April 2025

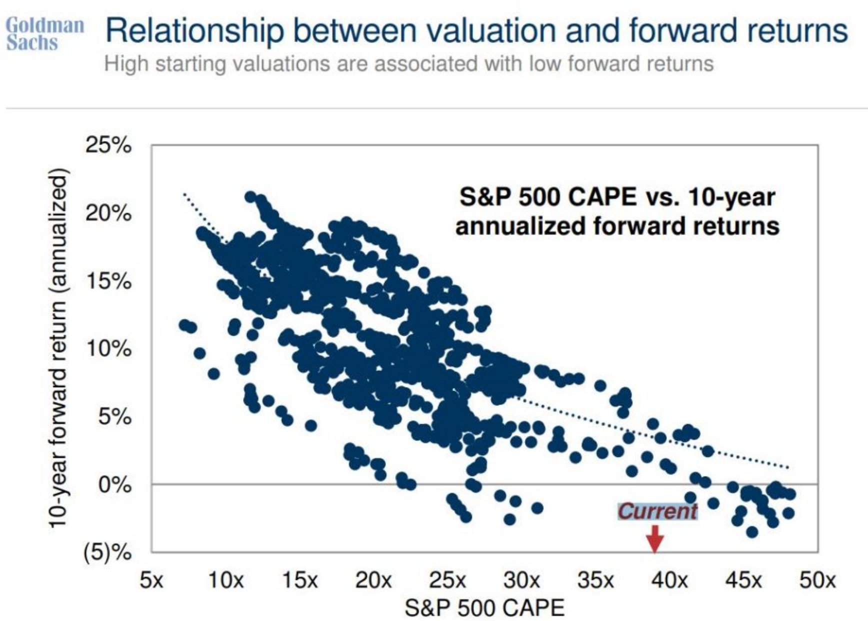
Dear Clients and Friends,

While stocks tend to rise over the long term, there are significant periods, some over a decade long, where stocks have posted little to no gain. These time periods of prolonged flat-to-down results are part of normal macroeconomic cycles and are referred to as secular bearish periods. Here are some of those weak market periods:

- August 1929 – August 1954 (~25 years)
- September 1965 – October 1975 (~11 years)
- March 2000 – December 2012 (~12+ years)

Stocks did move around quite a bit during these timeframes, but they were unable to sustain gains. As we write this, stocks appear to be in another of these periods. The recent sharp declines in stocks have brought indexes down to levels seen at the end of 2021; hence, a 3+ year period of almost no return.

From the graph below you can see that markets have been set up for a possible negative return period.



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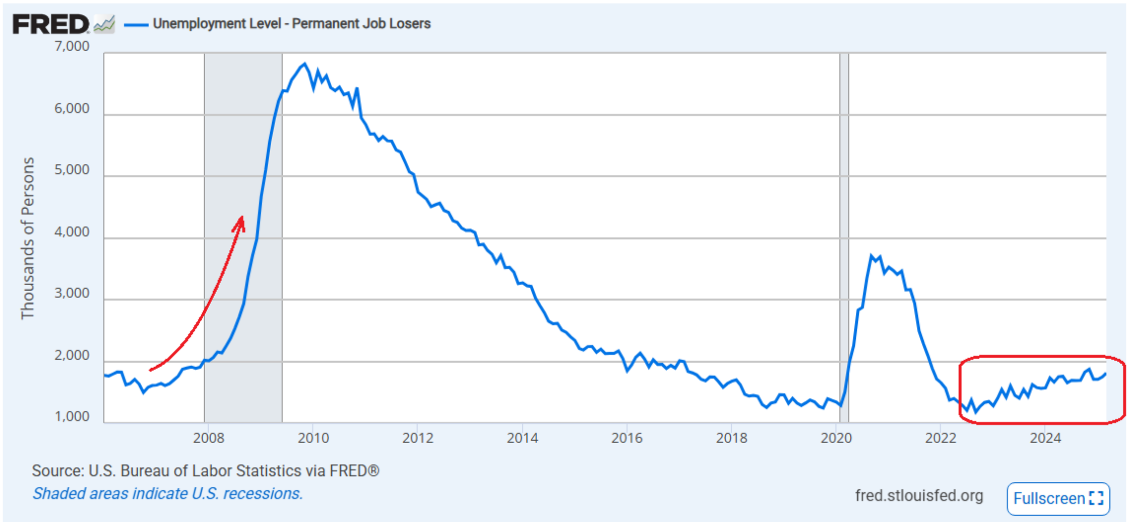
This above-average risk of negative stock market returns makes it paramount that we focus, first, on protecting, and second, growing the money that you entrust with us. This expectation has led us to lean more toward a couple of newer approaches: 1) income-producing strategies of which our structured note program is a part. The notes provide clearly defined risk-return outlines with returns higher than straight bonds. Though their values will be marked up and down with the market and appear like stocks, the underlying notes virtually always hit their contracted return level 2-3 years out. We have also shifted toward more short-term tactical trading in some accounts to minimize volatility while achieving modest returns regardless of market performance. Both approaches are ways to achieve solid returns with minimal risk over time. If we indeed continue to see a rollercoaster stock market with little ultimate gain over time, these strategies will outperform with minimal risk of loss.

