Thinking Man 108: Tariff Tantrum 2025

We entered the year optimistic that the Trump administration's pro-business stance would continue the post-pandemic growth trajectory. At the same time, we were sensitive to the stretched valuations in US equities (as measured by earnings multiples and risk premiums) and in US corporate credit (as measured by credit spreads). We were also aware that after four years of record fiscal stimulus and mounting federal debt, bringing back fiscal discipline would feel like treating a drug addiction —necessary for the long haul, but painful in the short term.

Over the last few weeks those concerns have begun to play out in real time, as financial markets have become more attuned to the possibility of short-term disruption for the world's consumers, companies and governments. What we are witnessing is no less than the reshaping of the world economic order. In this Thinking Man we will offer our interpretation of the current economic, market, and political backdrop. Part of our focus will be on separating the effects of policies that are likely to continue under any scenario (more deportations, less federal spending, and China decoupling), from policies that we see as being more dynamic (trade policy with allies and domestic industrial policy). We will attempt to take a wider-lens view, with less emphasis on the day-to-day rollercoaster which is the 24-hour Trump news cycle.

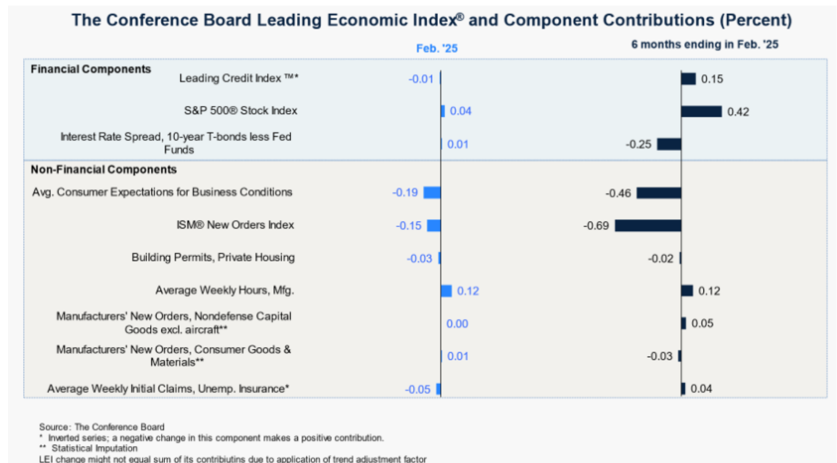
What's the greater macroeconomic risk: growth or inflation?

Since the beginning of the Fed's rate hiking campaign, we have emphasized the structural forces that would keep inflation above trend. Among these forces was the decoupling of the American and Chinese economies, as supply chain and national security concerns would increasingly outweigh the cost-savings of producing in China. When combined with the fiscal excess of the last four years, and immigration policies that would most likely increase labor costs in agriculture, construction, and hospitality, our view was (and still is) that inflation would be a sustained issue. Adding in the effect of the more recently announced universal baseline tariffs of 10% (plus the potential for the reinstating of reciprocal tariffs in 90 days), gives us conviction that short-term price pressures are here to stay. We temper that outlook with three observations:

1. China decoupling will accelerate, but hostile trade policies with non-China countries (particularly with American allies like the EU, the UK, Japan, Canada, and Mexico) are likely to be walked back in negotiations, resulting in even lower trade barriers and stronger bilateral relationships. The resurgence of American manufacturing need not entail the end of globalization, but rather a version of globalization that is less dependent on China. If the pandemic was any indication, greater control over supply chains will be a longer-term asset.

2. The deflationary effects of automation and AI are still very much in place and can work to alleviate price pressures. Productivity and technology are the strongest long-term determinants of lowering production costs. We should not necessarily be too concerned about run-rate labor scarcity in job categories that are soon to be automated anyway.

3. America's federal debt and deficit spending are problems, but they are problems that are shared by a majority of the world's developed economies. Though the US fiscal picture is not pretty, it is arguably still the least ugly of all the contestants in the beauty pageant. This is primarily because the US retains military, monetary and technological primacy, that is only truly rivaled by our primary geopolitical adversary: China.



And so, though we are no doubt concerned about price shocks like those we saw during the pandemic, we are more concerned about the near-term growth outlook as a result of all the unpredictability generated by attempting to do *too much, too fast*. When corporate managers don't know what policy will be, they delay decisions like hiring and capital spending. When consumers are unsure about their near-term economic prospects, they are likely to hunker down and delay major consumption decisions. This effect becomes more pronounced when household balance sheets are tight, as is the case today. This is already showing up both anecdotally (Stellantis idling auto plants in Canada and Mexico) as well as in consumer confidence surveys. The result is a deceleration of economic activity, not from policies themselves, but by the fact that everyone is paralyzed by not knowing what the policies are going to be.

