Préfontaine Capital Inc.

- FINANCIAL LETTER -
FIRST QUARTER 2025

Outlook

The chaos of the Trump regime is causing much uncertainty and fear. This includes economic issues such as the tariff war, the deportation of immigrants, and cuts to the state apparatus; geopolitical concerns with a pivot towards Russia and far-right parties and against democracies; and American domestic politics with a shift toward autocracy and corruption. Confidence is greatly shaken, which has already started to weaken both business investments and consumer spending.

Let's try to reframe things in a broader historical perspective. The United States has often gone through dark periods—think of the reckless war in Iraq under George W. Bush, the era of lies, the Vietnam War, and stagflation in the 1970s under Nixon, the triple assassinations of the Kennedys and Martin Luther King in the 1960s, the witch hunts of the 1950s under McCarthy, or the destructive tariffs of the 1930s. In all these instances, reason eventually prevailed. Our hope is that there are still enough well-intentioned and educated people in the United States for the Trump era to go down in history as a harmful temporary experience. Nevertheless, some long-term consequences will likely remain.

We believe that if current policies don't change, they will lead to a North American, if not global, recession. However, the most damaging effect in our view will be felt long-term. The reputation of the United States will be tarnished, and China will benefit in terms of "soft power"; the ability of a nation to exert positive influence contributes to its economic performance. Furthermore, cuts in education and scientific research will diminish the U.S.'s greatest strength: its capacity for innovation, while China invests massively in science. Lastly, cuts to public services and regulations will increase the chances of a public health, financial, or environmental crisis, with state resources possibly being insufficient to properly respond. As we said, we believe countervailing powers within the U.S will change the current policies.

The Stock Market: over the long-term, it reflects companies' profits and grows at a rate of about 9% annually. Over the short term, it reflects emotions dealing with temporary circumstances.

As for the stock market, it's important not to just say "oh, it's a disaster" or "oh, it'll bounce back." During major corrections or crashes, two questions always arise: have we hit the bottom, and how long will it take to return to previous market levels? There is never a perfect answer. One must analyze the present situation, which is different from the tech crisis in 2000, the financial crisis in 2008, and the Covid crisis in 2020. Yes, the market (S&P 500) will return to its prior peak, but will it take 9 months like in 2020, 6 years like in 2007, 13 years like in 2000, or 13.5 years like in 1968?

During the 2008 crisis, our thesis was that the fiscal capacity of 7 billion humans was enough to contain the financial crisis. During the Covid crash, our thesis was that historically, pandemics tend to burn out after around 3 years. This allowed us to invest during the storm with more confidence. In both cases, it was very rewarding. Having a thesis helps guide our investments. A thesis is not a certainty—it's a balance of probabilities to the best of our knowledge. Our current thesis is that the U.S. trade war against the world is unsustainable both economically and politically. Trump is trying to overhaul long-standing supply and industrial chains that were built over decades based on economic efficiency. He wants to bring large parts of industrial production back to the U.S. We believe the cost of this reshoring is so high that economic, market, and popular pressure will cause a retreat, as has just begun to occur with his recent backpedaling.

Our base scenario is that over the long term, the U.S. will maintain much lower tariffs than those announced on April 3. The average U.S. tariffs before Trump were around 2%. With the April 3 announcement, they rose to over 20%. Our best estimate is that they will be significantly reduced by the midterm elections in November 2026—after having caused much damage (especially to the U.S., which will isolate itself as a result). The extent of the damage is hard to predict. There's a race against time to negotiate with the 90 or so affected countries before the U.S. economy suffers too much. At the time of writing, Trump reduced tariffs for all countries to 10% for 90 days but is intensifying the tariff war against China, such that overall tariffs are still above 20%. Trump's climbdown was caused by a building bond crisis, which is really a crisis of confidence in the US economy.

At the time of writing, the U.S. stock market (S&P 500) has dropped about 15% from its February 19 peak (about 20% for the NASDAQ). Let's not forget it rose by over 50% in 2023–2024, and valuations were very high before the current turmoil. We believe that the drop in prices could present some buying opportunities for those willing to wait for a return to normal. The main risk is that Trump prolongs the pain beyond what Americans can endure, leading to even lower or stagnant stock prices. Another risk is that a tariff war could trigger resentment and escalate into broader conflicts. The opportunity is that markets might anticipate a reduction in tariffs to more sustainable levels by the November 2026 midterms. Several high-quality stocks have dropped 30–40% and are now at more reasonable valuations. A good approach in times of uncertainty is to invest gradually, in tranches.

Our investments

"Simplicity is the ultimate sophistication."

-Leonardo da Vinci

"Invest at the point of maximum pessimism".

-Sir John Templeton

In January and February, we continued the reduction in equities that began in early November, particularly for our older clients and those with more sensitive risk profiles. In total, since Trump's election and up to the end of February, we reduced equity weightings by about 15% for clients with shorter investment horizons, which has proven prescient. For most other clients, we had reduced stock exposure by about 5-7% during the same timeframe. These reductions were spread across ten or so stocks we felt were excessively priced. We also completely sold Intel during its rebound to around $26 on February 18. We didn't make any significant equity purchases during Q1 2025. We resumed buying stocks on April 3, but very gradually.

Here are the returns on our model equity portfolio as of March 31, 2025:

As of March 31, 2025 (annualized for periods over 1 year):

	1 yr	3 yrs	5 yrs	10 yrs
Préfontaine Portfolio	6.9%	13,2%	20.7%	13.9%
Benchmark index	12.8%	9.6%	17.2%	10.0%
Difference	-5.9%	+ 3.6%	+3.5%	+ 3.9%

Returns before fees, including dividends. Fees vary according to the size of each portfolio. As an indication, our average fee as of March 31, 2025, for the total portfolio of all clients is 0.75% annually. Comparable index (total return -TR i.e. including dividends and in CAD) adjusted each year according to the allocation of the Préfontaine Portfolio; as of March 31, 2025, 53.6% S&P500 Equal-Weight TR, 37.2% S&P TSX TR and 9.2% MSCI Europe TR. The Préfontaine Portfolio is an actual portfolio made up of all Stéphane Préfontaine's personal and corporate accounts and those of the Fondation Préfontaine-Hushion over the entire reference period.

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