TWINFOCUS

APRIL 2025

Investment Research

THE GLOBAL RECONFIGURATION:

Navigating Trade Tensions and Regime Change

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In our quarterly letter, we discuss what we believe are the current administration's authentic views, beyond mere sound bites, the impact these views have on global capital markets, and our optimal investment positioning at this juncture.

The current Treasury Secretary Scott Bessent recently made a statement that garnered significant attention: "The American Dream is not, 'let them eat cheap flat screens'...it is rooted in the concept that any citizen can achieve prosperity, upward mobility, and economic security."

Depending on your political beliefs, you will likely hold various perspectives on this topic. We will attempt to stay clear of politics and focus on the impact these views and strategies have on the markets.

We will also discuss the key events of the past quarter, of which there are many. Our crucial point is that the global landscape has shifted, and there is a growing unease surrounding the assertion that the US is inherently exceptional and therefore asset diversification, outside of US assets, is unnecessary. We will (again) examine the theme of "US exceptionalism" and provide a broader perspective.

Lastly, we will conclude with our highest conviction positioning. In October, we discussed that Gold is not a bug but rather a feature, and in January, we discussed the high likelihood of a bubble in US mega caps. We are more convinced of these predictions today.

Today, we are leaning into the narrative that after fifteen years of a singular prevailing trade, diversification is now essential and that the potential for a generational regime change is possible.

Disclaimer On Politics

Let us begin with the rationale: what might a seasoned macroeconomist like Scott Bessent observe in the global landscape, and why might he advocate for change, or, more pertinently, why might his superior wish for change?

Before potentially alienating half of our audience, we wish to state objective facts. We are open to private discussions regarding the merits or the probability of these shifts occurring; however, our primary goal is for readers to understand that "Macro Investing is BACK" and that simply relying on US exceptionalism as expressed by impressive profit growth may no longer be the only allocation necessary to produce returns.

What Is Trump Trying To Do? And Why?

Trump's Treasury Secretary Scott Bessent has been actively sharing his worldview on the speaking circuit. We have diligently reviewed his podcasts, YouTube videos, and press conferences to discern his core beliefs and their influence on the President's policies. He summarizes his economic vision as follows:

- 3% GDP Growth
- 3% Budget Deficit
- 3 million additional barrels of shale oil production per day.

Currently, the deficit stands at approximately 7% of GDP. Considering a fiscal multiplier of 1.5x, the impact on GDP from reducing the deficit would be substantial. Therefore, it seems improbable, at least in the short term, that he anticipates simultaneously reducing the deficit and sustaining trend-line growth, which is around 3% in the US. The goal of three million additional oil barrels, representing roughly 3% of global supply, would likely result in lower oil prices. Given that shale oil breakeven costs range from $50 to $70 per barrel, it is unlikely that drillers would cooperate at those price levels.

We believe that these stated goals may not reflect his true intentions. Instead, let us examine the structural problems he perceives and the potential solutions he might pursue:

1. The US has a significant deficit, leading to a large global surplus of Treasuries. Janet Yellen, the former Treasury Secretary, attempted to mitigate the market impact by shortening the duration of Treasury issuances. While this strategy has short-term benefits, it exacerbates the problem of short-term debt funding on long-term assets, an inherently unstable balance. Scott Bessent's proposed solution is rather innovative and has received limited attention: he intends to increase the leverage US banks can hold on Treasury bills and potential notes. This would effectively generate increased demand, estimated by some to be nearly $2 trillion, thereby lowering Treasury yields through a substantial increase in demand.
2. The US maintains a substantial trade deficit with the rest of the world. Any increase in domestic production would reduce this deficit and potentially diminish the demand for dollars for recycling, thus lowering the value of the US currency.
3. Trump and his team have expressed interest in expanding US economic control over Greenland, Ukraine, and Panama, which could reduce the trade deficit and potentially depreciate the dollar.

Collectively, Trump and Bessent appear to believe that the populist revolt against big government and unfair treatment of workers can be addressed through more balanced trade, a weaker dollar, and a reduced fiscal deficit. Intriguingly, despite the perceived chaos, partisanship, and egos surrounding the Trump presidency, a closer examination reveals that the administration is explicitly seeking to reverse many of the significant market trends of the past 15 to 30 years. In essence, "Macro is back." Or said another way, capitalism is less pronounced and populism is more.

The imbalances under negotiation include:

1. China's trade surplus and repressed consumer spending.
2. The US trade deficit, dollar demand, and underpaid workers.
3. The US fiscal deficit and pressure on NATO partners to increase defense spending.

The trade gap remains substantial and continues to widen, despite the tariffs imposed during both Trump's first term and the Biden administration. The chart below compares the growth in imports in the US and the rest of the world. Our appetite for cheap imports is staggering, and if anything continues unabated. With hindsight, importing cheaper foreign goods has allowed our economy to grow above trend generally without traditional inflation impulse, traditional economists are pleased with this outcome. The debate comes if we have taken this too far.

This chart unequivocally demonstrates that exports are experiencing rapid growth, notwithstanding the economic disruption caused by COVID-19. Furthermore, it highlights the US's increasing contribution to the overall global trade imbalance. The recent surge in imports is particularly concerning, indicating an accumulation of inventory beyond current demand levels. This overstocking was likely a preemptive measure to circumvent potential tariffs; however, the subsequent drawdown of this excess inventory will inevitably contribute to a slowdown in the global economy.

This chart vividly illustrates the remarkable growth in both exports and imports in China over the past fifteen years. The recent widening of the gap underscores that China's strategy to maintain growth above 5% appears to be predominantly driven by exports rather than domestic consumption. As a reminder, the last fifteen years have coincided with the best stock market performance we have experienced over any comparable period. The underlying narrative is straightforward: robust profit growth coupled with suppressed inflation allowed price-to-earnings multiples to expand alongside earnings. This low inflation was, in part, a consequence of globalization. Any efforts to curtail globalization will likely intensify inflationary pressures (regardless of tariffs) and diminish the effectiveness of a "FED Put."

China: y/y export and import volume growth
change in trailing 3m average

Export volume growth (y/y change in 3m average)
Import volume growth (y/y change in 3m average)

The fiscal deficit is a well-understood issue, and we believe the accompanying chart effectively summarizes the problem. The current interest burden on our debt now exceeds our defense spending, a situation that is clearly unsustainable in the long term unless foreign entities are willing to perpetually finance our debt. While the US dollar holds reserve currency status and global investors exhibit a strong appetite for US investments, there is an inevitable tipping point. Recent actions by Treasury Secretary Yellen to adjust the duration of Treasury issuances and lackluster Treasury auctions offer signals that we may be closer to this critical juncture than the current administration acknowledges. Of note, the last few weeks, is that while the market is down almost 20% from 2/29, the yield on 30-year treasuries is almost unchanged. To compare against other crisis...COVID-19 30-year yields are down about 150bps, Brexit about 75, 2008 Housing Crisis about 200, something has changed. Could it be that some of the imbalances we discussed at the beginning are starting to be reflected in asset prices?

