

Summary

- We remained concerned about the fiscal situation in the United States.
- Government spending has not been holistically addressed since 2010; it was not successfully addressed back then, and since the last effort, the national deficit has more than doubled.
- While the Department of Government Efficiency (DOGE) faces significant hurdles related to authority, political dynamics, and workforce issues, it also holds potential for substantial reform in federal spending and regulatory practices if it can navigate these challenges effectively.
- While a lower government deficit has the potential to boost investor confidence, lower interest rates, provide more fiscal flexibility in downturns, and promote economic growth by freeing up capital for investment, it also carries risks associated with potential cuts in government spending and political resistance that could create market volatility.
- Potential positive investment implications of a lower deficit could be higher growth rates, improved price-to-earnings ratios, and lower interest rates. Potential negative investment implications could be lower near-term growth and increased market volatility.
- While TIFF is optimistic that DOGE may be able to deliver some fiscal prudence, TIFF remains skeptical of fixed-income prospects and prefers Diversifying Strategies due to their expected lowly-correlated return streams. Our concern with US fiscal profligacy also leads us to believe small positions in crypto-currency and gold may make sense as modest hedges against fiscal imprudence.
- However, despite the US fiscal risks, the US remains an attractive place to invest relative to other countries, which have their own, in many cases, more troubling issues.
- As global citizens, we should all care about the US fiscal situation as it sets the precedent that we may be taking more than our fair share at the expense of future generations. Even if DOGE is partially successful, additional fundamental reform will likely be required to achieve a continued appropriate balance of support for our society today and support for future generations.

The Hard Part

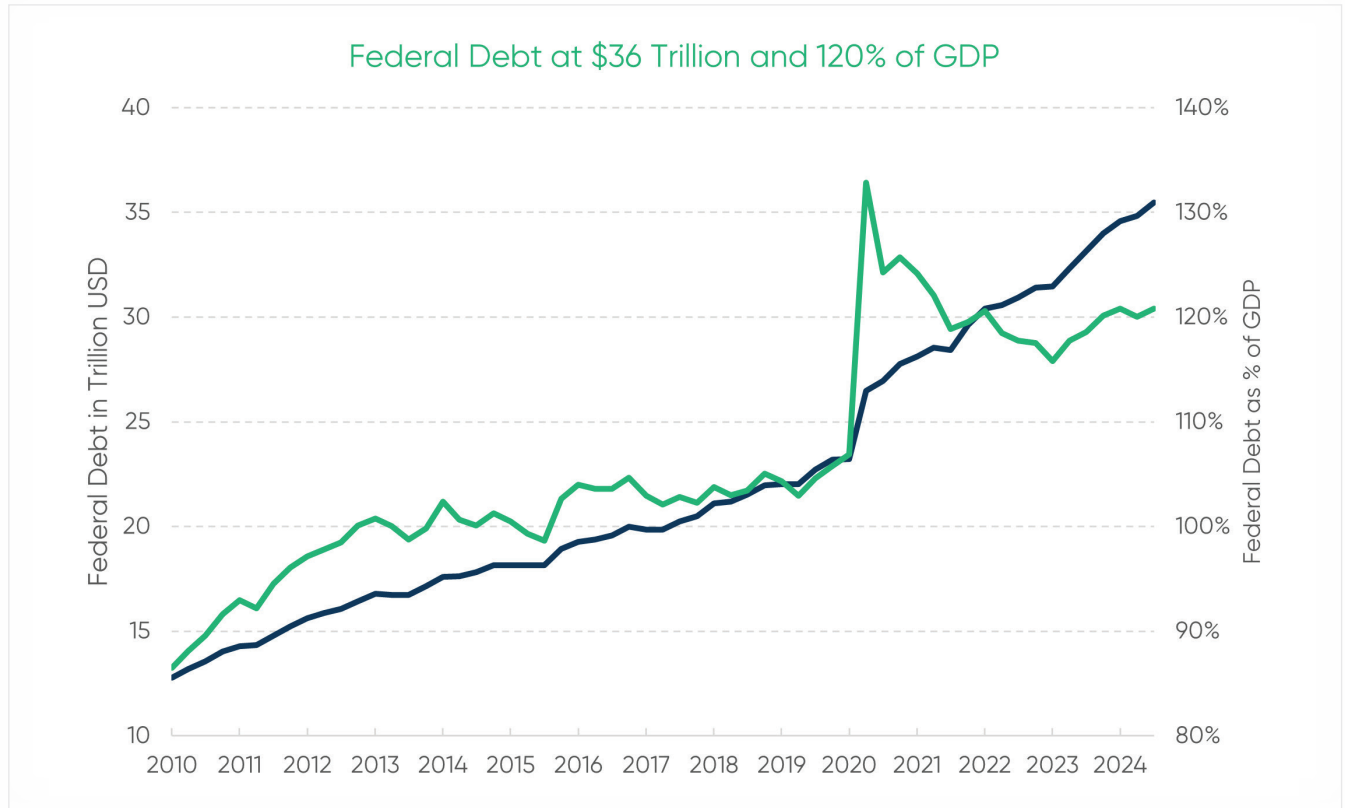
This quarter, we aim to address a topic that will likely elicit a range of opinions: the fiscal trajectory of the United States, the impact of the newly formed Department of Government Efficiency (DOGE) on that trajectory, and their implications for the markets. Driven by our concern over the nation's unsustainable fiscal path, we are committed to offering a hopeful and constructive perspective, with the goal of providing a balanced and thoughtful analysis.

