Commentary

What the recent tariffs could mean for the market and investors

April 2, 2025

President Trump's aim to use tariffs to help bring manufacturing back to the U.S. and addressing what he identifies as trade imbalances between the U.S. and the rest of the world is impacting markets. What the current trade and tariffs scenario could mean for investors can be viewed in the broader context of evolving policy and regulatory events, many of which are still unfolding. These include tax reform, immigration, and deregulation, among others. One thing that seems clear regarding the reciprocal tariffs announced on April 2 is that lingering uncertainty around them is the biggest risk. Are they essentially a starting point for negotiations or intended to be long-term? While the economic impact of these potential changes for the U.S. economy is expected to be moderate, market volatility is likely to remain elevated—and the situation remains fluid.

Key takeaway: Uncertainty is the watchword for now

- There is still considerable **uncertainty** around the holistic impact and true intent of the reciprocal tariffs. **This uncertainty is a bigger risk than the tariffs themselves**, given the lack of clarity around duration and who absorbs them (exporter, importer, consumer).
- **Uncertainty has led to a deceleration of economic activity and may increase the odds of an economic recession** over time.
- While a recession is not our base case, investors should be aware that **the market may remain volatile** as tariffs remain a prevalent topic for businesses and the market. Market multiples (i.e., price-to-earnings ratios for the S&P 500 index) may continue to re-rate lower in this market environment.

What investors should bear in mind

- Given the uncertainty, we believe the odds of a more stagflationary environment have modestly increased—and a more neutral vs. fully risk-on positioning may merit consideration.
- Recession is not a given: Our base-case remains that of a resilient economy (albeit with sticky inflation) and growing earnings, which informs our positive outlook for U.S. and international equities.
- While tariffs may create market volatility, long-term investors should focus on their overall strategic goals and diversification needs rather than reacting to short-term events.
- Greater portfolio diversification through exposure to alternative asset classes can help provide ballast during market volatility.

Interpreting the April 2 tariffs announcement

It is still too early to determine whether the imposition of reciprocal tariffs is a negotiating tactic or a long-term policy tool. The surprisingly broad tariffs raise near-term growth and inflation risks. We believe tariffs may lead to a quickly realized one-time inflation increase. The growth impact—driven in part by uncertainty—could last longer and hit later.

Following are points to keep in mind as the current trade and tariff situation unfolds:

- The 10% universal tariff that covers all but non-targeted trade partners could have been worse, but **we believe the overall effective incremental tariff was more than the market anticipated.**
- Our early back-of-the-envelope calculation is that the **effective tariff rate equates to about 26%; it has not been above 10% since the 1950s.**
- **Equity and energy futures markets reacted negatively** immediately following the announcement and yields on U.S 10-year Treasury notes declined. Gold prices rose.
- The administration announced a series of reciprocal tariffs on regions and countries with high trade deficits with the U.S., including China (34%), the European Union (20%), Vietnam (46%), Taiwan (32%), Japan (24%), India (26%), and South Korea (25%).
- The U.S. announced a baseline 10% tariff on countries not specifically targeted.
- The U.S. announced a 25% tariff on imported autos.

As of April 2, 2025:

- **The scope of the tariffs** is significant, marking the most expansive tariffs from the Trump administration to date and the largest escalation for U.S. tariffs in the postwar era.
- **Tariffs are being enacted faster and at higher effective rates than our consensus expectations** had assumed and are disproportionately hitting the largest U.S. trading partners.
- Evidence is mounting that the administration views tariffs as a necessary tool to increase domestic manufacturing and jobs.
- The size and rapidity of the tariff announcements prevent firms from adequately addressing supply chain issues—and therefore **increase the near-term downside risks to growth and upside risks to inflation.** In other words, the risk of stagflation rises.

Implications

- While the U.S. administration seeks an increase in tariff revenues, it is unclear who will ultimately pay these taxes. The breakdown of "who will pay" will impact the U.S. economy and corporate fundamentals in ways that cannot yet be ascertained.
- Considerations of who will pay these taxes should include **both corporate supply chains and consumers**. The impact to GDP simply measures the % gained from tariff revenue and does not assign an allocation to who pays. Supply chains and consumers may share the burden, which will differ by sector and industry.
- The impact on economic growth and inflation is dependent on how the "who will pay" breakdown plays out. For example, if supply chains absorb more of the costs, it may be more detrimental to growth (i.e., a lower U.S. GDP growth rate). However, if consumers end up paying more for imported items, that may result in a higher inflation rate.
- To fully ascertain the net effects of this breakdown, knock-on effects must be considered. For example, corporate margin compression leading to layoffs may further slow economic growth (but likely would be disinflationary). Also, consumer behavior may lead to the consumption of alternative products not affected by tariffs—or they may seek out substitute products or altogether defer the consumption of a particular product.
- **As illustrated, the bottom-line impact of tariffs on economic and corporate fundamentals is challenging to conclude. Therefore, investors should remain vigilant and patient—and stay focused on diversification in their portfolios.**

Conclusion

While the 24-hour news cycle can create anxiety, we remain steadfast that focusing on long-term investing is in the best interest of clients.

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