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Market Commentary
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Executive Summary

Trump is making many forceful moves both at home and abroad. But push generates counter push and some of the forces Trump is stirring into motion are greater than he. Investors must position themselves for a turbulent period ahead.



Trump's Domestic Program

Trump's sprawling domestic program is coming into a degree of focus. It consists of four main points.

1. Revenge against perceived opponents. Trump has withdrawn the security details of four of his former cabinet level officers. As a man who has survived two assassination attempts, Trump can hardly pretend to ignore political violence. In fact his actions invite the murder of these former officials.

Trump has long been notorious for abusing staff, but these actions take things to a new level. Unsurprisingly, Trump is finding it difficult to recruit competent new staff. In last month's commentary we discussed the unimpressive character of Trump's cabinet. Lack of competent support is a source of systemic weakness.

2. Trump is determined to massively downsize the Federal government largely along ideological lines. Although packaged as efficiency moves, the clearly ideological

selection of those targeted indicates efficiency is merely a pretext. A case in point is America's "soft power." In the diplomatic setting hard and soft power are euphemisms for coercion and persuasion. Most parents understand these are complementary tools for dealing with unreasonable humans and that the most effective way to maintain order is a blended approach. But in the small club of diplomatic ideologists there are those who forget these home truths and who equate power with coercive power only. Fully signing on to this extreme view, Trump is targeting famine relief, media outreach and public diplomacy for shutdown. Trump also is notably indifferent to foreign perceptions of himself and of the United States. Ideological decision making is a second source of systemic weakness.

The other problem with Trump's downsizing program is constitutional. It is Congress which decides the government's mission and resourcing. A president's primary job is execution and only secondarily advising on mission. Trump's hope is that Congress is so paralyzed by political divisions that he can safely usurp its powers. Trying to get things done outside the regular channels of power just makes them harder to accomplish and less likely to survive the next change in government.

3. In his first term Trump passed through Congress a package of temporary tax cuts. The cuts were the signature accomplishment of Trump's first term. Those cuts are now expiring and tax rates are scheduled to rise in consequence. Trump seeks to renew and possibly make permanent the tax cuts. He has also promised to expand the tax cuts. Getting the cuts through a paralyzed Congress will be challenging. The cuts are currently unfunded. Trump's cost cutting in point 2 is likely driven in substantial part by the desire to fund the cuts. So too is his effort to raise revenue through consumption taxes (tariffs.) These measures, however, are unlikely to be sufficient. We expect Trump to rely on expanded borrowing to fund his cuts. Doing so could result in a substantial fiscal stimulus to the economy.

The Republicans have passed through the House an initial blueprint of how they plan to fund tax cuts. Annual savings of about \$1.1 trillion will be realized through reductions in aid to

the poor (food and health care) and reduced support for education. Half of the savings will be spent on tax cuts, most of which benefits will flow to the wealthiest segment of society. Major increases in border security and token increases in military spending will absorb the rest of the savings. The plan assumes the government will borrow to pay interest on the national debt. Drastic as it is, the budget blueprint fails to meet Trump's full tax cut goals. With aspects of the plan unpopular across the political spectrum it remains to be seen what will ultimately emerge from the budget process. Probably Speaker Johnson hopes to use the pressure of hitting the current debt ceiling as the whip to enforce support on his more reluctant members.

This budget, if enacted, will amount to the launching of class warfare in the United States. It will strongly polarize the Democrats and when they regain power investors will likely see them attempt to enact confiscatory wealth and estate taxes in response to this budget. Indeed in his parting message President Biden identified controlling the power of oligarchy as the preeminent national challenge. We do not find the nation's rich a homogeneous group and we do not find taxes targeting a demographic the best response to a few prominent members of a demographic exercising their legitimate right to engage in political activism. But we are under no illusion that voters suffering a substantial loss of income will take so nuanced a view,

Trump incidentally is on a different beat than the House Republicans with regard to the budget. While they plan on modest increases to the defense budget, Trump's Secretary of Defense has instructed the Pentagon to plan for a 40% defense cut over five years. Unilateral disarmament while your adversaries are arming is one of the bad ideas from the 1920s currently being recycled in Washington.

The administration has also begun the purge of the high command that was part of Project 2025.

The first few dismissals were characterized as “diversity hires” which certainly made it sound as if the officers were being cashiered because they were not white men. We wonder if the Republican Senators will go along with a wider purge. Many retain lively memories of fleeing for their lives in

the face of the lynch mob Trump sent to Congress on January 6, 2020 and which he released from jail a month ago.

Stoking social and political discord is not a recipe for enduring success.

4. Trump is determined to implement a vigorous program of deportations and border interdictions. Presently he is tasking military airlift and surveillance assets to tasks which could be performed perfectly well by private charter operators and by the civilian air patrol. Trump is doing things in a deliberately wasteful way to send a message. But if he intends to sustain these programs long enough for them to achieve substantial results he will have to move to sustainable measures. Contrary to the claim that Trump is only targeting criminal undocumented residents, border officials have begun warning legal permanent residents (green card holders) returning from abroad to limit their international travel or face revocation of status.

