Perspectives

APR 2025

Trade Turmoil: Assessing the Impact of Tariffs on Markets, the Economy, and Investors

The global trade landscape has been significantly reshaped by a series of aggressive tariffs initiated by President Donald Trump. These measures have elicited strong reactions from market participants and U.S. trade partners alike, leading to elevated levels of market volatility, souring economic sentiment, and strained diplomatic relations. While the situation is ongoing with major developments seemingly arising each day, this paper aims to summarize the events that have led to this point, detail the impact of the trade war on global markets, and provide commentary on what investors might expect in the months ahead.

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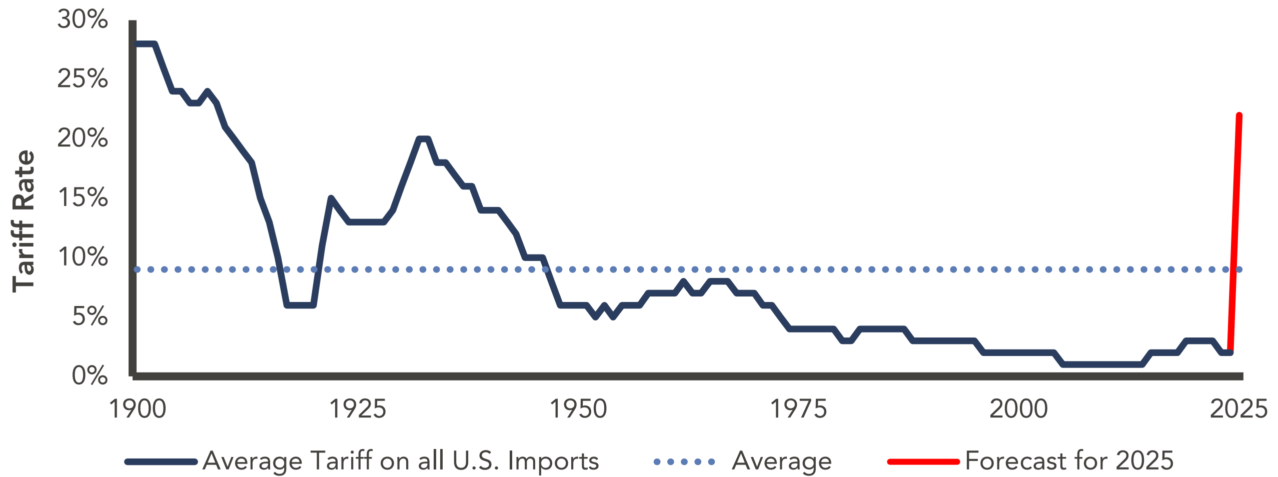
HOW DID WE GET HERE?

Trade conflicts have existed throughout U.S. history. The Smoot-Hawley Tariff Act of 1930, for instance, raised U.S. tariffs to unprecedented levels on thousands of imported goods with the goal of shielding American industries from foreign competition during the Great Depression. After World War II, the U.S. and other allied nations worked together to establish a new global economic order, reducing trade barriers and ushering in a period of relatively peaceful trade relations. This period largely persisted until the first Trump administration, when the U.S. began imposing tariffs on imports from China due to Chinese trade practices that were perceived as unfair by policymakers. In January 2020, the two countries reached a trade agreement under which China agreed to purchase more American goods and committed to intellectual property protections. That said, many tariffs remained in place through the Biden administration and disputes over China's practices continued. While China remains in the crosshairs of the second Trump administration, the U.S. has widely expanded its list of trade combatants in recent days. Exhibit 1 on the following page outlines the effective tariff rate for the U.S. throughout history, which is now expected to reach its highest level in over a century as a result of the tariffs announced last week. These developments are outlined in greater detail in Exhibit 2.

Exhibit 1: Forecasters expect the average effective tariff on U.S. imports to skyrocket in 2025



Source: Bloomberg, Fitch Ratings, U.S. International Trade Commission as of April 2, 2025

Exhibit 2: Recent months have seen a significant escalation of global trade tensions

JAN 20: President Trump, on his Inauguration Day, calls for tariffs to be implemented on Canada, Mexico, and China effective Feb. 1.

JAN 26: Trump threatens a 25% tariff on Colombia after the country refused to accept U.S. planes with deported migrants.

JAN 27: Trump rescinds his threat of 25% tariffs on Colombia after President Gustavo Petro agrees to accept planes with deportees from the U.S.

FEB 1: Trump signs executive orders to implement tariffs on Canada, Mexico, and China, set to start on Feb. 4. Canada and Mexico threaten tariffs in response.

FEB 3: Trump delays tariffs on Canada and Mexico for 30 days after the two countries made moves to address Trump's concerns over border security and drug trafficking.

FEB 4: 10% tariffs are put in place against China; China issues retaliatory tariffs. The U.S. Postal Service bans packages from Hong Kong and China.

