First Quarter 2025

Economic and Market Commentary

By Ray L. Lent, Founder & CEO, The Putney Financial Group LLC

Two hundred years ago, the dominant indigenous people of Northeastern Ontario Canada were the Algonquians. They shared the land with other tribes including the Potawatomi, Nipissing and Iroquois, amongst others. Collectively they are known as the "Anishinaabe people." Each tribe maintained its own culture, language and traditions. Collectively, they shared the land and its resources in a surprisingly peaceful way. The common ideology translates to "a dish with one spoon." If only modern global societies could emulate that same sense of, *we're in it together*.

In Comes a Mill

Other than a limited number of fur trappers, the region had few European inhabitants. It wasn't until 1818 that the British crown granted 200 acres to a Scotsman named David Shepherd to put in a mill in order to spur on European migration. The site became known as "Shepherd's Falls." After a few years, Shepherd sold the mill and his holdings to another Scot named Daniel Shipman and the settlement was renamed "Shipman's Mills."

Most of the new settlers were from Scotland and Ireland and within the next 30 years it became a prosperous community boasting no less than seven busy woolen mills and clothing manufacturers. Next the railways came in and the town was soon renamed Almonte. By 1861, it had a population of over 2000 people. In the fall of 1861, a young Scottish couple in town gave birth to a strapping young son they christened James. James grew up and became an agile and bright child who loved helping on the family farm and playing games of skill and cunning with his many friends. A most likeable youth, he regrettably lost both his parents and grew up in the loving care of his Aunt and Uncle. After graduating from Almonte High school, young Jim headed off to college.

On To Montreal

In the late summer of 1883, Jim enrolled as a freshman at McGill University as a student. He excelled in all facets of undergraduate life. He maintained excellent grades and was a star athlete in gymnastics, soccer, rugby, lacrosse and football. Upon his graduation in 1888, he took a position at McGill as their first "Director of Athletics." Jim stayed there two more years before moving to Springfield, Massachusetts to study at the YMCA International Training School.

Time To Join the Faculty

After completing his training as a YMCA physical director, he soon joined the faculty as a full-time member in 1891. He quickly recognized how challenging it was to keep his student athletes in tow as they found themselves confined indoors during the long and harsh New England winters. The task proved so arduous that Jim often found himself losing his temper at his charges and feeling disappointed in himself.

It wasn't long before the head of physical education, Luther Gulick, stepped in and told Jim he had 14 days to invent a new game that could be played indoors and present an "athletic distraction." There were some strings attached: The game couldn't take up too much room, couldn't be too "rough" and would help track athletes stay in shape.

Jim took his assignment to heart and studied the most popular team games of the day, football, soccer, lacrosse and baseball. He realized many of the injuries that took place in these sports came about either from running with the ball, being hit by the ball or trying to defend against the other team scoring. Armed with his newfound realizations, he decided his game would use the softest ball around, a soccer ball. The "field" would be the confines of the Y's gym. There would be no running with the ball only passing and to avoid hard defensive contact, the ball would have to pass through a target high off the ground.

The Birth of An Innovation

Now armed with his basic rules and protocols, he asked the Y's janitor to secure for him two equal size boxes that would be suspended from the railing of the gym's gallery 10 feet off the ground. The janitor searched and searched but the best he could come up with was two peach baskets. Jim said they would have to do. Our Jim, of course, is James Naismith, the father of what he termed "Basket Ball."

The first game of Basket Ball was played in December of 1891. It was immensely popular. By 1893, the YMCA had introduced the game internationally. By the turn of the century, colleges throughout the country were playing it. In 1936, it became an official game at the Berlin Olympics. Regional tournaments were played all through the country culminating in annual national tournaments. It wasn't until 1939, a new term entered the American vernacular when a high school basketball official in Springfield, Illinois, Henry V. Porter, was trying to communicate to a colleague over the din of the crowd saying this is *March Madness*.

Let Me Bring It Home

Vladimir Lenin once wrote, "There are decades where nothing happens, and there are weeks where decades happen." Markets never like uncertainty and for the past 10 weeks, the country has been ripe with uncertainty; much of which will keep constitutional scholars, defense analysts and social anthropologists writing about for decades to come. March Madness came early. The focus of this commentary has always been on economics and the markets. After back-to-back years of strong returns in the US equity markets with some major indices hitting all-time highs as recently as February 19th, the question begs to be asked why in the world markets have nose dived in the last 6 weeks. In large part, the answer can be summed up in one word, "tariffs."

