

# Trump's Gambit

1st Quarter, 2025

## Summary

- U.S. markets faced a challenging first quarter. U.S. large-cap stocks ended the quarter down -4%, while small-cap stocks declined by nearly -10%.
- The government is pursuing aggressive trade and fiscal policies, using tariffs and reducing wasteful spending to restructure federal debt—partly to support extending tax cuts.
- March saw a sharp drop in both investor and consumer sentiment, with tariff-related concerns cited as the key reason for growing uncertainty.
- The Trump administration is making a high-stakes economic gamble—betting that short-term pain from tariffs and tighter fiscal policies will yield long-term gains in deficit reduction, domestic manufacturing, and re-balanced global trade.

## Overview

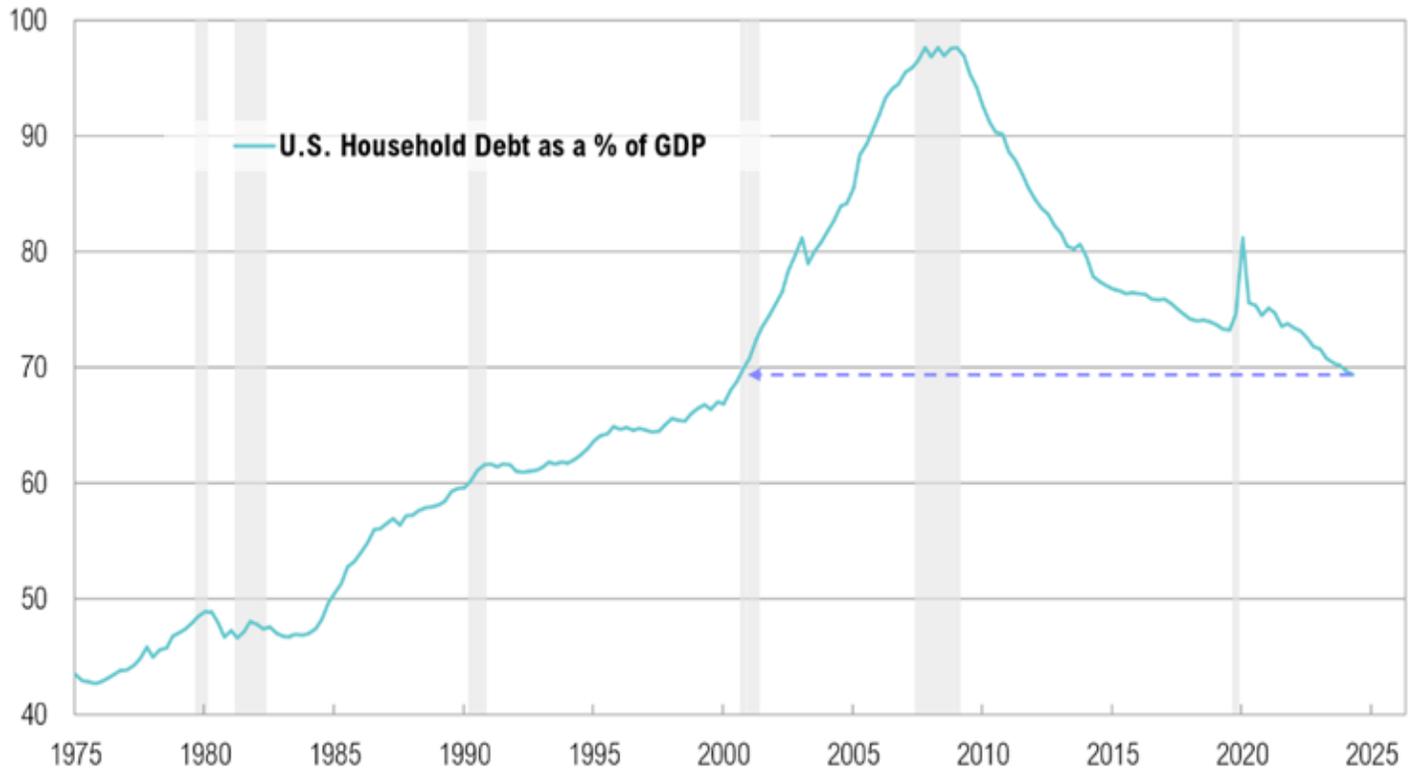
U.S. equity markets faced a challenging first quarter. U.S. large-cap stocks, as represented by the S&P 500, ended the first three months of 2025 down -4.3%, while the small-cap Russell 2000 Index declined -9.5%. This marked the worst quarter for both U.S. large- and small-cap stocks since the second quarter of 2022. In contrast, U.S. fixed income markets fared better, with the Bloomberg U.S. Aggregate Bond Index gaining 2.8% in the first three months of the new year.

