First Quarter 2025 (April 1, 2025)

In the first quarter of 2025 U.S. equity markets were mostly lower, following two strong calendar year returns in 2023 and 2024. We have always viewed the SEM Investment Management Commentary as a communication to our clients about our SEM investment process, the current economic and investment climate we are working in, and general market observations. We may not cover each of these topics every quarter, yet this is where our focus will remain.

The market decline in the first quarter seemed to be driven by two events. First, in late January Chinese AI company, DeepSeek, released its open-source reasoning model claiming the same capabilities of models by OpenAI, Anthropic and Google, at a much lower training cost. DeepSeek's announcement negatively impacted a wide swath of public companies in that space from large to small and we cover this development in our **SEM Select Growth Commentary**. Towards the latter half of the quarter stocks prices fell further as optimism quickly faded for the new administration's policy actions, especially global tariff implementations and proposals. This was a reversal from optimism at year-end 2024 when stock prices may have gotten ahead of themselves, so we update our thoughts on today's prices versus values.

Whole Lotta of Shakin' Goin on!

Post election enthusiasm for Trump's policies has transitioned. What started out as a hopeful synchronized swing dance has morphed into the jitterbug. Proposed trade tariffs at very high magnitudes that spread near (Canada and Mexico) and far (China) are driving uncertainty that markets don't like. Historically speaking open markets have been better and closed markets can exacerbate consumer costs and inflation, conditions that have already strained many U.S. consumers' budgets over the past few years.

Enthusiasm has quickly reversed, and U.S. corporate leaders have gotten jittery. In a February survey of more than 300 executives, 47% said they were optimistic about the U.S. economy, down from 67% in the fourth quarter of last year. Many CEOs spoke out during Trumps's first Presidency but are less vocal today in the hopes of keeping discussions with his second administration private and seeking to influence tariff policies, while at the same time not drawing attention to their companies that might result in a strenuous relationship with the President. If fully implemented, proposed tariffs could drive a dramatic change with both our allies and our bigger country rivals. Less free trade can affect all nations by limiting markets and consumers; there are fewer buyers to offer goods and services too. An elevated trade war would not benefit the global economy long-term; American companies, especially large ones, depend on global cooperation among nations.

The Trump administration's domestic policies have also had a mixed reception, especially cutting the federal workforce and government spending to narrow the budget deficit. In many folks' opinions, the Department of Government Efficiency (DOGE) is using an axe, rather than a scalpel, to try to increase productivity. Treasury Secretary Scott Bessent said the U.S. economy needs to undergo a "detox period" to purge misallocations of taxpayer money.

Valuation Revisit and Earnings Dependent

At year-end 2024, we commented that our portfolios were "a little overvalued." Intrinsic value is inherently an estimate so that is why we choose a qualitative description versus a precise quantitative number. "A little," in our minds, is 5% to 10%, versus say 25% over or undervalued which we would consider "significant." With the stock market decline this quarter, we have swung back towards fair value to "a little" undervalued range.

Going forward two highly correlated factors to watch are global consumption trends and consumer confidence, which ultimately determine the direction of earnings growth. U.S. Consumer Sentiment sank in March to the lowest level since November 2022 according to the University of Michigan index and lots of reports indicate consumers are pulling back spending either from inflationary cost increases or concerns over tariffs. On the positive side, 151,000 new jobs were added in February and the unemployment rate was 4.1%, both at a steady level. Some areas of the economy seem mixed. For example, travel cruise operators are optimistic about bookings while several airlines have said air travel demand is off to a choppy start. An important point we frequently make is that consumer confidence, or the lack thereof, is a self-fulfilling prophecy, especially in the short run. If consumers are optimistic about their incomes and their jobs, as well as the country and world they live in at the moment, their spending patterns will reflect that, and vice versa.

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Spring Ahead

We believe it is a bit early to tell how President Trump's policies will land, though we do believe he will work quickly. In a short period of time we will learn whether it is just the thrill of the negotiations that drive him and he is fundamentally a free trade advocate, or if he will break and reset the world order which was established way back in 1944 when Bretton Woods ushered in the beginning of free trade and low tariffs, and five years later the establishment of NATO. The Trump administration has much more it wants to accomplish in the short run. Still to come are the extension of the 2017 tax cuts and the hope of additional tax cuts, progress in deregulation and better efforts for responsible cuts in Federal spending. We also hope the Trump administration brings a peaceful resolution to the war between Ukraine and Russia, as well as the Middle East. The negotiator in chief will not be perfect, no one is, and he has much to accomplish in less than four years.

We only observe and do not predict the future, though we are always optimists at heart and always will be since we are investors in the future. We believe with time, important global issues will change and in our optimistic mindset will improve, whether they are economic, such as stubborn inflation in the context of a possibly slowing economy or involve the conflicts of nations. We support open markets yet also recognize some measures of protection will always be considered, like security for our citizens and technologies.

The economy is a mix of all sorts of businesses. SEM's focus is on owning a select group of companies growing their earnings as much as possible no matter what the economic climate. We also believe that no matter where we land within the administration's efforts to make deals with other nations or to emphasize reshoring and "American Exceptionalism," management of our companies will successfully adapt operations and continue to prosper.

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With valuation at fair value to slightly below, earnings and the markets will be dependent on consumer confidence. Emotions in the short run can easily drive the markets in any direction, positive or negative, regardless of whether we are close to fair value or not. We are confident that across our three equity portfolios, earnings growth will continue even if pockets of the economy have setbacks. In the long run the general economy tends to progress upwards, as does the value of our portfolio companies, though it is never a straight line. Thanks for your continued confidence and we will keep working hard at it.

Sincerely,

Don	*Dan*	*Amy*
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CIO	President	SVP / Co-Portfolio Manager

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