End of an Era

Weekender

April 26, 2025

When a work lifts your spirits and inspires bold and noble
thoughts in you, do not look for any other standard to judge by:
the work is good, the product of a master craftsman.

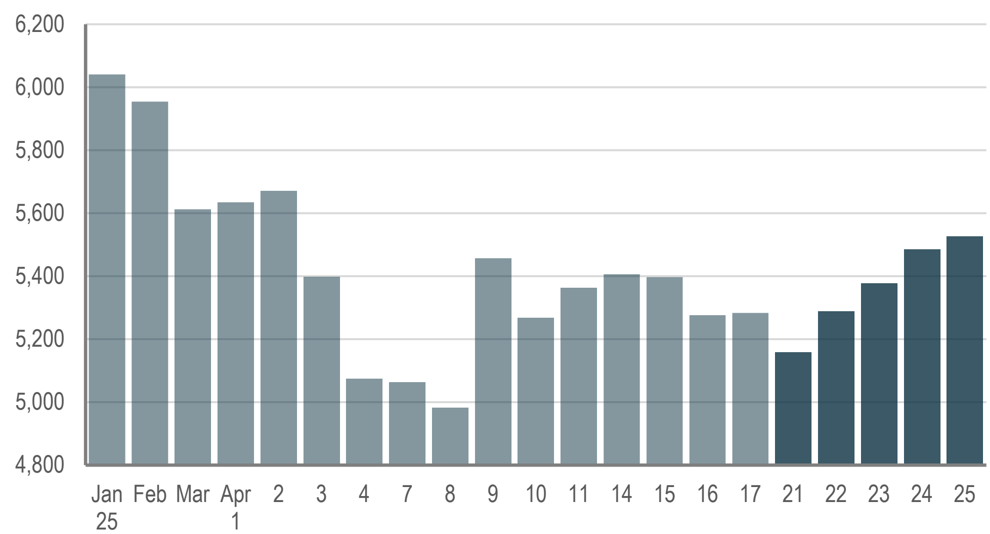
Jean de la Bruyere

We don't value craftsmanship anymore! All we value is ruthless efficiency, and I say we deny our own humanity that way! Without appreciation for grace and beauty, there's no pleasure in creating things and no pleasure in having them! Our lives are made drearier, rather than richer! How can a person take pride in his work when skill and care are considered luxuries! We're not machines! We have a human need for craftsmanship!

Bill Waterson

Good morning and welcome to the *Weekender* for Saturday, April 26, 2025. From the perspective of equity markets, it was a fantastic week. Over the last week alone, US equity markets were higher by 4.6%. A couple more date ranges provide insight. As of April 8, the S&P 500 was lower by -18.9% from its February peak. But over the last fortnight, news of a softer tone on tariffs lifted markets to the point that they are now down only -10.7% from the high-water mark of February 19, 2025.

S&P 500 Index Levels
(Source: Bloomberg)



Fearing a free fall in the financial markets from tariff-related destruction, the Trump administration blinked and began orchestrating a softer tone on tariffs. While the administration eschews any interest in financial market responses in open corridors, data suggest the opposite. For markets to remain sanguine, more blinking will need to happen.

Are We There Yet?

Perhaps the most crucial investment-related question is whether it's time to deploy capital in the wake of the Trump administration's apparent equivocation or at least softening its hard tariff stance. Markets, at present, expect a return to normal as soon as tariff-related issues fade to the background and more pedestrian issues, like making his previous administration's tax cuts permanent, are brought to a boil. In our view, the recent two-week gains are nothing more than a relief and positioning rally based on the sense that the Trump administration has returned from the tariff cliff edge.

Not to look a gift horse in the mouth, but we have taken advantage of depressed prices and discount valuations to build positions in already-favored names. We will continue to do so as stocks come into our buy range. However, we do not believe it's time to jump into markets broadly. Uncertainty and volatility remain abnormally high, giving us attractive entry points. However, earnings estimates are still persistently high and must go down. Valuations are beginning to adjust as discriminating capital finds a home in cheaper markets in Europe and Asia.

Certainly, declines in some names present an opportune time to begin building positions. We are taking advantage of this opportunity as it presents itself. However, we do not believe markets have yet to internalize higher tariffs' economic or profit repercussions. This will take a couple of quarters.

We are not market timers, and no one is. Markets are too complex to believe anyone can foolishly predict market bottoms or tops. However, we believe that, when appropriate, letting markets do some of our work by providing good entry and exit points is helpful. Deployment into non-cyclical positions that have fallen in tandem with market declines is a good strategy. For more cyclical names, prudence favors waiting.

