Quarterly Market Letter

GENTER CAPITAL MANAGEMENT

First Quarter 2025

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- Inflation up, GDP down, unemployment sideways
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Introduction

"April is the cruelest month," T.S. Eliot writes, because, in his view, it bears the false promise of new beginnings. "Winter kept us warm, covering Earth with forgetful snow," he adds, but then asks, "What are the roots that clutch, what branches grow out of this stony rubbish?" He answers: "You cannot say, or guess, for you know only a heap of broken images, where the sun beats." In other words, spring is mere camouflage for death, dying, and shattered dreams.

Eliot may have been raised in St. Louis and educated at Harvard, but his perspective is not very American (indeed, he would renounce his American citizenship in 1927 to become a British subject). Americans realize that our earthly lives have a mortal ending, of course, but that is no reason to be ungrateful for fresh starts. Our country was *built* upon the idea of starting anew. Whatever the sad outcome at the end of the road, there is still life to live, liberty to treasure, and happiness to pursue.

The American approach to new beginnings is captured in the way we welcome a new baseball season. For baseball enthusiasts, April is the moment where there is more optimism than cynicism, more hope than hopelessness. As the season grinds through its lengthy schedule, unfurling its stories and unleashing its ups and downs, the springtime dreams usually—not always—turn to ash. But even when *that* happens, we keep our chin up and talk about "getting them next year."

This April, as our quarterly report goes to press, the markets have been in upheaval over the rollout of President Trump's new tariff policies. New beginnings are not always like baseball's Opening Day, where the happy sense of anticipation eclipses, at least for a bit, our ability to keep expectations reasonable. But it works the other way as well: our sense of foreboding can outrun our ability to stay realistic. It is not too difficult to strike a balance between being too gleeful and too morose. Right now, investors are well advised to find that balance.

Domestic Economy: Quarter in Review

Whenever a new President is inaugurated, it marks the dawn of a new era in our country. We refer to them, for example, as "the Eisenhower years" or "the Clinton years." The earliest days of a new administration create uncertainty for the rest of us. We know that the new president will try to convert the poetry of his politics into the prose of government policy. We do *not* know the extent to which it will be effective.

After the last election, no one had a clear picture of how Donald Trump would prioritize his agenda, making the range of prospective outcomes very wide. Would Trump govern as a "big government conservative," with policies that were broadly growth-positive, but inflation- and deficit-negative? Would he use his mandate to clean house, reduce the size of the federal government, put government finance on sounder footing, and perhaps induce a recession to bring down rates? How would President Trump square the circle of his campaign commitments?

Uncertainty reigned through the first quarter of 2025, as President Trump quickly began implementing his will. As an unconventional politician, Mr. Trump was elected to disrupt "business as usual" in Washington. Drawing from his prior experience in office, President Trump launched a multipronged attack, from the DOGE efforts to reengineer and scale back governmental operations, to much stricter immigration policies, to shakeups at the Pentagon and in law enforcement, to sweeping changes in health policy, education policy, and social insurance policy. Regardless of what one thinks of these changes on the merits, they involve a strategic and economic vision which broadly deviates from the conventional wisdom of the past four decades. It is also a strategic and economic vision ratified by the voters last November.

As the market sought to calculate the impacts of these new policies, and anticipate the impact of policies unannounced, the economy rolled along under its own power. Unemployment is now at 4.2%, and the March nonfarm payroll number was a robust 228K. In its Summary of

Economic Projections (SEP), the Federal Reserve did not meaningfully change its view on unemployment, despite altering its projections on growth and inflation. One disconcerting data point was the ISM Services employment number; it fell 14%, the largest drop since COVID. Since the United States is largely a service economy, we think this may be important.

Still, we ask the same question we have been asking over the past few years: is a low unemployment recession a high-impact event? The answer is invariably the same: a recession with low unemployment and (relatively) high inflation is different than a recession with rampant unemployment and imploding prices. Even though both have negative GDP growth, they generate fundamentally different outcomes.

