BRIEF INSIGHTS

April 7th, 2025

Our Perspective on Current Markets:

We understand that the current market sell-off, triggered by the recent change in U.S. tariff policy, is concerning to investors and can be difficult emotionally. We hope that sharing our perspective on the initial market reaction can provide some clarity and reassurance during this time, as we navigate through this period of volatility.

Last week, Trump announced his plans for sweeping tariffs starting at a baseline tariff of 10% on all imports into the U.S., plus higher "reciprocal tariffs" on select nations his administration has identified as imposing excessive trade barriers. This effort to reshape global trade is intended to boost economic growth in the United States by way of increased revenues and subsequent tax cuts. If accomplished, we will see a resurgence of domestic manufacturing, greater self-reliance, and protection from global supply shortages.

Following the recent and highly anticipated tariff announcement, analysts are digesting the new information and making preliminary estimations for economic growth and market levels. According to UBS, the new administration had already increased the effective tariff rate to 9% within its first few weeks up from 2% last year. This is the highest level since WW2. Capital Economics calculated the additional tariffs laid out in the Rose Garden will lift the global tariff rate to 24%, the highest level since early 1900s. As we await further clarity on Trump's tariff policy as to longevity, retaliation, and exemptions etc., Fed Chairman Powell sees higher prices and slower growth in the interim. He does however see long term inflation within the 2% objective range, at least for now. We expect the Fed to keep interest rates stable - wary of inflation until further evidence of an erosion of economic growth - before they resume rate cuts to ward off a potential recession.

What caught Wall Street off guard and caused the market sell-off is that it underestimated actual tariffs imposed. Markets therefore reacted strongly to the downside. Rather than using actual tariff rates imposed by foreign countries, the Trump team took a country's trade deficit of goods with the U.S. and divided that number by the total goods imported by the U.S. from that country. Simply put, this calculation is a measure of the trade gap a country has with the U.S., rather than a representation of foreign trade barriers. This leaves quite a large disparity between the actual tariff rate imposed by other countries and the "reciprocal rate" announced on April 3rd. In fact, actual tariff rates are significantly lower than those reported by the White House. For example, the actual tariff rate imposed by the European Union, according to the World Trade Organization, is a 2.7% on a trade-weighted basis. That compares to a rate of 20% the U.S. just imposed on the European Union. This means that the ability of countries to negotiate is somewhat limited and ambiguous. This only adds to uncertainty, weakening market sentiment, and puts downward pressure on markets.

Trump's tariff policy could simply be a negotiating tactic to raise Federal revenues in support of his manufacturing renaissance agenda. The idea being, using an upper hand to expand our manufacturing base, lower our trade deficit, avoid foreign supply disruptions and grow our military stockpiles. To accomplish this, tariffs would need to be relatively short in duration in order to avoid igniting inflation and/or pressuring corporate margins lower. Noteworthy here is that during his first term Trump demonstrated that stock market performance is a very important gauge of success. Thus, there is always the notion of the "Trump put" that refers to his commitment to step in if share prices fall dramatically.

Another issue the market is wrestling with is the shift towards tariff revenues replacing income tax revenues to fund the federal government. This was discussed in a JP Morgan broadcast on April 3rd. Income taxes tend to be more progressive and impact higher income Americans more. Whereas tariffs are a form of a regressive tax on all Americans. Meaning, middle- and lower-income Americans spend a greater percent of their income on goods and would therefore bare a disproportionate impact from higher prices. Tariffs also cultivate an environment of substitutions, reduced competition, weaker growth, and higher prices, all which could temper the boost to revenues over time.

In the coming days and weeks, we should learn more about the potential for foreign retaliation and domestic pushbacks, each of which could have an impact on the longevity and severity of shifting trade policies. Initially, we anticipate foreign retaliation to be limited as countries understand a trade war is in no one's best interest. While retaliation cannot be ruled out, nor can the possibility of trade relationship realignments in response to the change in perception of the U.S. as a reliable trading partner. We also expect some bipartisan pushback from Congressional members challenging Trump invoking his authority under the International Emergency Economic Powers Act of 1977 (IEEPA) to address what he's designated as a national emergency. We immediately saw that the Senate resolution opposing Canadian tariffs attracted bipartisan support in the Senate. We also could see a rise in litigation from specific trade groups seeking relief. These are all areas we will be watching to gain clarity to better assess economic impact.

For now, we expect market volatility to remain as we await further economic releases. The administration's tariff strategy undoubtably is a huge gamble, that has the potential for success should manufacturing migrate back into the U.S. at record speed.

As part of our portfolio strategy, we continue to move defensively in portfolios. For example, in the first quarter of this year, we added to Healthcare with Hologic and Baxter, and added to Consumer Staples with the food company Keurig Dr. Pepper. Our Technology exposure, paring back our position in Microsoft, stands at half the market weight - and our Healthcare at ~35% overweight versus our process benchmark. Continuing the implementation of this defensive equity strategy should ameliorate portfolio volatility during periods of economic stress. As we gain better clarity on the trade issues and the Fed response, we will keep you appraised of additional portfolio rebalancing in the weeks and months ahead.
