April 15, 2025

Many readers of this letter have a personal history with that grand old firm, A.G. Edwards & Sons. In January, we alumni bid farewell to a dear friend, respected colleague, and larger-than-life individual, Al Goldman. As that firm's longtime market analyst and strategist, Al was well-acquainted with every market move one could imagine. If he were writing this letter, I know exactly how he would begin it. We both loved T.S. Eliot and he would have quoted the opening line of *The Waste Land*.

April is the cruelest month… This second quarter has gotten off to a strange and ugly start. Economists have a rather quaint term for a mistake made by government leaders: *policy error*. By *mistake*, economists mean a decision that produced an economic outcome which the policymaker almost certainly did not intend. I don't think a policymaker ever intends the result of their actions to produce a recession or some other terrible outcome; rather, they expect that their actions will produce something good for the economy. But since the future is hard to predict, and since economic variables are so complex, it is exceedingly difficult to know what the outcome of an economic policy change will be. Unfortunately, policymakers are rarely so humble as to admit their decisions could possibly have negative surprises.

My experience is that the immediate cause of most recessions is none other than *policy error*. This doesn't mean recessions wouldn't have eventually happened anyway, but they usually occurred *when* they did because of a decision made by economic policymakers in Washington. The Fed gets the blame most of the time. Often, they are raising interest rates in order to head off rising inflation or a bubble in asset prices. But, regarding interest rates, it's very hard to know how high is too high. By *too high*, I mean high enough to cause a recession. The Fed has been working on this for decades and, I'm sorry to say, they have a track record of overdoing it: raising rates so high that a recession is induced.

These thoughts were occasioned by the events of the last two weeks. This time, the so-called policy error came from the White House. I take President Trump at his word when he says he wants to bring more high-paying manufacturing jobs back to the US. He had telegraphed that he would use tariffs to restrict competition from foreign-made goods and thus protect and nurture US manufacturing. But the size and breadth of the tariffs he proposed on April 2 went well beyond what Wall Street expected. Those tariffs would have slowed global trade to a crawl and raised the probability of a global recession. I say "would have" because on April 9 the president paused the most onerous tariffs for 90 days, whereupon the market breathed a sigh of relief.

As with Fed policy errors, I doubt the president was intending to cause a recession but was rather expecting a good outcome in the long run. In the opinion of the markets (and me), the short-term pain he was expecting would be much worse than he anticipated. Fortunately, he responded to market feedback with the adjustments on April 9. He left in place the 10% base tariff (something the market had expected) and only kept extremely high tariffs on China. This change has, in my opinion, greatly reduced the probability of recession, provided this pause is extended or made permanent. Markets have a way of influencing policymakers away from trouble, and we hope the paused tariffs stay that way.

As a securities analyst for the last 45 years, I've had a front row seat to the drama of job losses in the US manufacturing base since the late 1970s. Prior to that time, the US protected many of its manufacturing industries through restrictive trade policies. While those policies did a pretty good job of protecting those industries and associated jobs, they had a side effect: inflation. Restricted competition means restricted supply of goods, which results in inflation. Remember, inflation is too much money chasing too few goods. We tend to focus on the money side of the definition because it's easy to measure, but my experience is that change in supply (too few goods) is the real inflation culprit most of the time.

Eventually, inflation became public enemy #1 and voters gave Washington the job of reducing inflation, which they accomplished primarily by allowing foreign-made goods into the US market. The increased supply of goods (usually manufactured at lower costs) allowed inflation to moderate. But as the economist Thomas Sowell says, "In economics there are no solutions, only trade-offs." And the trade-off here was that low-cost, low-inflation foreign supply damaged US jobs as off-shore competition forced the shutdown of US manufacturers. The result was stagnating real household income for the last 40 years, especially for the nearly two-thirds of US workers who do not have a college degree.

So, here we are, almost 50 years later, and many US voters have indicated they want a different model. But what took 50 years to implement cannot be undone in a few months. It will take years and, according to Sowell's dictum, there will be trade-offs. We suspect that, in the short run, a recession may result, and, in the long run, inflation will run hotter than we are accustomed to.

What's an investor to do? I came of age in the high-inflation era, and I believe what worked then will work now. Own stocks of high-quality companies that have pricing power, the result of substantial competitive advantages. Keep fixed income maturities relatively short. And own some gold.

With Al's passing, the three A.G. Edwards men who taught me the most about stocks and markets are gone: Al Goldman, Derick Driemeyer, and Oliver Langenberg. I learned so much from each. As I recently told a new Confluence employee, "This is an apprenticeship business." There are no schools that teach this. We learn on the job from our mentors.

Al, I don't have Jake the Labrador, but I do have Dolly the Newfoundland. And she says, as always, "All is well."

We appreciate your confidence in us.

Gratefully,

Mark A. Keller, CFA
CEO and Chief Investment Officer