With reference to growth, it is important to note that GDPNow, the Atlanta Fed's real time econometric model, is reflecting -2.4% growth, a dramatic departure from the eleven consecutive quarters of positive annualized growth. The Atlanta Fed does have an alternative model which is "gold-adjusted"; it is currently reading -0.3% growth for Q1—still negative, but less dramatic. In March, the Federal Reserve reduced its consensus SEP forecast for 2025 from 2.1% GDP growth to 1.7%. Even before the dustup with the new tariff policies, growth seemed to be sagging.

For inflation, both headline CPI and core PCE are at 2.8%, up from where we were at the third quarter of last year. The flattening of the path toward 2% is no doubt a source of concern at the Fed. The recent SEP also changed the consensus forecast for its target core PCE to 2.8%, up from 2.5%.

Other inflation metrics remain elevated. The "supercore" numbers and the Atlanta Fed "sticky" are well above 3%. More favorably, the S&P Case-Schiller housing price stats have resumed a downward trend. We think the shelter/OER (owners' equivalent rent) measures are overstated, and over time expect OER to play a disinflationary role. Services like insurance have also played a large part in keeping inflation high, but goods, especially autos, have been an important driver of disinflation. This will presumably change as new tariffs are instituted.

Toward the end of the quarter, the Federal Reserve stripped its risk assessment from "balanced" (between the upside risk of inflation and the downside risk of unemployment) to what might be called "active waiting." It clearly thinks that events could break rapidly in either direction and is no longer treating the balance of risks as being properly aligned.

One would have to reach back to the last New Yorker serving in office, Franklin Roosevelt, to find such a consequential beginning to a presidency. Roosevelt was up against the darkest days of the Great Depression, with unemployment at 25% and GDP growth at -13%. There was none of that when President Trump assumed office for a second time, but there was a sense that "business as usual" in Washington is not sustainable.

Regardless of one's opinion on who is to blame for the current state of affairs, President Trump is articulating a "new beginning" which is both ardently supported and ardently opposed. The noise arising from this ardency—both the anger and the triumphalism—can be deafening. But when we tune the noise out, we may see that—no matter which side of the political divide we occupy, no matter where we stand on the great issues of our time—things are not *that* bad.

Special Report: The New Tariff Policy

The next few quarters should be interesting for testing long-held assumptions about the drivers of growth and prosperity. The new Administration's efforts to reconfigure trade policy have shaken and angered many influential investors. Perhaps they thought that Donald Trump would not follow through on his campaign promises, but redefining trade is exactly what he has been talking about since the 1980s. No one should be surprised if, as President of the United States, he uses the moment to put power behind his words.

Americans, and President Trump, are fine with trade itself. We are a productive people, and trade rewards productivity. But Americans are historically distrustful of *multilateral* trading arrangements, and the new tariff policy partly grows from this distrust. While paradigm shifts do not come easy, the basic impetus of this shift is to improve our strategic position in the world, especially relative to the emerging superpower China.

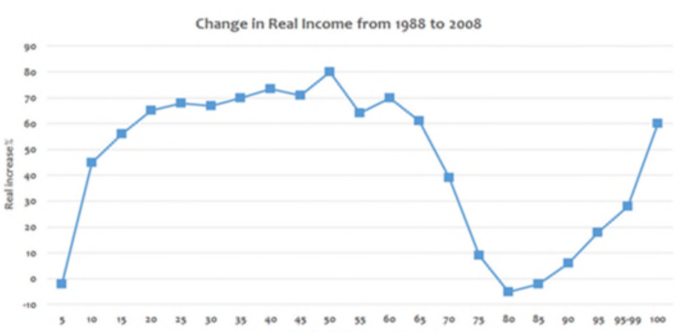
The key to the success of the new tariff regime is the ability of the Trump administration to *expeditiously negotiate new bilateral deals*. Right now, it looks like other countries *are* interested in playing ball. We expect to see our trading partners come to the table, and to see positive progress in the coming weeks. This would not only put a bid under the market, but help shape our picture of the years ahead, where an administration dials up or dials down based on the tone of bilateral relations.

