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Quarterly Investor Letter

Running from one side of the ship to the other

Heading into 2025, investors were fairly blasé about President Donald Trump's tariff threats assuming they were largely a negotiating ploy. We took the president at his word and assumed tariffs would be in line with his previous statements and likely higher than what most investors expected. Now that investors have raced to the other side of the ship, we find ourselves leaning in the other direction.

Tariffs are not inflationary…

Tariffs are not inflationary. Rather, they are a one-off shift in specific price levels. Tariffs are, in fact, a tax hike[1] and taxes are widely considered anti-growth. We believe President Trump's "reciprocal tariffs" will likely damage the U.S. more than its trading partners as they are a tax on consumers and profits.

But trade wars might be…

The "reciprocal tariffs" – at the stated levels – might push the economy into a recession. Further, large "reciprocal tariffs" effectively lock out imports creating a negative supply shock[2]. Negative supply shocks – as we learned during Covid lockdowns – can kick off an inflationary process and are particularly bad for bonds as investors demand a higher term premium for receiving interest payments further out in an uncertain future.

Uppercase "R" Recessions vs. lowercase "r" recessions

When most investors hear the word recession, they assume the worst. The last two recessions (2008-09, 2020) were uppercase "R" recessions – deep economic downturns with very high unemployment and drawn-out recoveries. By contrast, lowercase "r" recessions, such as those from the 1990s, early 2000's, and 1950s-1960s, were relatively short and shallow with moderate unemployment and a bigger economic bounce back. While our base case does not include a recession, we think the current risk is of the lowercase variety, driven by downturns in the real economic cycle rather than a financial crisis.

The Mad Man Negotiating Theory

President Trump prefers maximalist demands and uncertainty when negotiating. His handling of European defense spending is an example. The president threatened to pull support from Ukraine unless Ukraine signed a mineral deal. He followed up by pulling back on command & control functions, surveillance, and intelligence that supported the Ukrainian war effort. European nations then quickly stepped in to fill the void. E.g., Germany subsequently amended their Constitution to fund fiscal stimulus on defense and infrastructure. In 60

[1] Per TrendMacro (a macroeconomic firm), a 10% tariff is roughly equivalent to a 1.3% increase in personal income rates.

[2] Per TS Lombard (a macroeconomic firm), a 50% tariff on China would effectively reduce Chinese imports into the US to $0.

days, President Trump achieved a common goal of every U.S. president since Dwight Eisenhower: to get European countries to spend more on their own defense. We think this negotiating template applies to tariffs.

A Market Implied President

President Trump is notoriously focused on his stature vis-à-vis polls and the S&P 500 index. We find no coincidence that the Administration backed off hitting the button on a trade war after the S&P 500 plummeted 20% in a month. Equity markets appear to be the new bond vigilantes. There were also signs in Congress of weakening support for the president's tariffs based on a bipartisan bill (with seven GOP votes) passed in the Senate to wrest back tariff responsibility to Congress. The president has historically always pushed for the very best deal and once there, quickly pivoted to another negotiating topic on no one's bingo card. We would expect a similar outcome on trade negotiations, ignoring the veritable cottage industry of bears who expect the worst of a very flawed president.

The End Game

We have long thought that Trump's tariff goals are less about reindustrialization and more about sourcing new tax revenue to finance individual and corporate tax cuts. It is a bonus to leverage trade partners on specific issues like non-tariff barriers, immigration, and the fentanyl crisis while scoring bipartisan points on China at the same time.

We think the president wants to permanently extend his tax cuts as a major policy win. He cannot pass a bill with narrow majorities if the economy is in a recession. We expect major trade deals to be announced in the next 90 days, mostly likely with Japan, Korea, Mexico, and Canada. The European Union will be difficult, and China will likely be dealt with last. We expect tariffs to be negotiated down to an effective rate of ~10% for all countries except China where we expect a ~30% tariff rate. Extending Trump's expiring tax cuts will drive the timeline as the Administration needs settled outcomes by 3Q25 if they want to factor tariff revenue into the 2025/26 budget rounds.

What to Watch this Summer

While most investors will watch the tariff headlines, we will watch the labor market. If the labor market softens, the Fed will cut rates, even if faced with higher than desired inflation. Recessions – lowercase or uppercase – are scarring events economically and the Fed wants to avoid this at all costs.

As the summer lengthens, we further expect the Administration to reverse the sequence and to focus more on the "good" stuff (budget, tax cuts, and deregulation) and less on the "bad" stuff (tariffs). We expect an economic slowdown, but not a recession. The recent market plunge, falling business confidence, and shelved capital spending plans will take their toll this summer. But a tariff shock is not inevitable.

The Silver Lining

Despite non-stop recession fears from pundits, the U.S. economy continues to grow strongly with 2%+ GDP growth, 150k-200k new jobs created per month, and near record low unemployment rates. Corporate and consumer balance sheets are healthy after a decade+ of deleveraging. We expect Central Banks to remain proactive and the economic data to be better than expected.

Most importantly, the fiscal pivot is happening outside of the U.S. We continue to expect positive surprises on fiscal and monetary policy in the coming months. In Europe, 2024 headwinds are likely to turn into 2025 tailwinds as rate hikes and fiscal tightening turn into rate cuts and Eurozone fiscal coordination. China is also waiting to fire their fiscal bazooka once they sense Trump's endgame.

We remain very bullish on Global equities. If we've learned one thing in a two-decade career in equities it is this: performance tends to be better when sentiment is negative.

Performance Update

Trailing Returns as of 3/31/2025							
Strategy	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception	Inception Date
Global Select Dividend (gross)	**1.1**	**3.1**	**9.0**	**17.3**	**8.6**	**9.3**	**12/31/10**
Global Select Dividend (net of 0.75%)	**0.9**	**2.4**	**8.2**	**16.5**	**7.8**	**8.5**	**12/31/10**
Global Select Dividend (net of 2.0%)*	**0.6**	**1.1**	**6.8**	**15.0**	**6.5**	**7.1**	**12/31/10**
iShares MSCI ACWI ETF	-0.9	7.5	7.2	15.2	9.0	8.8	
U.S. Select Dividend (gross)	**-4.0**	**3.0**	**9.3**	**19.1**	**11.6**	**12.8**	**12/31/10**
U.S. Select Dividend (net of 0.75%)	**-4.2**	**2.3**	**8.6**	**18.3**	**10.8**	**12.0**	**12/31/10**
U.S. Select Dividend* (net of 2.0%)*	**-4.5**	**1.0**	**7.1**	**16.8**	**9.3**	**10.5**	**12/31/10**
iShares Russell 1000 ETF	-4.5	7.8	8.5	18.3	12.0	12.9	
Small Cap Core (gross)	**-1.1**	**6.6**	**3.8**	**15.6**	**8.7**	**10.9**	**9/30/12**
Small Cap Core (net of 0.75%)	**-1.3**	**5.8**	**3.0**	**14.4**	**7.7**	**10.0**	**9/30/12**
iShares Russell 2000 ETF	-9.5	-4.0	0.4	13.2	6.2	8.7	

Net of model maximum 2.0% wrap fee

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