GDS Investments

Client Note, May 2025

> *"In the United States we should be looking to trade with the rest of the world, and we should do what we do best and they should do what they do best."*
>
> —Warren Buffett

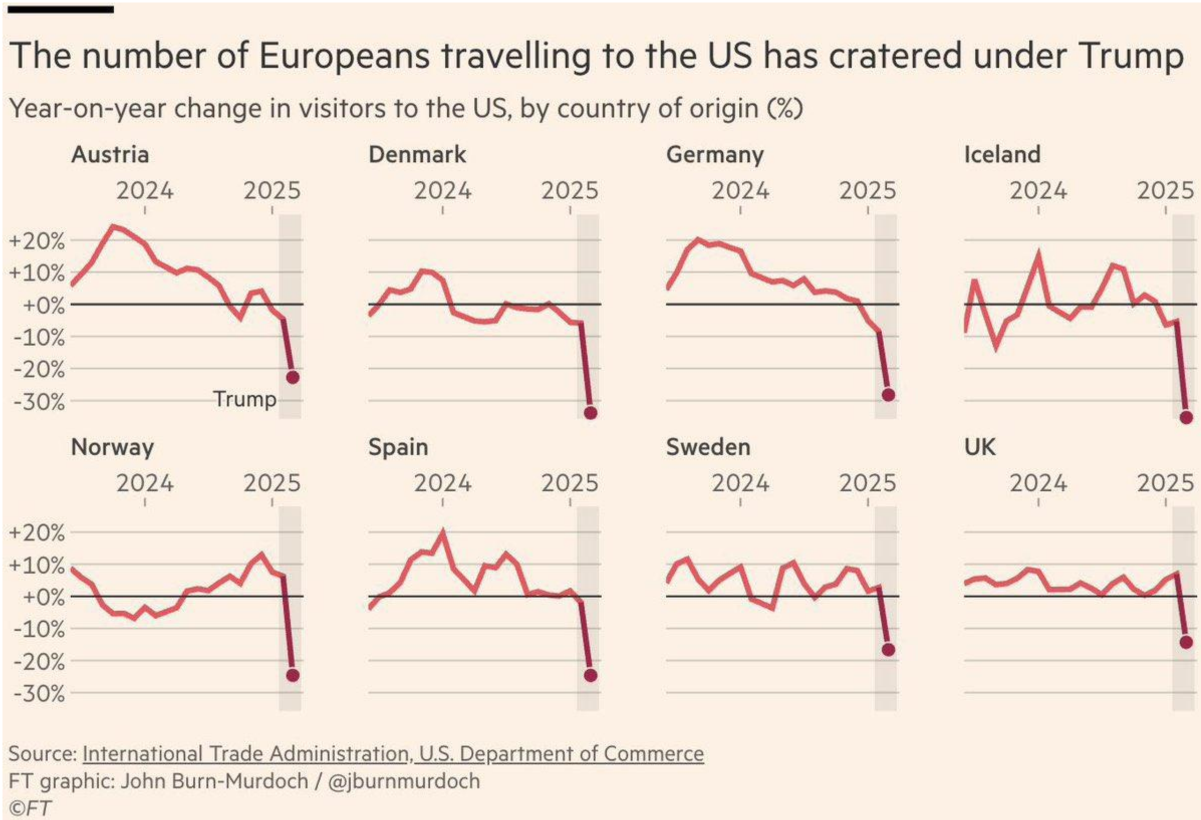
Last month, we wrote at length about President Trump's tariffs imbroglio: an aggressive package of tariffs based on bad math, all but certain to produce economic outcomes ranging somewhere between bad and dire. The market subsequently protested vigorously, and—just after publication of our letter—Trump (mostly) retreated.

This month, we want to zoom out a little. The tariff story exemplifies a larger playbook that has come to define Trump's approach to economic policymaking. Now that we've seen that playbook fully in action, we want to look at what it suggests about the economic fortunes of the U.S. under a second, protectionist Trump Administration.

