GW&K MARKET INSIGHTS

Transcript of 2Q25 conversation with Harold Kotler and Bill Sterling, moderated by Dan Fasciano

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We invite you to listen to our quarterly conversation with Harold Kotler, Bill Sterling, and moderator Dan Fasciano as they review events from the second quarter of 2025 and discuss:

- What's been driving the markets up, and how long that might continue;
- How the One Big Beautiful Bill may affect the US economy; and
- How potential geopolitical risks are weighing on their near-term outlooks.

Edited transcript

Dan Fasciano: Welcome to the Second Quarter Client Conference call for GW&K Investment Management. This call represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance.

My name is Dan Fasciano, Director of Private Wealth here at GW&K. Joining me on today's call is Harold Kotler, GW&K's Founder-Chairman and Chief Investment Officer, as well as Bill Sterling, our Global Strategist.

Harold, I'll begin by giving credit where it's due. When we spoke 3 months ago, the S&P 500 was a thousand points below today's level, and the mood was uncertain. You struck a bullish tone on that call, and here we are up over 20% in the last 3 months. When you look out over the next 3 and 5 years, do you remain constructive on equities? And if so, why?

Harold Kotler: Simple answer? Yes.

To anybody listening to this call, you have to scratch your head and ask, why? Why would anybody be upbeat when there's so much confusion and tension politically in the world? And I guess my answer is, *that's* why. I've always believed, and I think in my career it has most often been true that when there's this much disbelief, uncertainty, concern — fear is the major factor — then the markets have discounted and will be going up.

It's clear when everybody gives themselves high fives and think they have discovered the next Holy Grail, we're in deep trouble. And quite the opposite, when everybody's fearful and concerned and can't understand why the market would go up, it does go up. And God willing I'm here two years from now, I'll tell you *then* why it happened.

Dan Fasciano: I'll bet you will. But let me push you on that a little bit — let's drill down. There are people out there who will say that valuations are stretched and that we're probably due for a real pullback. How do you respond to that?

Harold Kotler: Well, there are valuations that are stretched. It's not a cheap market, that's true.

The market is complicated because there are areas of the market that are not stretched, but the indexes and the multiples of 21 – 22 times earnings is, one would say, fully valued. So how could the market continue to go up in a fully valued market? Good question. The answer would be, earnings will be upward surprises.

Why will earnings be an upward surprise? Because of the beginning of AI and how it impacts businesses, how it changes the way businesses operate. And is it every business? No, but a lot of people will be benefactors of this.

Also, tariffs — to what degree, how much, who will they affect, how will they adjust, how much will be absorbed by companies, and how much will be passed on? No one knows the answers to these questions, and you can speculate all you want, but no one has the answers. Most likely, it's not going to be as bad as people initially feared, and we'll see what happens. But don't forget: Once it happens, it happens, and then it's in the rearview mirror. It's not as if it goes on and on. I mean, it becomes part of the establishment, but the impact will be adjusted, and people will make changes as necessary.

Dan Fasciano: Bill, Harold is setting the fiscal table here for us. The Big, Beautiful Bill now is the big, beautiful law. It’s still early days, but do you have any takeaways at this stage from a macroeconomic or market standpoint?

Bill Sterling: I think it's definitely helped equity market sentiment because it should be a notable plus for growth later this year, and into next year and the next few years — particularly with the generous provisions it has for businesses to promote capital expenditure.

It also takes the debt ceiling issue off the table. It extends those 2017 tax cuts for individuals, which supports consumer spending, and then it's got some of those new tax cut provisions, such as no tax on tips or overtime.

But all that said, the stimulus does come at the cost of large deficits continuing, with the estimated 10-year increase in deficits of $3.5 to $4 trillion, and so concerns about the large-scale issuance of Treasuries continuing in the future, I think, is something that could contribute to a higher-for-longer rate environment. And you've clearly seen that reflected in a steepening of the yield curve this year.

Dan Fasciano: Let's stay specifically on the Trump administration. Where are you right now in terms of thinking about tariffs? Something that's really emerged since our last call is the idea of the “Trump always chickens out,” or TACO trade. Do you have a view on that?

Bill Sterling: It definitely looks like high tariffs are here to stay. I've seen estimates recently that the average effective tariff rate, which was 2.5% last year is now running about 21%. So that's a big effective tax hike. And even after some deals are reached, it looks like that's still going to stay around 15% for many years.

