

## Investors Need to Have Their Trump Cards Ready....

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Changes in the political landscape can play a varying role in our decision-making when it comes to investing in our client's assets. Donald Trump's return to the Presidency is, if nothing else, unprecedented. Grover Cleveland, who was the nation's 22<sup>nd</sup> and 24<sup>th</sup> president was the only other president in history to serve two non-consecutive terms (with Benjamin Harrison sandwiched in between). Trump's return to the Presidency while also controlling a narrow majority in the House and Senate has many of his detractors in a condition of panic and many of his supporters optimistic for sweeping changes. What lies ahead in this Trump Presidency is unknown and likely to have a meaningful impact on financial markets. If there's one certainty I can offer for our outlook, it's that Trump—by design or impulse—is anything but certain. It is our job to construct portfolios that have the durability and flexibility to weather an array of potential policy outcomes. While the topics below are not exhaustive, they represent what we believe to be the most critical for investors to weigh as it relates to financial markets. AI/Technology, Rates/Inflation, Tariffs, Federal debt/Dollar, and Immigration/Geopolitical conflict are likely to have among the most profound effects on the nation and, subsequently, the economy in the years ahead.

### **Artificial Intelligence/Technology**

Few in the world realized how much progress was being made in the world of artificial intelligence until the emergence of ChatGPT in November of 2022. Some of you may be aware that we have been an early investor with the folks at the Allen Institute for Artificial Intelligence (AI2) through Evergreen's private investment funds. In a recent phone call with one of their managing partners, Jacob Colker, he joked that ChatGPT was a godsend because, after 20 years of working on AI, his parents could finally grasp "what the hell he spends all day working on."

We believe the world is entering a new kind of global arms race. This is not one like the Cold War, where the score is kept by the number of nuclear weapons stockpiled, but instead, who will win the race to develop and apply AI? Frankly, it is our thesis that the stakes are so high that it could ultimately shift the global balance of power. The application for AI will touch every industry and, in many cases, has already begun to. Yet, we are still in the infancy of AI adoption. If we contemplate the evolution of a computer's capability from 30 years ago to today, the progress is nothing short of astounding. We believe that the effects of AI on the economy and society will be even greater than the invention of the computer, which is funny to say since it actually runs on computers!

At some point in the future cars will drive themselves. Medical tests will be more accurately analyzed by machines than humans, something that is already happening in various parts of the medical field. Soldiers will rely on AI to help analyze battlefield situations, among other military applications. AI has started to replace menial tasks but will, over time, likely be able to swim upstream in terms of complexity. It's hard to know where its limits exist, but what's evident is we are nowhere near them today. Economies powered by AI will vastly outpace economies without it, and, fortunately, the US has many advantages in this arms race. Our universities still serve as the preeminent institutions that brilliant foreign students want to come study at. Our venture

capital ecosystem remains unmatched at transforming new ideas into revolutionary companies. Just how closely the world is following the race for AI armament was evidenced when a Chinese company called DeepSeek appeared to have created technology on par with that of US tech behemoths at a fraction of the cost. However, doubts surround the accuracy of these reports. The event, however, was enough to send a sting into the stock prices of many AI companies. President Trump called the event a "wake-up call for our industries."

We believe the government must work hand-in-hand with big tech to ensure we don't lose this race. While there are admittedly huge questions relating to what role the government should place in the existence of AI, the one role it cannot play is obstructionist. Thus far, Trump and the tech world appear to be playing nicely with each other, a notable departure from their relationship in his prior term.

There will be longer-term questions economists will ponder. In particular, the impact of AI on the job market. Intuitively, one might think that the more prevalent AI becomes the greater the risk for job loss. However, if history is any guide, this has not occurred. In 1900, 41% of all jobs were related to agriculture; today, only 2% of the workforce works in agriculture. Modern machinery replaced a considerable portion of the labor force, yet new jobs emerged. In today's age of technology, unemployment in the US is running near historical lows.

