GCM Quarterly Report

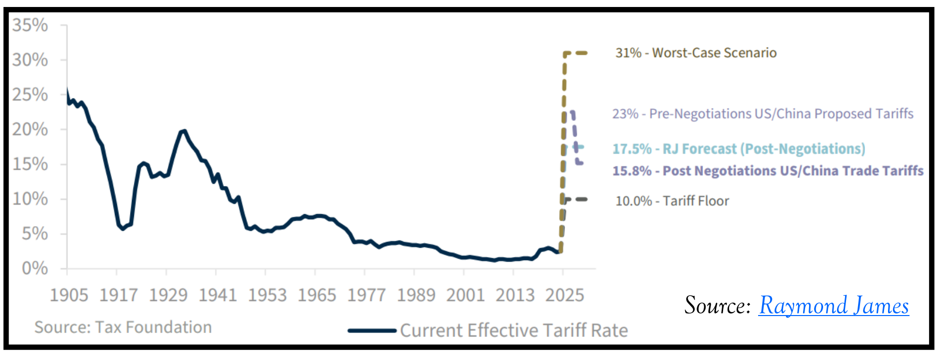
May 2025

Springtime means baseball is back! Much like investing, the 162-game baseball season is a marathon rather than a sprint. Teams must maintain level heads and healthy benches from early April until late October if they want a chance at the World Series title. Also like investing, successful ball clubs experience their fair share of defeats; even the best teams typically only win ~2/3rds of their games in a given season. In fact, the 2024 World Series champion LA Dodgers won just 60.5% of their games last year.

LA Dodgers superstar Shohei Ohtani signed a blockbuster contract early last year with unconventional terms. Rather than receiving his salary in annual installments over the contract period, Ohtani elected to defer the bulk of the income until a decade from now. Why? This article from NC State's business school tries to answer that very question. For those of you seeking additional financial stimulus this quarter, we hope you enjoy this slight tangent from our usual discussion topics.

Tariffs and politics

We begin with the main economic news of the quarter: tariffs. President Trump's announcements on "Liberation Day" initially sent markets into a tailspin. Not only was the tone more aggressive than many expected, but the new tariff rates were orders of magnitude higher than forecasted. After a period of large single-day swings, markets have ultimately recovered much of the initial declines as positive developments have emerged regarding trade negotiations. However, it's our opinion that volatility is likely to remain elevated for the foreseeable future. It is the president's belief that the rest of the world does not trade with the United States on fair terms, and he has made correcting this imbalance a key (if not THE key) tenant of his second term. Until investors are able to gain real clarity concerning global trade negotiations and their impacts on economic growth (both domestically and globally), we anticipate the risk of market swings will remain elevated. Even if the outcomes of these negotiations ultimately turn out to be positive, market participants will not like uncertainty in the meantime. A link to a brief Q&A with Raymond James's strategists concerning the temporary truce with China can be found here.



Source: *Raymond James*

Corporate earnings

It has been a busy quarter. With earnings season almost wrapped up, results have been better than expected but forecasts are, unsurprisingly, a bit more uncertain. For the January-March period, (with about 3/4ths of S&P 500 constituent firms reporting), aggregate earnings growth has been just over 13%

Market Statistics	YTD	Trailing 12 mo	3-year annualized	5-year annualized
S&P 500	-4.92%	12.10%	12.18%	15.61%
Dow Jones Ind. Avg.	-3.65%	6.83%	10.80%	14.41%
Russell 2000 (Small cap)	-11.67%	0.49%	2.84%	9.46%
MSCI EAFE (Foreign developed)	11.76%	12.57%	10.07%	11.37%
MSCI ACWI (Global)	-0.40%	11.84%	10.27%	13.07%
MSCI Emerging Mkts.	4.28%	9.02%	3.85%	6.35%
Bloomberg US Aggregate Bond	3.18%	8.02%	1.95%	-0.67%

Source: Morningstar, as of 04/30/2025

compared with the first quarter of 2024. Highlights include the sectors of healthcare (+42.7% earnings growth over Q1 2024), communications (led by huge upward surprises from Alphabet and Meta), and technology (thanks to Apple and Microsoft in particular). On the other hand, the energy sector has reported the weakest earnings, with a 14% decline as of this writing. Factset's analyst John Butters attributes lower earnings to lower oil prices compared with this time last year.

