2025

GKV CAPITAL

FIRST QUARTER

MARKET REVIEW AND OUTLOOK

The End of Free Trade

1Q25 DATA POINTS

S&P 500	-4.6%
GLOBAL EX. US	+5.2%
REAL ESTATE	+3.5%
US BOND INDEX	+2.8%
10-YEAR TREASURY YIELD	4.23%
S&P 500 LTM DIVIDEND YIELD	1.27%
S&P 500 12-MONTH EPS	$238.09
S&P P/E	20.3x

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Opening Thoughts

In the two days after President Donald Trump announced his tariff plan, more than $6.6 trillion was wiped out in U.S. stocks. That's the equivalent of the entire annual U.S. government budget. Only two days! We anticipate the repricing of U.S. assets to continue.

Confidence is hard won and easy to lose. The U.S. economy is the envy of the world. Economic growth in U.S. since the Covid pandemic significantly outpaced the rest of the developed world. New innovations in technology and health care, such as artificial intelligence, vaccine development and GLP-1 weight loss drugs promise to increase productivity and improve the quality of life. U.S. per capita discretionary income hit an all-time high in February.

There was much to be excited about coming into the start of the year and as a result, investors from around the globe were willing to pay a premium to invest in U.S. companies. Companies that reach every part of the world, delivering software in India, construction equipment to China and food to Europe.

Through free trade we created an efficient, finely tuned, interconnected system that took advantage of whatever unique capabilities exist from the various geographies and people around the world. It has been a system that has improved the lives of billions, leveraging comparative advantages.

Sure, there are difficulties. People and politics being what they are, look for comparative advantage and at times exploit each other, but fundamentally the system has succeeded through mutual cooperation.

The underpinning of globalization, free trade, has been restricted. A pseudo mathematical formula has been fabricated to justify perceived slights against the U.S. by both allies and enemies alike. The significant tax on parts that American companies are dependent on will impact all Americans. Business supply chains will have to be rethought and reconstructed.

2025 has quickly become defined in our mind as one of uncertainty. Uncertainty about the economic outlook. That includes corporate earnings, jobs and American income.

The American economy is incredibly resilient. Our exit from the pandemic demonstrated that resiliency. The value of U.S. stocks is being repriced to reflect the new reality of an uncertain outlook. Over the long-term, U.S. stocks will continue to yield strong returns, but 2025 will be more challenging in the short-run.

1Q25 Review

The first quarter of 2025 started off with tremendous optimism. There was a pervasive belief in "American exceptionalism" among investors. That new innovations and economic strength would continue to propel the equities markets higher. For the last two years investment returns in U.S. equities significantly outpaced the rest of the global markets. In hindsight, it is the periods of high expectations that investors should be most wary. The first quarter of 2025 was the first quarter of declines for the major U.S. indices since 2022.

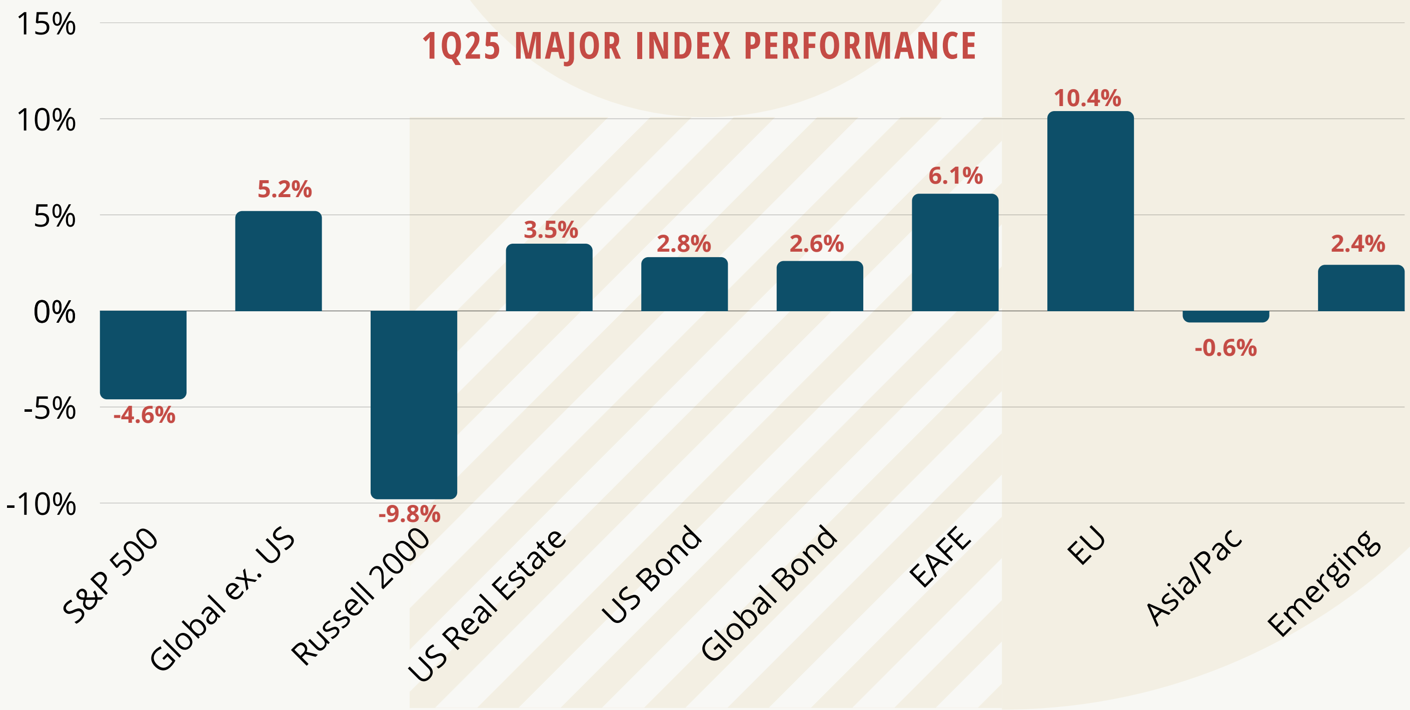
The broad S&P 500 index fell 4.6% for the first three months of 2025. The Russell 2000 Index, which tracks small public companies, declined 9.8%. The Barclays U.S. Aggregate Bond Index gained 2.8% due to a modest decline in interest rates over the quarter.

