Market Overview

The first quarter seems almost the distant past. The tumultuous events of April so far have thrown out many of the assumptions investors rested on even as recently as three weeks ago.

The first quarter started with optimism for deregulation and tax cuts under the new US administration, and ended with concerns about the impact of long advertised (without detail) tariffs. Investors worried about higher inflation and slower economic activity. Large technology company stocks rolled over, and, because of their weight in indices, led equity markets down.

The S&P500 fell almost [1]5%, the worst quarter since 2022. The NASDAQ fell over 10%. Big tech companies led the way. For example, Nvidia fell nearly 20%. Tesla fell 36%. Microsoft fell about 10%. European equity markets, benefitting from flows out of the US, gained. Major Asian equity markets declined, less than US markets. Gold rose to an all-time high. US Treasury yields fell. Oil declined on fears of slower economic activity.

Discounting mechanisms such as financial markets are now having difficulty making sense of the rapid series of sometimes conflicting policy decisions. It's difficult to see ahead.

Portfolio Returns

AMWHAM portfolios (Global Equity and Energy Transition) both produced positive returns in the quarter, significantly ahead of the S&P 500 and the MSCI ACWI indices. Both portfolios exhibited low risk characteristics compared to equity market indices. (Portfolio fact sheets are at the end of the letter.) Our concerns over possible negative asymmetries in financial markets were justified. Portfolio positioning, as set out in our last letter, worked well.

Elements that helped returns were relatively low exposure to large technology companies in the US, holdings relating to the energy transition, and portfolio holdings in gold bullion and gold mining companies. Cash and holdings in companies with long-term culture and good dividend yields helped too. Relatively high exposure to companies in Europe and Japan, which are residuals of our portfolio ideas, were also a positive factor.

Investment Outlook

US tariff policy is a difficult and sensitive topic. Views are dictated as much by political persuasion as by economic and financial analysis. We don't intend to add to that debate here. Our concern is to try to navigate an unstable market environment as well as possible. This said, we observe that even at levels prevailing today (April 15th 2025) after various roll backs, aggregate tariffs are higher than they have been for a century. The consequences for global trade flows and relationships will be very significant, and are as yet unknowable. In the interim we think that the general opinion that higher tariffs will lead to higher inflation and slower economic activity both in the US and around the world is reasonable.

US tariff policy changes abruptly and unpredictably. It's unlikely that the ninety day pause will resolve matters. Markets hate uncertainty. If US policy developments aren't possible to predict, we believe that

[1] Source: Bloomberg: S&P 500 -4.3%, NASDAQ -10.3%, NDVA -19.3%, TSLA -35.8%, MSFT -10.8%, Euro Stoxx 50 +7.7%, Hang Seng + 16.1%, Nikkei 225 -9.9%

for investment purposes it will be more useful to think about how corporate leaders, and political leaders outside the US might act in these circumstances. We discuss how China might act in its particular trade war with the US. We analyze conditions in the context of the long arc of globalization since the 1980s and its impact on margins and profits. Finally, we think about possible implications of deteriorating international relations for the US $ as a reserve currency, and the attendant stresses and risks that appear to be building in US rates and credit markets.

Corporations

Rational company CEOs (US and international) have short and medium term levers to manage their businesses in the new tariffed world. In the short term the task will be to both absorb as much pricing pressure as possible within their supply chains, and to pass on to customers as much price as possible without losing market share. Margins and profits will inevitably be squeezed all through the supply chain. Sensitivities will be different at different points in supply chains in different industries.

At the same time strategic plans to modify supply chains to bring manufacturing capacity back to the US will be made. Here the critical element is time. New factories and new supply arrangements will take from 3 –6 years to build, depending on the industry. This assumes available supply chains and labor. CEOs will broadcast strategic plans in public, but will hesitate to act on expensive and extensive capital expenditure until they see how the political landscape develops in the US. The mid term elections will be an important milestone. Supply chain retooling, whatever the eventual extent, will also squeeze profits and margins.

Foreign Governments

Foreign governments will think about time horizon in similar ways to corporations. In the short term, to the extent that is politically possible for their domestic purposes, they will attempt, one by one, to negotiate the best tariff arrangements possible with the US for their country and its important industries. Time pressures are critical here since tariffs are imposed instantly. But at the same time they will begin to explore new trade arrangements with other countries in order to reduce their reliance on the US in the future. They will accelerate efforts to wean themselves from reliance on US tech and defense industries in particular. This will take time. Foreign governments will also be aware of the US political calendar.

It would probably be a mistake to underestimate the resolve of the major European countries for which recent events may have been galvanizing. How different countries group together to protect their interests against both the US and China remains to be seen, but it’s certain the geopolitical discourse, beyond US tariff policies, has changed.