Importantly, profit margins have also expanded slightly. For the first quarter of 2025, aggregate margins are estimated at 12.7% compared to 11.8% this time last year and a 5-year rolling average margin of 11.7%.

Now for the cautious side. Although results for the first quarter were good, many firms (and analysts) are lowering guidance for the next few quarters due to tariff-related uncertainty. Executives love to "under-promise and over-deliver," so tariffs may simply be offering them the perfect opportunity to do just this, but we expect tariffs will impact some sectors of the economy more than others – particularly discretionary goods and materials.

Raymond James's equity team has cut their calendar year 2025 earnings forecast from ~$270 per share for the S&P 500 down to $250-255 per share, representing a 5-6% reduction. However, it's important to note that earnings of $250-255 would still represent an increase over 2024's figures of 2-5%. They believe that the healthcare and financial services sectors are most insulated from tariff impacts, while discretionary goods are likely to be most impacted.

Consequently, Raymond James's team has also lowered their S&P 500 price target for 2025, from 6,375 to 5,800, now representing a low single digit return for the year. While price targets should not be considered exact forecasts, they are helpful for determining where the balance of risk lies (upside, downside, or neutral). Based on their current year-end price target, RJ's analysts believe the market is fairly priced at current levels. Further progress on the trade front could increase this price target, while speedbumps are likely to lower it.

The economy and the Fed

Economic growth for the first quarter of 2025 declined for the first time in 3 years. GDP is calculated as the sum of several factors, including consumption, investment, government spending, and the difference between imports and exports. While most of these factors actually grew during the first quarter, the trade balance (exports minus imports) cratered due to companies accelerating their imports of materials and goods ahead of tariff announcements. It's not clear how the relationship between imports and exports will change over the coming quarters, as it will likely depend heavily on ongoing negotiations, but the expansion of household consumption and business investment was welcome news under the surface.

The personal consumption expenditure index, or PCE, is the Federal Reserve's preferred measurement of inflation. This index saw a notable rise during the first quarter, from 2.4% for the fourth quarter of 2024 to 3.6%. Excluding the more volatile components of food and energy, the index still increased by 3.5%.

Given this data, the Federal Reserve yet again finds itself in a difficult position. The economy is indicating softening (but stable) conditions, while inflation remains stubborn. There are mounting external pressures to lower rates, but we believe the Federal Reserve will remain "data driven" and act accordingly. The policy mistakes of 2022 remain fresh in their minds; given the choice between lowering rates at the risk of runaway inflation, versus maintaining rates at the risk of tilting the economy into a recession, we believe they will err towards the latter.

What we'll be watching

We end where we began: tariffs. You may have noticed that tariffs have peppered our quarterly commentary. International trade hasn't been this big of a news story for decades. We expect trade will remain front and center (at least as far as economic news goes) for the foreseeable future. We are hopeful that negotiations with China, Japan, and South Korea in particular can make meaningful progress, though not overnight. Resolution with Europe may take more time, as the many nations comprising the EU will have different demands and expectations. Markets are nervous, poised to move quickly (up and down) according to the developments of the day, but our plan is to continue managing portfolios according to our time-tested principle: invest in a diversified and balanced manner according to one's unique time horizon and risk tolerance. Stay calm!

Ben's corner

After a multi-quarter sabbatical, my editorial finally returns to the subject of finance. Tariffs seemed like the obvious choice, but I was hesitant to cover a subject that is so politically charged at the moment. So, while staying within the realm of tariffs, what I've decided to do is tell the (sort-of) famous story of a particular tariff: the "chicken tax" of the 1960s. For disclosure purposes, some of the information presented below will be cited with appropriate sources. However, this is mostly my version of the story as I know it, cobbled from various sources and people over my lifetime (or at least, however long I've been aware of the tale).

