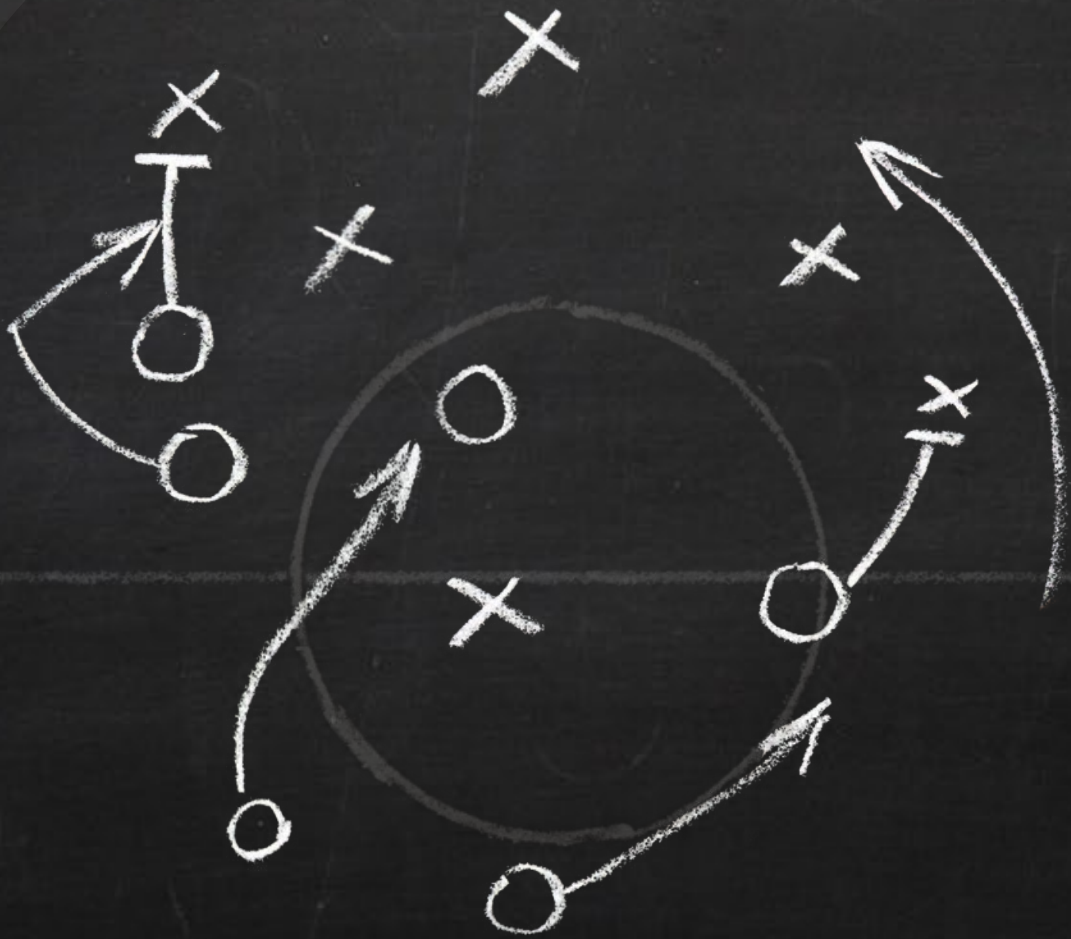




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NOTE FROM THE CIO OFFICE

Liberation Day

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Liberation Day

Yesterday afternoon, President Trump announced a slew of reciprocal tariffs on approximately 60 countries around the globe in what he called “Liberation Day”. His reasoning behind the move stems from what the President had deemed as unfair trade practices by other countries on the United States, where the U.S. was being charged higher tariffs on its exports than what it charged on the exports of these countries. In an attempt to level the playing field, the Trump administration will be implementing a minimum 10% tariff on all exports stemming from these countries, although most are likely to get hit with numbers that are higher than the minimum. For example, China will be charged an incremental 34%, bringing the total tariffs paid by that country to 54%. At the same time, the European Union will pay a 20% reciprocal tariff, while Japan, India, and South Korea will pay between 24% and 26%. The list is long. Interestingly though, Mexico and Canada will be excluded from these tariffs, at least for now. According to the President, these tariffs were the “lite” version of what should have been implemented, as they represent approximately half of what these countries charge on U.S. exports. The markets disagreed.

