

Assessing the Impact of Tariffs on Markets and Investors



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On April 2, 2025, we received the long-awaited tariff announcement from President Trump, dubbed “Liberation Day”. He announced a broad list of reciprocal tariffs with our trading partners, starting at 10% for most, with levies rising far higher in the case of those countries with whom the U.S. runs the highest deficits. The rollout of the administration’s new tariff policies has been shrouded in uncertainty until the announcement. Overall, the announced tariffs were more aggressive than market expectations.

As a result, the market reaction has been rapid and significant. US stocks have not been spared and fell as much as 4% as measured by the S&P 500 index on Thursday, April 3, 2025. Foreign markets, measured from the perspective of a US investor, are taking this surprise relatively better. While these markets are weak in local-currency terms, the currencies underpinning these markets, such as the euro, yen and pound, have all appreciated against the US dollar, offsetting much of the weakness in local currency terms.

Given the heightened volatility, many investors may be unnerved. What follows is a brief summary to help you understand the impact of tariffs on the underlying economy and markets, along with some important reminders about investing through uncertainty and volatility

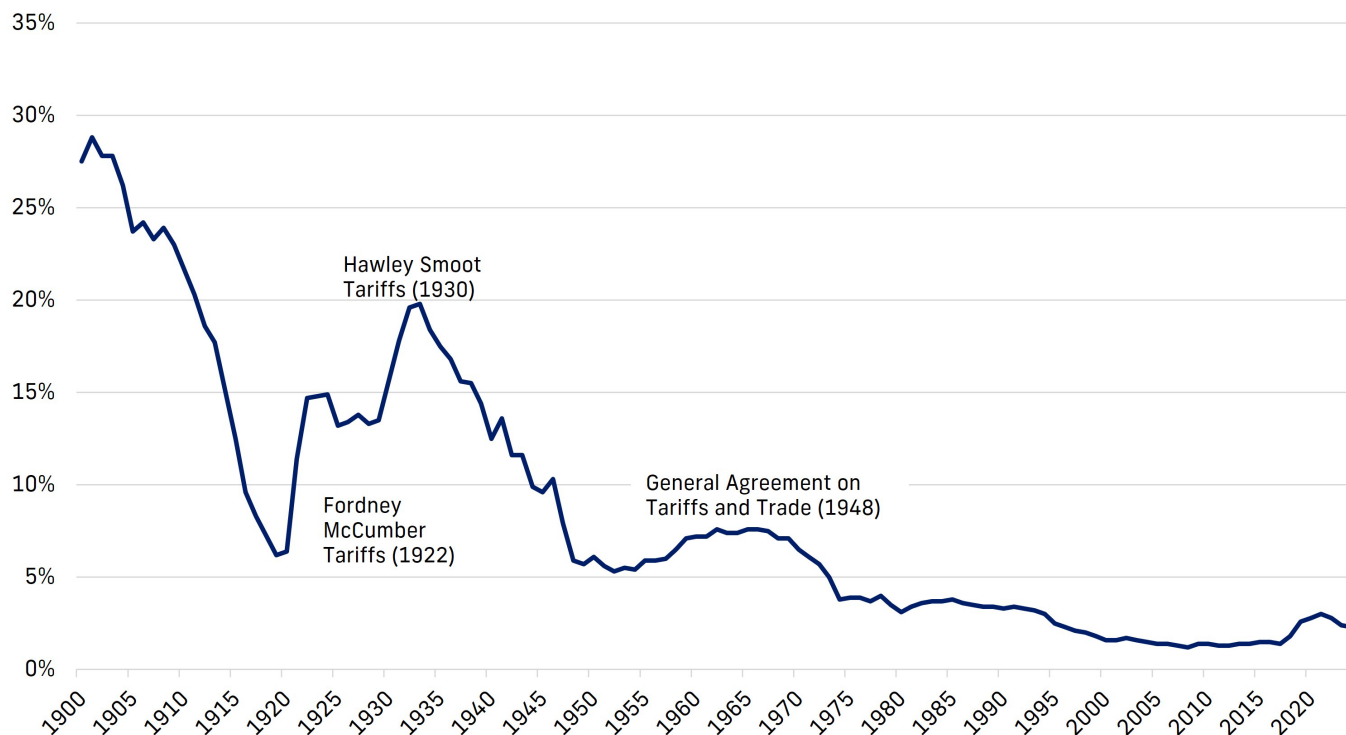
The history on tariffs

Tariffs are nearly universally panned by economists. They view it as a market distortion. Many invoke the Smoot Hawley tariffs of 1930 as a driver of the Great Depression, but this is incorrect, and our global economy is not on the precipice of another depressionary environment. The Great Depression had many causes, including a credit crunch and a plunge in industrial production. Tariffs made a very bad situation worse, but were not the primary cause of the Great Depression.

