FRIDAY, APRIL 25, 2025



Hello and welcome to this week's Dividend Cafe. I'm recording from a hotel in Tucson, Arizona Friday morning, and I have been this week in New York and then Dallas and then Oklahoma City, and now Tucson and I will end up tonight in my own actual bed at my house in Newport Beach. So it's been one of those weeks, awful lot of meetings, a lot of speeches, a lot of reading, a lot of activity and obviously a lot of travel, but there's also a very full Dividend Cafe today. And I really enjoyed writing it in a weird way. I could have written a whole Dividend Cafe about what the title is and the initial subject we're about to get into, which is the psychology of the president.

And it's revisiting that this week made possible about that subject of the Trump market put, is there still this desire from the president for markets to govern? A lot of his policy, does he still care about markets as a signifier of his administration and his presidency? And so I'm gonna start with that topic.

But then I also could have written a whole Dividend Cafe about the kind of middle section we're gonna get into, which are five themes, five considerations, five things we're focused on going forward right now as we get here into late April. We're in a different position than we were four months ago, and what we were looking at, thinking about projecting, wondering four months ago as 2025 began, has changed a little bit now and so I wanna update you as to what our five major focuses are.

It the current lay of the land. And then I want to close out with something that could definitely have been its own Dividend Cafe and it could definitely be its own book, which is dealing with the sort of end of the world fears. We had a significant, and what I believe will prove to be a somewhat historical market swoon, the measurement of the market swoon. If it was at a bottom that I do not know that it was, if we were at a bottom a few weeks ago, then the violence of that market move was not necessarily that significant in history as far as drawdowns go, but the factors behind it, the self-induced nature of it, the rapidity of it, those things are historical, but either way, they became yet another one of the.

Somewhat infrequent, but nevertheless, consistent opportunities that happen in markets to challenge our beliefs about the future and how we are dealing with our own portfolio, construction, financial planning, et cetera. And give me a chance to, I think this week. Set up a couple reminders about how to think around the end of the world.

And so there's a lot to chew on here. I'm gonna get right into it. The easier part I think in this psychology of the president is to reiterate, I. That the theory of the case has been that President Trump has strong opinions about certain things like tariffs and international trade and the US' relationship with trading partners, and a lot of his opinions there.

I disagree with, I. Most of the American people agree with a lot of the sentiment behind it of wanting American interests to be given greater consideration than they feel that they have been in the past. The emotions or intentions are not really the issue, but just what to do about a lot of that I think is very, is reasonable debate.

But all of that is still coincided with, certainly through the first term, and what a lot of us believe coming into the second term, this idea that the president still believes markets matter, and not just the publicly traded stock market, but the overall state of financial markets and the us' role in, in the world.

And there has been questions this year as to whether or not the president no longer feels that way, that he is not. Measuring himself necessarily with financial markets. And I wrote a piece before the April 2nd trade war launch, questioning if the Trump market put was dead and suggesting that it was premature to call it dead because markets were down 8%.

And that's just. Too basic, too mid, as the kids would say, to call it point of Trump market panic. And that my theory of the case was there was a point at which he would, and yet that point would likely be a place that still put a lot of people in a precarious position. In terms of their own, confidence in financial markets and also could be past the point of no return and what it would do to the real economy.

I think I ended up being more right than I thought I would be. As things did shake out here through the month of April, I. It appears to me that the president was unmoved by 8% drawdowns in the S&P and was significantly moved by a 20% move that the president did end up carrying. He did end up retracing and retreating, and that there is damage that was done even through some of the retracement or walk backs that have taken place.

And that thus far. That prior piece is the Trump market put dead appears to me to have aged very well, and by age, I mean over the last four or five weeks or whatever since I wrote it. But my point being. That this week you really got two new illustrations of this principle playing out, and one was not related to trade, war and tariff, it was related to the president's threats a week ago around firing the pres the chair of the Federal Reserve, Jerome Powell, and a lot of things he has explicitly said about that.

I'm not referring to his right to disagree. With Jay Powell on certain matters of monetary policy, but referring to the belief that the president can directly intervene in matters of monetary policy and federal reserve Central Bank independence. And then on Tuesday he came out, the markets dropped a thousand points on Monday.

And the markets were up 2000 points on Tuesday, Wednesday, Thursday. And largely as the president came out and just said no, I'm not gonna fire j Powell. I never said that, and so forth. So regardless of what he did and didn't say, it's irrelevant. My point being, I think that he, we saw that market put in effect that also came with Secretary Besson.

Talking about a lot of willingness to move and adjust and get and do things to get a China deal done. The president expressing a lot of confidence that we were going to get a deal done. The tariffs were gonna end up being a lot lower. So there, there continues to be some sort of sensitivity to market pricing out of the president.