The 2024 election is over, but the political landscape remains in flux. The President-elect, Donald Trump, and his expanding team will face a range of priorities, many of which will represent a significant departure from current policies. Trump's approach to communicating these policies also will differ from that of the outgoing administration. Given the uncertainty surrounding the details and direction of new policies, it is difficult to assess their potential impact at this stage. As a result, we will avoid making predictions about specific issues such as tax rates, tariffs, and immigration policies. While the eventual details will be crucial to understanding their effect on the fiscal situation, it is too early to confidently make any definitive conclusions about their long-term impact on the budget deficit and national debt.

We aim to focus on the potential impact of DOGE. The goal of DOGE is to reduce government spending and waste—a goal that is not new, as reducing these issues has been a long-standing priority. The last major focus on fiscal matters was in 2010, following the Great Financial Crisis when President Obama established the bi-partisan Simpson-Bowles Commission. Led by Republican Senator Alan Simpson (Republican) and former Clinton White House Chief of Staff Erskine Bowles (Democrat), the commission aimed to reduce the growth of federal budget deficits over a 10-year horizon. However, this effort fell short largely due to Congress being unable to agree to the requisite changes due to partisan political disagreement, a challenge that seems much worse today than it was 14 years ago.

Since 2010, our national debt has more than doubled, growing from \$13 trillion to over \$36 trillion, and is expected to grow to \$85 trillion by 2054. As a percentage of GDP, debt has risen from about 80% to 120%¹, and is projected to rise to 179% in 2054. This trajectory is unsustainable. Without change, America faces the danger of financial insolvency and defaulting on its debt. This is where President-elect Trump believes DOGE can help ameliorate some issues.

¹ St Louis Fed.



Notably, even if DOGE is 100% successful in its announced target of \$2 trillion of annual savings, policy changes may be necessary to ensure the US does not continue on this unsustainable fiscal path. In addition to being investors, we are all global citizens, and many of us reading this letter are US citizens. We should all care about our society's long-term future and what we are leaving for the generations to come. We must remain vigilant in looking for solutions and striking the right balance between today's consumption and the debt we leave for the next generation to pay.

The Realistic Part

To get started, we turned to AI for assistance, specifically using perplexity.ai to provide an analysis of the challenges and opportunities facing DOGE, under the leadership of Elon Musk and Vivek Ramaswamy, in the United States. In summary, while DOGE faces significant hurdles related to authority, political dynamics, and workforce issues, it also holds potential for substantial reform in federal spending and regulatory practices if it can navigate these challenges effectively.

