House View Summary

Weekender

March 8, 2025

The greater the obstacle, the more glory in overcoming it.

The world, dear Agnes, is a strange affair.

Jean Baptist Poquelin "Moliere"

The world is in greater peril from those who tolerate and encourage evil than those who commit it.

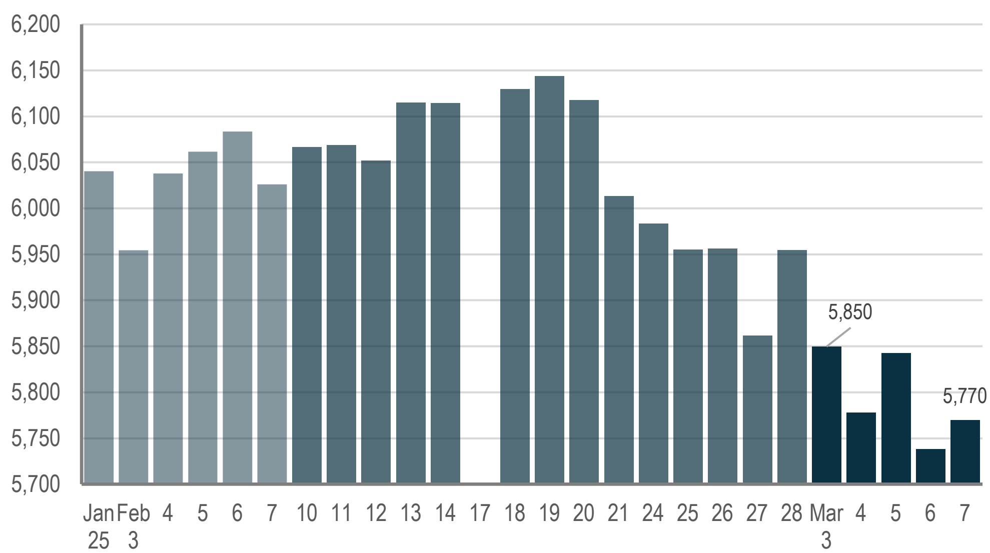
Albert Einstein

Good morning, and welcome to the *Weekender* for Saturday, March 8, 2025. This *Weekender* summarizes our March 2025 *House View,* which provides detailed analyses of our investment positioning and allocation from our portfolio management group.

Equity markets were lower by -2.1% this week, as measured by the S&P 500, completely wiping out all post-election gains in US equity markets.

S&P 500 Index Levels

(Source: Bloomberg)



The S&P 500 was lower by 3.6% weekly from Monday through Thursday for most of the week. On Friday, markets were set for another turn south but were saved by comments from US Federal Reserve Chair Jerome Powell suggesting the US economy is just fine and tariffs, to the extent they were "one-off," will be manageable. Brought to you by the same team who said pandemic-era inflation was just transitory, Powell's assurances should be seen in a similar light. He was in no position to school Trump on basic economics in the media. It's a bit like the China shop owner voicing hopeful optimism as the bull enters the door and starts poking around.

Weekly Gains for the S&P 500

November 8 - March 7, 2025

(Source: Bloomberg)

A combination of noise and signal always drives financial markets. Last week, the Trump noisemaker was deafening. President Trump's whack-a-mole tariff approach, where tariffs were on and off within 24 hours with no apparent justification except for a change in the prevailing winds, accentuates choppy markets. The air of uncertainty in the markets keeps adversaries on their toes, an environment that Donald Trump enjoys and has benefitted from as a dealmaker in business and a politician trader. For investors, the lopsided noise-signal ratio, favoring noise, makes disciplined investing challenging yet rewarding.

In the din of tariff talk last week, several essential signals were heard to give us a better sense of the future. A staccato description here sets the stage for today's discussion. The US labor market remains strong and resilient, although cracks are beginning to show. February's job creation was weak, unemployment is slowly rising, job openings are coming down, and layoffs in both private and public sectors are growing significantly.