Trump has proven himself a master of political theater. But he has really outdone himself by positioning the world's richest man (Elon Musk) as his hatchet man. Ultimately, however, this is not a good look and it will likely come back to bite at at least Musk. Musk is doing to the current Federal workforce much what Joe McCarthy did in the 1950's. McCarthy's reign of terror lasted four years, did great damage to the government, ruined many innocent people's lives and ultimately led to McCarthy's own disgrace. His downfall was orchestrated by Eisenhower who also was a Republican. As an elected Senator McCarthy's position was far stronger than Musk's who serves at the pleasure of the president. We expect Musk, in the way of hatchet men, to exit the scene abruptly once his usefulness is ended.

Meanwhile his companies are being boycotted by customers upset at his political role. European sales of Tesla suffered a 50% decline – a development which a stock priced at a PE of 100 can ill afford.

Musk's role is also troubling in other ways. Trump invited him to his first cabinet meeting because “Musk gives direction to the cabinet secretaries.” Constitutionally the cabinet reports to the President. There is no intervening management layer and certainly no role for someone not

subject to Senate confirmation. The media is describing Musk as a “co-president.” Musk acquired South African citizenship by birth, Canadian citizenship by inheritance and US citizenship by naturalization. Naturalized citizens are not eligible for the Presidency, so “co-President” is as close as Musk can get.

The rule of South Africa by a white minority ended a generation ago. Showing great restraint, the black majority government left the white landowners in possession of most of the country's agricultural land.

Naturally this situation is resented by the black population and recently the government has put forward a bill to begin redistributing land by a combination of purchase and expropriation. The Trump administration has decried this legislation as racist and stated that it will give political refugee status to persons of European descent dispossessed under this bill. The Trump administration's response may seem racist to some. We would disagree. The Latin Americans whom the administration is actively deporting are just as much of European descent as the Boer farmers whom the administration proposes to admit. The true distinction between the groups is that the Latins are Catholic and the South African Boers are Protestant. The administration's thinking is sectarian rather than racist. Since World War 2 Catholic Europeans (Irish, Italians, Poles etc) have been regarded as “white.” But prior to the war, only European Protestants (English, North Germans, French Calvinists) were regarded as “white.” In this small detail, as in much else, the administration reveals that its thinking is centered in the 1890-1928 period of American history.

That period of American history is remembered today for its pervasive corruption. Trump has instructed the Justice Department to halt enforcement of the law which forbids American bribery of foreign government officials. He has also ordered the department to disband its unit focused on prosecuting domestic bribery of officials. Finally prosecution of Americans for acting as undeclared agents of foreign powers is to be reduced. Further weakening the rule of law, Trump has dismissed the senior officers tasked with enforcing the military code of justice. The US military code is

strongly centered on protecting a citizen soldiery from abuse by higher command or foreign captors. Consistent with his emphasis on aggrandizing power, Trump would sweep away the limitations imposed by those goals.

Or maybe it is just overly enthusiastic cost cutting. Apparently by accident Elon Musk fired the entire governmental unit tasked with ensuring the safety and working order of the US's nuclear weapons. These are somewhat specialized jobs and the government is now scrambling to locate and rehire its former staff. We hope it succeeds before they accept offers from foreign powers to “consult” about their specialized work experience which includes detailed knowledge of the design of US strategic weaponry. The philosophy of “move quickly and break things” does not work so well when nuclear warheads are involved.

Currently there is a global pandemic of avian influenza underway. Recalling Covid, the disease developed from a mutation in Southern China, but it quickly spread to all seven continents as birds went through their usual migrations. The disease is now adapting itself to mammalian hosts – primarily dairy herds. It has begun to infect poultry and dairy workers and it has passed from them to domestic cats. So far human infection is rare, but lethality rates approaching 50% have been reported. This rate is probably an overestimate as, like Covid, there seem to be a number of asymptomatic infections. While a lower fatality rate is of course desirable, asymptomatic disease carriers make an epidemic far harder to control. Fortunately there is a well established program for developing and distributing influenza vaccines. Unfortunately, Trump did not learn the lesson that pandemics should be taken seriously. He has forbidden the CDC to distribute information to other health organizations or to the public. He has put a declared opponent of vaccines in charge of the Federal Department of Health and Human Services. However, concerned about the price of eggs, the administration has announced a \$1 billion program to import eggs from as far afield as Turkey. With eggs currently costing a dollar each, this program will be adequate to supply each American with three eggs. We think vaccinating chickens would be a more effective use of funds.

Unfortunately the administration does not seem to have learned the lesson of Covid that, in the case of pandemics, treating causes of disease is far cheaper than ameliorating the consequences.

It is also notable Kennedy, the cabinet secretary for Health and Human Services, has decided to end public comment on proposed rule making. Government agencies which issue rules normally post the draft proposed rule and invite public comment. This process allows the public to inform the agency of technical factors, special cases and unforeseen consequences of the proposed rule. The agency typically incorporates at least some of this comment into the formulation of the final rule. There is decades of experience that shows public comment results in better rules more palatable to the public. There is simply no good reason for Kennedy's action. The bad reason of course is the desire to rush out rules which you know will be opposed by at least part of the public.

Besides opposition to vaccines, Kennedy is also skeptical about fluoridation of tap water. There is some reason to be concerned about the quality of American tap water, but fluoride is certainly not a top concern. If Kennedy succeeds in mobilizing an anti-fluoride movement, the primary beneficiaries will be dentists – and particularly those with a child oriented practice.

