CARDEROCK
CAPITAL® MANAGEMENT, INC.

April 10, 2025

Today as we write this letter, the S&P 500 Index has declined approximately 15% just over the past week. While the selling started during the 1st Quarter, it has accelerated since the April 2nd announcement that the administration would enact devastating tariffs on foreign trade. Despite widespread belief coming into the year that these tariffs were merely a negotiating tactic, the investment community must now grapple with the economic consequences of untethering trade arrangements with the rest of the world that have been in place since the end of World War II.

Even before the tariff announcement, the S&P 500 index had both a valuation and concentration problem coming into 2025, with a small percentage of issues constituting most of the index's cumulative gains (**41%**) over the past two years. At the same time, low quality stocks had been rising on speculative themes with little fundamental weight behind them. We recognized this frothy behavior as a warning sign and became more defensive by slowly raising cash, as markets priced in perfect conditions that were unlikely to materialize. Our current cash reserve from stocks is now 20%.

While our preferred strategy of holding a diversified basket of Quality Growth issues has held up relatively better than the S&P Index thus far, we fully understand the importance of absolute returns and for your portfolio to have as much price stability as possible during times like these. Therefore, for now, our focus is not just defending your portfolio but also looking for attractive opportunities once we have more clarity on the path forward.

To wit, our recent activity can be summarized as follows:

- As mentioned, we have increased our cash reserve targets to 20%, a step up from a historically low 10% because of increased volatility in stocks.
- Selling has outpaced buying at a ratio of 1.25 to 1, which will likely continue as valuations come down in the face of declining earnings.
- Portfolio turnover will increase somewhat, as we seek to rebalance stock portfolios in a tax-considerate manner.
- We will continue to utilize treasury bills to supplement higher cash reserves in your portfolio.

Looking forward, we expect the following themes to drive our decision making over the remainder of the year:

- Economic growth will be blunted by higher tariffs, raising consumer prices and thus lowering demand and investment.
- Artificial Intelligence ("AI") investment has defied high interest rates and buoyed construction spending, but there are signs that the Technology sector is dialing down investments in the face of more efficient ways of building models.
- More than two interest rate cuts look increasingly likely as the Federal Reserve must deal with a slower growth environment. Though we recognize inflation would need to moderate for rates to go lower.
- Labor markets will soften throughout the year as growth slows down, with government, consumer-oriented and cyclical sectors taking the brunt of the impact.
- Continued war in the Middle East and Ukraine will add to headline and geopolitical risk.

While we prepared for a slowdown to start the year, few anticipated the extent of the damage that would be inflicted due to the current slate of proposed policies. Fortunately, our long history of managing Quality Growth portfolios through volatile periods prevented us from going "all in" on the issues that are declining the most so far this year. Our firm's investment discipline and market experience over the past 39 years will help guide us through times like these.

As always, feel free to call us with any questions or concerns you may have regarding your portfolio.

Warmest Regards,



Daniel A. Kane, CFA
President



Stephen F. Knapp, CFA
Director of Research



Jeanne C. Goedecke, CFA
Portfolio Manager

In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

Random Gleanings

"The American economy is richer, more innovative and continues to expand at a high rate compared to most of the developed world. But it seems exceptionalism might be ephemeral. Less than 100 days into a second Trump administration, commentators are already discussing the coming end of American exceptionalism. American exceptionalism is a risk mindset supported by strong institutions that is extremely hard for any one president to undermine. Americans tend to be more open to risk and are less dependent on the state, rewarding risk-taking with lower tax rates and generous bankruptcy laws. What makes America exceptional is a healthy appetite for risk, and an economy that can compete without heavy government intervention that picks winners and losers and gives handouts to the best connected." Allison Schrager, "*Is This Really How American Exceptionalism Ends",* **Bloomberg**, March 31st, 2025.

