



## Managers' Letter 1st Quarter 2025

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### Economic and Market Environment

2025 started well for financial markets and it seemed that we were poised for another great year for investors. On January 31<sup>st</sup>, global equity markets (MSCI ACWI) were up 2.7%, Europe was up 6.5% and our US Buyback Free Cash flow strategy 5.0% YTD. But then, in the words of Robert Armstrong, the US Financial Commentator of the **Financial Times**:

*"...the Trump administration's economic policymaking has been unpredictable and incompetent at a moment where high deficits and lingering inflation worries mean there is no room for amateurism..."*

Most investors expected some kind of measures by the United States on international trade in early April, as Donald Trump had long campaigned on the theme, but very few expected these measures to be so widespread. Virtually no country is escaping the onslaught of tariffs, even the closest allies like the United Kingdom and Australia, will have to pay 10% on every export and 25% on car, aluminium and steel exports. The other surprise is their high level, 20% on EU imports, 31% on Switzerland, 46% on Vietnam and now 145% on Chinese imports! There are several oddities, with tariffs imposed on countries with negative trade balances with the US and the Heard and McDonald islands that are only inhabited by penguins and seals. The other problem is the apparent indecision from the American administration. After a stock market plunge and US government bond sell-off, Donald Trump has now decided to suspend most tariffs for 90 days for most countries with the notable exception of China. This change led to a sharp recovery for most stocks on Thursday 10<sup>th</sup> and Friday 11<sup>th</sup> April and hopefully to more level-headed negotiations going forward.

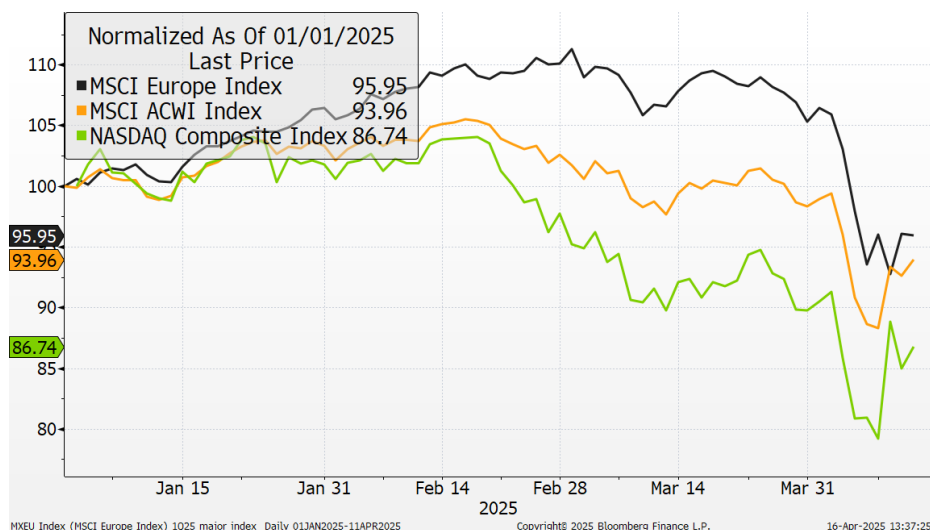
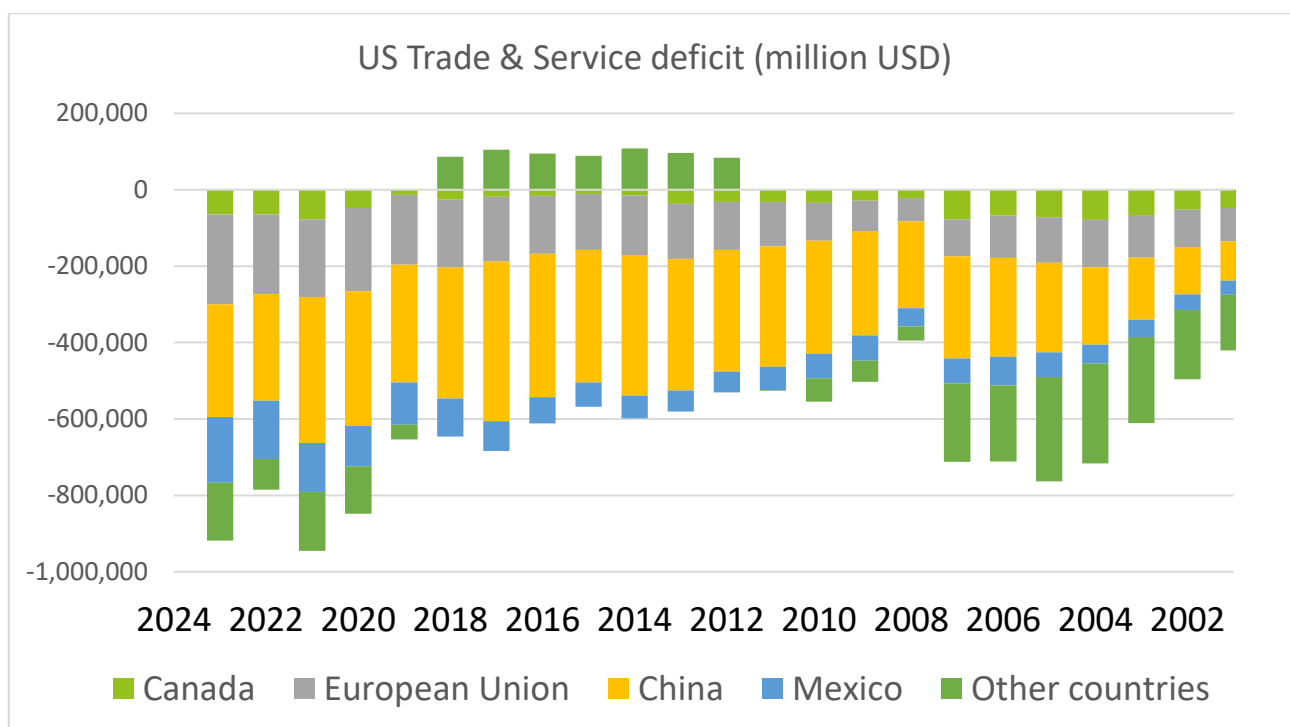


