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Flash Market Update

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THE "LIBERATION DAY" JOLT

Much Higher-Than-Expected New Tariffs

President Trump's highly anticipated "Liberation Day" tariff announcement at the Rose Garden turned out to be worse than what most market participants expected as he opted to shake up global commerce and supply chains with aggressive new tariffs. The market's immediate assessment is that these tariffs will pressure global economic growth and fuel higher inflation, a stagflationary combination that will make it more difficult for central banks to come to rescue with standard easing actions. The market's initial reaction is to sell stocks and buy Treasuries.

Details of the proposed measures, imposed by President Trump using the International Emergency Economic Powers Act of 1977 (IEEPA) authority, include:

- A 10% tariff on all imports effective April 5, 2025.

- Individualized reciprocal tariffs on countries that have the largest trade surplus with the U.S. will take effect on April 9 in place of the 10% base tariff. The steep reciprocal tariff rates include:
  - 34% on goods from China, which is in addition to the existing 20% tariff rate, meaning that the new tariff rate on Chinese imports will be 54%;
  - 46% on Vietnam;
  - 36% on Thailand;
  - 32% on Taiwan;
  - 24% on Japan;
  - 26% on India;
  - 25% on South Korea;
  - 20% on the European Union.

- Some goods are exempt from the reciprocal tariff:
  - Steel/aluminum articles and autos/auto parts already subject to the 25% Section 232 tariffs;

  - Copper, pharmaceuticals, semiconductors, and lumber articles.
  - Precious metals.
  - Energy.
  - Certain minerals that are not available in the U.S.

- For Canada and Mexico, USMCA compliant goods will continue to see a 0% tariff, and non-USMCA compliant goods will see a 25% tariff; non-USMCA compliant energy and potash will see a 10% tariff. Non-USMCA compliant goods would be subject to a 12% reciprocal tariff after the existing fentanyl and migration issues are resolved.

I would like to share these initial observations and thoughts:

- Some have estimated that these new tariffs will generate close to $500 billion of revenue on top of the $150 billion from previously announced tariffs. These are equivalent to a substantial tax hike of $650 billion, or 2.2% of GDP, which will likely push the U.S. economy into recession.

- The economy could be further pressured by retaliatory measures from the U.S.'s major trading partners such as the European Union and China.

- These sweeping tariffs will likely foment further dissatisfaction among U.S. allies who have already been concerned about America's commitment on various fronts such as security and global health. The potential backlash could create strange bedfellows to weaken America's influence on the global stage. For example, it has been reported that China, South Korea, and Japan have agreed to jointly respond to U.S. tariffs by facilitating regional trade. Given the history of tension and mutual distrust between these nations, a closer tie could be unusual and concerning.

- The 10% across the board tariff on imported goods does not make much sense as there are some goods, such as shirts, toys, and accessories, that are better off being produced overseas since making them domestically offers neither economic nor strategic benefits to the U.S. Imposing tariffs on these products would only disproportionally punish lower-income households. Furthermore, if another country eliminates its tariffs, the 10% across-the-board tariff imposed by the U.S. would violate Trump's principle of reciprocity.

- It is quite possible that these punishing tariffs will be used as negotiation leverage to force concessions from the U.S. trading partners in the form of lower trade barriers and even policies aimed at strengthening their currencies (please refer to the April 2025 CIO Monthly Perspective on the rumored Mar-a-Lago Accord). American businesses will also lobby aggressively for various tariff exemptions, which could favor companies with greater lobbying resources and access to Washington.

- Some of the proposed tariffs will likely stay as Trump is determined to force businesses to bring manufacturing back to the U.S., especially among industries deemed critical to national security. At this point, with trade negotiations expected to pick up pace materially, it is difficult to gauge how much additional tariff revenue will be raised above 4Q24's annual rate of $86 billion. I do not believe it will be as much as $600 billion, but even a third of that amount will exact a toll on the economy in the near term.

- Despite all the foreign direct investments that various companies and governments have promised to the Trump administration, the reshoring process – planning, permitting, construction, etc. – will take considerable time to bear fruit. To partially offset the drag from new tariffs, the Trump administration will likely pressure Congress to pass sizeable *new* tax cuts as quickly as possible. That is, new tax cuts would be needed as the extension of expiring tax cuts will not be additive to the economy.

- In reaction to tariffs imposed on China during Trump's first term, many companies moved their production to Southeast Asia. Now, with punishing tariffs imposed on these countries (such as the 46% tariff on goods from Vietnam), American businesses will have to reexamine their global production strategies. It appears that Mexico may wind up being a major beneficiary.

- While Congress is unlikely to reclaim its Constitutional power to set tariff policies, Trump's use of the IEEPA to impose sweeping tariffs may be challenged in court.

In the near term, it is going to be difficult to put a positive spin on Trump's punishing new tariffs as even the potential benefits of reshoring will take time to bear fruit, and higher domestic production costs and the skills mismatch will likely lead to higher inflation. The best investors can hope for is that these new tariffs are opening bids in tough trade negotiations with all our trading partners.

For now, American businesses are left in a difficult position of accepting these new tariffs or lobbying and hoping for some relief, which will take up considerable time and resources while freezing up new initiatives. Many companies will thus offer very conservative guidance in the upcoming earnings reporting season – that is, nudging analysts to lower their earnings estimates. As businesses behave more cautiously, consumer confidence and spending will likely weaken further due to rising job insecurity. Such is the negative feedback loop that could precipitate a recession.

In short, President Trump's aggressive tariffs - an outgrowth of his long-held aversion to trade deficits - may have unwittingly set in motion the countdown to recession unless the collision course of higher tariffs and trade wars can be altered. There will be much distortion of economic data in the months ahead as many may seek to increase the purchase of foreign goods before the new tariffs go into effect. Investors will be looking to the Fed to come the rescue if the economy takes a turn for the worse. Unfortunately, these catalysts are unlikely to materialize before more pain is felt in the economy and financial markets.

For investors, a defensive posture is still preferred until policies – fiscal, monetary, or regulatory – turn more supportive or equity valuations become attractive enough to improve the risk-reward tradeoff. One positive contrarian signal is that investment sentiment has turned quite bearish, which usually happens close to market troughs. One can also argue that there is now ample room for Trump to reduce threatened tariffs. In short, stay diversified, focus on quality, and avoid making emotional decisions.