"If some of the data center buildout news sounds eerily familiar, you may be noticing a rhyme with the fiber-optics build-out of the late 1990s. The fiber/telecom bubble outlasted the dot-com bubble, as some argued that telecommunications infrastructure was safer than dot-com companies. Then as now, it's not that the underlying technology wasn't useful, but rather that the capital response to early high demand led to eventual excess capacity: By 2002, only 10% of long-haul fiber carried signal, and then just at a tenth of their capacity. As the data-center glut arrives, the price of compute will drop and Big Tech will pare back its capital expenditure. GPU depreciation will accelerate, meaning that neither cash flows nor hard collateral will make data-center creditors whole." Jim Grant, "*Bubble, Interrupted",* **Grant's Interest Rate Observer**, January 31st, 2025.

"It's clear Trump's plan would add to what are already the nation's highest tariffs since the 1940s. Their effect will be lower economic growth, higher inflation, higher unemployment, the destruction of wealth and a tax increase on American families. It will deal a blow to the rules underlying the global trading system and further empower China. Running bilateral trade deficits is generally not an indication of problem or an abuse, and there is generally no correlation between a country's tariff levels and its overall trade balance. Tariffs will lessen the overall volume of trade, and are another step toward hurting the US economy and creating a geopolitical system that increasingly has China at its center." Jason Furman, "*Trump is About to Bet the Economy on a Theory That Makes No Sense",* **The New York Times**, March 31st, 2025.

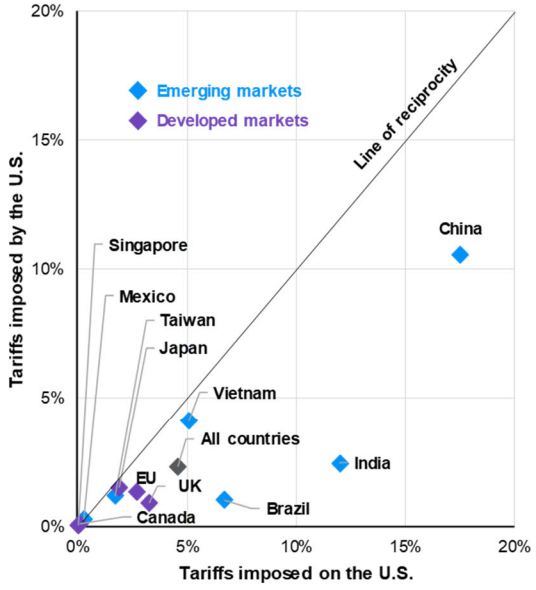
"The goal of tariffs commonly cited by Trump administration officials is bringing manufacturing jobs back to America-reindustrializing the nation. Stock investors are clearly spooked. Consumer sentiment recently hit a 29-month low, the largest decline since the pandemic. The problem is that trade wars don't reduce trade deficits. While tariffs may lower imports, retaliation by trade partners lowers exports. If the current administration doubles down on their unpopular agenda, we may find ourselves testing Mr. Lutnick's assertion that a recession will be worth it." Jared Bernstein and Dean Baker, "*Tariffs Won't Bring a Boom in American Manufacturing",* **The Wall Street Journal**, March 26th, 2025.

"Don't expect the Federal Reserve to rescue the US economy from the epic tariffs the Trump administration has imposed on imports from most of the world. The only question now is how bad the damage will be. The weighted-average tariff will likely climb to 25% or more of the value of imports this year, from less than 3%. Demand will decline, businesses will delay investments under uncertainty, and people will cut back on spending. The US will most likely end up in a full-blown recession accompanied by higher inflation." Bill Dudley, "*Stagflation is Now America's Best-Case Scenario",* **Bloomberg**, April 7th, 2025.

Trade policy risks

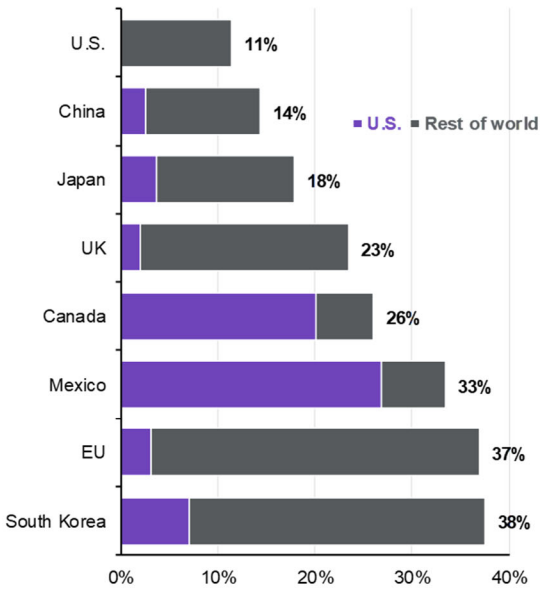
Tariffs between the U.S. and its trade partners

