# US TARIFFS

## a means to an end, or a bad idea?


**Many investors are in a state of 'concerned contemplation' about the impact of US tariffs, a potential resulting trade war, and what it will all mean. In this briefing note we outline what has happened, and provide some thoughts on how the dust may settle.**

## *What has happened?*

On Wednesday 2nd April the US announced the imposition of 'reciprocal tariffs' on trading nations at levels much higher than anticipated. Large falls in global equity valuations followed. As the equity sell-off has taken grip, bond yields have fallen only slightly, strengthening bond prices but not by much. Commodity prices have also seen a slide, with even gold, the eternal safe haven in times of choppy waters, retrenching.

## *Why tariffs?*

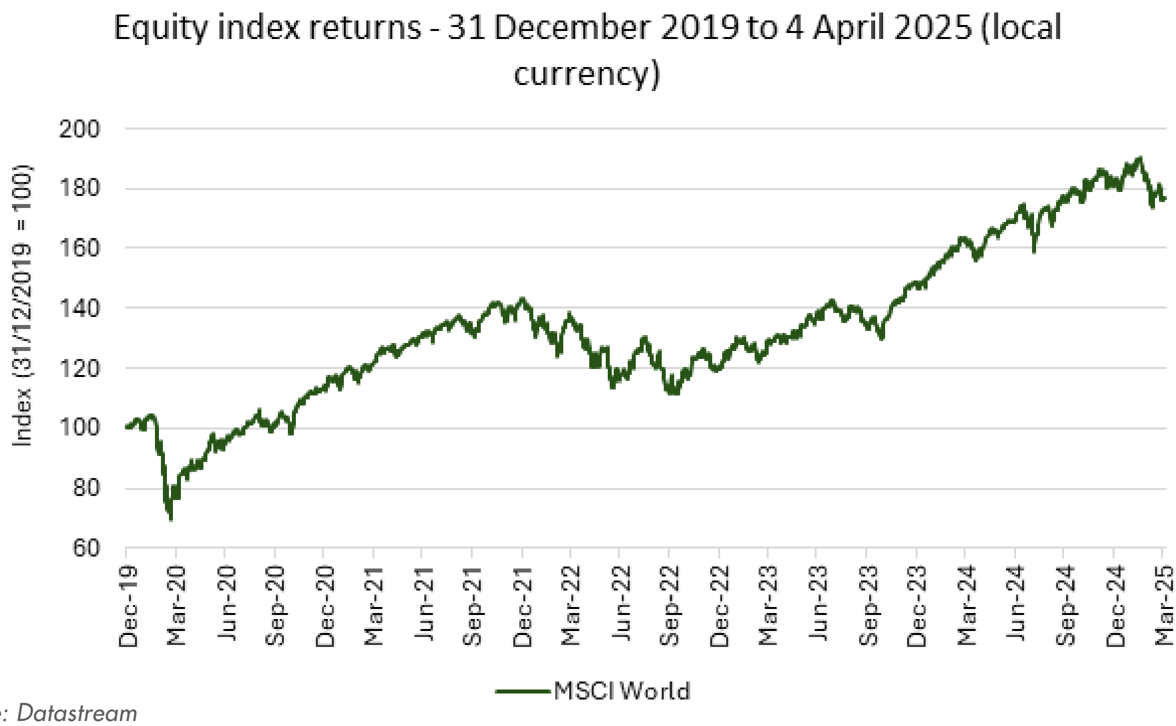

One cannot separate economic policy from political policy, but in this section we are going to consider why 'reciprocal tariffs' have been imposed by the US, without questioning the economic wisdom of the policy.

The US administration holds the view that other nations benefit inequitably from US consumption of international goods, enjoy intellectual property that originates from the US without fair reward, and gain a dividend from the military protectionism that the US provides. Further, the US government believes the US debt burden has become too high and refinancing it is becoming unsustainable. They aim to lower the debt burden through greater efficiency in government spending (via the newly formed DOGE) and establish a more equitable trading balance. The ultimate goal is to re-industrialise the US, as far as is deemed necessary, and reduce the value of the US dollar whilst retaining it as the World's reserve currency.

The imposition of tariffs is a major step in instigating the responses from overseas governments that the US administration is keen to see. Their expectation is that either countries will seek to negotiate 'reciprocal tariff' rates, a likely outcome, or manufacturers will move their operations to the US. Implicit in this is the idea that the era of off-shoring manufacturing to where it is cheapest, i.e. totally free trade, is no longer the optimal strategy.

## *Equity market reaction*

Global markets have, to use a phrase, been hammered. Since Wednesday, the global equity index has fallen c.11% to date (Monday 7th April). Taking a wider context, it's true that before this correction company valuations were at historical highs, and from a longer-term perspective this could appear to be just a (large) bump in the road, but such a fall, at such a pace, signals a material re-adjustment to a new order, and this is why things feel somewhat different this time.




