One of Those Times March 12, 2025

During the onset of the COVID crisis, I made a note to myself to write an update in five years to discuss what happened to the markets since that trying period of time. This week, I received a task alert in Salesforce reminding me to write that update. While the exact circumstances were different, then as now, the air was thick with uncertainty, as people debated what the unknowns might mean for their health, the economy, the nation, and their stock market portfolios.

Before getting into our thoughts on the situation today, another one of those times, let's do a quick review of what happened to the markets following that swift, double-digit drawdown five years ago. Make no mistake, the fears were real. I received calls not only from a handful of clients but from more folks who weren't clients as well, trying to pick my brain and justify going to cash. I took the calls, as I usually do—and at some point, thought it might be wise (or at least entertaining) to leave myself a note to write a 'what happened' update in five years.

Just as real as the fears at the time are the gains achieved over the subsequent five years. From the Covid bottom, the markets not only recovered but went on to gain 178% from those lows of March 23, 2020, to Friday's close, March 9, 2025. On an annualized basis, this amounts to nearly 23%, far above the market's long-term averages of 8-10%!

The environment today, as it was then, is one of those times. While the market drawdown has so far been roughly in line with the average annual drawdown in any given year, it has felt and continues to feel far worse, as many of the decade's biggest winners have fallen the most.

The first quarter earnings season of 2025 has largely been a strong one, with revenues up an average of 5.4% and earnings gains of 17.4%, according to data from JP Morgan. Despite this fact, it is equally true that it hasn't mattered much, as stocks have declined on both good and not-so-good news. This is one of those times.

What might be the reason for the gloom today, when just three short weeks ago the markets were reaching new highs? We'd offer up three possible ideas, none of which may be mutually exclusive. These include the self-inflicted recession (tariffs and government policy), a growth scare, and an AI bubble regime change.

Let's go over each in turn.

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9 Aurora Street, Suite 5 Phone: 330-650-0921
Hudson, Ohio 44236 www.broadleafpartners.com

The Self-Inflicted Recession

The most obvious reason for this pullback is that we are shooting ourselves in the foot. President Trump's strategy in his second term has been unprecedented by modern standards, even relative to his first term. Believing he has a political mandate for change, he is using the tariff cudgel at will, along with executive order after executive order, to not only punish our enemies, but our historical allies as well.

While President Trump's actions are harsh and unpredictable, some believe there may be a method to the madness. Like his love for boxing, he may be hoping to get both our enemies and friends off-balance to such an extent that he can eventually rearrange the global status quo such that fewer on the global stage rely on American largesse for military security. The hope may be that these resources can then be spent on efforts to Make America Great Again, by bringing jobs back to America for the "forgotten man", his core political constituent. Oddly, this may mean we could be in for an interim period where America Doesn't Feel So Great Again, at least for some of those who have had it so great.

The US economy over the last couple of years has largely been a bifurcated one – with the top wealth cohorts largely keeping consumer spending afloat. Consumers have elected to go with the cheapest option, evidenced by the popularity of generic brands, or to pay up for a premium experience. Companies such as United Airlines, Pepsi, and Disney have decided to swim up – focusing on international flights, organic snacking options, and premium park passes while diverting their attention from their formerly core products. This "premiumization" is potentially indicative of the economy that has been built in a free trade world – leaving a hollowed out American middle.

Winston Churchill once commented that one should never waste a crisis in implementing once politically difficult reforms. In this vein, it feels as though Trump may want to force the economy into a recession so that a rightsizing for the future can quickly be implemented. The whole strategy reminds us of Musk's playbook when he bought Twitter and ripped up everything including the kitchen sinks. He has followed a similar approach with rocket engines and Tesla vehicles, removing parts to the point that the product fails, but then slowly adding them back until it works again, with the end result being a more simplified, efficient design.

The President is meeting with business leaders today, many of whom, like Delta Airlines expressed last night, are already starting to see evidence of recessionary pressures lurking in their businesses. (Things like advertising and travel are often the first to flash warning signs.) It is imperative to recall that President Trump is a fighter at his core, and fondly admires President William McKinley, the so-called 'tariff king'. We have no illusions that tariffs are painless or harmonious, but they have been a frequently used economic tool (just not recently in a free-trade world). We wouldn't shortchange the probability that Trump digs in his heels, forcing us into a short-term recession (reset) to attain his loftier long-term goals. Probability: 40%.

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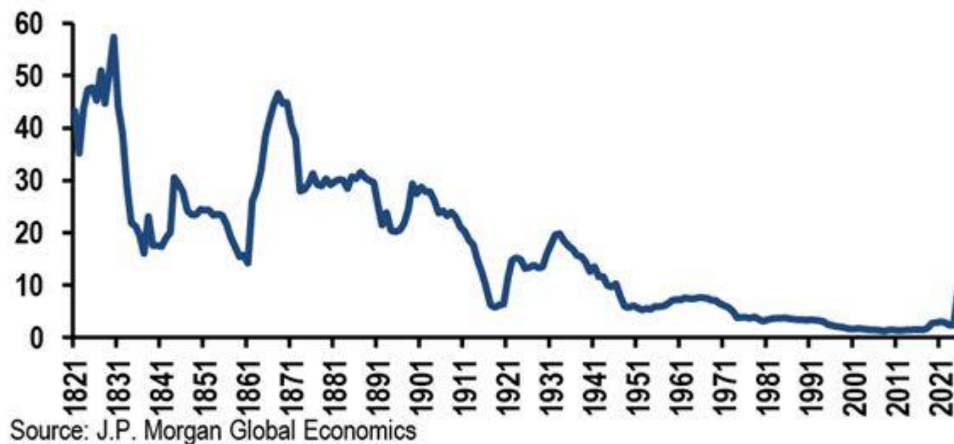

