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Will there be a Peace Dividend?

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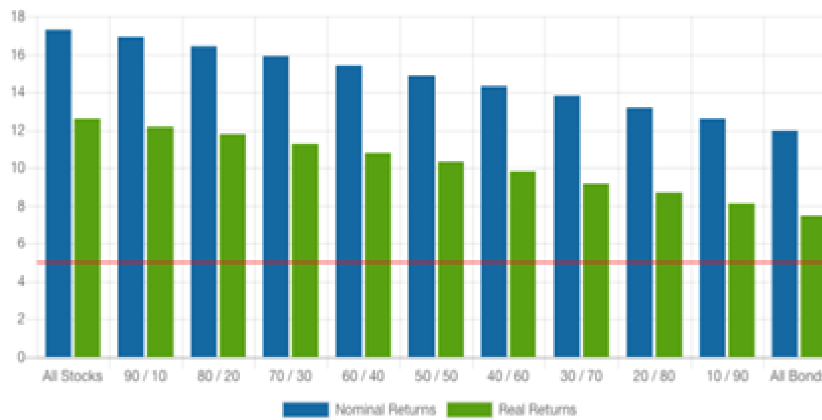
President Trump has not taken long to demonstrate that he was serious when he said a sea change would occur if he were elected for a second time. From ultimatums to Russia and Ukraine to firing 98% of the staffing at USAID, the country is clearly going in a different direction than the last four years. Trump, love him or hate him, is a master negotiator so it is always a challenge to know how much of the bombast and threats are simply being used to accomplish a negotiated result or he intends to follow through with a specific action.

The President said he would end wars and conflicts if elected and is doing an admirable job of achieving that. Before he was inaugurated, he was instrumental in achieving a cease fire and pseudo-peace agreement in Gaza between the Palestinians and Israel. His suggestion that the US might take complete control of Gaza and spend billions developing it to create opportunity and prosperity for everyone in the region was met with scorn by some but other leaders suggested it is time to look for new solutions.



There are expectations by many in Washington, DC that a peace deal between Russia and Ukraine will be reached in March 2025. In the three years since Russia invaded Ukraine, more than $213 billion in financial support has been sent to Ukraine so the potential cost savings of ending the war are massive. If peace is achieved, even for the moment, in the Middle East and Ukraine, might there be a Peace Dividend that propels the markets to significantly higher levels?

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The concept of a Peace Dividend goes back to George Bush and Margaret Thatcher in the late 1980's during the dismantling of the Soviet Union. The idea is that a reduced need for military spending allows dollars to be repurposed into social programs that lift economic growth around the world. The global prosperity and stunning stock market returns of the 1990's, where the S&P 500 generated over 15% real returns (returns in excess of inflation), was in part attributed to the concept of a Peace Dividend.

Are we likely to see a repeat of surging global prosperity and market advances if peace is achieved in 2025? Sadly, I do not think that will be the case for several reasons. Let's start with the "cost" to maintain a cease fire or peace in the Middle East and Ukraine. The US has borne the largest share of the cost of war and Trump has made it clear the US will no longer be the primary funding vehicle in these regions. Europe and NATO understand they will have to commit significantly larger percentages of their budgets for defense offsetting, in those regions, any Peace Dividend. Most of Europe spends 2% of GDP today on defense while the US is closer to 4%. According to World Bank data, the US spent almost $1 trillion on defense globally in 2024 that represented more than 40% of what was spent globally on defense. European countries have committed to increasing their spending on defense to 3% of GDP this year with the goal of spending 5% by the next 10 years. Any Peace Dividend that Europe would enjoy will actually be spent in an effort to maintain peace.

Another reason why a Peace Dividend is unlikely to increase economic growth and push markets higher is the potential of an economic war with China that is likely just beginning. The US economy remains the world's most important economy not just for its overall size but for its purchasing power. The US consumer is the world's largest consumer and Trump understands that. China may have a GDP that rivals the US but its domestic consumption is a fraction of the US and likely still decades away from being to a place where the US is not important to them. It seems likely that tariff-related economic disruption may overwhelm any benefit the US economy will receive from the ending of conflict in different regions of the world.

A Peace Dividend may provide benefit, or harm, for specific sectors of the economy, particularly where it overlaps with priorities Trump has publicly spoken of. Energy, for example, could change dramatically as a result of peace in Ukraine. A deal between Russian and Ukraine may release sanctions currently in place on production that increases global supply of oil and drives the prices significantly lower. There is also likely to be a shake-up in healthcare related stocks given the public discussions of changes at HHS.