In the face of increased job uncertainty, consumers have been spending every penny they earn and borrow, lifting consumer debt to record levels. Delinquencies on consumer credit are hitting recession levels on average; on auto loans, delinquencies are at thirty-year highs. Empty savings provide few emergency reserves for consumers who want to continue spending. Fully strapped, it's now the wealthiest ten percent of consumers supporting the economy. If they back away, the US economy will slow as well.

Aside from consumer spending, corporations have recently begun postponing expansion plans and non-artificial intelligence investments. Under the new Trump presidency, government spending will undoubtedly slow from its Biden-era trajectory. Talk of a balanced budget, to the extent it's not a ruse, will necessarily crimp government spending.

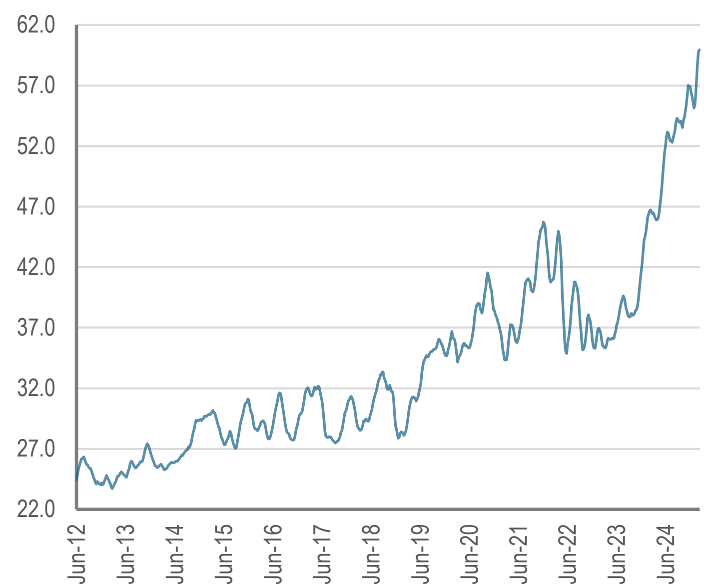
Costco Earnings

Costco reported earnings last week. Results were broadly in line with expectations, but their outlook, especially regarding the impact of tariffs, suggested

Costco PE Ratio

June 29, 2012 - March 8, 2025

(Source: Bloomberg)



they may need to increase prices. Profits may also be squeezed from related margin compression. Costco's share price fell by 9.1% during the week. In past *Weekenders,* we have highlighted the rich valuation of Costco stock. Disappointing results often punish companies that trade well above their average valuation. Even after last week's price recalibration, Costco shares remain significantly overvalued compared to their historical levels.

We believe Costco, one of the best-run companies in the world, is still set up to overreact to potential disappointments, such as softer consumer spending.

In this *Weekender,* we summarize six elements critical for managing investment expectations going into the coming year and next. These elements include: 1. Economic strength; 2. Earnings growth; 3. Political uncertainty; 4. Geopolitical realities; 5. Consumer resilience; 6. Interest rates; 7. Inflation; and 8. Equity valuation.

Consult a qualified investment advisor before making substantial investment or financial decisions.

Economic Strength

Describing the US economy as resilient would be a dramatic understatement. Going into the pandemic in the last half of 2019, economic growth slowed significantly after the longest economic expansion in modern history. A recession was likely inevitable without the gargantuan fiscal and monetary stimuli infused into the economy as a response to the uncertain outlook brought about by the global COVID-19 pandemic. Few of the dire economic outcomes predicted materialized. Inflation was the outcome few expected. As most economic cycles bend toward recession, central banks lower rates and increase monetary stimulus. At the same time, governments increase spending. The desired outcome is to keep spending taut, employment solid, and recession at bay, or at least short and shallow.