Final fourth-quarter gross domestic product (GDP) results, released at the end of March, confirmed that the U.S. economy continued its steady pace of growth throughout 2024. GDP growth for the quarter was revised marginally upward, from 2.3% to an annualized 2.4%. Government spending increased at an annualized rate of 3.1% while consumer spending grew by 4.0%—the strongest pace of 2024.

Personal income has grown steadily in 2025, rising 0.9% month-over-month in January, followed by another strong increase of 0.8% in February. Although personal savings remain below pre-pandemic levels, they have started to recover, reaching 4.6% in February as income growth outpaced spending. Meanwhile, U.S. household debt-to-GDP levels have declined to 70%, the lowest since 2001.

## Household Debt as a Percentage of GDP is At The Lowest Level Since 2001

U.S. Household Debt as a % of GDP



Source: Bloomberg

Inflation remains sticky, but there are promising signs. Headline inflation rose to 3.0% year-over-year in January before easing to 2.8% in February, aided by declines in food and energy prices. Notably, core inflation in February rose at the slowest pace since April 2021, increasing by 3.1% year-over-year. As expected, the Federal Reserve kept interest rates unchanged at its March Federal Open Market Committee (FOMC) meeting. Despite inflation above 2%, Fed officials still anticipate the equivalent of two 0.25% rate reductions for 2025, while market expectations for rate cuts increased from two 0.25% cuts to three, with the first cut expected in June. The Fed also announced plans to slow the pace of quantitative tightening, reducing its monthly runoff from \$60 billion to \$40 billion, with a maximum Treasury runoff of \$5 billion per month starting in April. Fed Chair Jerome Powell attributed this decision to the debt ceiling, which was reached in January.

The 2024 earnings season concluded in March, and S&P 500 earnings grew by a solid 11% for the year. Growth was led by the communication services (+23%), technology (+19%), and financial (+19%) sectors. Looking ahead, earnings growth estimates for the first quarter have declined from 12% at the start of the year to 7% by the end of March. At the sector level, healthcare (+36%), technology (+15%), and utilities (+10%) are expected to drive earnings growth in the first quarter.