On the TACO trade issue, clearly the President has shown a willingness to pivot by implementing that 90-day pause when it looked like April tariff hikes were going to derail the economy, and further pauses are certainly possible, but I think it should be kept in mind that the tariffs, as constituted now, could raise $2 trillion or more for the US Treasury over the next 10 years, and that could go a long way to financing much of the One Big Beautiful Bill. So I think they're going to be a permanent feature of the economic landscape that businesses and consumers will be adapting to, echoing what Harold had to say, and it certainly seems to be the case that businesses and consumers already are adapting. If you look historically, other countries have adapted various types of national sales taxes, or value added taxes, which temporarily slow growth and temporarily bump up inflation. But then life goes on and people adapt. So I think this will be another case of that.

Dan Fasciano: Harold, you and Bill are doing a really good job setting the macro backdrop here. Let's take the plane down from 30,000 to maybe 15,000 or 10,000 feet. When you talk to the investment teams and you look at the data and the news yourself, are there any opportunities or asset classes where you see value or don't see value in the world today?

Harold Kotler: What strikes me about the world today is the concentration of wealth and success and the ability of some companies to lead the pack, whether it be taking employees away from another company and paying $100,000,000 for an employee, or doing AI, or building systems and their own energy factories and energy plants. Big companies are really in an amazing position in this world's market. And I don't know what it really means for the smaller companies. I think the smaller companies that we invest in will be better off when short rates decline — which they will, next year, if not the end of this year — but the concentration of wealth and success that exists. It reminds me of when they busted up big oil in the 1920s. Some of these companies are so huge. And that's what's happening: success leads to success, and it's I think it's hard to bet against them. You have to really be careful about how you diversify your portfolio, but I would say there's no place you should not go. I still think that the AI agenda, whether it be in utilities or whatever needs to be done, nuclear to build out the infrastructure, that seems to be the opportunity of the next 5 – 10 years.

Dan Fasciano: That's great perspective, for investors to take a look at who those winners are and see if they're sustainable, all the while looking at opportunities around them. It's a pretty thoughtful theme.

Bill, maybe a little bit more microeconomic in a way, although with a tariff backdrop: We're getting inflation reports this week, and one risk of increased tariffs was that increased prices would simply be passed along to consumers. Are you seeing anything in the data now? And we've just pivoted into the second half of 2025. Are there any indicators you're going to be paying closer attention to as we make our way into the second half of the year?

Bill Sterling: Well, the last few months of inflation data has been very encouraging. On a 3-month annualized rate through May, the inflation rate dropped to under 2% on the CPI numbers.

But the June numbers, although they were more or less as expected, did show some increases in tariff-sensitive areas like apparel and home furnishing prices that, I think, are something that the Fed is paying attention to and the Fed, I think, wants to look at the fact that it often takes many months for tariff hikes to show up in consumer price inflation. So the upcoming reports for July and August are going to get an enormous amount of attention from the Fed.

The consensus among economists is still that we'll see inflation. The core in June was 2.9% year on year. We'll probably see that bump up to 3.3%, or something like that, by the end of the year before it settles down again in 2026. So I think there'll be a lot of focus on those upcoming inflation reports, because that will kind of get into what Harold mentioned. We could get rates lower by the end of the year if the inflation is not as bad as expected, that would certainly give the Fed more ammunition for beginning to cut rates later this year and into next year.

The other thing I think we should be paying close attention to will be earnings reports, because that's where we're going to get a sense for how corporations are adapting to these higher tariffs. Are they passing along the prices to consumers? Are they improving their productivity? Is it coming out of their margins? We don't have a playbook in history with tariff hikes this high, so we're going to learn a lot from just listening to companies as they adapt and respond.

Harold Kotler: I think it's a very good point, Bill, and I also think that all management teams aren't created equal, and it will be a test to see how they figure these issues out. That will be something that the analysts need to really watch.

Dan Fasciano: Bill, in the last minute or so I've heard you use the words “inflation,” “cutting rates,” and “the Fed.” Also, this week the President put Jay Powell back on the hot seat about his role — although Trump did pretty quickly walk it back. Is there anything that we should make of that?

