

# Playing with Fire

## *Weekender*

April 12, 2025

It's the disease of thinking that having a great idea is really 90% of the work.  
And if you just tell people, 'here's this great idea,' then of course  
they can go off and make it happen.

The problem with that is that there's a tremendous  
amount of craftsmanship between having  
a great idea and having a great product.

**Steve Jobs**

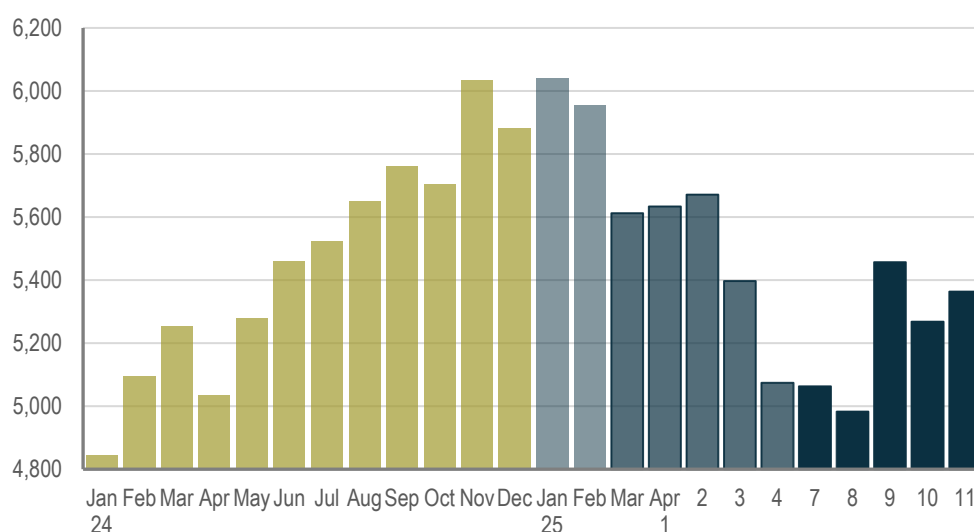
Real craftsmanship, regardless of the skill involved,  
reflects real caring, and real caring reflects our attitude about ourselves,  
about our fellowmen, and about life.

**Spencer W. Kimball**

Good morning, and welcome to the *Weekender* for Saturday, April 12, 2025. Tariff Krav Maga created all the noise markets could handle. Equity markets, as measured by the S&P 500, were higher by an eye-watering 5.7%, even though the index is lower by -8.8% on a year-to-date basis. Fixed-income markets were also volatile last week. US Government ten-year bond yields ended the week at 4.5%, and thirty-year fixed mortgages, as measured by bankrate.com, settled at 6.9%.

### S&P 500 Index Levels

(Source: Bloomberg)



Unhealthy decibel levels of market noise drove last week's volatility. Minimal signal was broadcast. After a few down days to start the week, President Trump decided to delay the implementation of his "true up" tariffs for ninety days. For those used to living without a steady dose of intravenous Xanax, the schizophrenic nature of the first ninety days of the new administration has been stunning.

On Wednesday, after President Trump announced a 90-day pause in most tariff implementation, the S&P 500 shot up by 9.5%, somewhat driven by a general sense of market relief from tariff delays and short position covering as position holders were choked to the edge of consciousness.

While companies are just beginning to release their first-quarter operating results, there are far too few to form generalizable trends. However, a snippet of the commentaries provided caused some concern. CarMax decided to disavow its financial goals for the year, and automakers have abandoned the sport of predicting results for this year or next. Delta Air Lines released better-than-expected results but said the uncertainty was too great to give any reliable color on the year ahead. Still, they expected revenue growth to be flat and hoped to be profitable at the end of the year. Ouch.

