Nordwand Capital LLC

YTD Market Commentary

Tariff Uncertainty Dominates Markets

May 6, 2025

Tariffs Roil Markets, Followed by a Strong Bounce

Ordinarily we limit our quarterly market commentaries to the end of the most recent quarter; given all of the developments in April we broke our rule and held the piece a bit longer than usual to incorporate market and economic developments following the April 2nd Liberation Day tariff announcements.

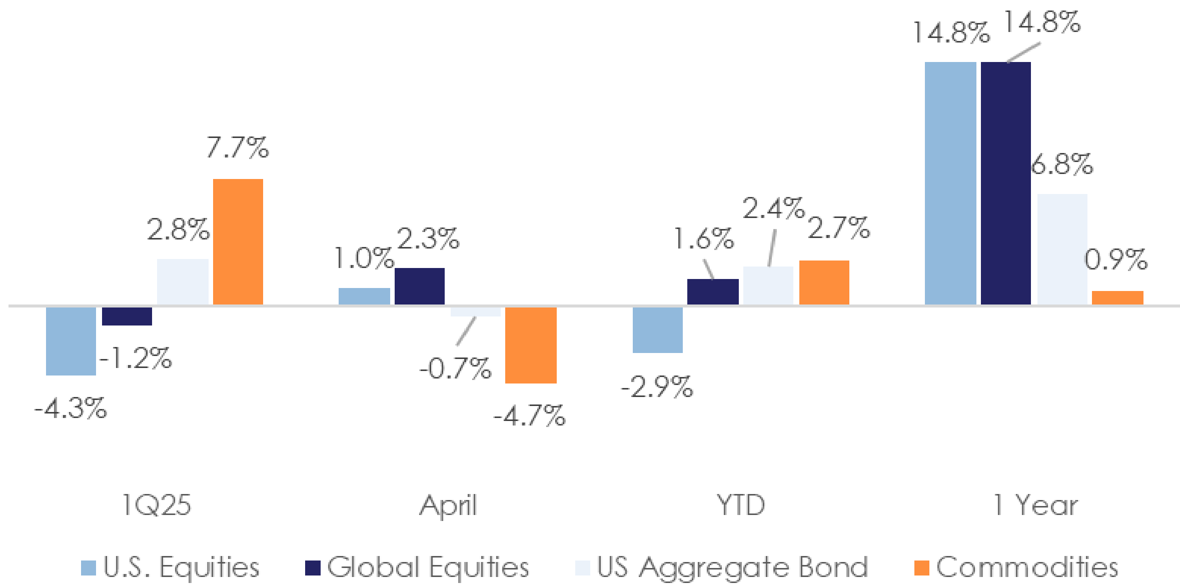
Overall, equities were weaker in 1Q25 – before the April 2nd tariff announcements – than they were in its wake. Bonds and commodities rallied somewhat in 1Q, only to sell-off in the last month. A great many things factored into these moves, some of which we'll discuss below.

The most important takeaway for clients should be that with the return of Trump we are seeing the return of volatility. In fact, the combination of personal communication style coupled with policy goals that seek to upend deeply entrenched post-war trade, alliance, and security policies really can't lead anywhere except short-term uncertainty.

With that said, we would remind clients to remain focused on goals and adjust portfolios accordingly. Shorter-term goals such as philanthropy or other large family cash needs should take into account the potential for poor exit timing; those with longer-term growth goals may be positioned to take advantage of good values and fortuitous entry points. As always, it depends on what your needs are.

We will focus this quarterly letter more closely on the impacts affecting public markets and return to our regularly-scheduled programming with the 2Q letter. Below we will discuss some of those thoughts as briefly as possible.

Figure 1: Asset Class Returns
(1Q25, Post-Tariff Period, YTD & 1-Year)



Source: Bloomberg, Nordwand Capital as of 5/2/2025.
Note: US equities = S&P 500 Index; Global equities = MSCI ACWI Index. "April" category includes period from "Liberation Day" tariff announcement on April 2 through market close on Friday, May 2, 2025.

In Figure 1, we attempted to highlight the relevant periods to analyze the short-term impact of the trade policy shifts that are potentially underway. Equity markets in the US were weak to start the year. With runaway tech success in 2023-2024 and valuations stretched, it should not be a surprise that investors entered this year skittish about their holdings. At home, value outperformed growth; energy, utilities, and healthcare outperformed tech and consumer discretionary. Globally, emerging markets and Europe performed better than the US. In other words, 1Q25 represented an unwind of risky positions going into the end of the year as investors got spooked and felt they were in a bad place to ride out any potential storm. A very logical – and very orderly – response to the worries we have been discussing with many of you over the last 12-24 months.

What's really notable, however, is the response to the April 2nd announcements. Inclusive of the negative affects on April 2 and the following days, money came back into equities quite strongly. This repeated itself not just in the US, but around the world – with developed markets and emerging markets all bouncing; except China, which alone among the major markets we track was down post-April 2nd.

Commodities were also down over the last 4-5 weeks, led by crude oil in the wake of the OPEC+ announcement it was increasing crude supply. West Texas Intermediate crude has dropped almost 20% in the last month through May 2nd. In fact, on May 3rd OPEC announced an additional ~400k barrel increase to be effective in June, so crude prices could see more weakness the week of May 5th. There are many reasons for the OPEC and Saudi decisions, one of which is a desire to punish quota-breakers within the cartel by forcing prices lower with a supply hike[1]; another reason has to do with geopolitical ties to the US and the favorable conditions it creates for the US economy if headline inflation prices fall due to dropping crude and gasoline prices ahead of summer driving season.