The major indices continued to notch positive gains at the start of the year with a gain of 4.5% through February 19th. The threat of trade tariffs from the Trump administration prompted a rapid retreat resulting in losses for the quarter.

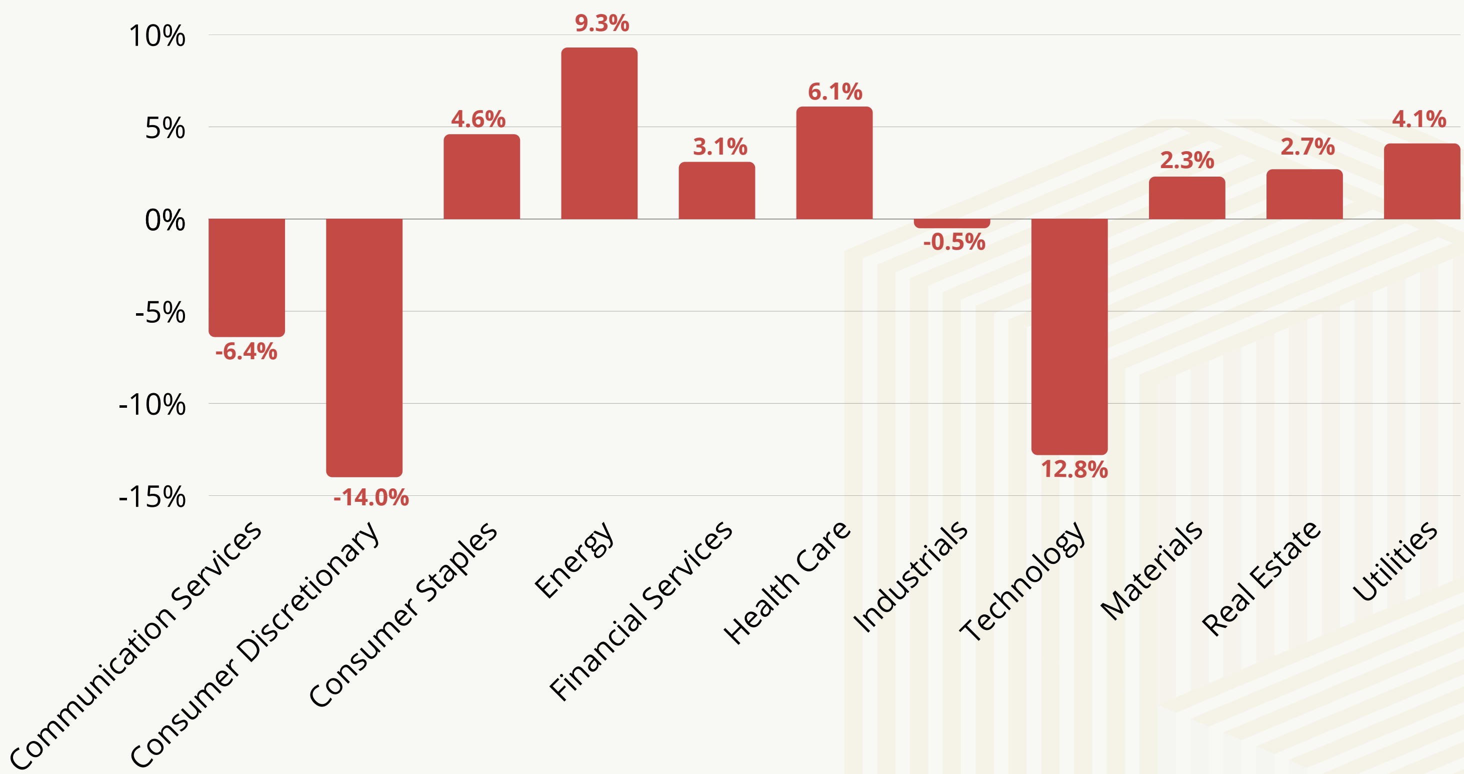
Despite the negative return for the major indices, at the close of the quarter, most industry sectors had gains. Energy, which was one of the worst performing sectors of 2024, ended March 31st with a gain of 9.3%. Health care, also one of the worst performers of 2024, recorded a gain of 6.1% in the first quarter.