We would also point to the fact that our two largest trading partners, Mexico and Canada, have already seen better treatment on oil and gas, farm products, and autos. This exemption in key areas reveals an overarching commitment to reshoring and near-shoring supply chains. We think it also demonstrates that the new tariff policy draws from a geoeconomic strategy, not spite or vendetta. While President Trump may be unpredictable and even unsettling at times, he thinks that such behavior increases his leverage at the negotiating table. He may very well be right, although tariff policy, and industrial policy in general, also requires a steady hand.

Do we expect to see a wholesale shift of supply lines back to the United States? No, not really. Will we see a rebirth of small- and medium-sized manufacturing in our country? Maybe. But what we *do* expect to see is the Trump administration, and subsequent administrations, calibrating tariffs in accordance with how they perceive our country's strategic interests. This is a different way of doing things, and while it injects an element of uncertainty going forward, it does *not* mean that the American economy is fated to an eternal cycle of slowdown and slump.

Over the past four decades, free-trade doctrine has assumed the dominant role in our discussions about economic policy. "The global economy is a force of nature." "Our hands are tied about the labor arbitrage game played by business." "Americans must either get with the times or fall behind." The establishment in *both* of our political parties held firmly to these pieces of conventional wisdom. How did the preeminent worldview, especially among the more prosperous segments of our population, come under such fire? Perhaps because it did a poor job serving most Americans.

The failure of globalism and free trade, at least where Americans are concerned, can be seen in the "Lakner/Milanovic Curve," more commonly called "the elephant graph." The graph reflects global income growth for the 20-year period extending from 1988 to the financial crash in 2008. As a practical matter, the right side shows income growth for affluent countries while the left side covers income growth for developing countries. During that period, some Americans saw spectacular growth in their real income, but many Americans fell behind.



The financial crash in 2008, and its aftermath, only reinforced the idea that the system was "rigged." Widespread frustration solidified the political conditions leading to the rise of Donald Trump and economic nationalism.

Free trade advocates advance the narrative that the Great Depression itself was a function of bad tariff policy. After the war, the story goes, policymakers created GATT (the General Agreement on Trade and Tariffs) to institute free trade and thereby avoid world wars arising from economic failure. In truth, GATT grew from the American effort to augment the Marshall Plan, which helped rebuild Europe, and to build an economic bulwark against the Soviet menace. It was less an attempt to avoid future armed conflicts than to strengthen our economic entanglements for the Cold War.

GATT was renegotiated several times from 1947 to the 1980s, and during that whole period, tariffs remained an essential part of the American policy mix. In 1988, the United States committed to trying to achieve a no-tariff zone with Canada. In 1994, that commitment was extended to Mexico, via the NAFTA deal. In 1995, after a decade of difficult and delicate multilateral negotiations, GATT was turned into the World Trade Organization (WTO). In 2001, China was admitted into the WTO.

The idea that the Great Depression grew out of the Smoot Hawley tariff legislation is similarly overdrawn. There are better explanations for why the downturn persisted through the 1930s. There is also a difference between instituting a tariff regime when our country and the global economy is reeling, as in June 1930, and instituting one now, when the economic fundamentals are decent, but apprehensions about the longer-term strategic health of our country linger like a scary nightmare.

There is no doubt that higher tariffs pose challenges to the American economy. These challenges are reflected in the current market anxiety. It is important to remember that American economy is not going anywhere. It is the world's behemoth, where 4% of the world's population produces 26% of its income. The expression that "when America sneezes, the world catches a cold" exists because we are the indispensable component. Any basic change to an economy this size creates, by definition, opportunities.