A Peace Dividend would be nice but may not be attainable given all the uncertainty surrounding the economy and markets.

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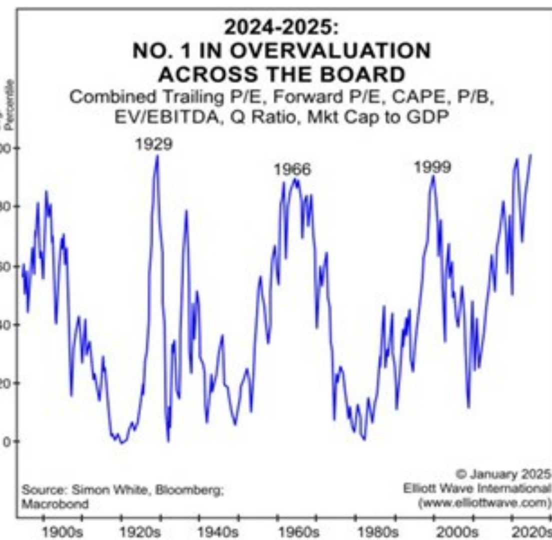
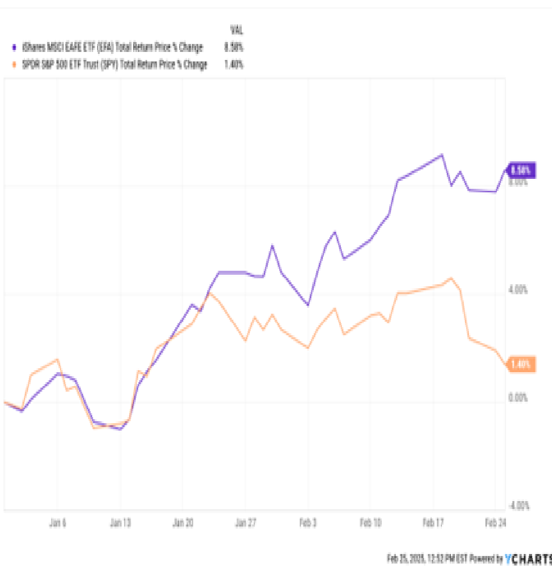
“Waving” Goodbye



Some charts need very little explanation. There is a long-standing technical indicator with an almost religious following, Elliot Wave Theory, has successfully identified many of the largest market tops in history, before the bell was rung at the top. Their system calculates when markets are overvalued using a combination of multiple, unrelated, indicators that are converted into a single reading. Going back to 1890 and looking at 135 years of data, there have only been 5 occasions where the reading exceeded the 90 level. Only the moment when COVID hit was there not a prolonged market correction after hitting the level we are at today. There is no perfect indicator but when a data series going back more than 100 years suggests we are at record overvaluation, it should be noted.

- Three of the seven indicators are versions of traditional valuation metrics including trailing and forward price-to-earnings and cyclically-adjusted price-to-earnings that is currently at an all-time high, suggesting significant overvaluation.
- The Q ratio, also at an all-time high going back to 1900, compares the total market capitalization of all stocks against the replacement cost of all their assets. The long-term index reading is .83 (83% of replacement cost) but now trades at 1.84.
- Other measures focus on macro indicators like comparing Enterprise Value to Earnings and total market capitalization compared to GDP, also known as the Buffett Indicator, that was trading at 67% above its long-term trend at year end.

International Outperformance



We’ve written numerous times in recent months about the dominance of the U.S. equity markets over developed equity markets overseas. Since the onset of COVID nearly five years ago, the S&P 500 Index with dividends is roughly higher by a cumulative 100%. By comparison, the MSCI EAFE Index, which measures developed markets outside the U.S., has advanced roughly 50% over the same period. The discrepancy is not surprising considering how earnings growth for U.S. companies has generally outpaced their international counterparts. However, as the chart illustrates, we have seen a material breakout of international over the U.S. this year, with the MSCI EAFE outpacing the S&P 500 by roughly 7%.

- Perhaps the chart reflects valuation sentiment. With multiples arguably stretched in the U.S., the perception going forward is limited domestic upside relative to international stocks. For example, the average PE ratio for the S&P 500 Index is roughly 26 versus 17 for the MSCI EAFE Index.
- While the timeframe is short, the breakout pattern we have seen in February could persist should U.S. earnings growth fall short of expectations while international earnings meet or exceed forecasts. According to data from the IMF, GDP growth is expected to accelerate in 2025 in most non-U.S. economies.

