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Recent Economic Events

There is the before and the after. Before January 20th, the economy was doing well based on strong consumer spending and a solid labor market. Inflation had been sticky because the economy was growing nicely and putting some pressure on resources, eggs in particular. After the new administration took office, things changed (a true understatement). The onslaught of executive orders from the President and the barrage of activity from DOGE have upended the economic trends in place beforehand. While the President doubled down on his policies during his State of the Union speech, we should all know by now that what is said today may very well change tomorrow. Uncertainty, especially surrounding trade, is off the charts.

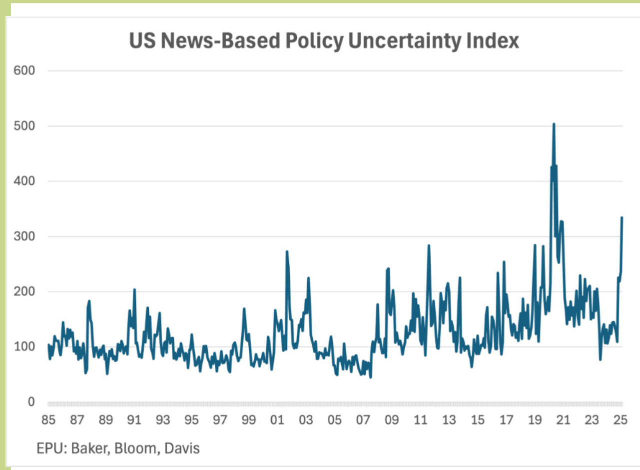
Fourth-quarter real GDP registered 2.3%, a slowdown from both the third quarter and expectations. However, the key reason for the shortfall was a drawdown of inventories, which shaved almost 1% off the total. When you adjust for the vagaries of inventories, trade, and government purchases to arrive at real final sales, the picture is quite different. Doing so results in a remarkably steady 3% growth rate over the last two years.

The labor market has been sending mixed signals over the past few months. On the one hand, average job growth has slowed, and job openings have trended downward. On the other, unemployment has declined to 4.1% from a 4.3% high last summer, and wage gains have continued to barrel ahead. In February, the economy created 151,000 jobs, a clear decline from 2024's average of 186,000. January's job openings totaled 7.7 million, well below the peak of almost 12 million. Wages advanced by 0.3% during the month, keeping the year-over-year increase at an elevated 4.0%.

Inflation is falling but at a snail's pace. The measures are stuck well above the Federal Reserve's 2% target even before the impact of tariffs. The annual headline CPI registered 2.8% in February while the core rate inched down to 3.1%. The Supercore (core services less housing) finally dropped below 4% with a post of 3.8%. This performance is not enough for the Federal Reserve to move just yet.

However, those statistics are mostly from "before". Since the new administration has assumed office, the potential for a sharp turn in prospects has jumped. The President has announced a slew of tariffs, some of which have been imposed, some postponed, and some modified. Because of the delay between announcement and imposition, business and consumers have ramped up import purchases, sending America's trade deficit to an all-time high of $131 billion in January.

Layoff activity spurred by DOGE has boosted claims for unemployment insurance by former Federal workers to a four-year high. In addition,



Recent Economic Events-continued

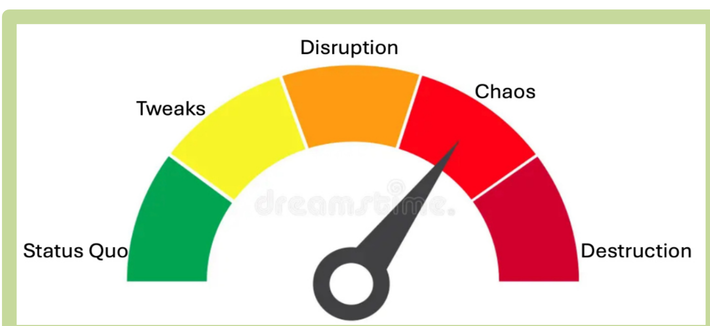
pre-announced job cuts rose from 50,000 in January (near the monthly average for the last couple of years) to 172,000 in February. The future labor market, especially around the nation's capital, is destined to weaken further.

Actual policies are starting to have an impact on the economy, but the elephant in the room is the massive uncertainty created by the President's policy flip-flops. (See Chart.) This is evident in stock market performance. Both the United States and Germany have inaugurated new leaders this year. Both have announced clear breaks with the longstanding status quo. One has been consistent in the change proposed; one has not. Contrast the year-to-date drop in the SP 500 against the double-digit gain in the DAX.

We are now in the "after". Consequently, the old rules may no longer apply. Unless and until there is some clarity on policy initiatives from Washington, businesses and consumers will be in wait-and-see mode. This implies less investment and less consumption, not the best recipe for economic success.

Commentary

Early activity from the Trusk/Mump (I mean Trump/Musk) administration has passed beyond disruption to chaos. Between the official Tariff Man's proposals and the Co-President's chainsaw, positive economic expectations have been replaced by fears of a recession. It almost seems that that is the goal. The President (Trump) recently allowed that recession can't be ruled out. On top of this, time-honored alliances are under threat, not only from tariffs, but also from a shift from shared values to a zero-sum worldview.



There is little question that the American public was frustrated by the status quo when they turned the government over to the GOP last November. Republicans now control the four most important levers of government policy — the Presidency, Congress, the Supreme Court, and the Federal Reserve (Jay Powell is a Trump appointee). There will be nobody else to blame if the changes enacted don't improve both the economy and everyday Americans' perception of the country. Both are important, as we found out during the election season.