I am of the opinion, I wrote this in the very weekend after April 2nd in my kind of liberation day. Article, that was a long time ago. That was three whole weeks ago now. But in that aftermath of what became about a four or 5,000 point drawdown in markets, I suggested that it was largely a certain pathology.

He he cares about how markets reflect on him. There's a certain pride and whatnot involved in it. And that could go either way, a pride to double down on what many would believe to be a bad policy or a pride to say, I'm not gonna let this do this damage. And, there's a lot of speculation as to what the ultimate end run is here.

I, I believe that they're still figuring that out themselves. And I try my best to be in very heavy communication with folks within the administration to understand where things are. I think that a lot of what has been said is very honest. I don't think that they know day by day I believe a lot of these things are unfolding and they're, developing policy and goals for policy as they go.

I. My point is that none of that's happening with a new paradigm about the pathology of the president. I still believe he cares how markets reflect upon his record. And that is a put, that may very well still allow for plenty of downside. The put is not 2% below present levels, but my point is it allows investors or ought to allow us to think about.

The fact that there is a significant left tail issue of a full on global trade war that is likely not in the cards as a result of this sort of psychological consideration, that doesn't help us a lot at forecasting, timing, forecasting what will happen, when it will happen, what the impact will be. It just simply provides a basic backdrop that had been called into question.

That's where I think we are, and that's where I think we're continuing to see more anecdotal evidence. Alright. The five things that I want to suggest we need to focus on here, I'm gonna just quickly, for those of you taking notes as you listen, 'cause you're very studious and impressive. I really appreciate that.

Number one, valuations. Number two, ai, CapEx and usefulness Number three. Tariffs. Number four, the tax bill. Number five, monetary policy valuations, number one is different than just the mere obvious consideration of. Valuations very high at the beginning of the year, and now as we correct that lower risk assets, it's now specifically valuations in the context, not merely of the E, of price to earnings doing well, but the P to E, the ratio, the multiple, the valuation perhaps dropping.

Now it's a question of whether or not the earnings themselves have been impeded and what that would mean to the valuation. If earnings drop 8% and the PE stays level, then you're down 8%. If earnings drop 8% and the PE drops 10%, you're down a lot more than eight. And would the PE only drop 10% if earnings were down eight.

The PE is based on growing earnings, not declining earnings. The PE is already elevated, so the valuation concern now is higher. Than it was at the beginning of the year. Even though valuations are a little bit lower now than they were at beginning of the year, why is valuation risk higher because of the E in the PDE?

Now, maybe that will not materialize. All I'm saying is that the risks are greater now than they were. That earnings growth there is vulnerable and in fact, some potential for earnings slowdown, especially at the higher risk CapEx sensitive, big tech parts of the market are on the table. That's number one issue I think we wanna look to for markets.

Number two, AI CapEx. I've devoted a couple entire dividend cafes to the subject already. Seven companies ANA amount to 27% of all capital expenditures in the S&P 500. And you can guess who those seven companies are. The Mag seven their free cash flow had grown last year by 50% year over year, and now looks like it made decline 3% this year.

Will that heavy CapEx is a lot of hyperscalers are buying for future investment and artificial intelligence. Will that break down this circularity of companies going up 'cause they're spending on AI and other companies going up because they're being spent on for ai. If there is a breakdown in that around the vulnerability of a narrative as to what ROI and AI will be.

That adds a different dimension of question vulnerability. My thesis continues to be that there will be new questions that come in 2025, not that we're gonna end with a negative answer on ai, I believe. That AI will be similar to the internet in producing certain efficiencies and opportunities for investors, but that what those opportunities and efficiencies prove to be will be different than many believed.

The difference is it's a monumental amount of CapEx being spent going into this. Without clarity on the answer to that question. This is not likely to get fully answered in 2025, but it continues to be a very relevant discussion as we go forward. Number three, tariffs. I don't want to waste a lot of your time again talking about it, but it's not a waste when it's the biggest story in the world.

I think China's largely in charge right now. The president said that the, this week that you know much of this right now depends on China. I think that the administration's posture has changed. They're not saying things right now. Oh, trade wars are easy to win. China's gonna be begging us for a deal.

China's the big question, and he has expressed certain optimism. They're saying that they're talking, China's saying they're not talking. I'll spare you all those details. But I do not bring up tariffs right now as point number three to say, oh, the big issue here is what will our deal with China be?

What deals will we end up announcing with Japan and Korea and India? I think the bigger consideration is what's going on because of tariffs that we don't yet see in the data. With cargo, with shipping, with freight, with trucking, with capital, expenditures, with durable goods, orders with manufacturing output, with hiring.

