THE DANA VIEWPOINT

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What if…

Tariffs don't cause inflation, a lasting peace comes to the Middle East, and interest rates fall?

The last six months have provided a strong example of why both individuals and larger organizations should not stray significantly from their baseline investment allocations aligned with their goals and risk tolerances. As we have said before, emotions tend to play a greater role in investment decision making at market extremes. However, an investment approach and allocation that is developed outside of the emotion of the moment allows for more consistent and better long-term investment decisions. As we wrote almost six years ago in 'Lessons Learned':

> "Usually, the lessons that will help us most as investors are the hardest to learn and practice because most useful lessons pertaining to investments are counterintuitive. One is that 'group decisions' are many times poor and late. Both individual securities and active investment strategies go through cycles where they outperform and underperform. It is difficult to step up and purchase a security after a period of underperformance, and it is easy to come up with many justifications to purchase a security after a period of outperformance. Buy high and sell low is the rule followed by most inexperienced, emotional investors, trend followers, and pure momentum investors. This is not a way to beat the market. Some degree of contrarianism is essential for significant success. After all, the market itself is a distillation of the groupthink of all the participants in the market."

In April, it was a strongly contrarian view that tariffs would not cause significant inflation. Jerome Powell still seems to believe it will. Unannualized CPI has averaged one tenth of one percent for the last four months. That's not inflation.

It is likely that the ability for the Administration to impose tariffs under their chosen statute will be curbed by the Supreme Court. Also, countries are coming to the table and unilaterally dropping some of their retaliatory tariffs. China has made a deal with the U.S. on rare earth metals, and Canada has dropped their plans for a digital tax on U.S. tech company revenues. We reiterate that we believe Trump's goal is actually lower net tariff levels across the world; i.e., freer trade.

Through the first six months of the year, the U.S. has collected almost $100 billion in tariffs, double the pace of 2024. Treasury Secretary Scott Bessent has said that he believes the U.S. could collect $300 billion in tariffs this year. That would completely offset the tax incentives and other benefits of the Big Beautiful Bill. Many of the business provisions in the bill are very pro-growth, including accelerated expensing of capital investment. If this is true, the economic drag of the tariffs would be completely offset by the positive tax law changes. It is also accepted among economists that 100% of the burden of the tariff would not be passed on to U.S. companies and

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consumers; so the net benefit of the new tax law is even greater to the U.S. economy. This net stimulative growth policy is probably the only way the U.S. can move towards lower structural deficits.

As the markets have stayed resilient, the prospect for near-term rate cuts has been pushed back, and intermediate Treasury yields have stayed in the mid-4% range. A couple more muted inflation reports should allow the Fed to begin rate cuts, providing another boost to the markets and the economy. It would certainly benefit the housing sector, where activity has slowed. Over the last 25 years, we have become accustomed to the Fed cutting rates for dire reasons: market shocks, Covid, and recessions. Now we are in a position for the Fed to cut for a positive reason, creating another economic and market tailwind. Muted inflation and Fed cuts would provide for stronger total returns in bond portfolios for the remainder of the year.

Rising capital investment by businesses, lower rates, and continued decreasing inflation would certainly be good for the equity markets. Maybe the markets are telling us that already. Following the sharp bear market in March and April, the forward price earnings ratios on some of the mega caps, including Apple, Amazon, and NVIDIA, are at multi-year lows. That doesn't sound like an overvalued market. We will be diligent and continue to look for opportunities to improve our portfolios.

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