Challenges	Opportunities
Limited authority to make binding changes as it is mainly an advisory role	Ambitious cost-cutting goal of annual \$2 trillion , including \$500 billion in unauthorized federal expenditures
Potential lack of bipartisan cooperation due to controversial DOGE leadership (Musk, Ramaswamy) and presumed ulterior motives	Innovative outside perspectives could lead to fresh ideas and solutions
May face litigation challenges as DOGE plans to use recent Supreme Court rulings to dismantle regulations	Potential bipartisan support from members focused on efficiency , especially in defense spending
Workforce reductions may alienate essential personnel needed to evaluate and implement change	Potential streamlining of regulations and supporting further economic growth by reducing red tape
Public perception may undermine its credibility and support if the public views DOGE as political retribution instead of a genuine attempt at efficiency improvements	Given Musk's background, there may be opportunities to leverage technology to streamline operations

Each of us may have, at some point, been involved in discussions—whether in a personal, corporate, or philanthropic context—about how to either grow revenues faster or, more likely, how to reduce spending to improve the odds of financial success. From our perspective, this may be America's best chance to proactively secure its financial future, as opposed to reactively as a US "United Kingdom 2022 Truss-like" market mutiny may entail. DOGE has a short lifespan, aiming to complete its work by the nation's 250th Centennial on July 4, 2026. If this effort is to succeed where others have failed, DOGE's claims that transparency and inclusion will be paramount. We hope DOGE can assemble a bipartisan team that excels at identifying inefficiencies and challenging them openly. An open, public approach could greatly shift the national conversation and gain widespread support for reducing waste and improving government efficiency. If this effort and other required reforms fail, we believe future generations may not inherit the same opportunity we were given.

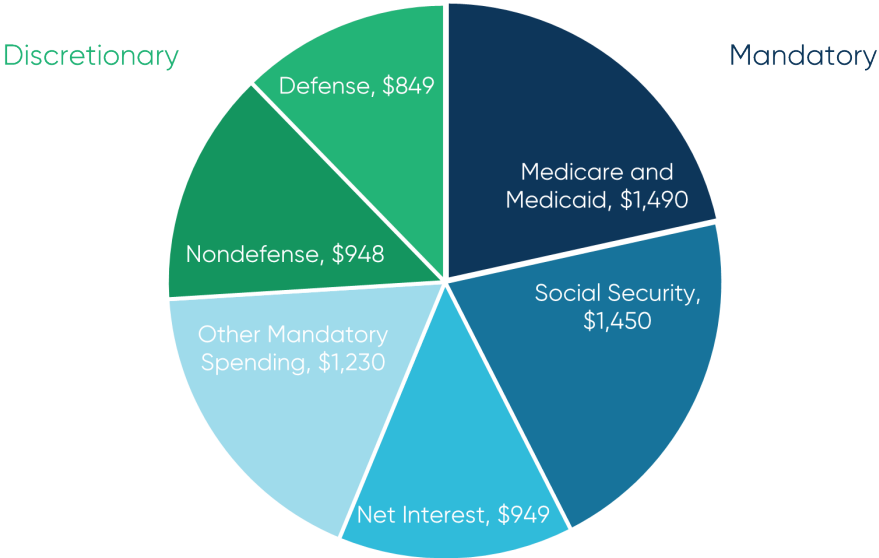
The Fun Part

What if DOGE works, and collectively, we support their efforts to slow the growth of the deficit? To be clear, in our view, success does not require eliminating the annual deficit in one or even 10 years. The goal is to reduce its growth rate to slower than that of GDP.

