

STRATEGIC OUTLOOK

Strategic Frontier Management

Q4 2025

The Audacious Reset

- *The Audacious Reset* of America First policies seek to restore foundational free market-oriented principles, global competitiveness, respect for private property, rule of law, equal opportunity, and pursuit of happiness to revive the American Dream consistent with values of Free-Market Capitalism.
- Transition to a new playbook will have positive real economic consequences. Economic, trade, fiscal aid, energy, health care, border security, national defense, and regulatory policies have shifted. These policies seek to bolster potential growth, global competitiveness, productivity, margins, job growth, and foreign investment, while lowering energy and material costs. Trade and fiscal deficits will decline.
- Keeping inflation in check will improve affordability for housing, energy, staples, health care (insurance, prescriptions) and even insurance with wage growth of improving prosperity. Spending cuts identified by DOGE targeted waste, fraud, corruption, and misappropriation, but should have little impact on non-government economic activity. It will reduce the fiscal deficit, and reduce government share of GDP.
- *Normalizing* inflation should average 3% CPI, which causes higher-for-longer interest rates. We still expect just two ¼% rate cuts this year (done), and another ½% reduction next year, consistent with our long-run policy interest rate or r^* of 3.5%. The Fed should continue winding down QE holdings since the U.S. needs no net monetary stimulus. Fed QE acquired bonds still need to decline by \$4 Trillion.
- Investors remain concerned about inflation and economic consequences of *The Audacious Reset*, but we think concerns are exaggerated. Uncertainty about the knock-on effects of tariffs and government spending cuts led to increased market volatility. We boosted our U.S. Potential Growth forecast from 1.8% to 2.5% a year ago, anticipating policy change.
- Numerous risks suggest both bonds and equities could struggle over the coming quarters. Equities are clearly overvalued, but U.S. earnings growth is still strong, and recession risk is low. Bonds are overvalued with flat to inverted yield curves, and limited further rate cuts approaching $r^*=3.5%$. U.S. inflation remains stubbornly high, hovering around 3%. Credit spreads are too tight as investors seem to ignore default risk. High fiscal deficits, reducing central bank holdings, private debt issuance, and struggling bond sentiment reduces demand with increasing supply that should steepen yield curves.
- Higher growth that increases income and profits results in greater tax revenues, which bring down fiscal deficits. Incentivized productivity drives lower labor costs and cost of production, thereby lowering inflation. Lower energy costs help too. We expect our *trade deficit* to narrow, which also boosts growth.
- We expect stronger productivity and potential growth with lower cost of commodities, basic resources and energy benefiting from deregulation. Free market capitalism incentivizes productivity and innovation, which drives greater potential growth that expands aggregate supply to meet increasing demand, thereby boosting income and profit, which increases tax revenues and reduces fiscal deficits. Supply-side economics is inherently disinflationary, driving lower prices, thereby bolstering long-term Affordability.
- *Return to Natural Order*: Higher interest rates, large fiscal deficits, weaker U.S. dollar, trade disruption, and geopolitical challenges have investors on edge. Normalizing valuations (S&P 500 \rightarrow 18X earnings), steeper yield curves, higher volatility are expected—favor value & small-cap tilts, non-US equity, but avoid Emerging Markets and long bonds. Cash and short duration credit are preferred, but avoid longer maturity bonds, and beware of rising default rate.
- *Affordability* became the touchstone for Millennials, coerced to believe Capitalism isn't working for them. It won't improve unless prices fall, also known as deflation—which nobody wants. We took disinflation for granted, until poor policies sparked inflation. Any notion Socialist or Progressive policies improve *Affordability* is an erroneous fantasy. Collective ownership of critical industries, land, and resources, while boosting government welfare and benefits, will instead increase inflation again. Raising taxes on the wealthy, their estates or wealth, and corporations to fund public health care, housing, basic income, or other such programs will reduce productivity and growth, stalling innovation, yet increases inequality.

Fast and Furious Policy Changes

Supply-side oriented growth policies seek to restore economic and financial stability, while reducing both our fiscal and trade deficits. These policies reform income taxes, spending, entitlements, regulatory burdens, trade, energy, banking, and health care policies, which pull America out of the ditch. Higher growth increases income and profits, which drive tax revenues. *America First* policies seek to improve government operating efficiency, reduce unnecessary regulation, secure our boarder, curtail lawlessness and crime, while bolstering national defense and homeland security.

Policies strive to improve health and welfare, reinforce freedom of speech and association. Increasing prosperity and restoring free market capitalist values are ascendant. Respecting basic rights of life, liberty, and pursuit happiness, which support equal opportunity for all and equal justice under rule of law, the valued *American Dream* is rejuvenated. Culture battles, privacy concerns, and citizen voting rights are being sorted out.

We will judge policy effectiveness based on certain key metrics improving, namely: Fiscal Deficit, Trade Deficit, Real Economic Growth (x-Government), Productivity, CPI Inflation, Employment, Real Wages, Revenue Growth and Earnings, as well as Profit Margins. The stock market will benefit if earnings deliver. These milestones can be achieved by reinforcing global competitiveness, re-shoring manufacturing and services, reducing energy costs, while encouraging foreign investment. This ambitious Agenda required *Fast and Furious* Re-engineering of Government within Agencies, yet many will be uncomfortable with policy-led change, instead favoring the flailing status quo.

Economic Forecasts	2021	2022	2023	2024	2025e	2026e	2027e
GDP Growth (Y/Y Real)	6.1	1.4	3.3	2.6	2.8	3.0	3.0
S&P500 Op Earnings Gr	49.0	4.8	1.5	9.7	7.6	9.6	10.5
CPI Inflation (Y/Y)	7.2	6.4	3.3	2.9	3.0	3.0	3.0
Unemployment	3.9	3.5	3.7	4.3	4.5	4.6	4.8
Fiscal Deficit (vs. GDP%)	-7.9	-5.3	-6.7	-7.1	-6.0	-4.5	-3.5
Fed Funds Target ¹	0.25	4.50	5.50	4.50	4.00	3.50	3.50
10y Treasury Notes	1.50	3.83	3.87	4.57	4.50	4.80	5.00
S&P 500 Target	4766	3840	4770	5882	6500	6900	7300
S&P 500 Total Return %	28.7	-18.1	26.3	25.0	11.8	7.4	7.1

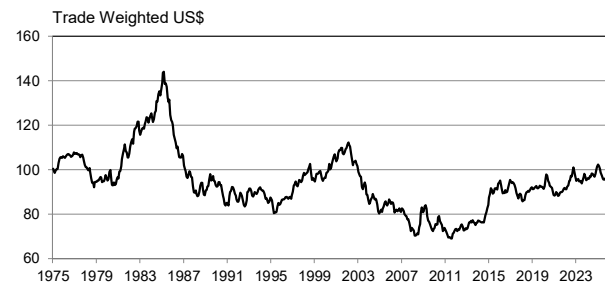
Source: Strategic Frontier Management (Year-end or Y/Y change)

1. Target denotes top of published ¼% policy target range

The Administration is changing the way government works, improving efficiency and effectiveness to run more like a business with defined measurable objectives. Re-engineering government for greater efficiency began by establishing the effective Department of Government Efficiency—this effort has now shifted toward working within agencies across government. Agencies have a lot of control, and Executive Orders provided legal basis and direction for what has been achieved. Cutting fraud, waste, redundancy, and misappropriation of government entitlements, subsidies, and benefits shouldn't cause a recession as long as lawful payments remain intact.

Promoting fiscal balance requires stimulating real growth with economic and trade reform, encouraging global competitiveness, innovation, energy independence, and reducing foreign strategic dependency of supply chains. Improving fiscal balance requires rethinking priorities and assumptions about government spending and taxes. FY 2025 Budget Reconciliation Act (H.R. 1) made permanent expiring tax provisions from the *2017 Tax Cuts and Jobs Act*. It included *No Tax on Tips...or Overtime*. Premium Tax Credits (PTC), enhancing Obamacare subsidies since the Global Pandemic, expire at the end of 2025. Suspending PTC was the primary sticking point for the recent Government shutdown.

Uncertainty about potential knock-on effects of tariffs and government spending cuts led to increased market volatility. CPI inflation declined toward 3%, but the US trade-weighted dollar declined 5.8% so far this year. Disinflationary forces also waned with the maturing *Fourth Industrial Revolution*. A strong U.S. dollar over the last 14 years kept import inflation in check, even if recent weakness was observed. Increasing use of AI should boost productivity, but we expect inflation to be resilient with restored pricing power and wage demands based on inflation expectations.



Concerns about potential inflationary effects of tariffs are exaggerated, and should be transitional before realizing a potential growth boost from improving trade balances. Rationalizing overly burdensome regulation and limiting trade barriers for U.S. exports can boost global competitiveness, thus lift profit margins and potential growth. Understanding the give-and-take in growth and inflation is challenging with many moving parts. We'll need to become less reliant on strategic foreign produced basic resources and commodities.

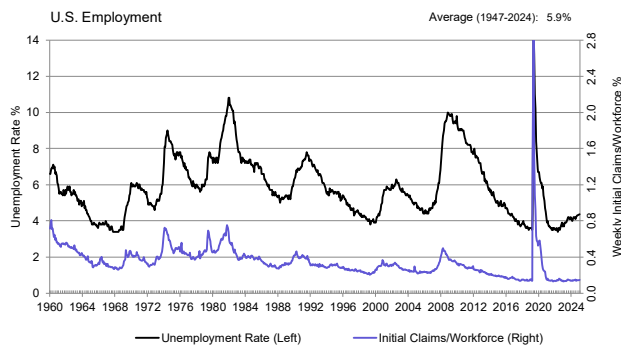
President Trump seeks to secure our border, strengthen homeland security and national defense, while limiting major crime, illegal immigration, gang activities (drug and human trafficking, theft, extortion, etc.). While tempting to consider each policy initiative in isolation, the full scope of the agenda must be assessed with many complementary parts. While investors still struggle with tariff effects, it is exhausting to keep track of the policy changes, initiatives and interactions in play. With a Republican majority in Congress, expect new policies to be backed-up by legislation, starting with U.S. Budget Reconciliation. We've observed President Trump isn't restrained by traditional rules of limited political capital,

but this should not be taken for granted either. The downside of a *Fast and Furious* effort is that policy decisions may extend beyond core values and guiding principles of *America First*. We'd concede that it is difficult for the President to maintain control over every policy decision when proceeding *Fast and Furiously*.

