2025 First Quarter Investor Letter April 18, 2025

Tariffs, Liberation Day, Chaos…Now What?

The first three months of 2025 were dominated by tariff discussions. While many thought the new administration might initially target tax cut extensions, Trump 2.0 surprised markets by targeting Mexico and Canada with threatened 25 percent tariffs. The administration said the tariffs were justified under the International Emergency Economic Powers Act (IEEPA) in response to the fentanyl and illegal immigration crises. China, which was expected to be a target, also was hit with a new 20 percent tariff. Following this initial tariff onslaught, there was a period of relative calm after Trump delayed the Canada and Mexico tariffs by one month and investors assumed that the forward "playbook" would involve lots of bold threats/proposals, followed by quick negotiations/concessions and then by compromises where the administration could claim victory.

This interpretation began to wobble when the Canada and Mexico tariffs went into effect one month later and this interpretation then became completely unhinged after the so-called "Liberation Day" when the administration essentially unleashed economic warfare against most of the globe. A universal tariff rate of 10 percent was imposed against nearly all countries, but reciprocal rates were much higher for many, including those generally considered allies of the U.S., including the European Union (20%), Japan (24%), South Korea (25%) and Taiwan (32%). Companies that had diversified supply chains out of China following Trump 1.0 suddenly awoke with massive tariffs in Vietnam (46%), Thailand (31%) and Malaysia (24%), among others. The greatest ire was reserved for China, which initially faced an additional 34% tariff (on top of the existing 20%). After China retaliated with new reciprocal tariffs, there came a series of escalating increases that ultimately settled at nearly incomprehensible U.S./China levies of 145% and 125%, respectively. With the U.S. suddenly imposing tariff rates that were the highest since the 1930s and with recession odds rapidly increasing, equity markets fell more than 10% in a matter of days. Additionally, the dollar plummeted and interest rates increased (more on this in minute) and therefore many feared that credit markets would quickly tighten. This new pressure was likely a major factor in a 90-day delay in the more punitive tariffs (10% tariff rates remain) for all countries except China, and markets staged the third biggest one-day gain since World War II.

It is hard to know exactly where to begin with the "Liberation Day" tariff rates. Even those more sympathetic to Trump 2.0's position on "unfair trading practices" were likely surprised that the administration would attack all countries simultaneously rather than focus on China, which many perceive to be the most egregious offender. Additionally, the disorganized rollout and the bizarre formula used as a basis for reciprocal rates sparked widespread criticism from those on the right and left from across the globe. One of the chief criticisms was the nearly inexplicable lack of accounting for services in balance of payment analysis. If country A sells a car to country B, then B (assuming this is the only transaction) has a trade deficit with A. But if there is a second transaction where country A buys a software license (or a legal service or a financial product or a hotel room) from B, country A has a service deficit with B. Bizarrely, these services, which have driven large amounts of wealth creation over the past decades in the U.S. and around the globe, are not accounted for in one of the more radical pieces of economic policy introduced over the past century.

Tariffs are supposed to strengthen the dollar and precipitate a drop in interest rates. Neither has transpired and there is not a single explanation for the unexpected moves. All else being equal, lower export/import volumes could weaken the U.S. economy, heighten uncertainty and lead to lower future interest rates. That said, companies cannot absorb precipitous 40-145% increases in input costs, and many will therefore turn to price increases for mere survival. Many consumers have already anticipated these price increases. Therefore forward inflation expectations, those most feared by The Federal Reserve Board, have skyrocketed.

Source: WSJ/University of Michigan Survey

Concerns over 10-year bond yield increases, combined with concomitant drops in the dollar, likely factored into the administration's decision to provide a 90-day reprieve on tariffs. Of course, 10 percent universal tariffs remain across most jurisdictions, while U.S./Chinese tariff rates of 145%/125% have effectively shut off trade between the world's two largest economies. It is less clear exactly what will happen over the next ~90 days. Some deals are likely, but so are other retaliatory tariffs. It is also possible that further one-off exemptions (such as those recently announced for computers, smartphones and other electronics/computer chips) will be granted, while new special rates on semiconductors and pharmaceutical companies could be introduced. Political connections and lobbying efforts might be major factors in the actual rates each company pays. If this uncertainty is not bad enough, future economic data will likely reflect both higher inflation and weaker economic growth. It could be months before both trends are visible and it is unclear how these conflicting forces will interact with each other.

