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Just Dance

3rd Quarter 2025

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"Just dance, gonna be okay…"
— Lady Gaga, 2008

It was a wild spring. Markets have fully recovered now, and investors are dancing like no one's watching. But today's market dance resembles the 2024 Australian Olympic breakdancer: clumsy, offbeat, yikes-worthy, and spinning in weird directions.

The tempo is off because the list of market vulnerabilities continues to grow – a near-record high S&P 500 valuation, extreme tariff uncertainty, ongoing wars, inflation risk, and exhausting U.S. political discourse.

Photo: Alamy

We chuckled early this month listening to an interview with David Einhorn on Bloomberg TV:

"If you **like** the news, just wait two hours. If you **don't like** the news, just wait two hours."

Despite plenty of fragile facts, meme stock mania is back. A fresh burst of speculative hype has sent shaky companies like Opendoor, Krispy Kreme, and Kohl's soaring—driven by Reddit chatter rather than business fundamentals. At the same time, the S&P 500 and Nasdaq 100 have brushed off April's tariff scare and marched to new all-time highs. Margin debt has certainly helped, eclipsing tech-bubble records, a clear sign that investors aren't easing back in—they're doing the worm at the wedding.

It should come as no surprise; we are dancing to a different tempo. We continue to maintain a defensive tilt, owning gold and focusing on dividend-growth stocks. Even with this defensive tilt, our global equity strategy is outperforming the S&P 500 year-to-date. That outperformance has come from international stock funds and gold.

While the April–June rebound has boosted investor confidence, history shows that sharp recoveries can happen during downturns. In the 2000–2002 downturn, the S&P 500 experienced several double-digit rallies, including gains of 19%, 22%, and 21%, before falling 47% from its peak. High valuation environments—then and today—can make market rebounds appear more promising. Short-term strength often masks the underlying problem - overpriced assets.

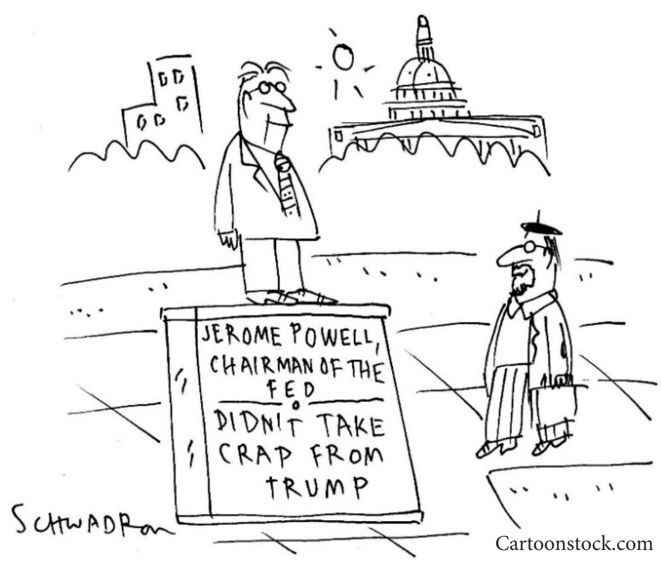
The Wobbly Waltz

Instability is the defining theme of 2025—macroeconomic, political, and monetary. U.S. growth is uneven, inflation has improved but remains sticky, and global trade is being reshaped by sweeping new tariffs. Trade deals that normally take years are being implemented across 180 countries in just four months, leaving both large and small businesses scrambling.

In Q1, many firms rushed to import goods ahead of tariff deadlines. This behavior created the largest trade-related drag on U.S. GDP since the 1940s. Now that buying has shifted back to U.S. producers, we expect trade to boost Q2 growth. However, one crucial caveat remains: this tariff program is a first in history – no one really knows how it will unfold.

That said, there is room for optimism. Trump's YUGE trade deal with the EU is a big win. Europe, hoping to avoid harsher tariffs, agreed to funnel $1.35 trillion into the U.S. through energy, investment, and defense. In return, the EU is hit with a 15% export tariff, while it drops its import tariff on U.S. goods to 0%. The rhythm is clear: the U.S. leads, and Europe follows.

