



In last quarter's market commentary, we described the likely political environment as "fireworks and drama". We perhaps downplayed the true consequences of the Trump administration's recent actions as we prefer to avoid being incendiary or hyperbolic in our writings. In order to manage through a variety of fiscal and monetary regimes we must be tempered in our assessment, attempt to be constructive, and remain objective enough to not place all our eggs in one "belief" basket. Good and bad economic, societal, and geopolitical decisions have been made "on both sides of the aisle" over the years.

We have witnessed investors' general under-appreciation surrounding some of President Trump's recent statements and actions, which has resulted in increased market volatility. Hope is not a sentiment that epitomizes today's reactions as markets seem to be resetting to the current environment. Separating the wheat from the chaff is understandably difficult given the elevated level of rhetoric.

Let us reflect on some of these actions. Tariffs can be achieved relatively quickly as we're now seeing. Tax cuts can also be accomplished relatively quickly, within the next year or so, based on the Republican majorities. Yet the U.S. Treasury has a number of fiscal policy tools at its disposal to perhaps offset some of the effects from tariffs. Controlling, to the extent possible, the price of oil is a tool that has rarely been discussed in past administrations but has often been mentioned by Treasury Secretary Bessent. To the extent this administration can influence the price of oil it may, in part, offset the deleterious impact of tariffs. DOGE, as is now well documented, has as its primary objective to cut significant government spending, which can contribute to GDP. The U.S. Treasury estimates that every \$300 billion in savings is equivalent to 1% of GDP growth. Now, it should be emphasized that the Treasury Secretary serves at the President's pleasure and we should view this statement with some reservation. One offsetting factor in the short-run is that pre-ordering, does give a temporary boost to economic growth which has already been taking place as companies began to anticipate tariffs. Lastly, while tariffs are broad, as we go to press, we should also expect incentives to counter the negative effects in the relatively short-term.

From an economic growth standpoint, we can reasonably assume that stable conditions will not prevail. We are likely to experience economic weakness possibly followed by improved conditions should offsets begin to take effect later this year and into next.

Another area where investors underestimate President Trump's will relates to the Federal Reserve. The President has made it quite clear that he wishes Chairman Powell to lower the Fed Funds rate. The Federal Reserve has been reluctant to do so as it fights its mandates of maintaining economic growth through full employment while simultaneously controlling inflation. Yet there is likely no clearer indicator of where short-term rates are headed than by looking at today's yield curve. This appears to us as close to a crystal ball as we will be lucky to get in our

line of work. The Fed is mandated to do what it can to offset economic weakness. Since economic growth is likely to decline meaningfully, engineered by the Trump administration, is it not therefore likely that the Fed will be under incredible pressure to lower the Fed Funds rate? This calculus is clearly working in the President's favor.

As a result of recent policies enacted by the President, we need to assign even higher-than-prior probabilities to a stagflationary environment or a recessionary environment, both of which tend to be negative for equity markets, at least at the onset. We have discussed the stagflationary environment for years and this is indeed what we have been experiencing—sticky inflation with weakening underlying growth. As a consequence of these increased probabilities, we think the yield curve could normalize across the maturity spectrum over the next year or so, setting up an improving environment for the Lending function. We capitalize Lending since we refer to the act of lending, of earning profits by taking in capital at a certain rate and issuing it at a higher rate. Banks benefit from this normalization as do so many other financial intermediaries. While they will be negatively impacted in the short-run from recessionary headwinds, a positive second phase in which economic improvement takes hold should be to their benefit.

That we are on a new path forged by the “America First” ideology has also become abundantly clear. America First goes along with a new world order which is fundamentally different from the one the U.S. has been the leader of over the last century. This new world order will be incredibly difficult to re-adjust to without suffering shocks. The U.S. is in an advantaged position because we are rich in resources, labor, entrepreneurship, creativity and in adaptability; the U.S. would be hurt relatively less under extreme circumstances. SKBA's view of this new world order is that our dealings with other countries may be primarily transaction-oriented rather than relationship-oriented. This tectonic shift is not how we have operated in the past. Because of the relationships that were based on mutual cooperation, the U.S. was able to maintain many advantages. We may not manufacture apparel to the extent we did one hundred years ago but we have become the reserve currency and attracted trillions in foreign investment into our Treasury markets. This has enabled us to maintain the lowest costs of debt in the entire world, giving us yet another advantage. However, there are worrying trends that result from the mostly unwarranted antagonism towards our economic foes and allies. Relationships have been frayed. Why, for example, has the Trump administration picked a fight with Australia? Australia is rich in natural resources and can easily sell its output across other parts of the world. The U.S. is no longer in a position to command trust which creates an opening for others to be less reliant on us. Some of our advantages have come precisely from the structure that the current administration is damaging. Once alternate channels are established which do not include the U.S., those will be difficult to reverse.

What are some of these negative impacts? Our agricultural export advantage will continue to deteriorate. Brazil and Russia stand ready to supply the world as Brazil has recently already taken the lead in some major crops. The same goes for oil and gas and other commodities which are available across the world. As a result of Russia's newly limited gas exports to Europe, the U.S. should be able to significantly export LNG into Europe, but so can Qatar, without the baggage. In the global automotive market, American companies have continued to lose global market share to China who can readily supply the world. Will Caterpillar and Deere continue to be viewed as global leaders in both construction and agriculture? How about Boeing, a company that already needs all the help it can get? It might be worth mentioning that China has begun producing commercial aircraft. If the U.S. is viewed as an economic aggressor, airlines may begin to order from alternative manufacturers, slowly at first but importantly over time. How about financial services? If we disrupt our economic leadership, it will become easier for foreign sovereigns to transact in currencies other than the mighty U.S. Dollar. Some countries are already beginning to do so. What starts innocently enough at the margin has the potential to expand beyond the point of no return if we

antagonize all of our economic relationships. We should be more selective in our trade actions otherwise our economic foes may well revel in the negative consequences of our actions.

All of this is not to say that some of the measures taken by the current administration weren't necessary, because many were. For example bringing back semiconductor, pharmaceutical and electronics manufacturing, among many critical industries, to our shores is a worthy, and some might say necessary objective. We are in full agreement that certain industries should be manufacturing on our shores in order to reduce quality, safety, and security concerns. It is simply that shock therapy does not always work. And when it doesn't, it can have long-lasting if not permanent effects.

Whereas we needed to increase the desirability of our products and services, the new world order may drive our former trade partners to forego "Made in America". We had the ability to be the source of global economic might whereas now our allies are presently seeking alternatives amongst themselves. Once those alternatives are set, it will be difficult to turn back the tide, putting the U.S. in an increasingly dis-advantaged competitive position.

The broad consensus view, which we do not dispute, has quickly become that inflation will be greater and growth will be lower than they otherwise would've in the absence of many draconian actions from Capitol Hill. This detrimental outcome is likely to have global consequences, which speaks to the importance of the U.S. on the global economy. It also appears to be an environment whereby most of our allies will suffer and some of our economic foes may benefit. We question whether this is truly the best path forward. One thing remains for sure. We are not done being surprised by this political drama.

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