thoughts

HANSON+DOREMUS
INVESTMENTS AND PLANNING

FROM HANSON+DOREMUS

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Not our usual page one fare...

No stocks, no bonds, no squiggly lines on graphs this time. Just a moral dilemma which was raised in an article in the year-end edition of *The Economist*. Here goes. You are sitting on a dock with a rescue rope next to you. You see a man floundering in the water. What do you do? Throw the rope to him or get up and walk away? Obviously, the right thing to do is to throw the rope and help. If you get up and walk away, you are not only a moral monster, but you will also be severely punished. Right? Well actually, wrong, based on the history of American law.

The American legal system is based on Common Law, the idea that decisions by judges over the years set a precedent for current cases. Earlier courts ruled there is no liability for those who failed to "warn, rescue or call for assistance" in case of an emergency.

Standards fortunately have changed over the years. All fifty states today have Good Samaritan laws, which protect individuals from civil liability when providing reasonable assistance in an emergency. (Educational sidelight: the term Good Samaritan comes from a parable in Jesus' time. A Jew walking from Jerusalem to Jericho is robbed and left to die by the side of the road. A priest and others walk by, but a Samaritan, who typically would be an enemy of the Jews, stops and gives aid). Now back to the story: So those bystanders who might be wary of getting involved are now assured by Good Samaritan laws, of legal protection when they intervene. But there is no requirement that bystanders must rescue or call for assistance in the case of an emergency.

Only three states (Minnesota, Rhode Island, and Vermont) have passed "duty to rescue" laws and another three states have "duty to report" laws (Hawaii, Washington, and Wisconsin). There have been very few instances of prosecution under these laws due to the difficulty of defining terms. Vermont basically admits this by setting the fine for failure to rescue at a very low $100.

Sources: Made with ChatGPT's DALL-E

Libertarians argue that Bad Samaritan laws (requiring bystanders to help in a rescue) are a violation of an individual's rights, and others argue that the whole subject is a slippery slope. For instance if you encounter a drowning man, most people would agree it is their duty and responsibility to toss the victim a life raft, but what if you encounter a starving man, do you have the duty to provide him food, or if you encounter someone sleeping out on a very cold night, do you have the obligation to provide them shelter?

Opioid deaths over the past decade have risen significantly. In Vermont there were 114 opioid deaths in 2019. By 2023 this number had increased to 231. The State has amended its Samaritan law to provide protection from criminal liability for those who call for help from the scene of an overdose even if they don't provide further help such as administer Naloxone if it is available.

At first glance, the idea of helping in an emergency seems simple and straightforward. But writing a one-size-fits-all Samaritan Act for everyone gets to be really complicated. I knew there was a reason I didn't go to law school!

- Eric Hanson

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By Julie Won

Are stock prices too high? If so, what then? . . .

The number one question we've been asked recently is whether stock prices have climbed too high and are due for a fall. It's the natural question to ask after the S&P 500 reached 57 new highs last year and just had back-to-back years of 25%+ returns – something that has happened only three other times since 1928.

We know there's plenty to worry about: the unpredictability in U.S. policy making, shifting geopolitics, the sense that the rules are changing . . . Plus, markets have pinned a lot of hope on Artificial Intelligence, which almost all of us agree is consequential, but few of us really understand. Risking real money on AI (or on anything) requires careful study and thinking – not just "this is going to be big." Yet that seems to be enough for many.

Of course, our answer on where markets are headed is that we don't know. We can never know if or when a correction is coming, how deep it will be, or how long it will last. That's the nature of the beast. Just because stocks have done well does not mean they cannot keep doing well. At the same time, as prices climb, risk rises because more needs to keep going right for positive narratives to stay intact.

Still, not knowing does not mean we cannot prepare. Preparation is about thinking about the full range of possible outcomes, taking a stab at what seems most likely, but also understanding how your personal biases color your view, and then being prepared to be wrong.

Here's my take: The U.S. economy is strong, corporate fundamentals are healthy, and consumers are in good shape. However, we still are relying on loose financial conditions and the high liquidity left over from a long era of low interest rates and fiscal generosity – even though rates have risen recently. If inflation stays stubborn, or worse, rises, liquidity will need to be constrained by interest rates that stay high or go higher. That would be bad for corporate earnings and the economy. And if that happens, it may be 10-year Treasury rates, not the technology sector, that become the driver for overall stock levels. That would require a wholly different kind of behavior than many have gotten used to.