U.S. Tariffs

President Trump confirmed that tariffs on imports from Canada and Mexico will take effect on March 4, citing ongoing drug trafficking concerns. Additionally, China will face another 10% tariff, doubling the earlier levy imposed in February. These measures aim to pressure foreign governments into stronger enforcement actions against drug smuggling, particularly fentanyl. Despite Canada and Mexico’s recent efforts, such as troop deployments and policy changes, the administration believes more action is needed. Meanwhile, businesses warn that higher tariffs will disrupt supply chains and raise costs for U.S. consumers. The textile, automotive, and manufacturing industries have voiced strong opposition. China has not responded significantly to these threats, and analysts suggest the move could be aimed at forcing new negotiations. Trump also clarified that additional reciprocal tariffs will begin April 2.

- Compared to Mexico and Canada, China has been less responsive to U.S. tariff threats, and the latest tariff increase may be intended to bring them back to the negotiating table. The latest tariff will bring total levies on Chinese goods to 20%, escalating existing trade tensions.
- The announcement of new tariffs has triggered significant movement in forex trading markets, with the US dollar (USD) strengthening as investors seek safe-haven assets.

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Quinn VandeKoppel

Macro View – U.S.-Ukraine Draft Minerals Deal

The U.S. and Ukraine have reached a draft agreement on mineral resource cooperation, which President Donald Trump has framed as repayment for past aid. The deal, expected to be signed during Ukrainian President Volodymyr Zelenskiy's visit to Washington, grants the U.S. access to Ukraine's vast mineral reserves, including critical resources like graphite and rare earth elements. However, it remains unclear whether the agreement includes security guarantees or future military aid. Trump's push for a quick resolution to the war with Russia has raised concerns about potential U.S. concessions that could weaken Ukraine's security. European leaders are alarmed by Trump's negotiations, which have largely bypassed both Ukraine and Europe. The deal could have long-term economic and security implications, depending on the level of U.S. commitment to Ukraine amid Russian aggression.

Taking Stock – Stablecoins

Bank of America is preparing to launch its own stablecoin once regulations permit, according to CEO Brian Moynihan. Speaking at the Economic Club of Washington, D.C., Moynihan confirmed the bank's interest in entering the digital asset space but emphasized the need for legal clarity before proceeding. He acknowledged the potential utility of a dollar-pegged stablecoin but did not elaborate on specific use cases. With pro-crypto policies expected under the Trump administration, regulatory changes could pave the way for major financial institutions to issue their own digital currencies. Stablecoins, such as Tether (USDT) and USD Coin (USDC), have become increasingly significant in digital finance, with a combined market capitalization of over $230 billion. Bank of America's move aligns with its history of innovation, as seen in its pioneering launch of a mobile banking app for the iPhone.

Fixed Income – Yield Curve Inversion

A key recession indicator, the inversion of the 10-year Treasury yield and the 3-month note, has resurfaced, raising concerns about a potential economic downturn. The Federal Reserve closely watches this signal, as it has historically preceded recessions within 12 to 18 months. The probability of a U.S. recession stood at 23% in January but is expected to rise due to February's sharp yield curve shift. Investors are increasingly cautious as uncertainty grows over economic policies under President Donald Trump. Despite a post-election surge, bond yields have since declined, reflecting fears that tariffs and inflation could hamper growth. However, while sentiment indicators suggest economic weakness, labor market data remains strong. Markets anticipate at least a 0.5% Fed rate cut in 2025, though the strength of the job market suggests a recession is not yet certain.

10-year 3-month curve

Technical – Under Pressure

The S&P 500, represented by the SPDR S&P 500 ETF Trust (SPY), has come under pressure recently as investors assess the implications of a slowing U.S. economy following weaker-than-expected economic data. After reaching an all-time high of 6,147 on February 19, the index has declined over 3%, falling below both the 6,000 level and the 50-day SMA. However, as shown below, the ETF is currently holding its upward trendline from August 2023. With Nvidia (NVDA) set to report earnings after Wednesday's market close, investors will be closely monitoring whether its key customers continue their strong capital investments. A move back above 6,000 following NVDA's earnings could set the stage for a retest of prior highs. Conversely, a disappointing report could push the index lower, potentially testing support at 5,800 or even declining further toward the 200-day SMA at 5,650.

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Tariff – Friend or Foe?