FEB 5: The Postal Service lifts its ban on packages from China because of the potential to create massive disruptions for online retailers and U.S. shoppers.

FEB 10: Trump says he will impose 25% tariffs on steel imports from all countries and raises aluminum tariffs from 10% to 25%.

FEB 13: Trump signs a memorandum that sets the stage for "reciprocal tariffs" to be announced on April 2.

FEB 25: Trump signs an executive order instructing the Commerce Department to investigate how copper imports threaten America's national security and economic stability.

FEB 26: Trump says he might give Canada and Mexico a reprieve on 25% tariffs on goods until April 2.

FEB 27: Trump reverses course and says they will go into effect March 4.

MAR 1: Trump signs an executive order to increase U.S. lumber production and orders a probe into potential lumber import tariffs.

MAR 3: Trump says that 25% tariffs on Canada and Mexico will start on March 4 and told reporters there was "no room" for the countries to make a deal before they begin.

MAR 4: Trump levies 25% import tariffs on Canada and Mexico and an additional 10% tariff on China. All three countries threaten retaliatory tariffs. China announces tariffs of up to 15% on imports of key U.S. farm products, set to take effect on March 10.

MAR 5: Trump grants automakers a reprieve from the 25% tariffs on imports from Canada and Mexico until April 2.

MAR 6: Trump changes course and postpones 25% tariffs for goods covered by the U.S.-Mexico-Canada Agreement (USMCA).

MAR 10: China begins imposing tariffs on imports of U.S. farm products.

Canada announces a 25% surcharge on electricity exports from Ontario.

MAR 11: Trump announces plans to double tariffs — to 50% — overall on steel and aluminum from Canada, effective March 12.

Canada agrees to suspend the surcharge. Trump backs off the double tariffs.

MAR 12: The European Union and Canada, in response to Trump's tariffs on steel and aluminum imports taking effect, hit back with their own retaliatory trade actions.

MAR 13: In response to the EU's tariffs on U.S. goods including agricultural products and bourbon set to go into effect on April 1, Trump threatens a 200% tariff on European alcohol.

MAR 24: In a Truth Social post, Trump announces a 25% secondary tariff on all imports from countries that buy oil or gas from Venezuela, set to take effect on April 2.

MAR 26: Trump announces 25% tariffs on imported cars and car parts.

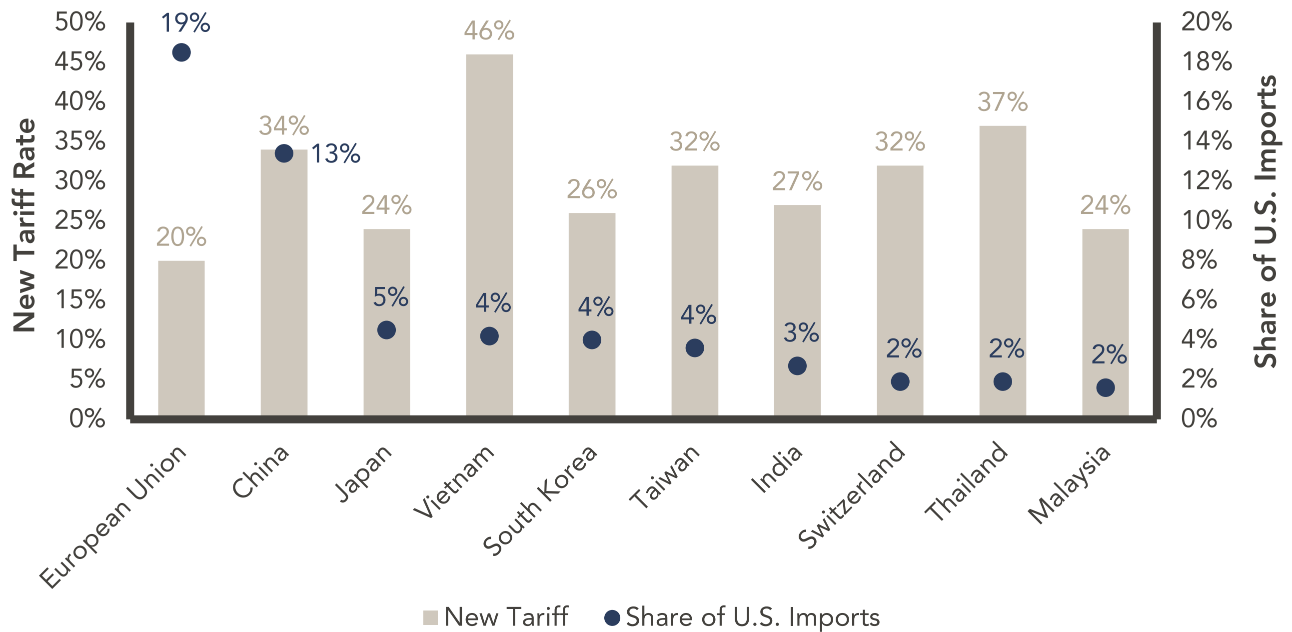
APR 2: Trump's "Liberation Day," when 25% import tariffs on Canada and Mexico take effect and reciprocal tariffs on a range of U.S. trading partners are announced. A 10% tariff is applied to all imports from countries that currently impose tariffs on U.S. goods.

