

Market Perspectives - Tariff Update

April 7, 2025



Markets fall precipitously after being surprised by the extent of the new tariffs

When we wrote about the volatility seen in the financial markets in early March, we stated that a 10% correction in stocks is healthy and normal as long as it does not precede a recession. At that time, economic indicators were not signaling a recession, and we estimated that the impact of tariffs on the economy would not be too material and had likely already been priced into the market. As a result, we believed it was a good time for those with excess cash to add to equity exposure. However, we, along with the vast majority of investors, did not anticipate how extensive the tariffs would be when they were announced on April 2nd. In fact, these new tariffs are expected to raise the average US tariff rate from 2.5% to 22.5%, which is almost 3x the increase anticipated. As a result, the S&P 500 fell more than 10% in two days (for only the third time in history) and is now 17% below its February 19th high. Also, many market experts have now increased their odds of recession this year to more than 50%. Below is a summary of the tariffs as well as how our trading partners have responded.

- 10% minimum tariff (effective Apr 5) + “discounted” reciprocal tariffs on roughly 60 countries (effective Apr 9)
- All EU products at 20%, no new tariffs for Mexico and Canada
- China tariffs at roughly 60%
- \$470 Bn in new revenue + \$150 Bn in revenue from previously enacted tariffs
- This equates to 2% of GDP, and is equivalent to the largest tax hike as a % of GDP in history
- We may still see more tariffs on pharmaceuticals, commodities, and semiconductors
- China has retaliated with a 34% tariff on all goods imported from the US
- Other countries are likely to retaliate as well, incl. non-economic retaliation
- Because these tariffs are a burden on corporations and consumers, it is anticipated that spending in the US will be negatively impacted and could lead to a recession and much lower than expected corporate earnings

The rationale for the tariffs is to level the playing field in terms of global trade, and the expectation is that our trading partners will negotiate with us by reducing the tariffs they impose on us in exchange for a cut in the new tariffs we have imposed on them. In addition, this new revenue is expected to potentially offset the US budget deficit or pave the way for significant tax cuts for consumers and corporations alike. However, these cuts will require Congressional approval before becoming law and given the magnitude of the tariffs, quickly enacting the tax cuts are a key strategy to sterilize at least a portion of the tariff impact and help avoid recession.

The stock market has reacted very negatively based on the perceived damage the tariffs will have on the US and global economies. However, there are a number of positive catalysts that could offset the negative impact and drive stocks higher, including:

- The Fed could cut rates if they believe these tariffs will materially impact the economy, specifically employment (this is how they responded to downturns in 2009 and 2020, but they weren't battling inflation during those periods as they are today)
- Tax cuts, using the tariff revenue to offset the cost
- Legal challenges – the President has used a provision that requires a national emergency to enact the tariffs, and many believe it won't hold up to legal challenges
- Negotiations with trading partners to reduce the tariffs on both sides
- Lower interest rates (the 10 yr Treasury yield has fallen by 0.25% in just the last week)
- A potential scaling back of tariffs if the President sees too much market and economic damage (i.e. "Trump put")

One concern is that a lot of damage has already been done to confidence in the US as well as to the willingness of foreign trading partners to conduct business with the US. There is still a lot of uncertainty regarding the eventual result of these actions, and spending tends to dry up when the future is murky. Politics also plays a role, as getting approval for tax cuts or other offsets will be difficult given the very thin majorities the Republicans hold in both houses of Congress.

The good news is that, as result of the stock market decline, equities are trading at much cheaper valuations than they were just one week ago. In fact, the forward Price Earnings ratio for the S&P fell from more than 20x to roughly 18x in the past 5 trading days. Also, the significant drop in bond yields has resulted in large price gains for fixed income. Finally, the steep stock drop on Thursday and Friday of last week is starting to look "capitulative," meaning much of the selling may have already occurred and we could be close to the market bottom.

So, is it time to add to equity positions? Well, we cannot confidently state whether stocks have bottomed or if there is more downside ahead. While it may be appropriate for some investors to slowly add to risk at this point, we'd like to see signs of a positive catalyst, such as we've cited above, before making significant increases in equity exposure. As an example, the market has historically responded well to Fed rate cuts following a material downturn.

	Policy	S&P 500 Forward Returns				
	Response?	2-Day	1M	3M	6M	12M
3/12/2020	✓	-13.9%	11.3%	21.0%	34.6%	59.0%
11/20/2008	✓	-12.4%	15.8%	2.8%	21.0%	45.0%
11/6/2008	✓	-10.0%	0.5%	-3.9%	0.5%	18.2%
10/19/1987	✓	-16.2%	3.7%	2.4%	8.1%	18.0%
10/16/1987	✓	-24.6%	8.1%	10.9%	14.7%	22.9%
Avg		-15.4%	7.9%	6.6%	15.8%	32.6%
Med		-13.9%	8.1%	2.8%	14.7%	22.9%

Source:Alpine Macro

Also, it's normal for a waterfall decline in the stock market to be followed by a short-term bounce and then a second selloff before a bottom is achieved. Further, we can't be sure whether or not a recession will occur at this point, and since 1950 a recession-induced bear market on average produces a 27.3% loss in the broad market, i.e. 10% more than we've already seen.

Major S&P Declines With a Recession - 1950 to Present				
Start Date	End Date	% Decline	Recession?	Worst GDP Quarter
2/19/2020	3/23/2020	-35.4%	Yes	-31.2%
10/9/2007	3/9/2009	-56.8%	Yes	-8.4%
3/24/2000	10/9/2002	-49.1%	Yes	-1.7%
7/16/1990	10/11/1990	-19.9%	Yes	-3.6%
11/30/1981	8/12/1982	-18.9%	Yes	-6.1%
2/13/1980	3/27/1980	-17.1%	Yes	-8.0%
7/15/1975	9/16/1975	-14.1%	Yes	-4.8%
11/7/1974	12/6/1974	-13.6%	Yes	-4.8%
10/12/1973	10/3/1974	-44.1%	Yes	-4.8%
11/29/1968	5/26/1970	-36.1%	Yes	-4.2%
8/3/1959	10/25/1960	-13.9%	Yes	-5.0%
7/15/1957	10/22/1957	-20.7%	Yes	-10.0%
1/5/1953	9/14/1953	-14.8%	Yes	-5.9%
Average		-27.3%		

Source: Strategas; As of 3.31.25

As a result, it's prudent to be patient and see how things shake out. The optimal approach is to be thoughtful and unemotional when making allocation decisions during volatile periods such as this. In the meantime, the best course is to not overreact to the market downturn. At some point we will see opportunities to take advantage of the improved stock market valuations.

What this period has reinforced is that, in times of market stress, it's important to have a diversified portfolio that includes stocks, bonds, and alternative investments. Such a portfolio, combined with a long-term investment approach, has proven to produce strong results over time.

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