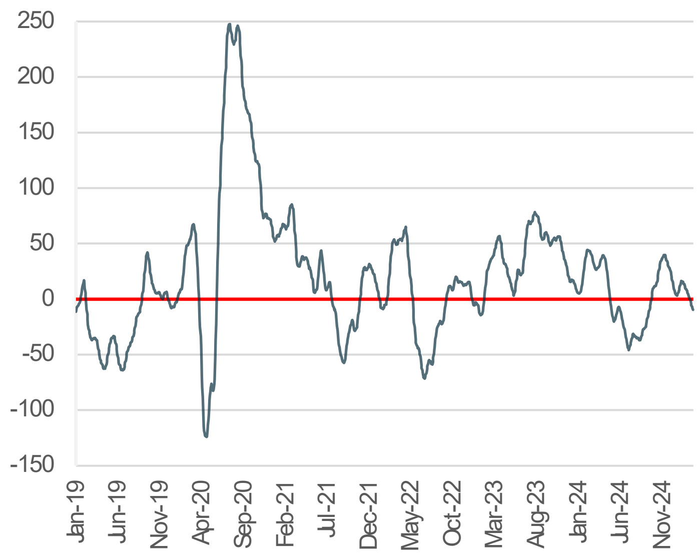
For the first time, in a matter of days, after a pandemic was inevitable, governments worldwide began to flood the economy with capital. In short, monetary and fiscal stimulus was applied well before signs of recession appeared. In response, the economy skipped the recession. As it happened, most employees kept their jobs, and remote work became a thing. Consequently, the trillions of dollars in fiscal stimulus were like found money and were quickly spent on consumer products, revenge travel, and the new game of "day trading" from the "working" from home couch. Now that inflation is coming down, pulling rates down, and global bootie is mainly spent, the global economies are trying to find new normal and sustainable levels.

The Citi US Economic Surprise Index records whether economic data releases align with expectations of a surprise to the downside or upside. It's a relatively volatile series but shows a disturbing trend: Data surprises more to the downside.

US Economic Surprise Index

January 15, 2019 - March 8, 2025

(Source: Bloomberg)

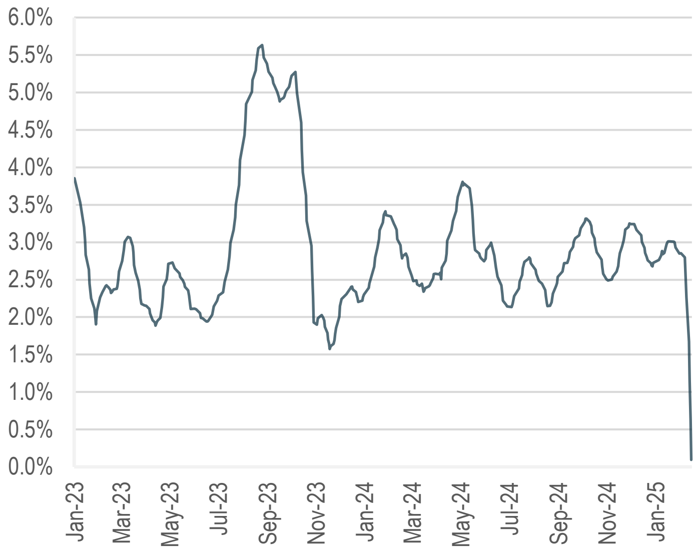


Economic data tends to be backward-looking, describing an environment that no longer exists when data is collected, collated, and released. The Atlanta Fed attempts to remedy this weakness by using data to predict the prospective quarter's economic growth in a GDP Now series. Since the administration embarked on its tariff melee, GDP growth projections have registered significant softness bordering on contraction.

