Markets Tremble: What We Value Informs What We Believe - The Concept of "True North"

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Since January 20th, we have witnessed a tsunami of actions taken on many fronts—economic, foreign policy, and attitudinal. Markets here and around the world have been trying to process all that has been occurring. Markets are resilient in the long term but very reactionary in the short term. This reactionary function can lead to day-to-day swings in sentiment and direction.

I will not publish a list of all the recent Executive Orders, proclamations, and threats; instead, I will try to explain why markets are becoming more risk-averse, which typically leads to an equity market correction at best.

Rapid change, at times feeling chaotic, will rattle markets, but such change can be seen as necessary and constructive, but only when such change does not call into question "True North" principles. A Harvard Business School professor, Bill George, wrote a book by the same name. He wrote in his book, "True North is where you discover your authentic self. It's a combination of your purpose and your beliefs." Bill George's book was about an individual finding their True North, and he points out that every person's True North is different. True North is more akin to core principles and institutional knowledge when applied to a group of people, an organization's culture, or a nation. Some may say it is akin to foundational values or the idea of "who we are." Change is constant in a dynamic economy, and change is embraced so long as it does not call into question foundational True North ideals - who are we? What do we believe? And what do we stand for?

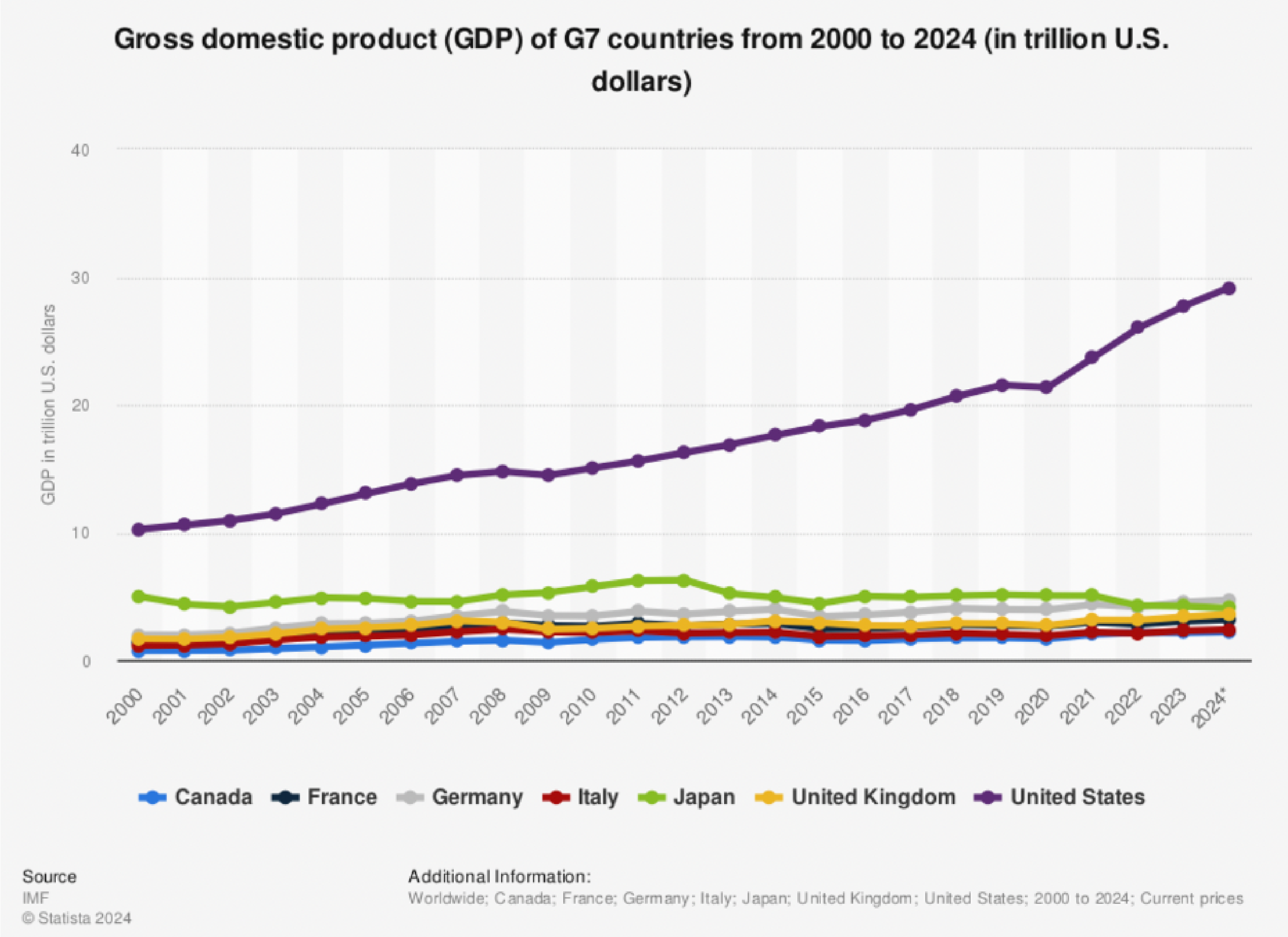
For more than 80 years, the United States has been a champion of free markets, and as that champion, we led by example. The United States encouraged other nations with tariff-protected economies to lower those barriers and demonstrated why this was in their best interest using our economic strength as proof. This ideal of free trade was part of the United States' True North.