The paradigm shift from global free trade to economic nationalism is extraordinary. As the policies are implemented, we think they will evolve into something reasonable and even predictable—that is to say, *ordinary*. We do not think the new tariff policy is going away, just as we do not think the threats to American strategic and economic primacy are going away. The "American experiment" has not only created an economic juggernaut worth preserving, but democratic freedoms worth protecting. Perhaps the rest of the world should bend to our will on this one—it may be for their good as well.

Equity Report

Although uncertainty makes markets, markets abhor uncertainty, and complacent investors will seek haven in the status quo. This haven was obviously shaken by the efforts of the new Administration to rearticulate global trade. The "Goldilocks" environment, which helped drive strong equity market returns in the past two years, finally succumbed to a "bear scare" in the past few weeks.

Equities began the quarter on the front foot with high expectations that the new Administration would usher in, as President Trump called it, a "Golden Age" for business activity. But equities ended the quarter with the S&P 500 down by 4.59%. The decline was largely driven by the new Administration's push to reduce government spending while threatening to take a sledgehammer to the global economic order. Both the effort to reduce government spending and to bring jobs and manufacturing back to the United States via tariff policies were seen as destructive in the short term—and "iffy" in the longer term.

While many businesses continue to anticipate regulatory and tax relief, which we think could drive the next leg of investment and growth, business chieftains remain on the fence until the rules of the road are better understood. We would reiterate, with reference to the uncertainty sown by the new tariff policy, that we think most of our trading partners will work quickly to strike bilateral deals. Combined with responsiveness from the Trump Administration, this should help alleviate the peak anxiety dominating near term thinking.

The available economic evidence suggests that U.S. economic fundamentals remained resilient through March, with job growth reaccelerating, unemployment low at 4.2%, wages still rising at a reasonable pace, and layoffs at moderate levels. Despite deterioration in consumer sentiment readings, actual consumer spending has remained firm. There has been some shift in spending priorities from Services back to Goods, but overall, the consumer is not significantly retrenching.

With this in mind, we think the recent sell-off in equities has been indiscriminate, and that good buying opportunities are starting to present themselves to truly long-term investors. As we have always done, we will continue to add high-quality, above average yielding businesses, trading at discounts to their intrinsic value, during this period.

While headline returns for the equity market were weak, it was something of a mirror image relative to the past few quarters, this time with Value-oriented stocks outpacing Growth-oriented stocks. For the quarter, the Russell 1000 Value increased 1.6%, significantly outpacing the Russell 1000 Growth, which declined -10.1%.

Mega-cap tech led the declines, with the "Magnificent 7" stocks down double digits. This was the result of a combination of concerns, including the prospect that AI investments may be dented (mainly on DeepSeek/China fears). In the background, of course, lurked the fear that tariffs could derail the economy. Nasdaq entered correction territory during the quarter, and individual names approached bear-market levels. Tesla led the decline down 35%, while Nvidia and Google fell 19% and 18% respectively. Rounding out the remaining Mag-7, Amazon, Apple, Microsoft and Meta declined 13.2%, 11.3%, 10.9%, and 1.5% respectively.

Last year's laggards were the first quarter leaders. Energy and Healthcare were the top performing sectors, up 9.1% and 6.1%, respectively. Utilities and Consumer Staples also posted solid returns, up 4.2% and 3.9% respectively, as investors rotated out of Technology and other high-multiple names into more defensive sectors.

We are maintaining our more value-oriented view of the market and continue to champion increased stock selectivity. The signs of excessive risk-taking we warned about at the end of last year are finally starting to be discounted, and some of the speculative excesses are beginning to unwind. Still, even though the market has pulled back from the heady levels at year-end, investors need to pay close attention to valuations. The risks that we highlighted last quarter, including potential trade wars, uncertain tax and fiscal policies, and ballooning government debt, are now well in focus for investors. As long-term investors, we will take advantage of these fears, as we think that the United States is still the most resilient and adaptable economy in the world.