A counter example is the Fordney-McCumber tariff in 1922, which doubled duties shortly after WWI. The

wartime industrial boom gave way to a softer economic patch, and US industry was competing against a Europe that was rebuilding from the war. This tariff occurred at the beginning of the roaring 1920s. Like the example above, it would be wrong to attribute the roaring twenties to a doubling in tariffs. These tariffs also caused economic distortion, invited retaliation from Europe, and increased prices, yet serve as a strong example that even a large surge in tariffs does not spell a crisis on its own.

US Average Effective Tariff Rate



Source: Bloomberg

The coming months will determine if this round of tariffs has the effect of stimulating manufacturing investment in the U.S., invites retaliation from other countries, and feeds into underlying inflation and inflation expectations. Tariffs alone should not cause a recession, but tariffs have unfortunately hit at a moment when both consumer and business confidence is weakening.

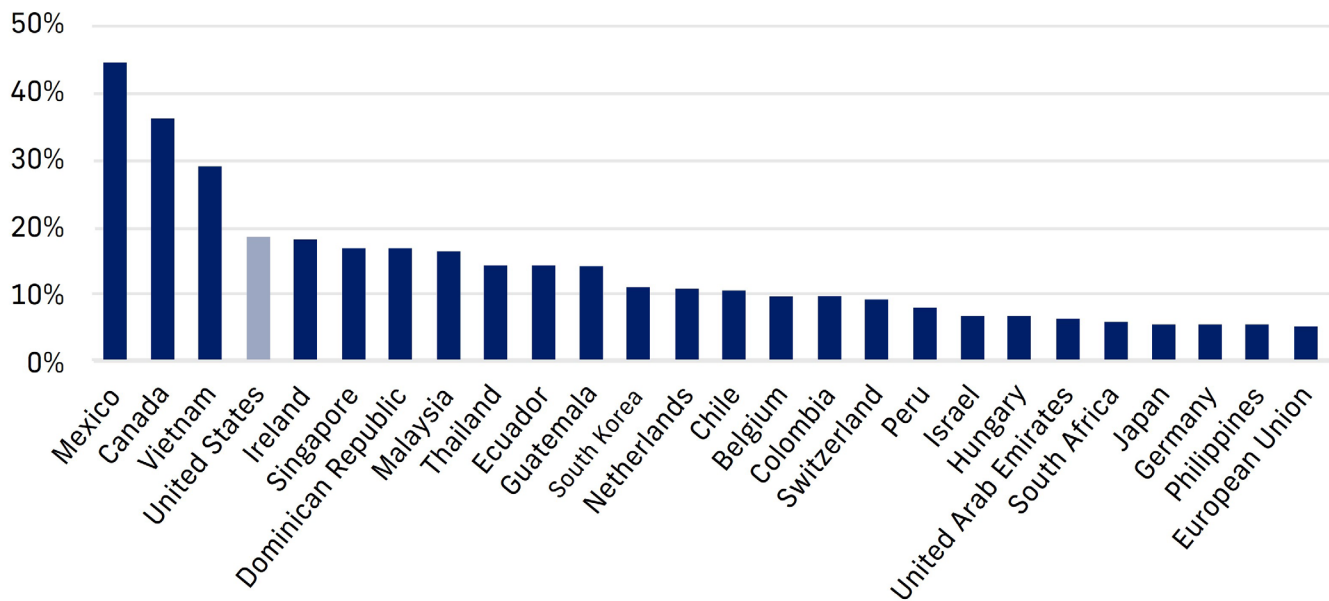
Global trade policies impact individuals and enterprises very differently

Given the US has instigated in what amounts to a resetting of global trade, what happens next depends on how the rest of the world responds (e.g. negotiations to talk us down or tit-for-tat escalation), how long these policies remain in place, and where trade ultimately settles. In today's environment, the U.S. consumer is the most sensitive to changes in United States trade policy. The chart below measures trade in goods as a percentage of GDP. The U.S. and its neighbors who depend on U.S. trade, Mexico and Canada, are economies that are most sensitive to U.S. trade in goods, given the magnitude of U.S. goods consumption from around the world.

As countries contemplate retaliatory tariffs, the U.S. producers of goods may find themselves involved and the potential for tariffs on services, in addition to goods, is not off the table. Most often, no one wins in a trade war. There are simply varying degrees of impact. The ones least impacted are those not in the center of the mudslinging. In this case, foreign consumers face no changes to the levies they face, and foreign producers, while they face levies to export to the U.S., encounter no changes to how they interact with the rest of the world. The market's early reaction to Liberation Day recognizes this, most notably through a weaker dollar and relative outperformance by foreign markets. An internationally diversified stance is incredibly important, especially in the near term.

US Goods Trade (% of Country's GDP)

As of 12/31/23. Source: World Bank, US Census Bureau, Factset, GMO



What happens next for inflation, the Fed, and markets?

