2Q | 2025

A Dickens' Tale…

TK Viewpoint

Dickens said, it was the best of times, it was the worst of times…And the first quarter was indeed both. The market rallied to new highs through February as better than expected earnings in the fourth quarter of 2024 and optimism for what deregulation may portend for a "threepeat" of positive returns for 2025. Sentiment changed in March around the chaos and uncertainty of tariffs and tax policy. Capitalists and corporations appear to be restraining capital until they have visibility and clarification on one or both issues. The unwillingness to commit capital and American's unease may bleed into the second quarter if decisions are not made and perhaps because decisions are made. The love affair with the Mag 7 stocks seems to be in its winter season with double digit declines in the first quarter contributing to the technical definition of a market correction for the S&P500 and the NASDAQ composite.

At the start of the year, we did not appreciate The United States-Mexico-Canada Agreement (USMCA) was at risk. That change is forcing a new calculus toward everything from manufacturing to farming and may cause an economic slowdown, or outright recession. Forecasted earnings for 2025 have been revised lower from 14% projections to 10%. We may see further reductions in earnings in the second quarter related to corporate America's inability to make deals, either because of the tariffs or the ongoing threat of tariffs. The US has a trade problem that needs to be addressed. We have run a trade deficit every year since 1991. The tactics to remediate are causing economic problems in the short run and geo-political problems as well with our neighbors to the north and south. What these tactics may mean in the intermediate and long term is still to be determined. Change is hard. We speak with clients every day that are equally heartened and horrified by the changes happening in the country around immigration, government reforms, tariffs, tax policy etc.

In focusing on the economics, tariffs will raise prices, slow economic growth, cut profits, increase unemployment, diminish productivity, and increase global tension. The President may be using these tactics to negotiate better deals for the country but the declines in the market year to date are based on uncertainty and fear rather than intractable policy and decision. There is time and space for a pivot before we are dragged into a recession.

While the economy did slow down unexpectedly and considerably in the first quarter, the unemployment rate is ~4.1% (good) and the inflation rate is ~2.8% (not bad). The dysfunction in the housing market has taken a backseat to discussions on tariff and tax policy, but it should not be ignored! The real estate industry has been obstructed by the relatively high interest rates impacting people's ability and interest to move into a mortgage that may be double or triple the rate they currently hold. The impact of higher prices, AKA, inflation, may hamstring the Federal Reserve's ability to lower interest rates. But, if there is finality around tariffs, the momentum of corporate America may at least be able to move from gridlock to resume a forward, upward trajectory…And if the Federal Reserve lowers interest rates this year, there is a case to be made for optimism.

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We are unabashed pragmatists! As such we employ a very disciplined approach to cash reserve (for emergencies and opportunities), and we maintain a disciplined and politically agnostic approach to investment selection that includes international exposure and fixed income. The latter two contributing to positive performance YTD. No one expected international stocks to outperform the S&P500 this year. The unintended consequences of US policy is forcing Europe to increase their spending on defense and industry and that fiscal stimulus has caused a renaissance in their economy. China, too, has seen their stock market outperform the US through an increase in deficit spending to stimulate their economy. These anecdotes are meant to illustrate that money flows where it is treated best. Capital is not destroyed; it just moves like water. We are staunch capitalists, appropriately paranoid and therefore prepared to be defensive or opportunistic.

China and Germany both have debt to GDP ratios in the 60s, while the US debt to GDP is over 100. This speaks to the other headwind we face which is fiscal policy. The US deficit is as much an economic headwind as a national security issue. The efforts of DOGE are tackling this problem from a cost perspective rather than a revenue one. Tax policy, entitlements and the specific extension of the Tax Cuts and Jobs Act are next on the agenda for the President. This falls in the coin toss category of will it help or hurt…

As we wrote in our 2025 newsletter:

The risk of inflation re-asserting itself next year is high based on current fiscal policy and proposed tariffs. If that occurs, we could see the Fed's hands tied in lowering interest rates. If interest rates are higher for longer than current expectations, there are negative implications on the housing market, deficits and ultimately risk assets in general. For these reasons and many more not touched on here, we will be focused on balanced portfolios that employ discipline in both position size and valuations. We will be adding to fixed income to both mitigate risk and capture absolute return in the form of interest income. The universal optimism for performance in 2025 is actually our biggest concern. So, while we see a path forward for positive performance in 2025, we will be proceeding with caution as the potential for the light to change from green to red is not only possible but likely.

The economy is entering an uncertain time, but from a strong starting position. It is not a forgone conclusion that the current trend will continue into yearend. Regardless, market uncertainty and declines, whether corrections or bears, are not permanent or terminal. They are short cycles that we must endure from time to time. They are also opportunities for disciplined investors. We raised cash in January and February to both provide cash flow for our retirees and rebalance portfolios that exceeded expectations last year. We remain vigilant in our work to provide performance, protect your financial futures and advise you and your family through all of life's ups and downs! For 2025, from this distance we see single digit returns…we just aren't sure if they will be positive or negative.

Yours,

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