Navigating Tariffs in 2025 — March 2025

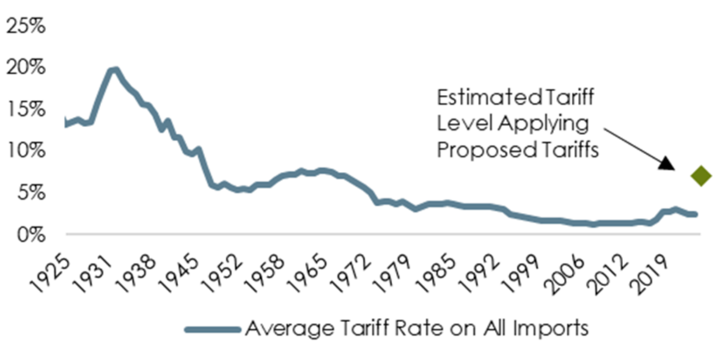
- **The US has a long history of using tariffs for both economic and political purposes**
- **Tariffs have complex short-term and long-term implications for consumer behavior, prices and economic growth**
- **The impact on financial markets is often immediate, as reduced earnings visibility leads to higher market volatility**

US Tariff History

Tariffs are taxes imposed by a government on imports or exports between countries, aimed at protecting domestic industries, generating government revenue, and influencing trade balances. During the Great Depression, tariffs peaked at 20% as the US sought to protect its domestic industry. In retaliation, other nations imposed their own tariffs, exacerbating the global economic downturn.

In the post-World War II era, the US embraced free trade agreements and globalization. While tariffs have not disappeared entirely, they have been used intermittently, often focused on addressing trade imbalances or national security concerns. Should tariffs of 25% on Canada and Mexico and 10% on China be enacted, the average tariff rate on all US trade would jump from 3% to nearly 10% overnight – the highest level in decades.

Proposed Tariffs Would Reach a Level Not Seen in Decades



Source: ACG Research, Tax Foundation

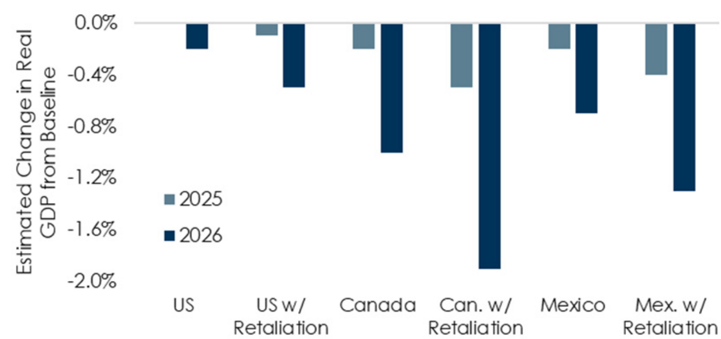
Impact on Economic Growth

Tariffs can yield both positive and negative outcomes, depending on the context. Positive impacts include the protection of domestic industries, revenue generation, and the reduction of trade deficits. Non-US governments can subsidize industries critical to their national security, such as semiconductors, and tariffs can help offset those subsidies, providing US companies with a more level playing field. While tariff revenue was crucial to the US in its early years, it now represents only a small fraction (around 2%) of total government income.

On the negative side, tariffs can result in higher prices for consumers, inefficiencies in resource allocation, and the risk of a retaliatory trade war. Although the tariff is technically paid by the importing company, a portion of the cost is often passed on to the consumer through higher prices. This upward pressure on prices can also contribute to inflation and higher interest rates.

Trade wars, especially when tariffs rise, tend to harm all parties initially. Under the proposed 25% tariff on Canada and Mexico, both countries are likely to face recessions (Canada's GDP is forecast to grow at 2.1% and Mexico's at 1.2%). The US imports significantly more from China than it exports, so retaliation from China would likely have limited impact. While the US would face a GDP slowdown, it would likely avoid a recession, with GDP currently at 2.8% and estimated to slow to 2.0% in 2026.

A Trade War Would Weigh on All Three Economies



Source: ACG Research, Peterson Institute for International Economics

Market Implications

Investors typically react to tariffs based on expectations of their potential to disrupt global trade and economic stability. In the short term, this often leads to added volatility, sector-specific sensitivity, and pressure on currency exchange rates. The unexpected tariffs imposed in 2025, particularly those involving major trading partners, have contributed to market fluctuations. Certain sectors are more sensitive to tariffs, particularly industries that rely on imported raw materials, such as the automotive and home building industries, which may see squeezed profit margins due to higher costs. Tariffs can also lead to a stronger domestic currency, boosting purchasing power abroad but making US exports less competitive.

During President Trump's first term, there were threats of across-the-board tariffs on China and the termination of the Mexico-Canada trade agreement. However, these threats were ultimately replaced with renegotiated deals. The volume and value of global trade subsequently increased and continued under President Biden. If history is any indication, current tariff proposals may serve more as negotiation tactics and have less of a disruptive impact on economic growth, sales, and corporate profits.

The prevailing view is that the current administration's tariff policies, should they be implemented, will likely reduce economic growth and increase inflation slightly. However, this outcome is not a certainty.

ACG's Position

In today's market environment, maintaining a long-term perspective, staying diversified, and resisting the temptation to react to daily news cycles reinforces the benefits of a long-term strategic allocation. We continue to believe in the advantages of a globally diversified equity portfolio. Portfolios that are diversified across regions, sectors, industries, market capitalizations, and investment styles are better positioned to weather short-term volatility and enhance long-term results. Similarly, we believe both US and non-US equity portfolios can benefit from active strategies that identify fundamentally strong companies well-equipped to navigate and capitalize on tariff-driven dislocations.

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