thoughts

FROM HANSON+DOREMUS

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INVESTMENTS AND PLANNING

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America and China: How deep is the mistrust?...

This page is not about economics. I really don't know whether President Trump will put a 100% tariff on goods coming from China or whether China will use its enormous reserve of rare earth minerals as a bargaining chip with us. What I do know, however, is that China-U.S. relations will dominate global politics for many decades to come.

Right now, the U.S. and China are drifting apart. We know less and less about each other, and I fear this may be getting worse. Remember, back in the 1950s and 1960s Russia was Enemy #1. There was suspicion, fear, and competition on both sides. It's estimated that in those two decades fewer than 1,000 Americans studied in Russia. We didn't know them, their culture or their language, and they didn't know us, and this was not a very good script for bilateral relations.

There are signs that things are developing this way with China. Fewer Americans are studying in China, fewer Americans are learning Mandarin, and the heyday of Chinese families paying full freight to send their kids to American colleges (and high schools too) seems to be over. China has for years been the leading foreign sender of students to U.S. colleges. The total peaked in 2020 at 373,000. The number of Chinese students in U.S. colleges is now down 25%. India has jumped to the top rung of countries with students here.

Chinese media is heavily censored. Good news about America is rare, but every crime against a Chinese student in America is front page news for days. President Trump is referred to in China as "Chuan Jianguo," or "Trump the Nation Builder" - not because he is making America great. Just the opposite, he is running America into the ground and forcing China to develop even faster! Both sides are less inclined to learn about the other.

Sources: Made with ChatGPT

The all-important Chinese college exam, the Gaokao, has started to deemphasize English, and according to EF Education First, an English language training firm, China has fallen from 38th to 91st among 116 countries in its English proficiency. Maybe it has to do with anti-American sentiment or maybe it's due to the rise in translation apps, but this is not good for global understanding.

American college students are also showing less interest in China. As recently as 2019 there were 11,000 U.S. students studying at Chinese colleges. Today that number is down to a mere 500. And on the tourism front, *The Economist* reports that the number of visitors from America to China is down by two-thirds since 2019. Covid has obviously had something to do with this, but I can attest from a visit to China a year ago, Europeans are there, and Asians too, but no Americans.

There are some positive signs here, however. The U.S. China Education Trust found in a survey that over three quarters of Chinese students who have come here to study say they enjoyed it and would do it again. And here in the U.S. many students are studying Mandarin even though they are not travelling across the Pacific to do it. Thomas Friedman noted in *The New York Times* recently that when Taylor Swift released her "Lover" album in 2019, there were one million combined streams, downloads, and sales in China within a week – the most ever for a foreign artist. Let's hope China-U.S. relations develop positively. We don't need another Cold War.

- Eric Hanson

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THE YEAR AHEAD

By Julie Won

What should we worry about now? . . .

In this season of January forecasts, we seldom expect many predictions to hit their mark. After all, in 2023, the nearly universally expected U.S. recession never came, and in 2024, the consensus on interest rates was completely wrong. Still, expert predictions do force us to think about risks, and that may be their real purpose.

The list of worries today is long – it always is. When people set their minds to thinking about all the things that could go wrong, they can really get carried away. But there still are plenty of optimists today. We are entering 2025 in good economic shape; deregulation, a revival of animal spirits, and strong corporate profits are potential positives. On the other hand, President Trump brings an element of unpredictability to policy making, and we've all been primed to expect a sea change in the way the U.S. engages with the rest of the globe.

We've reproduced here two lists covering the waterfront of 2025 risks. One is from Torsten Slok, Chief Economist of Apollo Global, who sees strong U.S. economic growth, but also potentially higher inflation and interest rates. The other, from Ian Bremmer of Eurasia Group, makes for some truly grim reading on geopolitics – but remember, he's paid to think of anything and everything that could go wrong.

