



Missive

OCTOBER 2, 2025

The Trump Economy

Dear Fellow Investors,

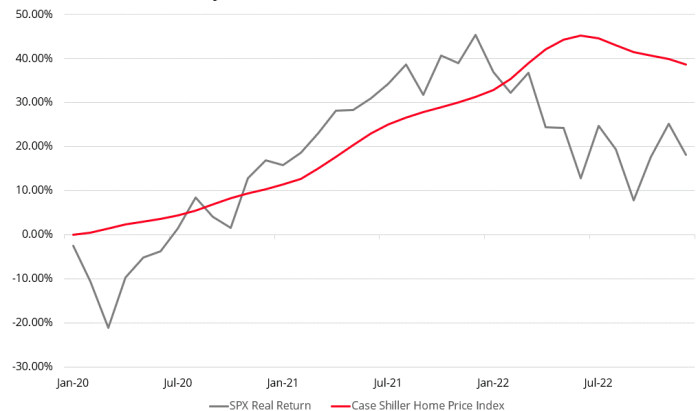
There has been a lot of controversy around the Trump administration's policy toward the Federal Reserve recently. What is less obvious to most investors is what they're aiming to accomplish. Trump continues to talk about getting rates lower, and this has been echoed in other parts of the administration as well. He has also talked about rates affecting housing. Let's unpack the Administration's reasoning and goal.

It looks obvious to us that the US will be running a seemingly hot and loose economy from a historical perspective. We have continually spent 6-7% of GDP more than we took in revenues. Now there is pressure by some Fed governors. You can see a path to 2.5% to 3% on the short end of the curve. The hot nature of this is the spending by the government on social security, Medicare, Medicaid and interest service. These are historically large. We normally only have these kinds of deficits during deep recessions or during times of war. We historically haven't done this in growing economies. The best way, in our opinion, to think about the current hot policy is to recognize how unlikely it is that you can have a recession with this spending.

Short-term rates declining while we are deep into a period of economic growth is the loose portion of the economy. Normally, the Fed would tighten credit to cool the economy out of fear of inflation, but the fear of inflation is losing out to what is good for the economy.

A good picture of the environment we are walking into is from 2020 to 2022. First, the Fed kept rates low despite inflation pressures picking up. If you look back at this period, labor inflation was the hottest in the lowest income quintile. The cheaper the labor, the more wage pressure there was. White collar folks saw less benefit. This hot labor inflation was going on despite allowing millions of people across the southern border who were entering the economy at the lowest wage.

S&P 500 Monthly Real Total Return vs. U.S. Home Prices, 2020-2022



Source: Bloomberg.

Housing benefited from this as cheaper mortgages, relative to the inflation pressures, caused people to not think about rates when buying a home. The poorest people in society during 2020-2022 saw the largest net worth increase. This is because the average American household's largest asset is typically home equity. If housing does well, we believe these people will see significant economic gains, which we will outline in further detail in our missive next week.

During that time period, wealthy people saw less benefit as stocks lost relative to housing. Herein lies what we believe is a misunderstanding: that what is good for the economy is good for the stock market. Let's say short-term treasuries are at 2.5%. We believe that in this policy structure, inflation pressures will be reignited as the value of the dollar and gold could be trying to tell investors. With 4% inflation, where would the 10-year Treasury be priced and what would the 30-year fixed mortgage rate be?

Banks borrow short and lend long. The relationship of the 30-year fixed mortgage rate has been running at 2%-2.5% above the 10-year Treasury while short rates have been high. When these rates come down, so will the mortgage rates. If the Fed allows a bank to borrow at 3% and lend at 5.5%, that's a great net interest margin and they will be willing to increase mortgage underwriting.

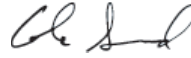
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This all comes at the cost of inflation and ultimately investors. We were reminded of this while reading a newly published book, *Inflation: A Guide for Users and Losers*. Mark Blyth and Nicolò Fraccaroli walk their readers through different eras of inflation with subjects like price controls, interest rates and the economy. What they push you to think about is who the losers and winners are. From 2020 to 2022, the winners were labor and housing to the detriment of bonds and stocks. The three years since then have been low inflation to the benefit of stocks and bonds. This benefits wealthy people.

When Ken Griffin, CEO of the Miami-based hedge fund firm Citidael, said this week, "I would not underestimate how grating a 3% inflation rate could be on Americans." He should have qualified this to say how grating this would be to wealthy Americans. The Trump administration understands that voters and wealthy folks are just as different as the economy and the stock market. The investors of Smead Capital Management anticipate that inflation pressure

will benefit households less tied to the stock market because of the lack of people entering the job market today and a steeper yield curve that enhances housing and lending. We believe this will help investors understand the path forward for the economy and housing. Inflation isn't the stock market's friend. It is the friend of companies that benefit from the inflation that would ultimately help the government pay back its debt in cheaper dollars. This doesn't tell you what stocks to own and why. It just helps us understand the winners and losers in The Trump Economy.

Play The Long Game,



Cole Smead, CFA
CEO & Portfolio Manager

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