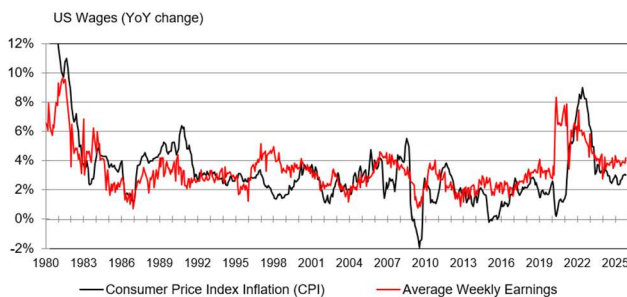
Economic Outlook

In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could. — Rudi Dornbusch

We boosted our US Potential Growth forecast from 1.8% to 2.5% a year ago. CPI inflation tumbled toward 3.0% by reducing unnecessary regulatory burdens, increasing energy supply, and driving productivity. Likelihood of U.S. recession is low, but the Eurozone, Japan, and China continue to struggle economically. Normalizing but still low unemployment of 4.4% (Sept.) suggests full employment is about 5%, but certain skills remain in short supply. Unemployment bottomed out at 3.5% in Spring of 2020, but soared during the Global Pandemic, and peaked at 14.8% in April 2020. Unemployment tumbled to 6.4% as President Biden took office, and bottomed out in Spring 2023 at 3.4%, reflecting the post-pandemic rebound.



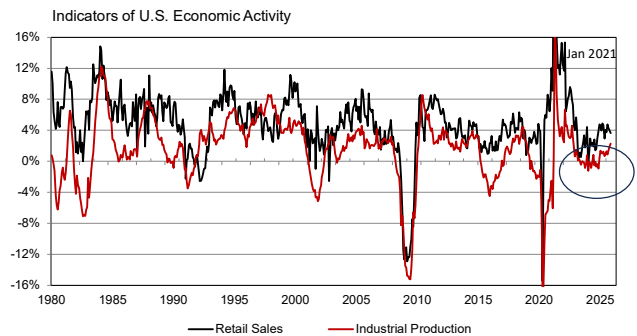
We grew accustomed to 4.0-4.5% unemployment, below the 5.9% average of the last 60 years. Generative AI has reduced employment confidence, and increasing layoffs translates into anxiety seeking raises or job security. Also, the notion that wage growth can outpace inflation for an extended period is sadly mistaken, but when wage growth is higher, expect inflation to be resilient.



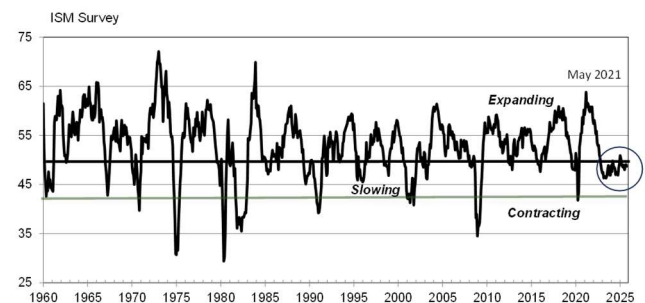
White collar jobs that involve systematic, quantitative, or data-centric work will be increasingly scrutinized, including accounting, customer service, administrative

clerks, paralegals, and even software engineering. Blue collar jobs were impacted by robotic and machine automation for some time. The nature of work is changing rapidly. There is a growing mismatch in available workers with the skills needed, and many will need to be retrained. Not enough plumbers, electricians, carpenters, mechanics, drivers, and other trades exist.

Consequences of supply-side policies driving a *New Dawn in America* should improve productivity, potential growth, profit margins, global competitiveness, fiscal and trade deficits, and margins with lower inflation. U.S. Recession risk is lower now, and we expect reversion to a more historically consistent economic regime, including higher inflation and unemployment compared to the last decade.



Consumption and industrial production are trending upward, as is the ISM Survey. The ISM Survey is one of the most reliable indicators of economic activity with a long unrevised history, and which is available for larger countries of interest, including China. GDP resilience suggests the U.S. economy skirted recession during 2021-2024, but actually observed disappointing real growth in weak retail sales, industrial production, construction, business sales, and even in ISM.



The recovery from the Global Pandemic combined with government spending stimulus, loose monetary policy (QE, forward guidance), and low interest rates, which pulled forward consumption, should have produced a much stronger growth cycle than we observed, indicating that policy was taking away much of the natural recovery. Disappointing consumer and business sentiment did reflect non-government economic weakness, suggesting that focus on just GDP can be misleading.

Revenue and corporate earnings growth have been remarkable, and seems to be driving record highs in the stock market. The S&P 500 returned 8.1% in Q3, boosting year-to-date return to 14.8% on rising earnings growth estimates. We remain concerned whether stock market optimism is extended, and if strong earnings growth can be sustained as consensus implies. We increased our 2025-2026 S&P 500 earnings forecasts, but remain below consensus.

We are nearing the long-run equilibrium in CPI inflation (3% inflation) and policy interest rates (3.5%). Expectations that interest rates can decline much more than 1/2% are inconsistent with economic history and theory without a slowdown—the U.S. economy seems to be accelerating, and the risk of recession receded due to reversing tragic misguided policies since 2022. There is no imminent need to easy monetary policy or lower rates, but the desire of political and corporate leaders to lower interest rates is insatiable. Interest rates will be higher and yield curves will steepen reflecting normalized inflation conditions and rationalization of credit spreads.

Still high fiscal deficits, reducing central bank bond holdings (QT), private debt issuance, and interest on debt require increased and longer maturity bond issuance that should push up 10-yr Treasury yields toward 5%. U.S. Treasury should take advantage of a flatter yield curve to extend issuance maturity, after Secretary Yellen recklessly drove lower average bond maturity, thereby flattening the yield curve. Secretary Bessent should not make the same mistake.

We expect to revert to normal financial conditions based on historically observed secular risk premia, including rational inflation risk premium and term risk premium. These are reflected in the yield curve and appropriate default risk premium in credit spreads. Rough water lies ahead for longer maturity bonds, high yield, and private debt. Most alternatives are exposed to equity and interest rate market factors. A reckoning for leveraged unprofitable companies relying on low interest rates is expected. Recent loan defaults and claimed underwriting misrepresentations suggest credit issues may be more widespread than assumed—Wall Street knows *there is never just one cockroach*.

DOGE recovered more than \$214 B in savings. Some was annual recurring, such as contract or lease cancellations or renegotiations, grant cancellations, and program changes. Asset sales, eliminating fraud, waste, redundancy and improper payments, regulatory savings, and workforce reductions reduce spending, and thus also increase interest savings. A \$9.4 B Recission Package (H.R. 4) included significant misguided State Department foreign aid and other unnecessary programs further reducing the fiscal deficit. Cleaning up the mess began with DOGE, which rooted out waste, fraud and abuse of spending programs to tackling the bureaucracy of agencies run amok. Agencies can now refocus on their primary mission and much needed deregulation.

Efficiency gains reducing redundancy and unnecessary workers can help drive the fiscal deficit toward 3%. We expect limited, but transitory, inflation due to tariffs, and energy prices declined significantly. Concern about policy-induced tariff-led inflation and limiting fiscal spending is overblown with incentivized productivity, potential growth. Trade reforms target unfair trade barriers (tariffs, import restrictions) imposed on U.S. imports, thereby boosting net exports and global competitiveness, thus U.S. potential growth.

The impact of US trade tariffs on imports have had far less impact on inflation or growth than investors feared. As tariffs are imposed, the balance of trade can't remain constant—foreign importers to the U.S. absorb some of this difference in their margin. This can be particularly problematic for China, which subsidizes its state-owned enterprises. Years of significant trade deficits drove U.S. manufacturing to increase automation and productivity. Imposing *reciprocal tariffs* was designed to encourage trading partners to reduce their trade barriers (import restrictions) and tariffs imposed on U.S. exporters.

New bilateral trade deals will accelerate re-shoring and reduce dependence on foreign strategic resources and materials resetting decades of failed trade policies. Consumers have observed little inflation impact from import tariffs, so far. but trade is not a zero-sum game with back-and-forth of comparative advantages—tariffs and trade barriers imposed on US imports were reduced, thereby increasing global competitiveness. Over \$90B in tariff duties were collected to date, including \$27B in June. Rising domestic production is driving growth and reducing our trade deficit, which increases potential growth and profits, which drive higher tax revenues.

Alongside trade negotiations, NATO partners agreed to more than double their defense spending to 5% of GDP—most European partners only recently achieved 2%, and Canada averaged 1-1.5% for the last decade, but it too committed to the 5% target. America produces much of what NATO partners need, incorporating advanced technologies unparalleled anywhere. European Defense contractors will benefit from increased sales, but years of underinvestment struggling to reach 2% of GDP means that European contractors are lagging behind, and need to catch up.

Consider that the *Threat* has Fifth Generation fighters, and now is developing Sixth Gen Fighters. Europe's best Fourth Gen Fighters, designed for Cold War threats (Eurofighter Typhoon, Saab Gripen) are far less capable than the Stealth ATF F-22 and JSF F-35 A/B/C. Europe hopes to leapfrog to a 6th-Gen platform, but it won't be available until at least 2035-2040, if ever. Failure to produce a 5th-Gen Fighter will make it difficult to catch up. The U.S. NGAD 6th Gen Program leverages vital 5th-Gen experience developing the F-22 and F-35. Thus, NATO countries are compelled to buy the F-35 to achieve interoperability. Canada and Spain are exploring alternatives after committing to the F-35 program, but it

is too late. F-35 Block 4 upgrades provide a significant performance boost over current specifications, whereas a proposed F-35 Gen-5+ upgrade unlocks Lockheed's F-47 NGAD prototype capabilities spanning 80% of the 5/6-Gen gap at a fraction of the NGAD cost.

To boost NATO defense spending to 5% of GDP will require many countries to more than double their spending on advanced weapon systems, including fighters, bombers, ships, tanks, missiles, C3/radar, cybersecurity, etc. U.S. weapon system advanced technology for export suggests American Defense contractors are well positioned to benefit most from increasing NATO spending, and increasing U.S. imports. Certain companies are better positioned than others.

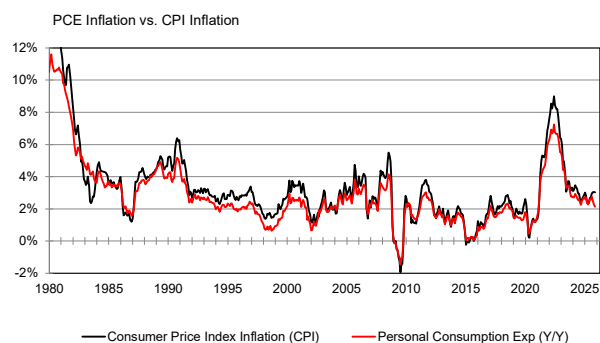
Inflation Expectations and Normalization

U.S. CPI inflation averaged 3.9% over the last 60 years, yet over two decades of disinflation and a couple crises (i.e., Financial Crisis, Global Pandemic), inflation averaged just 2.5%. This is not likely repeatable. U.S. CPI inflation should normalize at 2.8-3.0%. Personal Consumption Expenditures (PCE) inflation, is typically about ½% lower than CPI. Periods of higher inflation, such as 2021-2023, are typically followed by subsequent waves of inflation over several years. Higher inflation expectations are hard to curtail once unleashed with increased pricing power and further labor cost increases. Inflation tends to revert to its long-run average.