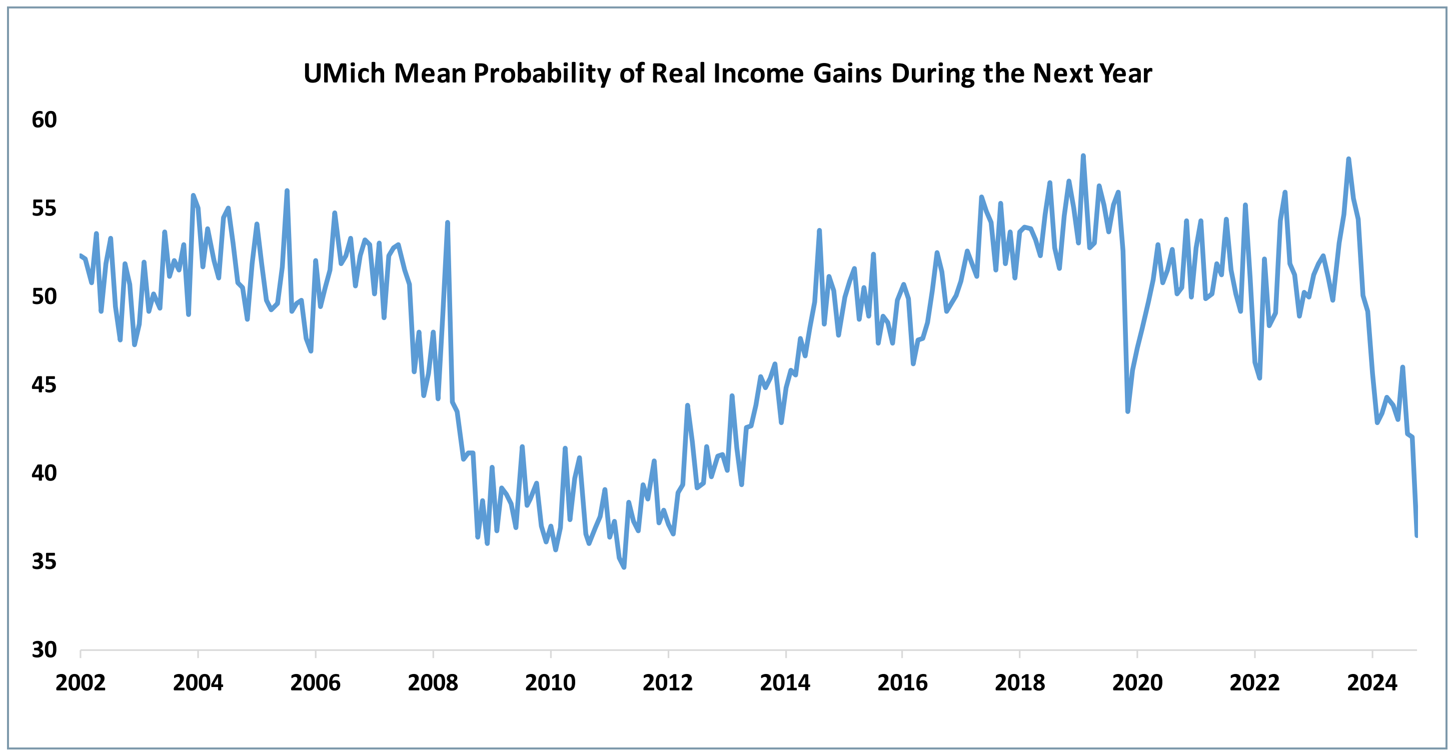
Public Debt Net Interest Payment to GDP

OECD Estimates for 2025

Country	Value
USA	4.6%
Greece	2.5%
Iceland	2.2%
Spain	2.0%
Portugal	2.0%
Belgium	1.9%
Poland	1.8%
New Zealand	1.8%
France	1.7%
UK	1.6%
Australia	1.1%
Austria	1.1%
Slovenia	1.0%
Czech Republic	1.0%
Canada	0.9%
South Korea	0.9%
Slovakia	0.8%
Finland	0.7%
Germany	0.6%
Netherlands	0.6%
Japan	0.5%
Ireland	0.3%
Estonia	0.3%
Lithuania	0.3%
Switzerland	0.1%

Source: OECD; Bloomberg; Tavi Costa - *Chart As of 7/27/2024* © 2024 Crescat Capital LLC

Lastly, regarding workers' share of the economic pie, while survey methodologies can introduce bias, the prevailing sentiment supports increased populism, not a decline. Workers anticipate a decrease in their real earnings in the coming year, with levels of pessimism not witnessed since the 2009 recession. Most consumers expect their real wages to decline in the year ahead, the current response is as dire as the housing crisis in 2008 and 2009.



Source: Bloomberg

What Is Populism, And What Are Its Origins?

We asked Google's AI, with the explicit instruction not to criticize the source: "Populism is a political approach that appeals to the interests and opinions of ordinary people, often contrasting these with the views of established elites. It typically emphasizes the idea of 'the people' as a unified group and can involve policies or rhetoric that resonate with a broad base of the population who feel their concerns are being ignored by the political establishment. Populist movements can emerge across the political spectrum and often express a desire for direct representation and a rejection of traditional political norms."

Currently, wages as a share of GDP are low, while corporate profits are at a record high; this serves as a straightforward illustration of the existing disparity. Wages as a share of GDP have been falling for decades, and profits are at an all-time high.

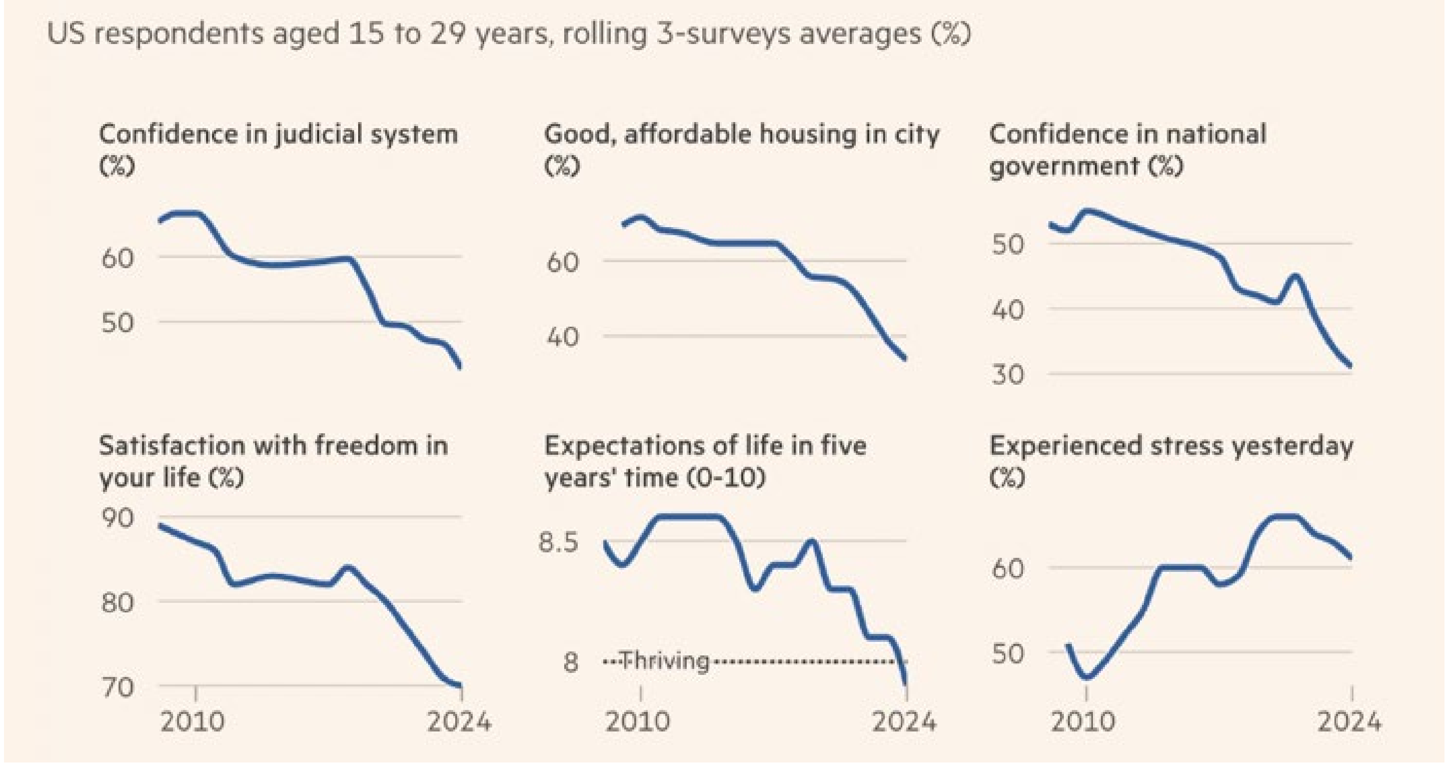
Labor vs. Profit Share of GDP (Rolling 5 Year Median)

Wages as % of GDP (Left) — Corporate Profit % GDP (Right)

