2025 Outlook: Steady Sailing in Choppy Waters

From The
Yardarm
Market Commentary & Analysis

December 2024

About Saturna

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We are long-term, values-based, and socially responsible investors. We view consideration of sustainable factors as essential in forming portfolios of high-quality companies that are better positioned to reduce risk and identify opportunities. We believe that companies proactively managing business risks related to sustainable issues make better contributions to the global economy and are more resilient.

At Saturna, we believe in making your investment dollars work hard for you and that your interests always come first. Saturna strives to not only offer the best investment opportunities from mutual funds to IRAs, but to match those sound investments with superior customer service.

Key Takeaways

- The US economy is expected to **maintain steady growth through 2025**, driven by gross domestic product increases and inflation's downward trend. However, uncertainty around evolving policies, tariff impacts, and global economic shifts persists — which could disrupt trade and business activity.
- Proposed tax cuts may modestly benefit certain sectors, but broader economic stimulation remains uncertain. **Immigration crackdowns could lead to labor shortages, higher costs, and slower growth in agriculture and construction**, despite productivity advancements such as artificial intelligence (AI).
- Microeconomic drivers such as **AI, infrastructure growth, and energy innovation** are critical to corporate performance. Investors should prioritize opportunities linked to productivity gains over macroeconomic or political disruptions.

Former and future President Donald Trump's victory in the 2024 US presidential election guarantees an altered market, economy, and regulatory environment going forward. While differentiating between campaign rhetoric and future policy initiatives remains an opaque process, based on his previous administration, we can make some educated guesses.

Trade Policy and Tariffs

If there's one thing we can say with certainty, it's that President-elect Trump loves tariffs and they will likely be imposed, increased, or both during his administration. We view a blanket global tariff as unlikely. The US runs trade surpluses with many countries, including Brazil, the United Kingdom, Spain, Australia, and the Netherlands,[1] while we also see the position as a bargaining chip for an incoming President who values "The Art of the Deal."

Tariffs during the first Trump administration were narrowly targeted rather than broad-based. That being the case, levies targeted at specific industries and nations will undoubtedly arise, with China squarely in the sights. Others at risk include Mexico, Vietnam, Germany, Japan, and Canada based on their running the largest trade surpluses with the US.[2] Bargaining ploy or not, the President-elect's recent statement that he will impose 25% tariffs on all goods from Mexico and Canada demonstrates his favorable bias toward the approach and his strategy of employing executive action on the tariff front in the name of national security.

While it's easy to single out countries, we should not forget that US companies choosing to manufacture or assemble overseas account for a significant segment of the US trade deficit, whether Nvidia artificial intelligence (AI) chips (Taiwan), Apple iPhones (China), or Ford and GM vehicles (Mexico and Canada). Companies importing raw materials and/or intermediate goods for final production in the US account for another large segment. Were the proposed tariffs to be levied against Canada and Mexico, economic disruption would result, and the prices of many goods would suffer a one-time shock.

We hesitate to declare the policy inflationary for two reasons. First, tariffs are a one-time price shock that do not necessarily lead to an inflationary cycle absent tit-for-tat retaliation. Also, were the US to penalize China, Canada, and Mexico to the degree threatened, the ultimate effect would be a slowing of trade, business activity, and investment leading to economic contraction and a decline in demand that would eventually cause prices to fall.

In short, tariffs take us into the world of unintended consequences. The experiences of Harley Davidson in 2018–2019 provide a case study.[3] Such gyrations aside, history tells us that countries facing tariffs typically experience currency weakness. Indeed, since tariffs were first imposed on China in early 2018 (subsequently extended by President Biden), the Chinese yuan weakened by over 15% against the US dollar. Many factors have contributed to the weakness, including China's real estate woes, but it has been estimated that 65% of the Chinese yuan depreciation over 2018–19 can be ascribed to US tariffs.[4]

If we extend the theory to other countries targeted by tariffs, their currencies will depreciate, making US exports less competitive and failing to result in any improvement in the US trade position. Indeed, during the President-elect's first administration, the US deficit in goods and services soared 41% from $481 billion in 2016 to $679 billion in 2020.[5]

Corporate Tax Rates and Fiscal Policy

Multiple tax cuts were proposed during the campaign, including no tax on tips, overtime, or Social Security benefits, a reduction in the corporate tax rate to 15% from 21% for manufacturers, a permanent extension of the 2017 personal tax reductions, and an increase to the $10,000 cap on state and local tax deductions.

We view the first three as unlikely given the multiple ways such tax breaks could be abused in the case of tips and overtime and the precarious financial position of Social Security. We believe there's a reasonable chance the latter three are implemented. The wild card in that calculation will be the ability of the Republicans to maintain discipline in the House of Representatives given their narrow majority and a small but vocal group that stands adamantly opposed to any deficit increasing actions.

Indications of the risk rose to the fore when a spending bill to keep the government funded through March succumbed to negative comments from Elon Musk and Donald Trump. The President-elect commented along the lines of ignore the Democrats, eliminate the debt ceiling, and keep the government open. No such luck as 38 Republicans joined the Democrats in voting down a revised bill. A third effort that did nothing to address the debt ceiling, but did keep the government funded through March 14 and included disaster and farm assistance, was finally approved hours before the shutdown deadline. The debt ceiling issue carries weight as the 2023 agreement to suspend it expires on January 1, 2025. The Department of the Treasury will implement "extraordinary measures" to delay the reckoning but eventually the House of Representatives must vote on raising or suspending the debt ceiling. This time around, the Democrats are unlikely to provide an escape hatch without significant concessions. Will the Republican deficit hawks compromise and maintain unity, or will they stand their ground leading to an even worse — from their perspective — agreement to keep the government funded?

