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Assessing the Impact of Trump's Tariffs

FOR FINANCIAL ADVISERS AND THEIR RETAIL CLIENTS

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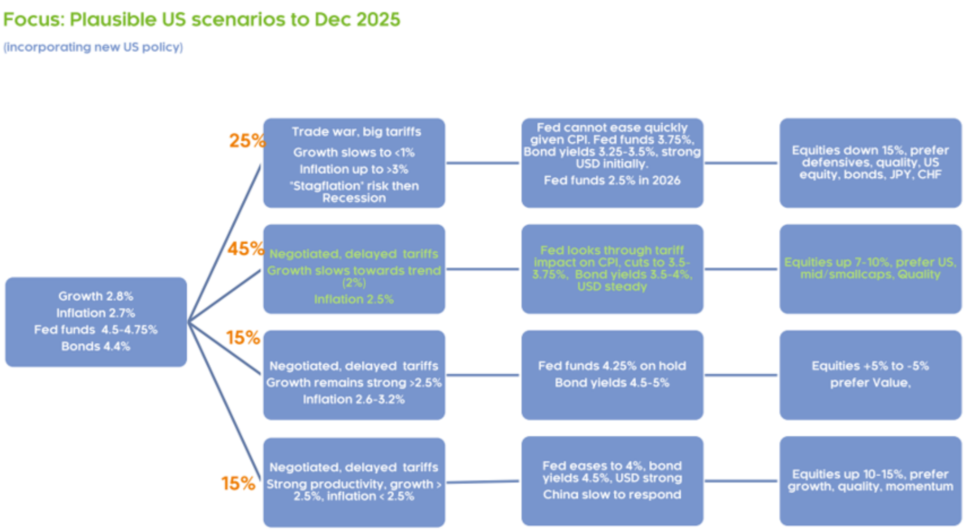
Global financial markets have been rattled by President Trump's announcement of new tariffs. Trump threatened the use of tariffs as part of his election campaign and has backed that up with the announcement of a 25% import tax on goods from Canada and Mexico, alongside a 10% tariff on imports from China. The tariffs on Mexican and Canadian goods were swiftly deferred but the threat remains, however, China has announced tariffs of its own in response. Meanwhile, the possibility of US tariffs against the EU and the UK have compounded investor concerns, triggering notable currency moves - although so far stock markets have remained calm.

We had anticipated a very high likelihood of US tariffs in some form. FE Investments uses economic modelling from Zenith, our sister company, and its current position on the most plausible scenarios for the imposition of US tariffs meant that prior to this week's escalation we had assigned a 25% chance of a trade war with significant tariffs. This scenario assumes economic growth will slow below 1% over the coming 9 to 12 months, while inflation remains above 3%, presenting a stagflation risk.

FE Investments' Outlook for Tariffs, Growth, Inflation and Interest Rates



Source: Zenith Investment Partners, February 2025

In financial markets, this could feasibly lead to a 15% reduction in the value of equities, although sentiment could either amplify or dampen this. In this scenario, defensive and quality stocks offer the most downside protection. Given this backdrop, we would prefer US equities, bonds, and defensive currencies such as Swiss franc and Japanese yen.

Despite these concerns we still do not see this as the most likely scenario (yet). We continue to assign a higher probability to a negotiated resolution or delayed tariffs, which would be a positive outcome for equities. One of the other scenarios we are considering outside the above could be that tariffs are mostly ineffectual as currency movements mostly offset the imposed tariffs.

While these protectionist measures introduce significant short-term volatility, the long-term implications will depend on how key economies respond. Trade tensions may disrupt supply chains, impact corporate earnings, and shift investment flows, but they also present opportunities for strategic positioning.

Market Impact & Investor Strategy

1. **Sectoral Realignment**: Industries reliant on global supply chains, such as manufacturing and technology, are likely to face cost pressures. However, sectors such as domestic infrastructure, energy, and select consumer goods may benefit from policy shifts favouring local production.

2. **Currency Volatility**: Investors should anticipate fluctuations in major currencies, with potential depreciation in economies most affected by trade restrictions. Diversified currency exposure and hedging strategies will be essential.

3. **Equity Markets & Safe Havens**: Equities with significant international exposure may see near-term corrections, but defensive sectors such as healthcare, utilities, and dividend-yielding stocks could provide stability. Gold, government bonds, and alternative assets are expected to play a crucial role in mitigating risk.

The Strategy Engine has helped us assess the risk and position the portfolios. This is important with Trump who has proven to be 'predictably unpredictable'. He may be a master of game theory, or a bit mad, we don't know because we are not experts in these fields; what we do know is dynamic and diversified portfolios, alongside a proactive risk-management mindset, will be helpful for navigating the shifting landscape.