INVESTMENT UPDATE

Ups and Downs: 2025 Tariff Rollercoaster

If there's one word you've heard in every financial news article over the last 6 weeks, it's TARIFF. Suffice it to say, the word is out that the President intends to follow through on his campaign promise to make America's trade more balanced. His methods this time around are somewhat different from even Trump 1.0, as has been the response of our trade partners.

A Quick Recap (from Ladenberg Asset Management)...

The stock market is experiencing heightened volatility with the implementation of aggressive tariffs and the threat of further trade restrictions by the Trump administration, causing the S&P 500 to erase its post-election gains. One of the primary reasons for the market sell-off is the speed at which these tariffs have been implemented, as many expected them to be more of a negotiating tool rather than seeing such rapid enforcement. On March 4th, 2025, Trump imposed 25% tariffs on goods from Canada and Mexico and doubled tariffs on China to 20%, with additional 25% tariffs on automobiles, semiconductors, pharmaceuticals and imports from the European Union set for April 2nd . While the extent and duration of these tariffs may differ from Trump's first term, history provides a blueprint for how markets react to trade disputes. During the 2018 trade war between the US and China, volatility surged. Yet despite ongoing tariffs, the S&P rose 25.72% from the start of 2018 to the end of 2019. Markets often experience short-term headwinds from trade conflicts, but recoveries tend to follow once resolutions are reached or investors adjust to new realities.

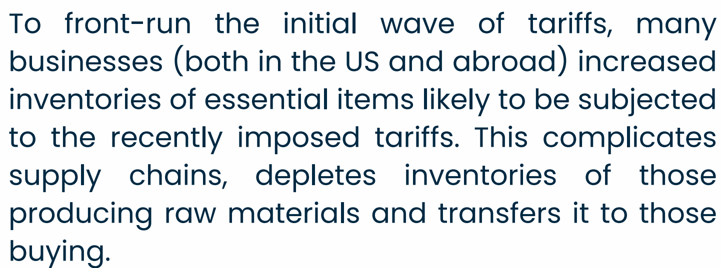
So Why Tariffs?

One key element is that tariffs can be executed through Executive Orders and do not require Congressional approval. The President may act using the IEBA statute that gives him the ability to act when national security is threatened. Therein lies part of the messaging around fentanyl. The challenges to this power are likely to come in courts in the coming months (thus the concession on USMCA protected items).

Unlike Trump 1.0, this time around he seems far less likely to be bluffing for a "good deal."Consensus is that he legitimately wants to improve the trade deficit with our neighbors and China. America has a debt problem, and balancing trade is viewed as one key element to arresting the growth of that debt. In each case so far, our trade partners have levied counter tariffs. The situations remain fluid! An overarching theme of Trump 2.0's diplomacy is about "fairness" of our allies and trade partners. This applies to both trade negotiations and NATO spending.

Uncertainty is high...

While policy is unknown, uncertainty will remain high. That is the case today when speaking of capital deployment among US companies. Given uncertainties around the cost of goods, many corporate executives have taken a wait and see approach to large spending projects and hiring new labor. Without certainty of the landscape a project fits in, sourcing labor, equipment, and raw materials becomes increasingly complex.



To front-run the initial wave of tariffs, many businesses (both in the US and abroad) increased inventories of essential items likely to be subjected to the recently imposed tariffs. This complicates supply chains, depletes inventories of those producing raw materials and transfers it to those buying.

The longer the "trade war" drags on, the greater the potential impact on 2025 earnings for corporate America. The longer uncertainty persists, the greater the potential threat of missing the 2025 earnings target for the S&P 500 (as CEOs take a wait and see approach to spending).The greater the probability of not hitting those lofty earnings goals, the more of an adjustment the markets likely make to prices of stocks. As some have suggested, short-term pain for a long-term benefit.

Is it all about Tariffs?

Respected economist and friend of our practice, Brian Wesbury, recently published his thoughts on tariffs and the markets' valuations. Below is an excerpt from that piece:

…it isn't all about tariffs. Many major models of overall stock market valuation show that the market is expensive. The so-called Buffett Indicator, which measures the market cap of the S&P 500 as a percent of GDP, says the market is overvalued. The Shiller CAPE PE Ratio, which measures stock prices compared to trailing 10-year inflation-adjusted earnings, shows the market is overvalued. In other words, compared to history, stock prices are on the high side.

Some argue that it's different this time. That AI, and technology in general are moving so fast, and so powerfully, that historical measures don't work. One way to deal with this is to compare stock values and earnings to a discount rate…in other words compare the stock market to the bond market.