Clint Pekrul, CFA

A cornerstone of Trump's economic policy is the use of tariffs to influence foreign trade to the advantage of the U.S. The administration announced today that tariffs against Mexico and Canada will begin on March 4th of this year, and that a possible 25% tariff against the EU is under consideration.

Apart from Trump's first administration, tariffs have not really captured the headlines for the better part of the past century. It's likely that the mention of tariffs harkens thoughts of the 1930s and the Great Depression. Today, however, tariffs are front and center and there are myriad points of view about their potential impact on the global economy.

Since formally taking office, Trump's proposed tariffs have incited backlash from U.S. trading partners and have left multinational corporations contemplating the road ahead. So far, markets have taken tariffs in stride as the S&P 500 is still positive for the year. Perhaps investors see the tariffs as a starting point in a longer negotiation that will ultimately benefit the U.S.

However, investors should also be prepared for potential backlash from our trading partners that might ultimately lead to an undesirable scenario – considerably higher inflation. Given the current backdrop, it's worth clarifying what a tariff is and how they impact the global economy.

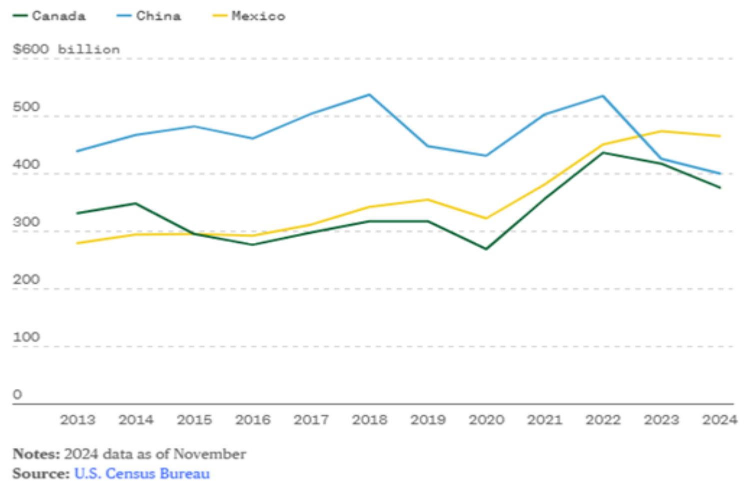
Tariffs Defined

A tariff is a form of fiscal policy (i.e., a tax) imposed on the import or export of goods and serves as a mechanism for foreign trade regulation. A government such as the U.S., for example, can impose a tax (tariff) on imported goods to 1) increase overall tax revenue and 2) make products produced domestically priced more competitively.

The rationale behind a tariff is to protect domestic industry by making imported goods more expensive. It is a form of protectionism that serves to bolster domestic production of goods and services by safeguarding against relatively cheaper imports. Proponents of tariffs such as Trump believe that they will level the playing field, so to speak, with our trading partners, reshore production and reduce the nation's trade deficit.

Tariff Implications

According to the U.S. census bureau, our top three trading partners – Mexico, Canada and China – imported roughly $1.25 trillion of goods and services into the U.S. in 2024. These imports represent 42% of the total. Given that the U.S. runs a trade deficit, the tariffs proposed by Trump would likely have a far-reaching impact on the prices of an array of goods and services.



Recall that in 2019, during Trump's first administration, the Federal Reserve issued a report1 concerning newly implemented tariffs and concluded that they led to job losses in the manufacturing sector and higher prices for consumers and producers. In other words, the tariffs had the opposite effect than what was intended.

The report determined that domestic buyers, either companies or individual consumers, ultimately paid more for goods because higher input costs were simply passed through the supply chain. Likewise, a lack of foreign competition led American based companies to simply raise prices.

Given the most recent CPI report, which indicated that prices rose 0.5% in January and 3.0% on an annual basis, the prospect of higher inflation due to tariffs is a legitimate concern.

As mentioned before, the markets, at least for now, have absorbed the tariff news as we have not experienced a material repricing of stocks. But that could change quickly if the inflation outlook deteriorates. Imagine a scenario where tariffs are implemented, and CPI subsequently accelerates. The downward pressure on stocks and upward pressure on shorter-term interest rates would create a challenging scenario for investors.

However, Trump could respond in kind with a pivot and scale back tariffs as quickly as he implemented them. Ultimately, the consensus among economists seems to be that tariffs simply don't work and are a relic of the past when global supply chains were less complex. Rolling out tariffs to undo decades of free trade will likely be painful for consumers in the short-run and not lead to domestic prosperity in the years to come.

