HOW TO MAKE SENSE OF TRUMP'S 'TOUGH LOVE' TARIFFS

MARKET INSIGHTS

President Trump's sweeping announcement on retaliatory tariffs is complex. We break down the potential impacts for investors.

3 April 2025 | By Paul Eitelman CFA

U.S. stocks underperformed in the first quarter of 2025, hit by a double whammy from intensifying policy uncertainty and a U-turn in select mega cap stocks. Into this volatile backdrop, April 2—President Trump's so-called Liberation Day—was circled on investors' calendars as a catalyst.

Tariff talk

Today's announcement from the Rose Garden marked another bold policy step, charging large reciprocal tariffs against many of the United States' largest trading partners. For example, the policy includes:

- A new 10% base tariff on most trading partners, effective April 5
- A ramp-up a few days later to match half of the tariff and non-tariff barriers that countries impose on the U.S.

We estimate the average effective tariff rate could increase by almost 14%—a historically large increase in trade duties.

Two higher level observations are important here. First, the reciprocal tariffs leave room for the duties to get negotiated away. Case-in-point: Some very large exporters like Vietnam have already said that they will cut all tariffs on U.S. products. Second, the exemptions separate the reciprocal policy from Trump's sector-level tariffs like steel, aluminum, and automobiles. This suggests to us that those sector-level tariffs are likely to be more permanent.

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Paul Eitelman, CFA
Senior Director, Chief Investment Strategist
Russell Investments

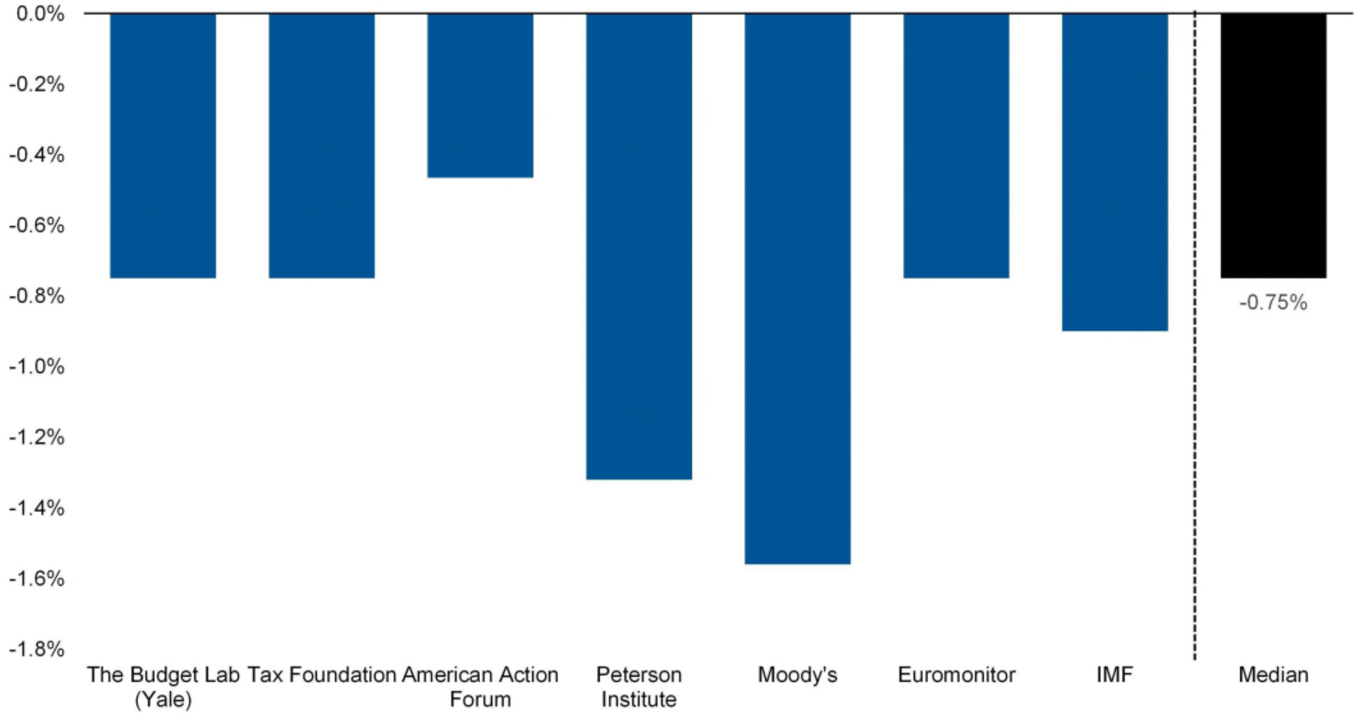
Growth hit

The administration had already pushed harder than expected on trade policy with tariffs on imports from China, Canada, Mexico, steel, aluminum, and automobiles & parts. While the policies could support domestic manufacturing over the longer-term, we estimated these measures were likely to act as a drag on real GDP growth of 0.5-0.75% and a boost to core PCE inflation of 0.75%.

Today's reciprocal tariffs could dent real GDP growth by another 0.75% and lift core PCE inflation by an additional 1%. That would likely leave the U.S. growth outlook at 1% or less for 2025 and push core inflation north of 3.5%. Accordingly, we've raised our estimate of U.S. recession risk in the year ahead from 30% to 35-40%.

Stunted growth?

Estimates on tariff impacts on GDP for 2025 vary



Source: Russell Investments adaptation of model-based estimates in "The Fiscal, Economic, and Distributional Effects of a 20% Broad Tariff" (The Budget Lab, 2025) and "How Will Trump's Universal and China Tariffs Impact the Economy?" (Tax Foundation, 2024). Our adaption assumes a 14-percentage-point increase in the U.S. effective tariff rate.

Pessimism not panic

U.S. markets were moderately risk-on through Tuesday's session. But the move reversed following Trump's announcement with S&P 500 Index futures trading down over 3% from the close. 10-year Treasury yields also declined by .05%.

We remain focused on holding diversified portfolio strategies into this period of extreme policy uncertainty. And we will be closely monitoring our measures of market psychology for potential dislocations in markets. Currently our signals show pessimism in the U.S. stock market but haven't reached an extreme level of panic. Treasury yields at 4.1% are in-line with our estimates of fair value for bonds.

Spotlight on Asia

In terms of regions, Europe saw a 20% reciprocal tariff, while Asia saw more aggressive rates. Tariff rates in Taiwan, Japan and South Korea were increased by 32%, 24% and 25% respectively. However, some of the goods that are already tariffed (for example, autos) are exempt and so this new tariff does not impact all exports from those regions. Australia is getting a 10% tariff rate. This is a notable drag on the region's growth, and we have seen equity markets react accordingly. The key watchpoints from here are the responses from leaders, as well as any developments on the sale of TikTok to a US company (President Trump has suggested that this could lead to lower tariff rates for China).

The market is now pricing in three interest rate cuts from the Reserve Bank of Australia, and we think that this development increases the chance of a May rate cut – especially given the Governor had highlighted global uncertainty as a key watchpoint. We continue to favour Australian government bonds and are close to neutral on Australian equities.

QUESTIONS?

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