



Investment Update – April 8, 2025

Having experienced a first quarter in which the S&P 500 declined by 4.3%, market participants were on edge awaiting President Trump’s “reciprocal” tariff announcements on April 2nd. He proceeded to communicate the establishment of tariff policies significantly larger—and seemingly of a much more arbitrary nature—than anyone had previously expected, sending the financial markets reeling on Thursday and Friday. The two-day decline of 10.5% for the S&P 500 brought the index down from slightly less than a 10% “correction” below its recent highs in February to almost a 20% “bear market” threshold. As we write this communication, the S&P remains on the cusp of entering bear market territory. While none of us enjoy these stressful moments, we remain stalwart believers in the resilience of the US economy. Furthermore, our investment portfolios focus on industry-leading companies with superior financial strength and resilient cash flows, giving them the capability of withstanding periods of stress. With regard to tariffs specifically, we believe our portfolio companies have inherent advantages - higher margin structures, advantaged sourcing, and strong pricing power - that will enable them to better insulate their profit streams. As we have counseled in previous periods of uncertainty, we believe the right strategy is to stick to the long-term approach of owning the world’s best businesses.

Many investors instinctively reacted to the tariff announcement, partly due to sheer uncertainty and partly due to the association of tariffs with contractionary economic policy. Suddenly concerned about the potential for slower growth or a recession, market participants began to try and protect themselves from this possibility on Thursday. Then, a record 26 billion shares traded Friday on the US exchanges, a larger figure than any day during the market panic at the inception of the Covid-19 pandemic. Leveraged investors faced margin calls on Friday, and there appeared to be indiscriminate selling. In addition, based on currency movements, it appears quite likely that some foreign investors reduced their investments in US assets.

Analysts and commentators have noted that Trump’s announcement would raise tariff barriers to the highest level in decades, but it is important to keep several things in mind while evaluating these developments. First, it is probable that the actual level of tariffs will wind up below what was announced. Having been imposed by executive order, a similar action can remove or adjust them without needing “an act of Congress.” While trade relations with China look particularly challenging, early indications are that many countries are already seeking to negotiate with the administration. In addition, the tariff policies need to be considered as part of a package of government policies, some of which would be expansionary, like tax cuts and deregulation. There are also some potential



FAYEZ SAROFIM & CO.

offsets to higher costs from tariffs, such as the recent drop in oil prices, ongoing declines in rental housing costs, and efforts to reduce government spending. As such, time will tell if the Federal Reserve might be able to cut interest rates further. One certainty in our system is that voters will have an opportunity to assess developments over time, and they can register their approval or rejection with midterm elections as soon as 19 months from now. So, there is a natural mechanism for making adjustments if needed in our system.

In times of market stress, our investment portfolios typically display downside protection, which they have been accomplishing so far in 2025. We rely on strong balance sheets with lower levels of debt as well as more stable generation of revenue, earnings, and free cash flows. Often, our companies can take advantage of more challenging periods to gain market share from lesser competitors or to continue investing when others cannot. The specific threat of tariffs is one we have been considering and has similarities to the recent experience of dealing with inflation after the Covid-19 pandemic. Given that the main challenge for companies is to pass higher costs on to their customers and avoid a profit hit, there are several factors that help to insulate our portfolio. First, our companies possess much higher gross and operating margins. Specifically, our portfolio's weighted average gross margin is 57%, compared to the S&P 500's of 34%. Therefore, an increase in the cost of goods (or some other cost item) is easier to accommodate with a lower amount of pricing. In addition, our larger companies often have sophisticated sourcing capabilities and stronger negotiating positions with their suppliers. Finally, we aim to select companies that have pricing power in their industries and persistent demand that is unlikely to change dramatically as a result of changes in the price level or cyclical factors. Although our portfolio does have a significant amount of foreign earnings, most of the companies earn those profits on in-country operations, rather than moving goods across borders.

Even if our companies do possess the ability to pass the tariff costs on to their customers, there will likely be a lag between the arrival of these more immediate increased costs and the actions needed to avoid them or enhance revenue. Consequently, 2025 earnings may suffer somewhat relative to previous expectations until companies find ways to offset the tariffs. First quarter earnings reports begin this Friday with several large financial institutions reporting results. Given this tariff shock, we expect companies may either reduce or retract their earnings guidance.

Our research team is actively reassessing our portfolio companies and the impact of these policies on their businesses. Utilizing the lines of communication that we maintain with company management teams, we have been estimating the impact of the announced tariff policies on their cost structure and the adjustments that each company



FAYEZ SAROFIM & CO.

can make to protect its level of profitability in the short and long term. Clearly, there will be an impact on 2025 profits, but we believe our portfolios are positioned appropriately, with higher profit margins, superior pricing power, and lower debt levels at our portfolio companies along with an emphasis on areas that tend to have a more stable demand profile. Starting from that position, we are also on the lookout for unique opportunities that may arise during this evolving situation.

During the 1987 stock market crash, our founder Fayez Sarofim pulled the firm's investment team into his office, reassured them about their employment, reminded everyone of how well capitalized our firm was, and sent them back out to do their jobs. After telling a nervous client to "go fishing," he and the client started in on what to buy. The market moved steadily higher for the next three years and eventually made new highs. Some kind of crisis scenario plays out every so often in our business, and it has always paid to be patient and focused on the long-term. Time and again, we have seen the marketplace underestimate the ability of companies to adapt to a variety of circumstances. As a result, we are taking our cues from Fayez's example and the playbook that we have seen work well over the many decades of investing in many of the world's best businesses.

Thank you for trusting our firm to be your investment adviser, and please contact us if there is anything else with which we can assist you.

This document is confidential and intended solely for the recipient and may not be published, reproduced or distributed without the express written consent of Fayez Sarofim and Co. ("FS&Co."). The information herein is neither an offer to sell nor a solicitation of any offer to buy any securities, investment products or investment advisory services. Past performance is no indicative of future results.

Any projections, market outlooks or estimates expressed in this letter are forward looking statements and are based on certain assumptions. Such projections, outlooks and assumptions should not be construed to be indicative of the actual events that will occur and do not constitute investment advice. Opinions and information included herein are current opinions and information only as of the date hereof or as of the date indicated, and are subject to change without notice. Additionally, while information presented above is believed to be accurate and/or derived from sources which FS&Co. believes to be reliable, FS&Co. disclaims any and all liability as to the completeness or accuracy of the information contained herein.

The volatility of the indices referenced herein may be materially different from that of FS&Co.'s products. In addition, FS&Co.'s holdings may differ significantly from the securities that comprise the highlighted indices. Definitions and descriptions of the indices referenced are available at: www.sarofim.com/definitions/.

As used herein "our portfolio(s)" reference FS&Co.'s model portfolio(s) used in connection with certain managed accounts, and the securities comprising such portfolios may differ from those comprising any individual investor or managed account. The performance of an investor's account with or managed by FS&Co. may vary from the performance presented herein due to investment restrictions, management fee arrangements, the timing of capital contributions and withdrawals, and the investor's tax situation.