So, if a major policy mistake has been made and if a recession will soon arrive or is already present, why not sell all stocks, run to cash, and consider purchasing firearms and canned goods? We asked similar versions of this rhetorical question (minus the firearms) at the beginning of COVID and again in early 2022, when a rapid 500+ basis point jump in short-term interest rates caused many economists to dramatically increase recession odds. While conceding that short-term pain was likely, we cited the less than glorious track record of economists in forecasting recessions[1]. We also noted that it would be unwise to make wholesale portfolio changes since macroeconomic events often have a way of taking unanticipated twists and turns far different than forecast by economists.

Admittedly, if you had told us in 2021 that short-term interest rates would jump more than 500 basis points in ~18 months or if you had told us in 2018 that a global pandemic would kill ~7 million+ people,

[1] Hites Ahir and Prakash Loungani *Can economists forecast recessions? Some evidence from the Great Recession*

then fleeing risk assets and parking funds in cash would have been temping. Unfortunately, such perfect clairvoyance is unattainable once…let alone the two times it was likely needed. Those who through luck or skill sold right before COVID hit or just before rates started rising looked wise short-term term as they avoided a good deal of pain in March 2020 and through large parts of 2022. Of course, the problem with such a move is: when do you get back in? At the height of COVID, who could have predicted that the overall market would finish the year 18% higher? If an investor was 100% cash in March 2020, would he or she have reentered once federal stimulus was announced? Or would he or she have waited until vaccines were developed? Looking back at the 2022-2024 period, it turns out that the global economy can absorb much higher levels of interest rates than was previously anticipated. If one sold in early 2022, would one reinvest after 2 months of favorable inflation/GDP data? 6 months?

At present, some can argue credibly that a worldwide recession is upon us, that policy uncertainty is too high, and that asset prices do not reflect this reality and therefore that selling is rational. In thinking about possible policy reversals or moderations, we take a certain degree of comfort in the late economist Herb Stein's "Stein's Law"[2] which noted that if something cannot go on forever, it will stop. Inflationary or economic damage from tariffs will not occur in a vacuum. Courts could rule that Trump's tariffs are unconstitutional and/or certain Republicans could break rank and vote to move tariff authority back to Congress from the executive branch. Alternatively, the administration could pivot and strike deals where tariffs would end up *lower* than previous levels in many jurisdictions. To be clear, none of this is guaranteed, but investors should consider these possibilities before stocking up on canned food.

Tariffs and dot.com…Rhymes a Little?

Certainly, there are many paths forward from here. Some are quite benign, but others are less so, and it is impossible to know the future path ahead of time. Once initial selling abates, market participants will try to assess which asset classes/market subsectors are best positioned. In thinking about historical analogies, the current dislocation has some similarities to the 1998-2002 dot.com period. At that time, overall valuations were at their most expensive point in history (~43x CAPE[3] vs. ~33x today) and an exogenous event (September 11) helped exacerbate problems with an already faltering stock market and weakening economic environment.

[2] Interestingly/ironically, Stein, a prominent economist and chairman of the Council of Economic Advisers under Richard Nixon and Gerald Ford, made the pronouncement which became Stein's Law during 1986 in response to those who thought immediate action was immediately needed to correct balance of payment deficits and debt levels relative to GDP.

[3] The Cyclically Adjusted PE Ratio (CAPE) is based on average inflation-adjusted earnings from the previous 10 years.

Historical S&P 500 Shiller CAPE Ratio

While the overall market was at its most expensive valuation ever during the dot.com era, there were multiple numbers of statistically cheaper smaller stocks (many of which ultimately performed well over the subsequent years). These pockets of value greatly contrasted with the nosebleed expensive large-cap names and piles of overvalued, crappy dot.com companies (pets.com, Webvan, etc.). Similarly, interest rates were at/near decade-high levels (peaking at 6.5% in 2020) as the dot.com meltdown got into full swing. The analogy is far from perfect. While today there is plenty of "expensive crap" (various shades of cryptocurrency, Trump Media which sports a Price/sales ratio of 900x+) and froth (Tesla, Palantir), the largest U.S. technology companies are better companies and sport lower valuation levels than the market darlings circa 2020 (Cisco, Oracle, Microsoft, GE). That said, we certainly have observed a blind faith in the "winner take most" artificial intelligence thesis that many believe would disproportionately (or solely) benefit big technology companies. Value has traded far below growth and international names far below domestic ones for years, but these large discrepancies have been considered justified, given the perceived quality and growth opportunities available to the largest technology names. Many concluded that few assets were worth considering outside a small market subset. In our opinion, some parts of this mantra seem to rhyme roughly with the mantra from ~25 years ago that the "internet will change humanity/valuations do not matter." Incidentally, the former proved to be true…it was the second part that proved problematic. It is possible that tariffs will be rolled back and that money returns to U.S. markets and U.S. technology companies will again dominate worldwide stock market gains for the next decade. We would simply suggest that the recent tariffs and other unconventional U.S. policies could be a catalyst that causes various pools of capital to look for opportunities outside that which has worked so well recently.