Just To Be Sure

The etymology of the word tariff comes from medieval Latin: "***Tarifa***" meaning set price. Now the practice itself goes back a good thousand years earlier when the ancient Grecian port of Piraeus charged a 2% tax on all goods coming into its port. After all, like all civilizations, they had to pay for their infrastructure and services, e.g. defense, water, sewage one way or another. Please remember the concept of income tax here in America only took hold permanently in 1913. Prior to 1913, the government operated on a combination of sales taxes and customs duties (taxes on goods coming into the country). For the longest time, many people believed that the "tariff" (read that as tax) was paid by the country exporting the good to the end user, the importer. That was simply wrong. It's the importer that pays the tariff. Here's an example: Say you have a sweet tooth for Dutch chocolate, and you normally pay $10.00 per pound when you go to the grocer. Now a new tariff is implemented of 25% on anything coming in from the Netherlands. Here's what can happen:

The Netherlands can cut their profit margin and sell the chocolate to the importing grocer at a lower price knowing the grocer is going to have to pay the 25% tariff. Unless the chocolate manufacturer was gouging the grocer in the first place, it's doubtful they would discount their product. If the manufacturer can't make a profit, they may very well just stop exporting. This results in supply side disruption and lower GDP.

Another possibility is the grocer might absorb the tariff and continue to sell the chocolate at $10.00 per pound. Doubtless unless the grocer's margins were so great they could absorb the shrinkage in their profit margin. Again, unlikely unless the grocer was gouging their customers in the first place.

Yet one more possibility is the grocer simply passes the tariff cost on to the consumer by making that pound of chocolate 25% more expensive. Now this added expense comes out of the consumers' pocket and we're talking about inflation.

Now the next to last scenario and perhaps the healthiest is the consumer gives up chocolate and just stops buying it. The consumer doesn't' get what they want, the grocer doesn't make the sale and neither does the chocolate manufacturer. Everyone loses and the global GDP goes down and jobs are lost.

The final possibility, although not one economist would think the most sensible, would be to build a new plant here in America, training our confectioners to be Duch chocolatiers. The problem is it's expensive and time-consuming to build and train, not the highest use of our intellectual and fiscal capital when those resources could be applied to things we already do well and competitively.

Obviously, this is a simplistic explanation of tariffs and their potential ramifications. Now bear with me for just a couple more moments so I can explain the next level of complexity. I'll stick with our chocolate example. It starts with the simple question: *What's the main ingredient in chocolate?* That's easy, it's cocoa beans. Next question: *Are cocoa beans grown in the Netherlands?* No, they are not. It's Ghana and the Ivory Coast that produces more than 60% of all the cocoa beans that are grown in the world. So, what if in this new world of "reciprocal" tariffs, the Netherlands puts a 25% tariff on cocoa beans, does that help them offset the 25% tariff on their chocolate? No, it simply adds to their cost or cuts down on demand. Now you have the makings of a global trade war.

Bottom line, trade wars tend to be mutually damaging, as higher costs of trade ultimately are paid for by consumers.

Are There Ever Any Good Reasons for Tariffs?

In certain circumstances, tariffs can be used effectively to a nation's advantage. Allow me to share the three most common situations where they can work:

PROTECTING INFANT INDUSTRIES: For hundreds of years, developing countries served little more purpose than supplying developed countries with raw materials. Great Britain's treatment towards the U.S. colonies is a perfect example. All Britain wanted from us were our furs, timber, rice and tobacco. Colonial manufacturing was all but prohibited as was buying from other countries. Britain wanted colonists to just buy finished products from them. As a founding father of the United States and its first Secretary of the Treasury, Alexander Hamilton was a staunch proponent for tariffs on other countries finished goods. He and many others felt this policy would both promote the domestic development of industry as well as create revenue for a young and cash-starved nation.

PREVENT DUMPING: Understand the concept of monetary manipulation; this is where one country distorts its exchange rate making their currency artificially cheaper against the dollar. Their cheaper currency enhances their competitiveness because it makes their exports cheaper and more attractive while discouraging the domestic consumption of more expensive imported goods. This practice improves a country's employment at the expansion of jobs lost by the importing country. This practice is sometimes referred to as "exporting unemployment." China has been a longtime practitioner of monetary manipulation.

NATIONAL SECURITY: Use of tariffs as they pertain to national security can take a number of forms. The most traditional and most often used pertains to a country not having to be reliant on other nations for its defense manufacturing capabilities, essential materials like steel, aluminum and iron, cyber security, shipping and so forth. A newer application has been to pressure foreign nations on issues like immigration and drug smuggling, amongst others.

Globalization

Since the end of World War II, the free world for the most part, has moved away from the practice of tariffs and benefited greatly by the Doctrine of Globalization. Now by no means is this a new concept. Once again, we can go back to Roman times when the empire spread its technology, economic and governing systems throughout their empire. For 1500 years, the "Silk Road" personified the next generation of globalization creating an exchange of products, materials and science from China to the far reaches of Europe and back. Now globalization is certainly not a new concept. Basically put, what it is centers on the process by which ideas, information, knowledge, goods and services are spread around the world.

From an economic perspective, all countries should benefit by what they do best, and in a world of free trade (no barriers, no tariffs) all countries will benefit. The premise has certainly proven to be true over the last 80 years. One needs to look no further than advancements in medicine, the decline in extreme poverty, increased life expectancy, just to name a few. Do these things often happen during times of global trade wars? The simple answer is no.