Adopting PCE inflation, as the Fed did in Jan. 2012, can't change the inherent historical relationship of inflation risk premiums (yield - inflation rate) rooted in CPI inflation. CPI has many advantages, including a century long record for comparison, whereas PCE has been relevant for just over a decade. CPI is still used to adjust cost-of-living and contract pricing changes, while comparable globally based on a similar methodology. Why focus on PCE if only to drive down the inflation term risk premium? The Fed lost credibility and PCE is a *red herring*.

We remain concerned about the longer-run forecasts in the SEP, specifically, inflation. Historically reliable CPI is a better econometric statistic than PCE, and is still a benchmark for cost-of-living and contract price adjustments. Considering the correlation between these inflation measures, for what purpose should this pursuit continue? It's irrational to believe you can change real rate expectations this way,

We expect higher inflation than the Federal Reserve's implied target given stickier forces of normalized inflation expectations, such as transportation, labor, and housing costs. Second order effects of cost-of-living or labor costs and contract adjustments compound this trend. We expect the current inflation and interest rate regime will be more consistent with 1981-2000, than 2000-2024. We can't be fooled into believing PCE inflation can substitute as a new inflation measure without consequence, and ignore a century of real interest rate history vs. CPI.



The significant policy mistake was adopting the PCE in February 2000, although the century-old CPI Index remains the primary and relevant U.S. inflation measure (i.e., contracts, cost of living, etc.) globally. The SEP and its dot-plot consensus introduced an implicit 2% inflation target in its long-run forecasts. However, the Fed's Congressional mandate remains: maximize employment and maintain stable prices. This suggests the only real purpose of PCE displacing CPI is to try to reduce the inflation risk premium to reset the yield curve ½% lower. Interestingly, the Bank of England recently announced the RPI is no longer its primary inflation measure due to technical deficiencies, and is adopting CPI.

Unleashed inflation expectations drive higher-for-longer interest rates, and steeper global yield curves. Higher inflation expectations are reflected in labor, basic material, and transportation costs are now more difficult to contain. Wage increases will persist, as will unleashed pricing power and contractual price indexing. Household formation continues to push home prices higher with a shortage of housing keeping inventory low. Housing is key to affordability, which has become a key issue for Millennials (births 1981-2000) as the average age of first home purchase drifted up toward 40 yrs old.

Labor cost inflation will be slow to recede as workers, adapt to maintain purchasing power, particularly in union contract negotiations. Pricing power was restored as consumers no longer expect relatively constant prices, so inflation expectations will be difficult to contain. Sticky inflation will limit retreat to the Fed's implicit target—we expect inflation to settle higher based on the trends of various key inflation factors.

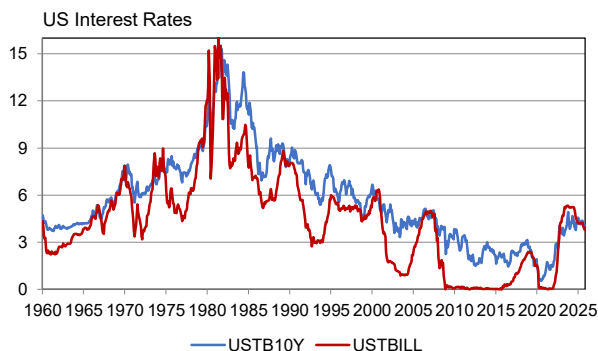
Benefit costs continue to exceed inflation increases as employer health insurance costs soared in excess of inflation by design of Obamacare (ACA), This necessitated higher premiums for employers and direct buyers of health insurance. Many insurers left California due to specific state program requirements and ACA rules, which reduced choice and competition. Obamacare is a failed experiment, and now is the time to revisit overhauling our healthcare system to make it more affordable for individuals and employers, which typically believe it is a critical pre-tax employee benefit.

Since 1999, health premiums for employer-sponsored plans increased 342%. During 2018-2023, small business insurance premiums rose 33%, and in 2024, increased 8.4%. Health premiums rose another 6.1% in 2025, and published increases for 2026 will average 6.5% for employee plans. Supplemental *Premium Tax Credit*, implemented during the pandemic, masked rising health insurance costs. It is another example of how government controls undermine free market competition.

Stimulative monetary and fiscal policies bring forward demand and increase lending, which reinforces spending, thus cause inflation without increasing supply. Consider the effect on housing prices when mortgage rates plunged during the Pandemic, or the U.S. Treasury sends checks (disposable income) to taxpayers.

Interest Rates

We expect higher-for-longer interest rates, above the Fed's implied long-run target of 2.9% given our secular average forecast of 3% CPI inflation. Yield curve normalization, assuming a term risk premium (10 Year – 3 Month) of 1.2-1.5%, could overshoot with higher yields and greater yield volatility, realizing negative real bond returns. U.S. Treasury should favor longer maturity issuance with a flat yield curve. Treasury seems to be shifting toward issuing shorter maturities—the same terrible mistake that Secretary Yellen made in not taking advantage of low bond yields to issue more long bonds.



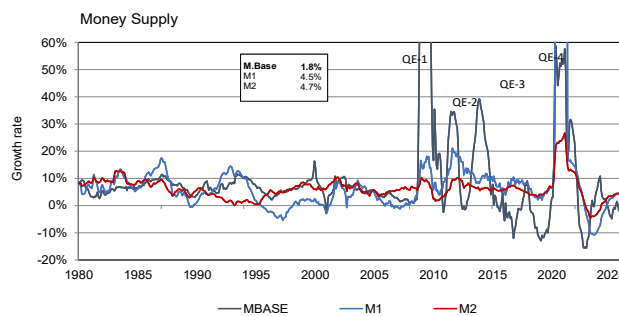
Real bond returns should continue to disappoint for the foreseeable future, even after dreadful performance of the last decade. U.S. Bonds remain a concern as inflation still hovers around 3% and the yield curve slope is flat to inverted. We think there is little room to cut interest rates much further given our longer-term Fed Funds average rate of 3½%, which is higher than historically inconsistent 2.9% in the Fed's SEP forecast. If CPI Inflation averages 3%, as we expect, then the 10-year Treasury yield should average 5-5½%, not 4.1-4.4% recently observed. Yield curves should steepen by over 1%. Some conclude that 2.5% policy rates appear normal, but consider 70 years of interest rate history--averaging rates since the Financial Crisis is misleading.

The interest burden of higher bond yields compounds federal debt with annual interest exceeding \$1.2 trillion.

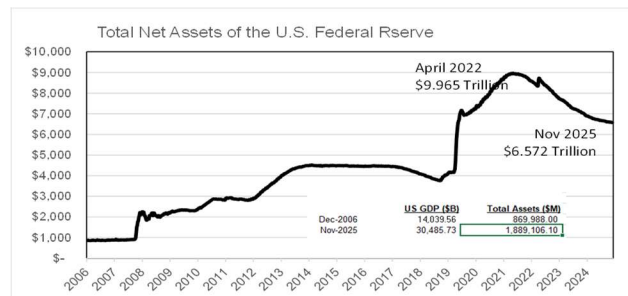
High duration and credit risk exists for long maturity, private unrated, and leveraged strategies, thus we recommend continuing to underweight bonds. Rising inflation expectations weren't transitory in 2022, yet left unchecked drove higher inflation expectations.

After the 40-year bond decline in bond yields, few traders remember higher yields of 1970-1990. What most do remember is steady decline of interest rates over several economic and financial crises, and extended disinflation driven by the *Fourth Industrial Revolution*. Experimental central bank policies and misguided fiscal policies continue to sow economic havoc—other central banks followed our example, and compounded these errors. Flawed monetary policies emerged during the Financial Crisis, and continued through the Global Pandemic.

Money growth volatility illustrates just how destabilizing central bank policy has been for awhile. Money growth shouldn't exceed the rate of nominal growth, nor should slow too much risking a liquidity crunch or credit crisis that causes economic stagnation, recession, or deflation. Repeated QE without reducing holdings in between meant we'd eventually need to suffer through low or negative money growth. How can we say the Fed is tempering volatility rather than creating more chaos?



Adverse financial and economic consequences of *Explicit Moral Hazard* in the Fed's *Too-Low-Too-Long* policy required rate hikes and Quantitative Tightening (QT), coinciding with massive excessive fiscal stimulus that fanned smoldering embers of inflation during the post-Pandemic rebound. Misplaced belief inflation was transitory implied the Fed could maintain 0% interest rates and retain excessive QE holdings. Inflation was a consequence of too much government stimulus, which failed to boost productivity, and loose monetary policy.



Source: Federal Reserve, FRED

We have only begun unwinding excess central bank bond holdings accumulated since 2008. The Fed should be targeting \$2 Trillion, by our estimate, rather than holding \$6.57 trillion. Normalizing \$4 trillion in excess Treasury holdings requires reissuing trillions in bonds. Adding back 12% of Treasury debt supply over a couple years would steepen the yield curve considerably.

The Fed used its discretion to peg the federal funds rate at 0% for too long after the Pandemic. With inflation rising during 2021, the Fed allowed real interest rates to fall below 0% because it believed inflation was *transitory*. Given monetary and fiscal stimulus drove classic demand-pull + cost-push + quantity theory of money, how could the FOMC assume it was transitory? They needed to start hiking rates and selling Treasury holding sooner. Many flawed monetary policy decisions created a difficult predicament, complicated by the forward guidance trap and a bloated balance sheet. Bond holdings are causing further losses that taxpayers must subsidize. Is this why the Fed is now suspending QT?

Misguided U.S. monetary policies, since the Financial Crisis and through the Global Pandemic unleashed higher inflation expectations alongside excessive fiscal spending, which normalized higher inflation and interest rates. Higher inflation expectations boost cost-of-living increases, driving sticky inflationary forces on labor costs, housing, health care, and other services. We still expect just two ¼% rate cuts this year, and another ½% reduction net year, approaching our long-run policy interest rate or r^* of 3.5%. The Fed should continue to wind down its QE holdings as it cuts rates, as the U.S. needs no net monetary stimulus at this time.