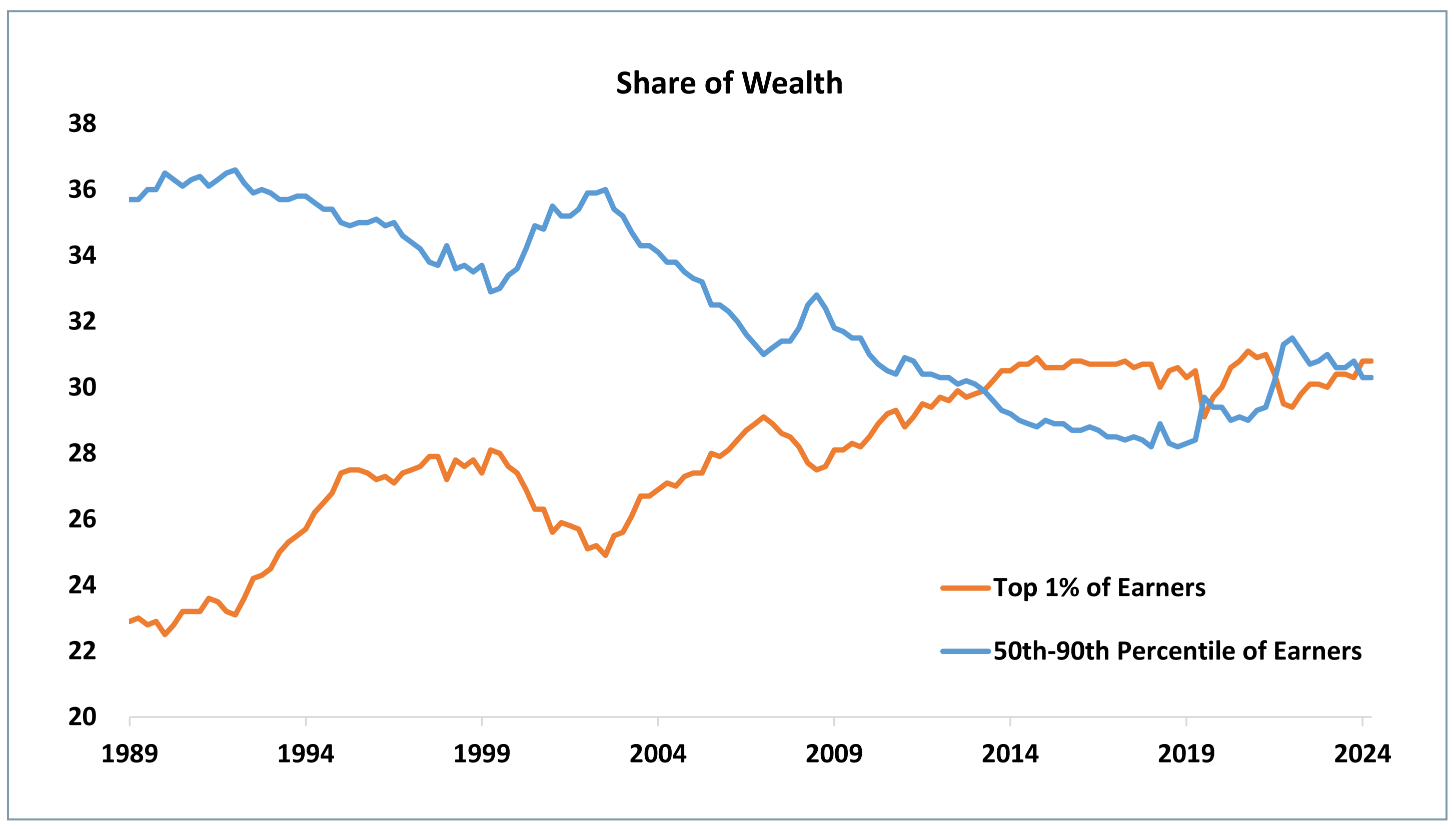
Left axis: 40%, 42%, 44%, 46%, 48%, 50%, 52%, 54%
Right axis: 0%, 2%, 4%, 6%, 8%, 10%, 12%, 14%, 16%, 18%, 20%
X axis: 1951, 1965, 1979, 1993, 2007, 2021

Source: FRED

The chart below is from Gallup. While just for the younger generation, their questioning of the status quo is at record highs, they will become a more critical voting block each election for decades. Potentially, their views change as they age, but the trend is evident.



This chart shows the increase in wealth of the top 1% as share of total wealth.



Source: FRED

To summarize, the mandate for Trump and his team is to disrupt the status quo. There are two distinct paths: maintain the current trajectory, which appears to be in jeopardy based on the announced tariffs and rhetoric from the Trump team OR embark on a rebalancing effort that attempts to restructure the global order.

Maintaining The Current Course!

If we maintain the current course, the trade and trend are clear: invest in US exceptionalism and wager on US corporate profits outpacing global growth—a trend that has held true since 2008! Another perspective on the last fifteen years is to bet on capitalists prevailing with higher corporate profits, potentially at the expense of workers' wages, the continued existence of the FED PUT, and uninterrupted global trade. These factors have collectively benefited capitalism. However, the recent actions are essentially a call to action, signaling a potential, albeit slight, shift in the balance of power away from capitalists and towards populists. Should this trend persist, we anticipate substantial market structure and performance changes.

The yellow line illustrates that since 2009, US Earnings Per Share (EPS) has grown significantly faster than that of Europe (a trend also observed globally). The blue line indicates that investors have recognized this disparity, resulting in higher relative returns. In other words, the price-to-earnings multiple has expanded due to this accelerated earnings growth—a potent combination.

DISPLAY 6: RELATIVE US VS. EUROPEAN EQUITY PERFORMANCE AND RELATIVE EPS GROWTH

Index
300
250
200
150
100
50
0
90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25

US - Europe EPS (LC) US - Europe Total Return (LC)

Past performance does not guarantee future results.

As of February 28, 2025

Source: LSEG Datastream and AB

This earnings growth is attributable to several key factors:

- Significant outsourcing of labor to regions offering cheaper and more efficient production.
- Faster economic and sales growth compared to international peers.
- Dominance in most emerging technologies; a contrast to the 1990s when European companies led in the mobile phone sector.
- A relatively unique capital system that channels substantial risk capital into venture and early-stage investments.
- A near-continuous bid from surplus dollars reinvested into US markets (more on this to follow).

We have previously discussed this dynamic in our Q1-2024 letter, where we explored how difficult it would be to continue the run of US exceptionalism (or rather US exceptional stock market performance). At that time, we were skeptical, acknowledging US exceptionalism but noting its widespread recognition and likely incorporation into market valuations. Subsequent events have validated our initial caution. Since at least June of last year, technology stocks and the S&P 500 have underperformed the most significant indices.

Normalized As Of 06/03/2024
Last Price
Nasdaq-100 Total Return Index 103.6203
S&P 500 Total Return Index - on 4/9/25 104.4602
Deutsche Boerse AG German Stock Index DAX 111.1889
MSCI China Net Total Return USD Index - on 4/9/25 112.0802

140
130
120
110
100
90

Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr
2024 2025

XNDX Index (Nasdaq-100 Total Return Index) Q1 25 Chart Daily 03JUN2024-10APR2025
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Source: Bloomberg

The most striking aspect of recent returns is that despite the widespread interest in technology stocks and their global dominance, these stocks have been underperforming for some time.

Is it possible that the market HAD already priced in the implications of the following chart? This chart illustrates that while Technology EPS growth was anemic from 1990 through 2010, it has surged dramatically over the last fifteen years, bolstering the narrative of US exceptionalism and aligning with the incredible recent performance in the US markets.

Earnings: Tech vs the Rest
(Trailing 12m Earnings, indexed to 1 = Jan 1990)

US Tech Stocks (TMT)
US Non-Tech (ex-TMT)

18
16
14
12
10
8
6
4
2
0

90 92 94 96 98 00 02 04 06 08 10 12 14 16 18 20 22 24

TMT = Technology, Media, Telecommunications

Source: Topdown Charts, LSEG
topdowncharts.com

Our counterargument would be to examine history and observe that the enduring strength of US industry lies in its continuous innovation. The table below highlights the largest companies in the market at various points in time. Two key conclusions emerge: first, even within the realm of corporate giants, Apple's current market capitalization of 7% is exceptionally large; and second, it is interesting to note that the only consistent factor over time is the emergence of new market leaders roughly every decade. Might we be approaching such a juncture today? Or more likely, even if this continues, diversification from these large companies makes sense based on the history of investing in the US.

1985		1990		1995		2000	
IBM		IBM	2.9%	General Electric	2.6%	General Electric	4.1%
Exxon Mobil		Exxon Mobil	2.9%	AT&T	2.2%	Exxon Mobil	2.6%
General Electric		General Electric	2.3%	Exxon Mobil	2.2%	Pfizer	2.5%
Philip Morris		Philip Morris	2.2%	Coca-Cola	2.0%	Cisco Systems	2.4%
General Motors		Royal Dutch Shell	1.9%	Merck & Co	1.8%	Citigroup	2.2%
Amoco		Bristo-Myers Squibl	1.6%	Philip Morris	1.7%	Walmart	2.0%
Royal Duch Shell		Merck & Co	1.6%	Royal Dutch Shell	1.6%	Microsoft	2.0%
Du Pont		Walmart	1.6%	Procter & Gamble	1.2%	American Internatio	2.0%
AT&T		AT&T	1.5%	Johnson & Johnson	1.2%	Merck & Co	1.8%
Chevron		Coca-Cola	1.4%	IBM	1.1%	Intel	1.7%

2005		2010		2015		2024	
General Electric	3.3%	Exxon Mobil	3.2%	Apple	3.3%	Apple	7.0%
Exxon Mobil	3.1%	Apple	2.6%	Alphabet	2.5%	Nvidia	6.4%
Citigroup	2.2%	Microsoft	1.8%	Microsoft	2.5%	Microsoft	6.4%
Microsoft	2.1%	General Electric	1.7%	Exxon Mobil	1.8%	Alphabet	6.2%
Procter & Gamble	1.7%	Chevron	1.6%	General Electric	1.6%	Amazon.com	3.8%
Bank of America	1.6%	IBM	1.6%	Johnson & Johnson	1.6%	Meta Platforms A	2.4%
Johnson & Johnson	1.6%	Procter & Gamble	1.6%	Amazon.com	1.5%	Eli Lilly	1.8%
American Internatio	1.6%	AT&T	1.5%	Wells Fargo	1.4%	Broadcom	1.6%
Pfizer	1.5%	Johnson & Johnson	1.5%	Berkshire Hathaway	1.4%	Tesla	1.4%
Philip Morris	1.4%	JPMorgan Chase	1.5%	JPMorgan Chase	1.4%	JPMorgan Chase	1.2%

Are we entering a new regime?