Growth Scare

The second reason for weakness could be a growth scare, like what happened last summer. In essence, this would be the path where there is no recession, but given fears of a growth slowdown, valuations contract between former winners and losers in the market, having the effect of an overall market broadening. This happened last summer, when small and mid-caps gained brief, albeit unsustained support. It didn't last.

If this is another growth scare, we can see it not only in the valuation compression of American growth stocks but also in the movement of capital to the market's more defensive areas and European counterparts.

Again, as we said before, the reasons for the current drawdown may not be mutually exclusive, but a rally in defensives implies heightened fears of a recession, while the rally in European shares may reflect a Make Europe Great Again trade and the feared end of American Exceptionalism.

Love him or hate him, we doubt President Trump's long-term objective is the end of American Exceptionalism. He may be attempting to increase the economic participation of his core voter base, but we don't believe that his view of success comes solely at the expense of American asset holders. The fact that so many tech oligarchs lined up behind Trump during the inauguration might provide some clues as to what is going on under the surface here, at least in terms of expanding the pie and a greater sharing of the wealth. Whether or not this ends up being a recession or another growth scare is Trump's coin to flip. Probability: 40%.

Artificial Intelligence Bubble and Regime Change

A third reason for current weakness could be the beginning pangs of an unwinding of a bubble in artificial intelligence spending. The pattern of market selloffs following earnings seasons in

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each of the past three quarters suggests that many seasoned pros in the business, like myself, may have scars from participation in the implosion of the dot com bubble twenty-five years ago. That implosion ushered in a regime change favoring new growth trends in all things China, American banking, and housing stocks.

Viewed from the perspective of history, growth regime changes do occur, but they are also rare and often not sustained. While money left the tech sector to chase growth in other areas, we all know what ensued, with the collapse of the housing bubble and financial system just a few short years after. The true secular winners of the 21st century thus far have been the internet based companies that arose from the dot com ashes. The Wall Street Journal published an excellent article on this subject yesterday.

While it is within the realm of reason that there is a bubble in AI spending that we cannot yet see, we wouldn't assign it a high probability, at least at this point in time. Over the very long term, we believe AI will unleash massive productivity gains for American companies, that are likely to occur linearly and over time, rather than exponentially, ending in a bang as it did during the dotcom/telecom bubble. The largest and most profitable companies led by visionary management teams are leading this period of spending far more than fickle startups more prone to bankruptcy risk.

We are living through a period of massive disruption in the economy today, perhaps politically as well. Tech companies may be the ones experiencing the greatest internal productivity gains from AI implementation today in things like advertising and computer programming, but we fully expect it to benefit all areas of American business over time. Even if a bubble pops, it won't mean the end, but just the beginning of something far greater. Probability: 20%.

Final Thoughts

A few years ago, in the face of rising inflation following the COVID shutdown, we did believe that a regime change for the markets might be at hand. As the SPAC bubble imploded and inflation reared its head, we chose to more broadly diversify the portfolio to capture growth opportunities elsewhere. While this shift saved us some downside in 2022, it did not sustain for more than a year and a half, as OpenAI emerged out of nowhere, reigniting growth prospects within the tech sector. Fortunately, we shifted the portfolio again, as inflation beneficiaries began to fade and profitable tech reasserted itself as leadership. Was our decision a good one? Yes, but it was also a lucky one that didn't last long. We don't see ourselves making similar shifts today.

In the end, we are paid to make our best estimates as to where long-term growth in the markets is likely to occur. We don't see these long-term opportunities for growth shifting all that much today, in spite of the recent fears. This doesn't mean we will be correct in the near term or that we might not experience even greater volatility, but we are not yet willing to fade the idea of American Exceptionalism in all things innovation. While all corrections and bear markets are different, they tend to offer one thing in common – better than average returns for the investor who sets aside fear and walks by faith and not by sight.

Having said this, we also believe we could be entering a heightened period of volatility and would encourage everyone to buckle up for the ride. If you are losing sleep at night, there is no harm

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in calling Bill Hoover, Jared Hoffman, or your third-party financial advisor to discuss an allocation that better matches your tolerance. Sitting on a local foundation board, I've come to learn that performance is an important objective, but far from the ONLY objective in defining independent financial success.

While we can't publicly disclose the details yet, we recently learned that the Broadleaf Growth Equity Portfolio has earned additional national recognition on top of last year's Manager of the Decade Award – stay tuned for upcoming announcements. Is it the end of our era? We certainly hope not and will continue to be diligent, abiding by the process that has carried us here thus far.

Thanks for your continued faith in Broadleaf, we don't take it lightly!

Kindest Regards,

Doug
Doug MacKay
CEO & CIO
dmackay@broadleafpartners.com

Pete
Pete MacKay
Associate Portfolio Manager
pmackay@broadleafpartners.com

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