Over 40 years, the Fed Funds rate averaged 4.2% vs. 3.2% CPI inflation, implying a short-term inflation risk premium of 1%. It is naive to believe swapping out CPI for PCE and adding 1% to that justifies the current $r^* = 3.04\%$ Fed Funds rate forecast. The risk premium should persist at 1%. Thus, the 3.0% interest rate SEP forecast below is inconsistent with 3% CPI Inflation we expect. If inflation is 3%, then r^* could be as high as 4%, or more consistent with its 40-year average than 3.5% we expect.

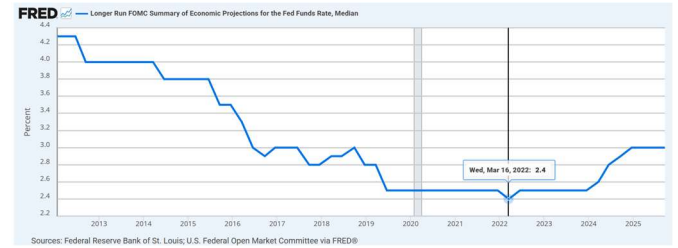
Median Forecast									LongRun Forecast	
U.S. Fed %	2021	2022	2023	2024	2025e	2026e	2027e	2028	Fed	SFM
GDP	5.90	0.50	2.60	2.50	1.60	1.80	1.90	1.80	1.80	2.20
U Rate	4.80	3.70	3.80	4.20	4.50	4.40	4.30	4.20	4.20	4.80
PCE	4.20	5.80	2.30	2.40	3.00	2.60	2.10	2.00	2.00	2.50
Core PCE	3.70	4.80	2.60	2.80	3.10	2.60	2.10	2.00	2.00	2.50
Implied CPI	3.50	6.10	2.80	2.90	3.50	3.10	2.60	2.50	2.50	3.00
Federal Funds Avg.	0.13	4.38	5.38	4.38	3.81	3.30	3.15	3.13	3.04	3.50

Interest Rates	2021	2022	2023	2024	2025e	2026e	2027e	2028	Longer Run
FOMC Avg.	0.13%	4.38%	5.38%	4.38%	3.81%	3.30%	3.15%	3.13%	3.04%
Forecast ¹	0.25%	4.50%	5.50%	4.50%	4.00%	3.50%	3.50%	3.50%	3.50%
Rate Change	0.00%	4.25%	1.00%	-1.00%	-0.50%	-0.50%	0.00%	0.00%	0.00%

Source: Strategic Frontier Management (Sept 17, 2025. Y/Y change)
 1. Fed Target rate denotes top of published ¼% policy target range

When the Fed's Survey of Economic Projections (SEP) incorporated the dot-plot of FOMC rate forecasts in 2012, the indicated long-run interest rate was 4.3%, but it declined steadily to the low of 2.4% in mid-2019. The long-run average interest rate (r^*) has since reverted

back toward 3.04% as of September, and on its way, we believe, toward a more appropriate 3.5% r^* target.



This chart is indicative of why we think misleading Fed forecasts that imply *Forward Guidance* are such a bad idea. This chart of long-Run equilibrium rates or r^* forecast should instead be a relatively straight line. It suggests FOMC members lost their economic bearings with a current r^* range of 2.63% – 3.87%, exceeding 1.2%, and the widest range we ever observed. Finally, why continue to quote the Fed Funds target as a ¼% range, initiated to deal with 0% lower bound? The SEP should return to simple ¼% target increments, as before.

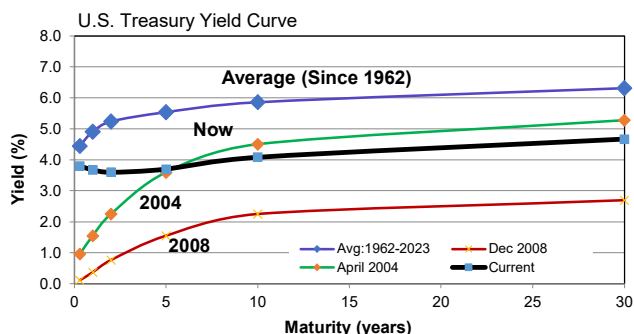
Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



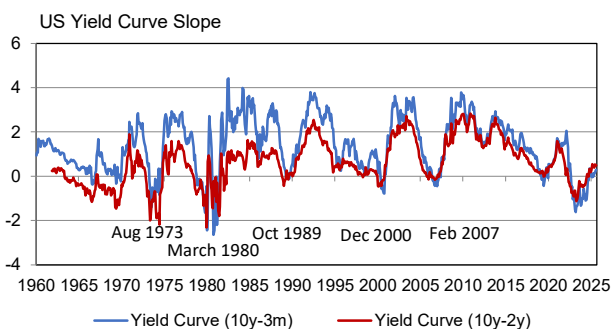
Source: Federal Reserve, FOMC SEP: Interest Rates. Sep 2025

For interest rate changes to have maximum effect requires *surprise*—that was taken away to increase “transparency”. The Fed must be coy about its intentions to be effective when it needs to be—it should suspend publishing the SEP and engaging in forward guidance. The SEP is not fit for general public consumption. and is an indictment of weak FOMC leadership.

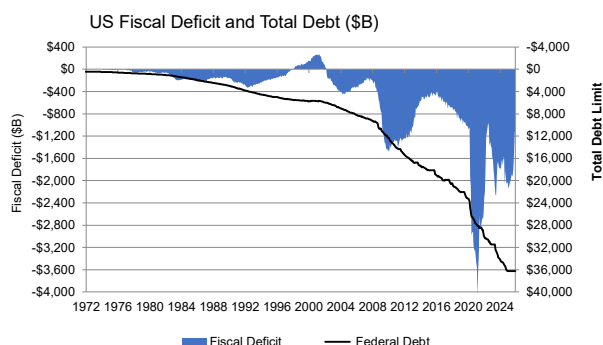
Years of manipulating interest rates and yield curves for an extended period induced *explicit moral hazard* that is now problematic—investors, borrowers, and businesses expect flatter yield curves and lower rates. U.S. Treasury must issue longer maturity bonds to extend its outstanding maturity. Terrible returns over the last decade should compel investors to favor shorter maturities, and reducing investor demand. Increasing supply with a still significant fiscal deficit and Quantitative Tightening should also steepen the yield curve.



On March 16, 2022, the Fed began to raise interest rates, which peaked at 5¼%. The US 10-year Treasury rose less from 1.85% to 4.57% over that period, and the yield curve remained inverted for an extended period, leading economists to believe a recession was imminent. The economy did muddle along, but real economic activity was slower than GDP suggested. Given all the stimulus, it was disappointing. It is unusual for the yield curve have a slope (10yr – 3mo yield) of < 1%. Real growth of 3% should drive a yield curve slope of ~1.5%.



U.S. debt exceeds \$36 trillion and is compounding faster with higher interest rates, spending \$1.2 trillion on interest in FY 2024, exceeding 4% of GDP. The fiscal deficit/GDP of \$2 trillion requires increased Treasury issuance, as private debt issuance is soaring too. U.S. Treasury needs to increase issuance maturity to extend outstanding debt, but to do otherwise is imprudent with an inverted yield curve and average maturity of about 6 years. Treasury Sec. Yellen favored issuing shorter maturities despite higher yield. This increased financing costs, interest rate volatility, and refinancing risk.



The Federal Reserve relies on regulatory fees and interest from its holdings to support its operating expense. Excess earnings are sent to the U.S. Treasury, as are losses, assumed by taxpayers. Net income was negative since September 2022 when expenses and interest on reserve balances exceeded revenues from interest on holdings and collected fees, net of bond losses. Government bonds acquired during the Financial Crisis and Global Pandemic were bought when interest rates were very low. Now bond yields have risen.

Federal Reserve securities holdings are not marked-to-market. Only when bonds mature or are sold are losses realized. Greater supply and loss of investor confidence will precipitate further losses, so avoiding this spiral may be why the Fed is suspending QT, at the same time U.S. Treasury announced it was favoring shorter maturity debt? Both actions manipulate the yield curve by reducing long bond supply.

The Fed began to pay interest on banking reserves in Oct 2008 during the Financial Crisis. We have argued it is unnecessary to continue to do so. This discourages lending when a bank can earn 4% risk-free on deposits held by the Fed. So, why do banks offer such measly deposit interest given this situation. Competition for deposits should support higher CD rates, even if it reduces net interest margin for Fed excess reserves

Foreign US Treasury holders have reduced their share of outstanding U.S. debt to 22.4% from 33% in 2015. Japan and China remain the largest foreign holders of US Treasuries, although China's holdings peaked in 2015 and Japan peaked in 2021. Reduced foreign holdings reduces demand, forcing long yields higher. Non-US government bonds persistently underperformed U.S. Treasuries for all periods out to 30 years. Is diversification enough to ignore such losing persistence?

Erosion of Central Bank independence

Waning confidence and independence of Central Banks appear to be a consequence of failed experimental policies and poor regulatory oversight since the 2008 Financial Crisis, contributing to the 2023 banking failures of *Silicon Valley Bank*, *Signature Bank*, *First Republic*, *Citizens Bank*, and *Republic Bank*. Repeated banking and systemic financial concerns with increased political entanglements, misguided forecasts, weak FOMC leadership, and poor communication undermined confidence in and respect for the Federal Reserve. Credibility might have been sustained by focusing more on the Congressional charter of the *Federal Reserve Act* and its bank regulatory role, rather than worrying about novel nonpecuniary or other intangible risks. Since Chairman Greenspan exited, another pragmatic and respected FOMC Chair has failed to emerge.

Recently Chairman Powell acknowledged that the Fed's pandemic-era policies, including purchase of mortgage-backed securities (MBS), depressed longer-term yields and contributed to higher housing prices—exacerbating

Affordability. With the benefit of hindsight, asset purchases may have "gone too far", for too long.

We discussed potential for *explicit moral hazard* of *Forward Guidance*, (inc., Fed's SEP, dot-plot forecasts, directed comments, etc.) to *Quantitative Easing*, and holding interest rates too-low-for-too-long, near the 0%-bound for an extend period. We warned about unintended adverse consequences experimenting with novel and misguided monetary theories. Poorly managed rule-making, miscommunication, and policy execution is also a question of leadership.

Once boxed in by the 0% lower bound, central banks, sought to flatten the yield curve slope, otherwise set by the market. Persistence of flat to inverted yield curves should be more concerning, Forward guidance and repeated QE drove lower bond yields and tighter credit spreads (default risk), which also reinforced asset speculation and leverage. The flat to inverted yield curve is no longer considered abnormal. Pulled forward demand limits future ability to manage a crisis. A yield curve should be upward sloped because investors demand higher yield to lend money over longer periods to compensate for risk of inflation or market uncertainty.