While most proportional tariffs were postponed by edict on Wednesday, those applied to China were not. Chinese companies listed in the US have taken it poorly. However, aside from the tariff noise, China's

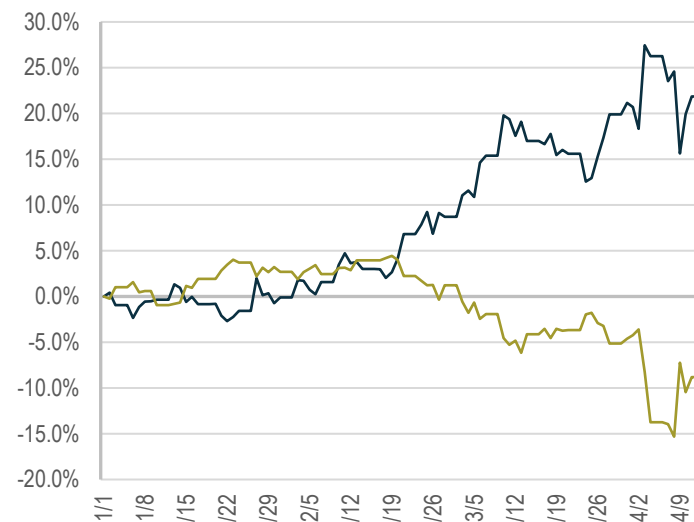
economy struggles. Both consumers and producers are in deflation driven by demand destruction. Newly applied tariffs will only accentuate the pain. China is in real economic trouble and feels backed into a corner by President Trump. We are very, very cautious about its medium-term prospects.

We believe the US economy is at the gate of stagflation. An equity index of stocks that perform well in stagflationary conditions is dramatically outperforming the S&P 500, and we expect this to continue. Even so, broader market volatility is giving investors incredible opportunities to own companies at reasonable prices.

### Year-to-Date Returns Stagflation Index (Blue) and S&P 500 (Gold)

January 2 - April 11, 2025

(Source: Bloomberg)



### Chinese Dragons Index

January 2, 2024 - April 11, 2025

(Source: Bloomberg)



### Portfolio Positioning

As regular readers know, we have been telegraphing expectations of expected consumer softness since the early fall of last year. Beginning in early February, we actively sold overweight technology and what we considered to be overvalued equity positions. For exchange, we purchase fixed income and, most recently, have been filling our portfolio allocations in our value sleeves. Active positioning like this has effectively preserved client capital to a remarkable degree. We do not believe markets are giving us an "all clear" signal. However, we are taking advantage of market declines to reallocate our growth sleeves to names we expect to perform well in the years ahead.

## From the Oracle

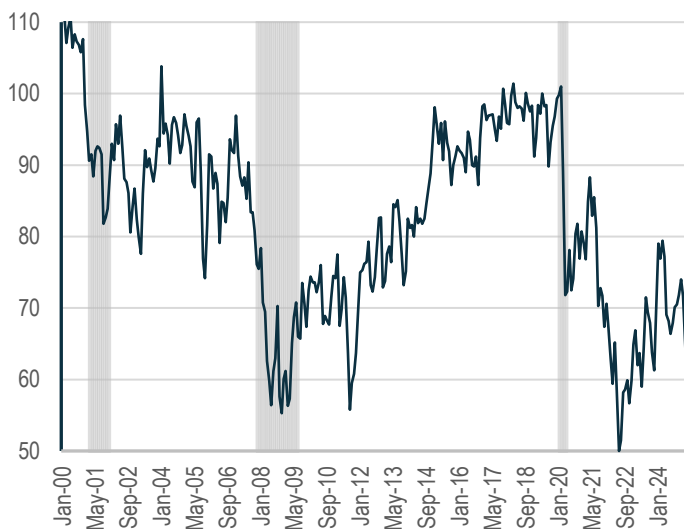
Warren Buffett aptly described financial markets in the short run as a voting machine, while they are a weighing machine in the long run. At present, markets are voting for a future that remains remarkably uncertain. An economic recession is a foregone conclusion if tariffs are employed at their proposed levels. However, monetary contraction is not the worst outcome. A thorough dislocation of global ties, treaties, and relationships, some built over centuries of war, tragedy, blood, and treasure, has never been more likely than now.