We believe the US economy is slowing considerably. Concern is becoming more widespread that tariffs and government layoffs will add to the already slowing economy. Over the weekend, President Trump declared that the economy is in a "period of transi-

Atlanta Fed GDP Now

January 20, 2023 - March 8, 2025
(Source: Bloomberg)



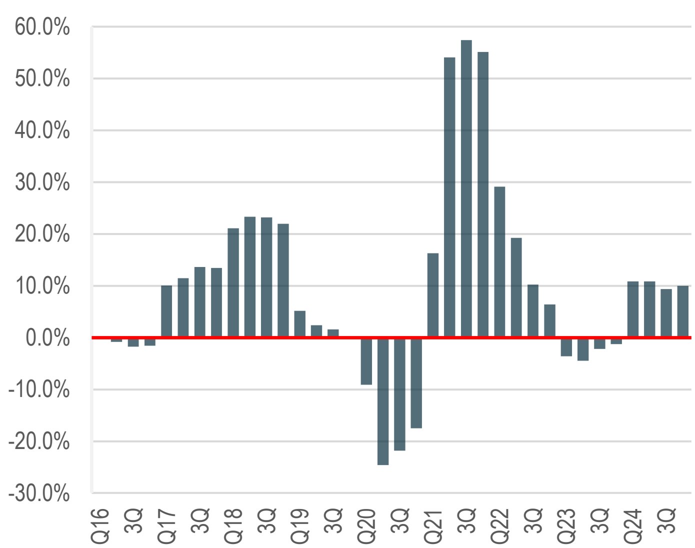
tion." He was vocal about his inability to predict if tariffs would result in a recession but did not rule out the possibility.

Earnings Growth

Stock market levels are highly correlated with corporate profits. This relationship forms the justification of equity research analysts. If, through their cunning and skill, analysts can predict the cash flow and profit of a company, they can likewise divine the stock's value well in advance.

US Economic Surprise Index

1Q 2016 - 4Q 2024
(Source: Bloomberg)



Equity values and valuations respond to earnings growth prospects. Higher growth equates to higher stock prices and valuations. Pandemic liquidity caused an artificial increase in demand for stocks, bonds, and other products used to park cash. At the same time, corporations were able to charge higher prices for their scarce products and services, resulting in record margins.

As the economy slows and excess liquidity returns to normal, valuations will come to heel. Corporate margins will soften as demand returns to normal, and earnings growth will fall back to a growth rate that tracks nominal economic growth. Such a reversion to the mean will remove valuation premiums for marginal growers like Costco. Companies that grow profits much faster than economic output will still command a premium. We believe outperformance in the years ahead will be the province of thoughtful, research-based stock analysis and portfolio management instead of passive investing.

Political Uncertainty

President Trump is known for creating environments of uncertainty. His often caustic approach to personal and business relationships is a thing of legend. His books, television shows, and media events are replete with scathing epithets for everyone except his most ardent admirers. Even so, he has a fantastic track record for moving things forward quickly, even in the quicksand that is governmental bureaucracy. Key to his approach is the requirement always to keep the adversary guessing.

At present, the President is squaring off with heads of sovereign nations, using tariffs as a blunt instrument to achieve his objectives. Against Mexico, Canada, and China, tariffs are designed to bludgeon countries to control illegal fentanyl from coming into the United States. Fentanyl precursors flow friction-free into Mexico, and the primary distribution chain has been across the Mexico-US border. A tiny fraction comes through the Canada-US border. Even so, fentanyl overdose is the primary cause of over 100,000 deaths per year in the United States alone. Interestingly, overdose deaths, in general, have begun to fall in all but five US states due to the widespread availability of Naloxone. Utah is one of the states where overdose deaths continue to rise.

Besides fentanyl, President Trump is rightfully annoyed at the differential tariffs charged among nations—even friendly nations. Historically, the United States has tolerated a world where it was charged higher tariffs than it assessed on trading partners. It was the cost of helping the rest of the world rise and the price of global dominance. Those days are over, and it's a fair conclusion that the job of enabling countries to focus on their comparative advantage, which was a purpose of the World Trade Organization, is completed.