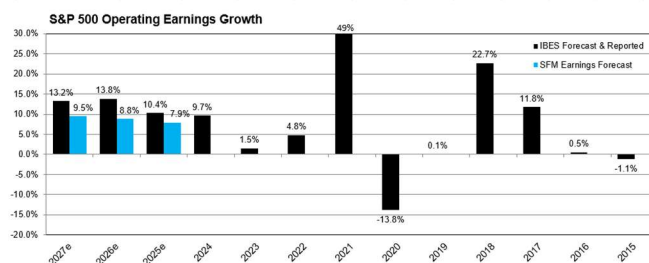
Even an independent Federal Reserve can trip over political influence—we caution the Administration from meddling in monetary policy. President Trump's criticism and attempt to remove Chair Jerome Powell further undermines independence and marginalizes credibility. President Trump nominated Jerome Powell as the Chair in 2017 to replace Janet Yellen. Among the candidates, Powell was the least qualified, in our opinion.

The Executive Branch should never direct monetary policy, although many Administrations sought to influence monetary policy, including the level of interest rates. Installing Stephen Miran, simply to nudge policy interest rates lower, was as bad a choice as it was for President Trump to nominate Jerome Powell as Chairman of the Federal Reserve, who was equally ill-prepared. President Trump will soon have an opportunity to pick another Chair for the FOMC. We hope Kevin Warsh, Greg Mankiw, Kevin Hassert, or Chris Waller will be among the leading candidates to be Chairman.

Earnings

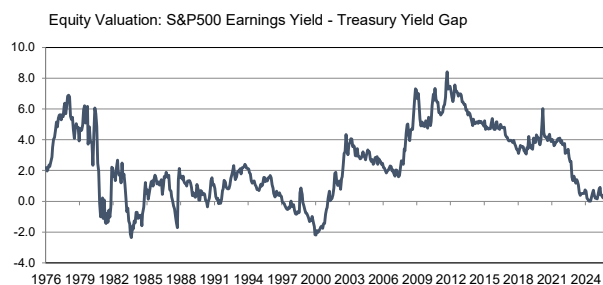
More realistic long-term earnings growth of 5-7% may be challenging for stretched valuations. We expect 8.6% earnings growth in 2025 vs. consensus of 12.6% as still lingering inflation will impact costs of goods sold, thus margins. The S&P 500 will still be overvalued, and could be subject to a correction if earnings disappoint.

Operating Earnings	2027e	2026e	2025e	2024	2023	2022	2021
IBES Forecast & Report	13.2%	13.8%	10.4%	9.7%	1.5%	4.8%	49.0%
SFM Earnings Forecast	9.5%	8.8%	7.9%				
SFM S&P500 Target	7300	6900	6500	5882	4770	3840	4766
Index Return (no Div)	5.8%	6.2%	10.5%	23.3%	24.2%	-19.4%	26.9%
Dividend Yield %	1.33	1.28	1.25	1.28	1.47	1.75	1.29
Total Return	7.1%	7.4%	11.8%	25.0%	26.3%	-18.1%	28.7%
S&P 500 @18x SFM TE	5616	5130	4716	4369	3984	3926	3746
S&P 500 P/F12 (SFM)	19.8	22.1	22.8	22.4	19.7	17.3	21.9



Source: LSEG I/B/E/S vs. Strategic Frontier Management Estimates

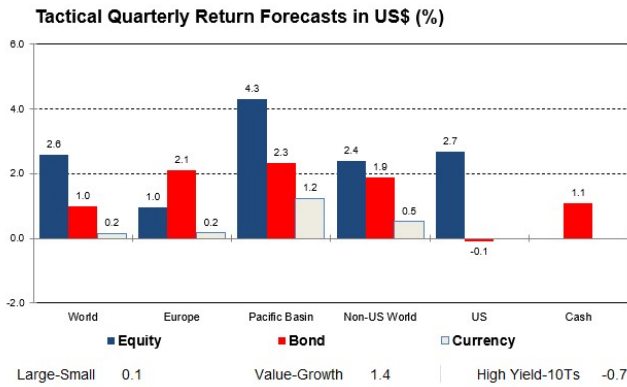
Valuations should be consistent with slower earnings growth expected. The U.S. equity market remains overvalued, particularly large-cap and growth, and will struggle to grow into its current valuation multiple: S&P 500 > 29x trailing earnings or 22x forward estimates. Rising equity prices far exceeded earnings growth since Q4 2023, and. S&P 500 valuations are now the most extreme since 2001. However, small cap earnings growth is rising rapidly and valuations relative to large are exceptional. We expect Small-cap, Value, and developed non-U.S. stock markets will outperform.



Global Tactical Asset Allocation Strategy

The key question for equities—can sufficient earnings growth restore favorable valuations or will a market correction be required. The equity market may be able to muddle along for a few years with subpar returns, but it is more likely equities will need to correct—and, if so, corrections tend to overshoot creating new investment opportunities. Relative market relationships are behaving more like 1998-2000 (Dot.com era) than any time since with overvaluation and volatility of Large-cap Growth. We would not be surprised to see a 10% correction, but the AI-driven speculation does have remarkable real earnings growth behind it, for now. Thus, a credit crunch induced debt crisis is more likely than a bubble-bursting equity crash exceeding 20%.

Global equities look tactically more attractive than bonds, but there isn't much excess return for global bonds over cash. U.S. bonds are an outright sell now given sticky inflation driving lower real yields. Our currency model suggests the U.S. dollar will struggle, but is also boosting return forecasts of non-U.S. equities. European equities are cheap, and the U.K. is probably the most compelling, but we would also favor Japan—particularly if they are able to sign a trade deal earlier rather than later.



Source: Strategic Frontier Management

We believe duration and credit risk exists for extended and leveraged bond holders, and recommend continuing to underweight bonds. Increasing debt, leverage, debt, interest burdens, loan delinquencies, and bankruptcies with rising bond yields increase risk of a global bond crisis, which could then trigger a U.S. equity correction with stretched valuations. We expect a market rotation at minimum, but such rotations can trigger a correction in market indices. We favor U.S. value and small-cap, although they seem out-of-step with momentum, but the playbook for 2000 Dot.com probably won't work well.

Total Return	YTD	1-Yr	3-Yr	5-Yr	10-Yr	30-Yr
S&P 500 Index	14.8	17.6	24.9	16.5	15.3	10.5
NASDAQ Composite	18.2	24.8	29.7	15.8	18.0	12.3
Russell 2000	10.4	10.8	15.2	11.6	9.8	8.6
Russell 1000 Value-Gwth	-5.7	-16.2	-14.7	-3.7	-8.1	-1.9
Non-US (World xUS)	25.9	16.7	22.3	12.2	9.0	6.3
Emerging Markets	28.2	18.2	18.8	7.5	8.4	6.4
Small-cap Global	14.8	12.0	17.4	11.3	9.2	
US 10-Year Treasury	7.0	1.6	3.1	-2.8	1.0	4.1
US Aggregate Bonds	6.4	3.1	5.0	-0.4	1.9	4.3
BAML High Yield Bonds	7.4	7.4	11.1	5.5	6.7	6.8
Short-term Bonds	4.5	3.8	4.8	1.3	1.9	3.3
JPM Non-US Bonds	10.3	1.2	5.3	-3.7	0.0	2.7
Cash (US T-Bills)	3.1	4.3	4.7	3.0	2.0	2.3
US Dollar (TWI)	-5.8	-1.4	-1.4	0.7	0.4	0.4
CRB Commodity Index	4.6	10.2	9.0	18.8	6.7	5.1
WTI Oil (US\$)	-5.8	-1.4	-1.4	0.7	0.4	0.4
Gold (US\$)	46.0	45.6	31.8	15.1	13.2	8.0
Bitcoin	22.2	80.2	80.4	60.3	85.5	

Source: Strategic Frontier Mgmt. Returns as of September 30, 2025 in US\$. Performance exceeding 1-year annualized.

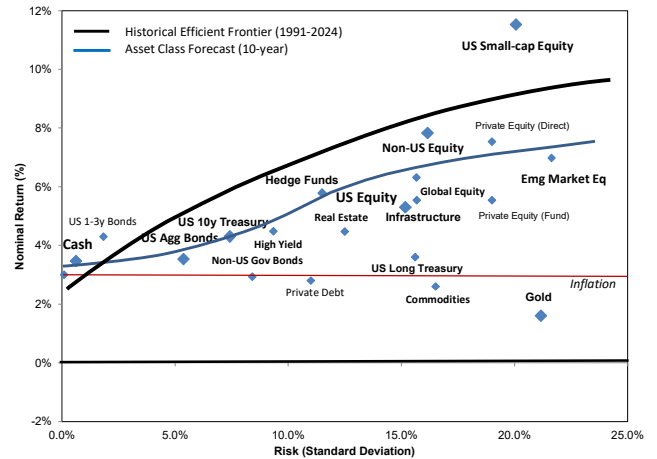
We continue to expect higher-for-longer interest rates and normalizing (higher) inflation, which increases concern about the global bond market's ability to absorb rapidly increasing government bond supply from high fiscal deficits and unwinding Treasuries purchased (QE). Indeed, other central banks must reduce their holdings too. High Treasury issuance plus the need to extend maturity, soaring private credit issuance, increasing default risk, and interest exceeding \$1.2 trillion annually

should result in steeper yield curves globally and increased bond return volatility.

Strategic Asset Allocation Forecasts

The bizarre risk premiums observed over the last decade, including small vs large, value vs growth, or absence of term risk premium in inverted yield curves make no sense. However, passive funds and strategies manage more than 50% of U.S. listed shares. Central banks have been manipulating market interest rates for decades, resulting in flatter yield curves. Are these all related? Anomalies are often driven by irrational momentum and speculative trends—investors chasing revenue growth—irrespective of valuations or appealing thematic stories that exceed rational beliefs. Reversion to normal seems more likely.

Rising 10-year yields are converging toward our long-run forecast of 5.0-5.5% yield given our 3.5% Fed Funds normal. We aren't surprised by yield curve steepening recently. We believed manipulating interest rates and forward guidance to drive bond yields lower would lead to *explicit moral hazard*, apparent in a dreadful 10-year Treasury return of 0.6% annualized over the last decade. Higher bond yields could overshoot and there is risk of a *Debt Crisis*, triggered by a *liquidity crunch* from receding bond sentiment, QT, leverage, and debt burdens.



Source: Strategic Frontier Management (October 2025)

Private equity and Private Debt are illiquid with high fees, lack transparency, and failed to produce higher returns net of fees, let alone risk-adjusted, for pension or high net worth investors.