This quarter the two worst performing sectors were consumer discretionary and technology, down 14% and 13%, respectively. Technology has an outsized impact on the board S&P 500 index representing 29% of the index. The threat of tariffs is likely to have a more significant impact on both consumer discretionary and technology as most products in both sectors are imported to the U.S. For example, the single worst performing sub-sector of consumer discretionary was automobile manufacturers with a decline of 33% in the quarter. The second worst performance was footwear, declining 23%. Both cars and shoes are almost entirely manufactured outside the U.S. even for domestic companies such as Nike and Ford. The hardest hit sub-sector in technology was semiconductors, which declined 19%. Again, the threat of tariffs is expected to impact the import of semiconductors.

Outside the U.S., equity markets bounced back, partly due to a rotation of investment leaving the U.S. equity market in favor of Europe and Asia. The MSCI EAFE (Europe, Australia, Far East) Index ended the quarter up 6.1%. European stocks jumped 10.4% in the first quarter after a weak performance for the last several years. Emerging markets gained 2.4% through March 31st. With the threat of tariffs and an exodus of investment in the U.S., the dollar fell 4% against a broad basket of global currencies wiping out half the



1Q25 SECTOR PERFORMANCE



currency's gain in 2024. The decline in the dollar is a headwind for U.S. consumers resulting in higher prices for imported goods even before the implementation of tariffs.

Core economic fundamental data in the U.S. remained very strong through the first quarter of 2025. Over two-thirds of the US economy is driven by consumer spending. We track employment data, income, debt, interest rates and inflation rates to gauge the health of households and by extension, the health of the U.S. economy. Unemployment remains low, ending March at 4.2%. Disposable income is up 3.6% over the year ago period while retail sales increased 3.3%. Many of these indicators are backward looking- they won't tell you what is going to happen in the future, but weakening trends can provide some insight into the direction of the broad economy.

The global economy is growing at a healthy pace driven largely by strength in the U.S. although forecasts are likely to be adjusted lower with the newly implemented tariffs. Global GDP was forecast to grow 3.2% in 2024 and 2.8% in the U.S. Prior to the announced tariffs, economist forecasts put U.S. growth at 2.0% in 2025 and 3.1% worldwide. Estimates for Europe are 1.2% in 2025, up slightly from 1.1%.

With an increasingly uncertain outlook due to tariffs, price-to-earnings multiples for expected future growth are being reevaluated in the U.S. Combined earnings for all of the companies making up the S&P 500 were forecast to reach $266.39 per share in 2025. This represents a 14% increase from an expected $233.35 per share for the full year 2024. For comparison, earnings grew 8.4% in 2023 over 2022 and 9.3% last year. The 2025 earnings forecast of 14% earnings growth appeared optimistic to us prior to the Trump administration's tariffs. We now expect a material reduction to this forecast.

The 10-year treasury yield ended the year at 4.23%. The U.S. Federal Reserve reduced the Federal Funds Rate three times during 2024 from 5.5% to 4.5%. The Fed Funds rate was left unchanged in the first quarter. Inflation has moderated at 2.8% in February but is still off from the Federal Reserve's target of 2%. It remains to be seen what the impact of tariffs will be on both inflation and economic growth. At the current time it is impossible to forecast the direction of interest rates without more data.

Mortgage rates declined slightly in the first quarter from 6.85% to 6.64%. The U.S. housing market is likely to remain moribund with little supply in the secondary market as homeowners with sub-3% mortgages are unlikely to want to give up their historically low rates.

The U.S. Aggregate Bond Index closed the quarter with a gain of 2.8%. If tariffs meaningfully slow the U.S. economy, we expect interest rates to fall further which would push bond prices higher. We anticipate a positive performance in the bond market this year at around 5%.

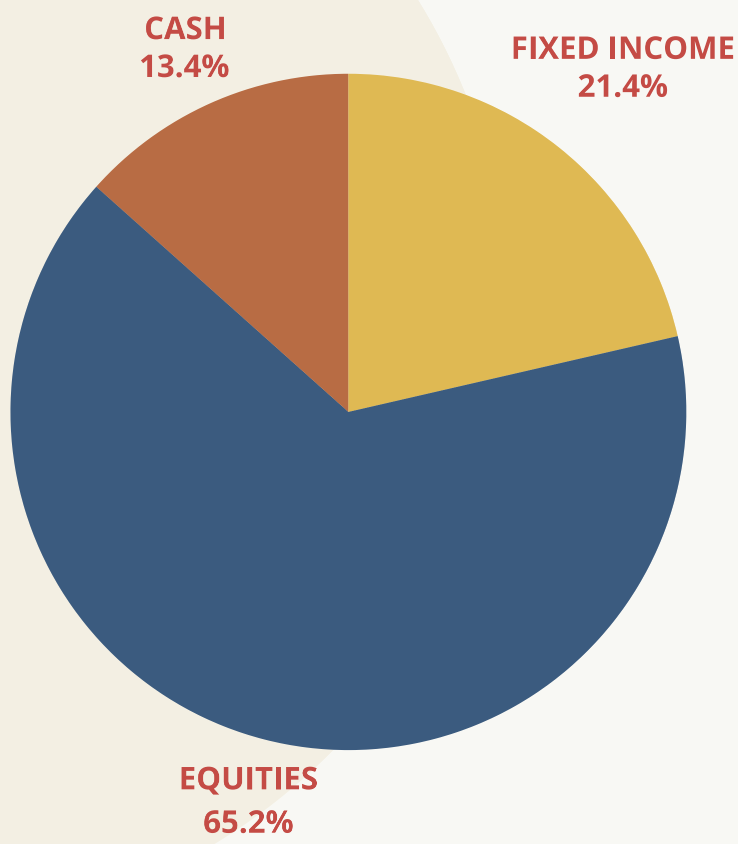
Due to its status as a safe haven in times of potential crisis, gold had a big run-up in the first quarter rising 18% since the start of the year to end the quarter at $3,089 per ounce. We believe that a large part of the rapid rise was due to arbitrage purchases ahead of the tariff announcement. Large market participants speculated that precious metals would be included in the tariffs and large shipments were moved from Europe to the U.S. ahead of the April 2nd tariff announcements.