Changing too many things at once, spawning chaos, making decisions for the sake of messaging – these are all well known ways to fail.



Trump's International Program

Internationally Trump continues to act in an ill advised fashion. Notably he gave a speech proposing to deport two million Palestinians from Gaza to Egypt and Jordan, to annex Gaza to the United States and to engage in a massive investment program to build a resort zone in this particularly

prickly part of the Middle East. Jordan and Egypt, staunch US allies to this point, rejected the proposal and labeled Trump a threat to their national security. The Gaza Palestinians, otherwise weary of Hamas, realized that only Hamas stands between them and dispossession and that they had no choice but to give Hamas their undivided support. Thus in one speech Trump deprived Israel of the fruits of their Gaza campaign. Finally we wondered who the customers would be for the projected resorts. The facilities will be magnets for revenge acts of terrorism. We think most holiday makers will prefer less blood soaked land for their beach vacations. We noted that Trump's speech was ill advised. In fact, that is not the fault of his advisers who were not consulted. The speech showed yet again that Trump does not know how to make effective use of staff. Incidentally, Speaker's Johnson's budget blue print provided no money for Trump's proposed acquisition and redevelopment of Gaza. Perhaps a supplemental appropriation is intended.

The Arab states presented an alternative plan for a speedy reconstruction of Gaza without displacement of the Gazans or a return to power by Hamas. It was rejected by the White House which insists on displacing the Gazans. Israeli vaguely went along with this rejection without stating a position itself.

Investors should keep an eye on the situation. Trying to displace the Gazans would likely trigger a war large enough to effect investment values.

Trump's conduct has caused grave concern in Iran. They realize they are vulnerable to Israeli attack and Trump is likely to green light such an attack. Indeed the US and Israel are currently practicing joint air operations involving US bombers and Israeli fighter escorts. The Ayatollah Khamenei has indicated there will be no negotiations between Iran and Trump given the latter's hostility and unreliability. It is likely the Ayatollah has given a secret go ahead to a crash program to construct a nuclear bomb. Iran currently has enough 60% enriched uranium for 8 nuclear devices. The likelihood that Iran is moving forward with a bomb project may well trigger the attack which Iran fears. But unless the attack is decisive, the attackers must reckon with the possibility of reprisals from Iran once its weapon is ready.

Trump has been seeking to open negotiations with Russia over Ukraine. We discuss Russia's perspective on these negotiations in a section below. Trump began with a stream of unforced concessions. His Secretary of Defense gave a speech in which he accepted Russia's territorial conquests in Ukraine, excluded Ukraine from joining NATO and stated the US would not provide security guarantees to Ukraine. These were concessions of three of Russia's four demands made for no reason and with no compensating concessions by Russia. The only part of Russia's demands not yet conceded is Ukraine's sovereignty, although Trump then signaled a US willingness to concede that also. One speech is not yet policy, and in parts of the US government it is being dismissed as a rookie mistake. That Trump's cabinet is mostly staffed with rookies well out of their depth is a point we commented on in last month's Market Commentary. Mistake or not, the speech was well calculated to encourage Putin to take a hard line in any negotiations. Finally Mark Rubio, the Secretary of State and one of the more experienced members of the administration, has described the conflict as a proxy war between the US and Russia. We wondered why he would adopt a manifestly false Russian talking point.

Having softened up the opposition with these moves, Trump then turned on his own side.

Trump's lead Ukraine negotiator General Kellogg has indicated an intention to exclude the Europeans from the negotiations. This move is quite remarkable given that the Europeans have provided more than half the funding to the Ukrainians and the Europeans are considerably more exposed to the consequences of any deal than are the Americans. It is, in fact, Trump's stated desire to withdraw the US from NATO. However, Congress has forbidden him to do so. So Trump falls back on mistreating America's allies in the hope they will pull away. This is not a great position from which to enter a high stakes negotiation.

Up to this point Trump looked like a modern Neville Chamberlain. Chamberlain sold out Czechoslovakia to Hitler in 1938 with the announcement that he had "negotiated peace in our time." But Trump was to take matters two steps further. His next move was to demand Ukraine cede \$500

billion in mineral wealth to the US. Suddenly Trump looked much more like Joachim Ribbentrop negotiating the partition of Poland with Molotov in 1939. When President Zelensky came to the White House to sign the “deal” he walked into a stage managed dressing down which reminded us of Hitler's treatment of Czechoslovakia's President Beneš. These games have been played before. The optics of this are not good in Europe, or anywhere else for that matter. With Trump clearly siding with Putin and eager to detach from the Ukrainian situation we think the US will not end up playing much of a role in whatever negotiations ultimately bring this conflict to an end.

The thought that their national security might be in the hands of a Ribbentrop is a compelling one for the members of the Western alliance. They have two logical responses. First diversify their weapon supply away from the US. Second, build their own strategic nuclear forces. There are a number of countries which could “go nuclear” in the next five years if they so choose (in geographical order): Sweden, Germany, Ukraine, Italy, Canada, Mexico, Brazil, Argentina, South Korea, Japan, Taiwan, Australia, Saudi Arabia and South Africa. France and the UK could in fact arm their closest allies in a few months if they so chose. There is nothing about this picture which is good for the United States.

