OLLI - GMU Investment Forum Presentation 2 April 2, 2025

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I'm pinch-hitting for David Toms, who is unavailable. My focus is somewhat different from David's. I don't do powerpoint, and I keep statistics to a minimum. Instead, I give my thoughts on the status of the investment climate within which we operate, highlighting developments that I think are most likely to have a direct impact on our ability as investors to prosper.

Mr. Market isn't a happy chappie. The S&P 500 ended the first quarter down 4.6% for the year, the worst start since 2022, and has been flirting with being in correction territory over the past couple of weeks. The cause can be summed up in one word: tariffs. And it's likely to get worse because today is April 2, the day on which President Trump is scheduled to unveil his latest tariffs. Speculation centers on two possibilities: Trump could take a targeted approach by levying tariffs on the 15 countries with whom we have the largest trade deficits; or he could impose 20% tariffs across the board.

I know that many of you don't like to talk about tariffs. I wish I could accommodate you, but in my opinion, the decisions the Administration makes on tariff and trade issues, along with those made by our trading partners regarding retaliation, will be fundamental to shaping the investment climate. Tariffs are taxes paid by the importer which often, but not always, are fully passed-on to the final consumer in the price of the imported goods. The higher they are, and the broader their reach in the economy, the higher the risk of significantly increased inflation, which will reduce consumers' real disposable income, and thereby consumer spending. Why is this important? Because consumer spending comprises 70% of our GDP. So if consumer spending falls, so does GDP growth, and most likely, total employment. Stagflation (higher inflation combined with lower growth) is one possible outcome. Recession is another. Retaliatory tariffs imposed by other countries will also have significant economic impacts. By making our goods more expensive than competitors' goods, demand for our goods in the retaliating countries can be expected to fall, which will lower our export earnings and the income of export-dependent industries. In this context, US agricultural exports may be particularly vulnerable. The combined domestic impact of our tariffs on GDP growth on one hand, and of others' retaliatory tariffs on export earnings on the other, is the "temporary pain" that several of the President's advisors have spoken about.

How deep and how long that "temporary pain" will be is an important question for investors to ponder. Will some of our tariffs be offset by firms in exporting countries cutting prices to maintain market share? Perhaps - the PRC did so in response to previous tariffs. But even if that occurs to some extent, there will be adverse economic impacts of the type I outlined a moment ago - and we don't know how long they will last. The Administration argues that the pain will be worthwhile. I would argue that it is impossible to know that beforehand, primarily because we don't yet have a firm idea of what global trade end-state the Administration wants to create. Does the Administration intend tariffs to be permanent in order to structurally reorient the economy towards manufacturing? If so, we can expect a relatively long period of "temporary pain" because structural reorientation takes a great deal of time. Alternatively, are tariffs only a tactic to make trade fair as well as free? If so, we can expect either bilateral or multilateral talks to equilibrate, or even eliminate, tariffs. Which will it be? Your guess is as good as mine.

There are lots more unanswered questions about the Administration's evolving tariff policy. Here are only a few. Once the tariffs are fully implemented, will manufacturers return production to the US, and if so, how quickly? And if they do, will there be supply chain bottlenecks as domestic parts and raw materials suppliers ramp up production to meet higher domestic demand from manufacturers? Would domestic manufacturers raise prices of locally produced products to capture the rent created by the tariffs' impact on the prices of imported products? If so, inflation will spike by more than just the increased cost of imports. Finally, will domestic firms make long-term investments in brick and mortar factories, machine tools, and labor when the new tariff regime may not last beyond the present Administration? I believe it's Impossible for us as investors to answer any of these questions now - we don't have enough information. Therefore, our ability as investors to rationally pick potential winners is limited. So…while I recognize that many of you would like us to pay less attention to the tariff issue, I think we do so at our peril.

Believe it or not, there has been economic news over the past week that has nothing to do with tariffs. Consumer spending increased by .4% in February, possibly fueled by buying to avoid higher prices once tariffs kick in. But the Fed's favorite inflation gauge (core personal consumption expenditures) rose by the same amount that month, which was higher than anticipated. In addition, consumer confidence, which has fallen for the past four consecutive months, is now at a 12 year low. That doesn't bode well for maintaining healthy consumer spending and GDP growth. The US dollar has been falling against most other major currencies. This should make imports more expensive and give exports a boost. The Federal Reserve recently decided to hold interest rates steady for the time being. Uncertain how long stability will last; if GDP growth and employment fall, the Fed may well have to cut rates. That will further weaken the Dollar. The fear/greed index is 22, which is in the extreme fear region. The price of Gold is at a record high.

Looking forward, there doesn't seem to be any progress yet in Congress on renewing the Trump tax cuts or raising the debt ceiling. Until these issues are resolved, they will add to the uncertainty that investors face in judging the investment climate.

On balance, it sounds to me like this would be a pretty good time to find safe havens to park money until more policy clarity becomes available. But if your crystal ball is clearer than mine, and you have some sandbox money to play with, you might be able to find some stocks that are tariff insensitive. European defense industry stocks might be another thing to look at given current tensions in the US-Europe defense relationship. Just my $.02, and probably not worth even that.