FRIDAY, MARCH 7, 2025



Hello and welcome to this week's Dividend Cafe. It is a beautiful day in New York City, but it has been a tumultuous week in markets that actually began last Friday and has continued with big up down movements each day since. Now as I'm sitting here recording, we have a few hours to go in the market day and we have been up a few hundred in the Dow and then down a few hundred and then some and then now have come back into positive territory, so I don't have any idea where it's going to end and I don't care to predict now, but from last Thursday, which was a huge market update to Friday, which was a big market down day, then Monday and Tuesday being down a lot, Wednesday being up a lot, Thursday down a lot, and then today having a lot of intraday volatility already. We know enough to know that six, seven days in a row of not just enhanced, but quite significantly enhanced volatility has been the order of the day.

Now, from a kind of starting point to starting point the Dow as I'm sitting here right now is 6 percent off of its high of a few weeks ago. Excuse me, 4%. The S&P is off about 6%.  The Nasdaq is down about 10%. So there's that sort of elevated progression of volatility across the three market indices.

And the thing we're going to talk about today in the Dividend Cafe is what's behind this, which is certainly volatile markets coming out of very volatile trade policy, very volatile trade talk and particularly as it pertains to tariffs that might happen or that will happen, that won't happen, that are talked about happening and then untalked about.

There's just a real elevated sense of uncertainty and I want to unpack what all that means. So we're going to jump into the Dividend Cafe, talk about tariffs and markets, and I have a very strong feeling it won't be the last time we get to talk about all this.

Let me start with just a summary lay of the land. It is hard to really unpack the roller coaster because there was a point, I believe about a week and a half ago where President Trump said, no, it's too late. These tariffs are coming beginning of March. And he said, no, we're going to wait till April. And then he said, no, we're going to go ahead and do it in March.

And then we got to that date on Tuesday of this week where he had said, there's nothing Canada Mexico can do. I'm unsatisfied with their help combating fentanyl trafficking. And then a day or so later, it did end up holding off, but not on everything. And there was a lot of complexity around what was going forward and what was not.

Right now, what has been said is that April 2nd is the date. That reciprocal tariffs, not just Canada, Mexico, but everywhere, are supposed to go into effect. That essentially, we would impose tariffs, proportionate to the level of tariffs being imposed on us. That policy has the benefit of sounding good.

to a lot of people. I don't think that's gonna be problematic politically. I think is going to be just utterly hilarious in terms of implementation for reasons I'm going to get into in a moment, 25 percent terrorists are supposed to go into effect on Mexico and Canada on April 2nd. Although President Trump said out of respect for Mexico's president, he wanted to wait And then they said they're going to do them on everything except for those things that were covered in the USMCA deal of 2019, which is so called NAFTA 2.0, but that is also confusing because there are about 3.1 million items that would then have to be adjudicated. There's 15,000 right now. There's a little bit of confusion as to what is to be included and not included. And the April 2nd date also says that they're going to treat the European VAT tax as if it's a tariff and apply a tariff reciprocally at the same level, but each European country has different VAT levels and oftentimes on different products and oftentimes with credits.

And exemptions that go against it. So even calculating where that number would be is going to be virtually impossible. I don't think the biggest change is the change of saying we're going to do these tariffs or not do these tariffs, or we're going to do them on certain things already carving out the automotive sector.

There are different rates on Canadian energy imports versus steel, aluminum. I don't think the chaos of it all is the big story. I think it is the narrative shifting from, I want to negotiate with Canada and Mexico to get more control of the border and less fentanyl coming in and things like that, to explicitly saying tariffs are going to make America rich or we're going to generate, there's going to be help for US workers as a byproduct of doing it.

What I really believe the best takeaway here of all the chaos around it the sort of different intentions and announcements at different times combined with the clearly uncertain path of where it's going to go and all the exceptions and exemptions already being talked about  is that we're in a discretionary tariff policy.

