FCI ADVISORS

PERSPECTIVES

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Face Reality

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In response to consistent budget deficits and growing federal debt levels, President Barack Obama established the National Commission on Fiscal Responsibility and Reform in early 2010 during his first term in office. The commission was tasked with recommending solutions to bring down the budget deficit to 2.3% of GDP through a combination of tax and spending changes. Former Clinton White House Chief of Staff Erskine Bowles and former Republican Senator Alan Simpson co-chaired the commission to help unite both sides of the political aisle. In the preamble of their initial report, "The Moment of Truth," they conveyed the clear and inescapable message "America cannot be great if we go broke."

After several efforts over a three-year period, the various proposals fell flat with congressional leaders. Politicians were united after all – to continue spending taxpayer dollars at an unsustainable rate. Over 14 years later, the U.S. federal budget deficit remains over 6% of GDP and net debt as a percentage of GDP is now 98%, exceeding levels even the commission had predicted if previous trends were left unchecked. Perhaps most concerning, with the recent rise in interest rates, net interest payments on debt are nearing $1 trillion annually and consume 14% of all government spending.

Bold Experiments

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As previous bi-partisan efforts failed, the current Trump administration is quickly taking action to repair both our trade and fiscal deficits mainly via executive orders. Two bold experiments, trade tariffs and the newly created Department of Government Efficiency (DOGE), are now being undertaken to reverse over 30 years of trade imbalances and ballooning federal spending.

Deal or No Deal?

On April 2, the Trump administration announced sweeping tariff rates on many trading partners in a so called "Declaration of Economic Independence." A tariff is a tax imposed by governments on imported goods, often used to protect domestic industries or generate revenue. If all new tariffs are enacted, it would generate roughly $600 billion of revenue and equate to the largest tax increase in modern U.S. history, at 2.2% of GDP. With no offsets, this may lead to a shallow recession and potentially higher inflation. There is also a risk that countries engage in retaliatory tariffs or seek trade deals with our rivals, including China.

While the tariff announcement was harsher than expected, the market has quickly priced this news into asset prices. What has not been priced in yet are the potential offsets or long-term positive drivers to the U.S. economy. We know President Trump loves to make a deal. We would expect, over the coming weeks, for negotiations to occur which could lower or eliminate tariffs altogether for some countries. Over the long-term, additional revenue from tariffs may reduce the deficit or allow for tax cuts for individuals or businesses. For context, the $600 billion of additional tariff revenue is slightly more

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than all corporate income taxes paid annually to the government. There is also the added long-term benefit of supply chain security and job growth as companies on-shore manufacturing.

DOGE

While tax increases are mostly unpopular, reigning in government spending is generally viewed favorably. According to a March 2025 Harvard Caps/Harris poll, 83% of respondents think the U.S. government should move to balance the budget in the next few years. When asked how they should reduce the budget, through tax increases or reduced government expenditures, 79% sided with the latter.

The creation of DOGE, led by Elon Musk, has a mission to reduce the deficit by $1 trillion. They are looking to achieve these cost savings through eliminating waste, fraud and inefficiencies such as selling underused federal buildings, eliminating outdated contracts, identifying social security fraud and workforce reductions. After years of unsustainable growth in federal spending, Treasury Secretary Scott Bessent commented the economy could see a short "detox period" partly as a result of DOGE. Over the long-term, trimming the fat from a $7 trillion federal budget should unlock capital for reinvestment in the private sector, potentially boosting GDP growth down the road.

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Argentina's Precedent

While this current environment feels unprecedented, we can look back just a couple of years ago to another bold experiment in Argentina for clues. After winning the presidential election, Javier Milei, nicknamed "El Loco" or the madman, immediately slashed regulations, eliminated ministries and cut public spending and employment. Initially, this was met with social unrest and economic contraction. By the end of 2024, Argentina posted its first budget surplus in a decade, saw monthly inflation decline from 25% to single digits and GDP growth rebounded nicely. After initial choppiness, the Argentina stock market has returned 65% since he took office in December 2023, massively outperforming global equity markets over the same time.

The U.S. stock market has clearly not fared as well, so far in 2025. The S&P 500 Index is currently in the midst of a 10% correction, the eighth time this has happened in the last 10 years. The uncertainty over inflation and economic growth, largely due to tariffs and DOGE, has spooked many investors, similar to the early days of Milei's term. Historically, U.S. policy uncertainty is nearing the all-time highs seen during COVID-19 and the 2011 debt ceiling debate which led to the first ever downgrade of U.S. sovereign debt. We believe this uncertainty creates opportunities to invest in high-quality assets and rebalance portfolios. In fact, average S&P 500 returns six and 12 months after the U.S. political uncertainty index reaches this level are 10.9% and 21.5%, respectively.

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Plan and Adapt

The wealth planning team at FCI creates financial plans for many of our clients. Our plans assume an appropriate spending level based on asset values and risk-adjusted rates of return. We often must have difficult discussions with clients regarding spending levels to prevent assets from being prematurely depleted during their lifespan. Importantly, when planning outcomes are better or worse than projected, we adapt the plan and face the reality. This can include adjusting a client's asset allocation to make sure it aligns with both their return objectives and risk tolerance.

The good news is that our current fiscal situation is being addressed before we reach crisis levels. The changing landscape will certainly lead to bumps in the road, but the U.S. economy is dynamic and well-equipped to adapt to these changes. Ultimately, these necessary adjustments to our country's "financial plan" will lead to a more prosperous future despite the short-term economic and market fluctuations.

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