Adding to the instability, the Fed is under intense pressure from the White House to cut rates now. Several politicians (Speaker Johnson, Senator Scott) on TV have claimed we need lower rates because the economy is "hot". These comments are a bizarre contradiction, since a hot economy is precisely when you **don't** cut rates. Either they're mixing up their metaphors, or they don't know what they're talking about. Furthermore, the White House appears to overlook the fact that, beyond short-term bonds, market forces—not the Fed—determine interest rates. With tensions rising, Trump has even called for Fed Chair Powell's resignation, but he backed off after the stock market dipped for a few days.



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Whatever the outcome with Chair Powell, it's not hard to imagine a future where central banking becomes a branch of the Executive Office. We don't believe the Fed is truly independent, but when President Nixon and Fed Chair Arthur Burns "collaborated" on monetary policy, the outcome was very high inflation and economic misery. Nixon Tapes

Offbeat Optimism

If you've read any of our letters in recent years, this won't come as a surprise: the S&P 500 is expensive. Very expensive! A decade of aggressive fiscal and monetary policy has kept it that way for quite some time. Today, virtually every major valuation metric indicates that the S&P 500 is super stretched. Said more objectively, the index has been more overvalued **less than 3% of the time**, based on average percentiles below.

S&P 500 Current Valuation Metrics

Valuation Indicator	Value	Average	Percentile
Buffett Indicator (1945 - curr)	2.0	0.8	97th
Price-to-Sales (1990 - curr)	3.2	1.7	99th
Price-to-Earnings (1928 - curr)	28.3	17.7	94th
Shiller Price-to-Earnings (1920 - curr)	37.8	18.4	98th

Spectra Investment Management, LLC
Data from InvesTech Research

Overvaluation alone doesn't cause bear markets. But it does mean that when things do break, overpriced assets can fall hard and fast, which we saw in April. In a highly concentrated, momentum-driven market, the exits are narrow when the crowd exits the ballroom.

Berkshire Hathaway seems to agree. Warren Buffett, nearing 95, has quietly raised cash reserves to $350 billion – the highest level in Berkshire's history and even greater than at the peak of the housing bubble. Time will tell whether this is misplaced caution or prudence.

Rhythm and Yield

Particularly in markets like this, adhering to a style and tempo matters. Most investing styles tend to prioritize one of three key factors: value, growth, or yield. But **dividend growth investing,** a strategic emphasis discussed in our May 2024 letter, *Dividends Ahoy!* —balances all three.

- We care about **valuation** because overpaying leads to weak future returns.
- We care about **growth**, specifically the kind that drives rising dividends and stock buy-backs.
- We care about **compounding** because reinvesting dividends leads to more dividends.

Especially now, we believe that dividend growers offer a more stable and rational path forward.

Tango with Opportunity

Beyond the U.S., international markets offer some of the most compelling relative value opportunities. Last year, we nearly gave up on these markets—as we noted in *Crossroads*—because they've lagged for so long. But after this spring's tariff tornado, capital is finally flowing into these cheap, high-yielding markets.

- Valuations are significantly lower, half in some cases, relative to the S&P 500
- Dividend yields are higher, often 2–3x the S&P 500
- Monetary and fiscal policy is turning supportive fast

After years of lagging, international dividend-paying stocks are back in the spotlight, with media coverage picking up noticeably. While we haven't increased our international exposure, our global equity strategy has a sufficient allocation to benefit from the strong rally.

With this mid-year update, our conviction is stronger that the stock market choreography doesn't match the music. Valuations are a problem, and instability is rising on several fronts. Eventually, we believe markets will return to a more timeless tempo—Diversification, Discipline, and Dividends. That's the tempo we're sticking with.

Key Takeaways

1. Valuations have reached near-century highs. While not a short-term timing tool, rich valuations increase the risk of sharp corrections.
2. Dividend growth is a timeless tempo. We focus on quality companies/funds that not only grow their dividends but trade at prices to support long-term compounding.
3. International is undervalued and underowned by most investors. It is plausible that the waiting is over. Given the attractive valuations and high yields, these stocks have plenty of room to run.
4. We expect more volatility in 2025 and are prepared with a focus on value, dividends, diversification, and hedges.

We don't pretend to predict the next song. But we believe our strategy doesn't require a perfect forecast—just discipline and patience.

Thank you for your trust and support as we navigate this interesting period in history. We look forward to spending time with you soon.

Very truly yours,

Scott A. Roads
Founding Principal

Julia E. Zaino
Principal

Important Disclosures:

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