We're not headed to a place Where there's going to be clear black and white lines on anything, but more or less, not just discretion, but pretty much presidential discretion and where that is Correct that we are headed there. We essentially are describing something of enhanced uncertainty And I would view that as a negative for markets.

If in some cases people like a tariff going higher for this sector in this country and in other cases people like the fact that a certain sector or a certain country didn't get a tariff or got a lower tariff, it's outside my point. It's not so much what I think is going to be popular as it's not going to be clear, and it's not going to be something that facilitates economic calculation when there is this much uncertainty around it.

But a discretionary tariff policy is inherently uncertain. Now, I would add, there is something incoherent about saying we need these tariffs because they're going to grow revenues for the United States, they're going to help workers and they're going to benefit our economy, but oh, also, we're not going to do them for this sector.

That's going to, that's going to be too much. Like, why would you hold back on helping workers? Helping the U. S. economy. I don't think that the people driving the policies believe that either, because the mere implementation of exceptions is an acknowledgement of the burdensome nature of this. And once you are clear about the burdens of nature, there's an incentive to find a path towards not going there.

And that's what I want to talk about a little more. The not so secret reality here is that in Trump's first term, there was a economic group of advisors my dear friend Larry Kudlow chaired NEC. Okay, Larry had a job called Chairman of the National Economic Council. The gentleman who has that job now, Kevin Hassett, was in the first term the Chairman of Council Economic Advisors. Many people know that Steve Mnuchin was the Treasury Secretary in the first term. Scott Bessens, the Treasury Secretary now. Every name I just mentioned you could more or less refer to as being in this kind of more orthodoxy approach to classical economics traditional supply side conservatives.

And Kevin Hassett wrote a book in between the Trump 1.0 and Trump 2.0 terms called The Drift, where he stated that there was two camps that were often at war with each other, There was this aforementioned Hassett Laffer, Kudlow type camp, and there was a kind of more protectionist and isolationist and nationalistic camp, whether Pete Navarro, Steve Miller Bob Lighthizer, etc., and Hassett said in his book, one wanted to drive, the other, them, the supply siders, Hassett, Kudlow, wanted to keep them from driving us into a ditch. Those were his words.  And I don't think it's a secret to anyone. I guess I probably know more than the average bear, but I don't think what I'm about to say is part of my inside knowledge.

It's reasonably obvious, I think, that we're in a similar position now, that there are warring factions, but they are doing a very good job at not bringing their warring into the public square. So you do get some of the more traditional orthodox economic thinkers  paying, playing some, paying some lip service to some of it.

But then you also have Jameson Greer, the new United States trade representative, Pete Navarro, a special trade rep. Stephen Miller is a very empowered policy advisor, one of the most empowered people in the administration. And then another difference I want to point out to everyone is I would have argued in Trump 1.0 that Vice President Pence was very much aligned on this issue, trade and tariffs, with that aforementioned camp of Kudlow and Hassett the more traditional Reaganite approach.  Where in this Trump 2.0 term, I think now Vice President Vance. Is not I think he would be more aligned with the other camp who I would argue vance, I would argue is much more empowered as a vp than pence was in the first term.

So yeah, there is a there is a divide but more than just the fact that there's a divide I think that one side of the divide is has the appearance of winning right now. And that is not necessarily going to last. We're six weeks in a new administration. The internal conversations are probably going more one way than the other, but I also believe that this divide that exists within the administration is a divide that exists between the ears of President Trump.

He himself has sympathies with both camps. He himself is drawn Intuitively to certain elements of both competing ideologies.  I would not want to formulate an investment policy on trying to predict where President Trump is going to go with this. But I don't think it's going to be a matter of does Kevin Hassett beat Pete Navarro in an arm wrestling contest.

I think it's going to be President Trump's discretion in the end. And that is a very unpredictable element to this. Now, the bond market is the real message that investors need to be paying attention to. This data I'm going to go through quickly, but it's very important for you to understand. The 10 year bond yield was 4.4% after the election day, after the election. And the tenure bond yield, as I've talked about a million times, is this wonderful proxy on how people are forecasting nominal GDP growth to go measuring the total structural growth of the economy over a period of time. And it got up to 4.8% January 14th, just before the inauguration.