The current administration has enthusiastically embraced tariffs in the name of negotiating leverage, to combat "unfairness, and to raise revenues. The markets are sending the message that tariffs directly threaten what equity markets care the most about—growth and profitability. The administration has been unclear but very rhetorically assertive about its plans for tariffs, which has exacerbated the markets' uneasiness. The markets have not decided whether the administration sees tariffs as short-term tactics or a long-term strategic shift in US trade policy. To be clear, markets are not ideological, but markets need certainty surrounding the landscape created by government policymakers.

History and economic theory tell us that tariffs are too dangerous to use as blunt trade negotiating tools because they can quickly morph into a trade war in which everyone loses. It is universally accepted in economic history that President Hoover's Smoot Holly tariff legislation in the early 1930s caused a severe economic downturn to worsen and become what is now known as the Great Depression. Today, those who favor using tariffs like to talk about unfairness and trade deficits with specific countries. When advocates of tariffs talk about trade deficits, they typically exclusively highlight the goods trade balance instead of including services. Generally, if one includes services, a US trade deficit versus most countries shrinks or even becomes a surplus. Secondly, tariffs have historically been regulated by the World Trade Organization (WTO). Under that construct, it has generally been understood that specific tariff policies are necessary and not unfair.

The US has historically used tariffs to rectify specific trade abuses, which has been very effective. On the other hand, it has been understood that certain economies need to use modest tariffs to protect those economies from economies that have established certain structural advantages or those economies where governments materially subsidize exports. I like to compare the tolerance of "fair" tariffs to the handicap system in golf. Using that comparison, the US, versus most other economies, has the lowest handicap, meaning that to level the competitive playing field, those competing countries are permitted to use a certain modest level of trade barriers, such as tariffs, to help lower the US's advantages. One could argue that this is not fair. Still, over the last thirty years, looking at GDP growth and employment comparisons across the spectrum of US trading partners, the US has consistently outperformed those partners' economies. If the trading system referred to by the WTO were unfair to the US, we would not have seen the US maintain and widen its persistent relative performance advantage.

Below is an excellent illustration published by Statistica of the Gross Domestic Product (GDP) of the G7 nations since 2000. The illustration shows that the US has consistently built on its economic advantages for the last twenty-four years.



Shining City on the Hill - I have a Feeling We're Not in Kansas Anymore

Maybe I view change differently than most people. Ronald Reagan was President when I was in college, the Berlin Wall and Iron Curtain came down as I started my professional career, and through my 35th birthday, I spent family dinners with a history professor Uncle, a WWI veteran Great Grandfather born in the late 1800s, and a grandfather who fought his way across the German border in early 1945. Through their eyes, I have seen the effects of significant, unimaginable changes they lived through. Still, I also came to appreciate the consistency in what our nation aspires to be for its citizens and the world.