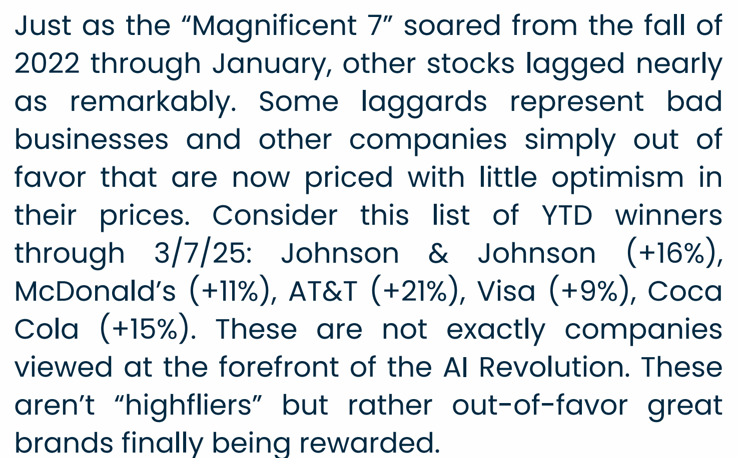
The Fed Model, which compares the earnings yield of the S&P 500 (the inverse of the PE ratio) to the 10-year Treasury yield or to a corporate bond yield, shows that stock returns relative to bond returns are the lowest since 2000 – the dot-com bubble.

Our Capitalized Profits Model, which discounts current profits by the 10-year Treasury yield, shows the same thing. We are overvalued relative to past relationships of earnings and interest rates.

However, as the saying goes, it is a market of stocks and not a stock market. Just because these models say the market as a whole is over-valued does not mean all stocks are over-valued. But because the S&P 500 is so top heavy, with just 10 stocks making up over 1/3rd of its total capitalization, it is hard for the other 490 stocks to offset declines in these very large cap companies

Zeroing in on "a market of stocks"

Not all stocks are created equally. It's a simple concept and one too easily forgotten.After all, news outlets run headlines about the major selloffs in the Dow, Nasdaq, and the S&P 500. It's rare on such days to see a headline about the 6 Dow stocks that were positive. Case in point, through 3/10/2025 over half of the S&P 500 stocks were positive year-to-date.



Just as the "Magnificent 7" soared from the fall of 2022 through January, other stocks lagged nearly as remarkably. Some laggards represent bad businesses and other companies simply out of favor that are now priced with little optimism in their prices. Consider this list of YTD winners through 3/7/25: Johnson & Johnson (+16%), McDonald's (+11%), AT&T (+21%), Visa (+9%), Coca Cola (+15%). These are not exactly companies viewed at the forefront of the AI Revolution. These aren't "highfliers" but rather out-of-favor great brands finally being rewarded.

Beyond the US, German markets are +21%, China +20%, and Europe +15% (through 3/7). Contrast that with the tremendous lag experienced by non-US stocks over the last 15+ years. Why? While US equities have "re-rated" because of higher starting valuations and the Tariff "noise", other parts of the world began at cheap valuations and have garnered the attention of a portion of those dollars leaving mega-cap US Technology stocks.

So, back to tariffs...

The noise of tariffs remains undeniable. It could get louder before it calms. Last week the Atlanta GDP Now projected a Q1 GDP figure of less than 0%. What was the culprit? The "stocking up" in advance of the tariffs created a trade deficit of $131.4 Billion for January. A deficit doesn't mean economic growth has stalled. Nonetheless, the headline will likely read something akin to "US GDP turns negative in Q1" irrespective of what cause that outcome.

One must look at AND through the data! The rhetoric and noise could intensify whether or not stocks trend lower from here.

The S&P 500 recently traded as much as 10% from its mid-February highs. We have yet to address European tariffs. This season may last longer than is comfortable...but that does not mean stocks cannot overcome the noise. Trump 1.0 initiated and repealed tariffs that were met with a selloff, then followed by a rally that resulted in a double-digit 1-year gain from the start of the tariffs.
Will this episode play out the same way?

Perhaps. Either way, remember the following:

- The starting point this time was relatively high valuations for US Equities broadly (especially tech)
- Not all stocks are/were expensive
- Not all stocks will respond the same to tariffs
- Bonds offer a far more appealing complement to stocks vs. 2016
- President Trump and his advisors are not blind to what market participants are feeling (both investors and corporate officers)

This will come to an end! It may not end in a week or a month, but we firmly believe that there is a path forward whereby the tariff tensions have eased. That path will also likely be accompanied by better trade deals for the US and meaningful positive strides toward a more"fair" lift by American allies. If the borders become more secure and the deaths associated with fentanyl use drop 50% it will be worth the volatility experienced by the stock market.

President Trump is often credited with playing chess while others are playing checkers. Right now, he's playing chess and seems more willing to play "the long game" than any of his competitors.

This pullback DID NOT catch us unprepared or by surprise and our clients' accounts have generally reflected accordingly!

As always, we will be paying attention to this ever-evolving situation and do our best to keep you informed and appropriately positioned.

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