Bill Sterling: We've had other experiences in US economic history where there's been a lot of pressure put on the Fed chair. So this isn't totally new, but I think going to the extent of actually firing a Fed chair would be one of those norm-breaking type of things that I think could certainly contribute to some market volatility. I still think of it as kind of a tail risk. It's out there, and it's being talked about, but there’s potential that it’s being put in play just to have somebody to blame if things don't go well on the tariff front, if inflation is a bigger problem than not, or if the economy slows more than not. We've even had the Supreme Court weigh in on this already, indicating they don't think firing a Fed chair is permissible, even though it might be permissible in terms of some other agencies, so we'll just have to see. But once again, I view it more as a tail risk, as opposed to any kind of base case.

Harold Kotler: Can I make a general statement that it's important that listeners do their best to separate from the static that comes out of Washington. It's constant, but it's not consistent. And therefore, it's very disconcerting. But it could be a red flag not to get bogged down in any of these positions. He's a different type of character, and we're not used to anybody like him. But we have to try to separate from the yakkety yak and see really what is happening. As Bill suggests, this guy is going to live out his term, and we'll have a new Fed chair next year.

Dan Fasciano: Well, I want to pull some threads together on what I'm hearing now and turn that into a question for you, Harold. We're talking about economics, earnings, and market activity, but running alongside this, you've long been a student of geopolitical activity and to many the world today feels a lot less stable than it has in a while. What do you make of the geopolitical uncertainty, and reconcile that, if you can, with how business leaders need to adapt and stay competitive.

Harold Kotler: Well, I think the answer to the second part is, business leaders have to adapt and stay competitive. That's their job, and they have no choice but to do that. As it relates to this kind of activity, we've never had a President quite like Donald Trump, but we certainly have had complicated times and political uncertainty and changes that were unforeseen, whether it be through war or inflation or other crises, even in my working career. So I've tried to learn to separate what I hear from what is. I think it's important.

Yes, you can be aware of what trends might be undertaken, but it's also important to see where they go and the results of them. Much of what Bill talked about in this new tax bill, people forget most of that tax bill is just a reinforcement of the existing bill. Everybody talks about the increased deficit, but that was already in the cards, unless it was changed, and it hasn't been. But the new incremental dollars, compared to what existed, isn't so substantial, and it's business activity. We've got to get this thing going. And I think it's all about earnings and businesses, adapting and making money. And I think that's what's going to happen in the next few years.

Dan Fasciano: Bill, we've been spending much of this call, really viewing opportunities and risk through a domestic lens. Harold mentioned earlier, diversifying some of your portfolio outside of the US this year has been a fairly rewarding allocation. Thinking about where we are today, are you able to give us a little bit of a non-US perspective on economies and markets? Are there any themes you're thinking about within the eurozone, Japan, China, or anything that you're monitoring a little more closely there?

Bill Sterling: Picking up on what Harold was saying about how markets can be counterintuitive, and you don't really figure out until a couple years later why they did what they're doing. Consider the fact that the main international EAFA (Europe, Australasia, and the Far East) Index is up about 18% this year, and China is up 20% — you would think, on the surface, that these tariffs are going to hurt those economies by hurting their export prospects, yet they're outperforming. Why is that? One reason is clearly the dollar weakening, and that provides kind of a tailwind for international equities which I think could be an enduring theme for a number of years.

You've also got the fact that some of these geopolitical changes are putting pretty intense pressure on economies like the European economies, to stimulate growth with more aggressive fiscal stimulus: defense spending in Europe, for example, infrastructure spending in Europe — that's a pretty big theme that's got legs. The Japanese are under pressure to stimulate their growth because of the tariff threat to them. And China, of course, has lots of issues on the real estate side, but they're doing quite a bit to try to turn their domestic economy around and begin to focus more on the consumer as a source of growth. So all of those themes, I think, are reasons why we could see potentially non-US equities do much better than they have in recent years, and perhaps even continue to outperform the US, especially if we're in a period of a multi-year dollar decline.

Dan Fasciano: Good perspective. Well, Harold, Bill, I want to thank both of you for sharing your thoughts, and as always, should anyone listening have a follow-up question. Please feel free to get in touch with your GW&K advisor. To all our clients and friends: Please enjoy the rest of your summer. We look forward to reconvening in October. Thank you.

Disclosure