



Winter 2025

Thoughts From Our Chairman - Alfred B. Van Liew

In this winter issue of As We See It our associate, Joseph Healy, reviews the current investment environment. Despite the last two years of outstanding equity returns the market landscape continues to challenge, however, we at Van Liew are optimistic 2025 will be a good year for investors.

We are Certain of Uncertainty

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New administration, initiatives and changes. Rumors. Headlines. Confusion about what lies ahead. As investors, what can we do with that? This issue examines where investment opportunities and risks might lie. The focus is on what we think we know. There will likely be time and opportunity to react, instead of guessing in the present. This piece strives to strip out politics from the investment discussion. To quote The Godfather, "It's not personal, it's strictly business".

Tariffs - Taxes or duties on imports or exports. Tariffs mean higher costs of goods, of which at least a portion will be borne by consumers and could be inflationary in the near term. We need to consider that tariffs could curtail the downward move in interest rates, supporting the interest rates being "higher for longer" narrative. Who benefits and who doesn't from potentially higher interest rates?

- Companies with higher levels of debt have less flexibility and potentially higher costs of capital as debt matures and is rolled over. For example, 35-40% of the names in the small capitalization Russell 2000 Index are currently unprofitable. A "higher for longer" interest rate scenario won't help small cap stocks, many of whom carry larger debt burdens.
- Conversely, companies with lower debt levels have a competitive cost advantage versus companies with higher debt levels. Think in terms of companies with higher cash flow, mega and large cap names – the types of firms that have led the rally over the past two years.
- Counterintuitively, if you look at the most recent period of tariff enactment, 2018, inflation

eventually fell after the tariffs were implemented as the higher cost of goods eventually proved to be deflationary, prompting consumers to consume less or switch to lower cost items.

- Longer term, whatever form tariffs take, the hope is they bring jobs back to the US. But that will take time. Another hope is that it enables our trade officials to negotiate deals that are more advantageous to the US while we still maintain our strong long-term relationships.

Volatility - Over the past few years we've become accustomed to low market volatility. It's reasonable to expect a greater level of market volatility as things, new or unanticipated, happen. Markets are typically more comfortable with "the status quo" and don't like surprises. Greater volatility is not necessarily a bad thing. But volatility does increase the importance of security selection and offer an opportunity to outperform passive or index strategies.

Less Regulation - Less regulation may lower costs and increase savings that could flow to the bottom line of publicly traded companies. That's how markets have historically read such situations. In a world where company earnings drive stock performance that could boost performance.

Fixed Income - Uncertainty reigns in bonds. Interest rates remaining "higher for longer" now seems likely. Bond defaults, while elevated, haven't surged which could speak to the strength of issuer balance sheets. What to do? First and foremost, in times of uncertainty investor's core bond exposure should be in quality. While last year's multiple

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interest rate cuts didn't drive up bond prices like many expected, neither did the omen of an inverted yield curve usher us into recession. In 2024 the mixed messages of bond markets was in contrast to the relative optimism of equity markets.

- With near term risk of higher inflation it's hard to buy longer term bonds. But the current entry point for bonds is attractive, in comparison to US equity markets which are on the heels of two years of outstanding performance and carry historically elevated price/earnings multiples. If anything, it serves as a reminder to not let asset allocations drift.

International Investments - While foreign equities may now appear cheap, on a price earnings multiple basis as compared to US equities - be careful. In the near term tariffs may help boost the US dollar and be a headwind to foreign investment earnings and currency translation. Some might speculate that if the US economy slows it could mean international stocks are poised for a bounce. Historically though, that has not been the case. During US equity market downturns the US has usually outperformed foreign indices, following the adage, "when the US sneezes the world catches a cold". The broader US equity market is technology heavy and growth driven, in comparison to developed Europe. It would be a healthy sign for markets to grow returns across a broader swath of the equity market (i.e. beyond the Magnificent Seven) than we've witnessed these past two years.

- 41% of revenue in S&P 500 companies comes from abroad so many US companies could feel this pain too.

Federal Debt - Much of the spending in the Federal budget is locked in and any approach to alleviate that will be painful. At this point it's hard to foresee inflation getting back to the Fed's target 2% rate, and our base assumption is that the cost of debt service will rise. Global debt as a share of GDP is at all-time highs and these conditions could put upwards pressure on interest rates and more stress on our economy. We've likely used up much of our "wiggle room" implementing prior stimulus packages. In the past, it was easier to do expansionary policy without fear of being

inflationary. That ceiling is lower now and may push up yields more quickly.

Artificial Intelligence ("AI") - With AI we haven't seen meaningful impacts on the broader range of companies and equity investments, though it's been a rewarding investment theme for a handful of companies. AI development and spending is still in its early stages and is certainly an ongoing, longer term investment theme. Recent developments in China have raised questions about the anticipated investment flows into such investments as to whether development can be done cheaper. But that doesn't change the overall trend.

- A side investment theme related to AI is its energy requirements and our aging energy infrastructure in the US. This will require significant expansion and updates to keep up with the anticipated demand of data centers and US consumers alike.
- AI, if it plays out as hoped, will improve productivity and business efficiency for companies. That's important in a future with aging demographics and lower anticipated US population growth trends.

Consensus forecast for returns on US equity markets in 2025 is under 10%. The global economy is fairly strong with some countries, like the US, stronger than others. Corporate earnings are projected to rise +14% in 2025, which is fairly lofty on the heels of last year. The Federal Reserve cut rates twice in 2024 and more recent numbers point to them being done. Things are fluid.

Despite the unknowns, more important are the "knowns" to keep in focus. While the above investment themes are significant, more important is focusing on what drives investment performance, even in uncertain times. Investors still need to recognize their risk tolerance, time horizon(s), have asset allocations in line with one's investment guidelines, periodically rebalance, be broadly diversified to achieve an appropriate risk-adjusted investment return and lastly avoid market timing.

We would be delighted to meet with you to share comments about this article, or to review your portfolio in detail.

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