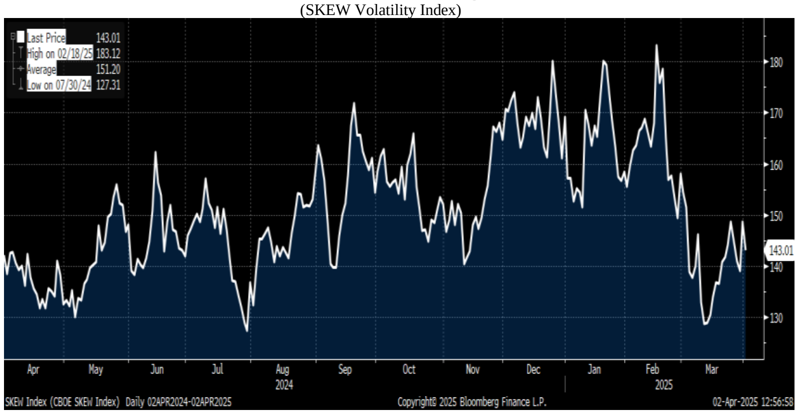
VANDERBILT Ave.
ASSET MANAGEMENT

1st Quarter 2025

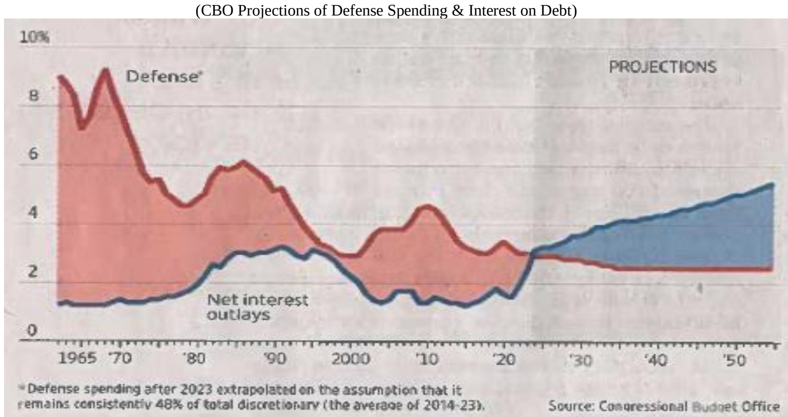
In Vanderbilt's (VAAM) **4th quarter 2024** quarterly, we pointed out that we were in for a period of heightened uncertainty and volatility. The advent of the new Trump administration has shown this to be the case. Volatility has been apparent for both policies making and the financial markets.

(SKEW Volatility Index)



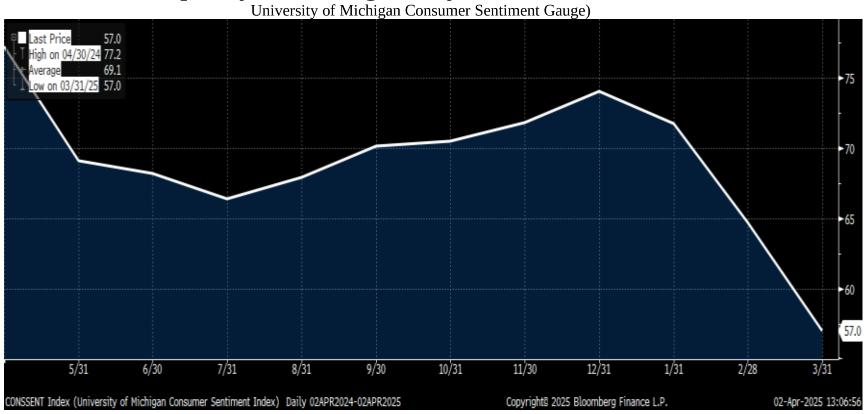
Fiscal policy proposals will extend both the existing 2017 tax cuts in addition to offering further tax reductions for both the consumer and for business. Spending reductions will not cover the lost revenue to the government and the current $1.9 trillion deficit will widen and cause a further expansion of the already large debt level. The deficit widened for several reasons; The IRS delayed tax filing deadlines last year for taxpayers affected by natural disasters, tax receipts have declined since 2022 due to President Trump's tax reduction policy passed in 2017. The costs associated with financing the Governments deficits have risen due to higher interest rates and American consumers purchased fewer imported goods and customs duties fell by twenty percent. First quarter 2025 saw Government expenditures propel the deficit higher by 39.4% than it was in the first quarter 2024. The total amount of debt has reached $36 trillion. Over the past fifty years, deficits carried by the Federal Government have averaged 3.3% of GDP. Currently, the present-day deficit equals 6% of GDP. One third of the current deficit is now going to interest payments, exceeding the Defense Departments budget. The maturity structure of Treasury Securities has become shorter and almost thirty percent of the national debt will need to be rolled over within the next twelve months, at higher interest rates.