We believe that some amount of economic damage has already been done. Whether that damage will result in a more sustained economic contraction remains to be seen, but at this point is ***more likely than not***. Over the next few months, we are likely to see a short-lived, pandemic-style stagflationary shock, where economic activity contracts, and prices temporarily spike. With more than 62% of Americans invested in the stock market, equity volatility can begin to affect real economic conditions. Though the wealthiest 10% of Americans own 93% of all stocks, they also account for more than half of all US discretionary spending, such that negative wealth effects do stand to impact economic growth. Over the medium-term we continue to believe that tax cuts, deregulation, domestic investment, and gradual monetary easing will serve as economic tailwinds, but these benefits will take longer to kick-in.

Tariffs: What's the point, *really*?

Count	Country/Region	Import Value in 2024 ($ bn)	% of Total Imports	Announced Tariff Rate (1)
1	EU	$606	18%	20%
2	Mexico	$510	15%	25%
3	China	$463	14%	145%*
4	Canada	$421	13%	25%
5	Japan	$152	5%	24%
6	South Korea	$120	4%	25%
7	Vietnam	$119	4%	46%
8	India	$87	3%	26%
9	Taiwan	$76	2%	32%
10	Switzerland	$61	2%	31%
Total / Weighted Average		**$2,614**	**79%**	**46%**
Value of Total Imports into US		*$3,296*	*Source: White House, Bureau of Economic Analysis*	

(1) On April 9th recirporcal tariffs on non-China nations were delayed by 90 days, while China tariffs increased to 145%

With respect to the most recent tariff announcements, we continue to believe that there is at least somewhat of a method to the madness, even if we also believe that the world economy is too fickle a thing to play games with. Nonetheless, we do take some comfort from the understanding that these policy actions are not as improvised as the news media (or Trump's communication style) would have us believe. The administration is still advised by competent strategists, and there are too many private interests that stand to lose were it really the case that the entire global economy rests on the whims of single man. The Trump administration's stunning April 9th decision to delay reciprocal tariffs by 90 days, while also increasing China tariffs to 145% (and keeping universal baseline tariffs of 10%) is somewhat of an indication of how the next few months will likely be – nothing is really as it seems, and no policy outlook is written in stone.

When Trump announces a reciprocal tariff policy that is more punitive than expected, it is not that the administration is clueless to how the stock market will react, or that it is entirely unaware of the theory of comparative advantage (i.e. that countries are best off when they specialize in goods for which they have the lowest opportunity cost). So the question is, what does the administration stand to gain from pursuing policies whose content and style would, from the surface, appear to be just plain stupid?

Our view is that it is as simple as bringing trade partners to the negotiating table as quickly as possible. Imposing only modest tariffs would risk making trading partners take a "wait and see" approach, effectively taking a gamble on whether their economies could survive without access to the American consumer market. By taking the "nuclear" option, the Trump administration risks short-term economic damage, but it gains a higher probability of working out advantageous trade agreements quickly. The more recent decision to delay reciprocal tariffs by 90 days demonstrates some sensitivity to near-term economic conditions, but the overarching strategy remains: give a taste of how ugly things can get if the world's countries don't agree to play ball. Whether that will turn out to be an effective strategy remains to be seen.

So what exactly are they negotiating? The end of trade barriers for American industries in overseas markets, the end of currency manipulations that benefit non-American exporters, and the end of practices which "hurt" American companies, all in the service of a worldview which claims that the US has been taken advantage of since the end of WWII. Whether this is a fair characterization is debatable, given the cost savings that accrue to US companies and consumers from globalized supply chains, as well as the informal benefits of maintaining a wide sphere of economic and political influence. What we are witnessing is a weaponization of that influence. As the world's most important consumer market, there are many exporting countries that will suffer greatly without some sort of resolution. No doubt, it does leave a bad taste in the mouth when a powerful country flexes its muscles in front of weaker ones. It also detracts from the ideological high ground from which the US has historically operated. History will surely not credit the Trump administration with very many style points, but there is still hope that they can make up for it with meaningful results.

We often hear protests which take the form of *"But American manufacturing is dead! We have moved on to higher valued-added services! Even if there was an industrial renaissance, less Americans want to work factory jobs!"* And yet consider for instance that the factories of the future will be practically unmanned, and that the cost of running automated manufacturing equipment is but a fraction of the typical labor cost in most emerging economies. What is at issue here is not only American protectionism of domestic manufacturing. It is about the foundational economic changes that will arise as machines are able to do more and more things for us, and positioning America for that future. What is at stake is not only economic fairness, but the economic viability of Western democracy in the face of authoritarian adversaries that have already met or surpassed many of the West's technological capabilities.

