April 14, 2025

Dear Clients and Friends,

The first quarter of 2025 seemed like it might see a continuation of 2024's exuberance over the incoming administration's preference for lower taxes and deregulation. That sentiment quickly shifted when the new administration revealed its intentions to first focus on curbing government spending and trade imbalances. Markets have been understandably rattled by a rapid succession of tariff announcements that continued through the end of the quarter and into April. Market volatility skyrocketed following the April 2nd "Liberation Day" announcement, which introduced significantly higher-than-expected tariffs on several of the nation's key trading partners—sending markets tumbling. Though tariffs have long been used as tools of economic policy, the current administration's unpredictability in announcing, modifying, and reversing trade barriers is making it especially difficult for businesses and investors to plan ahead. The lack of clarity on when and how extreme the White House's tariff regime will eventually settle has economists, corporate managers, and consumers hanging on every word and assuming the worst, souring consumer confidence and delaying corporate investment.

Even before the tariff announcements and subsequent reprisals, signs of a potential pause in AI infrastructure spending had introduced fresh volatility to some of the stock market's most widely owned growth companies. After an extraordinary run in 2023 and 2024, driven by the rapid expansion of generative AI applications and the massive data center build-out required to support them, the pace of investment began showing signs of deceleration. This weighed on the market values of leading AI chipmakers, as well as on shares of utilities and energy companies that had benefited from the surge in electricity demand tied to data center growth. Against this backdrop, the first quarter total return for the S&P 500 index was down 4.3%, while the tech-heavy Nasdaq declined 10.4%. Following the trade announcements in early April, stock prices have whipsawed wildly as investors attempt to interpret the implications of the messages emanating from the White House.

President Trump has a long history of establishing extreme positions and then moving toward the middle. In *The Art of the Deal*, he describes this tactic as a way to anchor negotiations and make space for concessions while still achieving his goals.[1] If trade war rhetoric cools and the Administration's focus returns to more friendly tax and regulatory policies, markets could recapture recent losses. Trump is also likely to push hard for a quick budget deal that includes substantial tax relief beyond just extending current tax cuts to offset some of the pain from his tariff policies on consumers and businesses. Elevated cash balances in money market funds could serve as a powerful tailwind for equities if investor confidence begins to improve and capital moves back into risk assets.[2] We don't yet know how the trade or budget negotiations will ultimately be resolved, but what's clear is that both are likely to continue to inject uncertainty and volatility into the markets in the near term.

[1] Donald J. Trump and Tony Schwartz, *The Art of the Deal*, 1987.
[2] *The Wall Street Journal*, "Americans Are Sitting on a Cash Pile as Stocks Reel," April 5, 2025.
https://www.wsj.com/finance/stocks/americans-are-sitting-on-a-cash-pile-as-stocks-reel-4b782b92

In a crisis, all correlations go to one

During times of crisis, correlations among risk assets tend to spike.[3] This "correlation convergence," can lead to simultaneous declines across all asset classes. Many investment firms rely on what we consider over-diversification to shield clients from market swings. Time and time again, including during this period of heightened volatility, those strategies have offered limited protection when fear drives investors to cash out.

Creating opportunity for incremental improvement

Rather than owning an overly diverse array of stocks or a basket of index funds, we believe clients are better off owning a targeted collection of some of the world's best businesses. During periods of market dislocation, we employ a disciplined and opportunistic approach to enhance portfolio quality, recognizing that broad selloffs often present rare opportunities to invest in exceptional businesses at more compelling valuations. Our team is currently laser focused on evaluating opportunities to reallocate capital toward businesses with even stronger balance sheets, more durable cash flows, and greater pricing power—hallmarks of long-term value creation and the potential for steady compounding of shareholder returns.

"Compound interest is the eighth wonder of the world. He who understands it, earns it; he who doesn't, pays it." – Albert Einstein (attributed)

The idea of compounding—where gains beget larger gains over time—has been known for millennia. Clay tablets housed in the Peabody Museum at Yale reveal that even the ancient Mesopotamians understood and applied the mathematics of compound interest in their accounting practices.[4] They recognized, as we do today, that value can grow exponentially when left undisturbed.

Over the long term, equities have historically rewarded patient investors with strong compounding returns. The S&P 500 has delivered an average annual total return of approximately 10% over the past 50 years, including both price appreciation and dividends. That's a cumulative return of over 100x, but it's only available to those who can stay the course despite the bumpy ride. It's periods of stock market volatility that can cause people to sell, interrupting the magic of compounding.

The long-term correlation between consistent earnings growth and rising stock prices is remarkably strong.[5] That is why steady earnings compounders like **Alphabet, Aon, Amazon, Costco, and Mastercard** have earned their tenures in our Douglass Winthrop portfolios. They are among a number of companies we aim to buy for clients when markets offer attractive entry points. A lesser-known company that exhibits the attributes we seek for long-term investments is **Copart.**

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[3] CFA Institute, "Global Asset Correlations During Crisis," 2020.
[4] Yale University Peabody Museum, Exhibit on Mesopotamian Mathematics and Economic Records, accessed 2025.
[5] Nasdaq, "Why Earnings Matter to Stock Prices," accessed March 2025. https://www.nasdaq.com/articles/earnings-matter-to-stock-prices

Copart may not be a household name, but it plays a vital role behind the scenes in the auto industry. The company operates a global online marketplace where insurance companies sell cars that have been declared total losses. What began as a single salvage yard has evolved into a high-margin, capital-light platform that benefits from powerful network effects and long-standing insurer relationships. Over 80% of the vehicles Copart sells come from these partners, ensuring a steady supply. The company has compounded revenue at 9.9% annually and earnings per share at 13.9% over the past five years, while maintaining EBITDA margins above 40% and returns on invested capital near 30%. Copart's scale and infrastructure—combined with more than 750,000 global buyers—create durable competitive advantages in a market with only one serious rival. With 18% of revenue coming from international markets and significant room to expand abroad, we believe Copart is well-positioned to continue compounding value for years to come.[6]

In periods of heightened uncertainty, it can be tempting to overreact or retreat to the sidelines altogether. But as history has shown, the best investment outcomes are rarely the result of rapid responses to news headlines. Rather, they come from patiently owning high-quality businesses through cycles, allowing compounding to do its quiet, powerful work over time.

"Play long-term games with long-term people. The returns in life, in relationships, in knowledge, and in finance all come from compound interest." — Naval Ravikant

We also believe that, just like investments, long-term client relationships themselves compound in value. Clients who have worked with Douglass Winthrop for many years benefit from our growing familiarity with their goals, risk preferences, and individual circumstances. This deep knowledge allows us to be more effective in everything we do—from portfolio construction and reliable account administration to thoughtful planning and strategic advice. As with the investments we manage, the longer the relationship, the greater the potential to accumulate insights, avoid unnecessary friction, and align decisions with long-term objectives. This is a form of compounding too—one rooted in trust, consistency, and partnership.

Warm regards,

Douglass Winthrop Advisors

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[6] Copart, Inc., Company filings and DWA internal estimates, 2024–2025.