Investment implication: we believe that investors need to strategically deploy money into this area, and we are not alone in this thinking. The term AI, is all the rage, and many companies have found that by mentioning the term AI they inflate their valuation. This means that investors need to be extremely discerning when evaluating the merits when investing in AI. As a firm, we believe that participating in this space through both public and private companies is optimal. In certain Evergreen investment strategies, we have exposure to stocks in this arena and some clients have even participated with ground-level private companies through investments such as the Allen Institute for Artificial Intelligence (AI2). The U.S. is in a strong position. This administration appears to be buying into the importance of this technology and the critical role it will play going forward. There are many companies that will masquerade as AI companies. There will be many who genuinely pursue the development of this technology but fail and there will be many others who emerge as amazing winners producing enormous returns for investors.

## **Interest Rates/Inflation**

The market continues to be heavily influenced by the actions of the Federal Reserve. After 40 years of watching interest rates fall lower and lower, we appear to be entering a new era. Following COVID-19, the combination of stimulus checks and clogged supply chains injected an unpleasant amount of inflation into the U.S. economy. The Federal Reserve finds itself trying to take away the punchbowl without ruining the party—a delicate act to pull off. Before Trump's victory, the market had been pricing in return to a lower-rate environment. However, as Trump's victory came into focus, the markets began sending a different signal. Rate expectations moved up sharply following the election. This was an unwelcome development for anyone who borrowed money and even worse for those who rely heavily on the use of debt, including the U.S. government. Recent comments from the Federal Reserve have shown a reluctance to relax interest rates, in large part due to uncertainty around the impact of tariffs.

If interest rates remain elevated for far longer than many were expecting, there will be economic

casualties. Many real estate investors have already found themselves on the painful side of this bet. Heavily indebted companies, who thought they could hold their breath long enough for lower rates to return, also appear to be running out of air.

The Federal Reserve has cited their reluctance to drop interest rates as driven primarily by the potential looming impact of tariffs on prices. However, there are many market observers who think that inflation in the economy is running much higher than what's been reported in the numbers. Whether the Federal Reserve is hiding behind tariffs as their reason for pause, it matters that, at the moment, any rate relief has been tabled. As the fallout continues to force bodies to float to the surface, skilled investors will be positioning their portfolios accordingly. To do this, one should avoid companies with large amounts of debt and favor companies with strong balance sheets. Evergreen's Dividend Appreciation strategy, which holds durable companies that emphasize returning cash to shareholders, could perform well the longer this situation persists.

Trump is a businessman at heart, and he's keenly aware of the negative effect higher rates have on real estate values and other aspects of the economy. He has made campaign promises to replace Federal Reserve Chief Jay Powell should rates not be lowered. This creates an interesting dynamic as the president nominates the Fed Chair, who is then confirmed by the Senate. At the same time, the Federal Reserve is supposed to operate with political impunity. The President has been highly critical of Powell, perhaps paving the way for his replacement by someone more aligned with Trump's desire for lower rates.

Meanwhile, Powell has responded by citing concerns over the uncertainty of tariffs as a reason for prolonging rate cuts. This financial soap opera is far from over and has a dramatic effect on the current economic backdrop. It is very possible this standoff persists and continues to rattle markets with each gyration.

Investment implication: Investors should both buttress their equity holdings with companies that can produce solid financial results despite a higher rate environment. Furthermore, investors should be on the lookout for opportunistic ways to capitalize on the carnage that lies ahead for those ill-prepared. As I mentioned, several of Evergreen's stock strategies are well-positioned and prepared to pounce on further dislocation. For clients with sufficient capital and risk tolerance, looking for private investments with the same characteristics. Evergreen's Private Credit fund has already been able to source a number of distressed deals, and we will likely be looking for more as they present themselves. Further, our investment in the Smith Tower also fits the mold of pouncing on distressed opportunities.

## **Tariffs**

The uncertainty around tariffs is creating, well, uncertainty. Trump has applied and rescinded tariffs on Columbia for refusing to accept deportees. Next, Trump set his sights on China, Mexico, and Canada, which, by no coincidence, are the top exporters to the U.S. In a dizzying frenzy, tariffs on these countries are seemingly changing by the minute. Tariffs on Canada and Mexico appeared to be set to go into effect, only to see Trump pivot, propping open a longer window for Mexico and Canada to comply with Trump's demands.

China remains a larger tariff target, and on Tuesday, February 4th, the two countries fired the opening salvo of tariff shots. In a first step, the US initiated a 10% tariff on Chinese goods. Beijing responded swiftly by implementing select tariffs and launching an anti-trust probe into

Google.