If we are indeed entering a new economic course, a shift that the market has begun to reflect this year with the US being the worst-performing developed market (as evidenced by the year-to-date returns of the countries mentioned earlier: then understanding the potential drivers and historical parallels becomes crucial.

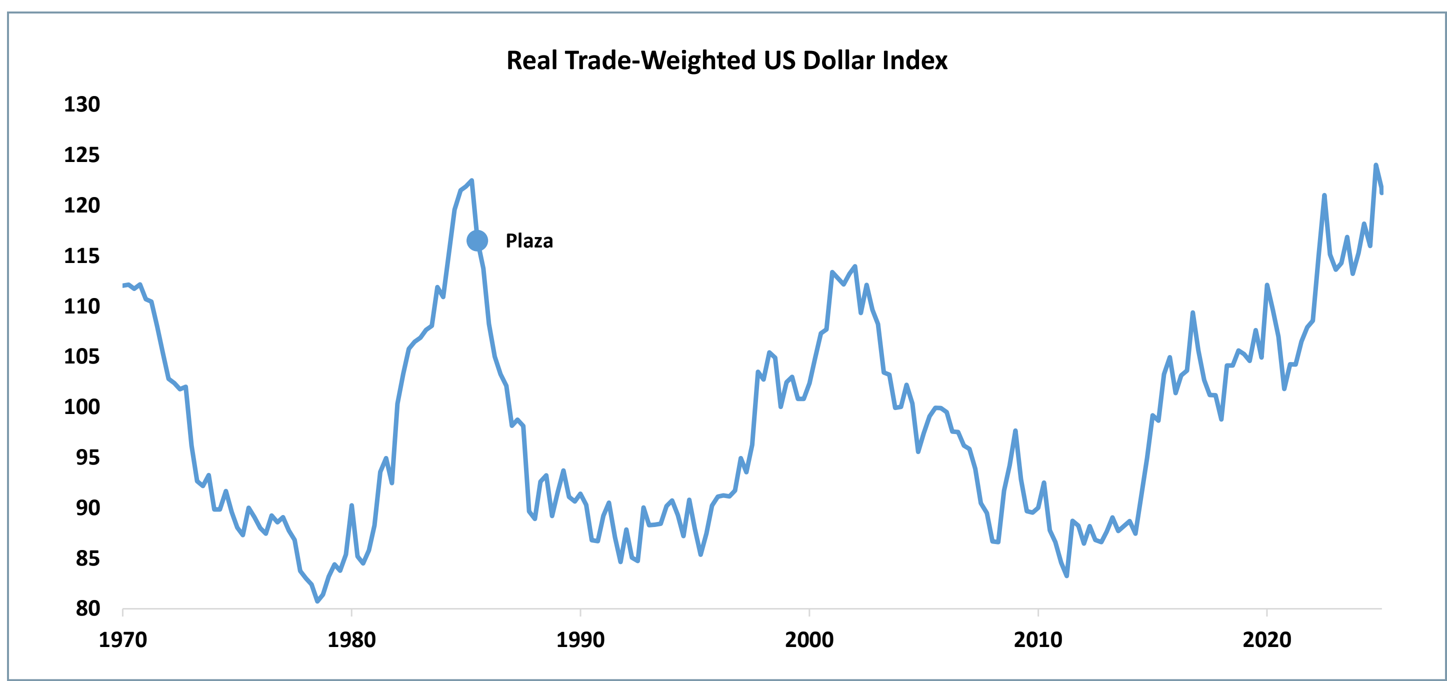
Source: Bloomberg

Politics And The "Rationale" For A Grand Bargain

Please do not interpret anything written herein as an endorsement of either Democratic or Republican viewpoints. Instead, our aim is to dissect what we suspect is the underlying grand bargain that may materialize if we forge another Plaza Accord-like agreement, or what has been discussed in the press as the "Mar-a-Lago Accord."

To provide some historical context: In the mid-1980s, prior to China's significant integration into the global economy, the US was experiencing growth challenges, which it attributed to the rapidly appreciating dollar and the resulting lack of competitiveness in US manufacturing (sound familiar?). The Plaza Accord was a coordinated initiative involving Germany and Japan to deliberately strengthen their respective currencies and, consequently, depreciate the US dollar.

Furthermore, these nations committed to adjusting their domestic economic policies to support the US's objectives. The immediate outcome was a successful depreciation of the dollar and a partial reduction in the trade imbalance. However, this agreement also triggered unintended consequences, notably a substantial appreciation of the Yen. This appreciation created a self-reinforcing cycle where both domestic and international investors increasingly sought Japanese assets, ultimately leading to a doubling of market multiples followed by a significant crash. The analogy from the root causes of the Plaza Accord resonates with the perceived problems by the Trump team, while the players have changed. Interestingly, these types of macro interventions usually come with chaos, which is hard to forecast, especially ex ante.



Source: Bloomberg

So, What Does This Mean For Investing?

We are currently facing three significant and interconnected global imbalances: China's trade surplus, US overconsumption, and a widespread sentiment that workers are not receiving their fair share of economic gains. Again, we are not taking a political stance on these issues. However, if the policies advocated by Bessent, Trump, and others are successful in achieving a form of Plaza Accord or "Mar-a-Lago Accord" that seeks to balance the interests of US voters, China, Europe, Canada, and Mexico, here are the likely implications for capital markets:

In the simplest terms, it suggests doing the opposite of the prevailing trends of the last 15 years. While simply being long US risk assets has been a winning approach, we suspect if the regime is changing, diversification, particularly away from dollar assets, is a winning approach:

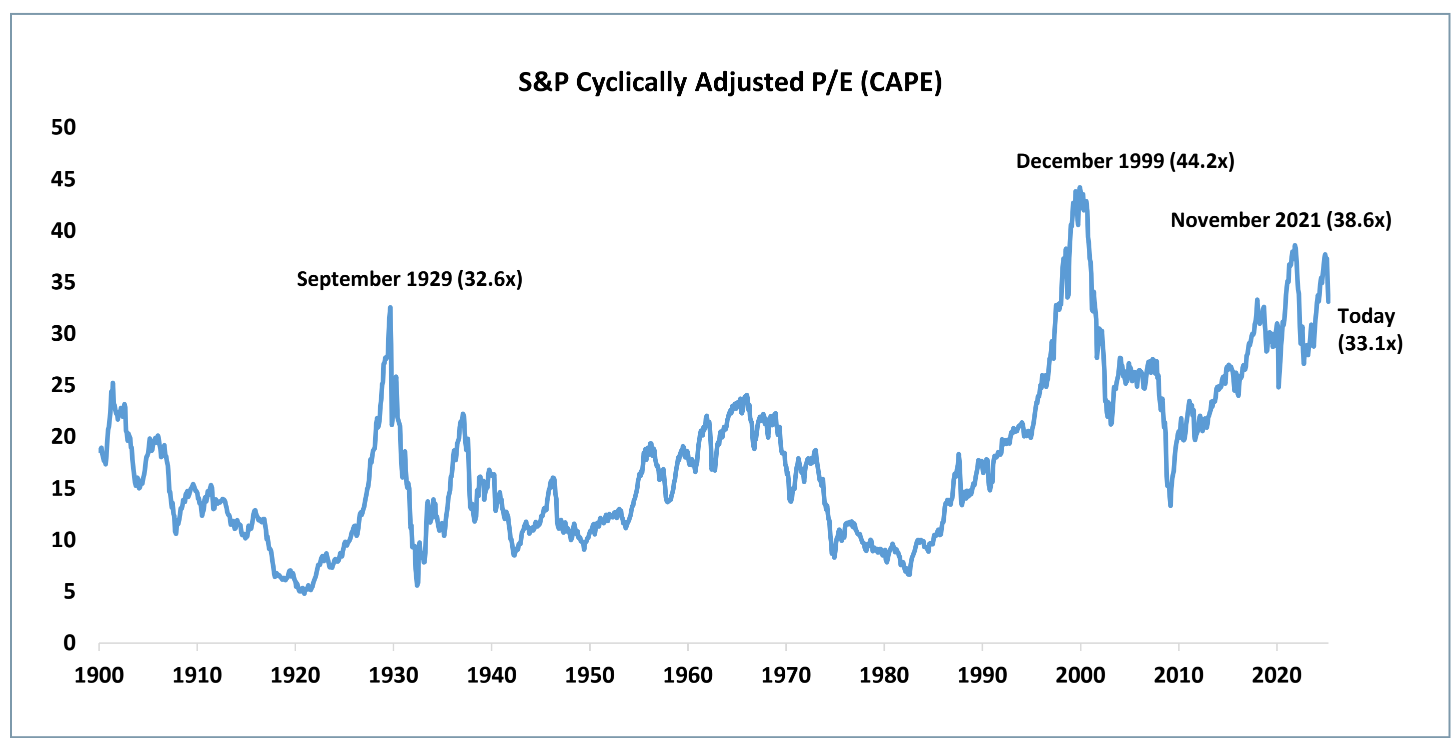
1. Reduce exposure to the dollar and dollar-based assets.
2. Increase portfolio diversification across different geographies and asset classes.
3. Prepare for the potential for increased volatility and unpredictability in capital markets, as elements of chaos theory may become more pronounced. As discussed in our Q3 report, gold may play a role in this environment.

