

Maclura Investments

1Q25 Review - Trump Tariff Tantrum Threatens



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Major US equity benchmarks had a roller-coaster ride during the first quarter as uncertainty weighed significantly on investor's minds. While corporate earnings and AI infrastructure spending announcements propelled the market to all-time highs early in the quarter, by mid-February, investors' concerns of the Trump's administration's policy-driven uncertainty started to weigh on the market. The S&P 500 was off just under 10% from its February peak, while the tech-heavy NASDAQ benchmark was off nearly 16% from its intra-quarter high. After providing an outsized performance to benchmarks for the past two years, the Magnificent 7 stocks were down on average 25% from their highs and accounted for nearly 96% of the S&P 500's decline for the quarter.

Exhibit I. Investment-Style Returns

Morningstar Index Market Returns		2017	2018	2019	2020	2021	2022	2023	2024	2025 1st Qtr.
Growth	U.S. Growth	29.52%	0.78%	35.90%	44.65%	24.79%	-36.70%	38.48%	23.42%	-9.24%
	Large Growth	31.15%	2.94%	33.81%	38.86%	21.47%	-40.36%	47.26%	27.75%	-7.53%
	Mid Growth	25.67%	-3.16%	36.01%	46.17%	14.97%	-32.37%	25.38%	20.33%	-6.27%
	Small Growth	23.77%	-5.67%	27.60%	43.52%	-1.00%	-33.13%	26.65%	12.89%	-8.43%
	US Market	21.47%	-5.05%	31.22%	20.99%	25.78%	-19.43%	26.44%	24.09%	-4.63%
Value	U.S. Value	14.23%	-7.51%	25.09%	-1.31%	23.98%	-0.72%	11.98%	13.77%	4.44%
	Large Value	15.09%	-5.90%	25.70%	-0.62%	21.49%	0.26%	11.82%	14.69%	5.95%
	Mid Value	13.02%	-10.63%	24.81%	-3.76%	29.02%	-2.39%	10.94%	12.28%	2.15%
	Small Value	8.40%	-16.61%	19.96%	1.01%	31.79%	-6.60%	14.58%	9.67%	-3.74%

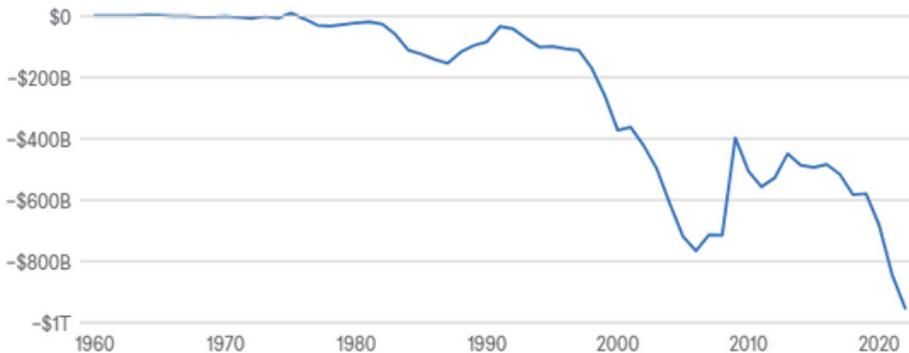
Source: Morningstar

Before discussing the tariff issue, it may be helpful to understand the circumstances that led the United States to its current situation. Since the end of World War II, the U.S. dollar has been the world's primary reserve currency, making it the most widely used currency for international trade. Countries require US dollars to fund their imports and settle international trades. This global demand for the dollar allows the United States to borrow money at a lower cost and use its currency as a diplomatic tool, as seen in the recent sanctions on Russia and Iran. Although there have been periods where the dollar's dominance appeared to be challenged—such as with the Japanese Yen, the formation of the Euro, and more recently, the establishment of the BRIC nations—it is unlikely that the dollar will lose its current reserve status soon. This is primarily because the US treasury bond market remains the world's largest and most liquid bond market. Foreign central banks predominantly hold their dollar reserve currencies in the form of U.S. treasuries, which they can easily buy and sell. This demand for U.S. treasuries increases the demand for the U.S. dollar, making it more expensive relative to other currencies. Consequently, it requires more foreign currency to purchase a dollar. This imbalance makes goods exported from the U.S. more expensive for consumers in other nations, while goods imported into the U.S. become less expensive due to the weaker currencies of other countries. This situation negatively affects domestic industries that export goods and leads to job losses. The chart on the next page illustrates the significant U.S. trade imbalance.

