The Smithfield
Forecast

A QUARTERLY SURVEY OF TRENDS

Issue No. 97 | January 2025

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A MESSAGE FROM OUR PRESIDENT & CEO

Happy New Year on behalf of Smithfield Trust Company.

For some reason, at least to me, this New Year has a different feel to it. Perhaps it is because Bob Kopf is not here to celebrate Smithfield's best year in its 28 year history having nearly $2.5 billion assets under management and continued growth of its professional team. Or is it because we are now in the second quarter of the 21st century? No doubt the international stage and changes in Washington, D.C. give cause for feelings like no other New Year in my recent memory. As Michael Drury points out in his comments below, there is reason for optimism. I am also reminded, as many of us are this time of year, to be grateful for the blessings we have. Here's to health, happiness and good fortune in 2025.

Cheers,

Betsy Poggi

SMITHFIELD FIRST QUARTER 2025

The return of President Trump and his aggressive policy agenda makes predicting the economic and financial markets outlook for 2025 – and more importantly 2026 -- the most difficult in our forty-plus year career. He has promised early implementation of fresh tariffs and immigration restrictions, which are likely to slow economic growth. However, he has also promised continuation and expansion of his tax cuts and a wave of deregulation that has businesses very optimistic about a new productivity driven expansion. The timing of policy announcements, their enactment and actual implementation could generate diverse outcomes – both for growth and inflation – which will weigh on financial markets, where equities are celebrating the opportunity and fixed income is contemplating the risk.

Compounding this uncertainty will be the unwinding of Biden's supply-side oriented policies, which helped cool inflation -- allowing real growth to shine through despite a slower nominal expansion. In reaction to inflation caused by supply bottlenecks, Biden provided substantial subsidies for selected industries to increase investment, and opened the borders to a wave of immigrants to increase labor supply. Immigration became a key issue during the election, leading Biden to tighten immigration early in 2024. Trump's immigration reforms will go much further – if fully enacted, and not offset by changes in legal immigration. Many firms benefitting from Biden's subsidies will see cutbacks – but new policies, like "drill, baby, drill" will shift incentives to new industries. Bottom line, we are certain there will be great volatility in the economy at the industry level, but it is unclear how that will percolate up to the macroeconomy.

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We remain quite optimistic for 2025, as it is rare that a President with aggressive new policies suffers a slump in their first year. Firms know that they have at least a four-year runway to plan budgets, hiring and new investments – and particularly when coming off a divisive election when policy uncertainty limited risk-taking. That Trump inherits an economy that has been growing at a steady 2.8% annual rate for two-and-a half years, with slowing inflation, provides both risk and opportunity. Old sayings like "don't change horses in the middle of the stream" or "if it ain't broke, don't fix it" will obviously be challenged early in 2025. However, the economy's solid fundamentals will cushion against policy errors, and full control of Congress means mid-course corrections should be quick. Moreover, the global backdrop is of increasing stimulus – lower interest rates nearly everywhere and an expansive fiscal policy from China.

We anticipate a rapid implementation of the Trump Agenda, both because he knows the ropes this time and because a very narrow advantage in the House – where 2026 re-elections will depend on early successes – means time is of the essence. With Europe and China still mired in economic weakness, threatened by tariffs, and facing an economic cold war, their stimulus will be front-loaded as well. Add in a surge in business confidence following Trump's election, and the early impact of Trump's policies should be positive -- as anticipated in US equity markets already.

However, the regulator of future growth both in the US and abroad is likely to be fixed income investors, as globally rising government deficits threaten higher interest rates. In the US, ten-year notes have risen on fears of both sustained deficits and sticky inflation. In China, rates are at record lows, with aggressive borrowing likely to raise them. Housing is already on the rocks in both countries, and higher rates would undermine home values which are critical to consumer confidence everywhere.

Indeed, in the US, we believe asset appreciation is now more important than wage growth. Consumer activity has been driven by the falling savings rate, as escalating asset values for stocks and houses reduce high income households need to save from current income. Two-thirds of Americans own a home – typically worth multiples of their income. Almost 60% own financial assets as well, but mostly through pensions and retirement accounts that are hard to tap, and smaller relative to incomes. The 20% that own stock directly, whose portfolios are typically much larger, have disproportionally supported the recent expansion. Meanwhile, the one-third of households that pay rent are clearly struggling with price pressures for necessities despite solid wage gains. They are already spending all of their income -- and appear taped out on credit -- leaving the fate of the US economy to the optimism of savers.

