January Commentary

Tossing Trinkets in a Parade and "Pie in the Sky"

For most folks, the last week of January 2025 was little more than the lull and necessary off-week between the NFL conference championships and the Super Bowl. However, it was full of important and potentially worrisome information for economic and investment types.

To those of you who were hyper-focused on professional football, and I don't begrudge you for that, there was a meeting of Federal Reserve Chairman Jerome Powell and his cronies of the Federal Open Market Committee (FOMC). Also, The Bureau of Economic Analysis (BEA) released its first Gross Domestic Product (GDP) calculation for the 4th Quarter of 2024. Hordes of analysts waited anxiously until the last day of January to get the PCE Price Index numbers. And lastly, Apple, Meta Platforms (Facebook), Microsoft, and Tesla reported their most recent quarterly earnings. So, too, did the following companies: Altria Group, American Express, AT&T, Boeing, Caterpillar, Chevron, Colgate-Palmolive, Exxon Mobil, General Motors, International Business Machines, Lockheed Martin, United States Steel, and Whirlpool. However, it isn't the 1980s or 1990s anymore, and those firms don't typically make a lot of headlines with their reports anymore. To quote my boss and our Chief Investment Officer, Bill Lanzon, "This isn't your grandpappy's S&P 500 anymore."

If that wasn't enough, we had the market meltdown on January 27, which wasn't much fun. If you missed it, a Chinese artificial intelligence (AI) company named DeepSeek claimed it made considerable advancements in the tech space for a fraction of the cost and the hardware compared to well-known behemoth American AI leaders. My limited understanding is that DeepSeek used competitors' AI to build its own AI platform. Go figure. Investors did not like what they initially heard, and the market reacted accordingly. However, I've been around long enough to know that if it seems too good to be true, it probably is. Does it strike anyone else, or is it just me? DeepSeek sounds more like an ocean-going treasure-hunting outfit than a technology industry disruptor, right?

As for all the stuff we investment nerds had been anxiously awaiting? The Fed gave us a real nothing burger and reiterated what it said at its last FOMC meeting. The GDP report and the PCE Price Index release data were almost spot on with most estimates. And, while Meta Platforms hit it out of the park, you could sum up the earnings releases of the other tech giants as "fair to middling" — could have been better but certainly could have been worse. All told, by the time the dust settled, the S&P 500 was up a very modest amount the last week of January until it wasn't. It was looking good until just after lunch on Friday, January 31. Frankly, the last few days of January had the feel of a basketball game where one team quickly jumped out to a double-digit lead. Then, the teams just traded baskets until the final buzzer. The good guys were ahead until the markets became highly concerned about the tariff deadline or the so-called proverbial line in the tariff sand.

And then, just like that, and to no one's surprise, the Trump Administration informed Mexico and

Canada of a 25% tariff on each country. If Ottawa and Mexico City don't blink, this action could be a significant problem for those export-heavy economies. For its part, China is to get a 10% levy, though Xi Jinping probably expected worse. Consider these facts: Mexico's total trade (exports and imports) with the United States was nearly $800 billion in 2023, making it our largest trade partner. The entire GDP of Mexico was about $1.8 trillion, so it doesn't take a brain surgeon to realize that trade with the United States is significant to the overall health of their economy. For Canada, overall trade with our country reached about $775 billion in 2023. That represented almost 40% of the Canadian economy, which was $2.1 trillion. By comparison, the combined trade with Canada and Mexico equaled only about 6% of the total U.S. GDP of over $27 trillion in 2023. I will admit that American consumers might not like the prospect of higher prices on Canadian and Mexican-made products. But I have to believe that Canadians and Mexicans are in three-alarm fire mode about the threat of onerous tariffs. Most would agree that the U.S. would win this trade war if push comes to shove.

You can call the tariff policy bullying if you'd like, though the tariffs aren't necessarily permanent. It will depend on how badly the political leaders in either foreign country wish to trade with the United States. You might think I am being somewhat cavalier about the punitive tariffs the Administration is tossing around like candy and beaded necklaces from a Gasparilla Parade float. Please make no mistake: tariffs could impede trade, harming economic activity. However, the White House aims to get foreign countries to 'toe the line' or play by its rules rather than restrict trade. Remember the crass expression, "Money talks and BS walks." We will see how loudly that resonates over the coming weeks and months. As of this writing, Mexico and Canada have capitulated and agreed to make their respective borders more secure. This compromise gives both countries a reprieve from the initial 25% tariff salvo for at least 30 days. As expected, China almost immediately announced retaliatory tariffs on select American imports and an antitrust investigation into Google. There will be more to come from China and Xi Jinping, for sure.