Lots of Value Outside U.S.…Will it Get Another Look?

Moving from macro to micro, what have we been doing? In past letters, we have highlighted multiple foreign domiciled names (PTSB, Arcos Dorados (ARCO), Millicom (TIGO), Metro Bank (MTRO), Glenveagh (GLV)) that we believe are good businesses, have reasonable growth prospects but are priced at bombed-out levels. We will not delve into each name (we hear the cheers) as we have extensively detailed these names previously (please see past letters for more details). We continue to own all of these names and have selectively added to several on share price weakness. We would emphasize that avoiding rash decisions is not the same as sitting on one's hands and doing nothing. We must look at the world as it is and not as how we would like it to be. Current market volatility is creating and will create additional investment opportunities and this could mean selectively selling "cheap" to buy "cheaper/better." Garrett Motion (GTX) and Sirius XM Holdings (SIRI) are two statistically cheap stocks with lots of potential upside that we have previously detailed. We believe there is still a strong upside case for both names. That said, both are highly dependent on car sales (SIRI only impacted by U.S. sales while GTX is impacted around the globe), and car sales have a high probability of being weaker in the year ahead. For this reason, we reduced exposures to buy some of the names mentioned above as well as a new UK name that we will highlight in a future letter. As detailed in our Q4 letter, we remain committed to vigilantly adjusting positions when results diverge from our investment theses.

Preferred Stocks Offer Decent Yield…Larger Opportunity May be Coming

As noted in past letters, we have added select preferred stocks in companies that we know well including those from Compass Diversified Holdings (CODI) and Liberty Broadband (LBRDA) that currently trade at 85-95% of par value and yield anywhere from ~7.5-9.5%. In the past we owned bank preferred stocks (principally Bank of America and Goldman Sachs) that pay a minimum of a small spread over SOFR[4] or a fixed rate. The basic premise behind the preferred purchase was twofold: 1) The preferred dividend payment was far more important than what might be implied by the headline credit rating. 2) Occasionally large institutional holders or panicked retail investors sell illiquid preferred stocks which creates fantastic entry points. CODI and LBRDP preferred stocks are currently decent income securities with less volatility than the common stock, but both CODI and LBRDP common stock offer far more upside. That said, it is possible that the above preferred stocks (and others) move meaningfully lower should credit spreads widen and/or selective institutions liquidate positions in falling markets. In these cases, we think it could be possible to grab low-to-mid teen yields with sizable upside to par value. Preferred stocks at these prices would essentially be something closer to bond-like securities with equity type upside. Bank preferred stocks sold off in and after the global financial crisis, while CODI's preferred stock suffered large declines during COVID. We think it is possible that there could be another opportunity if the current downturn worsens.

Spring Postcards from Ireland: Tariffs Dominate Conversations…Ireland Risk Manageable

We want to give a brief update following Davy's March 2025 Conference and a recent trip to Dublin where we met with PTSB's executive team, Bank of Ireland (BOI), Allied Irish Banks (AIB), non-bank financial companies, the Department of Finance (DOF), brokerage firms and other investors. Concerns about tariffs dominated most of the macro discussions at the Davy Conference and in individual meetings in Ireland, and these are now *the* issue following events of the past weeks. As we have mentioned in past updates, many of the technology and pharmaceutical companies based in Ireland need to access the EU market, and Ireland is one of two EU countries with English as its official language. While we are conscious that new U.S. rules/legislation are possible, we would again note that companies plan manufacturing plants years and sometimes decades in advance and we therefore do not believe there will be wholesale departures. Furthermore, moving intellectual property domiciled in Ireland is difficult as many firms would face a substantial tax upon exit. Many believe that Ireland's risk is limited to less foreign direct investment (FDI) versus any outright exodus of existing firms. Admittedly, it is possible that

[4] The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

countermeasures from the EU might lead to further tariff escalations and it is difficult to predict possible knock-off impacts.