APR 4: China hits back at Trump tariffs with 34% duties on all U.S. goods.

Source: Bloomberg, NPR, and Wall Street Journal as of April 4, 2025

Perhaps the most significant development in the ongoing trade war saga came last Wednesday, April 2, a date President Trump dubbed "Liberation Day" on which expansive new tariff measures were unveiled. Using national emergency powers, Trump announced reciprocal tariffs on imports from roughly 90 nations that are on top of a 10% across-the-board tax applied to all U.S. imports. Higher rates will apply to partners deemed to be bad actors when it comes to trade, including Japan and the European Union, which will face duties set to go into effect later this week of 24% and 20%, respectively. The administration noted that many goods will be exempted from reciprocal tariff policies, including copper, pharmaceuticals, semiconductors, and lumber, all of which may be subject to future restrictions. The new tariff rates for key U.S. trade partners are detailed in Exhibit 3.

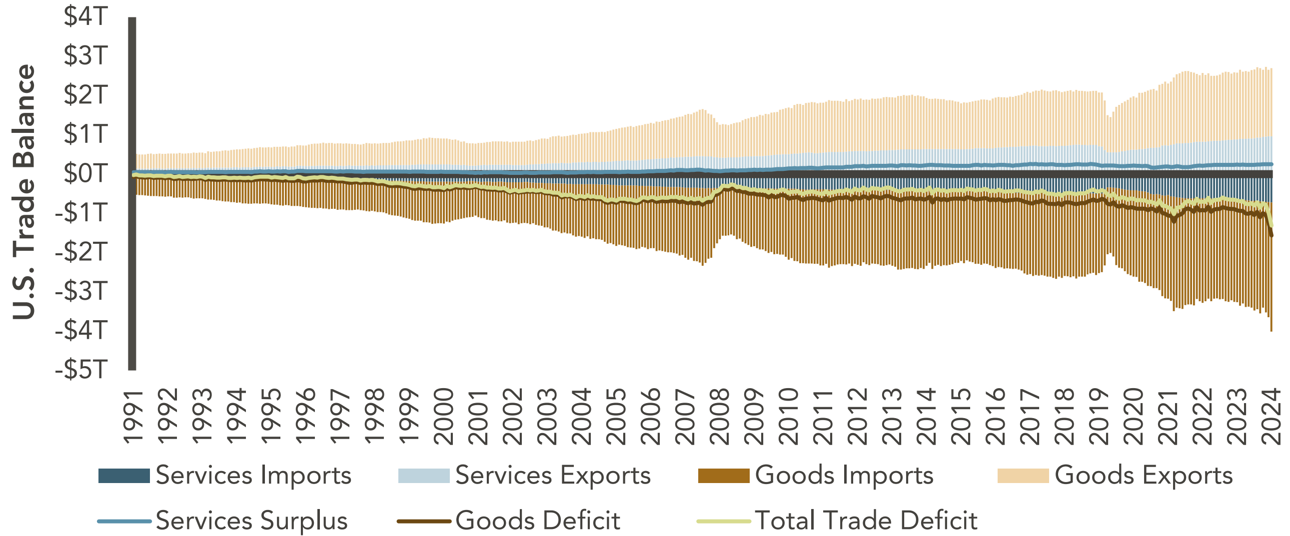
Exhibit 3: Top U.S. trade partners were hit with new trade restrictions by the Trump administration last week



Source: Bloomberg as of April 4, 2025

The Trump administration has stated that it has a variety of motives for disrupting the global trade landscape. First, policymakers believe revenues from tariffs can be used to reduce the U.S. federal budget deficit without having to raise income taxes. Additionally, Trump aims to reshore manufacturing jobs and curb the flow of fentanyl and illegal immigration into the United States, which are some of the main reasons the administration has given for focusing on countries like Mexico and Canada. Finally, the Trump administration believes that the U.S. is being exploited by countries with which the U.S. runs a trade deficit (i.e., nations from which America imports more than it exports). Indeed, many of the new tariffs appear to be a function of the size of a given country's goods-trade imbalance with the U.S. and how much the U.S. imports from that nation. It is important to note that a high trade deficit is not necessarily a bad thing for a domestic economy. In the case of the U.S., the deficit stems largely from strong demand for low-cost foreign-made goods, which serve as a financial benefit for domestic consumers. That said, a reliance on foreign markets for goods does leave the U.S. vulnerable to potentially onerous trade terms.