I believe two curiously related developments can help us understand the disconnect between traditional economic statistics and consumer sentiment: income/wealth inequality and the democratization of information. The former has boosted average economic results as they move further and further away from median results. The latter has eroded the authority of experts in most any field. When the two come together, you have economists pointing to ebbing inflation indices while everyday folks point to $8 eggs.

Commentary-continued

The politicians in Washington rode the wave of disenchantment with economic performance (especially that of inflation) to victory last November. Their plan appears to be to push forward with policies that will exacerbate inequality while further denigrating expertise. The divide between the haves and have-nots will widen when benefits for those on Medicaid are pared as taxes are cut for the most well-off. There appear to be few, if any, experts in decision-making roles. Not only are tariffs held up as a magic bullet on assertion alone, but the cabinet official in charge of American's health suggests cod liver oil as a treatment for measles. Shades of drinking bleach to cure Covid!

As someone who has always contended that the facts will out in the end, I look upon the present situation with real concern. In the long run, ineffective policies will fail, and alternatives will come to the fore. However, the long run can take forever to arrive, and real damage can occur in the meantime. Perhaps souring consumer and business sentiment along with a plunging stock market will temper some of the more egregious actions, but perhaps not. An administration that makes up its own facts to justify its initiatives may not have the constraints that would normally be expected.

On the other hand, perhaps it is my perception that is wrong. Perhaps the current chaos is prelude to a new American revival. Perhaps ignorance is bliss, and we are on the cusp of Nirvana.

Market View

The markets have also exhibited a before and an after. Optimism was running high for the stock market and crypto-currencies from election day until about the middle of February. Longer-term interest rates had risen in anticipation of a stronger economy. Then the combination of Federal government layoffs and the reality of tariffs hit home. We have made a very quick transition from the Trump Bump to the Trump Slump. And it appears that the markets have been clear-eyed in their judgment. As opposed to the last few years when the United States was an outlier in both its economic growth and in equity market performance, early 2025 has reversed the narrative. The SP 500 has fallen year-to-date, and the NASDAQ is in correction. At the same time, European and emerging markets have gained, with even China outperforming. Have we reached a watershed moment, or is the recent activity a small bump in the road to continued American exceptionalism?

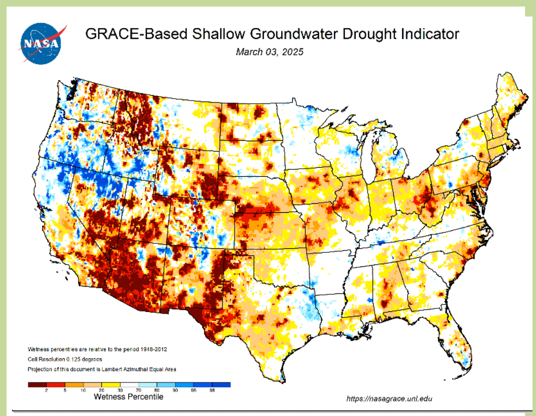
A key factor in American outperformance over the years has been its knack of attracting capital from around the world. This has led to an outsized ability to fund start-up companies which have provided advances in technology. These advances have powered productivity gains that have outrun other countries, leading to GDP much better than other developed countries. This in turn attracts even more investment dollars in a virtuous cycle. Tariffs threaten this advantage.

As you may or may not remember from Econ 101, foreign trade in goods and services is offset by the movement of capital in the opposite direction. A country with a trade deficit must have a capital surplus and vice versa. The dollars that come into the United States as investment in our equity markets or directly into factories started their journey as payment for imported goods and services. Cut the trade deficit with tariffs and you cut the capital surplus that buys our stocks and

Market View-continued

bonds. This dynamic suggests to me that US equities will have a difficult row to hoe as long as tariff threats remain.

The US stock market is in correction. European and emerging country markets are not. I would sell rallies in the United States, paring positions that are not part of your core holdings. I would dollar average into non-US markets with Europe at the top of the list. By type of stocks, defensive options look far better in the current environment than do growth stocks. Having a nice dividend doesn't hurt either.



Longer-term interest rates are balanced on a knife-edge. If America enters a recession because of the upheaval caused by the Washington wrecking crew, rates five years and beyond will fall. However, the magnitude of a decline will be limited by sticky inflation. In fact, if we enter a period of stagflation, we may not see much of a term rate drop at all. If we avoid recession, longer-term rates are likely in a trading range, but a trading range with an upward bias due to the pressure of large government deficits and the aforementioned sticky inflation. I continue to recommend shorter-term fixed income options up to three years or so.

Commodities are destined for their time in the sun. Note the nearby map of the US showing areas of drought. This speaks to the potential for food stress. Also, some tariffs are bound to stick, keeping pressure on industrial metals. Energy is a tale of two worlds. Oil is most likely in surplus, but natural gas isn't. Finally, precious metals have proven their superiority to crypto-currencies.

Politics have massively impacted markets, requiring a rethink of investment approaches. Uncertainty is never good for risk assets, and America's growth stocks are a prime example of risk assets. The time has come to shy away from them while looking for value in both the US and overseas. Short-term high-quality bonds have a good risk/reward in the current environment as do commodities in general. There is always the refuge of gold as well.

Editor's Notes

During this year's polar vortex, New Orleans was blanketed with over 8" of snow. Needless to say, the city stopped for a week while warmer weather did its work. This puts me in mind of Susan's and my trip to Tokyo in 2014. We arrived to a cooler than normal February which turned into the biggest snowfall the city had seen in 40 years. Snow shovels are uncommon in both Tokyo and New Orleans. In the former, we witnessed shopkeepers scraping the sidewalk with plastic dustpans. Here in New Orleans, my neighbor was using the same clever technique. By the way, if anyone is thinking of opening a ski slope in Florida, Susan and I would be happy to attend the grand opening to guarantee a snowy kickoff.

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