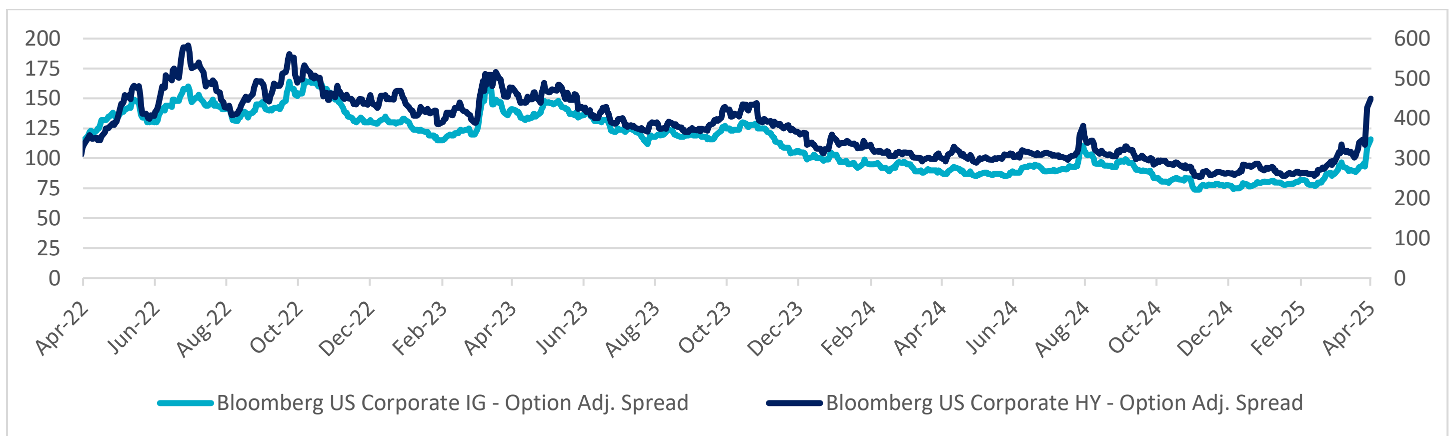
Unknown Unknown's

We have recently started placing a greater emphasis on the resurfacing of unknown unknowns, i.e. risks that we do not even currently register as being risks. This is a product of the truly unprecedented nature of the moment we are living, and the overtly aggressive rhetoric that has become more common on the international stage. The more emotions flair, the more extreme outcomes become likely. We speak specifically of anti-American rhetoric which is already fueling less tourism into the US, boycotts of American products, and animosity towards American tourists.

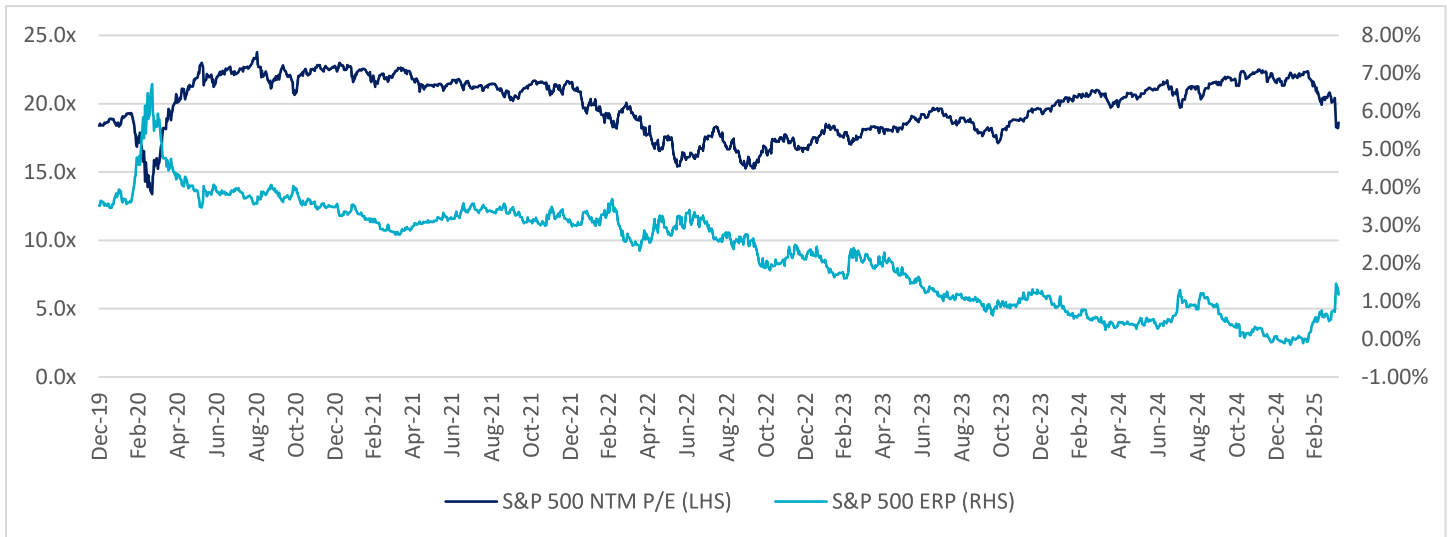
To any person accustomed to the dignified attitude with which American diplomacy has historically been carried out, the incendiary attitude of the Trump administration, along with the open displays of corruption and use of policy for self-enrichment are all legitimate reasons to be skeptical. This would not be the first instance where arrogance, ineptitude and an overestimation of American strength resulted in unintended consequences.