Exhibit 4: The U.S. excels at exporting services, but a high level of goods imports has fueled a large trade deficit

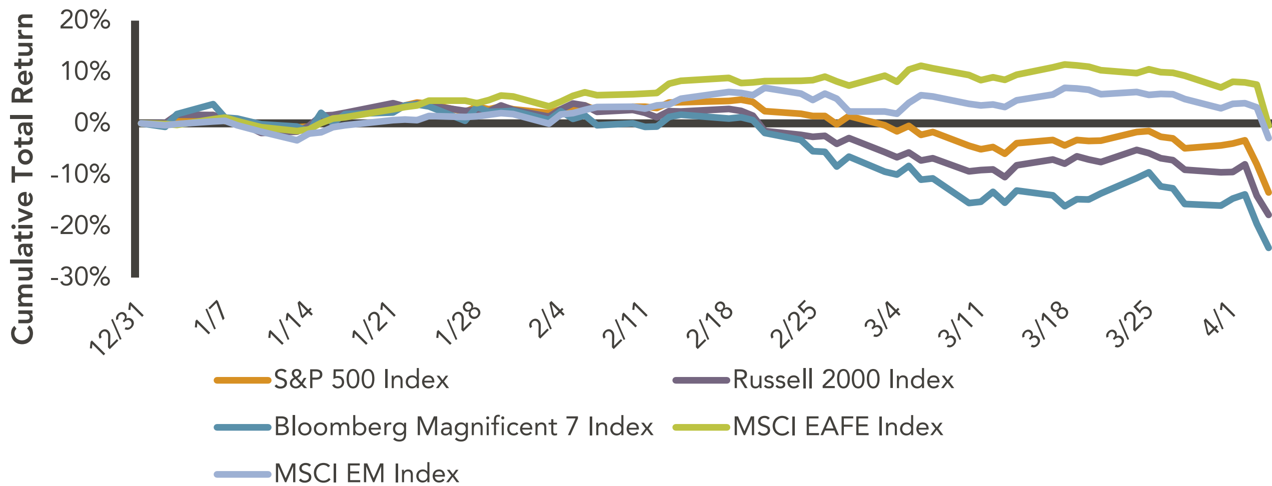


Source: Federal Reserve Bank of St. Louis as of March 31, 2025

THE MARKET'S REACTION

Capital markets have reacted sharply to the developments described previously. Since reaching a peak in mid-February, the bellwether S&P 500 Index has fallen nearly 17% through the end of last week, losing more than 10% in the last two days alone. This skid marks the most pronounced two-day drawdown for the index since the COVID-19 crisis of 2020. Other domestic indices have fared no better, with the small-cap focused Russell 2000 Index falling by roughly 16% in the last few weeks. The Magnificent Seven basket of stocks, which notably led the U.S. equity market over the last two years amid investor fervor related to artificial intelligence and technology, has fallen nearly 27% since the end of January. These businesses are especially reliant on global supply chains and derive significant revenues from international markets, making them particularly susceptible to tariffs and restricted access to key foreign markets. Pain has not been limited to U.S. stocks, with non-U.S. equity benchmarks like the MSCI EAFE Index and MSCI EM Index drawing down in recent days as well.

Exhibit 5: Global equity indices have exhibited sharp drawdowns in response to recent trade posturing