Figure 1 Source: Bloomberg

Some investors might wonder why the Trump administration suddenly decided to launch a trade war with everyone in the world, while the American economy appears to be one of the best in the world, with low unemployment, a booming stock market until the last few weeks and a leadership in technology, pharmaceuticals, energy production, global finance and media. While the overall economic picture in the United States has been pretty strong since the end of the COVID pandemic and in recent decades, there are a few structural weaknesses which could become problematic if not addressed properly. One potential problem with the American economy is its structural trade deficit, meaning the country imports more goods and services than the value of its exports. The United States has had a structural trade deficit since the early eighties, but that deficit significantly expanded after China's access to the World Trade Organisation in early 2000's, reaching a first peak in 2006 close to 800bn USD per annum. It went down significantly after the financial crisis in 2007 first as a result of lower aggregate demand in the United States but also because of the shale oil & gas revolution in the United States massively reducing energy imports in the country. The deficit expanded again following the COVID pandemic as American households, flush with cash and confident due to booming stock and labour markets, started a buying spree.



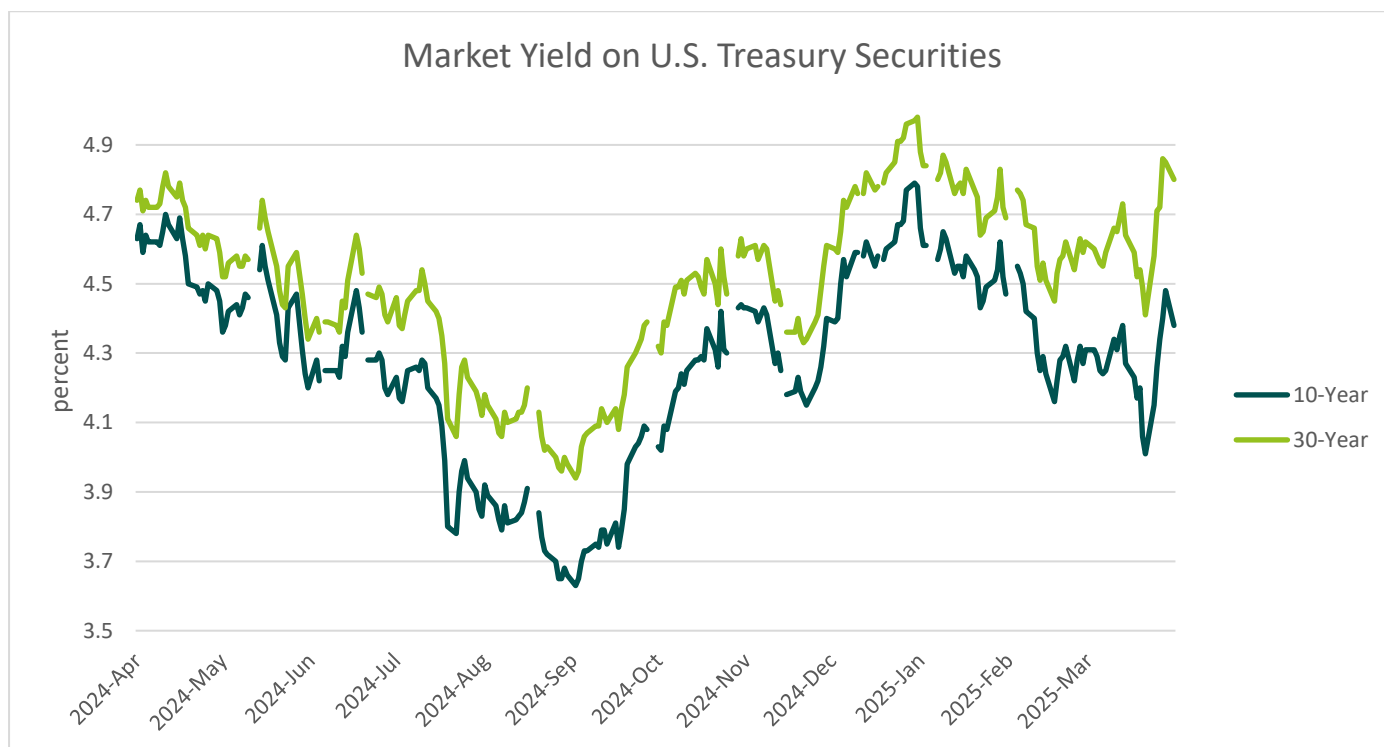
Source: Bloomberg

A trade balance is only part of the picture though. A country can run a trade deficit forever without many consequences, as long as other financial flows compensate for the deficits. The American economy has a number of characteristics which might allow to run a trade deficit forever.

First, the US is where the largest number of multinational corporations are headquartered. These companies make a significant proportion of their profits outside the United States. Hundreds of billions generated in foreign countries can be repatriated in USD relatively quickly to pay back loans, share buybacks or dividends. Secondly and probably the most important factor enabling structural deficits is that **the USD and the American financial system** represent much more than simply the US economy. **They are the global financial system and currency.** All over the world, companies, governments and households borrow, save, invest and transact in USD instead of using a domestic currency. Historically, the United States being the only truly globalised superpower has benefitted from the status of a safe haven. 11 countries have currently adopted the USD as their official currency and many more have dollarized economies. Oil, still the most important commodity in the world is also traded in USD. Most global investment banks are also prominently American, meaning a lot of global financing is also done in USD. As a result, the USD tends to behave very differently than other currencies. It went up in 2008, while the United States was going through a major financial crisis! The downside of having a very strong currency, which doesn't really adjust to the competitive trading