1.https://www.federalreserve.gov/econres/feds/files/2019086pap.pdf

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Q: What impact will the German election have in Europe?

Many were surprised by the national election in Germany that saw Friedrich Merz, leader of the CDU or Germany's conservative party, win the election with almost 30% of the seats in Parliament. More surprising was that the Alternative for Germany party, led by Alice Weidel, secured the second most seats in the Bundestagi, more than doubling their vote from just 4 years ago. The outgoing Chancellor, Olaf Sholz, saw his 3-party coalition decimated in the election, posting the worst result in over decades for liberals in Germany securing only 16% of the vote. After seeing polling in France, Portugal, Belgium and Austria in 2024 shift significantly rightward, the German result is probably not as shocking as some have made it out to be. Validating the move to more conservative representation is the fact that turnout in the German election was the highest in 40 years suggesting a larger ground swell.

The world is going to look very different over the next 4 years, even more so if the US and Europe are able to be increasingly aligned. The last 4 years have seen the world moving towards higher globalization with increasingly liberal policies. There will be reversals of many of those policies in the name of populist movements as countries adopt policies that are focused on domestic priorities over globalist objectives. Make sure you have plenty of popcorn, it will be a very interesting next couple of years.

Germans turned out to vote in numbers not seen since 1987, with roughly 83% participation. The results revealed a move to the right with Friedrich Merz and the conservative faction claiming roughly 29% of the vote and the far-right AfD party claiming roughly 21%. The markets reacted favorably to the results with the German DAX moving higher against the backdrop of the fiscally conservative Merz. The results somewhat mirror the Trump election in the U.S. with a move to the right and a rejection of more leftist policies, particularly over the economy and immigration.

Merz's appointment as chancellor could represent a meaningful shift in transatlantic relations between the U.S. and Europe. The narrative from Merz is that the Trump administration is indifferent to the security of Europe and threatens the future of NATO, and that Germany should form a coalition with France and the U.K. at the exclusion of the U.S. This narrative is a shift from post-World War Two policy, with mention of the buildup of independent European defense capabilities. Ultimately, Merz's comments might read like hyperbole as he questions the existence of NATO. But Merz will need a lot of help and money to build a successful European coalition.

Q: Is it too late to invest in AI?

It is an interesting question that some may relate to buying Bitcoin today, but very different in my opinion. I view AI today similar to networking in the early 1990's when capital expenditures (capex) were skyrocketing in a race for tech companies to grab as much market share as possible. The biggest difference between the two periods is today's industry innovators, rather than a group of upstarts, are actually among the largest companies in the world. The global leaders in AI are Alphabet (Google), Meta (Facebook), Microsoft and Amazon and they have publicly made plans to spend a cumulative $340 billion on AI infrastructure just in 2025. These companies are in a race to create AI models that can be applicable for businesses and individuals in ways they can later monetize. Each of the companies have billions in annual earnings so rather than this capex being fueled by massive levels of debt, it is mostly funded out of earnings.

Considering prior booms that led to widespread speculation, such as the gold rush, it is often preferable to invest in the picks and shovels rather than a potential gold mine. Whether you struck gold or not, you had to buy the equipment for mining regardless. AI consumes so much computing power and data storage in order to eventually impact every aspect of society that massive spending on infrastructure will be required. The servers, powered by Nvidia chips, have sat in air-conditioned rooms and are air cooled. The new servers, called Blackwell servers, are water-cooled and significantly expand capacity and speed.

The narrative today seems to be that the market has already priced in future earnings growth associated with the development of AI. Stocks like Nvidia and Microsoft trade at lofty valuations relative to historical levels, and an investor could make the case that the largest companies investing in AI will not be able to support current valuations. For example, Microsoft currently trades at roughly $400, or a forward price-to-earnings ratio of roughly 30 times. At this level the company would have to grow its earnings at roughly 17% per year for the next decade for you to get your investment back. This can seem like a high hurdle and the margin for error is very narrow.

Should earnings miss estimates, the downside can be substantial. According to analysis from Vanguard, corporate revenues would have to grow at roughly 40% over the next three years within the AI sector to support current valuations. This assumption reflects the fact that profit margins are already stretched. However, if you truly have a long-term view and can stomach a -30% to -40% drawdown from current levels, an investment in AI could pay off handsomely. The technology is not a passing fad and will be a critical driver of economic growth for the foreseeable future.

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