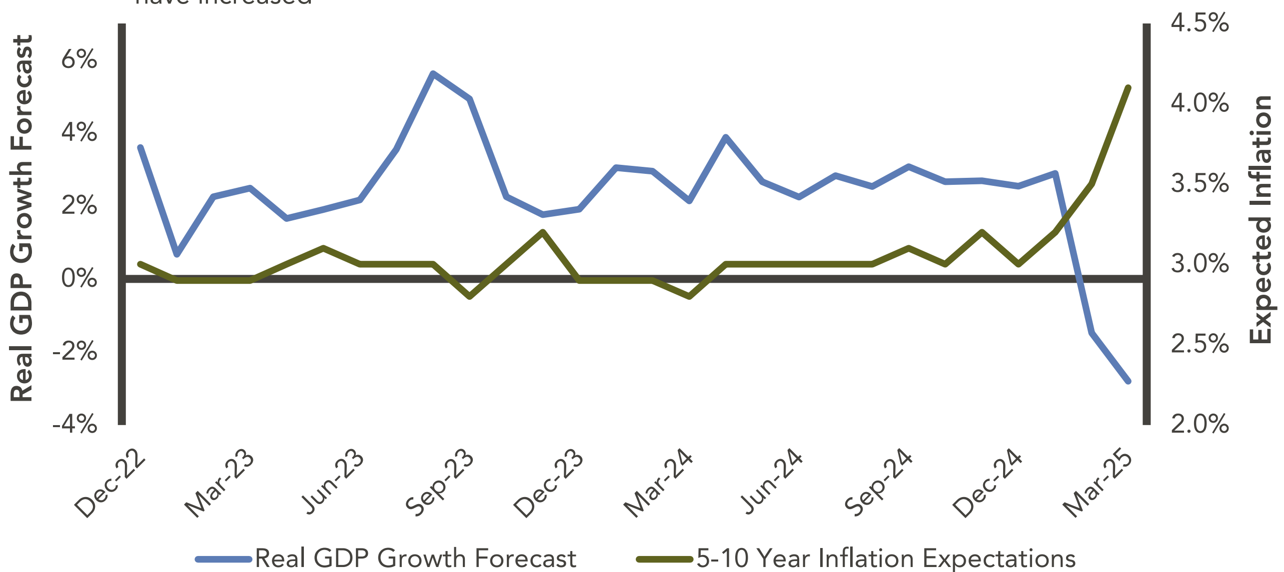
Source: Bloomberg as of April 4, 2025

Because of these dynamics, investors have turned to fixed income with the hopes of hedging stagflation risks. U.S. Treasury yields continued to plummet late last week, with 10-Year Treasury yield falling below 4.0% to a low not seen since October of last year. The yield had risen above 4.8% mere weeks ago based on hopes of future tax cuts and economic growth. Bonds prices rise as yields fall, and the Bloomberg U.S. Aggregate Index has returned nearly 4% since the start of 2025. On the currency front, the U.S. dollar, which is often viewed as a safe haven for investors during periods of stress, has depreciated against other major currencies since the start of 2025. While the greenback would typically benefit from the inflationary nature of tariffs, the ongoing trade war has increased expectations of near-term interest rate cuts from the Federal Reserve amid forecasts of slower economic growth. These factors have hindered performance of the dollar. Commodities have not been immune to souring investor sentiment, with the prices of natural gas and soybeans falling sharply last week. Additionally, oil prices dropped to their lowest level in nearly four years as a plan by OPEC and its allies to increase supply added to fears that tariffs might plunge the global economy into a recession.

THE PATH AHEAD

The coming months are clouded with uncertainty and expectations surrounding the path of economic variables like inflation, growth, and interest rates have changed materially since the start of the year. To that point, longer-term inflation expectations have surged amid concerns about supply chain disruptions and increased production costs being passed on to consumers in the form of higher prices. According to a popular University of Michigan consumer survey, the median expected change in price levels over the next 5–10 years has climbed to a multi-year high of 4.1%. Readers will note that PCE inflation, the preferred gauge of the Federal Reserve, has sat above the central bank's target level of 2% for more than four years and a prolonged trade war will almost certainly keep inflation levels higher for longer. Additionally, growth forecasts have been revised downward with many economists expecting real GDP to contract under the weight of the new tariffs. Based on the GDPNow forecasting model, the U.S. seasonally adjusted annual real GDP growth rate in the first quarter of 2025 is expected to be -2.8%. While it is important to note that these two figures are projections, they do speak to the potential for tariffs to have a pronounced effect on the stability of the domestic economy.

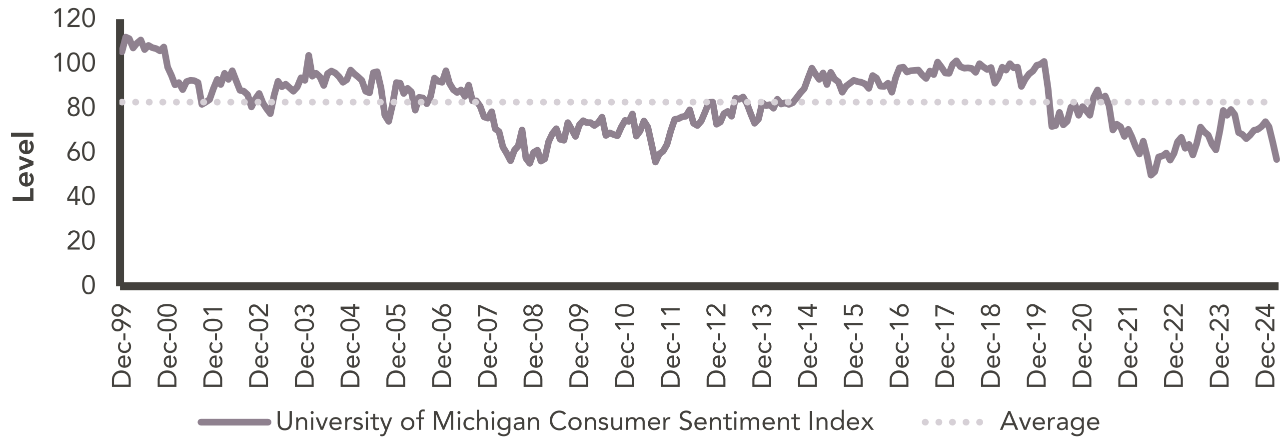
Exhibit 6: Growth forecasts have fallen sharply in recent months while long-term inflation expectations have increased



