April 22, 2025

We invite you to listen to our quarterly conversation with Harold Kotler, Bill Sterling, and moderator Dan Fasciano as they review events from the first quarter of 2025 and discuss:

- The potential impact of proposed new tariffs on global trade, US households and companies, and domestic economic growth;
- The overall strength of the US economy and what the odds are for a recession; and
- How they are talking to clients about changing policies and the risks and opportunities they're seeing in the markets now.

Edited transcript

Dan Fasciano: Welcome to the First Quarter Client Conference call for GW&K Investment Management. This call represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance.

My name is Dan Fasciano, Director of Private Wealth here at GW&K. Joining me on today's call is Harold Kotler, GW&K's Founder-Chairman and Chief Investment Officer, as well as Bill Sterling, our Global Strategist.

Harold, I'll start with you. We are still just in the first 100 days of the Trump administration, and there's plenty to discuss. Focusing on tariffs, what do you make of the president's current posture on trade and investors' reactions since the first tariff announcement last month?

Harold Kotler: Why don't you start with an easy question? This is a very, very complicated time. And none of us really can fully understand the scope and the process that the president is using. I'm sure there are some benefits in what he's trying to do at the margin, but it's creating a lot of discomfort around the world, and certainly in the country and in the investment world.

To the extent that presidents have to get their policies implemented early on — most presidents do this because midterm elections are critical to their future success — so oftentimes, or all the time, they move very quickly. This feels incredibly fast and a little helter skelter, so it's very hard to rationalize everything he's doing. But the backdrop is, I'm sure there's some benefit if it's successfully negotiated with our trading partners. We have to see. We just have to watch. It's a very complicated time. But he is the president and he's implementing these policies. And we have to be open-minded and just see how this all comes to fruition. We'll wait.

Dan Fasciano: Bill, Harold lays out kind of a framework for the thinking here. With as much certainty as you're able to muster, what are some of your takeaways should everything move forward on the tariff front? And I guess specifically, what do you think of domestic growth here in the US and inflation prospects? The second part of that might be who's going to bear the brunt of this, and what's the probability of a US recession, in your mind?

Bill Sterling: Well, Dan, roughly speaking, it looks like the average tariff rate is increasing by about 20 full percentage points, which is going to put it at a level not seen since the Smoot-Hawley tariffs of the 1930s.

So unless there's a massive reversal by this administration — and you never know — that's likely to result in an effective tax on households of more than 2% of GDP. And that would make it the largest tax increase we've had since at least 1968. So, just viewing it in the lens of a tax hike, it is enough to take an economy that had been growing nicely at about 2.5% and push it to what economists call stall-speed growth of about 0.5%, along with inflation temporarily spiking up into the 3.5% – 4% range.

But what's more than that is that it can also be viewed as a shock to manufacturing supply chains, since nearly half of US imports are so-called intermediate goods that are inputs into the things US corporations produce. So while the first hit comes to consumers' wallets, especially low-income consumers, the second hit likely comes through investment spending and corporate profits, since many businesses are going to be facing margin squeezes and business models that are pretty much upended overnight. Of course, they're all going to make adjustments over time, which happens to any new tax system. But based on what we now know, I'd put the odds of recession at close to 50%.

Dan Fasciano: I want to take all of that, Harold, and drill down onto the financial markets side a little bit. The S&P is lower by 12% this year. We're not quite 20% off the highs, but we're close enough. Taxable bonds and munis are flat to slightly negative on the year. So as you talk to our equity, our muni, our fixed income managers and analysts, how are you interpreting what they're saying and what are you telling clients?

Harold Kotler: I think I'll take the latter part of the question, because the analysts are stuck in the weeds trying to figure this out as they talk to companies, and the management of companies are just like us: confused, without a clear vision. But if I put on my entrepreneurial hat, I think it's about as negative as it can get without anything happening. The financial system is healthy, the banking system is healthy, values were a little extended, but profits were healthy. Unemployment is low. And everybody thinks the world's coming to an end.

So my intuition is that this is a bottom, or a bottoming process. This is how bottoms are created. And at this point, one can never see the light at the end of the tunnel — it's so hard. The interesting thing about, particularly bonds, as I wrote in my quarterly letter, I think for the first time in 20 years, bonds are attractive, with rates up to 4% or 5%, having been at zero, 1%, or 2% for a long time. So bonds certainly are a competitive instrument to stocks. Given that stocks sell at 17 to 18 times earnings. So I think both of them have attractiveness. And I think it's very important somehow to disengage from the day-to-day conversation, which can drive anybody crazy to look at, as I wrote in my letter, the basic strength in the United States economy and where we go from here. And don't forget artificial intelligence. I still believe it's a game changer and a margin changer and a profit changer. That's a different way to answer your question, Dan, but that's how I'm trying to put my arms around it.

Dan Fasciano: I think that makes a lot of sense. And you're trying to put your arms around something that, as we've discussed, is unprecedented in a way. Bill, as I think about the kind of economic backdrop as it's been painted — Harold just took a shot at what he's thinking on the market side of things. Let me steer into policy, if I could. The Fed finished 2024 with a directionally lower bias. It had decreased target fed funds rates by 1% in the final FOMC meetings of the year, but seemed content to be patient and monitor incoming data in 2025. Let me start by asking you, what's currently priced in for fed funds for 2025, and for next year, if you can see that far? Do you have any comments, particularly over the last week, related to President Trump's statements around Chair Powell, and beyond tariffs what themes are you looking at?