Firmwide, we ended the first quarter with 13.4% of assets in cash, 21.4% of assets in fixed income securities and 65.2% in equities. This is a significant change from the start of the year with 3.6% in cash, 16% in fixed income and 80% in equities. The implementation of tariffs has significantly complicated the economic outlook and our earnings forecasts. We are actively reducing our clients' exposure to equities in favor of cash and fixed income asset classes.

WE MANAGE SEPARATE ACCOUNTS FOR EACH OF OUR CLIENTS. EACH PORTFOLIO IS CUSTOM TAILORED FOR THE CLIENT

GKV FIRMWIDE

Asset Allocation



The End of Free Trade

Strong, consistent growth provided a sense of confidence as we began 2025. Inflation has moderated, interest rates peaked and are declining, unemployment just above 4% is historically low and disposable income in the U.S. is at an all-time high hitting $65,285 in February. By virtually any metric the U.S. economy is in great shape. The strength of our economy gave rise to a belief in American exceptionalism – that new innovation, significant investment and consumer spending would lead to continued growth. As a result, investors were willing to pay a premium to invest in our economic success. Trailing price-to-earnings for the S&P 500 at the start of the year was 25.2 times. The average price-to-earnings since 1988 is 19.5 times. In other words, investors were willing to pay a nearly 30% premium to invest in U.S. stocks from the average valuation over the last 37 years.

It is shocking how fast confidence can be shaken. The introduction of sweeping U.S. tariffs, announced on April 2nd, on all our trading partners has kicked off a trade war and undermined the certainty of the economic outlook. The announced tariffs, if unchanged, total $258 billion representing the largest tax hike since 1982.

Like most of Wall Street, we misunderstood President Trump's rationale for tariffs. We assumed tariffs would be a lever that the President could readily utilize to extract trade concessions from economic partners. Trump has long expressed conviction that other countries, both allies and enemies have been taking advantage of America for decades with unfair trade practices.

The announced tariffs were far more significant than we imagined. Economists across Wall Street were shocked at the breadth and scale of the proposed tariff regime. Many still believe that the magnitude of the import taxes will be substantially reduced, but we no longer can afford to make that assumption. Based on the rudimentary formula used to derive the level of specific tariffs against each country and a better understanding of Trump's motives, we no longer assume that the tariffs are a negotiating tactic.

The Trump Administration's goal is to bring back American manufacturing. By substantially curtailing illegal immigration and foreign trade, the President believes that domestic manufacturing can thrive as it once did. The tariffs are protectionist in nature, derived to stem the flow of lower cost goods to the American consumer in a bid to revitalize American manufacturing.