It's hard to deny that President Trump was successful as a private sector businessman, but one thing has become clear now: what works as a private business owner does not necessarily work when you are the chief executive of the world's wealthiest and most powerful nation. Impulsive policy-setting based on superficial analysis doesn't just affect one company; it affects the whole world. As a result, we have now seen 'Private Sector Trump' and 'President Trump' colliding in spectacular fashion to the detriment of the American economy. Along the way, he has alienated many former allies and trade partners while also unsettling domestic businesses and investors.

And for what? What is achieved by either this rhetoric or these punitive economic measures?

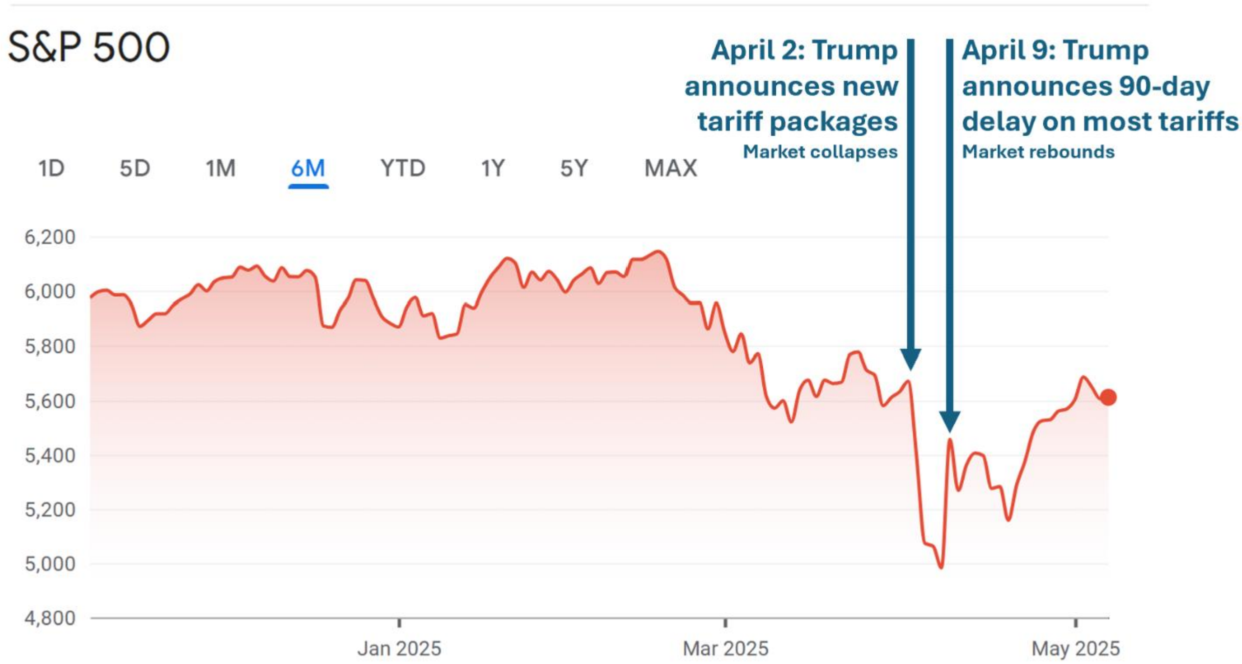
Is it to increase the risk of recession this year from an already-high 40% to 60% (or even create an instant recession for specific sectors)? To make Americans panic about empty store shelves in the weeks and months to come? To see the cost of living go up and inflation worsen? To weaken the U.S. dollar? To destroy the U.S.'s appeal to foreign consumers, investors, and visitors (see chart below)?



Is this what winning looks like?

The market doesn't think so. Immediately after Trump's so-called "Liberation Day" announcement, the S&P 500 crashed, losing 12% of its value in less than a week and recovering only after he announced a 90-day pause. We discussed this event in our April 9 letter. The market's opinion of the tariffs could not be clearer; they scrambled away from the market when the tariffs were announced and returned only when the tariffs were paused (see chart below).

