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President Trump's First Three Weeks

Executive Summary

- The range of possibilities in financial markets is always wide and unpredictable. In normal times, equity investors should expect a 10% decline every 1.5 years and a 20% decline every 5-6 years. With a new, maximalist US administration confronting a world of heightened geopolitical uncertainty, that range may be even wider than usual.
- During President Trump's last Presidency, S&P 500 stock futures plummeted 7% on the night of his election, 20% in 2018, 33% during the pandemic, but compounded at nearly 18%.
- Rather than reacting to the daily news that can whipsaw investors, we advise clients to ensure they have the cash on hand to meet all potential near-term liabilities. As always, it is imperative to review risk tolerances and asset allocations to ensure they are aligned with potential losses.

Despite offering very little guidance or assurance, we think Jerome Powell's take last week when asked about Trump tariffs had some valuable lessons. To paraphrase a bit, he stated,

> "We just don't know. As tempting as it is, we don't want to start speculating. We didn't know in 2018. The range of possibilities is very, very wide. We don't know what's going to be tariffed, we don't know for how long or how much, what countries, we don't know about retaliation, we don't know how it is going to transmit through the economy and to consumers. We're just going to have to wait and see and the best we can do is what we've done- study up on this, look at historical experience, read the literature[i]."

We just don't know and don't want to start speculating.

Before last Friday's January 31st's market close, White House press secretary Karoline Leavitt stated Trump would impose 25% tariffs on Canada and Mexico and 10% tariffs on China effective Saturday. Stocks and bonds, which were higher earlier in the session, both declined. Over the weekend, speculators drove Bitcoin down -8%, Ethereum down -35%, and Trump's meme coin down -16%. Stock and bond futures looked ugly heading into Monday but then reversed course after talks with Mexico and Canada resulted in a 30-day tariff delay. We don't know whether it was due to the market turmoil, retaliation threats, or promises to cooperate on illegal drugs and immigration. We do know that speculators who elected to sell over the weekend, missed the rebound in bonds, global stocks and cryptocurrencies.

The range of possibilities is very, very wide. We didn't know in 2018.

In financial markets, the range of possibilities is always very wide and unpredictable. With Trump's maximalist negotiation tactics meeting heightened geopolitical uncertainty, the range of possibilities is perhaps wider than ever. Neither a lasting peace nor a deeper conflict with China, Iran and Russia would surprise us. The confluence of macro and geopolitical factors could very well lead to a boom or a bust.

Howard Marks reiterated two crucial points in a recent podcast[ii]. First, "in the investment business, there's no place for certainty." Speculators who sold heavily this weekend, in 2008, 2016, 2018, or 2020, hopefully learned this lesson. Therefore, "each of us should figure out what our normal risk posture should be normally, should I be a low-risk or high-risk person?" Our client-specific asset allocations are built on that risk decision, and it is imperative that clients understand this. A high-risk investor, with an all-equity portfolio, should be prepared for 10% loss every 1.5 years, a 20% decline every 5-6 years, and much deeper 50% declines at least once in their lifetime. Warren Buffet has lost 50% twice in his life.

We do follow Marks' advice and "vary that position from time to time as conditions change", but we are also mindful that he has done this just five times in fifty years when conditions were crazy and even then, he moved gradually and early. As we've noted, we are gradually becoming more defensive considering high valuations and heightened ebullience, but we will rarely drift dramatically from our long-term targets. The range of possibilities is wide, perhaps wider than ever. As always and particularly now, **everyone should review and confirm their risk tolerance and long-term asset allocation plan.**

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As we found out this weekend, nobody seemed to know how long the 25% tariffs on Mexico and Canada would or will potentially last. Lawyers are already questioning the legality of imposing tariffs to reduce the flow of illegal drugs. Trump's promised 60% tariffs on China have so far been instated at just 10%. Although China thinks fentanyl is an "American problem[iii]", their retaliation to date has been restrained.

Executives, consumers, workers and investors who follow the news closely may have been whipsawed on numerous occasions over just the last two weeks alone. On Tuesday, the Postal Service suspended parcels from China. On Wednesday, they resumed accepting them. Executives who scrambled to stave off and minimize the impacts of tariffs over the weekend, worked for naught to date. Consumers who rushed out to buy whiskey, avocados and cars before potential tariff related price hikes ensued may have pulled forward some demand. Government workers who emailed "resign" to DOGE accepting eight months' severance to "watch movies and chill" may not be in the spending mood after all. Legal experts question the President's legal right to spend money Congress has not appropriated. To date, Trump's administration has made at least eight actions that may be contested in court. All the parties above, especially investors, would be wise not to overreact to the daily, maximalist news flow.