China

There is a de facto tariff war between the world's two biggest economies. US tariff levels on China reach 145%, and Chinese tariff levels on the US are 125%. How the process plays out in the near term should be understood in political terms. Any attempt at rational economic or financial analysis is only secondary to an understanding of the political set up on each side. China, for the reasons set out below, is a more predictable actor.

China's leadership has complete political economic and financial control within its borders. Domestic factors such as debt levels, slowing growth, company exposure to foreign trade, and an ageing population will not affect its resolve or ability to wage a tariff war, which it must be seen domestically and internationally as not losing.

China cannot be seen to lose because of the status of the communist party and its president for life, its long pursued geopolitical goals, and its desire to present itself as a steady and rational global player, albeit with ideological differences, and an equal geopolitical power to the US. Its idea of its destiny is part of this. Because it has no apparent domestic political challenge, the Chinese government can inflict considerable domestic economic and financial pain on its population in the pursuit of these objectives. It can play a long and patient game, as the last 40 years have shown. It must demonstrate that it is a powerful country.

Financial issues that emerge, as in the past, can be tidied away and hidden, with no effective mark to market and losses postponed indefinitely. It's remotely possible that domestic opposition emerges, but it's reasonable to assume that China can hold out longer against domestic political challenges than the US. Asian culture and the importance of not losing face are another element that should not be underestimated.

China will be very aware of the US political cycle, and the need for President Trump to show some sort of success before the midterm elections. If this is wrong, the presidential election is in 2028. China is well aware of both emerging domestic US pushback against tariff policies, and international resistance to them. Even if China cannot establish common cause with the rest of the world against US tariff policies, it will still share common interests, and it will be careful in its dealings, especially with Europe. China will consider President Trump already weakened following his policy reversals of the last two weeks, triggered by Treasury bond market stress and appeals from large corporations particularly vulnerable to China tariffs. China may well think that its best course is simply to wait because of its time horizon advantage. Conceding anything to the US would probably have to be a function of having achieved real advantages with the rest of the world, isolating the US more in the long term.

Bad economic implications for both countries are inevitable, if unquantifiable. In the foreseeable future the passage of events will be determined by which side can take the pain the longest. This is a reasonable view of the process. The destination is completely obscure.

Globalization, Margins & Profits, Technological Change

Globalization has been at least a 40 year process. From the perspective of corporations, the bargain was the ability to access new markets, and outsource low value-added activities, most often manufacturing. The geopolitical backdrop favored this process. The intended consequences for corporations were growth and higher and higher margins and profits. In the US today margins and profits are at all-time high proportions of GDP. The flip side of this coin is the observation that economy wide returns accrued more and more to capital, intellectual property and finance, leaving labor behind. Long run equity market returns have been fantastic, despite the blips on the way. Other unintended consequences were losses of industries of strategic importance in a less friendly world.

Tariff policy is supposed to remedy these problems. This is very unlikely. It fails to consider technological change, what that does to labor and jobs, and the ways in which economic rents are distributed in an economy. Technological change has always transformed labor. One role of government is to make transfers within society, (for example building multi-generational public infrastructure, or social security), which amongst other things are necessitated by technological change. It’s possible to debate the degree to which government should mitigate the challenges of changing labor markets, but it’s impossible to deny the lack of effort to do so over the years, facilitated by a successful economy. Even if tariffs succeed in filling strategic industry gaps, factories will be full of robots, not people, and the labor problem will go on.

The more simple conclusion is that all-time high margins and profits as a proportion of GDP will fall as national interests are asserted. Company returns face headwinds from many directions.

Trust, Reserve Currency & Bond Markets
The Marshall Plan, decades of current account deficits, large liquid financial markets, confidence in the Fed since Volker defeated inflation, confidence in the rule of law, and decades of sensible policy making are why the US$ is the world's reserve currency. More recently, until this year, any doubts about its status have been overwhelmed by the lack of an obvious alternative.

Recent market action suggests that investors may be losing confidence in the US dollar as a reserve currency. Gold is reaching frequent all-time highs, even at a time of higher interest rates, and foreign central banks are buying it for their reserves. Foreign central bank holdings of Treasuries are falling as a proportion of ownership and in absolute terms. In current financial market stress, Treasury yields rose and the US dollar weakened, in contrast to other times of stress this century. US government bond yields are higher than those of Germany, Italy and even Greece. These are anomalies. It seems that stresses in US Treasury markets caused the reversal and pause of tariffs imposed on April 2nd.

In other US financial asset markets, both private credit and private equity have been showing more signs of stress. Higher interest rates are part of the cause, but the growing need for liquidity as returns have faded are adding to the pressure. The absence of marks to market disguises falling credit quality. US equity markets have fallen more than international equity markets so far this year. US exceptionalism of recent years has evaporated quickly.