However, Trump was surprisingly dismissive of the market reaction, simply telling Americans on April 5 to "hang tough" and describing spooked investors as "yippy."



Source: Google Finance

But what not even Trump could ignore was the bond market.

When equity markets initially sold off, people understandably assumed that selloff would trigger a flight to quality. That would have been a normal response and would have helped the U.S. dollar, bonds, etc. But we didn't see that; instead, there was also a bond selloff.

That's because to the credit investor, who is pricing in the sovereign risk of the U.S., the U.S. suddenly looked a lot more economically fragile and a lot riskier. If you're buying U.S. sovereign credit, your perception and expectations around U.S. economic growth have changed in light of these higher tariffs and potential retaliation and counteractions, like a potential U.S.-China trade war. Ultimately, it was the credit markets' repudiation of Trump's tariffs that triggered the 90-day pause.

So, what are our takeaways from these events and their implications for economic outcomes in the near- and long-term?

First, Trump is bringing an economic playbook to bear that isn't working.

This might seem obvious, but it's worth unpacking. Donald Trump—'Private Sector Trump' specifically—seems to have been able to spend most of his professional life making impulsive decisions and treating people with a low level of respect and dignity, all without significant consequence. He could make up demeaning nicknames for people. He could refuse to pay contractors. And worse.

But the calculus of this kind of behavior changes when you're President of the United States. Alienating former allies just risks seeing them fall into a closer relationship with China. Worse, that kind of behavior upsets and panics investors upon whose financial decision-making rests the prosperity of the nation. When investors start putting their money into other global markets because those markets are stabler and offer more confidence than our own (*a sentence that is by itself an extraordinary and terrible thing to write*), it is the entire American economy that suffers.

His playbook is also top-down in a way that is unhealthy. After his "Liberation Day" announcements, Trump met with major executives who all quietly, diplomatically argued against these policies. In our view, the surprising element here wasn't that CEOs of companies like Target (**NYQ: TGT**), Walmart (**NYQ: WMT**), and Home Depot (**NYQ: HD**) would oppose the proposed tariffs. It's that the Trump Administration hadn't *already* solicited input from the private sector as part of the policy drafting's fact-finding, due diligence process.

Second, market reaction has been reassuring.

The market's repudiation of the tariffs and Trump's subsequent retreat are reassuring. It means at least one of the guardrails against the Trump Administration's more extreme economic inclinations has functioned appropriately, even if it was at the cost of a great deal of upheaval and volatility. It's a signal that Trump is not *so* committed to these damaging policies that, in the face of significant counter-reaction, he's not willing to pause.

The market response also showed perhaps some unexpected resiliency. The most successful companies in the U.S. make up the backbone of our economy, and their handling of recent events has demonstrated that they are efficiently run. In fact, in some ways, the past month has, ironically, highlighted the advantages of offshoring. Outsourcing has given capital-intensive American businesses a way to lower costs and make more efficient use of capital investments, in turn giving them a greater hedge against economic disruption.

It's not that international outsourcing is all upside, of course. The effects of offshoring are complex, and everything involves tradeoffs. But offshoring does offer significant efficiency benefits that the Trump Administration is, realizingly or not, trying to unwind.

Third, Trump is continuing to play with fire when it comes to the American economy.

We are reassured for the moment, but nothing is settled, and this uncertainty is perhaps the most dangerous aspect of the Trump economic playbook. Trump didn't end the tariffs; he simply delayed a final decision on most of them. Is this what economic policy is going to look like for the next four years? Skirting outright disaster by constantly kicking the can down the road, repeatedly doing incremental damage all along the way and gambling true catastrophe never strikes?