Three reasons motivate a country to build a military: 1. to keep the current government in power over its domestic opposition 2. to discourage attack by foreigners 3. to project power. In most countries that is also the order of priority. In a few countries 2. takes precedence over 1. Uniquely, the United States's order of precedence is 3,2,1. The US adopted this policy after the Pearl Harbor attack. Observing the destructiveness of modern war, the US decided it was better to fight on foreign soil than to defend its interests on its own ground. The United States's emphasis on power projection makes it potentially a very frightening power to the rest of the world. Only a century long record of eschewing ambitions of territorial expansion and of championing a law based open international order has been able to defuse that natural fear and build up some level of trust and confidence in the United States. To us it appears that Trump is deliberately calibrating his actions to destroy that trust.

American presidents have often had a touching confidence in their ability to make a personal difference in the ruthless world of power politics. Past presidents, for instance, have claimed to have looked into Putin's eyes and seen his soul or to have shaken his hand and be able to do business with him. That is not new. But few prior presidents have been as invested as is Trump in the image of themselves as great negotiators. We think Trump systematically overestimates both his own skills and the inherent strength of his position. Such overestimation has a pithy Greek name: hubris. It typically invites a visit from another Greek: nemesis.



A Preliminary Assessment

Trump has large ambitions to restructure the United States both internally and with regard to its place in the world. But his strength in Congress is not proportionate to those ambitions. Nor did his electoral victory, built more on a collapse by the opposition than a movement towards Trump, constitute a mandate for radical change. Trump hopes to overcome those deficits by moving unilaterally and quickly. However the United States's Constitution has been carefully crafted to restrain the overweening ambitions of a President. Trump is likely to be substantially checked in his ambitions by the Federal Judiciary, by the Federal bureaucracy, by the governors of a substantial block of states and by Foreign states. As we have noted, Trump is not building on the foundations required for lasting success. We think Trump will mostly succeed in creating a mess domestically and in isolating America abroad. Carter and Clinton provide useful recent case studies of just how weak a checked President can be and we expect Trump to ultimately contribute another such case study.

Longer term this period of chaos is probably going to be closed by substantial amendments to the US Constitution.

The US Constitution is framed in terms of a small number of high level concepts: Congress, the President, the Courts, The States, the Indian Tribes, the People. As the United States's government has grown in power, Congress has enacted a number of subsidiary concepts which allow for a more fine grained disposition of political power than can be articulated using just the Constitution's original concepts. Examples include independent agencies, cabinet departments, courts administering specialized law codes, and the public trust funds. That growth has largely been encouraged by the Supreme Court and it has allowed the United States to evolve from a small agrarian society on the margin of the world into the world's dominant power without undergoing massive Constitutional reform. Uniquely Trump is using the power of his office to attack the institutional structure that supports the United States. But a country needs stability. The emerging constitutional question is to what extent the country's institutional structure needs to be more deeply anchored in the Constitution. There is at this point a long list of issues looking for constitutional amendment: legal immunity of the president, term limits for Supreme Court justices, Congress's power to create independent regulatory agencies, a professional permanent civil service, an implementable impeachment power, a president's obligation to abide by formal treaties, the place of private militias, gender rights, and the position of public trust funds. These questions will not be answered quickly and so we think the present instability may last for a number of years.



Domestic Polictics

Inflation has risen from the 2.5% at the end of the Biden administration to 3% currently. Trump's program of tariffs and deportations will increase it further. If he increases the fiscal stimulus that also will feed inflation. The Federal Reserve will likely not resume interest rate reductions unless inflation trends lower or the job market worsens. The country

appears headed towards stagflation. This may in fact be deliberate. The deep thinkers behind Project 2025 probably anticipated that the radical change they seek cannot be accomplished without a recession and they hope by triggering the recession at the outset of Trump's presidency to have reached an upswing before the 2026 midterm elections,

Rising turmoil has caused corporations to adopt a wait and see attitude. Hiring has softened some in consequence. The modest recent jobless claim for instance came in 10% above expectation. A CNN story highlighted the plight of a 59 year old corporate HR executive who lost her \$150,000 a year job and was only able to find employment as a bathroom attendant. How does this come about? We cannot comment on this specific case, but we do note business process automation (BPA) as a technology which is reshaping corporate employment.

BPA begins by reducing job tasks to defined highly structured processes. Typically each step of the process is represented as a node in a flow diagram and business logic rules determine a routing through the diagram. Work orders, invoices and similar pieces of paperwork are reduced to electronic form and routed along the paths of the diagram as the task moves from inception to completion. At each node an employee or software agent will typically perform a narrowly defined function.

To give an example, let us consider the process of hiring a new employee. A generation ago the hiring manager would have ambled down the corridor to the HR executive's office, described the issue and the HR executive would have assigned one of the departments' recruiters to the task. The recruiter and hiring manager would work on a job description. The recruiter would place the ad in an appropriate publication, would collect and screen incoming resumes and would forward the pile to the hiring manager who would construct a short list. The recruiter would invite candidates in for interviews and in due course a potential hire would be identified. The hiring manger and HR manager would agree a compensation package and the recruiter would send out the offer letter. On the job being accepted the

recruiter would set up the onboarding process and notify the facilities department of any needed resources (e.g. a desk and access card.) Ultimately the new worker is delivered to the hiring manager's team. The whole process moves at a leisurely pace and perhaps takes 8 weeks to complete. The leisurely pace would also permit candidates to flow in through more informal processes, e.g. lateral transfer within the corporation or personal referrals. This possibility gave considerable potency to personal networks.