Feeding into the concerns about a longer-term period of flat results are near-term worries about the economy. It was only last October that “The Economist” magazine profiled the US economy as the envy of the world. However, now about half the economists predict a recession for the US economy sometime in the next 12 months.

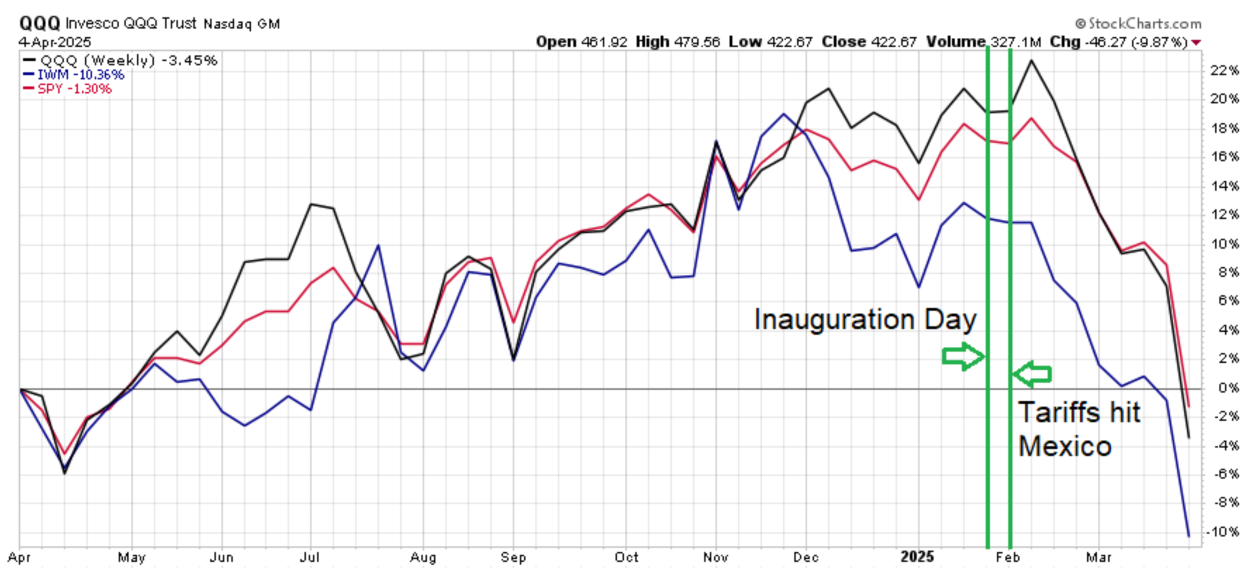
In last quarter’s letter we warned of the stock market being in a precarious position, trading at expensive valuations with a narrow leadership that might be tiring. To change course away from the high-priced AI-driven mania of 2023-2024 markets needed a trigger. Uncertainty surrounding the economic plans of the new Trump Administration combined with news from China of a solid AI competitor (DeepSeek) have provided that trigger.

In the near term, tariffs and trade disruptions are inflationary and will accelerate an economic slowdown which is already underway. Permanent job losses have already increased by over 50% since the employment peak in September 2022 reaching 1.8M (in the red boxed portion of the following graph) and once companies sense a slowdown, they are historically quick to cut headcount as shown in the 2008 timeframe (recession appears in gray).



While recessions are not always a death knell for equity markets, a weakening economy combined with the uncertainty noted above and a somewhat expensive stock market have already produced hefty drawdowns. The tech-heavy NASDAQ and the Russell 2000 small cap indexes have fallen into bear market territory with greater than 20% declines from their peaks.

From the following graph, the NASDAQ 100 (QQQ), the S&P500 (SPY) and the Russell 2000 (IWM) have all dipped into negative returns for the last 12 months and are now back to their levels at the end of 2021 – thus, a 3-year period of scant returns for stocks.