Market Reactions & Investment Implications

The last couple of weeks have been truly historic for global markets. Following Trump's April 2nd press conference, the S&P 500 suffered some of its worst single day drops since the outbreak of the pandemic, and briefly passed through the 20% drawdown that signals the beginning of a bear market. No risk asset has been spared, with everything from international equities, to oil, gold, and crypto, all down double digits. Even the 10-year Treasury yield, widely perceived as a safe-haven asset bounced back to as high as 4.5%, after having dipped below 4%. At +450, high yield credit spreads are back to Fall 2023 levels, and are flashing signs of increased distress, with average CCC rated corporate interest coverage ratios now below 1.0x. Monday April 7th, saw the highest stock volume traded in a single day in the stock market's history, alongside some of the lowest liquidity conditions in recent memory. Following Trump's announcement that reciprocal tariffs would be delayed by 90 days, the S&P 500 proceeded to rally ~10% in single day.



Nonetheless, the constant flow of news headlines is making it very difficult for investors to develop any truly sustained measure of confidence. This has been exacerbated by aggressive escalations with China, who have vowed to not back down. Consequently, Chinese imports are now set to pay 145% import duties unless they rescind their retaliatory tariffs. We do not entirely discount the possibility, that if China feels itself backed up into a wall it might risk more drastic military escalation via a naval blockade of Taiwan (in order to disrupt the American AI supply chain). Though a 90-day delay does give global governments and companies some wiggle room, we are not so convinced it has any meaningful effect on the uncertainty and economic paralysis already affecting corporate managers and consumers. Over the coming weeks we will be focused on further communications from the White House and signs that trading partners are coming to the negotiating table. We will also be hyper-focused on corporate commentary once Q1 earnings season kicks off over the coming days.



With respect to our investment outlook, we continue to stick to our emphasis on quality assets, and portfolio management that is focused on controlling what can be controlled. We achieve this by having balanced portfolios where we tactically manage exposure by overwriting equity positions (covered calls), as well as managing duration and credit risk in our fixed income positions. As a result, it is precisely in these types of global panics where our philosophy shines brightest. Above all we are most sensitive to valuation, and as such have a particularly high bar for when the time is right to put on more risk. At 19.6x NTM earnings, the market is surely more attractive than it was at 23.0x. Having said that, next twelve month earnings estimates of $278 imply 12% earnings growth over the last twelve months; an expectation that is simply too high for the current macro backdrop. Assuming flat earnings growth still puts us in a relatively expensive multiple of 21.0x. Consequently, we are of the view that patience and caution is likely to be rewarded for the remainder of the year. To conclude we offer three investment truisms for consideration in uncertain times:

1. From value investing sage Howard Marks, risk means more things ***can*** happen than ***will*** happen
2. It rarely pays to panic when everyone is panicking
3. Things are rarely as good or as bad as they seem

We conclude with a table of forward performance following two-day drawdowns of at least 10%. We note that in every instance the market eventually bounced back because there was monetary and/or fiscal policy response. Our intention is not to encourage naive or politically motivated optimism, but only to highlight the psychological biases that result in exaggerated swings in sentiment. Long-term investing requires the ability to navigate the storm when you are in it, while also being able to see through the storm to clearer skies ahead. As long-term investors, we maintain an ever-present eye on downside risk management, as well as for signs and opportunities for leaning into risk when the time is right.

Date	Policy Response?	2-Day	1M	3M	6M	12M
3/12/2020	✓	-13.9%	11.3%	21.0%	34.6%	59.0%
11/20/2008	✓	-12.4%	15.8%	2.8%	21.0%	45.0%
11/6/2008	✓	-10.0%	0.5%	-3.9%	0.5%	18.2%
10/19/1987	✓	-16.2%	3.7%	2.4%	8.1%	18.0%
10/16/1987	✓	-24.6%	8.1%	10.9%	14.7%	22.9%
Median		**-13.9%**	**8.1%**	**2.8%**	**14.7%**	**22.9%**

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