Bill Sterling: Fed funds futures markets are currently pricing in about 3 – 4 quarter-point rate cuts by the end of this year, and that would take the upper limit on the fed funds rate, currently at 4.5%, down to, say, the 3.5% – 3.75% range by the end of this year. And then the markets have that followed next year by roughly three more cuts, which would bring that rate down to close to 2.75%.

But the Fed is in a bind, obviously, because it is concerned — and has to be concerned — about cutting rates, even as inflation is potentially accelerating, later this year due to the tariffs. So it's probably going to need to see a clear move up in the unemployment rate before it starts cutting rates. And in that regard, President Trump's threats to Chair Powell may turn out to be counterproductive by making the Fed even more reluctant to cut rates before it sees higher unemployment.

Beyond tariffs, we are trying to keep in mind the other aspects of the Trump agenda, that may be more friendly to markets as the year progresses. Those include potential tax cuts and deregulation. As Harold indicated, we're getting the negative stuff out of the way very early into this new administration.

Dan Fasciano: That's helpful context, and I suppose that leads to the next question I had in my mind. Harold, you said that this is how bottoms get created, and it's important to disengage from the day-to-day. Over the last month, you've been sharing with some of us here in the office that it's reminiscent of past episodes in your career. I wonder now that we've had just a little bit of time to digest how the administration is approaching trade and expenditures, what's your take on these events in a historical context, and what are you advising clients as it relates to that? And I have a follow up: What are you sharing with clients from a historical perspective?

Harold Kotler: Compared to my early years, during the Vietnam War and the demonstrations, this is a walk in the park. I think it's important to remember that this is a man who believes he can change the direction of the last 25 years. He was elected to do that. So it's all within the context of economics, business, and trade. So far, it's not how it was, with war and demonstrations, totally out of control. As you suggested, he has a very short window to succeed. We say it's four years, but it's not four years. It's two years — really one and a half years because Congress runs mid-term. So is he going about this in the way one of us would have done it? Of course not. He is who he is. And he's been elected twice. Some of us scratch our heads, but he has an agenda. And that agenda is, believe it or not, for the health of the US economy. That's his agenda. Bring jobs home. Make us more self-sufficient, build our own chips, and not be dependent upon other countries for supplying

critical technology — even medicine. That agenda is not being criticized. It's the implementation that's driving us all a bit nuts.

Dan Fasciano: I have a follow up for you on this then, Harold, what do you say to those who assume the kind of lower volatility, Goldilocks market-return period is over for good? Is it for good, or is it on an extended rain delay?

Harold Kotler: I think with him in office, and the way he handles his articulation of anything and everything, he creates a lot of energy. Even when he was on TV. This is his style. He creates this kind of behavior. I would suspect that volatility will be part of our economy for a while. By the way, and I have to say this, most discretionary money is managed in New York, Chicago, and California. Therefore, most of the managers are just beside themselves. The people who really support everything he does are not at the front of the stock market. Most people who manage money are very uncomfortable, and I think that has an impact on how they buy and sell securities.

Dan Fasciano: That's an interesting perspective, in what states the money is being managed and how that relates politically. Bill, I want to get back to you for a moment. Earlier Harold said this is creating discomfort around the world, and we've really focused up until now on the domestic situation. I wonder if you could put some global perspective on top of what's happening, with an eye towards currencies, commodities, and other markets? Am I naïve in thinking that if the US catches an economic cold, other nations are going to get the flu?

Bill Sterling: I'll start with currencies because clearly the dollar's had a big move — so far it's down 9% this year. But, if you look at its historical levels, it's still historically high, and I think has ample room to decline further if global investors shun US assets — which might be part of the plan. A weaker dollar has historically been a plus for commodity prices in general because it increases the purchasing power the rest of the world has, in terms of what their local currencies are worth. Gold, of course, has been a big beneficiary from its safe-haven demand, and is up nearly 30% this year. But oil has slumped, and that's clearly reflecting concerns about global growth. And I think that means you're not at all naïve to think the rest of the world will potentially be affected by a US slowdown.

But I'm old enough to remember when the dollar had a big move down in the 1980s following the so-called Plaza Accord, that forced US trading partners to stimulate their domestic economies to offset the currency shock. So I suspect we'll see similar impacts like that in places like Europe, China, and Japan this time around as well. And that could be a force that helps foreign stock markets outperform the US market after a long period where the US market was the only game in the world. Those are just a few observations.

Harold Kotler: I just want to make another observation about world currencies. I've heard people talking about people selling US bonds and running away from the dollar. I just have to remind everybody that there's no place to go. They could increase interest rates by 40 basis points, but you can't get rid of the dollars, because there's no haven that can absorb those dollars. It's all a matter of price. They will be buying US Treasuries at a price. End of story. So far, though, people on Mars can't buy our bonds, and they can't sell our bonds to Mars, so we are the currency of the

world, we are the market of the world, and US Treasuries will always be, I think, the most secure asset in the world.

Dan Fasciano: That's a good reminder right there. Harold, Bill, we've been doing this for some time, but this call in particular has a lot of content to it, with one dominant theme out there, and I think you both did a really excellent job sharing your thoughts.

As always, should anyone listening have follow-up questions, please feel free to get in touch with your GW&K advisor. To our clients and friends, please enjoy your spring. We look forward to doing this again in July. I want to thank our two speakers again because it was just a really fun and wide-ranging call this time. Thank you all.

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