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By the Way

Monthly commentary from Jack Way

"If you're not a little confused about what's going on, you don't understand it"

The Trump administration comes with no consistent logic, thread or common sense. It is almost impossible to predict what it might do or say next. That doesn't make the President a bad person (although it could), but it does make for volatile times and markets. So just to state the obvious and protect my posterior, I'll quote Chris Verrone of Strategas; "We know we don't know". Charlie Munger, Warren Buffet's deceased partner once opined, "If you're not a little confused about what's going on, you don't understand it". Nevertheless, we press on.

The large size of the proposed tariffs and the aggressive tone of Trump's speech surprised me and everyone else. There were suggestions that he would soften or tone-down the tariffs, but obviously that was not the case. The highest tariff estimates I saw even the day before his speech were in the range of $300 billion, but up-to-date estimates are closer to $600 billion. It is universally accepted that the formula the White House used to calculate the reciprocal tariffs was wrong and was a haphazard effort that produced a much too high result for most countries. Some think this was done on purpose. I believe the President has finally convinced us that he means what he says. He, or at least his closest advisors, (read Peter Navarro) strongly support tariffs to compensate for the rest of the world abusing American generosity as far back as the post WWII Marshall plan. In his opinion a short-term fix won't get the job done; "real regime change" of the current trading system is required. We don't have to agree with him, but it would be wise to appreciate the fact that the old and accepted practices might no longer apply.

Countries are lined up to try to negotiate new tariff arrangements with the U.S., but keep in mind the U.S. believes protectionist policies go well beyond tariffs. Peter Navaro, Trump's trade advisor, was quoted as saying about Vietnam; "It's the non-tariff cheating that matters". Closer to home, the Canadian government has a long history of supporting the auto industry through loans, bailouts, write-offs and other financial assistance. As I've said before, Trump may be able to justify some of his policies, but I can't get behind his strong-arm tactics. I liked a quote from a midwestern farmer about the President, "He might be wrong, but at least he's trying". I can't decide if that's funny or frightening.

Whether you agree or disagree with the new tariff policies, it's apparent they will be a negative for the U.S. domestic economy.Strategas consistently wins the vote as the best brokerage firm analyzing the macro-economic environment, and in just the last two months it as increased the chance of a U.S. recession from 15% to 45%, and it is prepared to go higher if something positive doesn't happen soon (such outcomes are possible LOL). Both consumer and business confidence surveys are falling rapidly since the tariff announcements and harder data is most assuredly coming. (I had to laugh when someone said most people hang up on surveys and those who don't, tend to be a bit weird.) Real consumer spending was up 3% in 2024 and is estimated to be 2% higher in 2025; I'm guessing it will go lower. As uncertainty increases, spending will likely fall, layoffs will occur, spending will fall again and we're staring at a recession.

The best chance to turn things for the better is in the hands of Congress and/or the Federal Reserve. The most pressure is on Congress. The revenue from the tariffs must be used to offset the negative impact on the economy, possibly by lowering income and corporate tax rates. Congress is spending a lot of time on internal squabbles, but it must come to grips with the tariff effects on incomes before summer or it might be too late to prevent a recession.

The FED has reacted in a restrained fashion so far, but it too will probably need to add some stimulus into the economy. It wants to wait for the hard data, but that could be a risk to growth. The Board is likely to be late to cut rates; hopefully not too late.

Obviously, the S&P 500 has been decimated since Trump's speech. Best guess is the tariffs have been priced in but a recession has not. Money flows suggest traders and hedge funds have reduced positions, but long only funds have only begun to sell and households and foreigners are on the sidelines for the most part. It's hard to believe it's only two months since stock markets were hitting all-time highs. Valuations are coming into line as the market falls; the S&P 500 price earnings multiple is down to around 18x from a high of 22x, but in 2022 it was 15x and in 2020 13x so there's still room to go lower. In addition, with the potential for an economic slowdown, the dominator (earnings) is almost certain to decline as well. There is hope in the fact that market sentiment and psychology measures have fallen so quickly and dramatically that a rebound could be near. For example, the VIX has traded through 45 and put/calls and inverse ETF's are seeing flows that indicate some capitulation. Hedge fund manager Doug Kass wrote, "The stock market is the only market where things go on sale and all the customers run out of the store".

The usual final thoughts:

- Warren Buffet extolled the virtues of import certificates over 20 years ago, which he acknowledged was just another way of saying tariffs.
- China will win the geopolitical game as the U.S. turns on friends and enemies.
- U.S. net immigration was 1 million on average pre-COVID, rose to 2.9 million in 2023 and is expected to be ½ million in 2025.
- The MAG 7 is becoming the LAG 7
- Keep in mind the old poker saying, "You don't have to play every hand".
- Don't let your emotions control you.

Disclosures