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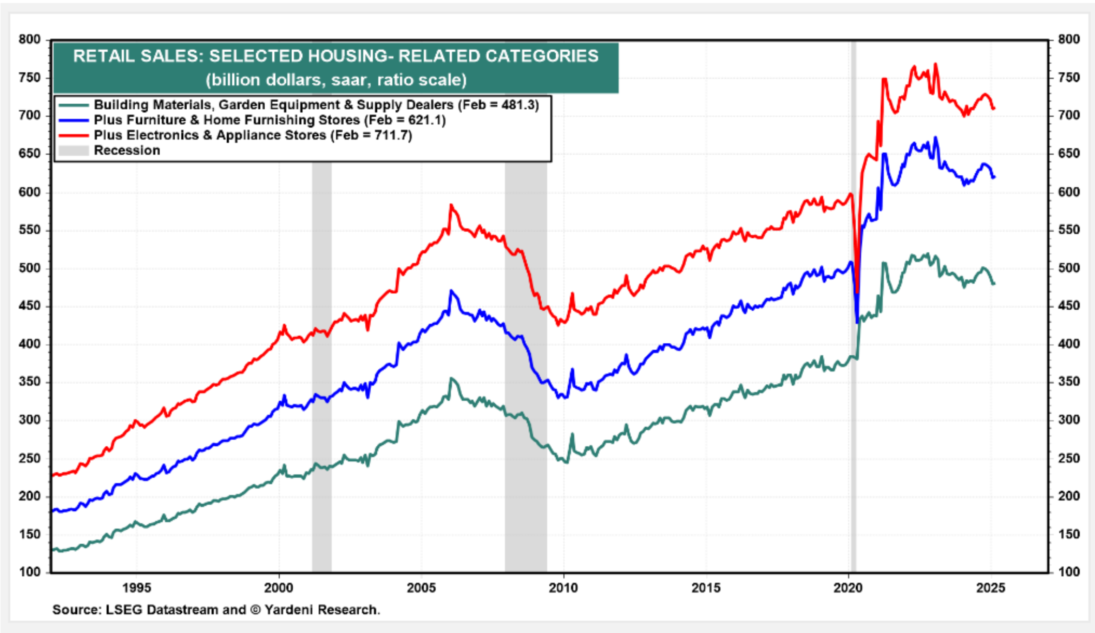
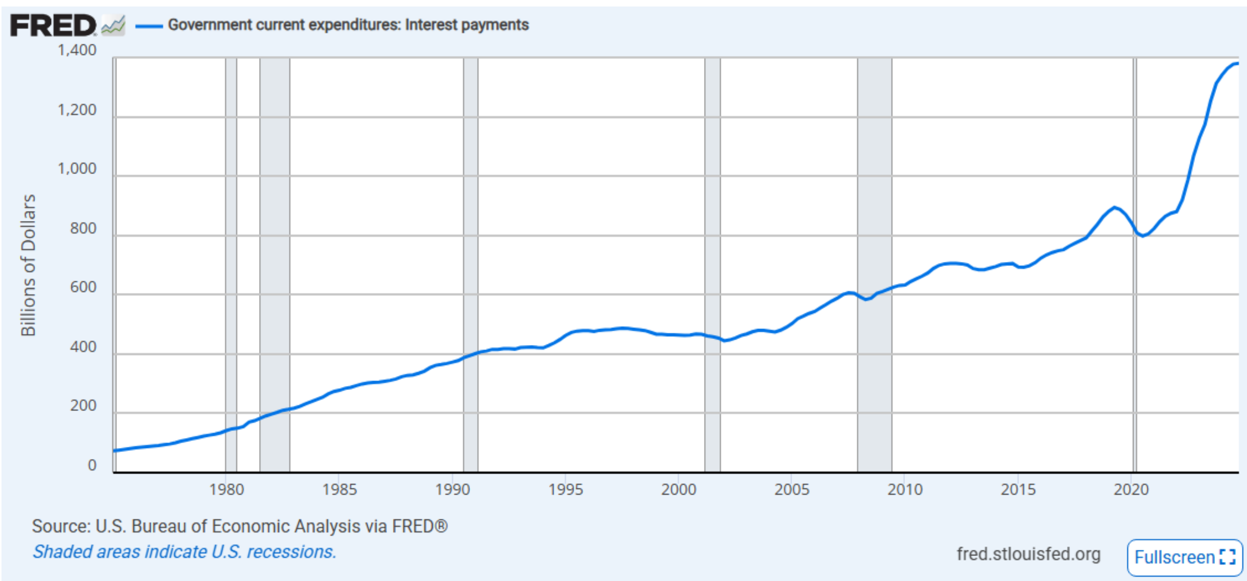
Consumer stocks have been among the hardest hit sectors. A toxic combination of higher interest rates, persistent inflation concerns, a weakening job market, and uncertainty about the future is having a dramatic negative effect here. Particularly hard hit have been consumer discretionary sectors such as sporting goods/leisure activities, electronics and appliances, furniture and home furnishings, and building supplies/home improvement. Data for some of these categories appears below. But all of these categories show a similar pattern of a bump during the Pandemic followed by a steady decline and a recent acceleration downward. What will arrest this downward move and get growth happening again? That's the question investors are increasingly asking.



This is another reason why we argue that, regardless of the outcome of the tariff issues, the broader outlook skews negative.

Finally, the ongoing issue of the U.S. government debt. Long a concern that never seems to be realized, the reckoning may be coming closer. Significant government spending intending to shore up finances during the Pandemic sent U.S. debt further upward. Bonds issued to pay for the massive stimulus are coming due (about $9T of the government's outstanding treasury bonds mature this year). Those bonds will be replaced at much higher interest rates. The 10-yr U.S. Treasury yield was 0.75% five years ago and is now around 4% -- a massive increase in interest payments to come. This chart shows the impact of rising interest rates on existing U.S. debt. This year's bond refinancing will further push the tally upward.



Plenty of concerns to be sure. We are committed to protecting your investments no matter what hand the economy is dealt, and to take advantage of the chaos in the markets to make money on your behalf as the opportunities arise.

To future profits,

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