FINANCIAL FOCUS

PETERSON FINANCIAL SERVICES

Limited Liability Company ◆ Registered Investment Advisory Firm

First Quarter 2025

April 1, 2025 – no foolin'

QUARTERLY MARKET RECAP

The first quarter of 2025 got off to a great start, building on the end of 2024's optimism about relaxed regulations and reduced taxes leading to strengthening economic growth and higher corporate earnings. But midway through, that gave way to fears that tariffs imposed on our trading partners, would increase costs on our own importers, forcing them to pass those on to us consumers, and lead to damaging retaliation. Stocks dived.

Last quarter all the major equity indexes took hits, and ended up with the DJIA shedding 1.28%. The S&P 500 retreated 4.59%, and while the NASDAQ was the star of 2024, it lost 10.42%. The small-cap Russell 2000 also got clobbered by 9.79%. Global stocks also lagged, partly owing to the strong US dollar, and ended 2.14% lower. Stocks are searching for a bottom now. The bond market finally stabilized last year and was investors' only bright spot. The Barklay's Aggregate Bond Index rose 2.91% last quarter. Futures markets peg the Fed making just two quarter-point cuts this year, likely now starting in July. Inflation is slightly reigniting and tariffs will make that worse. Corporate earnings and economic growth are softening, and the markets are reflecting that. As we've been saying for a couple quarters, we have many economic policy changes coming in 2025 and 2026 which will have significant and lasting impact.

FREE TRADE ALLOWS CONSUMERS TO BUY WHAT THEY WANT AT THE BEST POSSIBLE PRICES. IT'S POSITIVE.

One of the many misunderstandings about tariffs is who actually pays them. President Trump prefers to use tariff policy to gain outcomes on a variety of issues that are not exclusively economic – such as border control and geopolitical goals. He claims that America will become rich through them and that the offending countries will pay them. The idea is to make their products expensive.

But when these goods cross over our borders the US importers pay the tariff, and they have only two choices: absorb the cost (which their profit margins in the global competitive economy may not allow for), or pass part or all, on to buyers. Tariffs are not paid by the foreign exporter in the originating country. They are paid when entering our country by the American recipient as an import tax. At that point the additional cost is passed along the supply chain to the end user who pays more. Higher end costs are the definition of inflation. Higher tariffs increase inflation. And this doesn't even address retaliation by our trading partners – they slap tariffs on us.

Another consideration should be how our economy has historically evolved to provide ever-increasing additional prosperity to our citizens. Like all economies, we started out fundamentally agrarian. The Industrial Revolution advanced our standards of living. That came at the cost of farming jobs. But those were displaced by higher-paying factory jobs, and the advent of industrial farming equipment allowed for more farm production with fewer workers, freeing up those for these new factory jobs. We then shifted beyond manufacturing to even higher-paying service and information technology positions. When politicians lament the demise of our manufacturing jobs, are they calling for more lower-paying jobs? If trade is so bad, why do we have full employment and record prosperity? This is the economic concept of comparative advantage: you make and do the things you are best at, and leave the rest to others who can do those things cheaper.

Many products we consumers buy aren't even made in America – at any price. And you can't build factories overnight. When there are no other options for buying something, but it has a tax placed on it, you must pay the tax. As well, many of the products US manufacturers make are done so with raw materials and components sourced from other nations. When tariffs were

IF THE COLLECTIVE WISDOM OF MILLIONS OF PEOPLE MAKING DECISIONS ABOUT PUTTING THEIR OWN MONEY AT RISK IS ANY MEASURE, TARIFFS AND TRADES WARS ARE NOT PROFITABLE.

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placed on imported steel and aluminum in the first Trump Administration, ostensibly to protect American producer's jobs in those industries, it hurt the makers of American autos, appliances, and all products made with those metals. Those tariffs "created" 1,000 steel jobs and 1,300 aluminum jobs. But for each American employed in those metals industries, there are 36 Americans employed in other industries that use those metals. Many of those jobs were lost. Using Federal Reserve data, Kadee Russ of Harvard and Lydia Cox of UC Davis estimated that those metals tariffs destroyed about 75,000 manufacturing jobs. American auto plants rely on materials and components made in Canada and Mexico, as well as other countries. According to an analysis by the Anderson Economic Group, the proposed 25% tax on those two nations alone would increase the cost of a full-sized SUV made by American auto companies by $9,000 and $8,000 for a pickup truck. Workers are also consumers.

Another misunderstanding is that trade deficits are inherently bad. But why do some believe this? An example from the micro-economic level applies to the macro level. Most of us do not raise, slaughter, or otherwise grow all our food. We buy it at grocery stores. The owner of the grocery store, who we buy thousands of dollars of goods from each year, likely doesn't buy anything from us. Thus, we have a "trade deficit" with our grocer. Is that bad? No. What we work at which gives us our income is sold to others – who have a "trade deficit" with us. There is no inherent "loser" in this economic arrangement. This gets back to the previously mentioned concept of utilizing each of our comparative advantages. This last point brings us to our final point.

What is called the trade deficit could be just as accurately referred to as a capital account surplus. Accounting ledgers have both credit and debit sides. The current (trade) account has an opposing capital (foreign investment) account. If we have a trade deficit with another country, we have a capital surplus which means foreigners are buying that much more in American assets, such as real estate, stocks, and bonds. This demand for our assets has boosted those values, adding to our wealth, and provides American jobs. When an American buys a $70,000 Volvo, Volvo Cars, Inc. has only three options for using that money. It could buy $70,000 worth of American goods or services, wiping out the trade deficit. It can buy $70,000 worth of short-term interest-bearing assets such as Treasuries, which finance our government deficits and enhance the lending capabilities of American financial institutions, funding short-term borrowing needs of our domestic corporations. Or, because Volvo expects the US economy to grow, it can invest $70,000 in US capital, say American real estate (factories) or stocks – which is investing in American companies. This investment prevents too many dollars from floating around in foreign markets, depressing the dollar's value. And Trump has said he'd like these foreigners to invest in America. The trade "deficits" provide the dollars to do so!

All of this manipulation of the efficient markets is not capitalism; it's mercantilism and nations that have gone down this road have not prospered. Let us also recall that it was the Smoot-Hawley Tariff Act of 1930 that converted a manageable market decline and economic down-turn into the worst global economic depression on record. There is no lesson in the second kick of a mule.

"There is no such thing as a good tax."

- Sir Winston Churchill

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we specialize in portfolio management, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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