In addition, despite the good corporate fundamentals, U.S. stock indexes do look expensive by many measures. Not all stocks – there are still values out there – but the opportunity set within the U.S. looks slimmer than it has been historically. Outside the U.S., opportunities look better.

Regardless of what happens from here, signs of expensiveness are a worry because they can augur subpar returns ahead. Return, after all, is a function of price paid, which is why "never overpay" is a great motto to stick with. Whether there is a "correction" or not, subpar returns can take many forms: They can be negative, or positive but lackluster relative to the risk-free rate or lower-risk instruments like bonds.

As an example, Vanguard's long-term forecast for U.S. stocks is that they will return an average of 2.8% - 4.8% a year for the next 10 years. That's a far cry from the 15% annual returns enjoyed the last decade. More pointedly, it's a far cry from Vanguard's forecast of 4.1% - 5.1% for low-risk U.S. Treasuries. For U.S. growth stocks, the 10-year forecasted return is even worse: just 0.4% - 1.6% a year, well short of Vanguard's forecast for annual inflation over the next decade of 1.9% - 2.9%.

Of course, Vanguard's view is just one of many possible outcomes. The point is not that we should accept Vanguard's scenario. It is that die-hard bulls should prepare for the possibility that U.S. stocks could struggle to keep up with Treasuries. Likewise, pessimists should prepare for the good times possibly continuing.

And that brings us to diversification as a solution. It's the same old boring answer we always hear. Yet, nothing is better as a form of preparation. In practice, diversification today could mean looking at non-U.S. stocks, holding "defensive" stocks, modulating amounts kept in bonds and cash, and taking small bets in real assets that might hedge against disaster. Hold your view but prepare to be wrong. Don't bet the house on anything.

Another recommendation is to stay wise to your biases. I know I am biased toward skepticism, and that inclines me to respond more to warning signs than to good news – often to my detriment. Instead of expressing caution on this page, I could just as easily have made a resounding argument for strong U.S. markets persisting. As Charlie Munger once said, "I never allow myself to have an opinion on anything that I don't know the other side's argument better." It's a great reminder of how much work it takes to have an opinion at all. It's also a great reminder to prepare to be wrong -- and that is more than a mindset. It is also having a portfolio that can pivot, which points to diversification again.

When I am asked what personal qualities are most important to being an investor, my answer often is twofold: One is having a high sense of accountability – always taking responsibility for the things that go wrong as opposed to blaming, say, the market or your style being out of favor. The other is being prepared to change one's mind, a quality that is in surprisingly short supply. So often, people come into investment meetings with their minds made up before discussion even begins – and then hold on tightly to their convictions. But the world requires adaptability.

In sum, let's stay optimistic but be prepared for turmoil. Let's also be highly selective, which means knowing precisely what you are looking for and doing your best to match it to what the world is offering. And finally, my personal plea: Let's stay kind.

AFTER HOURS

By Neil Macker

Is alcohol use drying up?. . .

Alcohol purveyors suffered through a tough start to 2025. Dry January, a campaign to get people to abstain from alcohol for the first month of the year, continues to gain momentum with 75 million American adults expected to have tried the challenge this year. Former U.S. Surgeon General Dr. Vivek Murthy piled on with a recent advisory that "alcohol is a well-established, preventable cause of cancer" and called for stronger warning labels for alcohol containers.

Both events occurred against a backdrop where alcohol consumption, a long-mythologized rite of passage to adulthood, declined among young people over the last two decades. Gallup recently released a poll that showed that the percentage of Americans ages 18 to 34 who say they drink has fallen from 72% in 2001-03 to 59% in 2021-24, just above the oldest cohort but well below the 69% for Americans ages 35 to 54 (*see chart below*). The trend toward less youth drinking accelerated over the last decade as more members of Gen Z (born between 1997-2012) entered adulthood and Millennials (born between 1981-1996) exited college into the workforce.

Multiple factors could explain this trend including health concerns, the rise of alternatives, and different social patterns. 65% of young Americans now view alcohol as unhealthy, up from 30% in 2001, and well above similar thinkers in the middle age (37%) and 55+ (39%) cohorts. Almost all the youngest group think that average drinkers should cut back on drinking (67%), well ahead of ages 35-54 (51%) and above 55 (52%). The data also reveal a strong anti-drinking contingent of roughly 20%-23% of Americans.