One worry that is top of mind today revolves around rising long bond rates, inflation, and federal debt (for more on this, see Anne's writeup on page 3). It is highly unusual for the 10-year Treasury rate to be *rising* while the Fed is *cutting* rates on the short end. That suggests that higher inflation is on the way – which isn't good for businesses or stocks – or that a lot of people are worried about our federal debt, which is growing faster than GDP. The U.S. consumer and corporations may be flush with cash, but not the federal government. In fact, one reason the U.S. economy has been so strong is probably ample fiscal largesse. Eventually, a costly reckoning may have to come.

Another area of focus is how much longer the U.S. stock market can continue defying expectations. We've been in a momentum-driven, low volatility market, and the S&P 500 has just had two years of back-to-back +25% returns. Since 1928, that has only happened three other times, and a three-peat would require a stretch of the imagination. Yet expectations remain high, especially for AI-driven stocks and other pockets of the market. The median forecast for U.S. stock returns in 2025 is still a healthy gain of 12%.

The geopolitical front is probably the most difficult sphere for making predictions. All of us know the narratives on U.S. global disengagement and China, but perhaps it's best to leave item numbers one and two on our top 10 list of risks blank. That would be an acknowledgement that something totally unanticipated could come at us from left field.

Finally, let's prepare to be surprised. Who knows? We all are expecting tariffs to rock our world, but if they are used mostly as a negotiation tool, as they were during Trump's first presidency, maybe the hype will quickly fade away.

EURASIA GROUP'S TOP 2025 RISKS

1	A G-zero world (a vacuum in global leadership)
2	The Rule of Don (-ald Trump)
3	U.S.-China breakdown
4	Trumponomics
5	Russia is still rogue
6	Iran is on the ropes (at its weakest in decades)
7	Beggar thy world (geo-fragmentation impedes growth)
8	AI unbound (governance lags tech advances)
9	Ungoverned spaces (think Sudan, Syria, Myanmar, Haiti)
10	Mexican standoff

Source: Eurasia Group and GZERO Media

TORSTEN SLOK'S RISKS TO GLOBAL MARKETS

with estimated probabilities

1	Tariffs coming	90%
2	Nvidia earnings disappoint inflated expectations	90%
3	U.S. economy reaccelerates	85%
4	Mergers & acquisitions/ IPO activity rebounds	75%
5	Fed stops talking about r-star*	70%
6	Q1 inflation accelerates	40%
7	Fed raises interest rates in 2025	40%
8	U.S. 10-year Treasury rate moves above 5% by mid-year	40%
9	Probability of recession in Germany	40%
10	China outright recession	33%
11	Fiscal crisis in the U.S.	10%
12	Probability of a U.S. recession	0%

*r-star is the theoretical "neutral" interest rate that is neither expansionary nor restrictive

Source: Torsten Slok, Apollo Global Management, "The Daily Spark" blog, 12/23/24

By Anne Doremus

The case for bonds remains strong . . .

Investors today can be excused for falling out love with bonds. Historically, the asset class has produced 5%-6% returns over the very long term. However, in the year just ended, the Bloomberg Aggregate Bond Index, a broad measure of the U.S. bond market, squeaked out a 1.4% total return, and over the last five years, bond investors are, at best, breakeven.