Importantly, lower crude prices will put downward pressure on headline inflation, although they are excluded from the core measures often cited by the Federal Reserve in its decision-making. Regardless of the Fed's public stance, any reduction in prices that hits American pockets tends to result in higher confidence, more spending, and positive economic traction. In light of the 1Q25 GDP results that showed a -0.3% contraction, relief from lower prices will be welcomed.

The topic of 1Q GDP is worth a brief detour. There was a significant frontloading of import activity in the first quarter (think fixed investment purchases of computer and communications equipment) that led to an estimated -4.8 percentage point drag on GDP – the largest on record going back to the 1940s. This is expected to reverse as we move through 2025, which will in turn have higher GDP impacts on those periods. There is also a shift in government spending practices that is as-yet undefined but could be leading to lower government employment and expenditures. The pressures that could materialize on employment and GDP later in 2025 are factors we are watching closely, of course.

Into this maelstrom enters the Fed, which has its next meeting on May 7th. The politics of this issue clouds the realities sometimes, so we'll hope to cut through the former and focus on the latter. The first thing to recall is that the Fed is already in a rate-cutting posture, one that began with a 50-basis point (bp) cut last September and was followed by two more 25-bp cuts before the end of 2024. The second is that the US government has somewhere on the order of $9+ trillion of debt to refinance and term out (to some degree) in 2025.

In other words, the Fed is cutting already and the government has every interest (pun intended) in seeing lower rates that reduce refinancing and long-term interest costs. While we don't expect a cut at this week's meeting, we think we will see more cuts this year. Further, if trade deals materialize they will place downward pressure on inflation expectations, making it safer for the Fed to cut. Finally, government employment seems poised to slow down if not reverse – which again would be accommodating to a central bank weighing whether or not to cut interest rates to meet its dual mandate of stable prices and employment. Recent trade news from Asia suggests some of these developments may be emerging, although it's far too early to detect a solid trend here, in our view.

On the topic of tariffs, we are hesitant to play the role of expert. But there are some overarching things worth keeping in mind. First, the US trade deficit ballooned to almost $123 billion in 1Q25, partly due to the frontloading issue we noted above, but even absent that growth we've been running an average $75 billion monthly trade deficit over the prior three years. Second, the signing of the North American Free Trade Agreement in 1992 and China's accession to the World Trade Organization at the end of 2001 brought with them changes to our trade policies that have accelerated current account deficits that are widely noted as problematic.

Putting these changes into context, we would point out that, according to the US Bureau of Economic Analysis, the US ran a $39 billion trade deficit in 1992; that figure exploded by 2024 to $918 billion (Figure 2). Even more starkly, China was admitted to the WTO in 2001 but was under a

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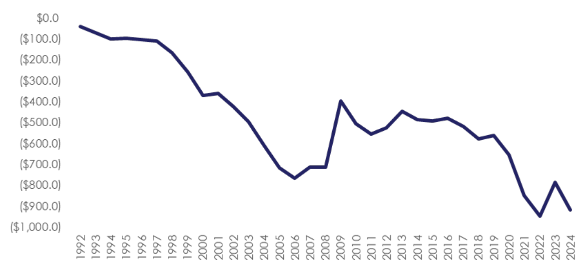
[1] *Saudi Arabia has among the lowest finding and development (F&D) costs for crude in the world, making profitability possible for them at very low prices, while some peers who've been taking advantage of the previous supply caps and the higher prices they created to sell "illegally" into the market often irks the Saudis.*

15-year pathway with conditions that effectively ended in 2016. During that 15-year period, the trade deficit grew at a modest pace; since 2016, the trade deficit has doubled.

Figure 2: U.S. Trade Deficit
($billions, annual since 1992)



Source: Bureau of Economic Analysis, Bloomberg, Nordwand Capital as of 5/2/2025.

Figure 3: U.S. Budget Deficit as % of GDP
(Nominal, 1968-Present)

Source: Bloomberg, Nordwand Capital as of 5/2/2025.

We remain extremely cautious about the pacing, tone, and the goals involved in changing trade policies and reverting to pre-war tariff structures and trade agreements – including concerns over the second-order effects on US strategic power projection around the globe – but we also should acknowledge that our trade and fiscal policies have been long-term issues called out by both parties and economists of all stripes for the last 30+ years. In fact, we've cited the fiscal budget deficit (Figure 3) in prior commentary letters as a source of concern, even as it lingers now near unsustainable 7% levels.

Tactically, without a de-escalation of the tariff conversation or successful negotiation of successor trade agreements, technology hardware, telecom equipment, autos, and certain areas of consumer products are negatively exposed to import duties. On the flip side, US-based manufacturing, metals, services, and utilities could be relative winners given the sourcing of their supply chains or the nature of their businesses. But as we noted at the outset, volatility is the most certain near-term outcome.

Summary

This is an unusual period of time – although it feels we keep finding new ways to say that over the last 2+ years. Whether it was emerging from the Covid shutdowns and dealing with global supply chain and demand disruptions, digesting monumental levels of fiscal stimulus, rapidly vacillating monetary policy objectives, or a potential fundamental re-thinking of US trade policy… we've all had a lot on our plate.

Equity markets have risen through this period, with markets still notably higher than they were 1 year ago, in fact. While we worry about the path of trade discussions, we also believe that as of now growth continues to win the day in public/listed markets. We continue to believe that EM and non-US developed markets can be effective hedges against over-exposure to the US, and that pockets of private credit and purposeful exposure to private equity markets can be highly productive pieces of a portfolio. This is especially true when volatility picks up and has proven so through the first four months of 2025, we believe. We look forward to speaking with you all soon.

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