If we anticipate a deceleration of US exceptionalism and a dollar depreciation, the initial conditions for investing in the rest of the world have never been more favorable.

Firstly, valuations and capital flows are currently at historically lopsided extremes. We believe that the continuous recycling of excess dollars back into US assets has been a significant factor in driving US market valuations above their intrinsic fair value. If Trump and team succeed in balancing payments, the scarcity of dollars will reduce, and so will some of the demand for US assets.

The Shiller CAPE ratio, which averages the last ten years of inflation-adjusted earnings against the current S&P 500 price, illustrates this point. While valuation alone is not a precise timing tool, it highlights two critical considerations:

1. The current starting valuation is unfavorable.
2. The CAPE ratio has expanded from below ten times to above thirty times since the 1970s. For investors to experience comparable returns in the next few decades, corporate profits would need to grow at twice the rate of GDP, and the CAPE ratio would need to expand by another factor of two or three. While we refrain from making explicit return forecasts, we are confident that returns over the next ten years are likely to be lower than in the last 5 decades, as the expansion in the price-to-earnings multiple is likely near historical peaks.



Source: Robert Shiller, econ.yale.edu

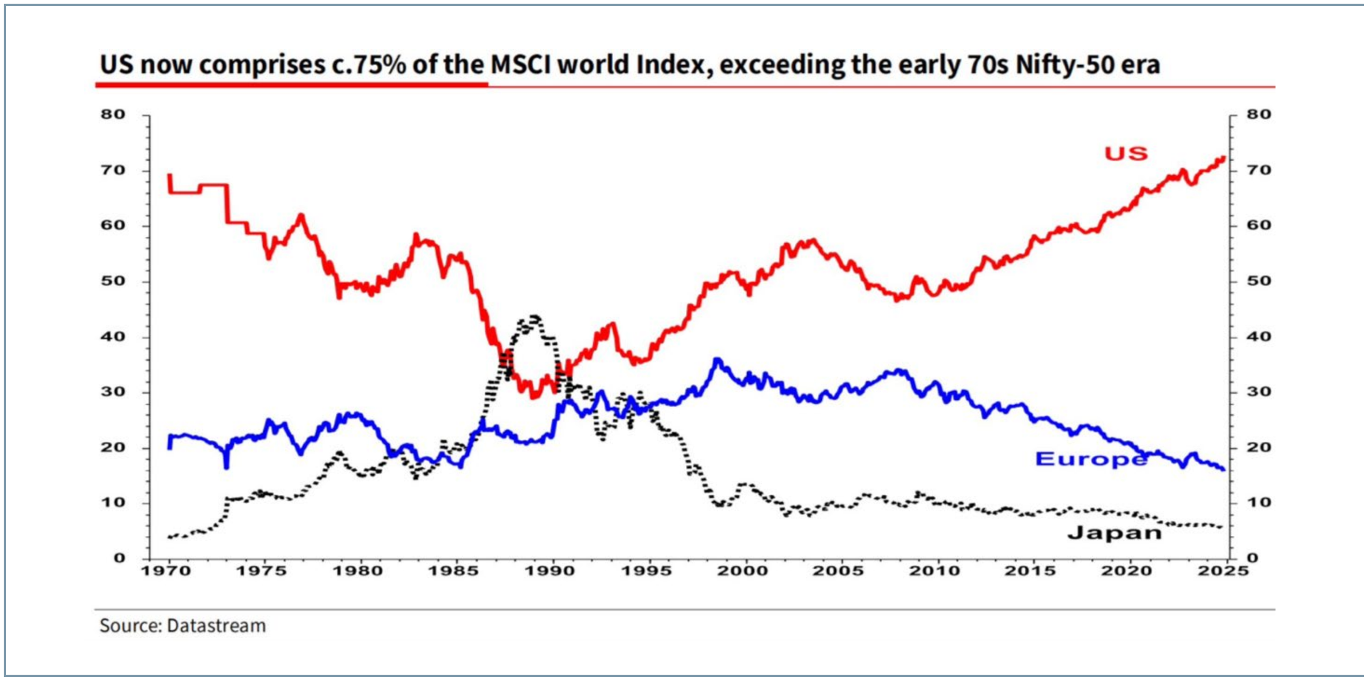
Second, on almost every metric we can find, investors are “All-In” on the trade. The chart below is a survey of Goldman’s clients in January of this year, it appears to have top ticked the allocation to US equities.

Share of clients expecting the US to be the best-performing global equity region at the Goldman Sachs Global Strategy Conference in January of each year

Year	2018	2019	2020	2021	2022	2023	2024	2025
Share (%)	16	20	25	24	32	18	32	58

Source: Goldman Sachs Global Investment Research

Other metrics show that US consumers' ownership of equities is near all-time highs, as is the share of US equities in the MSCI index.



Aggregate financial asset allocation across households, mutual funds, pension funds, and foreign investors

Equity 51%

Debt 19%

Cash 14%

0%, 10%, 20%, 30%, 40%, 50%, 60%, 70%

1952, 1962, 1972, 1982, 1992, 2002, 2012, 2022, 2032

Source: EPFR, Goldman Sachs Global Investment Research. As of March 13, 2025.

Global Investment Research

Lastly, and maybe a bright spot, the relative P/E of the various markets has improved considerably over the last month, with the US down about 4 points. So, while the quarter-end value is still extended, it is now within the 90th percentile. We would highlight that Wall Street estimates have not been cut due to the past month's events, so we suspect the "E" in P/E has further to fall.

In summary, we believe that the natural interpretation of the actions from larger players in the globe is that we are attempting to balance at least three things:

- China and its wants.
- Corporations/Capitalism and their wants.
- Labor/Voters and their wants.

It is unclear how it ends, but we hope a grand bargain can be had. This negation suggests a departure from the relatively straightforward investment landscape of the past fifteen years, where US earnings consistently outpaced global counterparts. We are likely entering an era where the delineation between market winners and losers will be far more nuanced.

MSCI Regions - P/E (20 Year History)