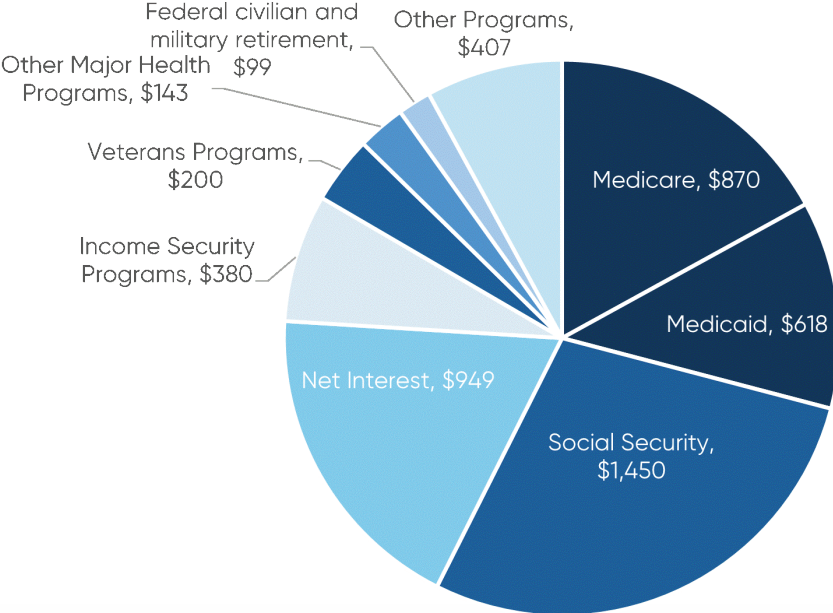


Success does not need to be DOGE's goal of \$2 trillion of savings each year. If we can reduce our deficit run-rate by \$250 billion every couple of years (keeping in mind that the commission is set to end on July 4, 2026) and the deficit grows by "only" \$500 billion per year after a decade or so, we will likely avert some of the worst consequences we have feared. Moreover, the path to achieving this could be quite rewarding.²

Mandatory vs Discretionary Spending in Billion Dollars

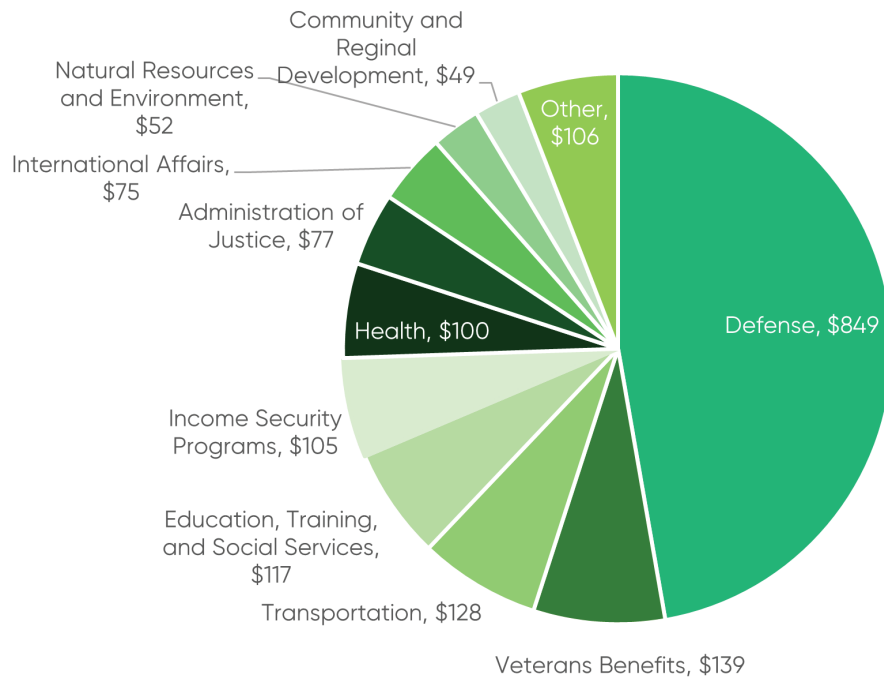


Mandatory Spending in Billion Dollars



² Chart data source: Congressional Budget Office.

Discretionary Spending in Billion Dollars



We asked perplexity.ai to summarize the potential benefits and risks of cutting deficits. The AI identified several key points: A lower government deficit has the potential to boost investor confidence, lower interest rates, and promote growth by freeing up capital for investment. However, it also carries risks associated with potential government spending cuts and political resistance that could create market volatility.

The AI perspective is detailed in greater depth below.

Positive Impacts	Negative Impacts
<p>Increased investor confidence given more stable fiscal environment</p> <p><i>Investment Implication: Higher price/earnings</i></p>	<p>Cuts to spending could negatively impact sectors reliant on federal funding</p> <p><i>Investment Implication: Lower growth</i></p>
<p>Lower interest rates if the government requires less borrowing</p> <p><i>Investment Implication: Lower interest rates</i></p>	<p>Potential short-term market volatility due to (1) investors reacting to changes in fiscal policy, (2) uncertainty about future government spending, or (3) political resistance leading to lack of progress and thus more uncertainty</p> <p><i>Investment Implication: Market drawdowns (higher VIX)</i></p>

<p>Enhanced economic growth by freeing up capital previously used for interest payments for investments in growth-promoting areas</p> <p><i>Investment Implication: Earnings growth rate improves; more job creation</i></p>	
<p>Improve capital access for the private sector as the government requires less borrowing</p> <p><i>Investment Implication: Increase in entrepreneurship</i></p>	

How TIFF's Investment Views are Informed by the US Fiscal Situation, with or without DOGE

This is not the first time we have written about the fiscal situation; in fact, we discussed it last quarter as well ([3rd Quarter 2024 CIO Commentary](#)) and previous ones. The impacts of our current debt /deficit trajectory inform many of our forward-looking investment views, many of which remain the same, even with the creation of DOGE and its potential success.