1989 Ronald Reagan said, "If in his farewell address, we forget what we did (the entry into the war in Europe during WWII), we won't know who we are." President Reagan ended his address by describing his frequently used analogy of the US's role in the world. The analogy is a Shining City on the Hill. He said, "I've spoken of the shining city all my political life, but I don't know if I ever quite communicated what I saw when I said it. But in my mind, it was a tall, proud city built on rocks stronger than oceans, wind-swept, God-blessed, and teeming with people of all kinds living in harmony and peace; a city with free ports that hummed with commerce and creativity. And if there had to be city walls, the walls had doors, and the doors were open to anyone with the will and the heart to get here. That's how I saw it and see it still. And how stands the city on this winter night? More prosperous, more secure, and happier than it was 8 years ago. But more than that: After 200 years, two centuries, she still stands strong and true on the granite ridge, and her glow has held steady no matter what storm. And she's still a beacon, still a magnet for all who must have freedom, for all the pilgrims from all the lost places who are hurtling through the darkness, toward home." Reagan had a very clear understanding of the nation's True North and governed using that as his guiding light.

Overall, the equity markets performed well during Ronald Reagan's two terms as President despite two recessions, America's first experience with a mass casualty terrorist attack that took place in Lebanon, the Iran-Contra political scandal, and the 1987 stock market "Black Monday" crash. Those eight years were fraught with severe economic and geopolitical challenges. Still, Reagan exuded both optimism and a contagious patriotism reinforced by our value-oriented role in the world as the champion and defender of liberal democracy. President Reagan spoke to the inner circle within the Executive Branch on January 20th, 1983, and reminded his leadership what Jeanne Kirkpatrick, his UN Ambassador, said to the UN; Reagan repeated that "the defense of American interests is tantamount to the defense of national independence, liberal democracy, and human rights throughout the world, and our defense of these principles must be considered a moral imperative."

What I remember most about the Reagan years was that he led with optimism. His ability to go toe-to-toe with foreign and domestic political foes at home without becoming defensive and combative served his presidency and the nation well. He exemplified freedom and democracy first. In doing so, he always led with values and ideals that most Americans and, equally important, our democratic allies abroad shared. Despite the country experiencing rare back-to-back recessions in his first term, he won his second term with 58.85% of the popular vote and a true landslide of 525 electoral votes from 49 out of 50 states. In my opinion, this historic victory was possible only because he set a tone for the country of unifying optimism built on shared values and ideals. As a result, his leadership was trusted by the voters and our allies abroad.

As I compare the state of our country today with Reagan's era, it is difficult to believe how much the political landscape has changed over the last 40 years. For those of us who have been professional investors over the preceding two or three decades, Dorothy from the Wizard of Oz said it best at the beginning of the movie: "I've a feeling we're not in Kansas anymore."

Markets are part financial and part behavioral. Markets are made up of buyers and sellers driven by a wide variety of motivations. Still, for equity markets to rise over time, market participants must be able to trust with a reasonable level of certainty that their forecasts about the future will be more right than wrong. Certainty can only be bolstered when core factors can be counted on to underpin other more volatile cyclical factors inherent in the economy, regulatory environment, tax policy, and global markets. The future becomes far more opaque when these core factors become less certain. When this happens, investors require a much higher expected return, which usually requires lower current prices.

We are now two months into 2025, and it is becoming more apparent that what worked well in 2023 and 2024 will not necessarily be the most appropriate strategy in the foreseeable future because some of the previously mentioned core factors are far less certain today. In December, I wrote about Irrational Exuberance. In January, I cautioned about an overcrowded AI/Magnificent Seven market and the risk that too many people on one side of a boat present to investors.

We never run from volatile markets, and as we wrote last month, we expect and embrace change. Today, the change we are witnessing is stark and chaotic. It is impossible to know to what extent the core factors investors historically have counted on to form a long-term thesis will be adversely impacted once the dust settles from this period of highly elevated uncertainty. Until then, we have been adjusting many portfolios to add diversification and reduce exposure to market areas we deem most at risk.

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- **The NASDAQ Composite Index is a large market-cap-weighted index of more than 2,500 stocks, American depositary receipts (ADRs), and real estate investment trusts (REITs), among others. Along with the Dow Jones Average and S&P 500, it is one of the three most-followed indices in US stock markets. The composition of the NASDAQ Composite is heavily weighted towards information technology companies.**
- **The Dow Jones Industrial Average (DJIA), also known as the Dow 30, is a stock market index that tracks 30 large, publicly owned blue-chip companies trading on the New York Stock Exchange (NYSE) and the Nasdaq.**
- **The Russell 2000 index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest US stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.**

The Russell 2500 Index measures the performance of the 2,500 smallest companies in the Russell 3000 Index, with a weighted average market capitalization of approximately $4.3 billion, median capitalization of $1.2 billion and market capitalization of the largest company of $18.7 billion.

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