2023, average weighted tariff rate on goods imports



Exports exposure by country

Exports as a % of nominal GDP, USD, goods, 2023

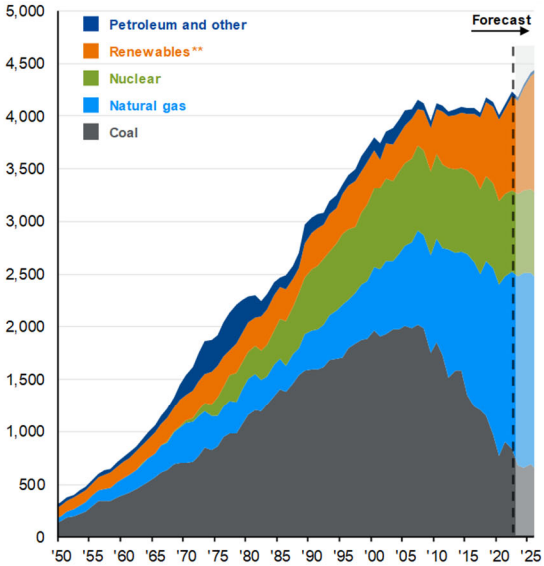


Source: J.P. Morgan Asset Management. (Left) J.P. Morgan Economic Research, World Trade Organization, U.S. International Trade Commission. Tariffs imposed by the U.S. are calculated by dividing duties collected by total imports for consumption. Tariffs imposed on the U.S. are the most-favored nation trade-weighted average tariffs except for China and for countries that have a trade agreement with the U.S. Excludes recent tariff announcements. (Right) UN Comtrade.
Guide to the Markets – U.S. Data are as of March 31, 2025.

Electricity generation and consumption

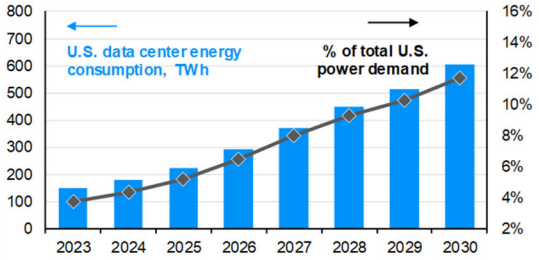
U.S. electricity generation by source

Billion kWh, 1950-2026F*



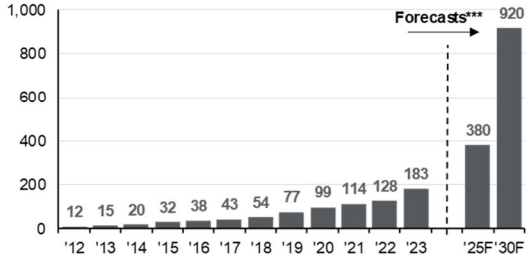
Data center expected growth in electricity demand

U.S. data center energy consumption, projections through 2030



Number of electric vehicle charging points in the U.S.

Thousands



Source: J.P. Morgan Asset Management; (Left and bottom right) EIA; (Top right) McKinsey & Company. (Left) Data are from the EIA "March 2025 Monthly Energy Review" report. *Forecasts are from the March 2025 EIA Short-Term Energy Outlook. **Renewables include wind, solar, geothermal, biomass waste, biomass wood and hydroelectric. (Right) ***Forecasts are from the International Energy Agency (IEA) – Global EV Outlook 2024 and are made assuming its "STEPS" outlook. The State Policies Scenario (STEPS) outlook from the IEA does not assume governments will meet announced policy goals and instead looks at what the IEA considers feasible given current progress.
Guide to the Markets – U.S. Data are as of March 31, 2025.