Now let us consider the same task today in the presence of BPA. The process probably kicks off with the finance department entering the position authorization into the software. The authorization is delivered to the hiring manager who types the job description into the software. That description is routed to a software module which adds firm boilerplate and posts the ad on Linked In and similar job boards. Within 24 hours applicants have electronically submitted 100 resumes. These are scanned by a software module and a subset are forwarded to the hiring manager. He selects his short list and that routes to another software module which emails the candidates an interview invitation. The interview runs remotely by voice or video call. Possibly the hiring manager invites top candidates in to meet with the team or sets up further remote interviews with team members. But more likely the hiring manager simply picks a candidate. The software probably recommends a compensation package. Possibly at this point the hiring manager actually talks with an HR specialist. In any case the details are set. Software composes the offer letter and emails it out. Acceptance is delivered by email. Any onboarding training and paperwork is likely delivered by the software and done remotely by the hiree. Facilities is notified and a start date scheduled with the new hire. The hiring manager greets the new employee, introduces them to the team and the job commences. The entire process takes perhaps two weeks. As you can see BPA has reduced a reasonably complex task to an orchestration of simple subtasks.

In the process of automation some work has moved from the recruiter to a general employee (the hiring manager). Other work has moved from the recruiter to a piece of software (e.g. preparing routine documents.) Finally the remaining HR job

has become a highly specialized role of setting compensation. In the process the role of a full time recruiter has disappeared. As enough HR tasks are automated in this way, the department shrinks from a large team of HR staff requiring executive leadership to one or two specialists where one of the specialist can double as the team manager. There is also no longer walking down corridors and passing paper memos involved in carrying out the task. There is thus no longer a need to collocate HR in the corporate campus. The shrunken department could be located in a remote satellite office, reduced to entirely at home employment or outsourced to an HR support firm. In any case the historic executive's department and job no longer exist.

A couple of points about this transition are worth noting. First the recruiter's job has disappeared. This was a typical entry level position. Such lower skill jobs are often the easiest to replace with software. Second the HR executive's job as such has disappeared and instead there is a new role for an HR technical specialist who covers the residual HR tasks requiring human involvement. Third, there was no AI in the described system but the creation of the system opens the door to easy integration of AI. In particular AI can first contribute to and later ultimately takeover the task of candidate screening and compensation determination. In the process the technical specialist's job is likely to be further whittled away until it can be outsourced or eliminated entirely. Third, the job market has grown much more competitive. Applicants must respond promptly to new postings and must tailor their responses to pass the screening process of fairly dumb software. In the early stages of the hiring process looking like something other than a generic employee may get the application discarded. This fact reduces the value of broad experience in the hiring process. Fourth, the automation of the process has diminished the scope for personal networking, although when it can work it is potentially more valuable than before.

Putting all of these points together we begin to understand various features of the current job market. Yes employment is high. But entry level positions are scarce, formerly stable executive careers are insecure, the available jobs are increasingly specialized and the hiring process is highly

competitive and stressful. Not surprisingly anxiety about being unable to enter the middle class and fear about falling out of it are higher than would historically have been the case when the economy is at its present level of employment.

In our August 2024 issue we commented on the job issues faced by executive employees over age 45. It is worth reiterating the advice given there. First, loss of an executive salary can be a devastating economic blow in peak saving years. It is important to start savings earlier in life and build savings continuously throughout a career. Second, executives need to manage their careers so that they have worthwhile second career opportunities. Not only is lifelong employment a thing of the past, but single careers also are going extinct. We are in an era where the nature of work is much in flux and each percentage point of GDP growth is being accomplished with less need for human input than the previous percentage point increase.

Beneath the executive level, staff positions are being reduced evermore to a cog in the machine. We are already at the point where many employees are monitored and assessed by machine. We are not far from the point where some of them will be managed by machine. As corporate employment grows more mechanical niche opportunities are opened up for specialist consulting firms which can provide the flexibility that corporations are losing. Such firms offer a possible refuge for displaced executives.



Russo-Ukraine War

Putin is stuck in a war his military cannot win. The British estimate that the Russians lost 5000 tanks and armor personnel carriers in 2024. Russia commenced the war with a vast reserves of Soviet built armor. But at current loss rates, the Russians could be hitting the limit of those reserves by year end. Russia's new construction rate is measured in hundreds of units per year, not thousands. In short Russia's

war is not only not winnable but it is not sustainable in the medium term. Indeed the lack of machinery is already so grave we hear scattered reports of infantry being transported to the front line by golf carts and donkeys.

In our January commentary we noted that Russia has absorbed 700,000 casualties since the outbreak of the war in February 2022. That number is about 15% of Russia's 18-25 age male cohort which forms the nation's prime military potential. This war will leave a lasting mark on Russia's demographics. Russia is already in population decline with deaths exceeding births. The loss of so many potential fathers will not help this situation.