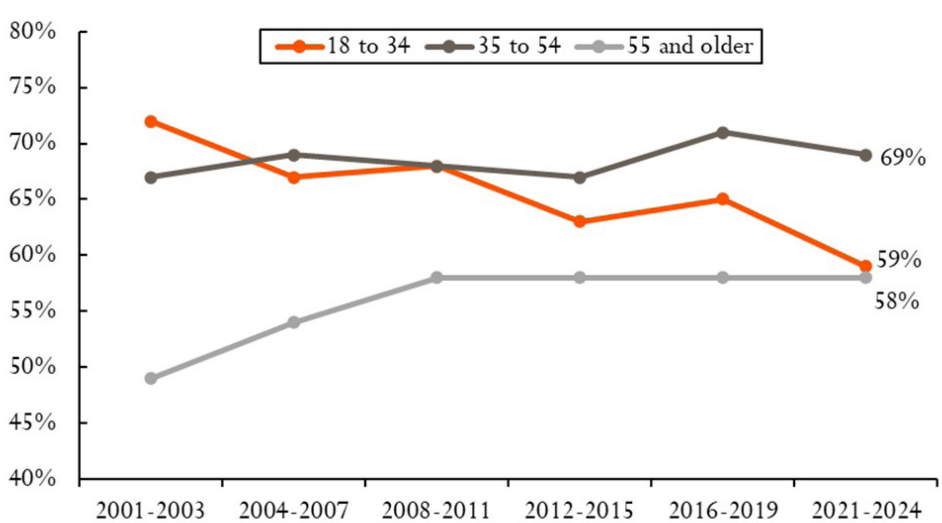
The fast rise of alcohol alternatives such as non-alcoholic beer, mocktails, and marijuana and their social acceptance could also contribute to the decline in youth drinking. While still illegal at the federal level, the Pew Research Center estimates that 79% of Americans live in a county with one dispensary, and Gallup notes that 68% of Americans now believe that marijuana should be legal, up from 34% in 2001. While approximately half of younger and middle-aged Americans identify as lifetime users, respondents ages 18-25 were more likely to have partaken in the last year and the last month according to the 2023 National Survey on Drug Use and Health.

Some attribute the lower consumption of alcohol by young people to the rise of loneliness or lower levels of social interactions. Others have also speculated that the change could be explained by younger people trading real life experiences for online activities, which generally generate less social peer pressure compared to going out to a bar or club. A recent *New York Times* article makes a related point discussing the possibility that progress in drug and alcohol addiction might be related to people turning to "digital drugs." Finally, with remote work, post-work drinks no longer hold the same prominence.

While health advocates cheer the lower level of drinking, the data show these trends can revert over time. In the 1990s, per capita consumption fell to just under 2.5 gallons per year from nearly 3.3 gallons in 1980. Several factors likely impacted this decline, including a higher legal drinking age and the increased acceptance of alternatives, including marijuana. But that low was not sustained, with alcohol consumption rising steadily to 2.85 gallons by 2021, a level last seen in 1988.

Trends to watch moving forward include the broader influence of Gen Z's attitude toward alcohol consumption. Beverage companies will likely continue to innovate with new drinks and formats to capture the younger generation's—and other teetotalers'—dollars. Another potential impact on consumption would be a harsher warning label like tobacco packaging.

RESPONDENTS WHO CONSUME ALCOHOL



Source: Gallup

TRADE POLICY

By Anne Doremus

The second order impact of tariffs...

Investors can be forgiven for tuning out the daily news on America's ever-evolving trade policies. Hardly a day goes by without reports of either a new proposal or the reversal of an old one. In the face of all this uncertainty, the market consensus seems to be embracing two things. First, trade duties are back in force, whether used to generate revenue, bolster national security, or protect domestic industry. Second, markets are now, as a result, assuming higher levels of inflation moving forward. Survey results from Bloomberg show a one-year inflation forecast (CPI) of +2.6%, up from 2.2% last November.

