating with a foreign adversary, Joe Biden or Donald Trump?"

We weren't around in the 1930s but most of us are aware of the stock market crash in 1929 which triggered the Great Recession. The seeds of which were borne out of the incredible growth in financial leverage (i.e., mortgages, margin debt, etc.) which had been amassed by investors and speculators alike in the 1920s. Speculation was rampant, fed by easy money, and a stock market that showed no signs of slowing down. It was further fueled by a naive belief that one had better get on board this train before you miss it. "You need to get your hands on some money, mortgage your house if you need to." Greed took over where common sense left off. Wall Street was and can be a tough place to "go to school." Noted investor Carl Icahn once said, "If you want a friend on Wall Street, buy a dog." We certainly hope our clients don't feel that way.

The environment that we see presently is still favorable for equity investors. Earnings are still growing and valuations are high at 22 times earnings. The range of P/E ratios in our recollection been as low as 4.78x in 1920 and as high as 44.2x in December of 1999 (Macrotrends). The current P/E of 22x, shown above for the S&P 500, has been very much affected by the performance of growth companies, particularly tech. If you were to look at the average multiple (unweighted) of all stocks on the S&P 500 it would be somewhere in the mid-teens. Importantly, balance sheets are in good shape. Liquidity too is still favorable.

Our new President has made it clear that he is pro- business and wants to reduce regulations that can impede entrepreneurs. Of course, CEOs may have differing views on what that should look like. President Trump raised a few eyebrows was when he talked about taking over the Gaza Strip to build a world class oceanfront resort or buying Greenland. We don't think folks know exactly what to make of our new President. Most would agree that he's a pretty capable individual but don't feel completely confident about his shoot- from- the- hip style. In some sense, leaving the fellow across the negotiating table a little unsure of his next move is part of his modus operandi. President Trump may need to tone down his rhetoric somewhat. If the person on the other side of a negotiating table views you as capricious, not clever, it may become more difficult to accomplish your objectives. It can damage your need to be seen as someone whose word is his bond.

The chart which appears below presents data on major indices at the close of the year.

| | 4Q 2024 (%) | YTD 2024 (%) |
|---|---|---|
| Dow Jones Industrials | 0.93 | 14.99 |
| Standard & Poor's 500 | 2.41 | 25.02 |
| NASDAQ Composite | 6.35 | 29.57 |
| Russell 2000 | 0.33 | 11.54 |
| Russell MidCap | 0.62 | 15.34 |
| Russell 1000 Growth | 7.07 | 33.36 |
| Russell 1000 Value | -1.98 | 14.37 |
| Barclays Capital Govt./Corp. Bond | 5.10 | 1.18 |
| Barclays Capital 5 Year Municipal Bond | 3.04 | 1.17 |

Source: Morningstar

There are few investors would find fault with last year's performance. The chart demonstrates that much of last year's equity returns were paid forward in the hope/expectation that Donald Trump might emerge victorious in the presidential election. The rest, as they say, is history.

In a continuing theme, growth stocks and NASDAQ took the lead once again helped in no small way by the frenzied fans of AI, where dreams of financial "sugar plums" danced in investors heads. In the final quarter of last year growth led the pack over traditional value equities. We would note that broad value indices were performing at approximately 43% of growth (i.e. 14.37% vs 33.36%). However, on a year to date basis, value is now outperforming growth. The Russell 1000 Value was ahead of the Russell 1000 Growth through the 7th of February (4.38% vs 2.34%). We view the recent juxtaposition as a normal market adjustment. Many stocks got a little ahead of themselves in the 4th quarter of 2024. That is why we don't get too excited about any one group's outperformance over the short term.

In our last letter we mentioned that we expected to see the market broaden out. Changing market leadership is part of that process. In our view, you may see more of this in the period ahead. But as always we keep an anchor to windward. We recommend that portfolios always maintain a balance which includes equities, fixed income and alternatives (which may include hedge funds, private equity, loans etc.). We are entering a period that will present opportunities and challenges. Our global leadership will be critical to our success. We hope, as you do, that the world finds a reason to choose peace and cooperation instead of war and strife.

We do believe that economically there are many things in place that could change the global outlook. Bombastic or not, we believe that our President seeks to become an agent for positive change and peace. We remember the Abraham Accords and documents that were signed back in September of 2020 and how the world felt at the signing.

We hope that markets this year bring good tidings to all of you, our dear clients and friends. We expect a decent year even under current circumstances. Should the conflict in the Ukraine be resolved it could have a significantly positive impact on world markets.

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