Source: Bloomberg, Federal Reserve Bank of Atlanta, University of Michigan as of April 4, 2025

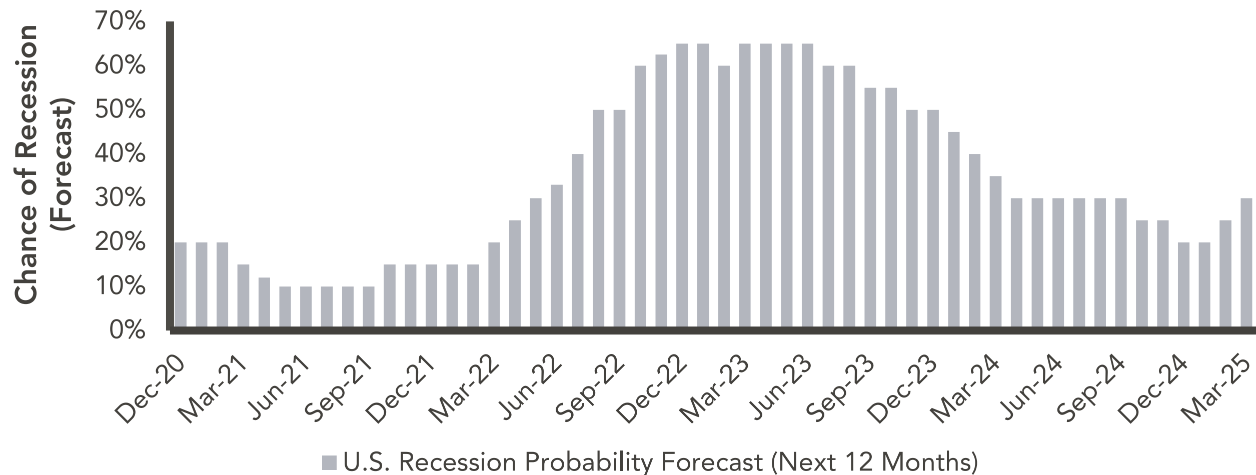
In addition to lower GDP forecasts, there is evidence of a significant decline in consumer sentiment. According to the same University of Michigan survey cited above, sentiment amongst consumers has sharply fallen to a nearly three-year low amid the prospect of a stagflationary environment. Data points indicate this souring sentiment is already showing up in real economic activity. To that point, a recent Department of Commerce report noted that inflation-adjusted consumer spending rose just 0.1% in February after a decline of -0.6% in the previous month. Since consumer activity represents roughly 70% of GDP, a weaker or discouraged American consumer would certainly spell trouble for economic growth and the performance of global equity markets. Consumers are not the only ones souring on the outlook for the U.S. economy, as many experts have increased their estimated probabilities of a near-term downturn. In a recent Bloomberg survey of various banks, the chance of a recession in the next 12 months was 30% (based on the median survey response), up from 20% just two months ago. JPMorgan notably increased its odds for a domestic and global recession to 60% last week, citing "disruptive U.S. policies" that will likely result in "a slide in U.S. business sentiment and supply-chain disruptions." While the March jobs report that was released on Friday showed a healthy employment picture, sweeping tariffs could test the labor market's resilience in the months ahead amid sagging levels of confidence.

Exhibit 7: Consumer sentiment has fallen to one of its lowest levels in the last two decades



Source: University of Michigan as of March 31, 2025

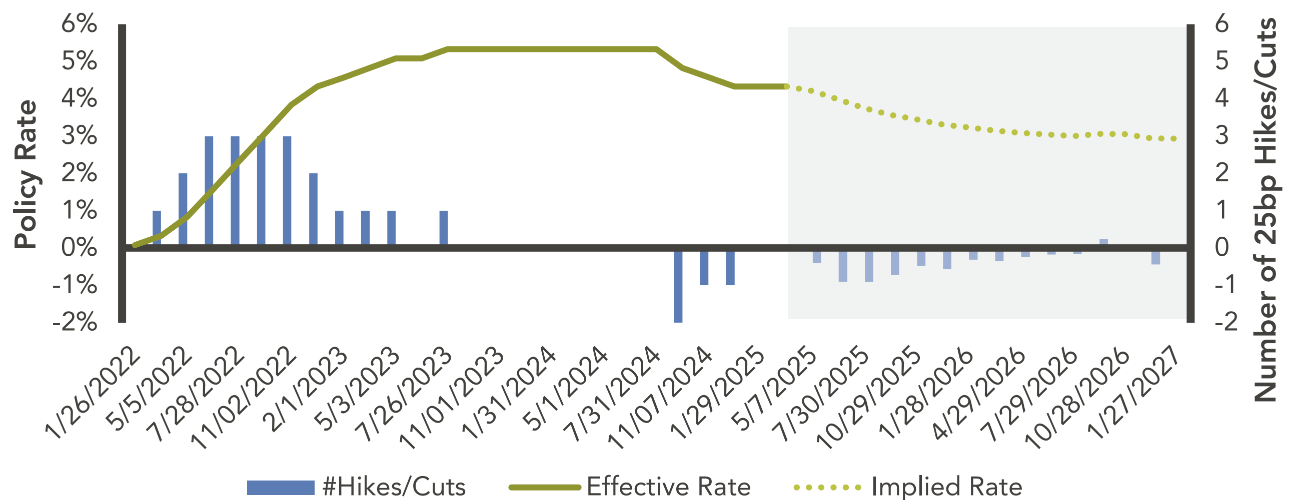
Exhibit 8: A survey of major banks indicates the higher likelihood of a near-term recession relative to the start of the year