The best we can do is study up on this, look at historical experiences, read the literature.

As a former macro hedge fund manager who bet on politics and markets for a living, Trump's Treasury Secretary Scott Bessent has certainly studied up on tariffs. While Trump is fond of William McKinley and his tariffs[iv], both Trump and Bessent are aware of history. While protectionism led Republicans to a clean sweep in the 1888 election, McKinley's 1890 tariff was disastrous. It immediately stoked inflation and Republicans lost nearly 100 House seats that fall and all branches of the government in 1892.

Republicans Smoot and Hawley recycled protectionism and tariffs in 1930 in response to the first stages of the Great Depression. Despite a petition signed by over 1,000 economists to veto the legislation and Henry Ford's cajoling calling it "economic stupidity", Herbert Hoover signed the bill. Other countries, including Canada, retaliated, global trade declined, and the Great Depression deepened. Smooth, Hawley and Hoover all lost their jobs. The 1932 Senate experienced its largest swing in history. Finally, Trump's own 2018 tariffs coincided with 2018 losses in both stocks and Republican congressional seats.

Many economists today agree that tariffs generally would increase prices, reduce global trade and growth and perhaps surprisingly decrease US manufacturing employment. Auto executives, like Henry Ford, urged Trump to avoid tariffs on cars complying with Trump's USMC agreement. Treasury Secretary

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Bessent purportedly argued for limited 2.5% tariffs. While no one person controls the market, we do think that Trump and team are very aware of the history, wary of inflation and view the market as their approval rating. Just yesterday, Bessent soothed stock and bond markets further by following his predecessor's strategy of issuing shorter duration debt to fund our deficits. This was the very strategy he criticized months ago, spooking markets. **Don't overreact to maximalist rhetoric, it may not be reality.**

DeepSeek, Markets and Earnings

Two Mondays ago, the market also experienced a bout of volatility following the significant adoption and downloads of DeepSeek. DeepSeek is a free AI-powered chatbot created by a small Chinese firm. Early rumors and headlines suggested the bot was built for just $5.6 million and without Nvidia chips. While Howard Marks noted in the podcast referenced above that he doesn't think we are in a crazy bubble, Nvidia fell 17%, the Nasdaq lost 3% and the market's AI enthusiasm briefly turned to despair.

While we also are not calling a bubble given their inherent unpredictability, we think it is important to note a few things both negative and positive. Paraphrasing one of our favorite all-weather managers, one sign of a bubble driven by excessive enthusiasm is the number of purportedly uncorrelated assets that lose value at the same time. For example, why did the prospect of tariffs lead to steep crypto losses? And when Nvidia lost 17%, why was Bitcoin off 4%? We think the answer lies in investor enthusiasm and how fickle that can be. We would be wary of holding a concentrated portfolio of "uncorrelated" assets driven by enthusiasm.

On a related but positive note and despite year-to-date weakness in some of the most heavily owned AI darlings, we see some signs of encouragement. First, after the initial fears DeepSeek may not be all it was cracked up to be. It likely cost much more the $5.6mm to train completely and likely relied heavily on other existing AI chatbots and notably ChatGPT during this training. While this still suggests that some of these large language models can be duplicated cheaply, it does not imply the same for more cutting-edge and data intensive inferential models. To wit, Microsoft, Meta and Google all released earnings and all doubled down on their commitment to AI, chips and data centers.

Finally, and perhaps most importantly, despite some weakness in the "Magnificent Seven", we are seeing a broadening out of the market. As of this writing, the equal weighted, midcap and small cap S&P indexes are all outpacing the highly concentrated S&P 500. With a third of the S&P 500 reporting Q4 results, earnings have come in strong at a 13% year-over-year increase and with 77% of firms beating expectations. While the US Information Technology sector remains in negative territory for the year, all the remaining sectors are positive for the year. Despite all the tariff angst, international stocks are also outpacing their US peers so far in 2025 and since Trump's inauguration. While past performance is never indicative of future returns, we are encouraged that these gains have been driven by solid earnings, cheap valuations and dour sentiment turning less gloomy. Closing on this theme, the Japanese have a term, Gaman, which means enduring the seemingly unbearable with patience and dignity. We think appropriately risked, diversified portfolios can withstand and benefit from expected volatility ahead.

February 6, 2025

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[i] https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20250129.pdf
[ii] https://podcasts.apple.com/us/podcast/odd-lots/id1056200096?i=1000685603876
[iii] https://www.bloomberg.com/features/2024-snapchat-teen-fentanyl-crisis-lawsuit/?sref=O12oKJVp
[iv] https://www.barrons.com/articles/mckinley-trump-tariffs-1d45020b