Artificial Intelligence & Quantum Computing Future

Artificial Intelligence (AI) has been and continues to be an important *Future Theme* in our strategy work, since I was first introduced to the exercise during my tenure at Wellington Management (1995-2002). I continue to revisit our Future Themes every couple of years. AI is a science and computational technology inspired by the way human thought engages our senses to learn, reason, and decide or take action. Much of what we do

today in AI leverages mathematics, statistics, and nonlinear optimization. When we talk about computing power, we are maximizing likelihood in decision making.

Over the last 40 years, I was fascinated by the potential promise of AI. The Imitation Game in "Computing Machinery and Intelligence" in *Mind* (October 1950) by Alan Turing defined a test of a machine's ability to exhibit human-equivalent intelligent behaviour. Progress in AI has been episodic and unpredictable over six decades, but the introduction of Generative AI and Large Language Models (LLM) have captured the attention of the World. It ignited developer imaginations by boosting capability of low-code/no-code systems, which enable programmers to build applications faster and more efficiently in less time, thereby requiring far less effort.

When we first described AI as a Future Theme 20 years ago, its potential spanned studies in fuzzy logic, natural language processing, neural networks, and machine learning. Generative AI is a narrow, specialized field under the umbrella of Artificial Intelligence leveraging computer science and mathematics. Machine Learning still has an intriguing potential to solve really complex problems. Machine learning in the early 2000s kept the AI dream alive. In the 2010s, the advent of neural networks, deep learning, and reinforcement learning took center stage, pushing what was possible to new heights. Today *Deep Learning* (large dataset pattern recognition or prediction) and *Reinforcement Learning* (sequential decision-making) learn through continuous interaction and feedback. *Deep Reinforcement Learning* is the hybrid combination of both, optimizing objectives to enable systems to learn without being programmed. Generative AI can produce realistic new images, videos, music, and text that is indistinguishable from natural sources—transformers and adversarial networks are distinct neural network architectures designed for GenAI.

Artificial intelligence (AI) is reshaping the real economy by increasing productivity, and driving new investment, but also causing structural shifts in the labor market. AI is a general-purpose technology with potential to transform most industries. Workers once perceived immune to automation, including software engineers, are having to adapt or acquire new skills. AI will accelerate automation, particularly for systematic, data-centric, or quantitatively oriented jobs—companies will be able to do more with less people, requiring retraining individuals.

The surge in AI interest was sparked by Generative AI applications, which can create new content, such as text, images, video, or even software code, by learning from existing data. The public was enamored, because it was useful for day-to-day activities. Business leveraged it too. Creation of Large Language Models (LLMs) require massive data acquisition and capital expenditure for data centers, content, hardware, software, energy capacity, and engineering. LLMs, linking vast data repositories, are logically directed, but computing associations remains a stochastic process that can pull information

from many sources, including biased or opinionated, rather than only vetted and factual. As a statistical process, it is not perfect or precise, and may *Hallucinate*, fabricating incorrect or nonexistent information. It is designed to produce plausible-sounding text based on patterns in its training data, so LLMs tendency is to fill-in-blanks even when its unsure, prioritizing a response over accuracy within tolerances allowed.

Fear of technology overinvestment reminds us of the internet and telecom rush in 1997-2000, which led to a speculative bubble, but eventually crashed without supportive fundamentals. Like the dot-com bubble, massive investment in *Generative AI* may outpace practical returns on investment. A critical issue is how do margin (assuming earnings growth) and return on investment manifest, particularly given rapid hardware depreciation rates and emerging competition?

Innovative AI applications, tools, and use may bring unprecedented technological advancement and prosperity. However, with investment flooding into AI, a high-profile appeal to regulate technology and slow development of AI underscore growing unease over whether we are moving too fast toward technologies that may be impossible to control. Regulation can stifle innovation, but also hinder competition, which reduce productivity and economic growth. Regulation targeted domestically can cause competitive disadvantage. Unintended consequences result when regulations designed to fix one problem create new, unforeseen problems, or hinder adjacent research and development.

AI evolution raises concerns about potential for misuse, deepfakes, algorithmic bias, fraud, corruption, data privacy, theft, security, and other malfeasance. Data ownership, usage, and copyright protections are challenging issues too. Yet, we are skeptical of efforts to slow development of AI, as some high-profile individuals attempt to limit perceived *existential threat* to society. Such regulation can be costly and impractical, slow entrepreneurialism, and impose economic or compliance costs, which are more burdensome for smaller innovative companies. Regulation tends to benefit larger, established players able to absorb costs, defend themselves or evade the rules. It can restrain those in the best position to limit dangerous uses against society.

Government lacks technical expertise or ability to adapt, to create effective regulations. Open-source proved to be crucial to maintaining competition, and minimizing oligopolistic behaviors of larger tech companies. The most effective means of AI oversight will be to drive competition and innovation to attract the best companies and founders. Government can't manage technological advances well, but it can nurture the environment, limit unnecessary regulations, incentivize investment, and promote research and development.

AI defies definition or domain boundaries as a ubiquitous technology increasingly used across most industries. AI

decisions or outcomes are difficult to predict because they rely on stochastic inference, involving optimization of maximizing likelihood probabilities. Discrete logical computing is deterministic or follow arithmetic or algorithmic processes that compute the same output for given input. The Gen AI challenge of calculation accuracy stems from reliance on pattern recognition, rather than deterministic algorithms. Many Generative AI systems are closer to a *black box* that is difficult for even developers to predict outcomes or explain its decisions. This is where bias, transparency, and accountability are more difficult to assess and judge.

The idea of winners vs. losers in a Global AI Race, as if it were a zero-sum game (ex: China vs. the U.S.), is flawed and misleading, because it ignores the complex, interdependent nature of global technological progress. We believe continued investment in AI Research and Development is necessary for the U.S. to maintain its global competitive edge. However, China will never slow its AI Research & Development as it views AI as a critical technology that can drive economic growth and strategic for national security. The U.S. should maintain a free-market approach where innovation is driven by competition, and remains a threat to China, if it can impose export controls limiting China's access.

Every technology enables certain risks. Recently, a coalition of scientists, technologists, and public figures called for a *global prohibition on developing Superintelligent AI until broad scientific consensus agrees that it will be done safely*. The statement warns *unchecked pursuit of Superintelligent AI systems could pose existential risks to humanity* if not developed under strong oversight. A similar group in 2023 called for a six-month pause in AI development, but AI investment and deployment accelerated. The latest call comes amid Big Tech firms seeking Artificial General Intelligence (AGI).

In our opinion, we are a long way from realizing *General Artificial Intelligence* (AGI), if *Strong AI* is ever possible. Strong AI or Artificial General Intelligence (AGI) is only a theoretical concept, which would possess human-level cognitive abilities to understand, learn, and apply intelligence to any problem it encountered. Thus, policymakers should focus instead on regulating how AI is *used* or misused, rather than limiting research and development or how AI is *built*. Existing laws should be sufficient and enforced to maintain accountability for harmful AI applications, and develop *regtech solutions* to detect harmful AI-generated content, use, or behavior, including facilitating cyberattacks, extortion, and fraud.

AI naysayers predict the decline of human work or believe AI is just overblown hype, if not an *existential threat* to society. We've observed a change the nature of work due to technological progress across many sectors and industries. AI created many opportunities, as it drives productivity with real economic growth and lower inflation to boost productivity. Few of us are ever

comfortable with change that challenges our vision of the future and our beliefs, let alone our livelihood or job.

AI is redefining economic structure and how business is conducted, including what skills your work will require. YCombinator's Garry Tan recently explained in: [What Everyone Is Getting Wrong About AI And Jobs](#) about *what history, economics, and real companies show us—that technology doesn't replace people, [but instead] it redefines what we can do*.

Technology valuations are extrapolating strong growth and high return on investment over a long horizon. Current demand is robust, but technology evolves rapidly and hardware financially depreciates quickly. Chinese AI startup DeepSeek rattled incumbents in early 2025 when it released AI models that it claimed rival LLMs from OpenAI and Google, but were developed at much lower cost using inferior GPUs—Deepseek's LLM V3 cost just \$5.6 million to create in a short time.

What is unusual this cycle is that capital investment in computing resources surpasses labor cost needs. Companies are creating applications with far fewer engineers, so the number of unique applications using LLMs is growing exponentially, and time to market is shorter than ever. These are interesting dynamics as companies witness unprecedented product overlap, resulting in heightened competition, which keeps sales prices and margins lower despite value-added. That still provides exceptional productivity gains. The power and GPU demand to run LLMs grows exponentially for now based on brute force approaches.

Quantum computing offers a solution computing resource limitations and power demand by performing complex computations exponentially faster and with significantly less power than classical computers, including GPUs. Classical computers scale linearly, but quantum computers' processing power scales exponentially, thus useful for complex problems in AI and scientific research requiring massive computation and power demand, as we've discovered recently.

Quantum Computing Rising

Forces of Secular Disinflation are moderating as *Fourth Industrial Revolution* matures, yet the Age of Artificial Intelligence and Quantum Computing has only begun, and hold new promise for driving productivity. Automation continues to encourage re-shoring manufacturing, driving America's competitive edge. These ideas are now paying off in key market sectors.

GenAI benefits from multi-threaded parallel computing, wherein problems can be broken down into independent tasks to compute in parallel. Nvidia's GPUs were designed for rendering graphics, which leverages parallel processing to execute repetitive tasks simultaneously. Understanding parallel processing reveals why GPUs are essential for GenAI, but also

struggle with complex problems that Quantum Computing excels at for the benefit of other forms of AI.

Quantum Computers can handle orders of magnitude more complex problems than state-of-the-art GPUs, originally designed for rendering video game and other graphics needs, requiring greater parallel calculations. This was a key requirement for training Generative AI models. We have been anticipating the arrival of Quantum Computing for nearly two decades—while there are various physical designs to manipulate qubits, Architecture that doesn't require super cooling we believe holds the greatest potential.

The potential for Quantum Computing to unseat GPU with orders of magnitude greater efficiency is a very real possibility, while consuming a fraction of the power needed today. We believe extrapolating the computing and power demand of the current LLM architecture more than 5 years is a mistake, particularly given the depreciation and innovation cycle of hardware generally, not withstanding competitive threats emerging. Future AI development will transition beyond brute-force scaling to incorporate more intelligent, efficient, and diverse strategies to ensure long-term viability. Rise of smaller specialized models fit for purpose will not need nearly the same compute and power required today. It is worth noting other areas of AI that are at least as promising, and an order of magnitude greater impact on society than today's LLMs. This is the Age of AI and Age of Quantum Computing, but we are only getting started.

in January 2025, Nvidia CEO Jensen Huang's CES keynote comments about Quantum Computing being 15-30 years away caused these stocks to plunge. He was forced later to walk back those self-serving statements, and apologized for his ill-advised remarks, but he seems terrified of Quantum Computing's potential.