Source: Bloomberg as of March 31, 2025

Given the equity market sell-off and the potential for future economic deterioration, investor attention has turned once again to the Federal Reserve. Last Friday, Jerome Powell noted that the new tariffs were significantly larger than expected and "the same is likely to be true of the economic effects, which will include higher inflation and slower growth." Powell added that the Fed's "obligation" was to ensure that a "one-time increase in the price level does not become an ongoing inflation problem." Market participants have updated their projections regarding the future path of interest rates considering recent developments, now expecting four cuts from the central bank in 2025 (up from the three that were expected as recently as two weeks ago). Investors have priced in a roughly 40% chance of a 25 basis point rate reduction at the next FOMC meeting in May, and some traders are even betting on an emergency cut before the May meeting, with open interest in the April fed funds futures soaring in recent days. President Trump himself even took to social media in recent days imploring Powell to cut rates as soon as possible. Clearly the central bank's already difficult job of achieving optimal economic output has now been made more difficult, as Fed officials must now contend with an unprecedented combination of sticky and potentially rising inflation, serious growth concerns, and political pressure.

Exhibit 9: Investors now anticipate four rate cuts from the Federal Reserve in 2025, with a roughly 40% chance of a 25 basis point reduction next month



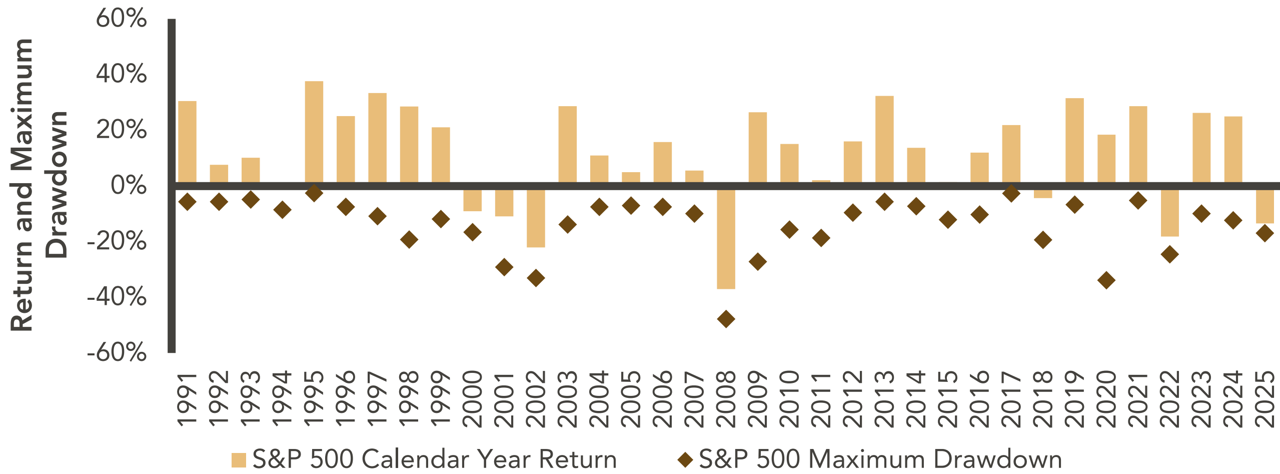
Source: Bloomberg as of April 4, 2025

WHAT'S AN INVESTOR TO DO?

A stagflationary environment will be difficult for financial markets. Low growth coupled with higher prices will limit corporate earnings, an uphill battle for stocks. Furthermore, credit spreads are likely to expand amid a low growth environment and rates — the primary fixed income risk factor — rise with inflation; these dynamics would drive fixed income prices down as well. Overall financial market performance could resemble that of 2022 when stocks and bonds fell by double digits as rates rose and historical correlations broke down.