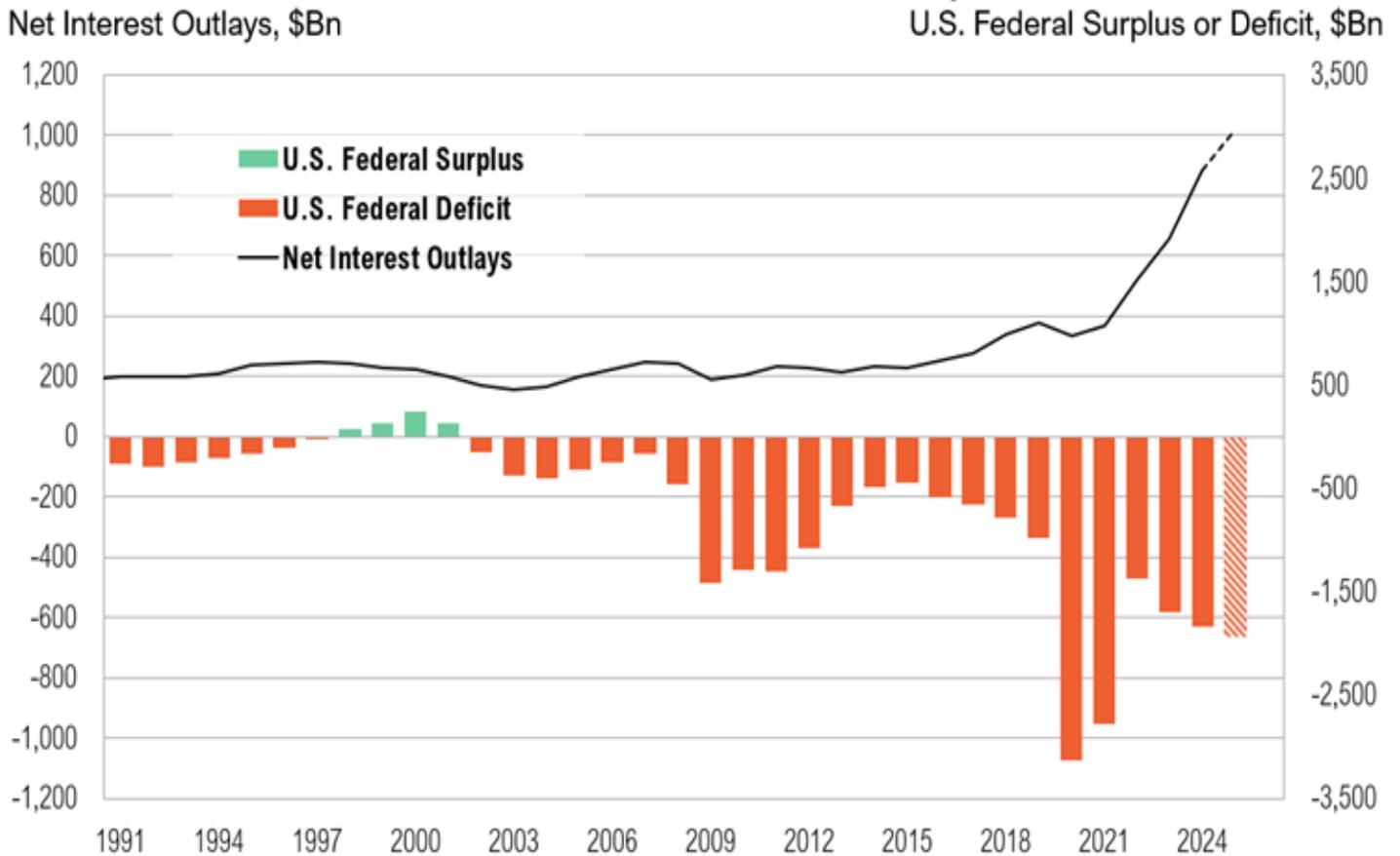
# Trump's Gambit

In chess, a gambit is a strategy where a player deliberately sacrifices a piece in the opening to gain a positional or tactical advantage. The goal is usually to achieve faster development, gain better control of the board, or put the opponent in a difficult situation. As the economy adjusts to reduced government spending and the impact of tariffs, President Donald Trump and Treasury Secretary Scott Bessent are willing to accept short-term economic pain to pursue potential long-term gains.

The Mar-a-Lago Accord is a conceptual economic strategy proposed by the Trump administration that aims to restructure the global financial system to reduce U.S. debt and address economic imbalances. Key elements of the proposal include boosting American manufacturing, restructuring U.S. debt, and leveraging tariffs and geopolitical influence to pressure trade partners to absorb financial burdens and adjust currency values. Though not an official policy, the Mar-a-Lago Accord aims to reshape global trade and finance by tying economic measures to national security (while sparking debate over its feasibility and risks).

The Trump administration's high-stakes economic gambit seeks to reduce government spending and increase revenue to extend the expiring Tax Cuts and Jobs Act beyond its scheduled expiration at the end of 2025. The administration has also proposed eliminating income taxes on Social Security benefits, overtime, and tips, which would reduce government revenue by over \$1.5 trillion over the next ten years.

## U.S. Federal Debt Is On An Unsustainable Path, and Requires Intervention



Source: Bureau of the Fiscal Service, Congressional Budget Office.

The administration has made it clear that reducing the fiscal deficit is a primary objective. The Department of Government Efficiency (or DOGE)—purported to enhance government accountability and efficiency through strategic oversight and reform—claims to have already saved the government approximately \$140 billion. If accurate, this remains a small fraction of the \$1.2 trillion fiscal deficit accumulated YTD. Still, the initiative appears to have widespread support. Treasury Secretary Scott Bessent has publicly endorsed the efforts, stating, “I am completely aligned with what Elon’s doing.” Public sentiment also favors cutting wasteful government spending. A recent Harvard CAPS-Harris poll of over 2,400 registered U.S. voters found overwhelming support for the government’s policies on eliminating fraud and waste in government spending, as well as reducing previously allocated expenditures. The survey revealed that 77% of Americans believe a full review of government spending is necessary, while 83%—including 72% of Democrats and 94% of Republicans—agree that spending should be cut. According to Musk, DOGE aims to achieve its goal of cutting wasteful government spending by \$1 trillion by the end of May 2025.