We continue to favor businesses and sectors with above average cash generation, selling below long-term averages. We see these businesses in the Healthcare sector. We also continue to believe that Energy provides good opportunities, with well above-average free cash flow yields, and a much more disciplined industry from a supply/demand perspective. We are becoming more constructive on Financials, which represent good value, as the long-term American economic prospects remain superior to other major economies around the world.

Our equity portfolios are well positioned with a balance of inexpensive, high-yielding cash flow businesses, along with industry leaders possessing above average growth prospects. The common denominator for *all* our businesses remains strong balance sheets. During the current scare, the importance of strong balance sheets has proven itself again. These provide the dry powder to invest in new opportunities, or to weather a storm better than the average stock.

Fixed Income Report

The fixed income markets were not immune to the wave of new policies, but as might be expected, they were more resilient to them. Even in the face of increasing inflation, growth concerns remain front and center. Throughout the first quarter, those concerns triggered a rally in Treasury prices, as investors sought refuge. And after quarter-end, "bond vigilantes" are credited with convincing the Trump administration to lengthen the runway on tariffs.

Corporate balance sheets are in decent shape. Although credit spreads came off the 20-year lows in November 2024, they remain historically expensive. We still see limited relative value in corporate bonds, and are positioning portfolios to be overweight credit on the short end of the curve. This enables us to extract additional yield without absorbing the risk of spread widening for longer-dated credits.

As increased uncertainty weighed on investor sentiment, we moved to a more neutral duration posture. Our taxable strategies performed in line with their underlying indices.

On the municipal side, the AAA tax-exempt benchmark curve became positively sloped (or normalized) during the first quarter. It marks the first time that the tax-exempt curve has been positively sloped since November 2022. The shift was a "steepener," with a "bull" steepening on the short end and a "bear" steepening further out.

Change in U.S. Treasury Yields

Quarter End March 31, 2025

Rate	Yield		Change BP
	12/'24	3/'25	YTD
1yr	2.97%	2.53%	-44
2yr	2.82%	2.62%	-20
5yr	2.90%	2.83%	-7
10yr	3.13%	3.16%	+3
15yr	3.38%	3.57%	+19
30yr	3.87%	4.22%	+35

Early in the first quarter, wildfires struck Los Angeles County, scorching 55,000 acres, destroying more than 16,000 structures, and claiming 29 lives. Preliminary loss estimates for the Pacific Palisades and Altadena fires are around $250 billion.

Despite the calamity, it is worth keeping in mind that the municipal market historically withstands natural catastrophes. No municipal bond has defaulted solely due to events like floods, earthquakes, or wildfires. We think this trend holds. We also think that resilience to these disasters is becoming an operational issue for state and local governments, along with their federal partner.

In terms of our holdings, there was no direct exposure to impacted credits. Indirect exposure was limited to 0.53% of our California holdings (and 0.20% of our municipal holdings overall).

One mainline credit, the Los Angeles Department of Water and Power (LADWP), came under significant pressure. As an example, in November 2024, LADWP bonds maturing in 2029 priced 25 bps through (lower than) the AAA curve; at quarter-end, those bonds were more than 50 bps wide (higher than) the AAA curve, reflecting 75 bps of price erosion. S&P downgraded LADWP bonds two notches, from AA- to A, while Moody's continues to hold steady at Aa2. Again, we have de minimis representation in this everyday credit. If anything, we are monitoring its progress for the right opportunity to *buy*.

Another interesting development in the municipal space has been the revived talk about rescinding tax exemption status from municipal borrowers. This conversation comes up whenever tax reform is in the air and government officials are looking for "offsets." Ranking 15th on the list of "tax expenditures," eliminating the tax exemption of municipal securities is not much of an offset.