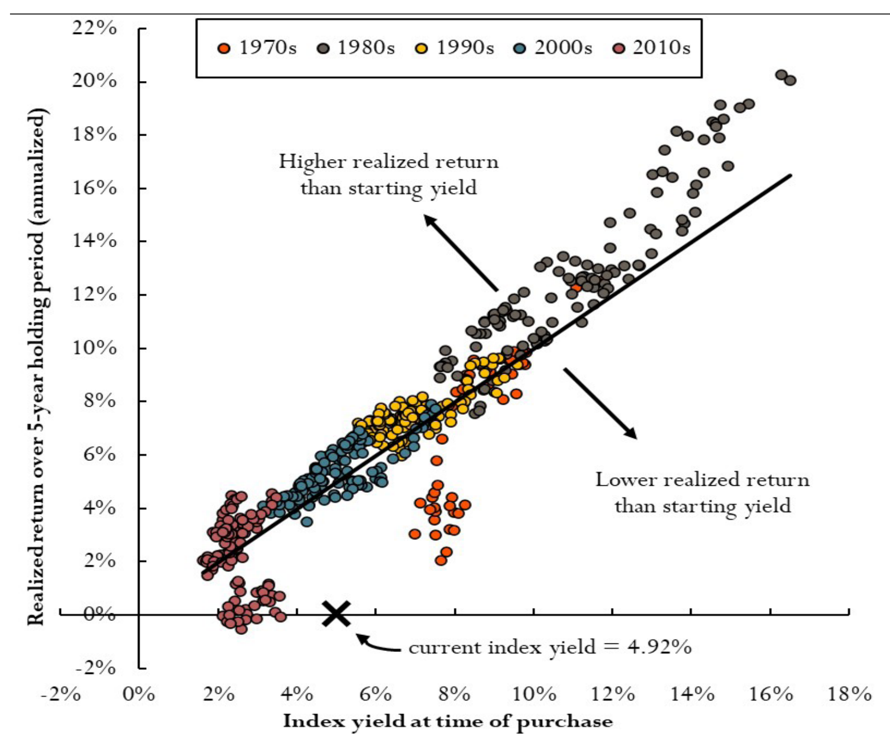
To better understand these results and the path forward, it helps to step back and look at what drives bond returns. When interest rates in the general economy fall, the yield offered on existing bonds looks comparatively more attractive, and their prices rise. Most investors' experience with bonds reflects just this behavior. Interest rates over the 40 year period beginning in 1982 were generally in decline, unleashing a bull market in bonds. But those happy times ended in 2021 when pandemic-induced inflation ushered in a period of rising interest rates. And just when the Federal Reserve's efforts to tame inflation seemed effective, in the fourth quarter of 2024, public policy uncertainty, resurgent inflation fears, and a still strong economy sent interest rates back up and bond prices tumbling once again.

In the face of all this volatility and uncertainty, why should investors consider bonds today? Many factors indeed support the case for higher interest rates (and lower bond prices) moving forward. Many of the incoming administration's anticipated policy initiatives, including higher tariffs and restricted immigration, could reignite inflationary pressure and the need for higher rates. Continued rising federal deficits could fuel higher rates from an ever increasing supply of Treasuries. Finally, higher rates may be needed to cool the U.S. economy which continues to show surprising resilience. But it is important to remember too that much of the above narrative is already factored into current bond prices. As recently as last fall, investors, assuming a slowing economy, expected the fed to cut interest rates as many as six times over the coming year. Today, they expect only one rate cut in the second half of the year.

Stocks' current lofty valuations also make bonds look more appealing today. Over the past two years, the S&P 500 has gained more than 50%. Some of this move is justified by the strong earnings growth produced over the period, especially in a handful of larger technology holdings. But valuations, or the amount investors are willing to pay for every dollar of earnings, remain elevated with most metrics now trading well above long-term average levels. In the past, investors simply had to accept higher valuations in the face of returns from competing asset classes, most notably bonds. That is no longer the case with intermediate term bonds now offering a current yield of just over 4.9%. *As the chart to the left shows*, this starting yield has been a fairly good predictor of the returns investors can expect from bonds over the ensuing five-year period. Finally, in a return to a more "normal" relationship, for the first time in some years, the nominal yield on bonds is higher than the return offered by cash and the expected rate of inflation.

Short-term interest rate predictions, and by extension bond returns, are notoriously difficult to get right. Bonds could suffer another disappointing year if interest rates remain at elevated levels or inch higher. But the positive inflation-adjusted returns bonds offer today make them more attractive than they have been in several years. This fact, together with their lower volatility, makes them a suitable option for those looking for smoother sailing in investment markets over the long term.