Trump's stated motivation with our northern and southern neighbors is gaining their cooperation principally on matters of border security and limiting drug trafficking. With China, the motivations likely run deeper as it poses America's biggest economic and military threat.

Some people will suggest that tariffs are good policy and have a protective effect on the US economy or serve other national interests. Others will argue that tariffs are a punitive tool that creates a tit-for-tat policy response by other nations, creating a lose-lose situation. I think there are compelling cases to be made for both arguments. Whether tariffs are appropriate is, frankly, irrelevant. What matters is if they will be enacted and, if so, what effects will they have.

Regarding whether or not they will be enacted and for how long, I think we have to look at Trump's history for a clue. It's logical to assume that Trump knows that any meaningful tariffs are likely to push prices higher, and the cost of imported goods will rise, creating a spike in inflation. If this happens, as we've established in the section above, the Federal Reserve will undoubtedly keep rates at higher levels than they would without tariffs. Beyond the effect these tariffs could have on the Federal Reserve's interest rate policy, they will cause immediate pain for US consumers in the form of higher prices, as well as disrupt the normal course of trade for companies in the US and China that engage in the exchange of goods and services.

It is my overall expectation that Trump plans to use tariffs as a tool at the negotiating table more so than to reshape the world economy. If this proves true, tariffs will likely be more temporary than permanent. For countries like Mexico and Canada, which rely heavily on exporting their goods to the US, I expect this to be an effective negotiating tactic. China's stage is set for prolonged and extended trade wars, which could quickly cause financial markets to completely vomit. Even under more benign scenarios, I worry that negotiations with China will drag on for months or even years. This could likely cause the Fed to remain in a holding pattern with rates. If so, the consequences I voiced above regarding the implications of higher interest rates will play out for even longer than is currently expected by markets.

Investment implications: Aside from the obvious risk that the Federal Reserve will keep rates higher for longer than what was anticipated, more risks are worth weighing. The use of tariffs from a thirty-thousand-foot view calls into question whether or not global trade will begin to unwind. For the past few decades, many American jobs have shifted abroad due to the cheap labor provided by countries such as China. While, at first blush, it seems to be bad for US workers, it has lowered prices for US consumers. Reorganizing the global supply chain out of cheap labor countries would certainly not help with inflation. Further, it makes predicting how US companies do business with China (and vice versa) very difficult. I am afraid that US stocks with material exposure to China will surely face a stiff headwind for the foreseeable future. Perhaps more alarming yet would be a scenario where tariffs become a unilateral tool used by Trump to slap the wrist of any country that crosses him, making pre-existing economic relationships between the US and any trading partner a potential landmine. Certainly, favoring US companies with a limited reliance on global trade relations would be prudent should Tariffs play a big role in the years ahead. Those companies are few and far between, as it has been a lousy business practice not to engage in the global economy. Perhaps a more obvious path for investors would be to choose asset classes whose fundamental value has little or no relation to global trade. One simple example would be existing US multi-family real estate properties, an area we already favor for other attractive fundamentals.

## **Federal Debt/Dollar**

Currently, the overall US burden sits at \$36 trillion and is growing by the second, in no small part due to the rise in interest rates. Higher rates mean that the interest expense owed is now the largest expense line item, eclipsing defense spending for the first time in our history during 2024. Said another way, the overall debt burden of the country has been, quite literally, a growing problem. The shift in interest rate policy that we are now living in has only exacerbated the country's debt woes. In 2020, the US Debt surpassed GDP and is now running at over 1.2 times. If you think about the US as a private citizen, it means that we now have 20% more in liabilities than we make in income for a given year. Perhaps more concerning is the fact there's no end in sight.

The introduction of the Department of Government Efficiency (DOGE) has sent shockwaves through Washington. Few would argue that it's not a worthwhile endeavor to reign in government waste, but how much of an effect can it really have? Elon Musk, the man tasked with leading the effort, said the goal was to eliminate \$2 trillion in waste. In a recent interview, he admitted that if they shoot for \$2 trillion, they may achieve \$1 trillion in actual reductions. Skipping over whether or not Musk can actually deliver on these targets, a larger problem looms.