(CBO Projections of Defense Spending & Interest on Debt)



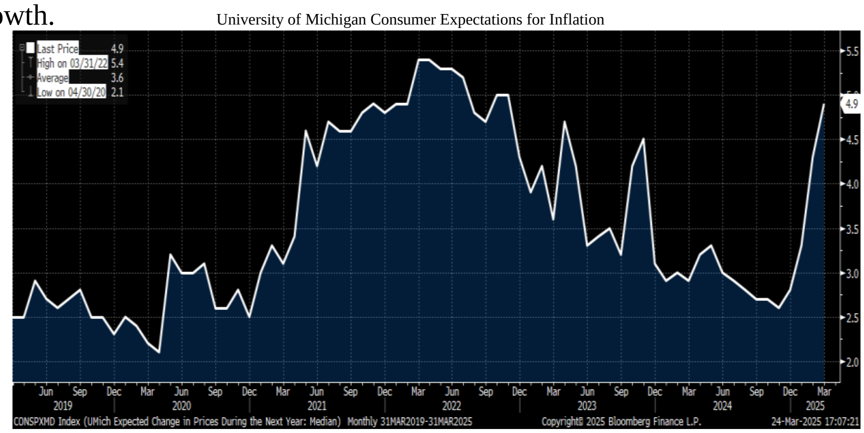
Immigration will reduce the labor supply resulting in having to hire workers at perhaps at a higher cost. Deportation will also remove consumers from the economy with many knock-on effects. Unfortunately, these effects may prove to be inflationary and impede economic growth. **Tariffs** are a regressive tax that will be passed on to consumers and the business sector. Some have suggested that tariffs are a one-time only event, we do not agree. A series of retaliatory tariffs can result as nations respond. Tariffs can also be imposed against non-tariff barriers such as duties, taxes, regulations and currencies. In addition, there are a couple of sources of confusion. One revolves around the activity of **DOGE**. While there is some spending that can be saved, it does not appear that the ramifications from DOGE's blunt actions have been thought through in a systematic fashion. Confusion is imparted on the markets as the policies seem to change almost daily. This uncertainty has led to a significant decline in confidence and sentiment for both the consumer and business sectors. Companies have become quite cautious in terms of their capex spending. The clear winner in the current economic policy mix is regulatory relief.

University of Michigan Consumer Sentiment Gauge)



Vanderbilt (VAAM) is looking for slowing economic **growth** with a 1%-1.5% real GDP growth rate for 2025. Adjusted for inflation, consumer spending dropped 0.5% in January-the sharpest monthly drop in almost four years. Private employment surveys indicate a slowing of hiring. There has been a sign of tentative weakness in the labor market as the number of workers employed part-time who wanted but could not obtain full-time work increased by 400,000 to 4.9 million, the most since the spring of 2021. Consumer delinquencies on auto and credit cards (where interest rates are near 20%) are approaching levels last seen in the aftermath of the 2008-2009 recession. The recent stock market correction could harm consumers by reversing the wealth effect that has buoyed consumer spending. The top 10% of earners, the sector that owns the most stocks, account for half of consumer spending. Indicative of a weakening in the consumer sector, a broad cross section of retailers have lowered their outlook for 2025. It has become more difficult to qualify for a mortgage thereby creating a headwind to growth in the housing sector. Federal government spending is approximately 23% of GDP and whatever spending reductions DOGE can realize will also be a headwind to growth.