Next week will be a time for weighing as the flood of first-quarter corporate earnings reports begins. A few came out last week, printing good numbers for the first quarter but signaling caution for the year ahead. Consumer sentiment for March was released on Friday. They are not happy. Inflation is still a poignant memory, and the future doesn't look bright. Although consumer and producer prices for March came in tamer than expected. Consumers expect inflation to pick up in the year ahead.

### Consumer Sentiment

January 2000 - March 2025

(Source: Bloomberg)



### Tariff Justifications

There have been four alternating justifications for tariffs among Trump and his advisors: 1. To raise money; 2. To right a series of wrongs wherein America's trading partners have been taking advantage for

decades; 3. Restore America's manufacturing prowess; and 4. Cudgel Trump's policy objectives include putting a clamp on Fentanyl transiting by way of the Mexican border.

As a practical matter, tariffs will not raise much money if they are just a negotiating tool and will eventually be felled if conditions are met. The United States has indeed held the short end of the stick on free trade, at least from a tariff perspective. For decades, we have had lower tariffs than most of the world. However, our government leaders chose and approved those tariffs through various trade mechanisms, treaties, and negotiations. Non-tariff barriers? We did not choose those. Restoring American manufacturing is a noble and reasonable objective. We will need a workforce that will take and prepare for manufacturing jobs. That will be difficult for the blizzard of snowflakes graduating from American institutions of higher education. Manufacturing is increasingly more and more technical, incorporating robotics, programming, and artificial intelligence. We are not producing a labor force that can meet modern value-added manufacturing demands. While civility has been on the wane in American public discourse for some time, diplomatic tête-à-tête held an air of decorum, which is sadly ending. Of all the tragedies made raw by the tariff bluster since President Trump was inaugurated, an end to international diplomacy is perhaps the most dangerous and disheartening.

We have no quarrel with President Trump about the validity or importance of his issues, positions, and gripes. However, staging a revolution within global systems of governance established over centuries is a risky path for redress. Once the genie is out of the bottle, we will be unlikely to get her back in.

Last week, UK Prime Minister Keir Starmer responded to President Trump's imposition of a 10% tariff on UK products imported into America by proclaiming, "Globalization is over." Since the early 1980s, as China burst on the scene for its self-proclaimed "peaceful rise" from a large, impoverished nation, the world has gladly transferred its manufacturing foundations to the Middle Kingdom in exchange for cheap plastic products. As designed, developed nations benefitted by importing deflation from China through more affordable products, increasing global

standards of living for both the importer and exporter. Those days are over.

We believe the White House's narrative is true. Countries worldwide are beating a path to the president's, or at least his trade representatives', door to work out a deal. China and other nations that retaliated against his initial tariff increase are left lonely in the penalty box, subject to Trump's unique public ridicule and flogging. President Trump, his advisors, and legislative Republicans are anxious to take the tariff issues off the front burner and bring the extension of tax cuts to a boil. However, a tariff implementation pause accomplishes one crucial thing: it takes the probability of an all-out trade war down and a concentrated trade war with China higher.

As China became the global maker of things, importing nations transformed into the purveyors of services. Tilting back toward manufacturing will be difficult and painful, although the tradeoffs are real and material. In 2023, the most recent year for which data is available, China filed for almost three times the number of patents as the United States. Annual patent applications in China are proliferating while those in the United States and Japan, which files the world's third most patents, are falling. Whether by design or not, China's "peaceful rise" has ended. America has helped groom an able adversary.

On a flight to Lubbock, Texas in 1987, I read Donald Trump's book *The Art of the Deal*. As an introverted soon-to-be college graduate, I found Trump's certainty, nee bravado, aspirational. Key principles espoused in the book remained with me about as long as the jet lag. But after reviewing the book again last week, my memory was refreshed. President Trump believes, and is probably right, that keeping his adversaries guessing forces a degree of compliance if for no other reason than severe exhaustion. And for Trump, everyone is an adversary. Centuries of friendship forged by allied positions in wars, peace, and change are discounted for the value of today's transactions. The next four years will be challenging to navigate.

## Conclusion

That's it for this *Weekender*. Have a wonderful week.

## Disclosure Statement

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