It's hard to know which way the causal chain runs – whether market action is leading to a loss of confidence in US assets and therefore the US dollar as the reserve currency, or vice versa. But we can be quite certain that the current policy environment is unfavorable. It's also not unreasonable to observe that restrictions on the flow of goods globally while capital flows are unrestricted in developed countries are a contradiction. The US imposed withholding taxes on interest payments to foreign creditors until the 1970s. Foreign investors are losing trust in the US, and appear willing now to accept lower returns in a number of other, smaller currencies rather than hold USD assets.

The pressures on US interest rate and credit markets are building. Private credit may be where system problems appear.

Conclusion
The broader headings referring to structural and secular change set out in the Investment Outlook section of our previous letter (Demographics and Productivity, Intergenerational Challenges, Complexity, and Physical Scarcities) remain very relevant, but are in the background for the moment. National and Global politics are the most important drivers now, with Growth and Inflation important derivatives of these.

For investors, in the immediate future politics are everything. If there is no financial market accident in the US, there may be a long period of policy brinksmanship and stasis against the backdrop of higher inflation and slower growth. Declining margins and profits for corporations are almost certain as we argued above.

But the chances of a financial accident are now significantly higher as investors globally (US and non US) lose trust in US policy and financial markets. These risks must not be ignored.

Portfolio Positioning

Our goal is to produce attractive risk adjusted returns over a 3-5 year cycle. We try to defend against market drawdowns as an important contribution to long term returns. This is the most difficult market environment we have encountered in the last 50 years. We hope that we will be able to achieve our objectives.

The main allocations of capital in our Global portfolios are set out below. Energy Transition portfolios are a subset with focus on those ideas.

1. We're still wary of starting aggregate valuations for equities in the US. We think that global frictions in the form of retooling supply chains, tariffs and growing national and regional competition will become headwinds to company returns.

2. We don't assume liquidity in financial markets, nor do we believe that we can time when our investment ideas work. We prefer to position portfolios when we can, rather than when circumstances dictate. We avoid illiquid investments. Circumstances when liquidity might be worth a significant premium now seem likely.

3. We are wary of the weight and concentration of AI investments in equity indices, which have been unwinding uncomfortably. We prefer in our portfolios to make careful individual stock choices, and to have much lower weight aggregate exposure in our portfolios than in equity indices. This is a somewhat contrarian view, which allows us to diversify portfolios better.

4. We believe we are in a world of digital abundance and physical scarcities. This supports the case for proportionately much greater exposure to energy in portfolios than in equity markets. The tech companies' scramble for available, reliable power supports the notion of a bottleneck. Our logic is that these investments should be at least the same weight in portfolios as exposure to technology. Under the general heading of energy, we're careful to avoid categories where capital has been overallocated, and instead to focus on areas where capital is scarce. Our working assumption is that long-term energy supply will be a mix of hydrocarbons, nuclear and alternatives. For alternatives the prerequisite is distribution and storage infrastructure that is so far lacking. Although the energy complex is caught up in fears for economic growth, we think the medium term case is strong, as an essential prerequisite for a successful economy.

5. We're wary of the degree of leverage supported by the economy. To us, at least, private credit is opaque, and probably provides better returns for its intermediaries than for end investors. It's definitely illiquid. We avoid credit risk and leveraged balance sheets in portfolios. Recent adverse developments in rates and credit markets support this view.

6. We have some exposure to undervalued pharmaceutical company R&D. This is largely uncorrelated to global political and financial headwinds, and in the meantime these companies pay attractive dividends. Healthcare spending accounts for about 17% of GDP in the US, almost double European levels. We avoid the complex chain of intermediaries in the US system that are likely to come under political pressure in the search for lower healthcare costs, and in the tariff agenda.

7. We maintain holdings in gold bullion while the possibility of more extreme financial or geopolitical discontinuity exists. We view this position as an insurance policy that would be valuable in times of distress.

8. For similar reasons we hold a significant position in cash (see fact sheets for reference). Interest rates make this decision easier. Its value will be realized if and when we can act in times of significant market distress.

Please get in touch if you have any questions, or if you would like to join the investment conversation. All ideas are welcome!

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Calculation Methodology Details:

- Correlation, Beta, and Tracking Error were calculated using monthly return data for the portfolios and respective indices
- Sharpe is calculated using the Bloomberg 1-3 Month Treasury Bill Index as the risk-free rate
- Turnover is calculated by the greater of buy or sale activity / net asset value at period end
- Figures are annualized unless otherwise noted
- Total return indices were used unless otherwise noted