Exhibit 2. Historical U.S. Trade Balance

The U.S. Trade Balance Has Become a Major Deficit

Exports minus imports, balance of payments basis



Note: Includes trade in goods and services.

Source: U.S. Census Bureau.

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President Trump consistently stated over the years that American businesses were treated unfairly globally. During his first term, the Republican-led Congress passed the Tax Cuts and Jobs Act (TCJA) of 2017. A key provision of this bill was the permanent reduction of the corporate tax rate from 35% to 21%. Before this reduction, the U.S. had the highest corporate tax rate worldwide. Consequently, companies were relocating their headquarters overseas to more "tax-friendly" environments to enhance their competitiveness. During his first term, President Trump also spearheaded the replacement of the NAFTA agreement with Mexico and Canada with the USMCA (United States-Mexico-Canada Agreement) and implemented targeted tariffs against China to encourage more mutually beneficial trade arrangements.

This background helps to better understand the motivation and potential consequences of the April 2nd announcement, referred to as Liberation Day. Leading up to the announcement, the market showed some improvement as rumors circulated that the tariffs would be implemented gradually from a small base. However, the stock market's reaction following President Trump's announcement of tariffs against 60 countries indicated that the news was much worse than anticipated.

Historically, tariffs have been used to shield a specific domestic industry from unfair competition from foreign competitors. Most countries impose a combination of port fees, tariffs, or value added taxes on imports. Trump's tariffs are intended to rebuild the manufacturing sector in America, which has been outsourced to less expensive regions over time. There are three potential outcomes of this tariff issue:

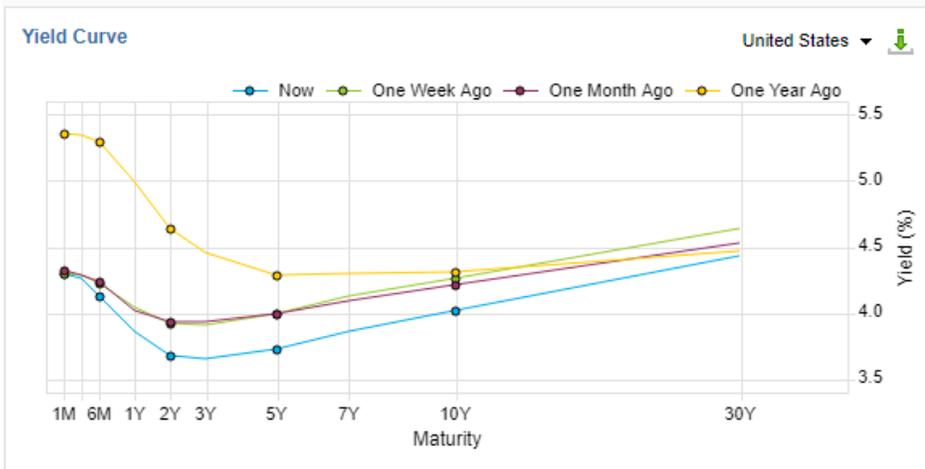
- 1.) The implemented tariffs may initiate a negotiation process leading to more favorable terms for the U.S. and potentially a more "free trade" arrangement. Although the tariff situation is still in its early stages, some countries have already contacted the Trump Administration to begin discussions on how to resolve issues. It should become clear in the short term (within months) whether countries are willing to negotiate.
- 2.) The implemented tariffs could trigger a trade war that negatively impacts the global economy and results in a stagflation environment, characterized by high inflation combined with minimal or negative GDP growth. China's immediate response of raising tariffs by the same amount as Trump's tariffs further

unsettled the global stock market, raising fears of another trade war similar to the Smoot-Hawley Tariff Act of 1930, which many economists believe exacerbated the Great Depression. To provide context for the China/US trade relationship, in 2024, China's exports to the US were three times greater than America's exports to China.

