Caron's Corner Transcript – 3.10.2025

The BEAT for March: Top Themes and Trade Ideas

Top Themes

- Europe: The Underdog - tariffs, reconstruction and reindustrialization
- To Be or Not To Be Inflationary - that is the question
- Let's Get Fiscal: Tariffs, Taxes, Budget - it's part of the plan
- Growth: Taking the Easy Way Out - despite the noise, growth is still good

Top Trade Ideas

- Adding to Equities – finding value and diversification in Europe
- Increased Exposure to European Construction - improving fundamentals with positive optionality
- Are Bonds Riskier than Stocks? - we have shifted to a modest underweight in duration
- A Turning Point for Real Estate - pricing stabilizing amid improving fundamentals

Jim Caron: Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Welcome to another edition of Caron's Corner powered by The BEAT. This time we're going to talk about themes, our top trades and thoughts for March of 2025.

The place to start is Europe which has been viewed as the underdog. I know people are worried about tariffs, but there are also some other issues out there like re-industrialization, reconstruction, many positives are coming out of Europe. Namely, there has been fiscal stimulus that has been announced to close to 1 trillion euros. Germany is talking about a 500 billion euro infrastructure deal and another 400 billion euros for defense spending as well. All together I think is going to be scaled and grossed up and ultimately exceed 1 trillion euros over time. This is a real positive for the German and other European economies as well, but we're also seeing bond yields across Europe rise and the euro is strengthening. If you look at euro equity performance, it's actually the best in developed markets anywhere from +15%, even as high as +20%. So far so good. We moved to an overweight in Europe starting in January and early February, so we're very happy to see this coming through in the price action.

Now what about inflation? As we like to ask, "to be inflationary or not to be inflationary?" and of course we're talking about tariffs. The real question is whether or not tariffs are inflationary, and this is a hotly debated topic. On one hand, they may not be because without a monetary offset, the impact is just a one-off price increase which is subject to substitution effects, which can also lower prices for goods. On the other hand, it may be inflationary because it could disrupt supply chains and create inefficiencies. What does the market think? That there is an element to inflation with this, yes, but I think what's also happening is that there's a stagflationary element that's coming through, which means higher inflation, but tariffs are also a drag on growth. With higher prices and lower growth, you get stagflation. As we know, stagflation is a valuation killer, and I think that's what's happening in markets today. We're seeing the valuations and the estimates for valuations start to come down, and that's why we're seeing so much volatility in equity markets, and you're seeing these prices come down as well.

Now, let's get fiscal. When we think about tariffs, taxes and the budget, this is what President Trump talked about in his recent address to Congress. Effectively what is taking place here is that tariffs need to be associated with taxes and the U.S. budget moving forward. We can think of tariffs and taxes as long and short positions on the economy where tariffs are the short, a drag on economic activity. But tax policy is a potential positive, which means that you can lower taxes but still keep that budget neutral because tariffs can somehow pay off some of the budget deficit. Those two things need to be netted together, but unfortunately what we're seeing right now is the impact of tariffs because that's a today event and the tax policy is something that's going to be discussed and developed over time. Tax discussions are going to run through May and we may not have resolution of this on the tax front until August. This is what's creating some of the disjointedness in markets.

Now when we think about growth, the GDP discussions, we think about it on a global basis, still reasonably good at this point. In the U.S. there has been a downshift. Many people thought that U.S. GDP in 2025 would be somewhere around 2% or so. Now those expectations are now 1.5% to 1.7% or 1.8%, somewhere around there. Clearly a lot of this has to do with some of the tariff and policy discussions, creating what's likely going to be a softer first quarter than what many people thought. That's a bit of a headwind. But when we look outside of the U.S. at the rest of the world, what we're seeing is GDP growth still holding up.

So what does that mean for our positioning? Well, we've been adding to equities and we primarily started this, as I mentioned earlier, in Europe. The marginal dollar that we're putting to work for investment is actually going to Europe. We started doing that in January, continued in February and now the European markets have raced ahead. We may pause a bit, but the point is that what is taking place is a rotation away from large cap tech, which is primarily U.S., into large cap value, which is primarily a European market discussion. In addition, the euro is improving in value, so holding those euros is actually positive for returns.

Now are also thinking about European materials, European construction and European defense. All of these sectors are likely to be positives, but we also have to think of the tangential benefits to other parts of the European economy that could potentially benefit. On the U.S. side, we are taking a little bit more of a cautious tone. The marginal extra dollar that we get is not going into U.S. equities at the moment. Now we do like, and where we have position, has been in the broader markets. It's been more in the material and cyclical sectors, more in the equal-weighted version of the S&P 500 as opposed to the market cap weighted version. T equal weighted S&P 500, representing the broader market, is actually performing better than the than the cap weighted, and that's because of high exposure to large cap tech, which is going through a pretty significant correction at the moment.

Let's now talk about bonds. Are bonds riskier than stocks? Well, bonds have actually held up reasonably well. We've seen bond yields come down and now there's more talk about potential for the Fed to cut policy rates. The ECB has just cut policy rates, so there's still plenty of central bank support that's holding up the front end of many bond markets, and we're seeing yield curves start to steepen as a result of that. But the one thing that we have to caution is that if this is a soft patch that we're going through. A lot of bad news is from a policy and tariff perspective and there's an adjustment that's taking

place, even weather related, right? We have had a lot of unseasonably cold weather and California wildfires, then all of the policy discussions that have been taking place. All of this is culminating into a soft patch for markets. Now, to the extent that we get past this, and this might not be until we get to the 2nd quarter, do we actually restart and re-kickstart the trend? I still do think that the trend is towards higher equity prices, which could also bring bond yields up a bit. So there is some risk attached to having too much duration exposure, but we don't believe that we're going to have a recession this year. We still like holding higher yielding credit, and despite all of the volatility in markets so far year to date, credit spreads have remained in relatively good shape here. We really haven't seen a widening. You're clipping a nice coupon and default risks still remain relatively low.

The other area that we want to focus on is in the private market space, where we're tarting to see a turning point for real estate. There's some stabilization being priced in as fundamentals start to improve and real estate has been experiencing a repricing over the last few years in response to higher interest rates, cyclical oversupply, and in certain sectors, secular demand destruction. However, the long term operating outlook is markedly improving. With future supply materially decreasing and the demand destruction underway in certain sectors is now starting to stabilize. So entry pricing is meaningfully lower, providing a margin of safety and an interesting access point to these improving fundamentals.

When we take it all together here, we do have to understand that there is a shock that's coming through the markets right now. Some of it's weather related, some of it's a payback in the 1st quarter for a very strong 4th quarter and we have policy and tariff related uncertainties. All of this is creating a lot of volatility in markets. We still think that this is a soft patch and a potential buying opportunity, but we want to pick our spots, namely Europe and in the bond markets in more of the credit oriented spaces.

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