BOND INDEX CURRENT YIELD VERSUS 5-YEAR RETURNS, 1976-2024



Source: Bloomberg; total return data for Bloomberg U.S. Aggregate Bond Index, monthly data from 1976 through 2024

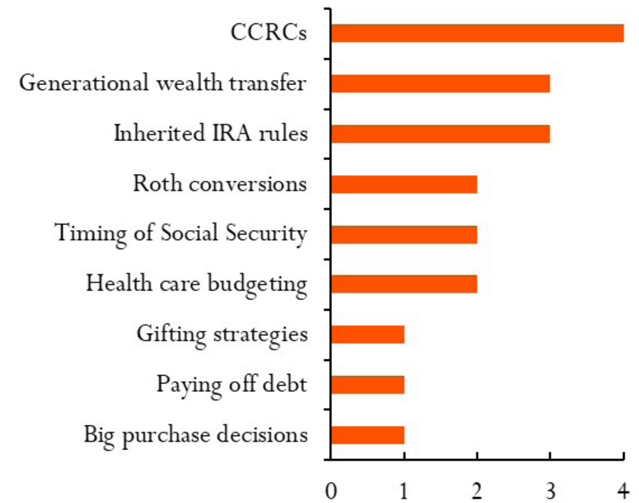
FINANCIAL PLANNING

By Art Wright

Top financial planning topics of 2024...

When it comes to financial planning, no matter what the world throws at us, some questions remain constant. How do I manage my day-to-day finances? How do I prepare for the future? And, perhaps most importantly, how do I deal with life's curveballs?

Sometimes, other topics bubble up, depending on the year, the market, or shifting legislation. *The chart to the right shows* what our advisors singled out for these "trending" topics in 2024. We'll dive into the top three here: Continuing Care Retirement Communities (CCRCs), involving the next generation in financial planning, and rule changes to Inherited IRAs.



Source: informal survey among H+D advisors

Continuing Care Retirement Communities (CCRCs)

CCRCs are like a one-stop-shop for aging. These communities offer a range of living options, from independent living to skilled nursing and memory care, all within the same campus. The appeal is the assurance that as healthcare needs evolve, residents will have the care they need. In many ways, a CCRC functions like long-term care insurance – offering a predictable, comprehensive solution for aging. Here are a few things to think about:

Know the costs: A standard "Type-A" contract requires a large upfront payment, often funded by the equity in your home, followed by a monthly fee. The monthly fees cover not just your living space and some meals, but the access to care as your needs change. Make sure to understand exactly what type of contract you are signing and how it fits into your budget.

Understand which of your expenses are reduced: Many of the costs associated with independent living – like property taxes, utilities, and home maintenance – may go away when you move to a CCRC. This can help offset some of the monthly fees, but be sure to map out your current expenses and understand what you'll still be responsible for.

Right-sizing your living space: It's tempting to go for the biggest, flashiest unit when considering a CCRC, but a smaller space may encourage a simpler, more manageable lifestyle, not to mention a reduced monthly expense. No matter the size of your unit, you'll receive the same level of healthcare services as everyone else. Larger doesn't always mean better in a CCRC.

Involving the next generation in financial planning

In 2024, we saw more families realize the importance of involving younger generations in financial planning. Historically, financial decisions were made without much input from children or grandchildren, but that's changing. A common reason for this among clients is their own unfavorable personal experience settling the estate of their parents.

Including younger family members in the conversation ensures they know how family wealth is managed and prepares them to take the reins when the time comes. It also reduces potential conflict or confusion during the transition of assets and teaches them valuable lessons about saving, investing, and managing money – skills they can use for their own financial futures.

New rules for Inherited IRAs

Before the SECURE Act, originally passed in 2019, non-spousal beneficiaries could "stretch" the Required Minimum Distributions (RMDs) over their lifetimes, allowing for long-term growth while minimizing tax. The new law now requires the full balance to be distributed within 10 years following the year the original owner passed – no more stretching.

Enter SECURE Act 2.0. The new rules, effective in 2025, might require non-spousal beneficiaries to start RMDs now AND keep track of making a full distribution by year 10. True to IRS form, the rules are a bit complicated and depend on factors like the age of the original IRA holder at time of passing and whether they had begun their own RMDs while still living. But the bottom line is this: if you've inherited an IRA, now is the time to review how the new rules impact distributions for your particular situation.

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