As of the time of this writing, the S&P 500 was down 3.4% before the market open, while the Nasdaq and Dow Jones Industrials dropped 3.9% and 2.9% respectively. The equity markets of the countries most affected by the tariffs also registered lower closes last night, with Japan’s Nikkei closing 2.8% lower, China’s Hang Seng Index down 1.5%, and South Korea’s KOSPI down 1%, while European markets retreated anywhere between 1.5% and 3%. Markets had been pricing in the probability that the President would go

easy and exempt several countries and industries. However, for anyone that has never read Trump's book "The Art of the Deal", he is a firm believer in negotiating from a position of strength and his style involves hitting with the proverbial stick first, then offering the carrot. We believe that there is a potential chance that some of these tariffs could eventually be rolled back, if, for example, these countries agree to either eliminate their own tariffs on U.S. exports or manufacture more goods in this country. However, that is only if these countries are willing to negotiate. If instead they choose to retaliate, a deeper trade war could unfold, a war in which there are no winners in the end.

Although the minimum tariff rate is 10%, the fact that different countries will have meaningfully higher rates makes the effective tariff rate closer to 25%. This would be equal to a tax increase somewhere between \$600-\$650 billion on the US economy, or approximately 2% of GDP. At the same time, inflation would likely increase to the tune of 2%. In a worst-case scenario, assuming that there is no negotiation, and the reciprocal tariffs rolled out yesterday afternoon stay in their current form, the US and the global economy would almost certainly enter into a recession. However, the Secretary of the Treasury Scott Bessent was out last night discouraging countries from retaliation, instead encouraging them into negotiation, which tells us that the administration is willing to talk things through. Hit with the stick first then offer the carrot. At this point, the willingness of other countries to negotiate or retaliate is unknown; however, the degree to which either or both happens will determine the outcome of this trade war.

The thing about tariffs is that they are like glue. The longer they are in place, the stickier they become and the harder they are to remove. In other words, the longer they stay in place, the lower the chance that they are transitory, as Fed Chairman Jerome Powell qualified them last month. Speaking of the

Fed, the markets appeared to realize last night that the Federal Reserve might not cut rates three times this year, as was being priced in. In fact, the Fed finds itself in a narrow corridor that just got narrower. If tariffs are in fact stickier than expected, inflation will move higher, making the Fed less likely to cut rates. However, if tariffs result in slower economic growth, the Fed might end up reducing rates, not because it wants to, but because it has to. The reason behind the potential cuts is key; there are such things as good rate cuts and bad rate cuts. Good rate cuts are a luxury resulting from a successful soft landing of the economy, implemented to keep things running smoothly. Bad cuts are a necessity to prevent the economy from crashing and burning.

To be honest, something that has been keeping me up at night is the effect of tariffs on corporate earnings and how quickly Wall Street will reprice this. Faced with potentially higher costs and lower demand, companies will most likely retrench until they have more clarity regarding the long-term effects of tariffs. This will likely lead to lower earnings growth outlooks from corporate America. Having covered individual companies for almost the entirety of my adult life, I can tell you that management teams do not like cutting earnings growth outlooks, and they especially hate doing so outside of earnings season. The fact that over the past month we have seen many companies do just this tells me that management teams are taking the current economic uncertainty very seriously. However, until recently, Wall Street analysts were still expecting double digit earnings growth for the S&P 500 for 2025. In fact, as of last night, 2025 consensus earnings growth expectations for the index were just under 10%. Some on the Street are starting to ratchet numbers lower, as we saw Goldman Sachs do earlier this week when it lowered its earnings growth number to 3% for the year. However, most analysts have not yet done that, and they will either do so before the Q1 2025 earnings season begins in a couple of weeks, or they will

be forced to do so once companies start reporting. Either way, volatility will remain high and U.S. equity markets are likely to trend sideways or lower until more clarity is gained around the overall effects of tariffs. Up until yesterday, the pullback in US equity markets had removed the proverbial froth or excess from equity valuations. However, by definition, the P/E valuation metric is underpinned by earnings, a variable that is now fraught with uncertainty. Think of the market as a cup of beer. The recent pull back removed the excess foam on top, now we just have to make sure that there are no holes in the cup, and we start losing actual beer.

The best defense against this uncertainty is a diversified portfolio across multiple asset classes, keeping a cool head, an eye on the long term, and staying informed. Rest assured that we will continue to monitor the situation and will keep you informed as the situation continues to unfold. ■



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