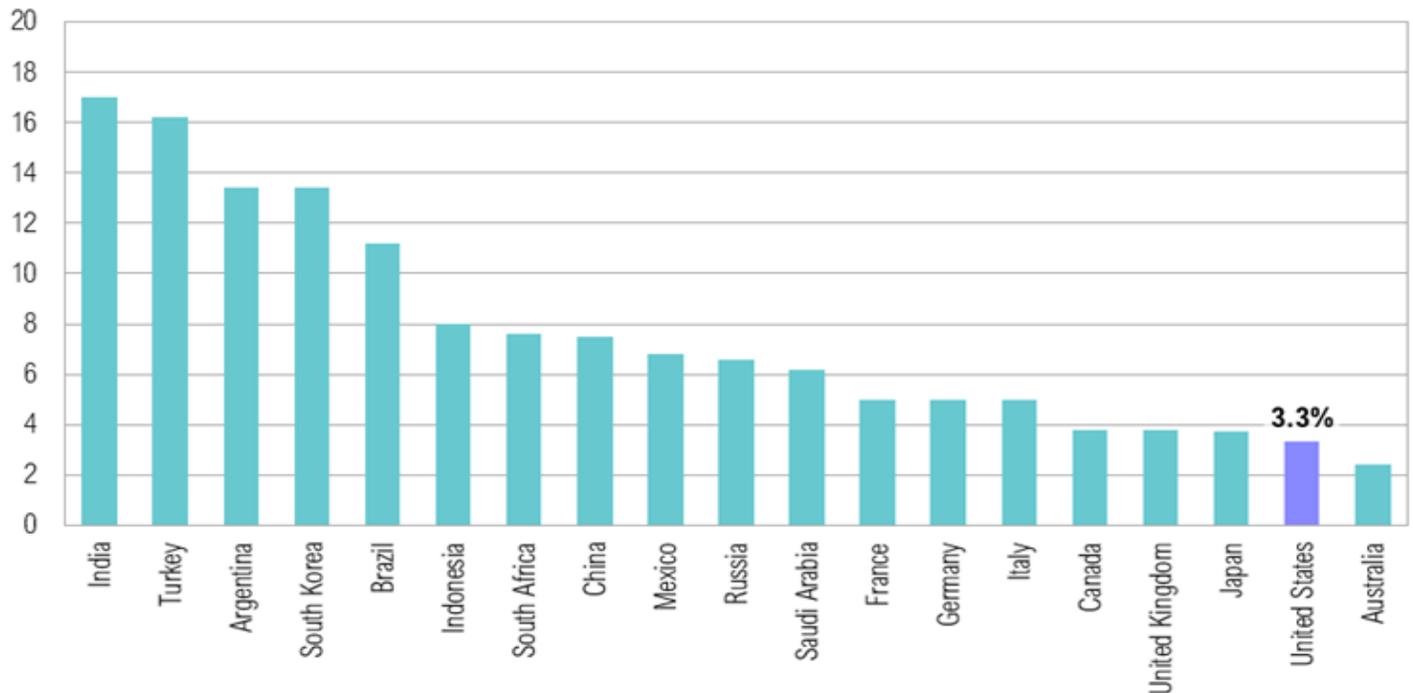
One of the Trump administration’s opening moves has been implementing aggressive targeted tariffs on various countries and global trade sectors, citing national security and economic interests. On April 2, baseline tariffs of 10% were announced on all imports to the U.S., and higher rates were implemented for major trading partners. At that time, the highest reciprocal tariffs were imposed on China (54%), the European Union (20%), Vietnam (46%), South Africa (30%), and Japan (24%). Unlike China, Canada and Mexico avoided additional tariffs. The Trump administration also confirmed a 25% tariff on all foreign-made automobiles. Since then, tariff policy has continued to evolve, resulting in significant market volatility.

President Trump’s current approach appears to contradict his previous stance, as stated in a 2018 tweet:

*“The European Union is coming to Washington tomorrow to negotiate a deal on trade... Both the U.S. and EU [should] drop all tariffs, barriers, and subsidies. That would finally be called [a] free market and fair trade...”*

### The U.S. Had Among the Lowest Average Tariff Rates of All G20 Countries

Average Tariff Rate, %



Source: World Trade Organization. G20 tariff average as of 12/31/2023.