Mr. Huang is now proselytizing that Nvidia GPUs "*will instead complement quantum processing units (QPUs), not be replaced by them*". This hybrid version may be a convenient partnership for awhile, but is it a sustainable alternative pathway in a highly competitive environment. Nvidia will once again be relegated to a supporting role, just as GPUs were originally designed. Nvidia may now be King of the Hill, but that position looks increasingly precarious given competitive forces, threat to margins, and the future we see in Quantum Computing. It is a fundamental economic principle that high profit margins attract competition, because it signals that there is a lucrative market opportunity, encouraging others to enter that market. AMD is already a formidable competitor in GPUs, and others will surely follow suit.

Misguided Policy Stumbles

We described the likely strong beneficial effects of the *America First* policies driving favorable U.S. economic conditions. However, we are concerned that *Fast and Furious* policy success can lead to overreach and difficulty managing the 15 executive departmental

agencies headed by a strong cabinet of Secretaries. There aren't enough hours to vet every initiative and decision made within every agency. Even when backed up by an Executive Order, we observe a cavalier creep in policy that may distract from America First goals and objectives. We discuss our concern about a few below.

President Trump's intentions are unpredictable, and can appear as chaotic or random whims, rather than strategic vision. We've discussed the President's seemingly unlimited political capital, but the danger of a *Fast and Furious* campaign is that there may be less vetting of some ideas. Consider various policies from the Department of Commerce ranging outside its domain. Commerce's mandate is to promote economic growth, job creation, and business opportunity. Its objective is to increase global competitiveness, promote technology development, and economic growth. Key functions include granting patents and trademarks, providing statistical data for decision-making, and supporting research and development.

Commerce has interceded in trade policy, visas, accounting standards (earnings reporting frequency), cryptocurrency, and taking equity stakes in U.S. public companies. In our opinion, new policies on visa reform (inc., \$100K H1B visas, \$1-2 M *Trump Gold Card*), and coerced foreign direct investment should be led by the State Department. Accounting and reporting frequency is something more appropriate for the SEC to manage. Whereas, cryptocurrency policy and regulation are the purview of securities regulators, particularly the CFTC for commodities, such as variable-priced cryptocurrencies, or banking regulators for stable coins (U.S. Treasury or the Federal Reserve). Commerce is intervening in agency domains it has no standing, and may be superfluous for the America First agenda.

Cryptocurrency policies such as establishing a Bitcoin Strategic Federal Reserve and "fair and open access to banking services" for the industry may appear self-serving if the Trump Organization is benefiting through *World Liberty Financial* and *American Bitcoin*. The Administration believes the U.S. should be the *Crypto Capital*, but this is irrational and pointless. However, the GENIUS Act is a new law to govern and regulate issuance of stablecoins pegged to the U.S. dollar. This was a positive way to establish the government's role in cryptocurrency, consistent with the U.S. dollar being the world reserve currency.

Introduction of stablecoins reinforce the trend of variable-price cryptocurrencies, such as Bitcoin, being used less for everyday transactions, and more as simply a speculative traded commodity. Stablecoins, such as Tether and USDcoin, offer price stability that is useful for functional exchange, or even a store of value without the volatility of Bitcoin or gold. Stablecoins offer a direct claim or pegged collateral exchange rate that define its value. Variable-price Cryptocurrencies are not a store of value, safe haven, nor prudent strategic asset allocation.

As virtual commodities without tangible use, expected real return (vs. inflation) is low, if not negative—thus, higher deposit rates are a hurdle for cryptocurrency without cash flow of interest due. Cryptocurrencies aren't money, currency, reliable medium of exchange, or even a store of value without ascribable intrinsic value—as a speculative commodity, they are not as unique or scarce as gold. *Marginal portfolio volatility* is greater than diversification cryptocurrencies provide. Bitcoin is being crowded out and diluted by relative ease of creating alternative coins. Bitcoin is limited to 21 million coins, but Ethereum (ETH), with 120-121 million coins circulating, can grow indefinitely. Over 37 million unique coins were created, but CoinGecko suggests only 19,000 coins are trading. 50% are dead, not functioning, or worthless.

Reciprocal tariffs were envisioned as means to level trade barriers and tariffs on U.S. exports, thereby boosting net exports alongside government spending cuts that should narrow fiscal deficits—at least that seemed to be the plan. Negotiating leverage for the purpose of restoring free and fair trade globally is a noble pursuit. Our trade deficit has spiraled over decades due to unfair trade barriers and tariffs imposed on American goods and services, so what better way than to reverse this than impose reciprocal tariffs *until the playing field was levelled*. The idea of \$2000 tariff dividend checks is a terrible idea with a fiscal deficit exceeding \$2 trillion—we believe the likelihood is low that Congress will incorporate this after the pandemic stimulus debacle. Sending out stimulus checks is inflationary.

Making tariffs permanent isn't consistent with global free trade—the basic idea of bilateral trade negotiations with was to restore free and fair trade imposed on U.S. exports, thereby increasing competitiveness. Trade policy instead pivoted to achieve other objectives in foreign policy. Many deals now include a permanent baseline tariff rate, such as Japan's 15% rate. It is remarkable how foreign policy leverage is available to resolve non-trade related issues after exhausting other means. Consider progress on: curtailing illegal immigration, drug and human trafficking, protecting intellectual property rights, access to rare earths, labor standards, and increasing NATO defense spending—any one of these is huge, but collectively are remarkable. The most surprising development has been the ability to wrap foreign direct investment into these trade deals.

We are concerned about U.S. government ownership of private enterprise, which is ill-advised and marks a dangerous precedent in industrial policy. The case against government control over technology is founded on the principles of free-market capitalism, suggesting that minimal interference leads to maximum innovation and progress. The rapid pace of technological change outstrips any government's ability to understand and regulate it effectively. The U.S. Government should never attempt to manage or control technological innovation or its development. This approach led to

America's pre-eminent dominance in global technology from semiconductors and software, to Artificial Intelligence and Quantum Computing. Indeed, Commerce has no business setting their sights on AI and Quantum Computing companies, as has been reported.

These are not insignificant stakes, securing 10% of Intel, 15% of MP Materials, 10% of Lithium America, 10% of Trilogy Metals, and U.S. Steel's Golden Share. Government should not be picking winners and losers, whereas the risk is that company decisions could be influenced by political, rather than maximizing shareholder value. Boardroom decisions could be influenced by the political party in power. Government doesn't have much competence managing equity stakes in public companies, so this is a dangerous intrusion.

Nations shouldn't attempt to dictate global technology leadership as sought for Artificial Intelligence and Quantum Computing. Attempts to regulate technology can stunt growth and innovation, but may be needed to ensure national security and consumer safety.

A better and well-accepted approach to promoting global technological leadership is supporting basic research funding through existing government laboratories, and research contracts with defense and technology companies overseen within respective agencies like Energy or Defense. Commerce has a key role in promoting innovation, general business interests, and competition. It should protect antitrust, corporate espionage, and national security interests, including technology export controls. Government should favor funding research and development, rather than pursuing investment or owning company shares.

Reporting Period Can't Fix Earnings Guidance Trap

The SEC is considering a proposal to extend earnings reporting periods from quarterly to semi-annual, hoping to reduce regulatory and operating costs, as well as short-termism of investors and businesses. Shifting from 3-month to 6-month reporting won't change investor or corporate time horizon or behavior. We strongly disagree with this proposal, and question whether it can reduce accounting costs. This change would cause harm to investor protections, timely disclosures, and accountability, while decreasing transparency and market efficiency. Reporting surprise, uncertainty and price volatility would increase, as would incentive and opportunities to engage in insider trading.

The World standardized on quarterly reporting, so any deviation reduces comparability across countries. Although the U.K. permits semiannual reporting, 90% of companies report quarterly because investors require that level of transparency. Most companies, if allowed to report semi-annually, will still likely report quarterly. Differences in reporting periods will reduce cross-sectional comparability within sectors, particularly as many companies use non-calendar year-end. Suggesting China's semi-annual reporting drive longer

horizon decisions is ridiculous, and China's governance of mostly *State-Owned Enterprises* is inconsistent with free market capitalism. Why would we follow their lead?

Companies can reduce price volatility and short-termism by maximizing long-term shareholder profitability. Maybe a little less financial engineering, accounting manipulation, or company fixation on short-term guidance would be more helpful. Imagine companies steered clear of short-term guidance, focusing instead on long-term risks, opportunities, and performance. Any focus on other non-pecuniary objectives is inconsistent with prudent fiduciary standards, as it is impossible to maximize both shareholder and stakeholder interests.

Closing books semi-annually reduces transparency and forecast visibility, while increasing latency and reducing comparability. This increases surprise, thus volatility and uncertainty. If you wish to forgo accountability to public shareholders, then go private, illiquidity *discount* aside. Deregulation must be pursued understanding both factual benefits and adverse consequences.

With limited government, smart regulation and rule of law must be enforced. Well-defined anti-trust rules deter collusion, oligopolies or monopolies, and cartels. This isn't an indictment of capitalism, but highlights the challenge of maintaining competition and fair incentive-based free markets to promote broad prosperity and equal opportunity, with a level playing field.

Affordability Crisis and Financial Security

This generation came of age during a turbulent time of economic volatility from the Dot.com Bust to the Financial Crisis and Global Pandemic. Many experienced financial insecurity and struggle with living standard affordability as wage growth lags inflation or even upward mobility (raises, promotions, job hopping). They struggle to buy and maintain a home, pay off student debt, healthcare insurance premiums and medical expenses, tuition costs, and job security in age of increasing automation, rapid technology adoption, and AI displacement. Managing *Saving for Retirement* (withholding and investment decisions) is a critical real challenge, but perceive its too difficult or not a priority.

So, why do Millennials and Zoomers (ages 16-39) favor Socialism and Progressivism? Surveys suggest they are consumed by *Affordability* concerns, seeking an alluring alternative to the current status quo. They are looking for an alluring alternative—one that promises to solve their problems, such as student debt, housing costs, and stagnant wages. Disillusionment with the conventional path to financial success, including homeownership and a comfortable retirement, leads many to favor perceived socialist utopia as a solution to their financial struggles.

They still believe in entrepreneurialism, liberty, freedom to pursue happiness, and equal opportunity, yet still question Capitalism's ability to provide for them. Such intuition may be simply naïve, misunderstands basic

economics (supply vs. demand, incentives, competition, merit), or are confused about implications of choosing between economic capitalism vs. political socialism.

Socialists promise to improve affordability and living standards by lifting up the impoverished with welfare, paid for by redistributing wealth and income, as well as reducing inequality. They promise to impose rent control, provide "free" healthcare, education and public transportation, while boosting wages (inc. minimum wage), lowering cost of staples (i.e., state-run grocery stores), and providing lots of other necessities. Taxes rates increase, growth slows, and tax revenues decline, even as inflation rises with higher costs and regulation.