We know that 30% of shipments to the United States from China have been fully canceled in the last two weeks. Will us shelves in stores start to reflect this? Steel prices are up 25% since the terra four began, but the actual output, what they're, let's say oil steels used in energy infrastructure, those input prices are higher, but the output prices of what we're selling from production is not higher.

D does that end up leading to various economic struggles, problems, concerns? I think it does. I think it's totally irrelevant when people right now are talking about data we're getting from February and March. Anything before April 2nd was is BC compared to the ad of what we're dealing with now.

The underlying tensions for markets and all of this remain, we do not know how all the tariff stuff will end. There is economic damage that's being done along the way, even when it does end. The assumptions that underlie the fundamental policy are flawed. Things like trade deficits themselves being a bad thing.

And then last but not least, understanding all the three things I just said. The Trump market put appears to not be dead somehow when us synthesize all of these things together. Number four, the tax bill. Understand that, we're basically trying to understand for markets, not if they're gonna extend Trump tax cuts, that's bare minimum has to happen.

Not if they're gonna make 'em permanent. Even that doesn't add to what the assumptions in markets were given the election results and even some of the more politically necessary additional tax cuts around no tax on tips and over time and salt deduction caps. They're not zero impact like the aforementioned extension of cuts, but they're limited impact.

Will the tax bill involve upside surprise around supply side growth, tax cuts, business rates, the effective rates, even not just the marginal rates, but the effective rates for businesses because of bonus depreciation, because of enhanced expensing, because of, you perhaps more of incentive for capital investment et cetera.

These are things that could potentially matter and it's getting very little discussion and it's something we're watching very closely. Number five, monetary policy. And I do not mean here what interest rates will be or not be. I'm just gonna take for granted. We are looking at anywhere from three to five rate cuts, so we'll call it four, anywhere from 75 to 125 basis points.

So we'll call it a hundred by end of the year, and I don't think markets much care what's in June and what's in September, and whether it's 75 or a hundred, 125, I think all those things are basically close to being about the same. The one thing that would disrupt that is if it didn't happen, that would then create downside risk to markets, but something in the range of one.

Percent lower Fed funds rate by end of the year is about right. So why do I bring this up at all? Two possibilities. One, a surprise risk and one a surprise. Upside surprise. What if monetary policies even looser than anticipated? Because economic conditions are worse than expected. I believe that would be a negative to markets.

What if monetary policy is exactly as loose as anticipated, but economic conditions end up being better than expected. That is really the dream scenario for markets. When you're getting accommodative monetary policy in a constructive economic backdrop, that is a boost to risk assets, both of those possibilities, one that makes things better than status quo, one that makes things worse than status quo are on the table, but as is status quo.

The economy does weaken a bit and that there's a hundred basis points. Both of those things are priced in, and then there's the left tail and right tail side of it. This is why I say the monetary policy interaction with the way the economy unfolds for the rest of the year remains an unknown and something worth watching.

Okay, I wanna close out this week with four quick principles heavily borrowed from or learned over the years from Howard. Marks one of the great investors of our era regarding those things about the end of the world. I believe it's largely a sociological phenomena. I. I think that there are people who are permanently attached to this concern.

And I don't mean the grifters and the professional doomsdayers that make their living trying to scare people that don't manage a dollar of real money and are basically some of the biggest PIRs God ever let walk through the door. I'm referring to basic, normal human beings. That understandably have a fear component because fear is a natural human response to certain things like the financial crisis and the covid moment and even the events of a few weeks ago when markets felt in total free fall and no bottom appeared to be in place.

And the question becomes, what if this is the end of the world? And I just wanna remind people that think about this, or for next time it does come up. That you cannot predict the end of the world. That's number one, and that, number two, you wouldn't know what to do even if you knew the end of the world was ending.

It isn't there would be a playbook for exactly what that is supposed to look like, and this is probably the most important. Number three, anything you could do to prepare for the end of the world would be disastrous to you if the end of the world didn't end up happening. And that, of course, is the most likely scenario because number four, you may have noticed, the end of the world usually doesn't happen.

So this idea of trying to prepare for it as a matter of making yourself feel better, I. Doesn't work. It's a self-refuting possibility for the reasons I've tried to outline in 25 years of professionally investing money and covering in my own studies many decades before that PERMA Bear investing annihilates those that are afraid of being annihilated.

There's always this thing of this time it's different, or next time it's gonna be different, and all of it. I can't say anything about that. I can only refer you back to these four points. Try to remember those where you can. All right, we've bit off a lot here this week. I need to run. I'm going to give a speech here in Tucson.

In the meantime, I do wanna thank all of you for listening and watching and reading the Dividend Cafe. We welcome your questions and feedback. Look forward to being with you again. In the Monday Divin Cafe as I'll be there at the home base of our Newport Beach office. Thanks so much. Have a wonderful weekend.