position of a nation, is that it can be very difficult for local manufacturers to be competitive. Some economists argue that Germany benefitted tremendously from the under-valuation of the euro. Similarly, you could make an argument that American manufacturers got decimated by a strong USD. It is no coincidence that Donald Trump is obsessed about devaluing the USD. His actions, trying to re-arrange the world economic order in just a few months could have a number of grave consequences. Bar big changes in his tariff policies, it is likely to increase inflation in the United States. The US administration is hoping that global companies will reshore production to the United States, but it could backfire as entrepreneurs will not make these strategic decisions with so much uncertainty. Even in a best-case scenario for the United States, it would take years to build the required factories. The tariffs might not even help local manufacturers much, as today's sophisticated manufactured products require a global supply chain. As an example, tariffs are supposed to help American automakers, but analysts estimate they might cost American car manufacturers up to USD40bn per year. Beyond the direct implications of tariffs, other countries could take counter measures severely affecting the US economy, China could again restrict rare earth exports, that are essential in high value manufactured products like Lockheed Martin's F35.

In addition to its trade deficits, the USA also has important government deficits. A significant proportion of US government bonds are purchased by foreign investors. After "Liberation Day"<sup>1</sup>, US treasury yields increased sharply. It appeared that the selloff was the main reason for Trump to backtrack on the tariffs. The contagion is spreading to private debt, with issuance and refinancing at historical lows.



Source: US Federal Reserve

After all the negative news, one might feel pessimistic about the market's prospects. As a reminder, US stock performance for 2024 and 2023 has been extraordinary and mostly supported by US businesses' higher profitability. The USD correction has merely brought back the currency to pre-Trump election levels.

Another re-assurance is that under enough pressure, political leaders yield. Trump paused most tariffs for a 90-day period to start negotiations with other countries. Under Liz Truss, the UK Conservatives dropped their budgetary proposals with unfunded tax breaks and in China, Xi Jinping abandoned the zero Covid policy after country wide

<sup>1</sup> United States president Donald Trump called April 2 "Liberation Day" and said it was "one of the most important days in American history" due to the newly introduced reciprocal tariffs

protests. The US Congress has started to act with a proposal to restrain the president from applying tariffs without Congress approval. The bill has garnered Republican support, not enough to bypass a likely presidential veto, but if Trump were to continue his reckless actions, he might lose the power to impose additional tariffs. For now, Republican congressmen and women are giving Donald Trump the benefit of the doubt, but this could change quickly if citizens start losing their job and inflation picks up.

## Our convictions

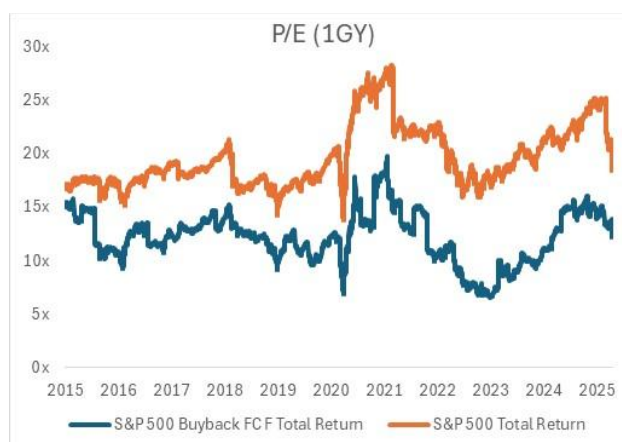
Against a backdrop of US equities<sup>2</sup> declining 16% year-to-date and the so-called ‘Magnificent 7’<sup>3</sup> declining 25% year-to-date, TreeTop’s strategies have performed relatively well<sup>4</sup> and offered much needed diversification.