We view the debt negotiations as risky given the thin Republican majority and the fact that multiple government shutdowns have moved the goalposts for acceptable behavior. House Speaker Mike Johnson will be caught between Democrats unwilling to assist the Republicans and an aggressive wing of the GOP that just may be willing to allow the US to default on its debts to make their point — while the Democrats stand by and watch. While a low probability, long tail-risk, the financial and economic implications of a US debt default make the global financial crisis of 2007–2009 look like a garden party.

Conclusions

The US economy currently enjoys positive momentum. The most recent Atlanta Fed GDPNow estimate forecasts fourth quarter growth of 2.7%, following 2.8% growth in the third quarter and 3.0% in the second quarter.[6] Progress on inflation has slowed and the Federal Reserve presented an interesting contrast of views and action following their December meeting with a 25 basis point rate cut accompanying commentary that progress on inflation had stalled, the economy was stronger than they anticipated and they're going to pause on rate cuts for a while, with the dot plot indicating two cuts in 2025 from four previously.

The momentum will likely continue through 2025 (assuming successful debt negotiations) since policy changes take time to implement — and even longer to have an effect. Anything beyond 2025 becomes difficult to predict given the change in administrations and the uncertainty regarding campaign promises versus policy decisions. In examining the three main policy initiatives — tariffs, taxes, and immigration — we can make several conclusions.

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Tariffs

In our view, any application of punitive tariffs or trade sanctions (apart from addressing specific national security concerns), increases economic friction and detracts from growth and efficiency. As noted previously, tariffs enacted during the first Trump administration failed to reduce the trade deficit. Let's not forget the Smoot-Hawley Tariff Act, which is considered to have increased the severity of the Great Depression by triggering a global trade war. Regardless, we must prepare for the eventuality and are reviewing the exposure of all of our companies to potentially increased costs from imported materials and components, as well as the potential impact on sales from retaliatory trade actions.

Taxation

Typically, any reduction in taxes would be considered an unalloyed positive. In terms of personal tax rates, however, it would be a continuation of the status quo rather than a step-change — nice, but no spur to activity. It does mean, though, that retirees would have more time to make Roth conversions in their retirement accounts at lower rates. A tax reduction for manufacturers will benefit them but manufacturing accounts for only 10% of US gross domestic product.[7] More specific potential tax changes, such as immediate expensing of capital expenditures could spur investment. We can anticipate further increases in the US deficit.

Immigration

While many observers have claimed that campaign promises to remove a million illegal immigrants annually were bluster, the President-elect and his "border czar" Tom Holmen (former acting director of Immigration and Customs Enforcement) have gone all-in on the policy. President-elect Trump has even mused about using the military, which would likely be illegal. Cost would, of course, be another consideration. In any event, implementing the policy leads to clear outcomes. Fruit and vegetable prices would rise. Hotels would face staffing difficulty. Construction activity would slow. Since economic growth is the output of working-age population and productivity, reducing the working population would curtail growth potential despite impressive US progress on productivity.

A Final Word

Presidential power has increased and there are steps President-elect Trump can take through executive action, especially on the tariff front. In other areas, inertia runs deep in the government and courts and the metaphor of turning an oil tanker hardly captures the reality. We typically do not base investment decisions on economic or political views as we consider microeconomic developments (the positive productivity effects of AI, surging electricity demand and alternative energy, infrastructure development, etc.) to be more significant in shaping investment opportunities. Indeed, we believe the future development path of AI and the potential productivity enhancements to be the single most determinative factor for corporate and economic performance over the remainder of the decade.

As for the stock market, historically high valuations face off against solid 11% earnings growth expectations for next year and a further 7% in 2026. A key factor of the anticipated earnings growth will be a narrowing of the gap between the earnings growth of the mega-cap technology stocks versus the remainder of the market. 2025 could see the return of the not-so-magnificent 493.

Endnotes

[1] *US Trade Deficit by Country 2024. World Population Review. 2024. https://worldpopulationreview.com/country-rankings/us-trade-deficit-by-country*

[2] *Ibid.*

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[4] *Jeanne, O. and Son, J. To What Extent Are Tariffs Offset By Exchange Rates? Johns Hopkins University. October 17, 2023. http://www.econ2.jhu.edu/jobmarket/2023/SonJW/NonThesisPapers/NonThesisPaperSonJW.pdf*

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[7] *U.S. Manufacturing Economy. National Institute of Standards and Technology. November 15, 2024. https://www.nist.gov/el/applied-economics-office/manufacturing/manufacturing-economy/total-us-manufacturing#:~:text=Some%20brief%20figures%20on%20U.S.,dollars%2C%20according%20to%20BEA%20data*

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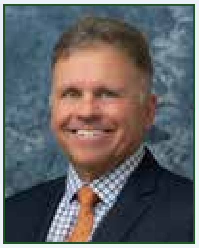

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Scott Klimo, Chief Investment Officer, joined Saturna Capital in May 2012. He received his BA in Asian Studies from Hamilton College in Clinton, NY and also attended the Chinese University of Hong Kong and the Mandarin Training Center in Taipei, Taiwan. Scott has over 30 years experience in the financial industry with the first several years of his career spent living and working in a variety of Asian countries and the past 20 years working as a senior analyst, research director and portfolio manager covering global equities. Mr. Klimo is a Chartered Financial Analyst (CFA) charterholder and an avid cyclist. He is a supporter of various environmental organizations and served for several years on the Board of Directors of the Marin County Bicycle Coalition.

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