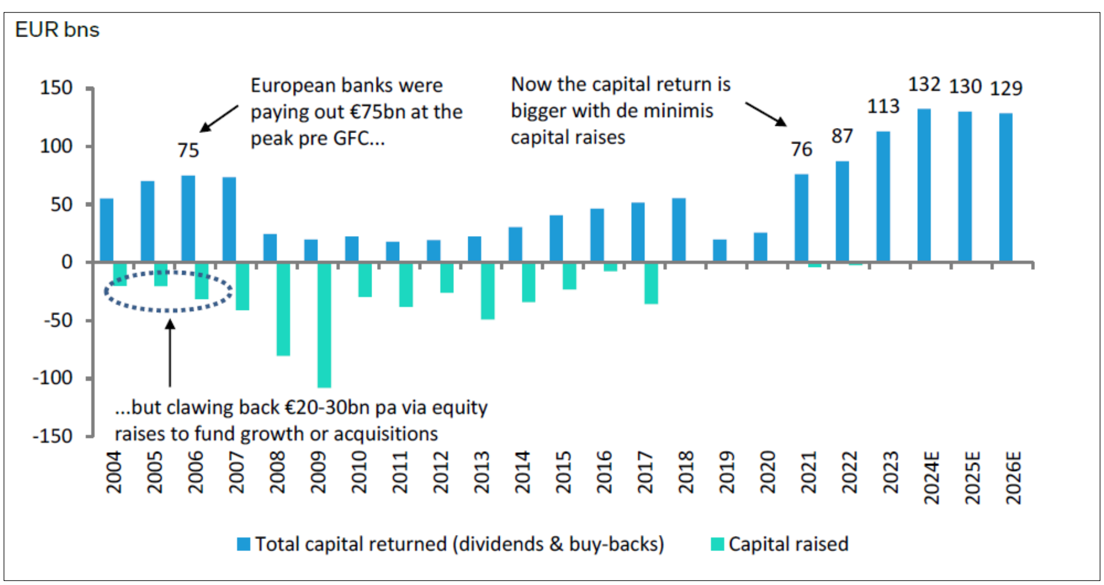
European Outperformance Interrupted by Tariffs…Still a Good Story (With Potentially More Investors Noticing)

European financial names started strong in 2025, but tariff concerns have negatively impacted financial names (including the Irish banks) along with nearly every other risk asset over the past couple of weeks. Despite the negative headlines, Ireland is well positioned for whatever lies ahead and we believe that Ireland would not trade its outlook with any other European country. Ireland is one of the few western nations to be running budget surpluses, its unemployment is under 4 percent, and the economy will likely be juiced by very substantial spend on housing/infrastructure. Even in a global recessionary environment, Ireland likely will post stronger growth than its European peers -- as well as the U.S.

While the European financial services sector has moved higher from trough valuations over the past 1-2 years, it still trades meaningfully below historical levels. Some portion of the depressed valuation in European financials likely stems from concerns about a return to negative interest rates and/or some concern about European regulators allowing capital return. Both concerns should be less worrying to investors. While ECB deposit rates have been cut seven times since last June and while further cuts are expected, Euribor curves still imply rates well above zero over the next 3 years. Admittedly, a stronger euro could negatively impact export growth and drive lower import prices (assuming no European reciprocal tariffs), both of which could lead to further rate reductions. That said, since the start of the year, Europe's fiscal response has been more forceful than anticipated. Germany has amended its constitution to allow ~€1 trillion in civilian and defense investments with the plan prompting ~15+ (50+ before the tariff announcements) basis point increase in the country's 10-year bond. Non-negative rates and a steeper than anticipated yield curve are both broadly positive for the European financial sector. Following the Trump 2.0 tariffs, some also believe that more "normal" government policy could be a tailwind for European financial names.

Meanwhile, European Banks are poised to spend record amounts on dividends and buybacks in the coming years -- amounts greater than those before the Global Financial Crisis.