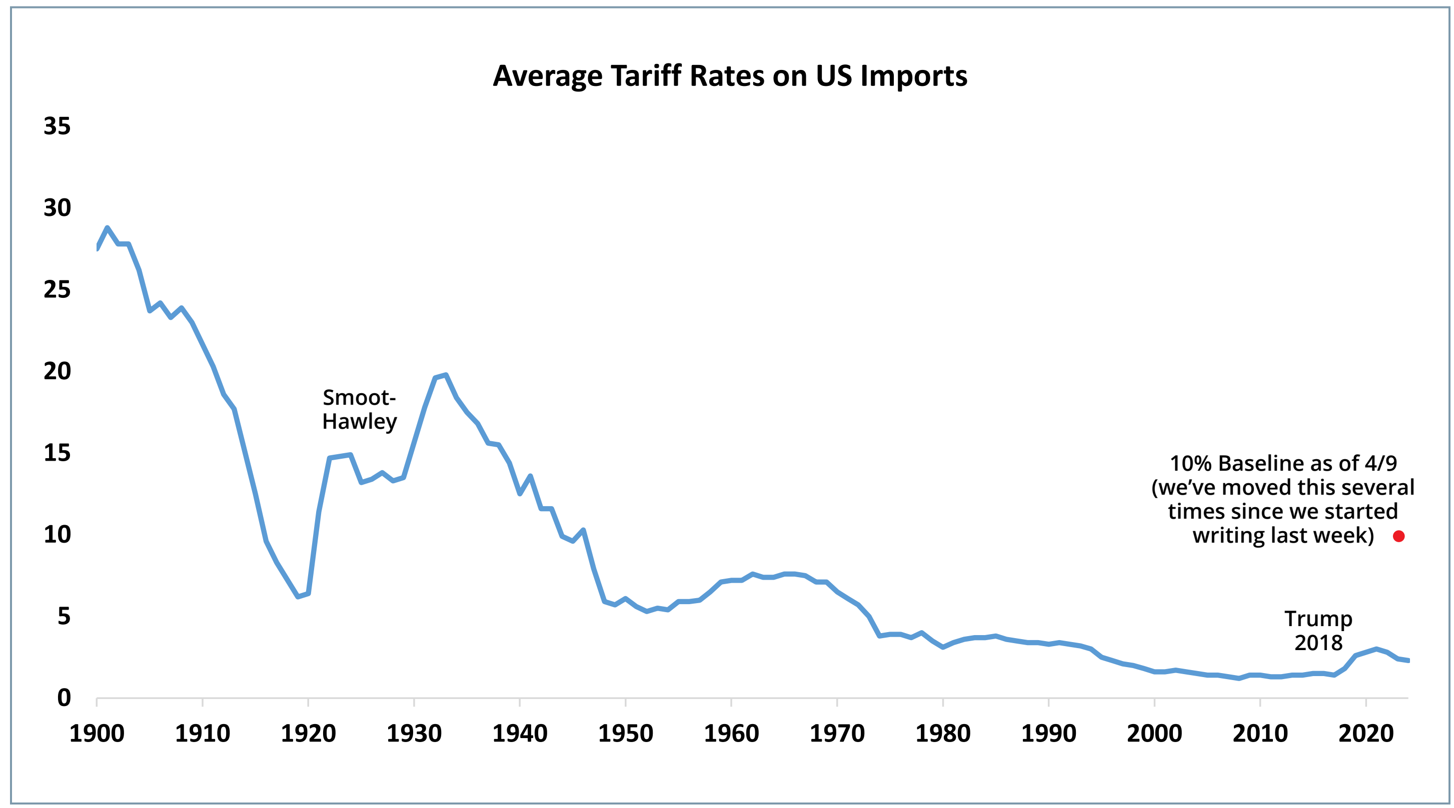
25
20
15
10
5
0
US
Europe
Japan
APxJ
ACWI ex US
EM
UK
China
10th-90th Percentile
Median
3/31/2025

Source: Bloomberg, MSCI

Tariffs, The Economy, And Strategic Maneuvering

We do not believe that tariffs represent the ultimate objective. Rather, we view them as a tool in the pursuit of the grand bargain previously described. However, the sheer magnitude and scope of the initial proposals from the Trump administration are undeniably significant, and investors are understandably apprehensive about their potential implications.

The chart below shows the trend in Tariffs since 1900; the trend has been unmistakable; tariffs have fallen as increased trade has taken place. Just to harp on the prior message, we do not know how much tariffs are going up, but we are certain that the trend of the past 125 years is now broken as the dream of PAX Americana that lifts all partners seems to be in question.



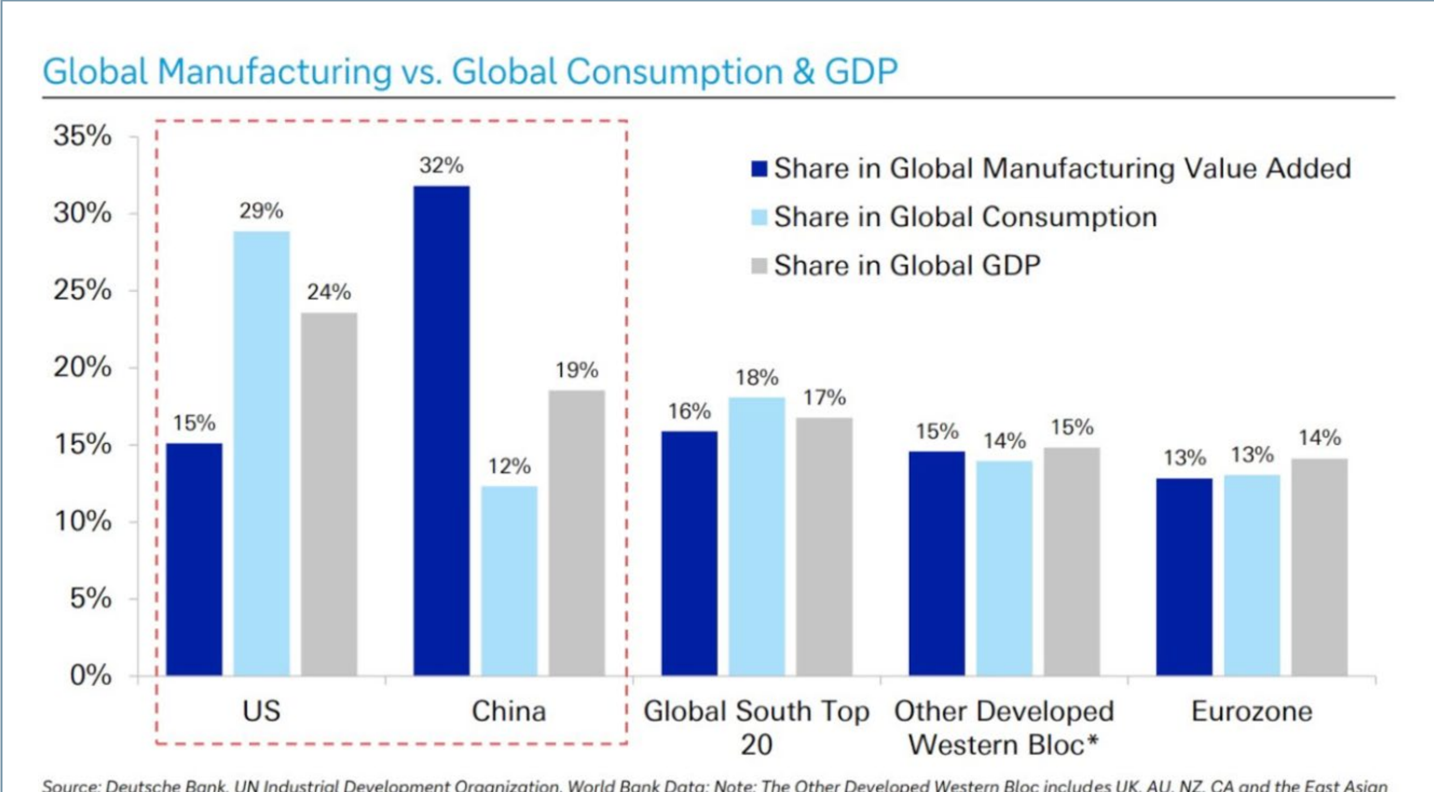
Source: Bloomberg

If global trade has peaked it will have two obvious impacts on investors and the markets.

1. The serial Fed Put will be less pronounced as deflationary pressures from global trade decrease.
2. Corporate profit margins, which have been maximized to align with the cheapest global sourcing, will come under pressure.

In the shorter term, market commentators and others appear primarily focused on Canada, Mexico, and our European allies. However, we believe the central narrative regarding the rebalancing of global trade and consumer surpluses lies with China. While developments with other nations are barely worth commenting on. The chart shows the large gap in trade between China and US and the relatively stable levels in other parts of the world. The positions in China and the US are unique.

Shown below, most of the geographies are relatively well balanced from a trade perspective, while China and the U.S. are extremely lopsided.



