4Q 2024
Market Commentary

Entering a new year is always fraught with hopes and concerns. While we are primarily bottom-up focused in our investments, we are also not agnostic about the top-down economic environments.

And boy is this new year ushering in a feast, domestically and globally. Geo-politics, monetary policy divergences and fiscal policy conundrums abound. From a political standpoint, the entire North American continent is witnessing leadership changes. Claudia Sheinbaum succeeded AMLO, as Andrés Manuel López Obrador is affectionately called, in Mexico late last year and there is hope that she will be more successful as president of Mexico than was her predecessor. Donald Trump handily won the U.S. election despite renewed vigor from Democrats tied to Kamala Harris becoming her party's candidate. And as we enter 2025, Justin Trudeau, Prime Minister of Canada has announced he is resigning.

Perhaps less discussed but equally important are some of our southern neighbors in Central and South America. El Salvador and Argentina have rarely been seen as beacons of economic stability yet their current leaders are demonstrating that stern measures to tackle economic problems can be highly successful, in stark contrast to many of Mexico's weak and failed policies. Nayib Bukele's "Iron Fist" has transformed his country from a near failed state into a model for some of its neighbors. We might venture to say that despite its diminutive size and perceived small importance, many of El Salvador's measures are being espoused around the world. Javier Milei of Argentina has also been very successful—so far—in tamping down runaway inflation in a matter of months and ending the country's recession.

In Europe, Italy in this case, Giorgia Meloni seems to be cut from the same cloth as her Latin American counterparts and appears to be doing a better job of managing her country than her European neighbors. On the other side of the political spectrum, Germany and France, the two largest economies in Europe, are suffering from slow growth and lame-duck governing. What most of the countries with new leaders have in common is a rise in right-wing nationalism and populism.

As we enter 2025, the tide has clearly shifted towards favoring nationalist firebrands due to some of their recent successes. A less salient version of this movement includes the equivalents in Russia, China, and Venezuela whom have been in power for longer than all others.

One question that must be asked is that while nationalism can clearly work when positioned in contrast to neighboring forms of governing, can it still work when most countries adopt it? Separately, is such a leadership style as effective for failing-states as it is for the largest democracies? We will find out soon enough. Reforms are clearly needed and the trend towards nationalism is sheer recognition of this issue. Yet every action has a reaction and 2025 is likely to bring about many of these.

Back on these shores, there is a perpetual tug-of-war between inflationary and disinflationary expectations. We do not yet know what the Trump administration will be able to enact but the current consensus is that his proposed policies, of which we have little detail at the moment, will prove to be inflationary. While that may be the case, inflationary forces could very well be driven by factors partly outside of the incoming administration's power; they may also be unintended. We shall see. We do know that there is little affection between the incoming president and the Federal Reserve. President Trump will want lower rates in order to stimulate the economy while the Fed will want to hold rates steady to keep inflation at bay. If anything can be agreed on with respect to the current monetary policy in the United States, it is that we are in a fairly stable Fed Funds rate environment due to our economic strength. The same cannot be said about our European counterparts whom are seeing flagging economies and are likely going to continue to lower rates. Christine Lagarde—current head of the ECB (European Central Bank), seems to be in a pickle as she recognizes that lowering rates would be an admission of weak European economies which would in turn further weaken the Euro. A weak Euro would offer fodder for even more nationalism, a trend that European traditionalists are attempting to limit. Rate decisions between the U.S. and Europe, with some lags in timing and magnitude, have been fairly coordinated up to now, a condition which is likely to change in the coming year. "Every country for itself" will likely rule the new day.

What intrigues us nearly as much as geo-politics in the current environment is DOGE—the Department Of Government Efficiency. How will it succeed? We are not suggesting it will fail but we are currently unable to quantify how successful it will be and if any agency would have the authority to cut spending as much as the incoming administration likes to think it will. DOGE, after all, falls under the auspices of the incoming Trump administration and what we know from the first Trump administration is that it did not prove to be fiscally conservative. Yet the single objective of DOGE is to not simply be fiscally conservative but to cut massive spending and fiscal waste. It is in the U.S.'s best long-term interests to reduce spending in order to limit growth in the country's debt yet we envision potential conflicts between the incoming U.S. Commander in Chief and his at-will fiscal hawk advisors. Let alone having two of the most opinionated and powerful individuals, those being Donald Trump and Elon Musk, agree where they have historically operated very differently. If DOGE is successful, president-elect Trump's tax cut extension will be offset in part. If not… fireworks, and drama.

We have only touched on some of the issues that will be upon us this year. We stayed clear of expounding on global conflicts which warrant much more space than is practical in this letter. Nevertheless, we do not handicap conflict resolution, whether it be in Russia and Ukraine, in China or in the Middle East, as having great likelihoods of success over the coming year.

How is one to invest in such an environment? Easily, and with difficulty.

Conflict, uncertainty and hope have always been part and parcel of investing. As Value investors, it is ingrained in us to focus on the less embellished side of that ledger—conflict, uncertainty, issues, concerns. We espouse the dictum that if we can manage through the downside, the upside will take care of itself. Perhaps we are accustomed to managing through turmoil and so that is the easy part in a strange sense. The difficulty is to not get swept up in either the euphoria or the dismay that may befall the markets. Rather, to acknowledge that each environment has its own set of opportunities.

There is no better example than the last couple of years. Despite such strong returns in US stock markets, many companies remain overlooked. Should markets decline, as they did in 2022, such market orphans, stocks and bonds, could once again outperform all the while our opportunity set widens. Should markets continue to perform well, we will participate. Market timing does not factor into our portfolio construction; instead we focus on what markets bring to our attention. The phone is always ringing, so to speak.