*Source: Datastream*

Some market commentators are postulating that this downturn didn't begin with the announcement of tariffs, but was seeded in January by the shock that emanated from the launch of DeepSeek's open source AI model, arguing that technology stocks were due a correction. Whilst market concentration and exuberant faith in AI technologies was perhaps a catalyst, we think it's safe to say that tariffs are now the major driver of the turmoil.

The full policy responses from major trading nations such as China and the EU are not yet clear. This uncertainty is contributing to the heightened levels of current market volatility. The VIX index (a measure of implied market volatility) has more than doubled in the last few days. Its current level at the time of writing was surpassed only during Covid and the 2008 financial crisis. Whilst it provides little solace, from a historical perspective, things aren't perhaps as bad as they could be…

## *What does this mean for markets?*

Put simply, higher tariffs lead to a loss of international competitiveness, and a reduction in international trade. This could result in job losses, and higher prices that would be inflationary. For domestic policy makers the resulting negative impact to economic growth will make balancing budget finances more challenging, whilst central bankers will be concerned about inflationary pressures and will be cautioning policy makers against borrowing increases. Here in the UK, the impact of the new tariff, even though it is at the lowest rate of 10%, has likely already wiped out the small amount of fiscal headroom that was projected in the recent Spring Statement. It seems ever more likely that Rachel Reeves is going to have to consider breaking her fiscal rules. Further tax rises and/or spending cuts are on the cards for the UK.

It will take a period for global markets to adapt fully to the implications of the new tariff framework and its level of 'permanence'. A number of countries, UK included, are already attempting to hammer out more favourable trade deals with the US. Some countries have imposed or are considering imposing higher reciprocal tariffs – notably China, who stand to lose the most in overall trade terms, who are now locked in not just a trade war, but a battle of wills with the US. And, importantly, EU member states who were looking to agree a retaliatory framework have most recently offered the US a ‘zero for zero’ tariffs deal on all industrial goods. Perhaps somewhat of a small victory for President Trump and his team, but it signals the willingness of nations to come to the negotiation table and that there is scope for deals to be done. In the meantime, the ongoing uncertainty surrounding where things will land is not helping market confidence.

A few global manufacturing companies have already signalled they will be, or are in process of, establishing or expanding plants in the US. These ‘first movers’ are effectively acquiescing to the US position. However, many businesses are unlikely to contemplate such changes until the new global trading framework is clear and they have greater certainty on long-term policy from the US Administration.

## *Could the market outlook change?*

President Trump and his senior team are signalling clearly that there will be a degree of pain to achieve their goals. This is a new Administration with a strong mandate that shows no sign of walking back, for now at least, despite widespread criticism.

However, the outlook could change, and potentially very rapidly. If a global trade war is looming then that would be punishing. No one is likely to emerge unscathed. Equity markets could fall further and inflation may become more sustained, or indeed heightened. Base rates could be higher for longer. And all the uncertainty would make businesses less likely to invest, and consumers less likely to part with their hard-earned money. The required rates of return on investment projects would be higher, which means overall investment would reduce. All of which makes for a rather pessimistic, downward loop.

On the optimistic side, if trade deals look like being negotiated then market stability could begin to return quickly. If this happens, there will likely be a degree of nervousness that remains as investors will rightly be wary of potential further changes to come. However, the market tends to have a short memory.

When trade policy makers do get to the negotiation table we may well see the US aim to persuade other currencies to peg to the dollar to prevent it increasing in value in future – thereby maintaining any trade advantage achieved via the new trading arrangements. As part of such talks, there is speculation that the US will seek a restructuring of the US debt pile owned by China – but we can’t see China in a hurry to agree to that.

## *What does this mean for investors?*

Volatility of returns is high. This is not in itself a bad thing, as it means there can be money to be made. However, as much as being on the right side of a trade can be beneficial, being on the wrong side of it can hurt very much. In our view, making any short-term material changes to investment strategy in light of the developments of the last week would be a conviction (read brave) move indeed!

The current uncertainty permeates every asset class and economic region. There is no obvious safe haven – bond prices may yet fall depending on policy maker responses, and any move to cash would crystallise losses and risk missing out on potential upside when equity markets find their new normal. In our view, now is not the time for wholesale change.

One last word of caution for those considering a transition between asset classes: these should be approached with great care. Any out of market risk following the sale of assets can be material and, with mainstream markets moving as much as 5% in a single trading session, mitigating that risk, or even taking the option of delaying transitions, should certainly be top of mind. We will continue to work with our clients on transitions and agree plans based on market conditions.

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