University of Michigan Consumer Expectations for Inflation



Core PCE (the Fed's preferred **inflation** gauge) has declined from 5.6% (YoY) in February 2022 to 2.8%. The Fed's inflation objective is 2.0%. We believe the path to the 2% objective will not be smooth but prove to be sticky and volatile. We have outlined that tariffs, deportations and fiscal policy will be inflationary. One uncertainty is the extent of these inflationary pressures. While a lighter regulatory environment should prove to be anti-inflationary, we do not know the specifics or the timing of these details. Another potential area for productivity gains is the expanding use of artificial intelligence (AI). Two factors account for the rise in the University of Michigan Survey of Consumers Inflation Expectations: **1) Politics**. Consumers identifying as democrats believe inflation will rise to 6.5%. Republicans surveyed believe inflation will rise 0.1%. **2) Tariffs.**

The first quarter found the **Federal Reserve** balancing its dual mandate to achieve stable prices and maximum employment under the backdrop of conflicting pressures from tariffs and immigration policies. As the Fed determined at the January and March FOMC meetings that prices and employment appeared in balance, they chose to leave interest rates steady. However, the statement summarizing the meeting now includes an economic growth warning: "*uncertainty around the economic outlook has now increased*".

Moreover, the Fed announced in their March meeting that they would initiate reducing quantitative tightening ("QT") in April. QT is a contractionary monetary policy tool, implemented by the Fed in June 2022, whereby it has allowed a portion of the maturing treasury securities on its balance sheet to run off each month instead of reinvesting all of the proceeds. In so doing, over this time period, the Fed balance sheet has shrunk from nearly $9 trillion to $6.8 trillion. Effective April 2025, the Fed will cut the quantity of un-reinvested maturing treasury securities from $25 billion per month to $5 billion per month. Agency and MBS roll off will remain at $35 billion per month. This will effectively increase the demand for treasury securities by $20 billion each month and decrease their rates. Powell reiterated that the FOMC is well positioned to wait for further clarity and is not in a hurry to cut again. In essence however, although the Fed hasn't actively lowered interest rates yet this year, through the implementation of a slowdown to the tapering of their balance sheet, they have the potential to lower interest rates.

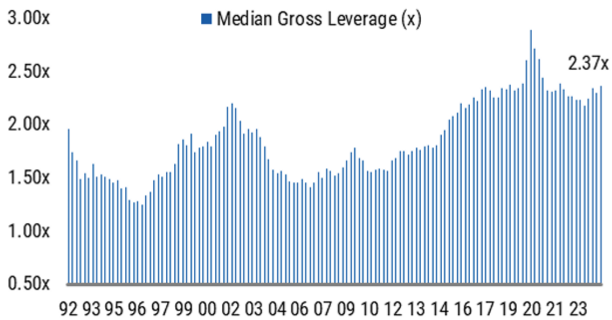
VAAM saw Chairman Powell's comments as somewhat dovish in two respects: first, he appears quite comfortable with the median projection of two rate cuts in the dot plot even though they arguably fit (a bit awkwardly) with the new economic projections; second, he downplayed the sharp increase in the University of Michigan inflation expectations. A data dependent Fed may find it hard to conduct monetary policy in an environment of slower growth and somewhat sticky inflation. Vanderbilt believes there might only be one interest rate cut in 2025 but continues to support backloaded cuts in 2026. The Fed might find itself in an even more untenable situation now that the Trump administration is calling for them to reduce rates regardless of the fundamentals.

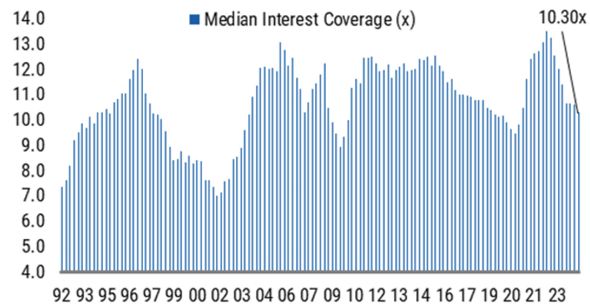
Fixed Income Summary 1st Quarter 2025

The interest rate market resumed its volatile swings at the start of 2025, with the 10-year treasury yield quickly rising from 4.57% at the end of 2024 to 4.79% in early January, followed by a consistent, though unsteady, decrease in rates throughout the rest of the quarter, finishing lower at 4.21%. This decrease in interest rates points to investors' expectations of an economic slowdown, which is a result of consumers' waning confidence due to uncertainties surrounding tariffs, employment, and prices.