Now does globalization come with its own drawbacks and limitations? What doesn't? Globalization leads to job loss as a result of companies needing to relocate to countries with lower labor costs. This loss of domestic jobs comes with the moral responsibility of retraining that segment of the labor force that became displaced. The new labor force can be exploited and subjected to poor working conditions along with negative environmental impact. Impact that does not just affect the host nations, but the world at large. Governments must consider the difficulties they can encounter to enforce their laws and regulations across borders.

Sure, this is just a sampling of the challenges of globalization, but the overwhelming consensus is the benefits far out distance the risks and when compared to a world immersed in trade wars, it's a hands down winner.

Looking Ahead

Are the tariffs here to stay or in the words of the president are they just a "great bargaining chip?" The administration's message continues to be mixed; how other countries react remains to be seen. This past weekend's Sunday morning news shows were riddled with politicians or administration officials saying more than 50 countries have already been "beating down the President's door" to negotiate a deal. Whether that's true or not, time will tell. Perhaps the Administration will get the "grand bargain" it's looking for; a fix to international trading flaws, unfettered U.S. access abroad, along with improved intellectual property protection. We will soon see.

A useful bit of perspective: At the moment the overall equity markets have been teetering on entering Bear market territory as defined by a 20% decrease from market highs.

Since 1928, equity markets have entered into 27 (this would make the 28th) Bear markets over that same period of time there have been 28 Bull markets, representing the markets attaining new highs before the tide changes again.

If in fact this tariff "strategy" does lead to a Bear market, one should take heart in knowing that Bear markets average slightly less than 10 months and represent a peak to trough average decline of approximately 35%. (Remember here the operative word is IF.) By comparison, the average Bull market runs for approximately 31 months with an average return during that period of over 110%.

By The Numbers

Over the last 20 years, 42% of the markets strongest up days occurred during a Bear market.

Over 36% of the market's strongest days in the last 20 years occurred during the markets first 2 months of the new Bull market, usually before it was clear a Bull market had even begun. In other words, the best way to weather a markets downturn is to stay invested since it's difficult, if not impossible, to time a market's recovery.

If you take an average investor, investing life being 50 years, they will weather an average of 14 Bear markets. Something very difficult to weather while you're going through it. What one must remind themselves of is that it's always been a temporary situation. It helps to remember over the past 100 years, Bear markets comprised just over 21% of those years meaning stocks have been up almost 80% of the time.

Complacency Is Not an Option

Just because equity markets eventually revert to the mean over time, and historically go up by no means an investor or advisor should be complacent and just wait. One should always try to fine-tune their portfolio heeding both cyclical as well as secular trends.

Let me give you just two examples pertinent to current market conditions:

European car sales are down. That was even before the tariffs. Volkswagen has already raised their prices. Given the excess capacity many plants will shut down. They are prime candidates for conversion to defense manufacturing. The plant is there, the skilled workforce is there, and successful defense manufacturers are already moving in knowing Europe will be every bit more reliant on themselves for their own defense.

Every product starts with raw materials, and with a potential disruption of materials in the global marketplace domestic suppliers not reliant on international suppliers will be hotly in demand. "Locally sourced locally sold" is a successful mantra.

These are the types of companies we have been researching diligently for inclusion in our portfolios and our sub-accounts inside the 401k plans, 403b plans and variable annuities that we manage.

Final Thoughts

Almost 10 years ago, during a steep but brief market pullback, Warren Buffet hosted his annual Berkshire Hathaway shareholders meeting. Melded into his closing remarks he read the Rudyard Kipling poem, "If" which emphasizes the importance of keeping a level head through life's ups and downs and maintaining a steady course. If you maintain that even mindedness, it will always serve you well. A poem I have always been fond of since I have always enjoyed Kipling's writings.

As a sailor, I was reminded of a stanza of a far less popular poem of Kipling that I believe so accurately reflects a proper course of action given the uncertainty of our times; the name of the poem is “A Song in Storm.” Kipling wrote it during the throws of WWI. In the poem, a storm rises up and tests the mettle and commitment of the sailors on board their ship. They are reminded of the capricious nature of the sea. Sometimes calm and placid and at other times rolling and unnerving. The central theme is that safety lies in keeping one’s wits about them, serve your station and maintain a course that will get you through the storm. In its day, the poem proved so popular and inspiring, it was eventually put to music and translated into dozens of languages. I’ll spare you the entire poem but will share with you one stanza so apropos to today’s market environment:

No matter though our decks be swept
and mast and timber crack,
We can make good all loss
except the loss of turning back.
Rudyard Kipling

Over the years, the brightest minds on Wall Street always come to the same ultimate investment truth. “Success hinges on time in the market, not timing the market.” Diversification and discipline are your staunchest allies in navigating even the most challenging market conditions.

It is my hope you have a safe, happy and healthy Spring.

As always, with very best regards,

Ray