Strong Earnings

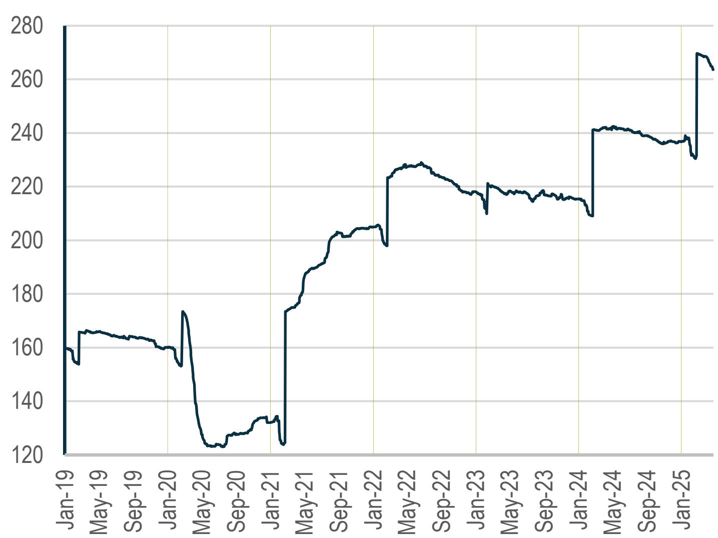
As expected, corporate earnings for the first quarter, before the tariff broo-ha-ha, are coming in better than expected. But the strength is not everywhere. Growth in consumer staples, energy, and discretionary sectors is profoundly negative. Higher tariff-related costs and softer product and service demand will begin appearing in the second quarter, forcing results in the third and fourth quarters. Even if the proportional tariff increases are somehow managed away, the across-the-board 10% tariff increase will be sufficient to wreak havoc on earnings growth by the last quarter of this year.

Equity prices are tightly correlated to earnings, a function of demand and margins. As the graph below illustrates, at the beginning of each year, equity analysts assess the profit prospects of each company they follow and then publish their earnings estimates for the year ahead. This is why the earnings estimate for the S&P 500 levitates a bit at the beginning of each year, marked by the gold vertical lines. As the year progresses, analysts weigh economic and company data and lift or lower their estimates to hit the actual number by the end of the year.

S&P 500 Earnings Estimates

January 2019 - March 2025

(Source: Bloomberg)



Analysts have quickly softened their 2025 profit estimates due to tariff uncertainty. We expect adjustments to continue as tariff damage becomes more prevalent and easier to understand. Lower earnings estimates generally lead to lower stock prices. Whether an economic recession sits near the horizon is still too early to call. An earnings recession, however, is a foregone conclusion.

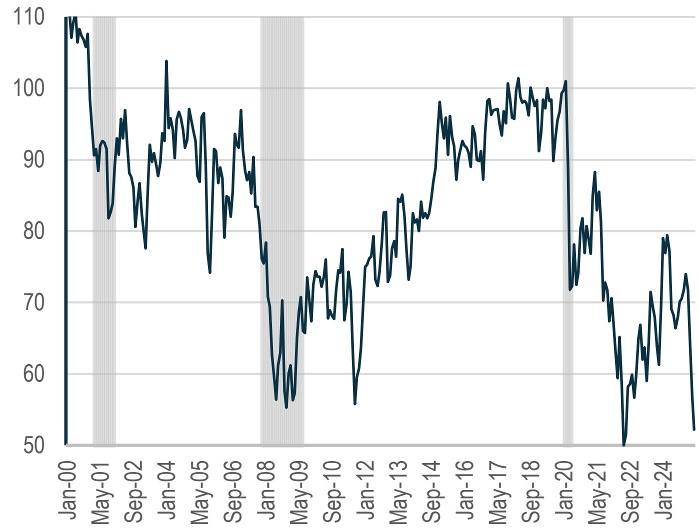
Economic Data

Most economic data is backward-looking, covering a calendar period before tariff implementation, and portrays a resilient US economy. However, softer data suggest the US consumer is nervous about tariffs and their impact on inflation. Tariffs, even those that are postponed, have already impacted price levels. Many retailers have pre-emptively increased prices in anticipation of tariffs being imposed. Container shipments from China to the United States West Coast have plummeted by -46.0% during a period where most merchandisers are stocking up for holiday demand. If this situation persists, stock-outs will be prevalent, and prices will skyrocket.

Shanghai to Los Angeles Container Rates
April 24, 2024 - March 26, 2025
(Source: Bloomberg)

University of Michigan consumer sentiment data was released on Friday, showing continued deterioration in the consumer's willingness to spend. There is often a gap between complex data and soft data. Hard data shows what is being done, while soft data suggests how consumers feel. Feeling generally predates doing. Looking past the whole history of consumer sentiment data, there was never a period where consumer sentiment fell to the current level and was not followed by a recession.