Tariffs increase prices. On the margin, measures of inflation are likely to increase this year because of the levies that have been imposed. Depending on how long these levies remain in place, inflation expectations may rise, which is a data point that draws close attention from the Federal Reserve. To borrow a much-maligned word from the Fed, however, the direct inflationary impact of tariffs is likely to be “transitory”. Trade levies increase the cost of imported goods once (potentially more than once if we see escalatory moves), but do not set off a cycle of higher price growth into the indefinite future. This initial round of tariffs has also been cited by prominent individuals in Trump’s administration as a maximum level, likely to be negotiated down materially from here. This would be consistent with the Trump administration’s previous negotiating style.

All else equal, measures of inflation should move higher through the course of this year unless a quick resolution develops. It is unlikely we will see a return to the inflation levels experienced in 2022 into 2023. The Fed will likely respond more to broader measures of consumer and business sentiment, as well as any increase in unemployment versus the “transitory” and

uncertain nature of tariff policy. Markets now seem to indicate more than three rate cuts by the end of this year, reinforcing this view. Should more rate cuts materialize, a high quality, longer duration bond portfolio has the potential to provide value during evolving market conditions. As of the end of March, the Bloomberg US Aggregate Bond Index yielded approximately 4.5%.

Within equity markets, the April 2nd tariff announcement, along with current economic and geopolitical trends such as nationalism, deglobalization, and increased security and defense spending, could signal an inflection point in US “exceptionalism” and outperformance. The dominance of U.S. markets relative to the rest of the world has recently waned. There’s been a notable shifting in the appetite of foreign investors for the perceived safe havens of the U.S. dollar and U.S. markets. As a result, the potential for international markets and diversified equity portfolios to close the valuation gap with the U.S. is stronger than it has been in quite some time. We believe that a globally diversified equity portfolio may offer valuable economic, fundamental, and currency diversification.

Investment perspectives given the April 2nd news and today's market reaction:

- **Be Humble.** Expect heightened volatility in the coming weeks and months. Liberation Day is the biggest change to the United States' trading relationship with the rest of the world since the passage of the GATT in 1947. Attempting to predict what will happen over the coming weeks and months is fraught with risk.
- The Trump administration's ultimate objectives and the response from other countries are both critical unknowns. Expect many talking heads to surface with strong and/or bold predictions in both positive and negative directions. In periods of volatility, it's typical that humility, balance and moderation are often drowned out.
- **Think Long Term.** This is a rapidly changing environment with many players and motivations involved. Making a significant long-term allocation shift over fluid policy and public theater has the potential to hinder overall long-term objectives and impair an investor's ability to reach their goals.
- **Stay Diversified.** Diversification has worked and continues to work well since the election. Investors seeking to optimize their portfolios in the months ahead may want to consider international diversification and diversified bond portfolio that includes intermediate and long-term bonds. Both strategies have shown resilience during 2025's recent volatility and offer potential opportunities for continued performance as market conditions evolve.

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The Bloomberg US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

The S&P 500 Index measures the performance of the large cap segment of the market. The index is considered to be a proxy of the US equity market. All constituents are weighted by their market capitalizations.

The General Agreement on Tariffs and Trade (GATT), signed in 1947, was a multilateral agreement aimed at reducing tariffs and other trade barriers to boost global trade and economic recovery after World War II, eventually evolving into the World Trade Organization (WTO).

Diversification, allocation and rebalancing does not imply you will make a profit and does not protect against losses.

Investments in equity securities involve a high degree of risk. Stock prices are volatile and change daily, and market movements are difficult to predict. Movements in stock prices and markets may result from a variety of factors, including those affecting individual companies, sectors, or industries. Such movements may be temporary or last for extended periods. The price of an individual stock may fall or fail to appreciate, even in a rising stock market. A client could lose money due to a sudden or gradual decline in a stock's price or due to an overall decline in the stock markets.

Investing in foreign securities carries inherent risks associated with political, social, and economic developments abroad. Additionally, differences in regulatory frameworks between U.S. and foreign issuers can pose challenges. These risks may include expropriation, variations in accounting and disclosure standards, currency exchange fluctuations, settlement complications, limited market liquidity, higher transaction costs, and challenges in enforcing legal rights.

Investment in fixed-income and debt securities such as asset-backed securities, residential mortgage-backed securities, commercial mortgage-backed securities, investment grade corporate bonds, non-investment grade corporate bonds, loans, sovereign bonds and U.S. government debt securities and financial instruments that reference the price or interest rate associated with these fixed income securities subject a client's portfolios to the risk that the value of these securities overall will decline because of rising interest rates. Similarly, portfolios that hold such securities are subject to the risk that the portfolio's income will decline because of falling interest rates. Investments in these types of securities will also be subject to the credit risk created when a debt issuer fails to pay interest and principal in a timely manner, or that negative perceptions of the issuer's ability to make such payments will cause the price of that debt to decline.

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