And tariffs are hardly the only economic front on which the Trump Administration could potentially do great harm. For example, Trump has already floated the idea (and, fortunately, backed off) of firing Fed chairman Jerome Powell, whom Trump described as a "major loser."

Fourth, Trump is slowly engineering a new economic world order.

All of this is just the entirely avoidable consequence of unpredictable and ever-changing economic policy predicated on some strongman version of "winning" rather than focusing on the mutual benefit that turned the U.S. into the world's foremost economic powerhouse.

What kind of mutual benefit? Consider Vietnam and an American producer of goods like Nike (**NYQ: NKE**). Nike can build supply chains through countries like Vietnam and, in turn, generate higher margin that can be reinvested in the company and workforce, to shareholders' ultimate benefit—all while lowering costs for American consumers. Simultaneously, Vietnam benefits with an economy buoyed by the business we send them. Those are big wins for everyone!

Yet, we're going to claim that Vietnam is somehow taking advantage of *us*? The U.S. has an average per-capita GDP of $89,105. Vietnam's is $4,806, and one-third of Vietnam's total exports go to us. We helped them get to a place they likely otherwise couldn't while infusing efficiency into our own businesses. It was a win-win, and now the Trump Administration wants to blow that up.

These accusations of other countries taking advantage of us are not merely absurd and false, they're cruel. They're not how you treat valued relationships. There must be a level of dignity and humanity in dealing with our trade partners that makes it possible for all of us to benefit.

And in the absence of that kind of mutual respect and benefit? It's anyone's guess what kind of new economic order establishes itself over the next four years, but the risk that it's an order without the U.S. at its center is high. This is, for us, perhaps the most concerning and dismaying realization to come out of the last month. "But the old US-led economic order is now unsustainable," writes Martin Wolf, the chief economics commentator at the *Financial Times*. "The US will no longer serve as balancer of last resort. The world — especially China and Europe — has to think afresh."

Fifth, Trump is also playing with fire when it comes to his own political standing.

The financial wounds incurred over the past six weeks have been entirely (and foolishly) self-inflicted, but the upside is that it means we have the power to reverse course at any time.

What we do know: Americans *want* manufacturing relationships with countries like Vietnam, even if they don't articulate it that way to themselves. A recent experiment by an American business whose products are manufactured in China and Vietnam tested whether American consumers were genuinely willing to pay more for "Made in the USA" products. They found that they were decidedly not willing;

Americans made literally *zero* purchases of the product, even if advertised as “Made in the USA,” if it meant higher costs.

For better or worse, U.S. consumers are addicted to low prices; we want affordability more than anything. If the Trump Administration ends up kickstarting a notable increase in inflation, it could trigger significant electoral backlash. In fact, Trump’s approval ratings haven’t merely dipped over the past month; they have collapsed even among his core supporters.

Finally, none of this is normal.

This is another statement of the obvious, but it’s worth spelling out. None of this is in the nation’s economic self-interest. Almost all the economic policies and actions floated or taken by the Trump Administration will hurt a lot of people, both at home and abroad.

We had hoped that we’d see a repeat of Trump’s first term, where his worst instincts and impulses were clearly reined in by experienced and level-headed advisers like former Treasury Secretary Steve Mnuchin, former chief of staff John Kelly, and former chairman of the Joint Chiefs of Staff General Mark Milley. Such advisers, excepting perhaps current Treasury Secretary Scott Bessent, are not in the room this time around. Bessent is perhaps the lone member of the administration to recognize and articulate that a trade war with China is not in the U.S.’s best interests. “Neither side thinks the status quo is sustainable,” he said last month about trade negotiations with China.

The fact that the Republican Party has gone from the party of Ronald Reagan, Rand Paul, and Mitt Romney—a party of free trade and letting the private sector do its work with fewer constraints rather than more—to a party of trade protectionism and high costs means we are at serious risk of unwinding all the postwar prosperity our country has generated over decades. This is not going to make the U.S. great again. It just risks making the U.S. poorer.

With warm regards,

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