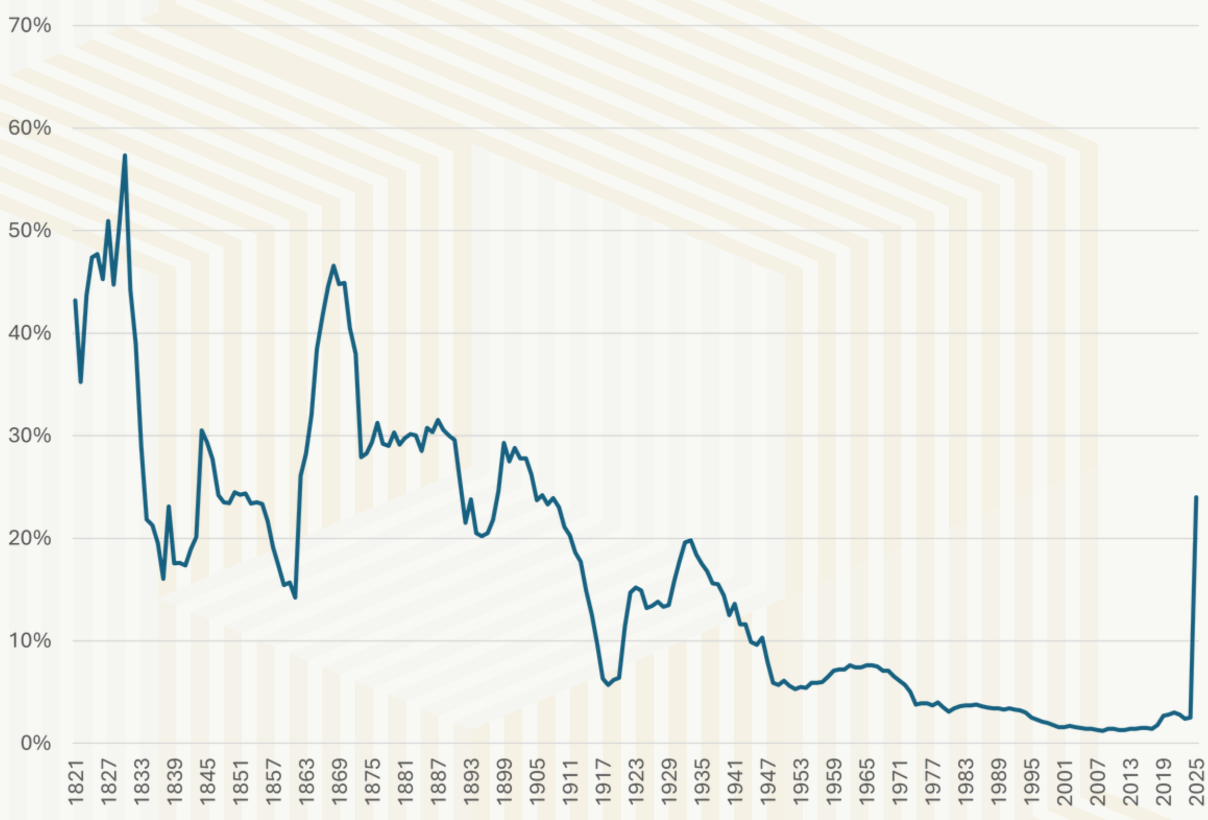
THE ANNOUNCED TARIFFS, IF UNCHANGED, TOTAL $258 BILLION REPRESENTING THE LARGEST TAX HIKE SINCE 1982

Without weighing the merits of the goal, we know that the process will be incredibly disruptive to businesses, consumers and the U.S. economy. We sincerely hope that for the sake of the country there will be a level of success, but we know that it will take some time for any positive outcome to develop. In the meantime, it is very apparent that there will be uncertainty and risk. These include the risks of greater inflation, slower growth, and even recession leading to increased unemployment and potentially lower household income. Instead of double-digit earnings growth in 2025, as was forecast at the start of the year, we suspect there will be little earnings growth this year. The premium valuation for U.S. large cap equities and "American exceptionalism" is rapidly disappearing. Despite recent economic strength, the S&P 500 is down 13.7% this year and we are already seeing a rapid repricing of the U.S. Dollar relative to other currencies with a decline of more than 5%. Foreign capital is now being pulled from investment in U.S. at a rapid rate.

Tariffs are taxes. They are not paid by the country exporting goods. They are paid by the exporter or importer, not the country itself. This additional expense is then passed on to the consumer. It is hard to understate the sheer size of the tariffs. Unless revised lower, the average tariff rate is between 20-24% which would put the rate even higher than the infamous Smoot-Hawley tariffs that helped prolong the Great Depression in the 1930s.

In a recent survey by the University of Chicago of leading economists, 95% of respondents "strongly agreed" with the statement that "imposing tariffs results in a substantial portion of the tariffs being borne by consumers of the country that enacts the tariffs, through price increases." Only two of the economists surveyed disagreed with the statement.

»AVERAGE U.S. TARIFF RATE SINCE 1898



If the tariffs stay in place at the announced levels, demand will decrease, inflation will increase, and earnings will decline. Economists estimate that for every 1% increase in tariffs, G.D.P. growth will slow 0.1%. At 24%, that implies a 2.4% decline in G.D.P., potentially wiping out the 2.0% growth forecast for 2025.

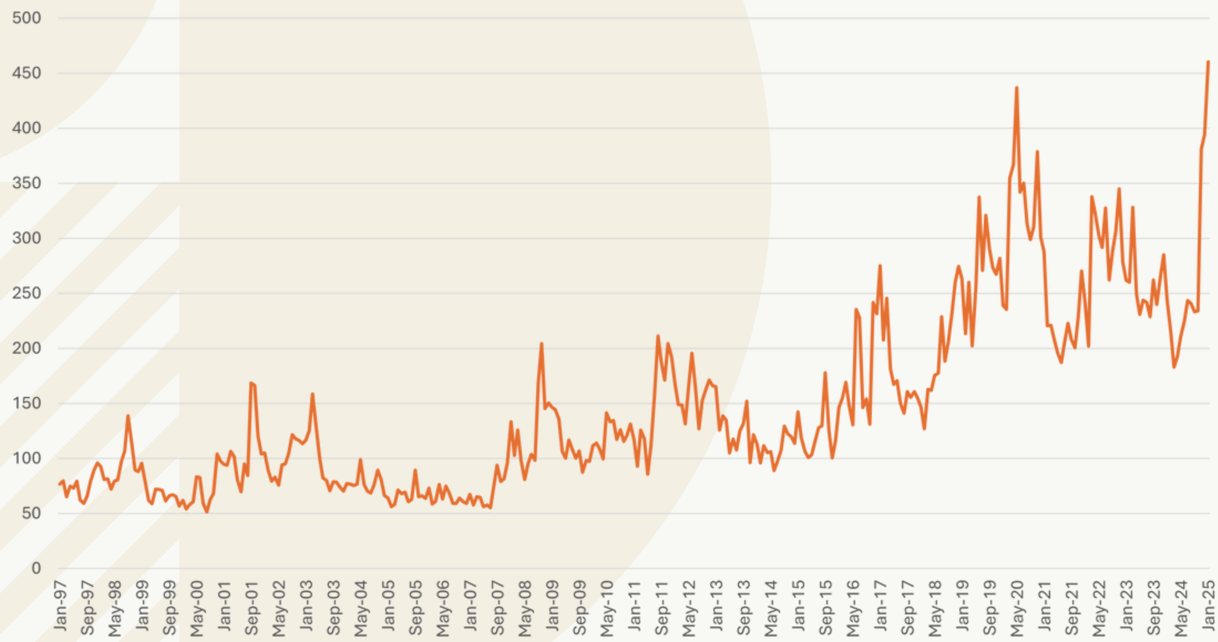
Globalization and free trade have been a powerful driver of American growth over the last 80 years. Companies have built intricate supply chains to maximize efficiency. Prices of goods in the U.S. have been declining steadily for more than 40 years. American advocacy of free trade has greatly benefited the whole world. While the global economy prospered, American G.D.P. has kept pace, consistently capturing a staggering 25% share of total global production. Unraveling our free trade philosophy is a shock to American business and will require fundamental adjustment.