In evaluating Trump's policy proposals, we start from the assumption that he will largely get whatever he asks. Much of what we read opines that his positions are negotiating ploys, and that he will moderate to whatever view the writer supports. We note that, in 2017, he asked for and got 21% corporate taxes – when the consensus was 25-26%. The cost of his new 15% target is modest compared to competing ideas, and seems likely to pass via reconciliation which only takes 50 Senate votes. Similarly, steep tariffs and significant deportations seem likely as well. Unlike most, we do not see them as inflationary.

Tariffs will certainly raise the relative price of goods affected, and reduced labor inflow will increase wages – especially for lower income workers. However, whether they generate broader inflation depends not on the rise in these specific prices, but whether the Federal Reserve loosens monetary policy to mitigate any drag on economic growth from these new bottlenecks. We doubt they will, since both restrict supply (of goods and labor) and the Fed's magic wand works mostly on demand. Indeed, the FOMC's focus on labor markets means rising wages reduce the need to ease, as that might threaten a wage-price spiral.

Stimulating new supply will depend on Trump's other policies of deregulation and tax cuts for business. Those policies will hit a broader swath of industries than tariffs or immigration reform, so in the short run we think the upside wins. Moreover, those firms suffering the most from tariffs and immigration reform may see targeted subsidies – as the farmers received when the reaction to earlier tariffs crimped grain sales to China. We wonder whether the effect of 15% corporate taxes will lead firms to return from off-shore tax havens. Notably, corporate taxes in Ireland are slated to rise to 15% to meet the EU minimum.

As always, our key guidepost for future economic growth is profits – as business will continue to do more of what's working and less of what's not, especially in reaction to a shift in policy. We are a bit nervous that nonfarm proprietors' income (small business earnings) has slowed to near zero over the past six months, largely because wages have firmed as immigration rules tightened. After growing over 3.5 million in 2023, labor force has risen only 150,000 in 2024. Seems like more of that will come in 2025 – but businesses are quite upbeat on Trump's election, as they were in 2008. Many sources now report that investment and hiring plans are improving for small businesses. We expect that faltering firms will be slower to cutback, hoping for a lifeline from tax cuts and deregulation. As unsuccessful firms often close right after the holidays, early 2025 may see a seasonal lift from less closures. Will they come later?

As to large businesses – just look at the optimism in the S&P500. The risk now is that reality must meet elevated expectations. We project a continuation of 5% nominal growth in US GDP, evenly split between real growth and inflation. That is not really a different backdrop than in 2023, when equities did quite well – but the industry winners and losers will be different as new policies work through the economy. The consensus is for faster moderation of both growth and inflation, but with wider bands on forecasts for both. One thing we are certain about is that we will have a lot to write about in 2025 – and that there is likely to be significant differences in how various analysts read the tea leaves. Thanks for reading!

– Michael Drury

We recognize that every person, family, institution,
trust or estate is not the same.

Therefore, we customize every account at Smithfield, regardless of type,
to achieve the goals at hand from a fiduciary, investment, and tax perspective.

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BOOK REVIEWS

OVERGROUND RAILROAD

By: Candacy Taylor

You may have heard the expression "driving while black," and the dangers that may entail. Statistics say that the police pull over proportionally more black drivers than white drivers throughout the country. Although this is an issue today, in the 1930s it was a far more serious issue. For example, in the South many black car owners would keep a chauffer's hat in their car because the police would not believe that a black person could own a car. With the hat the driver could plausibly argue that the car belonged to their boss and that they were on an errand for him.

The book is a history of this problem, and tells of a book called "The Green Book" that helped motorists to cope with it. The Green Book was created by Victor Green, and was first published in 1939. It listed restaurants, gas stations, grocery stores, and hotels that would cater to black people, organized by state. It also warned of places like "sundown cities," where black people were not allowed to be seen in public after sundown.

Green continued to publish a new edition of his book every year, except during World War II, up until his death in 1960. After that his wife Alma published a few more editions. Langley Waller and Melvin Tapley published the final two editions in 1964-65 and 1966-67. "Overground Railroad" traces the evolution of The Green Book as it grew in size and in variety of information to help black travelers. I found it to be a fascinating history of a very regrettable aspect of the American experience.

– Henry Haller, III

Please consider contributing a book review to future publications. To submit a review, please email your review to forecast@smithfieldtrustco.com by the 15th of each March, June, September and December.

ENHANCEMENTS TO THE SMITHFIELD FORECAST STARTING IN 2025

We are excited to share that our monthly investment commentary will now be part of The Smithfield Forecast. In addition, the enriched Forecast will also feature fiduciary insights from our tax and estate planning officers aiming to provide our customers with a comprehensive view of wealth management matters and tax law updates. This will supplement the existing economic commentary from Michael Drury. Don't worry, book reviews shared by customers and friends of Smithfield will remain the highlight at the end.