The Russians have been trying for a year to capture the Ukrainian town of Pokrovsk. At times their efforts have appeared threatening. But the latest troop movements suggest they have given up on this objective and they are turning their efforts elsewhere. Reportedly Ukrainian drones are so thick around Pokrovsk they have shut down road movement eleven kilometers behind the Russian front line. As a result the Russians are experiencing great difficulty resupplying and relieving their front-line units which are effectively isolated from their rear. If the Ukrainians can sustain this air dominance the Russian lines will eventually either break or be forced to fall back.

Despite these military setbacks, Putin continues optimistic that the Western alliance is crumbling and Trump will assist him to annex Ukraine. Putin's optimism is built on key European countries being led by weak coalitions and Trump betraying Ukraine. Indeed Trump has already cut off military supplies and intelligence support to Ukraine.

For Putin this is fortunate as his negotiating flexibility is quite limited. He will be very reluctant to acknowledge that despite massive effort Russia failed to fully occupy the territories it aspired to annex or that it could not retake its own territory from the Ukrainians. Similarly, he will be reluctant to demobilize his army and be faced with reintegrating to civilian life a traumatized and angry mass of veterans. Probably the only realistic settlement Putin can agree without risking his own position is to freeze the conflict along

its present lines and maintain an armed peace. But that solution would leave substantial Russian territory under Ukrainian occupation.

However, Putin is not asking for a ceasefire along current lines. His peace proposal is that Ukraine cede four major cities containing about a million citizens to Russia, disarm and accept its status as a Russian client state. Further NATO should basically withdraw to its position prior to the collapse of the Soviet Union. This is not a realistic demand given the battlefield realities. Primarily it reflects Putin's confidence that he can destroy the NATO alliance.

Whether Putin wins or loses in Ukraine, the damage is done to the US. The United States's credibility as an alliance partner is already destroyed. It seems likely a geopolitical realignment is underway which could well bring China into position as the world's dominant power. China probably prefers to keep Russia a dependent satrapy rather than allow it to rebuild its empire. A deal between China and the Europeans which ends the Russian threat but which gives China a free hand in the Western Pacific is a reasonable outcome to expect of Trump's foreign policy.



The Mideast

In the Middle East the Israeli military has won a victory, but now comes the political problem of translating battle field success into enduring political gains. Netanyahu is a master of the political game, but he has his work cut out for him. To his right, hard line politicians are unhappy with what they see as an incomplete victory. To his left, a substantial opposition continues eager to lynch him. Trump is an enthusiastic but chaotic ally currently in the pocket of Israel's extreme right wing. Nearer at hand, acceptable Arab leadership continues weak enough to not be a threat but also too weak to enforce a peace deal. Unacceptable Arab leadership is temporarily weakened but as hostile as ever.

Possibly the only silver lining is that much of the Israeli public understands the challenges and has realistic expectations of what their leadership can achieve. At this moment the Mideast looks unlikely to generate important consequences for investors, but it is not free of danger. If Trump seduces Israel into expelling Gaza's Arab population or attacking Iran, a war with significant impact on capital markets could result.

In Syria things seem to be moving favorably for the HTS and unfavorably for the US's Kurdish allies the SDF. In his first term Trump cut-and-ran on these allies and it is doubtful he will aid them now or that they will trust him. The HTS also seems to be tending towards allowing the Russians to maintain their naval base in Syria. That would be a sad development for NATO and it may encourage some of the NATO countries to provide more aid with fewer strings attached as a way to secure the expulsion of the Russians. In Lebanon, Hezbollah is trying to regroup but with HTS blocking supply lines to Iran, the process is proving complex. HTS also seems to be shutting down the narcotics peddlers that Assad sheltered in return for protection money. That move is appreciated by Syria's neighbors. There seems a hope that HTS could bring the country stable rational government. If so it will be a remarkable evolution for an entity that started life as an ISIS ally. HTS's preference seems to be for a Sunni dominated state with grants of toleration to but no real protections for minorities. However, it is showing some flexibility in allowing local administration under overall central direction. It remains to be seen if that vision can bring Syria the stability it needs to heal a tragically fractured society.



China

For the moment China's focus seems inward directed as it continues trying to repair its economy. That is proving no easy task, but it is still being seen as an aggravated cyclical problem rather than a structural problem. China's ambition to take Taiwan is undiminished and so the possibility of a US-China naval war remains in the scenario set. While China is actively preparing for that conflict, the US remains distracted by other priorities. Indeed Trump recently issued an order that the Federal government switch back to using plastic straws rather than paper straws in its canteens. China doubtless assesses the Trump administration will cut-and-run here too and that Taiwan will fall in its lap on the first show of force. Meanwhile China has dispatched a flotilla to conduct live fire exercises in the Tasman Sea – part of its continuing effort to browbeat Australia. With the US unstable and China threatening, we expect Australia to develop a strategic nuclear deterrent patterned on the UK's submarine arm.

China appears to be reducing its official holdings of US Treasury debt. Probably much of the apparent reduction is actually being transferred to nominees and front men. Some of it is being exchanged for gold and foreign currency holdings which are repatriated. These moves might be war preparations or they could simply represent portfolio diversification by China's Central Bank. But portfolio diversification on its own would not require use of nominees. At a minimum China has observed the measures taken against Russia's reserve holdings and wants to protect itself against similar pressures being applied to it.



