Fountainhead Partnerships Fund
Market Volatility update- Spring 2025

At the end of March, the S&P 500 was down 6% YTD and MSCI World was down 2%. Fountainhead Fund was down ~4%. As of April 4, S&P 500 is down 13%YTD, MSCI world is down 9%. The Fund is doing better than benchmarks.

Tariffs Turmoil:

The latest downdraft in the market is caused by the worse than expected proposed tariffs announcements by the US administration, followed by China's tariffs response to reciprocal tariffs. Not sure what a tariff response to a reciprocal tariff is called!

The market is trying to digest the impact of these proposed tariffs, none of which are in implementation yet, in typical fashion of *shoot first and ask questions later*.
Here our thoughts on the rationale and impacts of the proposed tariffs by the US administration.

There are three theories of why the Tariffs are proposed in the first place:

1. *Generate Revenues for Tax cuts*: USA has been running over 6% fiscal deficit in the last 4 years, which is the highest 4-year cumulative deficit during any non-recessionary period since 1950. Hence there is no fiscal capacity left with US to provide tax cuts to corporates. In the current format as per some estimates, the proposed **tariffs can generate USD 700bn** of additional tax revenues.

2. *Slowing the economy so that lower Bond yields will create savings on interest payments*: The US administration is trying to slow the economic growth by spending cuts. That slowdown is causing bond yields to come down and reduce interest payments. US interest payments have ballooned to over a trillion dollars annually and a 100bps drop in yield can save close to $300bn in reduction in fiscal deficit. That will create more space for Tax cuts. The US govt hopes that it can achieve its own soft landing without pushing the economy into a recession.

3. Lower US dollar: The chair of White House Council of Economic Advisors Stephen Miran, in a November 2024 paper, laid out possible options for reforming global trade and reducing economic imbalances that are arguably driven by the US dollar's overvaluation. There is a general belief in the foreign exchange markets that **an Un-official Mar-a-Lago accord** is being implemented globally to weaken the US dollar. A weaker US dollar increases exports earnings and reduces the trade deficits.

4. Fourth and least popular theory around reciprocal Tariffs is a design to bring back manufacturing to US. This is a low probability theory, but difficult to completely disregard since one cannot rule out anything with current US administration.

The first three rationales for Tariffs may suggest that in the current form Tariffs may not be sustainable. Once the objective of tax cuts is achieved, they will be rolled back, if not earlier, as they do not require congressional approval. Fourth possibility will have the most adverse impact on the global economy particularly on the US. This possibility will likely create a global recession, increase prices immediately (if not inflation for next few years of adjustments) particularly in the US and create a capital outflow from the US capital market. We think the market is pricing in that scenario with the worst back-to-back down days in decades.

One additional piece worth mentioning here about the Tariffs sustainability is the US govt's offer today to China for easing in Tariffs if China allows Tiktok to be sold to a US company. Some might consider this offer as an art of deal while others would consider it a blackmail. Whether this approach will work or this time foreign governments will call US administration's bluff and test its pain threshold, is unclear.

Last act in this tariff drama came from the US Federal reserve chairman who made the statement today that said "*Our obligation is to keep longer-term inflation expectations well anchored and to make certain that a one-time increase in the price level does not become an ongoing inflation problem.*" Interpreting this statement is difficult, but it shows some willingness to cut rates without specifying how quickly. US Fed must be feeling quite miserable seeing its achievement of an impeccable soft landing turning into a likely recession. Can they do it again in two years?

S&P 500 is down close to 20% from its all time high in February 2025. Market's valuation has come down from 24x PE at the market peak to ~18.5x now. Many large cap stocks are down close to 25-35% from their recent highs. This valuation has not been seen since 2022 and seems an attractive level at which to allocate capital.

What Fountainhead has done in this Volatility:

Coming into April, the Fund had close to 13% in cash and generated some liquidity through its options activity. We deployed a good part of that liquidity today in the companies both existing and new holdings that we consider cheap and expect to keep their growth profile even in this turbulent scenario. We look to add more cash to the companies that in our opinion are poised to outperform in the coming quarters. We wanted to hedge the portfolio with index options spread, however the index vols in the last few weeks have not been conducive to any options hedging activity. Instead, we decided to hedge through individual company options. The Fund has outperformed the market every month this year and we are modestly confident that this trend will continue for the rest of the year.