MULVIHILL

By the Way

Monthly commentary from Jack Way

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President Trump is dominating the global geopolitical conversation. He is pretty much all we talk about. He has managed to suck the oxygen out of the room such that only his thoughts and opinions matter. During the campaign there were lots of questions about the sincerity of his platform versus speculation that his many threats were merely a way to establish a negotiation position. While there still appears to be some room for negotiation, the speed and aggressiveness with which he pressed his agenda on his first day in office suggests to me he means what he says. These matters are not up for discussion but reflect new policies the President brings with him to the office and believes in strongly. The best definition I have read calls this a change from a so-called soft diplomacy that was previously practiced by the U.S. to a hard diplomacy favored by the new President. He speaks in pronouncements not the usual diplomatic jargon. Words like "mainstream" or "traditional" don't apply in Mr. Trump's geopolitical world. He plays by his own rules and others should fall in line or suffer the consequences. Canada, Mexico, Panama, Greenland, Gaza are all examples of a new way for Washington to interact with friend and foe alike, and the President has not been in office for even a month. There is an old Chinese saying that "You kill the chicken to get the monkeys attention". I think the President is a strong proponent of that theory; in that by attacking friends and neighbors he gets the rest of the world to take notice. The legality of all these "Executive Orders" is open to question, although I have heard no great hue and cry against them. Trump's invoking of the International Economic Emergency Powers Act to justify the imposition of tariffs without Congressional approval seems particularly questionable.

Those people who are not fans of President Trump will often say that if we can suffer through the next four years we will be able to return to some form of normalcy. I am far from convinced. There are any number of people following in his footsteps, more than ready to pick up the banner and carry on his policies. One need only read the background and beliefs of the President's cabinet appointees and close advisors to appreciate that fact. The U.S. Constitution based the power of the Federal Government on three separate branches (Legislative, Executive and Judicial) with checks and balances to ensure that no one branch could act independently. Mr. Trump must have been home sick the day that lesson was taught. I remain supportive of much of what he seeks to accomplish but disturbed by the methods he chooses to employ.

Speaking of the difference between theory and practice, where does Mr. Musk and his Department of Government Efficiency ("DOGE") fit into this crazy mosaic? I don't believe anyone thinks there is no waste and inefficiency in governments around the world, including intentional fraud and just plain incompetence. Therefore, the DOGE mission is commendable but are its techniques? I have no way of offering an informed opinion, but the recent dismantling of USAID does remind me of the old adage that one shouldn't throw the baby out with the bathwater. A bit of oversight wouldn't hurt.

The U.S. tariffs enacted or to be enacted are based on a policy of protectionism but will impact the economic growth of the country as well. (The rest of the world too; see Canada where 67% of GDP is made up of imports and exports.) Strategas estimates that U.S. revenues collected by the tariffs (as currently foreseen) will amount to $150 billion, which is four times that raised in Trump's first term. Strategas also estimates the tariffs will be equal to an 11% corporate tax, or a 3% overall tax increase. Although there have always been significant offsets to higher tariffs:

- A change in currency levels;
- Substitution of other similar or cheaper products;
- Companies can accept some margin compression and maintain prices.

Anyone who thinks the U.S. is being nice to Alberta and Canada by lowering the energy tariff to 10% versus 25% on everything else must realize that 60% of the needed imports to the U.S. for gasoline refineries come from Canada. The U.S. is energy sufficient overall, but this lower tariff will help keep a lid on prices at the pump. Meanwhile Mexico will still experience a 25% tariff on energy.

In general, the outlook for the U.S. economy remains in good shape, consensus estimates for GDP are in a range of 2-3% and inflation projections are similar to those numbers. Nevertheless, politics and geopolitics present the possibility that many different disruptions could impact forecasts.(They always do, but it feels even more so this year, particularly with our inability to predict the intentions of the new administration.)

Despite any increased risk of turmoil, the policies of the Trump presidency are based on themes that should be positive for corporations and equities. They are:

1. Pro-business
2. Pro-growth
3. Pro-deregulation

So far though, since the inauguration the S&P has experienced many ups and downs, and twists and turns but has remained in a fairly tight range not breaking out in either direction, perhaps because the positives were already priced in. It doesn't take much to expose the fragility of the market, but just as strong is the urge to "buy the dip". Chasing headlines seems to be the current modus operandi, at least for the time being. Consensus EPS growth forecasts for the S&P index in 2025 are 13-14%, which is not a bad return despite the unlikely expectation for higher P/E multiples. Also providing support for financial markets is the potential for a significant increase in liquidity in the economy. Unless a deal is reached to raise the debt ceiling, the Treasury Department will need to pay the Government's bills out of its general account providing fuel for higher prices for stocks and bonds. Although valuation levels are very weak predictors in the short term, P/E's are elevated and by almost any historic metric, leave ample room for a significant decline should something go awry. The future of artificial intelligence and the necessary capital expenditure required is one such uncertainty, potentially either good or bad. No real disruptive competition has arisen for the main AI competitors, but the release of the DeepSeek open platform exposes the potential risk. Goldman Sachs points out that with early-stage technologies like AI, things can happen fast. It would be imprudent not to recognize that the Trump administration is also at an early stage and things are already happening fast.

Try to enjoy the ride, but stay safe.

Disclosures