	Index Performance in Euros (Annualized Total Return)			
	YTD 31/12/2024 – 11/04/2025	1 Year 12/04/2024 – 11/04/2025	3 Years 18/04/2022 – 11/04/2025	5 Years 13/04/2020 – 11/04/2025
MSCI ACWI	-13.5%	-0.9%	5.3%	12.7%
S&P 500 Buyback FCF	-10.1%	-4.7%	6.1%	18.2%
S&P 500	-16.2%	-0.1%	6.9%	15.2%
NASDAQ Composite	-20.6%	-2.0%	7.1%	15.5%

Source: Bloomberg

## S&P500 Share Buyback FCF strategy

The strategy has weathered the first three months of year far better than the overall US equity market as it focuses on companies that are attractively valued, and therefore often has much lower exposure to large technology names that dominate the S&P500. The chart below shows that the strategy trades at a much lower P/E (Price/Earnings) multiple than the S&P500.



Source: Bloomberg

Year-to-date, the strategy has benefited from its exposure to healthcare (such as **Cencore**, a pharmaceutical company, **McKesson**, a distributor, and **HCA**, a hospital group), telecoms (such as **T-Mobile**, a wireless network operator), and consumer staples (such as **Monster Beverage**, an energy drink producer), all of which are relatively defensive sectors and have outperformed amid heightened concerns about US economic growth.

By contrast, the strategy’s performance was negatively impacted by names that are exposed to the AI investment cycle (such as **Dell Technologies**, which produces servers and computers, and **Vistra**, a utility company) or tariffs (such as **General Motors**, a car manufacturer), and those that are considered more cyclical in nature (such as **Lennar**, a housebuilder).

<sup>2</sup> S&P500 (SPX Index) in Euros (on April 11<sup>th</sup>)

<sup>3</sup> Bloomberg Magnificent 7 (BM7P Index) in Euros (on April 11<sup>th</sup>)

<sup>4</sup> No guarantee of result or performance

## Global Equities strategy

TreeTop has always believed in a global approach to investing. The global equity market, as represented by the MSCI All Countries World Index (MXWD Index), retains a significant exposure to the US (65% at the end of March), but also offers exposure to other markets, such as Europe, China and India, all of which have outperformed the US so far this year. The diversification is even greater at the company level, with over 2,500 constituents.

Global equity market valuations have corrected over the past two months, with P/E (Price/Earnings) multiples now below their 10-year average. However, there is obviously a risk that earnings decline as a result of the recent tariff announcements, so valuation is possibly best assessed by looking at P/B (Price/Book Value) instead. Here again, valuations have corrected this year but remain above long-term averages Error! Bookmark not defined.



Source: Bloomberg

At TreeTop we remain convinced that investing in listed companies through the stock market remains the best way to build wealth in the long run even during volatile periods Error! Bookmark not defined.. Last quarter's events and the resulting volatility have reminded us of how important it is to:

- (1) Diversify and have a global approach to investing. At TreeTop, investing worldwide is our DNA. We have always been on the lookout for the most interesting strategies for our customers, regardless of geography or sector.
- (2) Invest in unleveraged assets. High volatility is triggering sales at the worst moments amplifying downward movements. Leveraged investors are forced to liquidate their holdings. In addition, the high yield and leveraged loan markets have all but shut down in 2025 compounding difficulties for hedge fund and private equity firms that were already under pressure
- (3) Invest for the long term: having at least a 5 year investment horizon is essential.
- (4) Reduce exposure to overpriced assets: The Nasdaq Composite index has corrected far more than the S&P500 index. Deteriorating consumer and industrial confidence and widening credit spreads are leading indicators of a probable global recession. Companies with strong cashflow and low price earning usually perform better during recessions.

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*Data & Information as of 11th April 2025*

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*Published by TreeTop Asset Management SA, a UCITS Management Company pursuant to the provisions of Chapter 15 of the Law of 17th December 2010 – Registered office at 12 rue Eugène Ruppert L-2453 Luxembourg.*

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