We expect President Trump's tariff strategy to fall short of his objectives. Tariffs will never come close to addressing US deficits or indebtedness. Not even close. The uncertainty of how they are applied has already begun altering corporate spending plans. Such alterations will lead to a weaker labor market over the near term. Although uncertain, they are likely to add to inflation.

Primary tariff inflation is attributable to higher costs for the product being levied. For example, at a primary level, if tariffs are imposed against imported automobiles, they will be more expensive to an American buyer. Secondary tariff inflation comes from the response of similar non-tariff products. For example, as the cost and price of comparable tariff products increase, competitive product prices also rise in a competitive response. Tertiary inflation is a more general level of inflation that comes from general price level increases.

We believe tariffs will be a vast disappointment aside from the press quality of "making America first." We also expect tariffs to provide some upward inflation pressure.

Geopolitical Realities

Almost immediately after the Berlin Wall began to fall in 1989, once-icey geopolitical relations started to thaw. By 1992, the world seemed on a path to mutual understanding. That year, Francis Fukuyama wrote a critical book, *The End of History and the Last Man.* He believed, as did many, that humankind finally reached "not just ... the passing of a particular period of post-war history, but the end of history as such: That is, the end-point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government."

Such sentiment guided many global agreements from 1992 to 2016 when UK citizens narrowly approved a referendum to leave the European Union. While it's not the fault of the referendum, it seems relevant that from the date of the referendum, the one-for-all and all-for-one Musketeer mentality of the still ancient global community seemed to be more than fraying at the edges. It was falling apart. Donald Trump's America First message resonated with US voters who elected him president in 2016.

Ever since, nationalism has been increasing among small and large states. Petty grievances remedied long ago have reemerged as critical points of contention. We do not believe the world will return to the kumbaya feelings of a global community in our generation. Personal, political, and enterprise volatility that flows from disparate national interests will likely prevail for the foreseeable future. As such, defense budgets will jump, trade walls rebuilt, and tit-for-tat retaliation for minor skirmishes of principle and practice will again be standard practice.

Without any judgment call attached, as the US withdraws from its post-World War II role as protector of freedom and focuses increasingly inward, those bent on increasing their stature and influence in the vacuum created will create a more dangerous geopolitical environment. This world will be much more akin to the Cold War period, except there will likely be two global aggressors (China and Russia) with multiple regional offenders. At its foundation, this new altered world comes from a generational social safety net created for but not funded by a post-World War II generation.

We believe geopolitics is the most critical and transformative alteration to the fabric of global society. It bursts upon the world as populations fall, government indebtedness stretched, and technological advancements prepared to drive a wedge between adversaries and friends alike. Global military and economic will cease to be defined by the providential gift of resources, geography, and culture.

Consumer Resilience

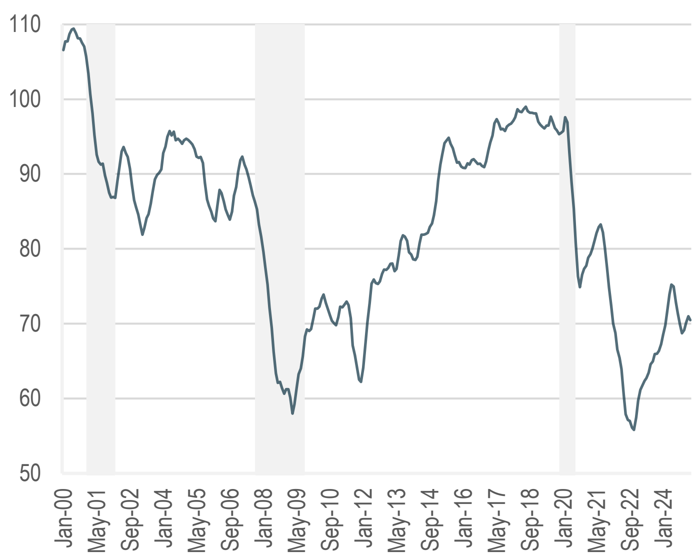
Any reasonable assessment would find the US consumer resilient, directly determining broader economic resilience. A fully employed labor market with wage growth exceeding inflation is the primary foundation of a resilient consumer. After that, consumers' ready access to credit permits spending beyond their means, which is the icing on the consumer cake.