Business thrives on predictability. Decisions about the allocation of capital require a level of confidence for the future. This is true for consumers as much as it is for CEOs. A large part of the strength of America is the stability of its institutions. The rule of law. The reliable infrastructure. With greater uncertainty comes increased volatility as investors attempt to gauge the economic outlook and discern what risk assets are worth. Below is a chart of the Economic Policy Uncertainty Index which looks at the newspaper discussion of economic uncertainty as well as disagreement among economic forecasters and the Congressional Budget Office. This month the global reading hit a new all-time high exceeding even the beginning of the Covid pandemic.

Uncertainty is particularly problematic for investors. Asset prices are based on the expectation of future earnings. The less confidence investors have for future earnings the more asset prices need to be discounted. This is intuitive. If I loan money to you, the less certain I will be repaid, the higher the interest I need to charge.

At the end of last year, the strength in U.S. equities assumed that earnings growth in 2025 would be even better than the 10% growth we experienced in 2024. The belief was that this was not only possible, but that it was the most likely scenario. The trade war makes these assumptions doubtful.

»GLOBAL ECONOMIC POLICY UNCERTAINTY INDEX



Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review, October.

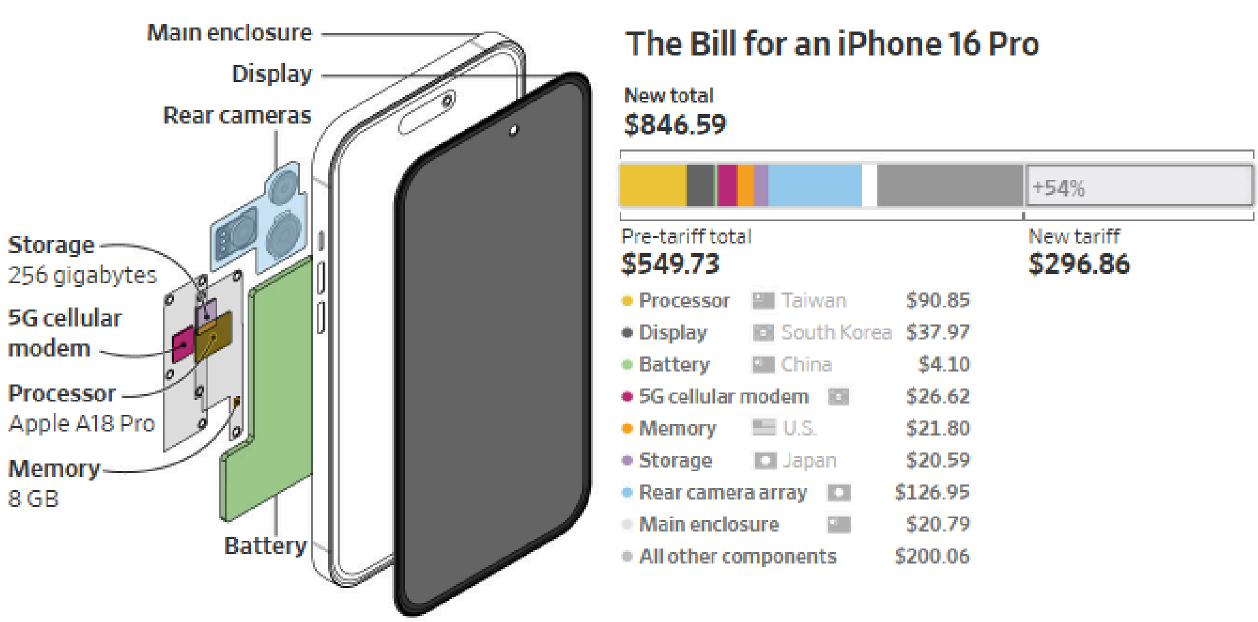
Operating margins for companies making up the S&P 500 have been very high in the last five years. High operating margins are partly due to globalization- the ability to source parts and labor as cheaply as possible around the world. In the December quarter of 2024, operating margins were 12%. This is the income after all expenses for all the S&P 500 companies combined. The average since we began tracking the data in 2006 is 9.5%.