The National Debt

The national debt is currently a focus of some discussion in financial circles. The debt has various components as shown in the next table

Table 1. Composition of National Debt
by holder

	Amount (T\$)
Held By Public	
...domestic investors	15
...foreign investors	10
..total	25
Held By Government	
...Federal Reserve	4
...Trust Funds & States	7
...total	11
Grand Total	36
Current Annual Interest	0.95

The total is about 100% of GDP and the interest is about 20% of the government's tax revenue. Neither figure is unmanageable. Causes for concern exist however. First some of the debt is in the form of low interest rate bonds issued in the 2010-2020 period. As these bonds mature they will roll over into new bonds paying substantially more interest. So the interest ratio is going to get worse. Second government holdings of debt are scheduled to decrease. The decrease comes about because the Federal Reserve is reversing its policy of quantitative easing implemented during the Covid crisis. Also the trust funds are experiencing negative cash flows as outlays exceed payroll tax revenue and as a result they are drawing down their holdings of the national debt. These dynamics mean that the quantity of debt held by the public will need to expand both to finance continuing government deficit and from the shift in how the debt is held.

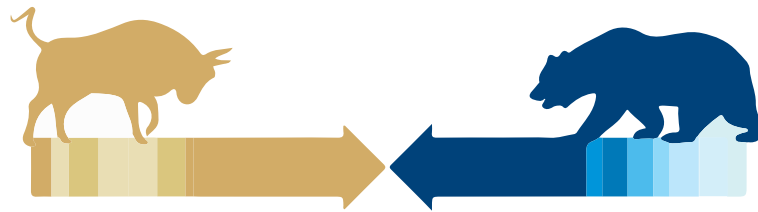
This increasing burden on the public will likely increase interest rates which in turn will increase the strain on Federal finances.

There are straight forward obvious ways to fix this problem. First one could raise income taxes, reduce spending and increase the age at which trust fund benefits fully vest. Second, one could continue to push inflation down and thus diminish the interest rate driven increase in interest cost. These measures would spread the burden of adjustment through the body politic and keep the pain from becoming intense in any one area. This approach was in fact what the Biden administration was roughly implementing.

The Republican approach is different. First they wish to raise tariffs. This will reduce international trade and trade surpluses held by foreigners. As a result foreigners will reduce their share of the US national debt, which primarily reflects banking of past trade surpluses on their part. That will increase pressure on domestic investors to expand their holdings and thus push interest rates up. Tariffs are also directly inflationary which pushes rates up. Second the Republicans propose to reduce income taxes and in particular taxes paid by the upper strata of society. This move is directly contrary to dealing with the debt problem. Third, the Republicans rule out changes to trust fund benefits or payroll taxes. As a result the entire burden of adjustment is thrown on spending cuts. These cuts are being focused in an ideological manner. Together with tariff increases, which fall heavily on the less well off, and reductions in social spending the burden is piled up almost entirely in one portion of society. So we would say the Republicans are not so much concerned about the debt as they are concerned to funnel tax cuts to their supporters and let the burdens fall on their political opponents. We expect that even so their plan will prove ineffective. Spending cuts have a way of being shelved or reversed by the political process. Interest rates will be buoyed up by the inflationary moves and borrowing costs are likely to come in greater than estimated. The debt ratios are likely to deteriorate.

So we conclude the government's fiscal problem is unlikely to be addressed effectively at the present time. While not yet a

crisis, the built in dynamic here is poor. Investors will need to keep an eye on this issue.



Capital Markets

Concerns about inflation and political instability are raising the price of gold. The US price has risen above the world price as traders speculate about the possibility of tariffs being imposed on imports of the metal. Heavy withdrawals are being made from the Bank of England's gold depository as gold dealers cash in on the geographic arbitrage. These withdrawals do not threaten the stability of either the banking system or the currency. If tariffs are imposed the result will be to expand the business lines of American smugglers.

Markets which had been in a rising trend have flattened out and paused to reflect. However there are certain points that stand out. Developed international markets moved ahead almost 15% while US large cap growth sold off nearly 5%. High quality lower risk bonds showed relative strength: medium term Treasuries, TIPS and Investment Grade Corporates. REITS also were strong.

Table 1: Recent Market Performance

Asset Group	Asset Class	6-month trend	6-month return	1-month return
Equity	US Large Cap	rising	-2.51%	-2.26%
	...Large Cap Growth	rising	-1.50%	-4.73%
	...Large Cap Value	flat	-5.61%	-0.46%
	...Growth – Value	outperform	9.02%	1.80%
	US Mid/Small Cap	flat	-8.94%	-4.38%
	Intl Developed	flat	3.13%	14.68%
	Intl Emerging	flat	-0.18%	1.12%
	Fixed Income	Treasury 3-7 year	flat	0.37%
Treasury 7-10 year		flat	-0.05%	2.20%
TIPS		flat	1.29%	1.52%
Municipal		flat	-0.89%	0.97%
Investment Grade		flat	-1.02%	1.71%
Medium Grade		flat	-0.02%	0.67%
Preferred		flat	-3.19%	0.06%
REIT		flat	-5.10%	4.37%
Commodity	Euro	falling	-1.94%	-0.36%
	Gold	rising	6.44%	1.33%
	Crude Oil	falling	0.57%	0.10%