Mortgage originations are one-third of their level during the first quarter of 2021. All consumer loan types, except student loans, experienced a significant jump in delinquency percentage from the beginning of 2022 when consumers were flush with pandemic cash. Credit stress is a powerful predictor of consumer strength for mid- to lower-income cohorts. What is increasingly clear from consumer data is that consumers in the top 10% of income distributions carry the economy.

University of Michigan Consumer Sentiment

January 2000 - January 2025

(Source: Bloomberg)



As measured by the University of Michigan, consumer sentiment is hovering in no man's land after plumbing levels, similar to an inflation crisis in 2022, which is responding to belt-tightening inflation. Since inflation has moderated significantly since then, gas prices are low, and the labor market is full, we believe consumer sentiment is reflecting a consumer that is just increasingly strapped, overleveraged, and exhausted. The following reading on consumer sentiment comes out on March 14, and we expect it to show a breakdown in consumer confidence and a pullback in expectations.

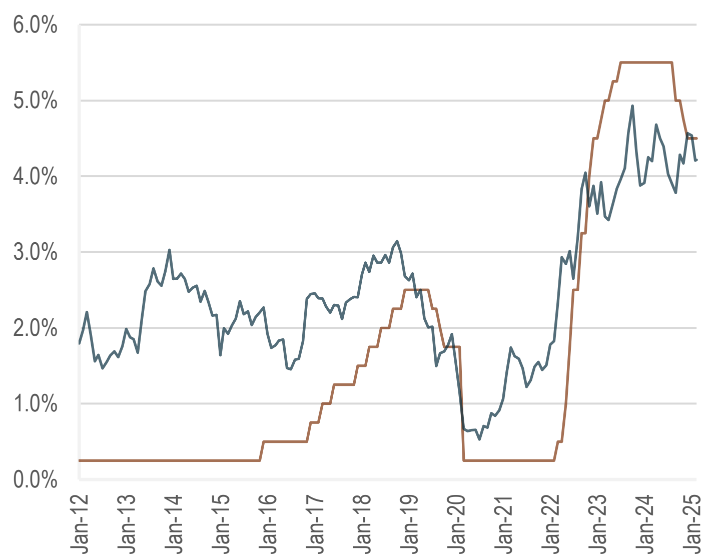
Interest Rates

While it's accurate that the Federal Reserve sets a benchmark rate intended to guide interest rate expectations, it's also true that interest rate markets have a mind of their own. The Federal Reserve's target interest rate has been falling after it peaked and plateaued for one year, from August 2023 to August 2024. But it's falling slowly. Tariffs, being historically inflationary, are likely to keep the Fed on the sidelines for a while until the dust settles. Fed chair Jerome Powell signals they are in no hurry to lower rates further until data compels them.

Fed Target Rate (Bronze) and US 10-Year Bond Yield

January 2012 - March 8, 2025

(Source: Bloomberg)



Our view has been and continues to be that interest rates will remain higher for longer than most expect. The Fed believes the US economy is solid. Potential inflationary pressures from tariffs compel the Fed not to lower rates soon unless the consumer experiences considerable strain. We believe the days of "near zero" interest rates are over. A more interest rate-sensitive consumer must adjust their expectations to the new interest rate normal. It's a lot like the old normal before the Credit Crisis.