That was the highest it had been since 2007, pre-financial crisis.  other than in late 2023 when it hit 5 percent for just a minute. As of right now, it's at 4.25%. So the nominal GDP growth expectations, the 10 year bond yield have come way down. By the way, they were at 4.15 earlier this week.  Now, then we can look at something called tip spreads, which measures really implied inflation expectations.

And those were, again, right after the election 2.27%.  They got all the way up to 2.44, but now sit at 2.34.  So essentially, you had real GDP growth.  The 10 year bond yield minus inflation expectations at the point of the election was two one.  At the point of the inauguration it was 2.36, but it's now taking the 10 year bond yield, which is lower, but minus the tip spread.

The real GDP expectation has come down to 1.9%.  Okay, so a half a percentage point reduction from roughly two four to roughly one nine per year for 10 years of real, that is net of inflation, growth expectations. Now that could change, those expectations can go up and go down, but that's what has played out just since the inauguration.

And why do I believe that is so pertinent? Because the lower growth expectations is more important to me than the fact that inflation expectations haven't gone up a lot. Some of the tariff defenders are saying, Hey, look, you people say they're going to make prices go higher. Inflation expectations have only gone up a little bit.

But my point is real growth expectations have come down more than a little bit. It is the first of all, concern over whether or not we're on a path towards supply side tax change. Outside trade and tariffs is the supply side agenda of this. On track. Is it being prioritized? The way it needs to be.

And secondarily is are the tariff issues and impediments to trade themselves putting downward pressure on growth expectations, the bond market and the way you unpack the ingredients in the bond market. To get to real GDP growth assumptions is telling you that is not what people were expecting after the election before the inauguration.

With a president of such a strong energy agenda, strong deregulation agenda, supply side tax cuts, nobody would have been expecting real GDP growth expectations to come down as they have.  By default, I have to conclude much of this is assignable to the role of trade and tariff policy. That is the real issue.

Now what am I concerned about? Am I concerned we're headed to a global trade war? I'm not. I would not say it's impossible, but I believe that President Trump time and time again has shown that he is mostly obsessed with making deals, whether it's with Canada or India or Japan or China, Mexico, he likes deals and some of those deals might be substantive and some might be.

cosmetic, but he likes it. And I acknowledge that the administration is not just articulating an agenda of deals. They are also doing, excuse me, agenda of tariffs. They're also doing things that go beyond the deal making apparatus. However what I would say is that his ultimate end, until I'm proven otherwise, Is the either appearance of a reality of a deal and not a global trade war.

Now, I could be wrong on number one, but then I believe markets humble the reality there. And should there be a global trade war impact in markets, I think it would catalyze a significant reverse of intent. So the global trade war gets avoided because of what happens in markets. If we begin to have a global trade war now This does seem like i'm trying to have my cake and eat it too that I don't think something is likely to happen But they're going to do a lot to flirt with it happening and that's not good And then even if it does happen, it'll be okay because they'll blow the fire out.

And maybe I am trying to have it a little too good there, but I think it's the most likely scenario. And it is a prediction I've had before. However, I don't think what I'm saying is that some sort of perfect alignment. Because even in that scenario you, let's say we're headed to a currency deal with China.

Let's say we're headed to a border deal in Mexico. Let's say we get better tariff and trade deals with European trading partners in the end. Along the way, there will be a delay. There will be a suspension of economic activity. There will be some downward pressure, even marginally.  on the productive activity that is necessary for sustained economic growth.

Therefore, even the scenario I'm describing where a global trade war is averted is not free of damage to the economy.  So I don't think I'm predicting anything benign or Pollyannish and yet measuring it is obviously very difficult. I would assume that a lot of where we're going to be headed is going to be in the form of a currency arrangement.