European Banks Are Paying Out More Dividends/Buybacks Than Before GFC



PTSB Sounding More Bullish…Execution is Key

Following interactions at the Davy conference and during our long, in-depth dinner discussion with the PTSB team (CEO Eamonn Crowley, new CFO Barry D'Arcy and Head of Investor Relations Scott Rankin), we would like to make a few quick observations:

- PTSB is certainly presenting a more bullish tone, particularly regarding the density review and PTSB's ability to achieve loan growth
- PTSB is presenting better to investors and, importantly, is taking a more professional approach to meeting new investors
- Barry D'Arcy is a substantial upgrade over the former CFO
- There is a noticeably better working relationship/camaraderie with the three executives versus the prior team
- There is a potential complementary tuck-in acquisition opportunity with one of the non-bank lenders; we extensively warned on the need for price discipline

As noted in prior updates, density relief is the biggest catalyst for PTSB, and we have discussed this at length in prior updates. Interactions with The Central Bank of Ireland (CBI) continue to progress well and PTSB expects a favorable outcome prior to year-end. Meanwhile, PTSB is forecasting annual loan growth of 4-5% from 2025-2027. This is underpinned by growth in aggregate mortgage volume and by PTSB maintaining/expanding its recent ~20 percent market share as well as 15-20% annual growth from the bank's small-and-medium sized (SME) book. Importantly, both BOI and AIB are also talking about healthy loan growth, and both banks have noted a pickup in SME loan demand.

Housing policy came up in nearly every conversation I had in Ireland – with cab drivers, bartenders (field research!), bank CEOs and DOF officials. Unfortunately, Ireland continues to face a chronic shortage of homes as progress has been far slower than anticipated/required. The problem is not on the demand side but instead on the supply side where home building needs to at least double from current levels to meet years of pent-up demand and future population growth. In a nation of ~5.4 million, there are fewer than 10,000 secondary homes across the country, and owning is ~40% cheaper than renting. Regardless of the macro environment, the current government will throw substantial resources into building more houses and this should offer support for Ireland's economy and PTSB's loan book. PTSB might have another opportunity to provide loans to housing developments and government agencies if the government decides to provide guarantees to banks versus direct lending support to housing associations and private developers. Please contact us if you would like to discuss the minutiae.

PTSB does have a potential acquisition opportunity. Non-bank finance companies have struggled to regain the market share held when interest rates were near zero. Currently, the securitization funding costs of these companies vastly exceed the three banks' deposit funding costs. PTSB has an interest in the SME business of one of the largest non-bank companies (Finance Ireland), but it is also possible PTSB may acquire Finance Ireland's mortgage book as well. We believe that PTSB is the only logical buyer for Finance Ireland, given the larger market shares of Ireland's two larger banks. Finance Ireland would provide enhanced scale to PTSB's SME business, and PTSB's lower cost of funding would provide a meaningful synergy. PTSB agrees that timing and price are critical, especially considering PTSB's bombed-out valuation level. Therefore any deal would have to be done at a discount to book value (including loan loss provisions) to make economic sense.

It is frustrating that recent signs of progress at PTSB have now been engulfed by global tariff uncertainty. That said, PTSB is an incredibly defensive investment with a strong balance sheet and no problematic assets. Additionally, PTSB has a hard catalyst to return capital once the density review is completed and strong loan growth prospects driven by a near biblical need for housing across Ireland. The recent 2025 outperformance of European markets may or may not prove sustainable, but we would argue that strong capital levels, non-zero and upward-sloping yield curves and low absolute and relative valuation levels all provide a strong backdrop for European financial names. In a better performing sector, PTSB's low valuation will be particularly noteworthy (albeit frustrating for existing investors) to the increasing number of eyeballs that may peer towards European investment opportunities. We continue to believe that the combination of density relief, government sales and operational execution provide a fantastic opportunity to rerate shares, but PTSB must execute. We emphasized this "seize the day" message in all our meetings with the PTSB team.

In closing, we would note that recent U.S. policy changes likely mean that market volatility will be present for the foreseeable future. That said, market corrections are a normal part of the investing process – no different than turbulence as part of the commercial flying experience. Before running for canned foods and shotguns, it is worth considering the possibility that public opinion over tariffs could shift, court challenges could overturn current policy, or multiple agreements could make tariffs decline from current levels. That said, it is also important to remember that markets traded at elevated levels entering this latest volatile period and that it is possible for a far larger correction to materialize due to a host of different factors. While nearly all risk assets will decline in true downturn, we do believe that several of our international and value names detailed in this and prior letters could ultimately be considered by investors who may consider names outside a select group of U.S. companies. We are trying to strike a proper balance between adding to existing and new positions while keeping some powder dry should a deeper correction materialize. We continue to assess individual investment theses, and we remain committed to pivoting when appropriate. We continue to own significant personal investments in the names discussed and we will maintain and add to positions alongside our clients where we believe the risk/reward remains firmly in our favor.

Thanks for your continued support.

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