Given prevailing valuation levels going into the year along with the concentration risk posed by the Magnificent Seven, a material market drawdown is not entirely a surprise. However, most investors did not expect steep tariffs to be the catalyst for this latest version. That said, historical drawdowns of this year's magnitude are not without precedent. To that point, the S&P 500 Index has exhibited a drawdown of at least 10% in 20 of the last 35 calendar years. Interestingly, many of these drawdowns came in years when the benchmark finished in positive territory, meaning equity markets have tended to recover rather quickly after periods of stress.

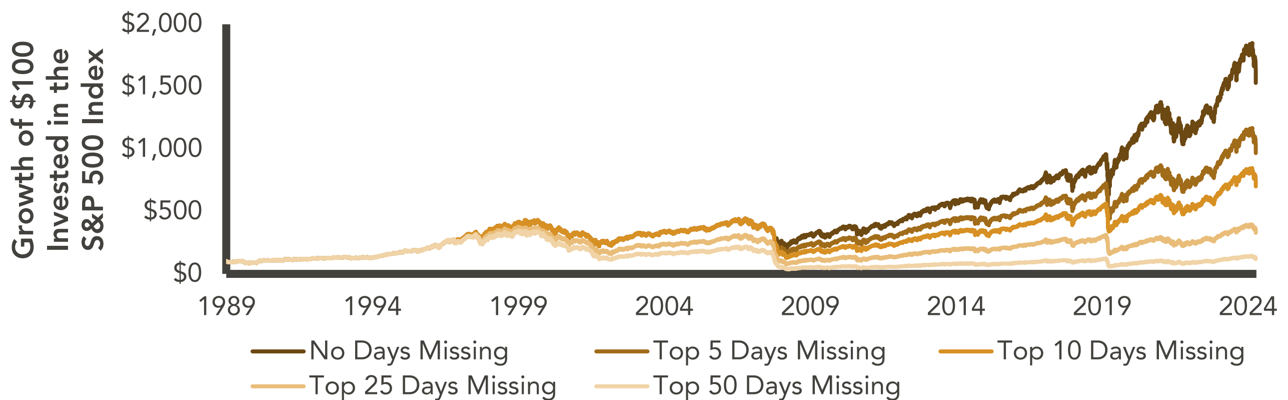
Exhibit 10: The S&P 500 Index has exhibited large drawdowns in the last few decades, including in years during which the benchmark ended positive



Source: Bloomberg as of April 4, 2025

Nevertheless, the current market drawdown feels different given the potentially long-lasting impact of tariffs and their impact on global growth. Further complicating the current outlook are the relatively few historical bouts of stagflation experienced by U.S. markets, which limit the playbook on how to navigate the sticky web of low to negative growth, high inflation, and high interest rates. Ultimately, the most proven recipe for weathering volatile markets is maintaining a diversified portfolio via a disciplined rebalancing program. Those that try to time their exit and entry into and out of risk assets will inevitably fail more than they succeed. Predictably, four of the five largest single-day returns for the S&P 500 Index over the last 35 years came after weeks during which the benchmark was down more than 10%. The impact of these outsized days on long-term returns of the benchmark cannot be overstated. Since 1990, the gains of an S&P 500 Index investor would have been reduced by roughly 36% had the top five days been omitted from the nearly 9,000-day return stream. In other words, the removal of less than 0.1% of the trading days in the last 35 years would have wiped out over one-third of the total return of the S&P 500 Index during that time. As one might imagine, the investor's forsaken gains become increasingly substantial as additional strong trading days are eliminated. Exhibit 11 emphasizes this point and should serve as a cautionary tale for investors thinking about reducing or eliminating equity exposure during bouts of market volatility.

Exhibit 11: Missing only a few days of market performance can have disastrous effects on an investor's long-term returns



Source: Bloomberg as of April 4, 2025

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CONCLUSION

Financial markets loathe uncertainty and return patterns support this claim. To that end, the current environment is not surprising. However, one of the most significant variables this time around is the uncertainty of depth and length as it relates to the tariff impacts. The Trump administration has framed them as a one-time cost increase with short-term pain while other market analysts fear a "doom spiral" that self-perpetuates and haunts economic growth and financial markets for years to come. Of course, no one knows exactly how this will ultimately play out but it is safe to assume that trade tensions will continue for the foreseeable future, meaning market participants should expect heightened market volatility in the weeks and months ahead. As the situation unfolds, investors should remain disciplined and adherent to strategic asset allocation guidelines while remembering that market timing is a notoriously difficult exercise. Additionally, fear-induced selling during periods of turmoil leaves investors vulnerable to missing out on outsized returns that often follow sharp drawdowns.

Markets are reacting swiftly to the daily barrage of headlines and policy announcements and we will deliver further communications around markets, managers, and trends. Uncertainty may be high, but our commitment to disciplined portfolio management within the parameters of each client's investment policy statement is unwavering and will anchor our guidance in the coming weeks and months. In the meantime, please do not hesitate to contact any of us with questions.

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