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2nd Quarter Market and Economic Update

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"History has shown that we shouldn't rely on governments to protect us financially." -Ray Dalio, Principles for Dealing with the Changing World Order: Why Nations Succeed and Fail

"Before we work on artificial intelligence why don't we do something about natural stupidity?" -Steve Polyak, Senior Director, Research Innovation Development, ACT Research

I hope you had a wonderful Independence Day holiday. As I worked through my "honey-do" list on July 4th, I caught myself thinking about the fact that we were celebrating the 249th birthday of the United States of America. Over that time, we have chosen as a nation to live by these words from the Declaration of Independence, "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable rights." As a child and into my 20's, I recall politicians from both parties working together, doing the right thing, and putting country over party. I remember that even though disagreements were had, politicians generally showed respect for those in the opposing party. Times sure seem to have changed and not necessarily for the better in that regard.

If you went to sleep on April 1st, and then woke up on July 1st, you may conclude that the 2nd quarter was kind of quiet and boring. It was anything but! In that three-month stretch, we survived Liberation Day, DOGE, a rout in the bond market, the bombing of Iran, and TACO. Despite everything, the major stock indices all finished strongly higher in the 2nd quarter. The NASDAQ was up 17.75%, the S&P 500 moved higher by 10.5%, and the Dow Industrials rallied by almost 5%. Except for U.S. Treasury bonds, the rest of the bond market recovered to finish up a bit. Meanwhile, except for gold, most commodities ended lower, as did the U.S. dollar. Thus, year-to-date, as of June 30, both the S&P 500 and the NASDAQ are each up 5.5%, while the Dow Industrials are up 3.6%. Notably, international stock indices outperformed U.S. stocks in the first half.

As I covered the oddly named Liberation Day in my last letter, I'll add only that the President realized the mistakes his Administration made in the rollout of tariffs on April 2nd. That botched rollout led to the bond rout as well as a near bear market in the major stock indices in the week following Liberation Day. A week or so later, President Trump introduced the world to his incredibly smart Treasury Secretary, Scott Bessent, who appears to have gotten the ear of the President when it comes to economic policy. In the world of investing, Scott Bessent is highly regarded, so I take some great comfort in knowing that he seems to be the one taking the reins on economic policy. Mr. Bessent has a deep understanding of all markets: stock, bond, currency, and commodity. Before I go any further, I should explain what "TACO" means. Some of you may be thinking of delicious Mexican food, but no. TACO is an acronym, created by Wall Street traders after Trump postponed his tariffs and the stock market rallied. TACO stands for "Trump Always Chickens Out". While I think it may be premature to think this way, it did strike me as funny. Wall Street loves its acronyms. Nevertheless, the truth is that some deals have been done on tariffs (England and Vietnam, for example), and others appear to be in the pipeline. Nevertheless, Trump appears to be steadfast in keeping some tariffs on just about every country, as the increased revenue certainly helps his budget. According to reporting by both Yahoo Finance and NPR, tariff revenue has surged since Liberation Day. To the surprise of many, inflation has not started to rise due to the tariffs. However, in a report released yesterday from Alejandra Grindal, chief economist of Ned Davis Research, she wrote, "*global manufacturing input and output prices accelerated in June but remained within their recent ranges*." We'll see how it plays out, but for now the tariffs are not showing up in consumer prices. Does this mean there is a lag effect and tariff-based inflation will show up soon, or will inflation remain subdued? I wish I had the answer, but I don't.

The first quote on the previous page is from Ray Dalio. He founded Bridgewater Associates, which went on to become the largest hedge fund in the world at one time. He retired some years ago, and now spends much of his time sharing his principles in books, videos and social media posts. He has written a new book titled, '*How Countries Go Broke*'. On June 26th, he posted about a trip he took to Washington D.C. to meet with both Republican and Democratic leaders about the budget and debt situations the U.S. now faces. Here is what Mr. Dalio wrote about his trip to D.C. (emphasis by Mr. Dalio):

"***Everyone*** *I spoke with on both sides agreed that:*

- *We are likely to have a big debt-economic crisis if we don't get the budget deficit down to 3 percent of GDP, so 3 percent should be an agreed-on goal,*
- *Getting the deficit to 3 percent will require both spending cuts and tax revenue increases because if they come from just spending cuts or just tax revenue increases alone, the cuts or increases would be too big and shocking.*
- *It's not possible for politicians to say these things publicly even though they believe them because they would be thrown out of office.*

The leaders I spoke with explained that there would an angry response like, "Are you telling me that you are going to work with members of the opposing party to raise my taxes (or cut my benefits)?" They explained that in our current political environment only absolute promises like, "I promise that I will never raise your taxes" and "I promise that I will never cut your benefits" are acceptable. Those who don't say such absolute things are thrown out of office.