Socialism failed in every incarnation. Economic history suggests the recent flirtation with Socialism will pass, but not without disappointment and chaos. A command economy will infringe on liberty, and fail to incentivize individuals or businesses to innovate. Government control of productive resources and lack of competition driving profit-and-loss results in inefficient production and allocation of resources, including capital, to increase supply of goods and services. Unproductive or failing enterprises in collectivist economies persist without any means to eliminate or cull them and reallocate resources efficiently. Command economies are naturally prone to fraud, waste, and corruption due to concentrated power, lack of accountability, and misaligned incentives—all problems recently exposed by our own welfare, entitlement, and government benefit programs.

Capitalist free-market organizing systems encourage businesses and individuals to innovate, develop new products and create services to gain a competitive edge for profit or return on investment. Capitalist incentive and free-market principles under rule of law experienced greater overall real growth and improving living standards worldwide for generations. Market competition drives efficiency in resource allocation as firms seek cost-effective ways to produce more goods and services for a better price. This limits price increases, keeping inflation low, and increasing productivity to bolster supply at a reasonable cost. Stronger growth increases tax revenue and incomes, which brings down fiscal deficits. *Affordability improves without higher taxes.*

Observing progressive policies of the last Administration that drove inflation to the highest level in 50 years, it is not surprising that cost-of-living is a concern, and has become a political hot potato. Inflation is fundamentally caused by imbalances in supply and demand. When demand exceeds the economy's supply of goods and services, then prices must rise to reduce demand and increase supply. This is often a result of strong spending outpacing production supply, and often exacerbated by supply chain disruptions. Inflation was a key issue in the 2024 election, but its evil twin, Affordability, should remain attached to the bad policies of President Biden's Administration (2021-2024).

Free market Capitalism and private property ownership have been widely acknowledged for their role in fostering significant innovation, productivity, and economic growth over the past century, thus greater prosperity than any other organizing system. Embracing Capitalism lifted millions from poverty, and driven technological advancements that have raised the global standard of living. Those that retained Socialism or Communism continue to suffer. This should be an easy choice, but at the local level, cities such as New York and Seattle prefer to experiment with Socialism, rather than observe what goes wrong in cities like San Francisco, Los Angeles, Portland, Washington DC, and Chicago.

Efforts to enshrine a multi-polar world failed due to China, Russia, Brazil, and other inefficiently organized countries around Socialist or Communist values being unable to build admired societies other countries would want to follow. Observe the ideological contrast between the wreckage of *Socialism* and *Communism* versus *Free-market Capitalism*. Economic consequences of these contrasting ideologies can't be ignored any longer.

Restoring American Dreams and Values

Under the *Audacious Reset*, transformation of economic, regulatory, fiscal (tax and spending), energy, trade, national defense, border/immigration, and foreign policy is underway. Efforts to restore our meritocracy, liberty, equal opportunity, and pursuit of happiness drive a re-emergence of the *American Dream*.

Upending federal policies across the board in just nine months is an effort to restore economic, fiscal, and financial stability. The objective is to improve government efficiency, boost global competitiveness, transform energy and trade policy, tame regulatory burdens, reduce crime, and increase national security. These policies seek to improve our national health, welfare, and prosperity, while reducing U.S. trade and fiscal deficits. Economic, trade, energy, health care, border, and regulatory policies have shifted, while targeting waste, fraud, misappropriation, and corruption of government spending. The 2017 Tax Reforms sunset in 2025 were extended permanently. Longer-term these policies seek to significantly boost potential growth, margins, and global competitiveness, while keeping inflation in check, bolstering Affordability.

America seeks to reduce our trade and fiscal deficit, tame our borders, and restore basic rights of life, liberty, free speech, and the pursuit of happiness with equal opportunity under rule of law. The fiscal deficit should decline by eliminating waste, fraud, and misappropriated spending, while reducing bureaucracy to improve government efficiency. Reducing regulation will improve profit and grow income, therefore boost tax revenues without increasing tax rates, and lower inflation.

Our highly progressive tax system with a top marginal rate of 37% on income in excess of \$609,351 ensures a disproportionate burden on high earners more than pay

their fair share. Including state and local income taxes, effective tax rates can rise to over 50%. IRS data from 2022 shows the top 10% of earners paid 72% of all income taxes, while the top 50% paid 97% of all income tax revenue. Given already such progressive distribution of the tax burden, wealth and income inequality are not resolvable in a meritocratic society, nor would we want to de-incentivize achievement—and for what effect?

Efforts to impose a state or federal wealth tax to boost tax revenue and promote greater equity is insidious, and undesirable due to administrative complexity, economic damage (capital flight, forced liquidations, suppress investment, reduce economic growth), if not being unconstitutional. Wealth taxes have failed repeatedly in Europe, because they can lead to capital flight and tax evasion, as well as difficult and expensive to administer. Wealth taxes raised little net revenue. Similarly, taxing *unrealized* capital gains would be equally devastating to the economy and impossible to administer.

The failure of political decision-makers to learn from past mistakes is disappointing, but voters need to understand the real economic consequences of their decisions. Collectivism and socialism can be appealing in response to societal challenges, financial insecurity, and perceived belief that capitalism is unfair if it can't provide equally for all. The erroneous suggestion that a collective approach more efficiently and fairly allocates society's resources, and increases Affordability to boost living standards is a lie, albeit appealing to naïve voters. We can observe how historically misguided policies yield predictably adverse economic and financial consequences. Socialist and Marxist ideological values should never be a challenge to Free Market Capitalism.

Execution of the **America First** agenda has been fast and furious, instilling a policy paradigm shift, driving a momentous *Turning Point*. This *Audacious Reset* seeks to reset U.S. policies, including fiscal spending, tax, energy, regulatory, trade, health, and border policy to restore competitiveness and economic prosperity. This will bring down our fiscal and trade deficits. We believe recession risk is lower now, after years of intermittent recession and weak non-government growth in the U.S. Transition to a new playbook can be disruptive, but we expect will have positive economic consequences rooted in real values. The Administration came out of the gate targeting government waste, fraud, misappropriation, and corruption of government spending, and carried on from there to tackle so many other initiatives.

Countries erected trade barriers that disrupted supply chains, and blocked natural comparative advantage. Low labor costs allowed China to become a primary source of many labor-intensive critical staples and basic needs, from medical supplies to pharmaceuticals, disposable goods and basic resources, as well as cheap electronics to appliances, and other household goods. Since the global pandemic, developed nations sought to reduce strategic dependency on critical imported goods

which were sourced from single country dominated supply chains. In turn, China has sought greater self-sufficiency in technologically-advanced sectors (inc., computer hardware, vehicles, robotics, and equipment) dominated by the United States and Europe.

Transformational Change in the way Government works will provide savings to reduce our fiscal deficit and slow our increasing debt burden. Understanding constructive economic forces, budgeting, and fiscal consequences of policies is key to long term prosperity. We have now embarked on a remarkable opportunity to improve efficiency and effectiveness of government, which can be a model for the States and other nations to improve similarly, or else fall behind.

The political face-off of economic *Free Market Capitalism* vs. *Socialism* or Progressivism centers on economic outcomes—the result is always the same. Socialism undermines competitiveness, potential growth, margins, and prosperity—available supply declines, costs go up, and inflation emerges, reducing *Affordability*. That's when authoritarian government takes control, causing real economic decay and destruction, loss of freedom, liberty, property rights, and civil unrest. Centralized economic planning, with control of media, health, welfare, and education is necessary to maintain control. It struggles to efficiently allocate resources (inc. labor) and capital, resulting in lower productivity and slower growth, limiting income and supply, even basic necessities, thereby increasing inflation, and reducing *Affordability*. Collectivism requires hiking tax rates that reduce growth and lower income tax revenue, while attempting to level inequality, cast as greed vs envy.

Free Market Capitalism remains unparalleled in its ability to drive prosperity, as global poverty has plunged over four decades. Capitalism leverages first principles of individual liberty, private property, equal opportunity, rule of law, *free market competition*, and right to pursue happiness. These fundamental rights incentivize growth and innovation for the greater good to bolster prosperity. Belief in restoring these values in an *Audacious Reset* seems to be what the voters desire. Incentivized economic growth resolves many issues. By increasing income, higher tax revenues reduce fiscal deficits. Increasing growth and prosperity boost living standards. Free Market Capitalism will always triumph economically over deviant Socialist and Progressive beliefs.

Capitalism is moral because the system rewards individual contribution, hard work, merit, and freedom to choose your pursuit of happiness—it endows our basic

rights and fundamental values. They will say it is unfair that some take advantage of inheritance, talent, or even luck—but what system can equalize this without impeding basic rights. Capitalism compels individuals to be productive, creative, responsible, and ethical to be rewarded for what they contribute and accomplish, trading human capital for a future benefit. In so doing, Capitalism increases available supply, so by the Law of Supply and Demand, lowers prices, which reduces inflation and increases *Affordability*. That's more complicated and less alluring than a political stump speech, but fundamental, following from first principles.

Socialism is selfish, seeks equity or social justice over merit and equality or equal opportunity, and pursues collective ownership in defiance of private property to redistribute wealth and income, contrary to *the right to pursue happiness*. Enlisting inequality triggers the powerful emotion of envy, but suggests *pursuit of happiness* (i.e., choices, sacrifices, college major, hard work, or creativity) should have no agency for financial wellbeing—disregarding the *entrepreneurial spirit* that sets America apart from others defies logic and reality.

Concentration of political control naturally inspires corruption, fraud, inefficiency, and wasteful redundancy, as observed with government programs generally. But what politician wouldn't trade votes for promises of free stuff to overcome their ideological shortcomings? Socialism is neither righteous or moral, proving time-and-again to be ruinous.

New Goeconomic Understanding is re-emerging, but not a *Multipolar World Order*, as some forecasted for a decade or more. Few, if any, can challenge American Superpower Hegemony. China's neo-mercantilist strategy, with initiatives like *Belt and Road*, seek to expand its influence. It emerged as America's primary rival with growing economic, military, commodity, and technological influence. The European Union bloc seek a greater geopolitical role, but no other nations is compelled or able to unseat America. We believe a *New Dawn* is rising in America after an *Audacious Reset* that can bolster productivity and global competitiveness, restoring higher potential growth, profit margins, and prosperity, reduce fiscal deficits, while improving *Affordability*. Efforts to promote fair trade will lower trade barriers and tariffs imposed on U.S. exports, improving global competitiveness. Reciprocal tariffs should not be permanent and lead to only a transitory inflation rate impulse rolling off over time, but leverage in restoring our trade deficit have enabled other foreign policy objectives.

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