It makes sense that imposing hefty levies (tariffs or taxes) on foreign products would increase prices. However, it isn't as straightforward when you start peeling back the proverbial onion layers. Let me start by saying that historically, trade has been incredibly beneficial for economic growth. The dissemination of goods, services, technology, information, ideas, and, yes, money across country borders and around the globe has allowed us to enjoy the lifestyles we have today. So, it goes without saying anything inhibiting trade could be detrimental to economic activity. With that in mind, what is most likely to happen to consumer prices if there is a slowdown in the economy? By definition, a downturn in economic activity would mean a decrease in demand. If what we learned in Econ 101 is true, when demand for anything falls faster than supply, the price of that item will decrease to a point where supply is equal to demand. As such, if these proposed tariffs hurt overall economic output, consumer prices, taken together, would start to fall at some point - this is just what happens when people stop consuming stuff. That should make some sense. However, prices will most likely rise in the short term because everyone in the entire supply chain operates with a target profit margin in mind, from the firm sourcing raw materials to the retailers selling the final product. Remember this, businesses will do anything they can to make money and turn a profit.

However, someone, somewhere, will have to absorb, say, a 25% tariff that gets added to the cost of products. One thing is almost certain: the consumer isn't going to eat all of the tariff increases. Follow my rationale for just a minute. Suppose consumers would currently pay 25% more for a product/service. Don't you think shrewd businesses would already take advantage of that reality? Truth be told: the marketplace would have sniffed that out long before the imposition of a tariff. No doubt, a consumer might occasionally cough up more than they would like for some things: once-a-year sports events, a round of golf at an iconic course (Pebble Beach is my choice), a brand new hard-to-get automobile, and the like. And those of us inclined to buy food or beverages at an airport certainly know what I mean. Let's face it: would we, or maybe just me in this case, continue to consume as much of Breakfast Biscuit X (disguised as not to offend the merchant) if the airport price were the prevailing market price everywhere? Probably not.

So, you and I need to be prepared to answer the following questions: Are we willing to pay significantly more for [name the product] because of a tariff? Don't we still have a say in the transaction, and can we walk away if we don't like the asking price? Can't we look for alternative products if we don't like the prices? Of course, we can. In a consumer-driven economy like ours, we have the last word about the price we are willing to pay. Unless it is a government-protected monopoly (utility company, etc.), there is precious little "take it or leave it" price setting in the real world. For argument's sake, let us assume we have to spend significantly more on some products because of tariffs, which means we will have less to spend on other things. In that case, the makers of all types of widgets and gadgets have a decision: should they keep producing the same amount and accept lower prices? Or should they cut back on supply to maintain price stability? Suppose they continue to make products at the same level and accept a lower price. If that happens, this will dampen the inflationary pressure from tariffs. If they decide to produce less, the demand for all the inputs necessary to make their products will also fall. As a result, prices will be reduced across the board, having a ripple effect on the economy. Essentially, businesses will be hard-pressed to pass along all their cost increases to the end consumer. If they could, they would, and companies would never go out of business or lay off employees. And, as we know, those things happen too often in our economy.

In the end, are tariffs good or bad? If compelled to choose one over the other, I would say tariffs are a cause for concern in the short term. Frankly, I can't fathom any scenarios where they are excellent across the board unless Trump and his congressional allies can bring to fruition the "pie in the sky" idea of eliminating personal income taxes and replacing them with tariff revenue. Now, that alone might earn him a spot on Mount Rushmore! In all seriousness, tariffs might cause pain in select industries. Even still, their impact on the entire economy won't be close to the nightmare scenario many in the media are claiming. The economy won't fall through the floor, and inflation isn't going to bust through the roof.

So, that is how we ended the first month of 2025 and turned the last week of January red. It wasn't DeepSeek, nor the economic data or earnings releases. It was unquestionably the threat of tariffs on Canada and Mexico under the guise of inducing both countries 'to do more' to stop the flow of illegal immigration and drugs into the United States. We will need patience and thick skin to reach the outcome as the administration continues to throw "goodies" from the parade float. Still, I'm hopeful this passes quickly, allowing investors to focus on other things.

Until next month—

by David Lackmann
Florida Director of Investment Management

First American Bank

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