3.) A prolonged trade war could incentivize US-based companies, both established and new, to develop domestic manufacturing capacity. This would allow them to capitalize on the "Tariff umbrella" created by Trump's trade policy, giving them a competitive advantage over foreign competitors. This is a complex decision, but if significant deregulation occurs in operational and environmental areas and companies can utilize America's abundant resources for power generation, it could mitigate the risks associated with the unpredictability of Trump's policies and future administrations.

From a macroeconomic perspective, Trump's policies are complicating the Federal Reserve's decision-making process regarding future interest rate adjustments. Currently, the market anticipates that the Federal Reserve Open Market Committee will cut the Federal Funds interest rate by 125 basis points, bringing the target range to 3.0% to 3.25% by the end of the year. As indicated by the US Treasury Bond Yield Curve chart, the market expects a recession induced by the tariffs. The Fed will likely remain data-dependent, waiting for evidence of a slowing economy or inflation before making any changes. The only certainty is an environment of uncertainty surrounding Trump's future policies or revisions to existing ones.

Exhibit 3. U.S. Treasury Yield Curve



While the world is understandably focused on the unfolding tariff issue due to its potential impact on consumer and corporate spending habits, encouraging progress continues within the economy, particularly in AI advancements. During the quarter, significant investments in infrastructure for AI services were announced. Amazon, Microsoft, and Meta platforms have committed to investing \$250 billion in data center infrastructure. A joint venture between Oracle, OpenAI, and Softbank, known as the "Stargate Project," has pledged to spend \$500 billion over the coming years to build data center infrastructure in the United States. There are rumors that Microsoft is slowing its investment spending due to concerns about overbuilding data center capacity. Typically, a paradigm technological shift involves an investment phase that companies must undergo before realizing economic returns.

Avoiding overspending during the "investment phase" is crucial, and this might be related to the perceived inferiority of NVIDIA's GPU chips in "inferencing" (using large language models) compared to "teaching" them. Nvidia has significantly benefited from the early development of AI infrastructure by anticipating the AI trend years ago and securing the capacity to produce the chips. They are currently the largest reliable chip supplier and are achieving substantial margins due to their strong pricing power. Although public companies continue to emphasize their partnerships with Nvidia, competing chips with better inferencing capabilities are emerging. In the coming years, data centers filled with expensive Nvidia GPU chips may struggle to achieve adequate returns once lower-cost chips (in terms of price and power consumption) enter the market.

Nevertheless, this does not change the future investment opportunities in AI. Investors are in the process of transitioning to the "return phase," which involves the commercialization of AI products and services. Although it is still early, this phase is expected to last for decades, with some companies emerging as winners and many others likely failing. This is probable given the large amount of capital that has been invested in this sector by venture capital and private equity firms. Additionally, there is a risk that established public companies could be displaced by emerging AI companies. Regardless of the outcome, the industry typically overestimates the early adoption of new technologies but underestimates their later adoption. The AI revolution will likely be more significant than most currently anticipate.

There has been considerable media coverage regarding the perceived decline in American exceptionalism. It is unclear how this conclusion is reached, other than the authors of such articles lamenting that the United States is not acting in a manner that they expected or desired. If the Trump Administration can successfully rebuild America's industrial and manufacturing base, given the country's resources, American exceptionalism will likely continue to be evident globally for many years to come.

My 2025 outlook anticipated a more volatile year than the previous two and that unexpected "left field" events would likely surprise investors. The market's early reaction in April to the Liberation Day news and the realization that the tariffs were higher than expected confirms this concern. While market pullbacks are generally unwelcome, historically, they often present excellent investment opportunities for long-term investors after the market stabilizes.

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