I've talked about this before that current Treasury Secretary Scott Besson was a global macro trader by trade. He has a keen understanding of global financial markets, but particularly in the world of foreign exchange understands currency very well.  And the fact of the matter is when you see the peso down 8 percent since all this started, that is the exchange rate adjusting to try to offset the competitive disadvantage the tariff is creating with a competitive advantage of the currency.

Trump feels that a strong U.S. dollar has been a competitive disadvantage for U.S. manufacturers and U.S. exporters. And if he can get a deal that allows some form of won appreciation and dollar depreciation, similar to what Secretary Baker did with Japan in the U.S. yen relationship in the 1980s. I think they would take that all day long, and I think it would accomplish the policy objective the President wants, and present very different optics both in China and in the U.S. Now, that's not going to happen easily either. That doesn't happen without a cost. None of these things are free, but an agreed upon and modest and controlled depreciation of the U.S. dollar will have a lot less impact than what would happen from the reciprocity and feedback loop of tariffs. I don't know that markets are going to care if my theory ends up being right in the short term because economic damage gets done.

And right now, I think you saw, they announced all these tariffs that we're actually going through. There's nothing they can do at this point. And then by Wednesday and into Thursday, said, okay, we're going to delay it a little further. And we're going to give exemptions on auto sector, and we're going to change the rate on energy products in Canada.

The market dropped anyways on, on Thursday, and again, as on Friday, it had also come down quite significantly, although as I'm recording it to come back up a bit, but my point is that markets might just be done trying to figure out what's serious and what isn't and saying, wake us up when there's a little more clarity.

It also could be markets say, okay, look, the tariffs are going to play out the way they're going to play out. But in the meantime, we don't see supply side tax wave coming. We, the economy doesn't have a significant catalyst to growth. And, by the way, this uncertainty issue is a real problem. If it, if the threat of tariffs compresses economic activity, then we have to, keep that in mind as well.

Mr. Market isn't talked that way. Mr. Market doesn't even think that way, but I'm trying to just boil down to a sort of net summary of where markets might very well be responding. In conclusion I am very aware that there are analysts, including some I respect a great deal.  that believe this is a new order altogether.

The administration's hell bent on blowing up the sort of trade apparatus we've had for 30, 35 years, and this is going to be highly disruptive and put significant pressure on market multiples and a lot more focus on high capital intensity businesses and a lot less focus on high margin and low capital intensity businesses.

And I, I think it's very possible it goes that way, but I still believe that there is too much chaos and too much discretion to go to a universal reordering of U. S. trade relations. I just don't simply see it happening. Not at this time. I could very well be wrong. I have strong opinions on what should be happening.

But I'm talking here in the Dividend Cafe about what is happening. And I see a more interventionist industrial policy. And yet and I say that as a negative. But I don't believe that we know yet that they are actually willing to see a full blown trade war happen. And basically sacrifice these other components of their own agenda and their own GPA, if you will.

I think that if one is looking for some sort of defense in this environment. First of all, you don't need any defense against single digit market volatility. It's part of the game. It's part of the process. I talked about this last week, but I would say if you just need something to pray for one of the big offsets to downward pressure on the supply side of the economy that tariffs are present.

is if you were to get upside supply side activity primarily from the the opportunities in tax reform, extending the trump tax cuts early, adding other tax cuts. That makes sense. That have the right pay for us that have the right rationale getting it passed through congress with proficiency With speed that becomes a very big deal So a lot more is riding on this because of the tariff issue that it makes the burden of passage all the bigger So that's where we stand.

I will continue covering it as I have to each and every day I look forward to being with you again in the dividend cafe on monday, but our big takeaway is that we have a lot of uncertainty compounded by the fact that the president's own end run here is very likely uncertain, surrounded by two different factions of advisors and a lot of complexity in the very policy matters themselves.

And along the way, there are plenty of other market circumstances. to look to that are screaming themselves for certainty. That's where we are. And we will navigate through this every step of the way. Thank you for listening. Thank you for watching.  Thank you for reading the Dividend Cafe.