Large U.S. companies are very finely tuned. Small changes in sales or expenses can have a significant impact. For example, in 2024, United Airlines carried 174 million passengers. The company reported a net income of $3.15 billion. That's a lot. Except when you consider the net income per passenger, it's only $18.10. If you wiped out the baggage charges or a few of the premium seat charges, all the profits are quickly eliminated.

In a recession, earnings decline rapidly. Companies cannot cut expenses fast enough. Laying off workers (labor is the most significant expense for businesses) is painful and takes time. The impact of layoffs trickles through the economy. Unemployment reduces average income leading to lower consumption resulting in lower earnings propagating more layoffs. It's a vicious cycle and why recessions are so painful. In 2008, earnings declined to zero and unemployment spiked above 10%.

A detailed look at the iPhone highlights the problematic impact of tariffs. Joanna Stern of the Wall Street Journal did an excellent breakdown of the iPhone 16 Pro, concluding that the current tariff levels will increase the cost of the phone by $296.86. That's an increase of 54%.

If Apple were to simply absorb the increased cost to import the iPhone, we calculate the company's operating income would be cut in half. Since stock prices are based on earnings, such a reduction to earnings would cut the value of the stock in half. Obviously, the company can't simply absorb the increased cost. Most of the difference will have to be passed on to the consumer. Instead of a $1,099 iPhone it's a $1,399 iPhone.



Wall Street Journal, April 5, 2025

PRESERVATION OF CAPITAL IS OUR PRIMARY OBJECTIVE

Maybe you think that Apple should simply manufacture the iPhone in the U.S.? At present that isn't feasible. The iPhone costs about $30 per unit to manufacture in China. In the U.S., estimates put the manufacture cost per phone at $300, which is as much as the cost of tariffs. And that's after assuming all the components were able to be manufactured domestically. They aren't.

Differences in labor costs are vast, even in North America. The cost per hour of labor for an auto worker in the U.S. is $70. In Canada that cost is $40 per hour. And in Mexico the cost is $7 per hour. For Ford or General Motors, who have invested heavily in manufacturing in both Mexico and Canada, ramping up production in the U.S. will be costly and those costs will be passed on to the consumer. Even Tesla, which manufactures its cars in the U.S. is not immune to tariffs. It is estimated that tariffs on necessary parts from overseas will add approximately $4,000 to each Tesla model, increasing the average price by approximately 11%.

The market discounts the likely economic outlook. Increased uncertainty in that outlook results in lower valuations. Instead of 25 times trailing earnings multiples, the market will revert to historical valuations of 18 to 20 times earnings, in our view. As we mentioned earlier, Wall Street analysts were forecasting 14% earnings growth in 2025 over 2024. But that was before tariffs. We now assume that earnings are now likely to be flat with last year at $230 to $240 per share for the entire S&P 500. A multiple of 20 times $240 puts the S&P 500 index at 4,800 resulting in a decline of 20% from the start of the year.

Stock prices are not arbitrary. They reflect the value of future cash flows. The more confidence in the future cash flows the more certain we can be of the appropriate stock price. That's why greater uncertainty yields greater volatility in stock prices. Today we can buy 10-year U.S. Treasury bonds that pay an interest of 4%. That's about as sure an investment as you can get. If you are a mortgage lender you can lend a home buyer money to buy a house and receive 6%. If you invest in stocks, you expect to get paid on your capital. If corporate earnings for the S&P 500 are approximately $240, at 4,800 the earnings yield is 5%. If uncertainty around those earnings goes up, the price will continue to decline until investors think they are getting adequately paid for the risk they are taking.