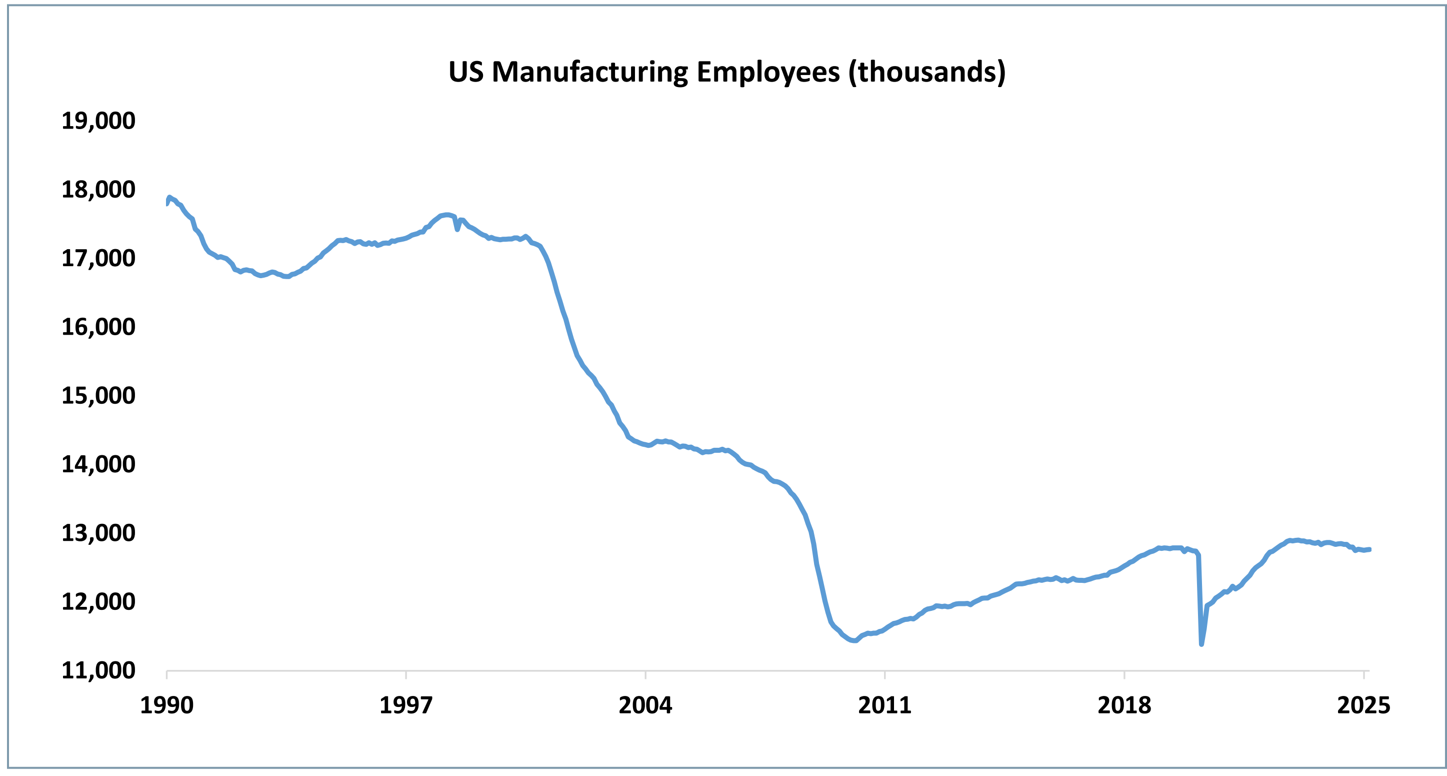
If we are to believe there is a truce coming from these two large economies, it will come in the form of the increasing value of the Yuan vs. the Dollar. Like the Plaza Accord, where Germany and Japan revalued their currencies higher. So far, it is quiet. If anything, the slow depreciation of the Yuan shows China's unwillingness to negotiate yet.

CNY/USD

Year	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024

Y-axis: 0.135, 0.140, 0.145, 0.150, 0.155, 0.160, 0.165

Source: Bloomberg



Source: FRED

A sharp downward movement means the trade war is just starting; a move up means we have achieved a Plaza-type accord.

American factory work is intersected with the view on populism, and as shown above, they have witnessed a shrinking demand that corresponded with China's entering the WTO in 2001. As Bessent said, the "American dream is not eating cheap TVs." We are skeptical that the US can regain the manufacturing dominance we had for most of the last century, but we believe that with some grand bargain, we can slow the bleed, which should stabilize the workforces in manufacturing-dominant states.

Warren Buffett, the Oracle of Omaha, presciently identified this issue in 2003, essentially highlighting the trends illustrated in the charts above. His core argument was that while free trade generally yields benefits for all participating parties, its implementation requires careful consideration and management. In contrast, The Economist's perspective this month champions the current global economic order, asserting its conduciveness to capitalism and suggesting a reluctance to alter a system perceived as functional. While the team at TwinFocus holds its own distinct views on the optimal path forward, our suspicion is that the eventual "solution" will likely lie in a compromise somewhere between these two extremes. We sincerely hope that global leaders can navigate these complex issues and arrive at a balanced resolution swiftly.

FORTUNE

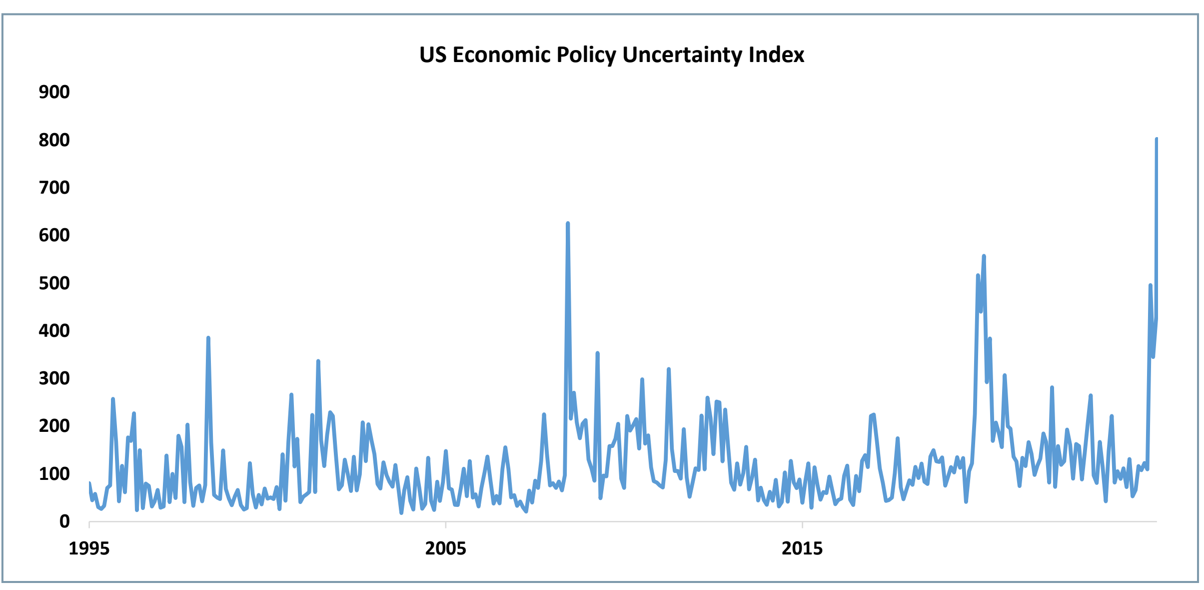
NOVEMBER 10, 2003

America's Growing Trade Deficit Is Selling the Nation Out From Under Us. Here's a Way to Fix the Problem—And We Need to Do It Now.

by Warren E. Buffett

Bringing It All Together, How Do The Tariffs Impact The Economy?

We believe the first transmission is through uncertainty. The US economic policy index is shown below; it is at a 30-year high. This results in a freezing of corporate decision-making. While there are many indications that corporations have slowed hiring and their sentiment is falling, the new orders index tells the obvious story: orders are falling in response to uncertainty. Below 50 is considered a recessionary signal; we are in that range.



Source: Bloomberg

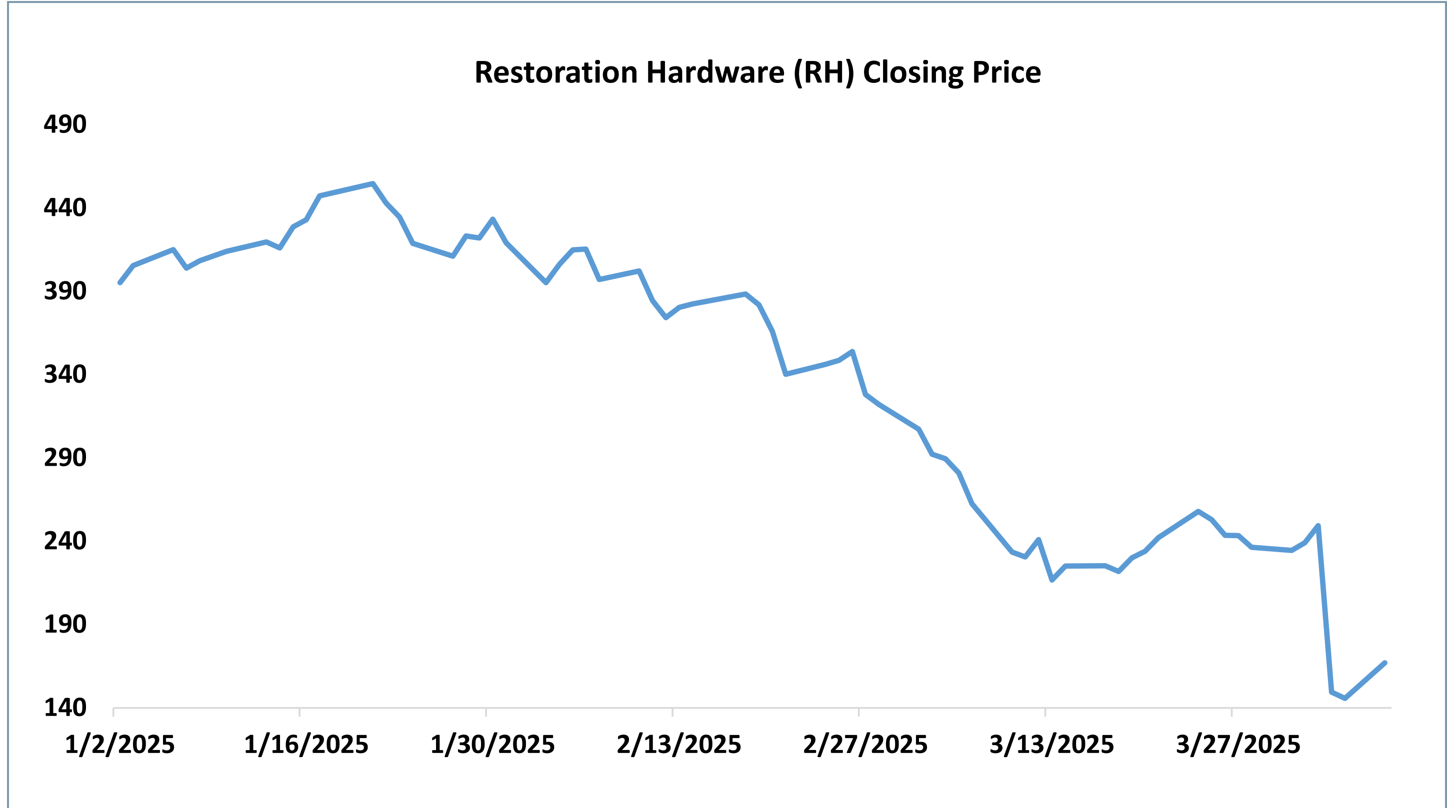
Lastly, while based on a single company's experience, we believe the commentary and news surrounding Restoration Hardware (RH) offer valuable insights. Their stock chart visually encapsulates the current market anxieties. It has fallen from over $400, where it was a beat and raise story, to $140 where their business model is being questioned in 90 days.