The US debt is growing at over \$2 trillion per year, so even if he achieves his own admittedly lofty goals, he will quickly be erased by more and more debt. The problem is we continue to spend more than we make. Consider this: Only 4 times in the last 50 years has the US experienced a balanced budget, which last occurred in 2001! Like any private citizen suffering from high indebtedness, we will have to grow our income and reduce our expenses. The problem any president faces will be the same. Few people can agree on how to grow our income or what should be cut. How serious Trump is about undergoing the requisite economic pain to tackle our debt problem meaningfully remains to be seen. Like so many who've come before him, the odds favor moderate to minimal improvement instead of kicking the can down the road. To fix our debt problem, we will likely need a financial catastrophe because neither Democrats nor Republicans are willing to bear the brunt of the political ramifications. In some ways, I don't blame either political party but the average American. Until Americans start to vote based on this problem, why shouldn't politicians punt on the issue?

Investment implications: The long-term effect that few want to even acknowledge. At some point our increasing level of indebtedness will have the deleterious effect of undermining the creditworthiness of our country. Said plainly, countries will view the Dollar as weak. They will elect to settle trades in a stronger currency, and they will not buy US Treasuries with anywhere near the ferocity we've been accustomed to enjoying. This is already afoot. Today, certain corporate bonds are traded at a premium to "risk-free" treasuries, implying that investors think that companies are more likely to pay their debts than the country itself. It's not a coincidence that currency alternatives such as cryptos and gold are also soaring in value. Additionally, investors should be wary of industries ripe for government cuts. Defense and healthcare immediately come to mind as industries that could be in the crosshairs for spending reductions.

## **Immigration/Geopolitics**

The escalating violence in the Middle East combined with Russia's invasion of Ukraine are

concerning events. Aside from the terrible and tragic horrors that come with any armed conflict, the world appears to be headed more toward instability than stability. In recent history, the U.S. has played a role as the global police chief. It seems this will no longer be the case. Democrats have long called for less war, and it seems Trump sees global conflict as bad business. Trump may successfully negotiate ends to these conflicts, or he may not. What appears to be clear is that he does not want to risk American lives in foreign conflicts, nor does he want to finance these battles without recompense.

Domestically, Trump looks committed to delivering on his campaign promises when it comes to tackling illegal immigration. Task forces around the country are currently undergoing deportation operations. Whether or not this should be taking place or how it's being conducted is for others to debate. Still unknown is how broad-sweeping the campaign on illegal immigration will be.

Barring some catastrophic change, it looks plausible that the tensions in the Middle East are cooling, with Hamas and Israel currently engaged in the exchanging of hostages. Trump appears to be intent on resolving the Ukrainian conflict and, if not possible, finding ways to lighten the financial burden on the US. While the human tragedy of these wars has been remarkably tragic, the markets haven't felt significant impact from either conflict. We cannot rule out escalating tensions from either conflict that could tip these events into a crisis that does worry the markets. But, for now, that appears to be a low probability for investors. Domestically, the widespread nature of deportations remains to be seen. Rounding up and deporting illegal immigrants with criminal pasts will have virtually zero effect on markets. Conversely, a broader, more comprehensive approach that attempts to deport all illegal immigrants will impact markets. While it's impossible to measure, estimates suggest that illegal immigrants comprise 5% of the overall US workforce. Deporting all illegal immigrants would likely leave our workforce devoid of workers willing to do what others likely will not. Estimates from The Peterson Institute for International Economics suggest that the GDP drag by 2028 could decline between -1.2% and as much as -6.7%. It seems hard to fathom GDP falling anywhere near that much, considering it declined -4.3% in the great recession, but the point should hit home. Large-scale deportations could be more disruptive than markets may be anticipating.

**Investing implications:** Should the Mexican government attempt to scuttle the U.S. deportation process, tariffs won't be far behind. Subsequently, investments reliant on U.S./Mexican trade would be hurt. Specifically, Mexico is an integral part of the supply chain for U.S. automakers. U.S. grocers rely on a broad collection of Mexican agriculture imports. Additionally, the U.S. farming industry exports a significant number of products across the southern border. The largest effect at work here remains to be seen. The impact of deporting illegal immigrants, if it occurs in mass, would have an undoubtedly negative effect on the U.S. labor force. Investors should monitor this and avoid companies that would be adversely affected by a major reshaping of the U.S. workforce.

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