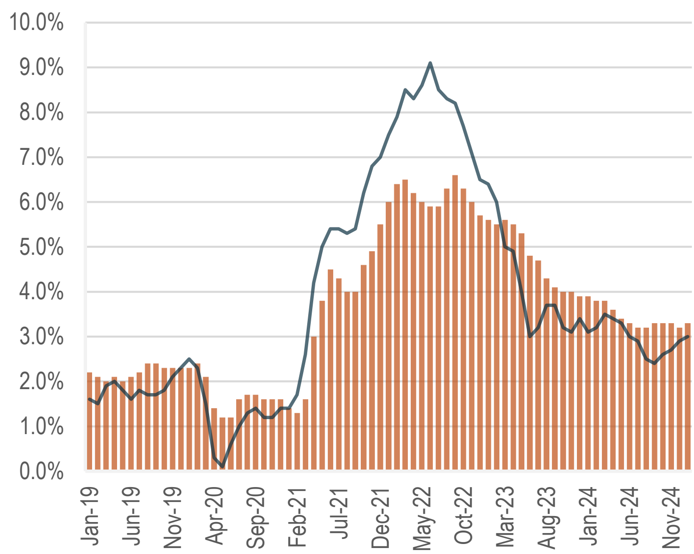
Inflation

As measured by the Consumer Price Index (CPI), inflation fell from 9.1% in June 2022 to 3.0% in January this year. While it's still above the Federal Reserve's target of 2.0%, the drop has been remarkable. More remarkable is that the fall did not come with a recession, at least not yet.

Consumer Price Index (Blue) and Core (Bronze)

January 2019 - January, 2025

(Source: Bloomberg)



We do not believe the recession is absent; it's just been postponed by the trillions of dollars in stimulus added to the economy to stave off a decline. It's likely that tariffs will provide sufficient friction, keeping inflation from reaching its target over the coming year. That said, the 2.0% target is largely arbitrary. We expect the Fed to begin distancing themselves from the target as a talking point and use fuzzier language like, "We are comfortable with the general level of inflation."

Equity Valuation

We have beaten the overvaluation drum for US equity markets for at least a year. Beginning in December 2024, richly valued stocks, especially those in the technology sector, struggled to keep pace with the rest of the market. We continue to be hesitant to buy into companies with stock trading premium multiples. Instead, we are rebalancing into high-quality stocks within an acceptable valuation range.

Since President Trump moved from saber-rattling to tariff implementation, US investors have dipped their toes in non-US equities, which until recently have significantly underperformed US equities.

We believe the move abroad is justified by the valuation asymmetry alone. US stocks remain overvalued. As US economic and earnings growth proves increasingly uncertain, we will no longer seek broad international exposure through exchange-traded funds in preference for modest international portfolio exposure through low-risk blue chip players in developed markets. Structurally, we do not view Asia or Europe as possessing better economic prospects. Increased allocation abroad is merely a function of risk-adjusted valuation.

Select Company Comparisons

	YTD Return	PE Ratio
Hong Kong	20.8	11.6
Italy	14.3	12.1
UK	6.2	12.4
China	0.2	15.1
France	10.0	15.2
Euro	11.7	15.4
Germany	15.6	15.4
Australia	(2.2)	17.2
Swiss	12.7	18.3
Japan	(7.5)	18.6
Dow	0.6	20.4
S&P 500	(1.9)	21.5
Nasdaq	(5.8)	26.7

(Source: Bloomberg)

Conclusion

That's it for this *Weekender.* Our next Weekender will have a detailed discussion of our five-bucket investment strategy describing model portfolio allocations in countries, instruments, sectors, themes, and special situations. We will also include a one-more-thing segment on Albert Einstein and a book review and investment summary from the reading club. The subject is a fantastic and influential one entitled *The Technological Republic: Hard Power, Soft Belief, and the Future of the West.* It was written by Alexander C. Karp and Nicholas W. Zamiska, the Founders and Chief Executive Officer and Legal Counsel of Palantir, respectively. Have a wonderful week.

Disclosure Statement

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors cannot invest directly in an index. Past performance does not guarantee future results. Investing involves risk, including loss of principal.

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