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Tariff Viewpoint

Investment markets had largely ignored Donald Trump's threat to impose stringent tariffs for much of the first quarter. However, in recent weeks there has been a move to risk-off sentiment as investors have focused on their potential negative impact on the global economy. However, the announced tariff increases are higher than markets had anticipated, with the imposition of a standard 10% tariff and a wide range of more stringent measures announced. This has led to heavy falls across global markets with the US facing some of the heaviest falls in value. In currency markets the pound has ticked up against the dollar (which will at least help the UK's inflation outlook).

The reaction of the market is focused on the outlook for US led global growth and inflation. The tariffs (if implemented) will lower the short to medium term growth prospects for the US economy. At the same time the price rises will increase inflationary pressures which leaves the Federal Reserve (Fed), and other central banks, in a tricky spot on whether to reduce rates to support growth.

In recent commentary the Fed has signalled that supporting growth and avoiding recession is the priority with tariffs probably increasing the scope for further US interest rate cuts this year.

Overnight, the market's expectations rate cuts increased with at least three US rate cuts pencilled in for 2025.

Nothing from Wednesday's announcement was a particular surprise and the worst thing you can do in such times of market volatility is panic! These tariffs are purely the start of a negotiating tactic with each country. It is a broad-brush approach rather than a clearly defined economic strategy (as illustrated by the fact he has imposed 10% tariffs on an Antarctic island that is only inhabited by penguins). Trump styles himself as the expert negotiator - whether taking on over 60 countries in one go is the best way of going about this remains to be seen.

One interesting aspect is what this means for investment in the US equities. Especially given that the US makes up 60% of the MSCI AC World index (the typical equity proxy to gauge global markets). For some time, the dominance of US large cap technology has been the only game in town and holding US or global index trackers – which are dominated by US stocks – has almost been the only stock market strategy you have needed.

However, the advent of trade war(s) is likely to lead to overseas investors reducing their US equity exposure (the US has over $33 trillion of equities and bonds owned by overseas investors). This is likely to drag on US assets and the dollar in the short to medium term and we have been seeing evidence of this so far this year.

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In our view, this sharp change in sentiment does reinforce a strong argument for including active management strategies and diversification across global equity markets, especially taking advantage of areas that are trading on much cheaper valuations than US equities.

Yet experience has told us that you underestimate the quality of the US corporate sector at your peril – irrespective of the US political or economic backdrop. Is this all just a negotiation ploy to get more US based manufacturing? In the long run you would be brave to bet against the potential of US equities. However, in the short-term, greater diversification against global equity markets seems a prudent decision.

If you have any questions, get in touch using the below contact details.

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