- 1. Fixed Income:** We remain underweight duration and skeptical about the fixed-income outlook. As there is high uncertainty about DOGE's success (or the success of any other efforts), there remains asymmetry in future fixed-income performance. Based on this view, we maintain our preference for Diversifying Strategies over Fixed Income. As we have discussed in many letters, we are also attracted to Diversifying Strategies with the potential to provide lowly correlated returns to a diversified portfolio.
- 2. Global Investing:** Despite all the negative talk about the US fiscal environment, the US remains, on average, more attractive than many other geographies, or as some would call it "the cleanest dirty shirt." The US dollar remains the world's reserve currency, we have the best outlook for innovation, and our economy, while still variable, remains stronger than many others.
- 3. Crypto / Gold:** While this letter is hopeful for some improvements to the fiscal outlook, until we see some actual progress, we will remain concerned about the long-term fiscal situation. Because our goal is to prepare for a range of outcomes, we have small positions as hedges against a fiscal mis-step (or moderate turmoil), such as crypto currency and gold.

The Really Fun Part

If we can work together to achieve a moderation of the deficit, the optimistic prognosticators we currently dismiss as overly ambitious may be proven right 10 or 20 years from now. However, the challenges facing DOGE and our nation are large and entrenched. Achieving success will require that we work together to identify and reduce wasteful spending at the federal level. Managing to do so has the potential to yield significant benefits. We hope that we can unite behind this vision of a better future and not let a few self-interested politicians put their own interests ahead of America's. We want to see the world that is possible if we succeed and to never have to contemplate a debt spiral again.

TIFF's Investment Program

We are again proud of our performance this year. We remain close to our strategic allocations of 65% equities, 20% hedge funds, and 15% fixed income. Most funds competed well in a challenging market environment, where growth stocks—especially the MAG 7—continued to outperform most others. Ensuring our factor exposures remained balanced helped, as did the second-half rally in small-cap stocks and strong manager alpha. Our diversifiers outperformed the Bloomberg Barclays US Aggregate Bond Index (the "U.S. Agg"), which positively impacted our portfolios, while fixed income continued to lag returns in other sectors.

Heading into the new year, we do not anticipate much change in our portfolios. We remain optimistic about the investment outlook for 2025, with both the US and global economies appearing stable and poised for growth. Pro-growth strategies in 2025 could benefit markets; and a resolution to the conflicts in Ukraine and the Middle East could lead to the end of both wars, increased energy and food supplies, and lower costs for both developed and emerging markets. Inflation seems less likely to accelerate from here and if DOGE can make some positive progress, the attractiveness of US assets could improve even more.

Despite equity valuations that remain elevated, we believe equities are still the most attractive asset heading into 2025. This is based on our belief that economic growth will remain solid, we may see efficiency gains from AI starting to help margins expand, and a boost to animal spirits in the US is possible. While inflation seems reasonably under control (albeit unlikely to return to the Fed's 2% target in the near term), we foresee some easing, though not enough to make fixed income attractive at this time. Spreads between corporates and treasuries are at multiyear (and, in some cases, multi-decade) lows,



signaling higher risk and lower relative returns than usual in non-Treasury fixed-income securities.

We expect our diversifying strategies to continue generating higher returns than the U.S. Agg, while also providing better protection in the event of an equity market pullback. Additionally, after nearly three sub-par years, a rise in mergers and acquisitions (M&A) and initial public offerings (IPOs) could help boost private equity's results. All the key factors are in place to help make 2025 another solid year for financial markets.

As always, we very much appreciate the opportunity to help manage your capital and help you achieve your organization's goals. We are here to assist you in any way possible, so please reach out and let us know how we can help.

Your TIFF Investment Team



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