Corporate Bonds

While a weakening in consumer spending and corporate guidance had a significant negative impact on equities, corporate bonds spreads only widened marginally, and spreads remain at historically tight levels. However, we maintain a cautious outlook on the performance of this sector. Companies' gross leverage, which measures total debt divided by EBITDA (earnings before interest, taxes, depreciation, amortization) continues to tick up. At the same time their interest coverage ratios, which measure companies' ability to cover interest expense with their EBITDA have decreased to pre-pandemic levels. At these fundamental rates, we prefer shorter maturities and higher quality in corporate bonds.





Treasury Inflation Protected Securities

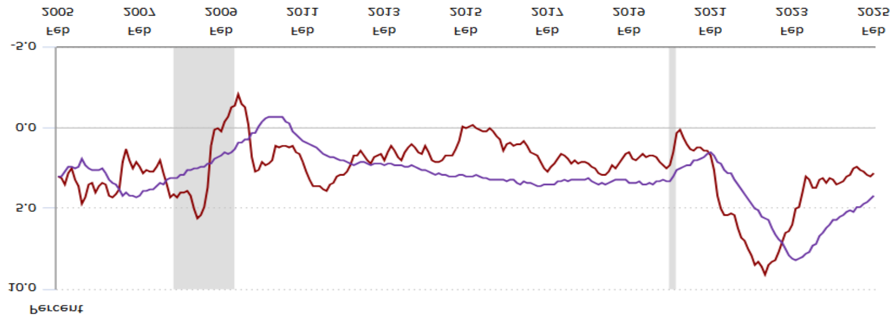
Treasury Inflation Protected Securities ("TIPS") outperform regular treasury securities when inflation and future inflation expectations increase. Unlike regular treasuries, the face value of TIPS increases when current inflation is higher, and the price of TIPS increases when the expectation for future inflation is higher. The combination of high inflation and high inflationary expectations is a boon for TIPS, and therefore these securities serve as an inflation hedge in a fixed income portfolio. Vanderbilt has included TIPS in your portfolio.

During the first quarter of 2025 TIPS returns were mixed: short maturity TIPS outperformed regular securities, but longer maturity TIPS returns were in-line or slightly below regular securities. TIPS performance diverged depending on maturity because, although the current inflation component had the same impact of increasing the face of all TIPS, expectations for future inflation varied based on maturity. The Trump administration's policies on tariffs, immigration, and taxes point to inflation in the short run. However, the pricing of TIPS discounts the long-term impact of tariffs, and Chaiman Powell's reference to tariffs' inflationary impact being "transitory" reinforces the market's conviction that there may be less inflation risk in the longer run. As a result, shorter maturity TIPS benefited from inflationary expectations in the short run, but longer maturity TIPS did not.

Housing

At 35%, shelter makes up the largest component of the Consumer Price Index ("CPI"), and with its recent 4.2% year-over-year increase, it continues to keep the total CPI elevated at 2.8%, which is above the Fed's long run target rate of 2%. While total CPI peaked in June 2022, the shelter component peaked later in March 2023 at a rate of 8.2% year-over-year. Since CPI shelter is based on existing rent and an owners' equivalent rent, the calculations lag current market trends and are not reflective of market shelter prices. As a result, CPI shelter pricing peaked later than other CPI components peaked, and CPI shelter prices are now coming down even slower.

U.S. Bureau of Labor Statistics 12-Month Percent Change Consumer Price Index



(Red line represents total CPI. Purple line represents shelter CPI component.)

High interest rates have constrained the supply of existing homes for sale, by discouraging homeowners from foregoing their lower locked-in mortgage rates and selling their homes. Life changes such as relocations, divorces, and down-sizing have resulted in a gradual pick up in the supply of homes for sale, but lower interest rates would assist the process. Additionally, over the last year, builders have ramped up the supply of new homes for sale and have accumulated significant inventory.