As these survey results show, so far, the markets are betting that inflation levels will be manageable. To understand why, consider the expected impact of the proposed 25% tariffs on Mexican and Canadian imports and new 10% tariffs on Chinese imports. JP Morgan estimates that these duties (excluding the most recent additional tariffs on steel) applied to approximately $1.39 trillion worth of goods, will raise about $200 billion in revenues in 2025 or about 1% of what American consumers spend in any given year. While this average impact is small, it would hit some imports, such as auto parts, much more heavily than others.

A strong dollar could also play an offsetting role by putting downward pressure on the price of U.S. imports (*see chart below*). Higher tariffs tend to lead to a stronger dollar as inflation and interest rates rise, making the cost of foreign goods relatively cheaper.

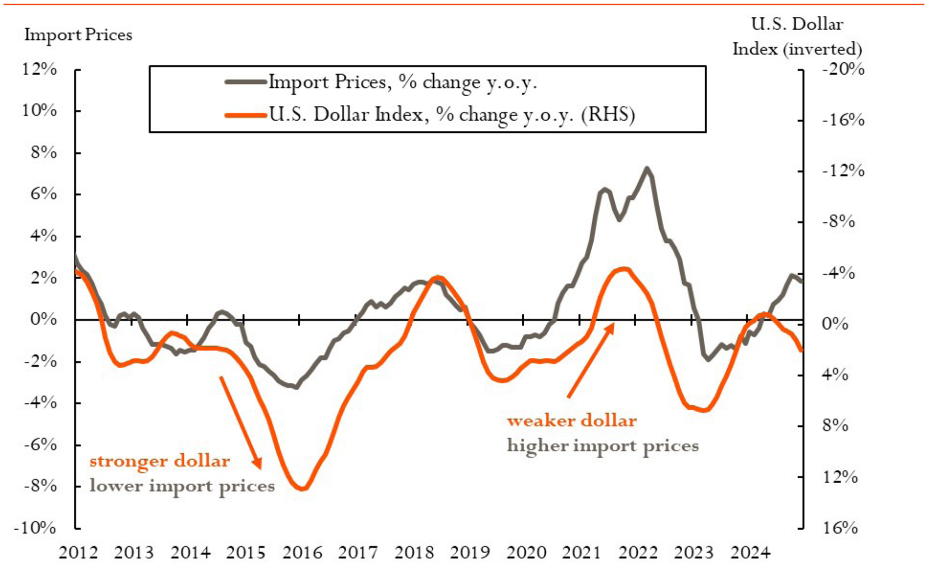
Understandably, much of the discussion today is focused on the near-term economic impact of higher tariffs. But the unintended consequences resulting from our shift to more confrontational and less predictable policies also deserve serious consideration. These include:

A reordering of trade relationships: As our approach to tariffs shifts, so too will our relationship with key trading partners. Mexican auto parts manufacturers, finding themselves with excess production capacity may, for example, enter into supply relationships with Chinese car companies seeking broader access to the Latin American car market. Or consider the case of Canadian oil producers. Historically, U.S. companies have purchased the vast majority of Canada's oil exports. In reaction to rising tariffs, Canadian oil producers may consider diverting exports to Asian markets using either recently expanded or new pipeline capacity. More generally, a more confrontational approach to trade (and existing trade agreements) may encourage global suppliers to alter their relationships in ways that may not favor us either economically or politically.

A hit to innovation: Trade barriers have long been used to protect domestic companies from foreign competition. If carefully enacted, and with the right additional incentives in place, these policies can give domestic firms the time and resources needed to catch up. But they also can have unintended effects. It is interesting to note, for example, that recent Chinese darling, DeepSeek, developed its groundbreaking approach to AI partly in response to U.S.-imposed trade barriers. Often, firms sheltered from competition have little incentive to produce better or cheaper products and the protection provided simply leads to lost productivity and higher prices. The uncertainty caused by shifting trade policies will also do little to encourage investment, a key ingredient of any innovative process.

Economists across the political spectrum generally agree that a prolonged, retaliatory trade war would result in significantly higher prices and reduced output. For this reason, I am somewhat optimistic that this outcome will be avoided. But caution is warranted. Global trade arrangements are complex and include a diverse array of participants with different political and economic agendas. How these partners adjust to our fundamental policy shift remains an open question.

A STRONG DOLLAR PUTS DOWNWARD PRESSURE ON IMPORT PRICES



Source: FRED; nominal broad dollar index (12-month moving average) and import price index ex-food and fuels