The Trump administration appears to be leveraging tariffs for two primary purposes: as a negotiating tool and as a macroeconomic strategy. When used as a macroeconomic tool, these tariffs are designed to protect domestic U.S. industries and encourage reshoring. Unlike most countries, the U.S. has historically maintained relatively low trade barriers, with an average tariff rate of roughly 3%. A third reason for earlier tariffs imposed on Canada and Mexico was to curb drug trafficking and stop the flow of drugs crossing into the U.S. via neighboring borders. Recent data from the U.S. Customs and Border Protection shows drug seizures in February dropping to the lowest level in at least three years.

Several countries have already proposed tariff cuts on U.S. imports in efforts to avoid reciprocal tariffs. For example, India has offered to cut tariffs on over half of U.S. imports worth \$23 Billion, including almonds and other farm products. Similarly, the European Union is engaged in talks to identify potential concessions in exchange for the partial removal of U.S. tariffs. To avoid or mitigate tariffs, global corporations have pledged nearly \$1 trillion in U.S. investment since Trump's inauguration. Apple, for example, has committed \$500 billion over the next four years, while Taiwan Semiconductor plans to invest \$100 billion to advance semiconductor manufacturing in the U.S., and South Korea's Hyundai will invest \$21 billion over the next three years to improve the U.S. supply chain and build a new steel plant in Louisiana.

Still, all gambits come at an immediate cost. Investor sentiment declined sharply in March. The American Association of Individual Investors (AAII) sentiment survey showed bearish sentiment rising to a one-year high of 61% in the last week of February, and sentiment remained negative throughout March. An average of 58% of survey respondents expressed a bearish outlook for U.S. equities over the next six months. Similarly, Bank of America's Global Fund Manager Survey in March recorded the largest pullback in investor sentiment in five years. In just three months, the percentage of fund managers overweight in U.S. equities fell from a record high to one of the lowest levels in over twenty years. While the National Federation of Independent Businesses (NFIB) Small Business Optimism Index remained above average in February, the Small Business Uncertainty Index rose to its second-highest level on record since 1975.

Consumer confidence has followed a similar trajectory. The Conference Board's Consumer Confidence Index in March fell to its lowest level since the pandemic, and the University of Michigan's survey recorded its lowest sentiment reading since November 2022. The University of Michigan survey also found that expectations for personal finances hit the lowest level since 1978, and an unprecedented 51% of respondents made unsolicited negative comments about government economic policy. Depending on political affiliation, consumer inflation expectations notably diverged over the quarter. Those identifying as Democrats expect inflation to more than double, rising to 6.5% over the next year, while Republican-leaning survey respondents believe that inflation is going to all but disappear over the next twelve months. Across both investor and consumer surveys, tariffs were cited as the primary driver of growing uncertainty.

The Federal Reserve's latest economic projections, released at the March Federal Open Market Committee meeting, suggest that they believe tariffs are unlikely to have a lasting impact on inflation. While year-over-year inflation expectations for 2025 have risen from 2.5% to 2.8%, the Fed forecasts inflation to decline to 2.2% in 2026 and 2.0% the following year, indicating that any potential tariff-related price pressures may be temporary. The Fed's 2025 outlook expects a slowdown in economic growth (from 2.1% to 1.7% year-over-year), and unemployment is projected to remain near historic lows at 4.4%.