For better or worse (almost definitely worse, though) we take commercially farmed chicken for granted today. Chicken is inexpensive, lean protein that can be cooked a thousand different ways, and its mild flavor allows it to be paired with just about anything. Prior to World War II, however, chicken was considered a luxury due to the amount of food/grazing land chickens require plus the infrastructure needed to protect them from predators. A brief tangent – it's funny how our perceptions of various commodities change with time and technology. As another example, aluminum was more valuable than gold when it was initially discovered in the 1800s because there was no efficient way to refine it out of the ore from which it was mined. Napoleon's dinner parties featured aluminum cutlery for the V-VIP guests and the tip of the Washington Monument was cast in aluminum in 1884 as a symbol of the nation's wealth.

Back to chickens. Commercial chicken farming started to take off in the United States after WWII, shifting chicken from a luxury delicacy to a low-cost everyday staple. Our friends in Europe weren't so lucky, with chicken farming remaining an expensive proposition (perhaps because they thought chickens deserved humane cultivation standards, but that's a different matter for a different editorial). Consequently, the United States started exporting cheap chicken to Europe, quickly bringing down domestic prices and destabilizing the European poultry industry. By the early 1960s, US imports represented half of all chicken imported to Europe. The response from Europe was not unlike some of the rhetoric of the past few months, with European leaders claiming the US was dumping chicken at a price below cost to manipulate the market. The French went so far as to suggest hormone-treated chicken from the US could negatively impact male virility (of course they did). It wasn't long before Europe instituted sharp price controls and tariffs in an effort to protect their own domestic interests.

These actions did not make US farmers or their representatives in Washington happy. In 1963, after much diplomatic jawboning, President Johnson used his executive order authority to implement a 25% tariff on a handful of imports which most notably included light trucks. Why light trucks? While the tariffs had global reach, they were intended to target specific European exports. According to this article from the New York Times, there was some horse-trading between LBJ and the United Auto Workers' union at that time, and the tariff on light trucks was an olive branch to the UAW to combat increased competition from Volkswagen's Type 2 utilitarian commercial vehicle.

Although Europe's import duties on poultry are mostly gone, the "chicken tax," as it became known, is still in effect today; all light trucks built outside of the US are taxed 25% on import. While this has effectively meant no "light trucks" are imported to America, several manufacturers have attempted to circumvent the "light truck" classification. At one time, Ford imported their Transit vans from Turkey with rear windows and seatbelts to classify them as "passenger vehicles," then immediately removed these items after passing through customs. In the late 70s, Subaru imported their BRAT (which looks like a small Chevy El Camino) with two rear-facing plastic chairs bolted in the truck bed to classify it as a "passenger vehicle" despite the fact that no one with a functioning brain would sit in them for more than a stationary photo op. If you don't remember the BRAT, I encourage you to search Google for a photo, or ask Peter about his back in college. The seats are very silly, unless you went to college a short drive from Daytona Beach.

Are we better off because of the "chicken war"? The Cato Institute says no. They argue that the lack of global competition has allowed domestic truck makers to continually raise prices. Indeed, pickup trucks are among the Big 3's most profitable offerings. Although Ford does not report profit-per-vehicle, this article suggests Ford earns up to $10,000 in profit per F-150, accounting for 90% of Ford's profits globally. It's true that Toyota and Nissan both have factories in America to build and sell pickup trucks* to Americans, but it's important to note that 1) the trucks they sell here are vastly different to the ones they sell overseas, and 2) their sales figures pale in comparison to Ford's F-150, GM's Silverado/Sierra twins, and the Dodge Ram.

For these reasons, I sort-of agree and sort-of disagree with Cato's argument. On the one hand, it's clear that the kind of Americans who typically buy pickup trucks typically want to buy American-made pickup trucks, and more trucks offered by more manufacturers probably wouldn't sell all that well here even if there was no chicken tax. However, on the other hand, protectionist policies have hampered competition (and, in my personal opinion, have allowed domestic automakers to get lazy), and any reduction in choice is not in the consumer's best interests. We'll never know, but it's possible the light truck market would have looked different today if not for the chicken tax.

**Several of our readers are Honda Ridgeline owners and may notice I did not mention the Ridgeline or the Hyundai Santa Cruz. Call this editorial prerogative, but these two vehicles are not built on ladder frames like traditional pickup trucks so I have elected to exclude them from my definition of the term "pickup truck." However, they are both fine vehicles in their own right, and they are both manufactured in Alabama. They also... don't sell very well.*

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