Hold the Presses! **Q1 2025**

Normally, I'd have had a good portion of this note finished or at least an idea or two before the end of the quarter. But after the president announced 'Liberation Day' was coming on April 2nd, I put the proverbial pen down. Surely 'Liberation Day' would bring clarity. It brought panic. I'm not going to rehash the details, but they were draconian bordering on bizarre. As Jeremy Seigel, the esteemed finance professor from the Wharton School of Business, said that Friday morning, "I think this is the biggest policy mistake in 95 years." He was but one voice in a choir of condemnation.

The markets' opinion of this nonsense was swift and painful, with the S&P 500 losing north of 10% in two days. We don't tell companies where to manufacture, and we aren't going to make sneakers and toasters and iPhones in this country. The average wage in Vietnam is less than $1 per hour. If this is the goal, it's absurd, and it will almost certainly galvanize retaliation and result in shortages, inflation, likely recession, and significant financial losses. We wrote last Friday that we didn't believe such a monumental and destructive trade policy could be sustained and that Trump would have to back down. He did so Wednesday afternoon, announcing a 90-day 'retaliatory' tariff pause, except for China.

But let's be clear on this: **we still have no idea what the goal of the tariff policy is,** and it's obvious the White House doesn't know either. At first it was fentanyl (a curse, for sure), then fairer trade, and on April 2nd a comprehensive, sustained, protectionist tariff wall specifically designed to force businesses to relocate manufacturing back to the U.S. And now a selective pause. It's mindboggling! Regardless of this latest twist, vigorous political and legal challenges are already underway. Recall that the original tariffs were authorized under a special condition whereby the president can declare a trade emergency and bypass congress' constitutional authority. No trade emergency exists, in our opinion, beyond that which they have created; therefore, Trump's actions are unconstitutional.

Enough with the bad news. Let's get on to the less bad news. Q1 stock returns were negative, but not dramatically so. The S&P 500 lost just over 4%, with tech and consumer discretionary stocks down 11% and 12%, respectively. After back-to-back blockbuster return years led by tech and the Magnificent 7, the market was precariously perched. Just a touch of ill breeze was needed to topple it. Tariff talk did the trick. Less cyclical areas benefited from the rotation out of risk, with healthcare up nearly 7% and utilities and staples each up over 4%. The average large cap stock was down a little less than one percent. Not bad, really. Small caps fared worse, with their index declining 10%. They're more sensitive to economic news which weakened a bit during the quarter. The weakness also pushed the 10-year Treasury bond yield down about 40 basis points by the end of March. All-in-all, domestic Q1 results weren't surprising given the market strength of the previous two years. And there actually was some good news. International stocks rose 6%, finally showing the benefit of diversification.

Of course, I have to end this thing back where I started. Just how much 'liberation' can the U.S. economy take? I believe it's a safe bet the eventual trade policy will be less destructive than outlined on April 2nd in the Rose Garden. Some damage is being done and slower than expected growth is a certainty, but I don't think a deep recession is likely. Yes, growth could be pushed negative, but our economy is demonstrably resilient and less cyclical than it once was. In the last 20 years we've really only had one recession excluding Covid. The Great Recession was grim, no doubt, but it was the result of the banking sector appallingly overexposed to a housing bubble it gamely abetted. Outside of that painful episode, the economy has absorbed all manner of bad news and bad policy.

Like the Great Recession, serious economic downturns are the product of an excess of malinvestment often funded by debt. No such condition currently exits, in our opinion. The Trump team can manufacture a panic and tip the economy into recession, but it will almost certainly bounce back smartly once the economic policy starts to make sense. We aren't clever enough to know when or how, and we're not going to panic out of world-class companies because of transient tariff misadventures. Stay tuned.

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