# Markets

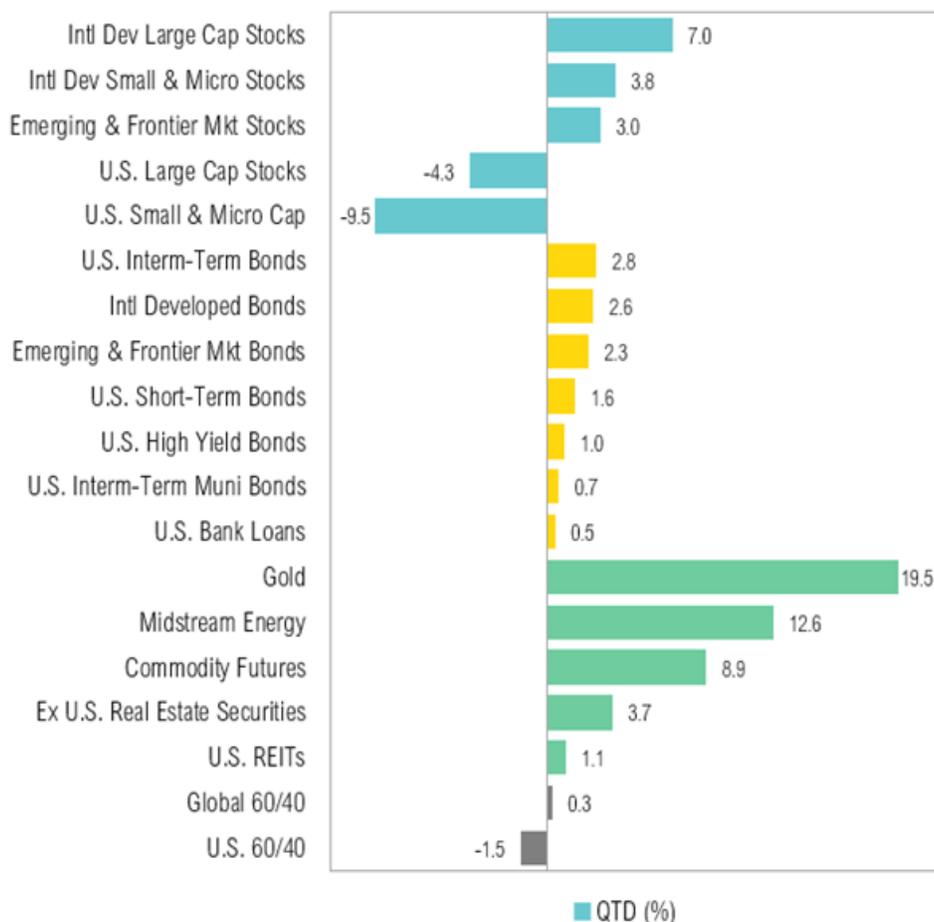
U.S. equity markets struggled in March, with Large-cap stocks falling over -4% for the month. This caps off their worst quarter since early 2022, and they underperformed global equities by the widest margin since 2009. Outperforming U.S. large-cap stocks by 15%, European equities had their strongest quarter relative to the S&P 500 since September 1985, when the Plaza Accord was signed with the goal of weakening the dollar to reduce the U.S. trade deficit. U.S. small-cap stocks ended the quarter down nearly -10%, their worst quarterly performance since the second quarter of 2022 when the Russell 2000 declined by -18%.

The Magnificent Seven—Apple, Microsoft, Amazon, Alphabet, Nvidia, Meta, and Tesla—have been a driving force behind the S&P 500's rally in recent years, fueled by strong fundamentals, market leadership, and exposure to transformative trends like artificial intelligence. However, the group ended the first quarter down -16%, driven by Tesla (-36%), Nvidia (-19%), and Alphabet (-18%). Tesla was the second-worst performing company in the S&P 500. The downturn in stock prices led to a pullback in valuations, bringing the Magnificent Seven's valuation premium relative to the rest of the S&P 500 to its lowest level since 2017.

International equity markets outperformed U.S. equities in the first quarter of 2025. Large-cap stocks in developed international markets outpaced their U.S. counterparts by more than 10%, with the MSCI EAFE Index gaining 7%. In Europe, investor optimism—fueled by an \$860 billion defense spending package—helped push the MSCI Europe up 11% during the quarter. Similarly, international small-cap stocks rose 4% over the quarter, whereas U.S. small-cap stocks fell -10%.

Fixed-income markets had a strong start to the year, with U.S. intermediate-term bonds gaining 3% over the quarter. After rising to 4.8% in mid-January (the highest level since October 2023), the 10-year U.S. Treasury yield ended March below 4.2% due to rising uncertainty surrounding tariffs. The spread between the 10-year and 2-year Treasury yields remained positive throughout the quarter, finishing March at 0.3%.

## Q1 2025 Key Market Total Returns



## Looking Forward

President Trump and Treasury Secretary Bessent appear to be playing the long game, hoping that consumers and markets—particularly bond markets—will look beyond a short-term period of uncertainty, or “detox” in the words of Bessent, in exchange for the long-term benefits stemming from a reduced fiscal deficit, increased domestic manufacturing, and more balanced global trade practices. In many ways, their approach resembles a true gambit in chess—deliberately sacrificing short-term stability in pursuit of long-term gains. The key question remains whether or not this calculated risk will ultimately pay off.

As always, if you have any questions or would like to schedule a meeting with one of our investment professionals, please don't hesitate to call us at 508-693-8850.

Sincerely,



Luke Murphy  
Managing Director,  
Martha's Vineyard Investment Advisors

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## Martha's Vineyard Investment Advisors

496 State Road  
West Tisbury, MA 02575  
(508) 693-8850

[www.mvinvestmentadvisors.com](http://www.mvinvestmentadvisors.com)

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## Performance Disclosures

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