Fans of American football whose team is trailing in the final quarter like to remind each other that “the show isn't over until the fat lady sings.” This aphorism is an obscure reference to Brunhilde's plangent lament for her lost lover at the conclusion of Götterdämmerung. In the present instance the fat lady is the world's capital market. She had expected to enjoy Trump's second presidency which she persuaded herself would be business friendly, low tax and confine its nasty side to drug dealers and other undocumented low life. Accordingly, it was with a purr of contentment that the lady welcomed Trump back to power. As they will, second thoughts are now having their day. The fat lady must now ask herself if Trump is another Liz Truss – an inexperienced politician in love with a specific policy prescription and prepared to push it through no matter how badly it fits the situation or how ruinous the consequences. With stretched equity valuations and ugly government debt ratios, the fat lady can certainly, if she so choose, voice her grief in a manner that will sweep other players from the stage. So a moment of tension is forming.



Advice

The United States is the ultimate source of political and economic stability in the world. With its economy amounting to about 25% of the global economy, the US is only able to fulfill that role by working with like minded foreign governments. Indeed it has spent decades nurturing that collaboration. Trump apparently believes the US is so powerful it need not work with allies and he can simply cut deals with our enemies. This view looks to be a ghastly miscalculation with systemic consequences.

Over the past decade US large cap stocks have nearly tripled in value. That increase was accomplished by a combination of earnings increasing 127% and valuation ratios expanding 31% (from a P/E of 20.84 to a PE of 27.4.) Suppose over the

next decade earnings increased by the same 127% but increasing inflation and global risks caused valuation ratios to regress to their 2015 levels. The return to stocks would still be positive – a 73% increase, but it would be far short of the tripling of values enjoyed over the past decade. Or to put it another way, the compound rate of return would drop from 11.53% to 5.64%. If inflation averaged 4% that would be a real return of 1.58%. That return would be just 63% of the 2.5% real return currently offered by TIPS. With the US equity market currently capitalized at \$62 trillion, the fat lady has a lot riding on stability, low inflation and thoughtful government in the US.

We observe that noted investor Warren Buffet has been trimming his exposure to large commercial banks which are some of the businesses most invested in stability.

Concerning as the start of the Trump Administration has been, its not necessarily the case that there will be four years like this. The Trump administration might settle down and begin listening to informed advice (possible, not likely), the enemies of the US such as Russia, Iran and China could be thwarted by internal issues (a good probability), Trump might die unexpectedly and bring Vance to power with a general reduction in bold moves (on an actuarial basis a 30% probability prior to the 2026 mid-term election), Trump's electoral bloc could weaken as inflation worsens (somewhat probable), some combination of Supreme Court Justices Roberts, Kavanaugh and Barrett could decide Trump is grossly exceeding his mandate and act to check him (a distinct possibility), the practical problems of implementing Trump's program could tie him up in endless complexities bringing forward motion to a halt (a strong possibility, perhaps even likely.) In short anything could happen, but usually much less than one imagines.

Our advice is to stick close to ones correct strategic position but to opportunistically increase cash holdings at present. Until the situation clarifies there is no pressing need to build long term holdings at the present juncture.

If a chronic persistent inflation becomes established the most secure assets will be TIPS, gold and in-demand income real

estate which is not rent controlled and which is financed with long term fixed rate debt. Investors may wish to familiarize themselves with those investment media at this time.

About the Cover Photo

The goddess Nemesis after Phedias. A temple to Nemesis existed close to the Athenian fortress of Rhamnous. The temple was destroyed by the Persians on their way to defeat on the nearby battleground of Marathon. After their victory the Athenians rebuilt the temple on an enlarged scale to house a 12 foot cult statute created by the famous sculptor Pheidias. The original statue only survives in fragments. This copy was made in the Roman period and it is now in the Farnese collection in Naples.

Traditionally represented as a beautiful woman, Nemesis embodies the implacable justice of the gods. Her specific role is to punish men and women of overweening pride. Typically she delivers an awful retribution by destroying the very source of pride while leaving the subject of her attentions alive to contemplate the folly of his ways and the ruin of his ambitions.

An interesting comparison is the Hebrew scriptures. Here there are references to avenging angels, but they remain nameless and their activities aim more at physical destruction than psychological devastation.



About Lloyd Tevis Investments

Lloyd Tevis Investments LLC is a registered investment adviser offering its services over the internet to US individual investors and their families. Our Precision investing service provides clients with highly personalized investment solutions tuned to the client's specific circumstances and objectives. We believe the strategic asset allocation decision is the key decision faced by our investors. Accordingly, our monthly commentary focuses on matters which can shape the longer term performance of asset classes. We do not time market swings or pick individual stocks. Discussion at this level of detail is made for the light which it throws on relative valuations and such discussion should not be read as an investment recommendation. Indeed, our investment focus is on maximizing diversification, careful risk budgeting and maximizing implementation efficiency. These are the proven builders of long term investment success. In evaluating political and social developments our perspective is that of long term investors. We believe the investor's interest is best served by a stable environment in which change occurs incrementally as broadly supported policies rather than by an environment of abrupt changes and frequent U-turns driven by transient partisan advantages. Finally, our assessments should always be read as what we consider likely to occur and not as expressions of what we would like to see come about.

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