Restoration Hardware embodies several key concerns for market observers: significant exposure to high-end consumers whose spending habits are closely tied to market fluctuations, and a substantial portion of its products are sourced from Asia.

The CEO's reaction during their conference call, coinciding with the announcement of Trump's tariffs—a candid "Oh really, oh sh*t"—clearly indicated that the scale of the tariffs exceeded their expectations.

In response, the company announced plans to increase manufacturing within the US. They also reported weaker-than-anticipated demand, attributed to the housing market slowdown. Consequently, they lowered their future earnings guidance (which we suspect also reflects the impact of the wealth effect dampening their sales).

Adding to these concerns, we believe that the US consumer, who has been a crucial driver of global demand, may be exhibiting signs of slowing spending. For the past few years, consumer spending has outpaced income. While affluent individuals remain relatively resilient, the broader population has less discretionary income than historically normal, as evidenced by the rising delinquency rates on consumer loans.



Source: Bloomberg

90+ Day Delinquencies

Credit Card | Autos | Mortgage

Source: Bloomberg, FRED

This trend warrants close attention. In addition, this data does not reflect the worsening of FICO scores for non-paid student loans; the inclusion of some consumers' total unpaid balances will decrease their access to additional credit, which likely spikes trends in the data above.

Absent a significant and swift reduction in policy uncertainty, which would necessitate global concessions to the announced tariffs and the rapid formation of a "Mar-a-Lago Accord," we anticipate an economic slowdown for the following reasons:

- Consumer spending, which has been running unsustainably hot, will decelerate. Wealthy consumers spent 2.5% more than wage growth last year, simply they spend out of stock market winnings, this can reverse. Early indications from travel bookings and airline conference calls support a slowdown in consumer spending on vacations.
- Inventory growth accelerated in the first quarter to preempt tariff implementation.
- Elevated uncertainty will stifle corporate decision-making, leading to slower employment growth and reduced capital expenditure.
- The substantial fiscal stimulus of 2024 will become contractionary in 2025.

We are not alone in this assessment. We believe that the recession odds currently being discounted are likely still too low without substantial concessions within the next 60 days. Lutnick's recent comments, if genuine, offer little reassurance of a swift resolution, stating, "No Chance Trump will back off Tariffs," and "Negotiating is Talking, no Talking, just Doing."

Recession Odds - Polymarket

Source: Polymarket, Bloomberg

Our interpretation is that these underlying issues will not be resolved quickly and that the market's current reaction of anticipating an imminent truce is premature.

Positioning:

Here is our current investment strategy considering the evolving global landscape:

1. **Maintain a Diversified Approach:** We continue to advocate for broad diversification across asset classes and geographies as the most prudent strategy for generating optimal risk-adjusted returns. Now, we believe that holding assets with low correlation to the US dollar serves as an effective hedge for most investors. Due to a combination of inertia and tax considerations, many individuals have become overly concentrated in US markets, embracing the narrative of US exceptionalism and dollar strength.

2. **Favor Short Duration in Fixed Income:** We maintain our conviction that a strategy of staying short in fixed income to position for longer-term opportunities remains appropriate. While the timing of a potential market repricing of global spending and its impact on debt markets is uncertain, the current flatness of the yield curve does not adequately compensate investors for extending duration risk. The chart below highlights that over the last one hundred years, investors have been compensated well for extending their duration, but that is not the case today. For the bearish in the crowd, the last time we had such an extended run of yield suppression was in the 1920s. The thought is that flattening the risk curve, while beneficial to capital markets in the short run, does pull forward investment that is eventually noticed when the curve steepens.

10-Year/3-Month US Tresury Yield Curve

%

4.5
3.5
2.5
1.5
0.5
-0.5
-1.5
-2.5
-3.5

1917 1924 1931 1938 1945 1952 1959 1966 1973 1980 1987 1994 2001 2008 2015 2022

793 Days

Date: 1917 Through 21st February 2025.
Source: Bloomberg Finance L.P., Bravos Research.

3. **Exercise Selectivity in Private Equity:** The proliferation of private equity offerings to a broader investor base has resulted in a significant increase in inbound inquiries across private credit, private equity, and venture capital from both established firms and emerging start-ups. Our rigorous manager selection process, detailed here, explains our decision-making framework, which we have refined over several decades. We believe selectivity is paramount in the current private equity landscape, perhaps more so than in previous cycles. As illustrated below, the average private equity and venture capital manager has had exceptional returns over the prior 15 years, but the returns recently have been anemic. We attribute much of this underperformance to significantly higher starting valuations, which dampen long-term return potential. Over the past five years, both buyouts and venture capital have slightly lagged the S&P 500, and we anticipate even more muted returns in the coming decade, as discussed in our earlier analysis here.

4. **Cautious on the Nasdaq broadly:**
While our long-term conviction in the growth of Artificial Intelligence remains, the initial surge of substantial capital expenditure in this sector appears to have been speculative. We anticipate that the returns on this immense investment will ultimately not justify its scale. We believe that the long-term bottleneck of power infrastructure is a fundamental constraint unlikely to be overcome by excessive financial commitments. Consequently, we continue to favor our existing positions in long natural gas, Master Limited Partnerships (MLPs), and Utilities.

For what it is worth, Musk appears to concur.

Elon Musk @elonmusk · 8h

As I said a few years ago, the AI scaling constraint will move from chips to voltage transformers to electricity generation.

That is worrying for US leadership in AI long-term.

5. Buy the dip then?

A common question among investors is, “When is the right time to buy?” If one were to take a shot for every instance a CNBC or Bloomberg reporter asks, “Should we buy the dip?” inebriation would likely occur within the first two hours of the trading day. Our perspective is this: if we have indeed entered a new economic regime, effectively marking the end of the globalization era as we knew it, then the established rules of investing have changed. We must now focus on understanding the emerging trends rather than reflexively buying every market downturn.

Simply put, US assets are expensive, earnings per share are likely to be revised downward rather than upwards due to the impending economic slowdown, and contrarian positioning has not even reached its post-COVID highs despite the recent market sell-off. The Put/Call positioning, while elevated as of 4/7/24, had not reached extremes seen in the last 5 years.

Put/Call Ratio (Last 5 Years)

4/3/2025 Peak

3
2.5
2
1.5
1
0.5
0

4/8/2020 4/8/2021 4/8/2022 4/8/2023 4/8/2024

Source: Polymarket, Bloomberg

Summary

Despite the recent market retracement, the US market still boasts a gain exceeding 100% over the past five years, receding from a high of 135%. In our analysis, this movement reflects not a bear market's fundamental shift, but rather a necessary recalibration from unsustainable peaks. The intricate and uncertain interplay of trade and tariffs—a veritable geopolitical chess match—leads us to suspect an eventual middle ground, a compromise allowing both the United States and China to claim a form of success. We believe this unfolding scenario signifies a regime change, urging investors to vigilantly seek emerging trends rather than assuming a continuation of the patterns established over the preceding fifteen years. As we compose this letter, we are acutely aware of the vast unknowns and our incomplete understanding of the rebalancing now underway, rendering us more circumspect than usual regarding the definitive accuracy of our projections.