The savings to the federal government would amount to $250B over ten years, or $25B a year. This is about 0.5% of the annual tax revenue collected by the federal government. More appallingly, removing tax exemption would *increase funding costs to state and local governments by $850B* over the same ten-year period. In our mind, saving $25B per year at the federal level in exchange for an added cost of $85B per year to state and local authorities is as irresponsible as it is ridiculous.

Tax exemption for municipal securities has deep lineage in our country. It was formalized by the 1913 Revenue Act, which itself came on the heels of the ratification of the 16th Amendment to the Constitution (also in 1913). The 16th Amendment granted constitutional permission to tax income in the first place, overruling an 1895 Supreme Court decision.

Since the launching of the federal income tax, and tax exemption for interest paid on municipal debt, the definition of interest payments *eligible* for tax exemption has been refined. Still, the baseline precept of tax exemption for state and local paper is drawn from the more fundamental federalist principle of separation of powers. Any attempt to overturn tax exemption would of course face constitutional challenges in the courts.

If Congress sought to revoke the tax-exempt status of bonds *currently* held, it would raise contractual issues on top of the constitutional issues. It would also righteously enrage every creditor in America, from the swankiest billionaire to the humblest retiree. We do not see the revocation of tax exemption for existing bonds happening. In fact, we see that kind of chatter as creating buying opportunities.

While there may be some narrowing of the tax exemption status in some corners of the market, such as private activity bonds, our base case is that tax exemption will live on, as it should. Rescinding it requires surmounting too many hurdles, such as the Constitution, fiscal responsibility, public outrage, and common sense itself. Even Congress, which has gone to some silly places in its time "under the sun," is not likely to bother.

To conclude, it is important to compare fixed income performance relative to other asset classes. Under most categories of escalating risk, fixed income securities are more likely to generate positive performance. Some asset classes have worked so long, and been so successful, that investors have ignored diversification and its benefits. Now is a good time to review your portfolio construction to see if you are absorbing the right amount of risk for your risk tolerance. The recent sell-off in the bond market has created an excellent entry point.

Conclusion

We do not share T. S. Eliot's bleak conviction that April is the "cruelest month." New beginnings are a part of living fully, whether the "new beginnings" are new children, new friends, new experiences, new presidents, new policies, or new baseball seasons.

There is a baseball story from August 1926. The Brooklyn Dodgers (called the "Robins" at the time) were playing the Boston Braves. The score was tied, with bases loaded, in the bottom of the seventh, with Babe Herman, of the Dodgers, at the plate. Herman hit a long fly to right field, which bounced off the wall. The runner on third base scored. The runner on second, Dazzy Vance, hesitated, thinking that the ball might be caught. As he lumbered around third and headed home, the ball had reached the cutoff man, and so Vance turned back rather than risk being thrown out. Unfortunately, the runner on first, Chick Fewster, was already reaching third base from the other direction. They looked at each other for a moment and then, half a beat later, head down, steaming at full speed, Babe Herman arrived with a slide. Three Dodgers on the same base!

Hesitation kept Dazzy Vance from scoring a run. Babe Herman's tunnel vision kept him from being aware of the unfolding situation. Neither "hesitation" nor "tunnel vision" are in the toolbox of successful investors. And sometimes, as the market careens about crazily, through no fault of our own, we may feel like poor Chick Fewster, stuck between "dumb and dumber." But this is also wrong. Both Dazzy Vance and Babe Herman were fantastic ball players. By all accounts, they were good men as well: affable, funny, and decent. They simply had a bad moment on a summer afternoon nearly a full century ago.

In the years that followed, Babe Herman would point out to anyone who would listen that the runner scoring from third was in fact the winning run. Dazzy Vance, who had a ferocious fastball, shut the Braves down in the final two innings, and the Dodgers posted a couple of insurance runs in the eighth to win the game, 4-1. Herman was responsible for "doubling into a double play," and he will always be remembered for that, but he also managed, in the same at bat, to hit the game winning RBI.