So, our biggest problem is that our country's political representatives can't even say, let alone do, what they need to do to fix our debt issues because their constituents would throw them out of office if they did that. *Such is the condition of our political decision-making system*."

Sadly, reading this piece merely confirmed what I already thought about our elected representatives. They are evidently too scared of losing their job to do what's necessary. However, this is part of a bigger problem consisting of people voting against their best interests because their understanding may be distorted by short-term thinking and ideology. It's not that our budget deficit is a problem that can't be solved. Rather, it's the lack of courage and political will to solve it that lies at the feet of our politicians.

The second quote on page one made me laugh, so I included it. I've been trying to come to grips with the rapid changes brought on by artificial intelligence (AI). I am far from an expert on any technology, but I've spent some time watching, listening, and reading those who are at the forefront of AI development and usage. For many of us, we think of AI as robots replacing humans in a factory, and that is happening faster than many realize. Robots are everywhere now. Amazon has over one million robots in its facilities, and they're taking jobs from humans. However, I was struck by what I read in a recent letter by Amazon CEO Andy Jassy, who wrote the following to his employees: "*As we roll out more Generative AI and agents, it should change the way our work is done. We will need fewer people doing some of the jobs that are being done today, and more people doing other types of jobs. It's hard to know exactly where this nets out over time, **but in the next few years, we expect that this will reduce our total corporate workforce as we get efficiency gains from using AI extensively across the company***." I added the bold to the last part because it is an eye-opener for me. AI is about so much more than robots. What other types of jobs could be replaced by AI? A partial list I found include the following: Data Entry, Customer Service, Telemarketing, Legal Assistants and Paralegals, and even Web Development. I don't bring this up to scare anyone, but rather to inform. According to other technology leaders, AI is likely to augment, not completely replace, many jobs. As former IBM CEO, Ginny Rometty said, "*AI will not replace humans, but those who use AI will replace those who don't*." Sundar Pichai, the CEO of Google, echoed the idea that AI's primary role is to enhance human potential, when he said, "*The future of AI is not about replacing humans, it's about augmenting human capabilities*." Augmenting human capabilities would seem to be a beneficial thing for all of us. I wonder if AI can augment or even replace some politicians?

President Trump's Big Beautiful Bill ("BBB") was signed into law on July 4th. Speaking only of the financial aspects, the massive BBB is mostly just an extension of the current tax laws, which were set to expire at the end of 2025. Thus, it's possible that many people may not notice a difference at all come tax time in future years. One notable change, however: The new law provides an enhanced deduction for taxpayers aged 65 and older. Those 65 and older with income under $75,000 (or $150,000 for a couple) can take this new deduction, which expires after 2028. The new $6,000 deduction is on top of the existing standard deduction. Please contact me with any questions about the bill, as I'm sure we'll all learn more details as we go. Also, please ignore the forecasts from both political parties on what this bill will do. The truth likely lies someplace in between the two extremes. I'll say this: if nothing else, we certainly are living in interesting times.

As I always say, my crystal ball is cracked and broken, so I cannot see the future. Coming into 2025, I expected a more difficult and volatile year. So far, that is proving to be the case. Our objective indicators show modest slowing in the global economy, but no signs of recession. Thus, the secular bull market in stocks should continue to receive the benefit of the doubt for now. That doesn't mean it will be smooth sailing in the back half of 2025. There are reasons for caution, so it wouldn't surprise me if the last six months of the year are a grind for financial markets. Instead of worrying about financial markets, I encourage you to focus on your long-term financial objectives and the things you can control. While you're at it, please spend some time with the people, places, and things that bring joy to your life. I'm trying to do better in that regard myself.

I hope you and yours are healthy and enjoying a wonderful start to summer. Please let us know if there is anything we can do for you. We're always here to help. From all of us at HFA, thank you for your trust, confidence, and loyalty. It is a joy and a privilege to work with you and your family.

Best wishes,

Harvey E. Hutchinson IV

President

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Sources of information used in preparing this letter may include the following: Ned Davis Research, Barron's, the Wall Street Journal, Wespath, Ray Dalio, The Credit Strategist substack page, and Howard Marks (Oaktree Capital).