US Consumer Sentiment
January 2000 - April 2025
(Source: Bloomberg)



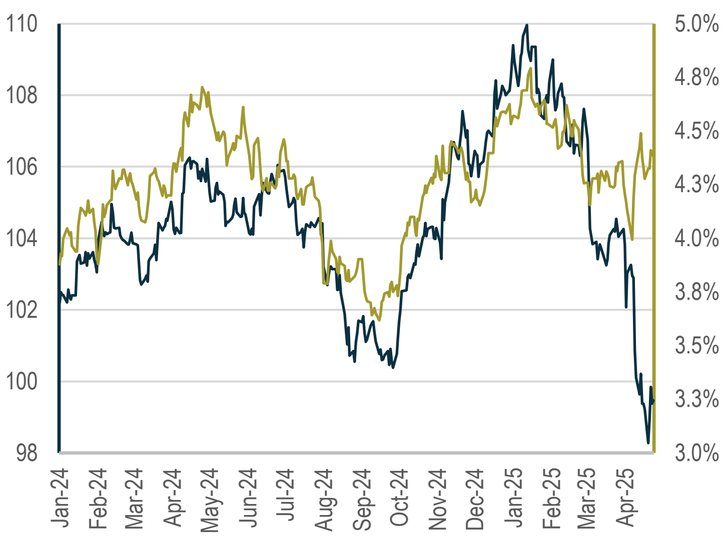
American Exceptionalism

As of last week, Trump had overseen the worst start to a presidency, measured by the stock market, for over a hundred years. We believe recent equity rallies are predicated on a false assumption that if all the tariff nonsense disappears, everything will return to a January 1, 2025, state of normality. Won't happen. We believe President Trump is cornered and looking for a parachute out of the mess he has created. To that end, we expect him to find a sufficiently plausible justification to declare victory through a combination of artifice and fact and distance his administration from the tariff blowback. He will then focus on a more attractive policy objective—extending tax cuts. We believe this pivot will open a window for the Federal Reserve to begin lowering benchmark interest rates and pursue other stimulative measures to keep the US economy from the brink of an economic recession. We believe that the most poignant and long-lasting issue facing the US and global financial markets is the seismic cracks in the foundation of the US's worldwide governance and influence. We do not quarrel with the principles of President Trump's 'America First' stance. For generations, the United States has held the short end of the stick in almost all world trade agreements. Demanding a level playing field is fair. But it comes at a cost.

Our actions, justified or not, will increasingly reduce our global influence. Having long been seen as the only adult in the room, our sometimes petulant behavior alienates allies and turns sovereign nations inward. Our leaving the room leaves room at the head of the table for less attractive hosts. It's not unlikely that our withdrawal will be significantly more costly than working within a rigged system.

Historically, government bonds perform well during periods of global economic uncertainty as investors hide under the protection of US assets. Over the past two months, sovereign interest rate benchmarks have begun to fall in response to the uncertainties generated by Trump's tariffs. US interest rates remain relatively high. Usually, this would cause a torrent of demand for US safe-haven assets like government bonds. Increased demand would push down yields and strengthen the dollar. Not this time.

Dollar Index (Blue) and 10-Year Govt Yield (Gold)
January 1, 2024 - April 25, 2025
(Source: Bloomberg)



Coming out of the Bretton Woods Agreement in 1945, the United States agreed to take a global leadership role. This included fostering democracy, patrolling shipping lanes to ensure rapid economic recovery, and acting as a stable currency upon which other nations with more fragile monetary systems could anchor. With notable deviations, we have remained faithful to the accord. As we now begin backing away, a natural vacuum will be filled. Alternative reserve currencies are already being fostered, which will remove an unnatural level of demand and strength from the US Dollar. A lower dollar will help our exporters, but it will also increase inflationary pressures, foster more pronounced business cycles, and generally reduce Americans' standard of living.

President Trump's 100-day mark in office is next week. Despite the frantic pace of motion, there seems to be more smoke than fire. DOGE's mission of cutting fraud, waste, and abuse is admirable and essential if the United States is to find sustainable footing on a path forward. Still, announcements' shock and awe have not yielded any meaningful reductions. Yes, every dollar saved counts. However, the dominant impression held by most citizens is not favorable. Progress on the border has been miraculous. But the mistakes often take the headlines. A well-deserved full-frontal attack on Harvard pushes major universities into a coalition that fights the administration. Without a doubt, any private or public institution that takes money from US taxpayers should, at some level, be responsible for them. But we fear that the brash approach the administration has pursued in almost all its policy implementation will now be challenged in court, resulting in a loss of power at the mid-term elections less than two years away. Seems a lot like a squandered opportunity.

Conclusion

That's it for this *Weekender*. Have a wonderful week. Next week, we will bring back the video version of the *Weekender* after its long absence.

Disclosure Statement

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