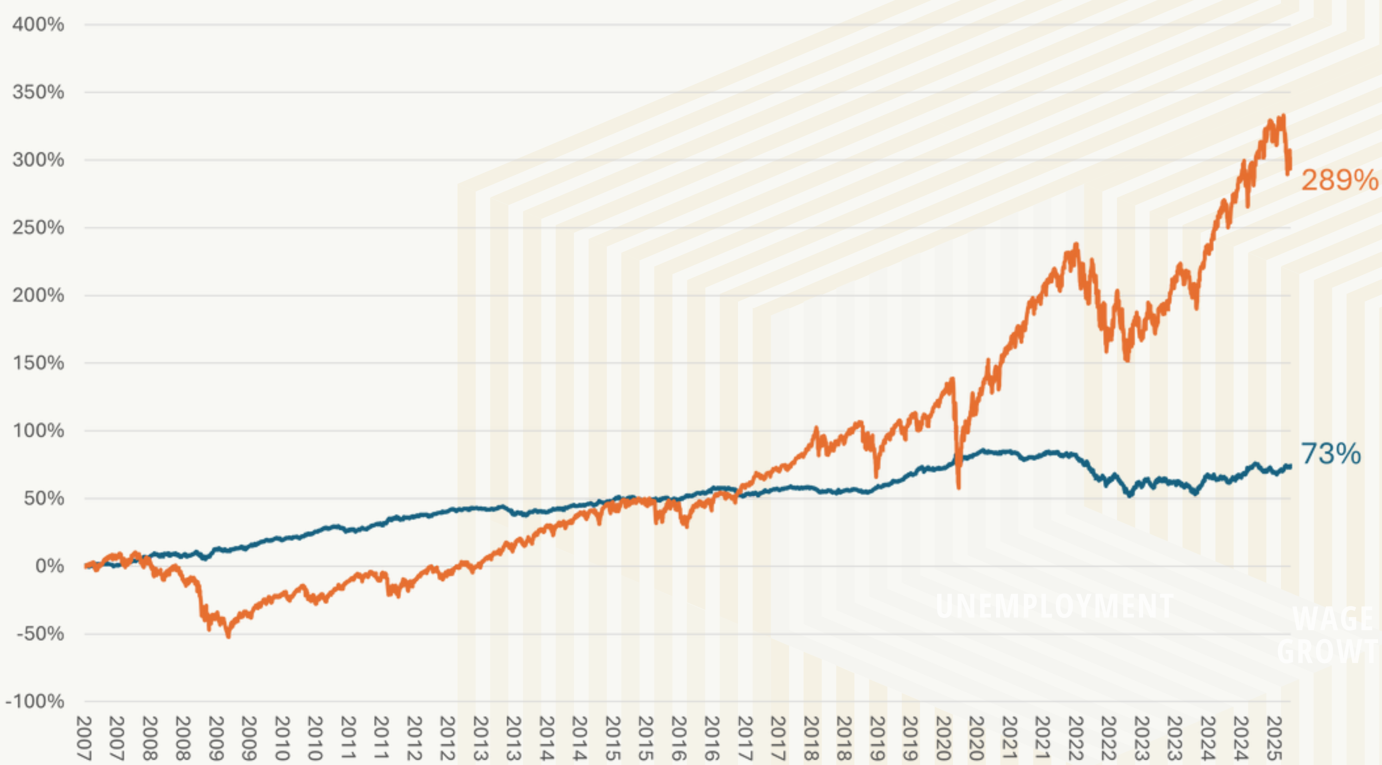
Increased uncertainty does not warrant a panic, but rather a revaluation of investment allocation. We have been reducing clients' exposure to equities, particularly high valuation equities, since early February. We will continue to reduce risk assets in the second quarter. We have increased investment in fixed income, high-dividend defensive stocks and even exposure to gold. In our equity portfolios, we have reduced allocations to technology and consumer discretionary stocks in favor of health care, consumer staples and domestically focused industries.

The U.S. economic fundamentals, employment, income, sales and corporate profitability appear intact for now but much of these metrics look backward and take time to reflect a changing outlook. The available economic data certainly does not reflect the likely impact of significant tariffs. As the possibility of a more uncertain outlook increases, we will continue to reduce equities. Particularly in equities that have had significant gains based on lofty future expectations. The U.S. economy is resilient. It may be that the dramatic change in international trade policy will have less of an impact than we anticipate. And it is possible that the Administration will change tack. However, based on our better understanding of the goals, nothing short of eliminating the significant foreign trade gap may be required to alter the Administration's course. Uncertainty has significantly increased, and we are reducing risk as a result. Preservation of capital is our primary objective.

We are reallocating investment to companies that have strong growth prospects with a low exposure to tariffs. This sounds good in theory, however if growth slows it will affect demand everywhere, even for companies with little exposure to tariffs. For the moment, cash is the best safe haven.

There will be a point where the price of the market will adequately discount the current economic uncertainty. We do not believe we are there yet. Usually when the outlook is truly bleak, it's time to get back into the market. We remain confident in the long-term growth of the American economy and that U.S. equity markets will resume upward trajectory, but we will wait for a little more clarity. Confidence is fragile.

»S&P 500 AND U.S. AGGREGATE BOND PERFORMANCE SINCE 2007



2025

BUILD YOUR WEALTH

To Fund Your Passions

GKV Capital Management is an independent investment advisory firm registered with the Securities and Exchange Commission since 1975. We provide portfolio management services for our clients which include individuals, families, charitable trusts, corporations and retirement plans. We are an independent, fee-only advisor. We do not receive commissions, and we do not sell any financial products. We have a fiduciary responsibility to put our clients' interest first.

Client accounts are separately managed and tailored to meet the specific needs, including risk tolerance, investment objectives, and tax consequences of each client. Client assets are held at an unaffiliated brokerage firm.

With extensive expertise in security analysis, we make direct investments on behalf of our clients buying individual securities. This eliminates costly mutual fund fees and increases the flexibility to manage volatility. We actively allocate capital to take advantage of investment opportunities altering exposure to individual companies, industry sectors, and asset classes in anticipation of the changing investment and economic environment.

We are transparent in all facets of our asset management practice and believe it is important for our clients to know what they own, why, what their performance is, and what they are paying in fees. We build comprehensive portfolios for our clients with a goal of reducing volatility and producing prudent growth.

We protect and build wealth at GKV Capital.

GKV CAPITAL

INDEPENDENT INVESTMENT ADVISORY

Southern California.

2555 Townsgate Rd., Suite 310
Westlake Village, CA 91361

Phone (805) 497-2616

Northern California.

1350 Treat Blvd., Suite 260
Walnut Creek, CA 94597

Phone (925) 627-8680

gkvcapital.com
greg@gkvcapital.com