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Trade War Redux: The Economic and Market Impact of New U.S. Tariffs

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A New Era of Trade Protectionism

The global trade landscape has taken a sharp turn as the U.S. government has implemented a series of aggressive tariff measures targeting key trading partners. In addition to previously imposed 20% tariffs on steel and aluminum and a 10% overall tariff on China, a 25% tariff on Canadian (10% on Canadian energy exports) and Mexican imports has now been implemented, though Ford, GM, and Stellantis imports and any others that abide by the US-Canada-Mexico trade agreement (USMCA) have been granted a 30-day grace period.

China's tariff rate has been increased to 20% applied across all Chinese imports. These measures signal a decisive move toward protectionism, raising critical questions about their long-term impact on global trade, corporate profitability, and economic growth.

The Likely Retaliation: A Brewing Global Trade War

History suggests that such aggressive trade actions rarely go unanswered. Key U.S. trade partners—Canada, Mexico, and China—are preparing to respond in kind.

- Canada has announced 25% tariffs on CAD$155 billion worth of U.S. goods, with a phased implementation over 21 days.
- Mexico has yet to reveal its response, though history suggests a targeted approach affecting industries reliant on cross-border supply chains.
- China has unveiled a multi-pronged strategy, including export controls on critical minerals, tariffs on U.S. energy (coal, liquified natural gas, and crude oil), agricultural products, machinery, and automobiles, and economic measures targeting U.S. businesses operating in China.

The structure of these retaliatory measures suggests that Canada and Mexico are focused on consumer discretionary goods and construction materials—autos, electronics, food, and steel/aluminum products. If fully implemented, these measures could increase consumer prices, disrupt supply chains, and dent corporate profit margins.

Market Reactions: Disruptions and Divergences

Financial markets have been quick to price in the risks associated with these tariffs. The most heavily affected sector has been consumer discretionary goods, which have suffered a 13.2% decline over the past month[1]. This sector, which includes automobiles, electronics, and retail goods, is particularly vulnerable given its dependence on cross-border supply chains.

On the other hand, consumer staples (+2.87%), healthcare (+1.42%), and real estate (+0.1%) sectors have shown resilience, reflecting investor rotation toward defensive sectors[2]. Despite broad market volatility, sector dispersion remains high, and the sell-off has been uneven. While correlations have risen, this is not a broad-based downturn but rather a selective repricing of risk in exposed industries.

The market reaction aligns with expectations of a stagflationary shock—mild to moderate in severity. If trade relationships remain unchanged, inflation is expected to rise by 0.46%–0.82%, while GDP growth could take a 0.4%–0.5% hit in the long run[3].

Corporate and Consumer Behavior: Adjusting to the New Reality

Economic data from February provides a glimpse into how businesses and consumers are reacting to these tariffs:

- Corporations have accelerated imports to get ahead of the tariff deadlines, evidenced by a notable uptick in import/export activity.
- Consumer spending has declined, as seen in the latest Personal Consumption Expenditures (PCE) report, with the steepest pullback in goods-related spending.
- Manufacturing and service-sector price indices have exceeded expectations, while new orders have fallen into contractionary territory—a warning sign for future growth.

While the consumer remains in a strong financial position (with stable net worth, manageable debt levels, and rising income), expectations remain the key risk factor. The latest survey data shows that 1-year and 5–10-year consumer inflation expectations have surged, while consumer confidence has deteriorated[4].

[1]Bloomberg, S&P500 Index, as of 3/7/2025
[2]Bloomberg, Standard & Poor's, S&P 500 Consumer Staples Index, S&P 500 Healthcare Index, S&P500 Real Estate Index, Trailing 1M returns as of 3/7/2025
[3]CNR Research, Tax Foundation, Federal Reserve, Federal Reserve Bank of Boston – these are estimates for impacts to inflation and GDP, they do not correspond to market returns, as of 1/30/2025
[4]As of 3/5/2025
[5]As of 3/7/2025

The Federal Reserve's regional business survey confirms this trend, with inflation expectations among manufacturing firms rising to 3.5% and service-sector expectations climbing to 4%. While longer-term inflation expectations remain anchored at around 3%, the rise in short-term expectations suggests mounting pricing pressures[4].

Broader Economic Implications

The situation remains highly fluid, and economic impacts will not be evenly distributed across sectors. A few key takeaways emerge:

1. Higher Prices, Slower Growth

Tariffs will contribute to higher costs for businesses and consumers, potentially squeezing profit margins and reducing discretionary spending. However, this does not necessarily trigger a recession on its own—but it does increase the risk.

2. Corporate Profits Remain Strong—For Now

Despite trade concerns, earnings season has been a blowout, with corporate profits rising 14.2% versus the expected 7.3%[4]. Additionally, personal income continues to grow, supporting consumption. The central question remains: Can this momentum withstand the inflationary impact of tariffs?

3. Market Returns Reflect a Policy-Driven Shift

Since February 19, the S&P 500 has declined -7.47%[5], and year-to-date returns are down -3.20% reflecting tariff concerns. However, this drop does not account for potential policy offsets, such as deregulation and tax cuts, which could mitigate some of the negative growth impact.

4. The Global Economy Faces Greater Risks Than the U.S.

While the U.S. remains relatively insulated, Canada and Mexico are at a far greater risk of recession due to their heavy dependence on U.S. exports. The fallout for China remains uncertain, but Beijing is already ramping up stimulus measures to counteract potential damage.

[1]Bloomberg, S&P500 Index, as of 3/7/2025
[2]Bloomberg, Standard & Poor's, S&P 500 Consumer Staples Index, S&P 500 Healthcare Index, S&P500 Real Estate Index, Trailing 1M returns as of 3/7/2025
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[5]As of 3/7/2025

Global Responses: Fiscal and Monetary Stimulus in Motion

As U.S. trade policies shift, global economies are responding with increased fiscal and monetary stimulus.

- Europe is ramping up defense spending in response to geopolitical uncertainty, taking U.S. policy shifts at face value.
- China is implementing broad-based stimulus measures across multiple fronts, including monetary easing, fiscal stimulus, real estate support, consumer subsidies, and high-tech investment (AI and semiconductors). Notably, Beijing appears to be warming up to the private sector, suggesting an effort to stabilize economic growth.

While international markets have staged a near-term rally, questions remain about the sustainability of growth and the evolving nature of geopolitical relationships.

Investment Outlook: Too Early to Make Major Allocation Shifts

From a portfolio management standpoint, it is still too early to make widespread allocation changes. While certain sectors have suffered short-term losses, tariff-driven economic shocks tend to evolve over time, making long-term positioning more important than short-term reactions.

In the near term, defensive sectors such as consumer staples, real estate, and healthcare appear relatively insulated, while consumer discretionary, manufacturing, and technology face greater headwinds. Investors should also keep an eye on policy adjustments—particularly potential corporate tax cuts or regulatory rollbacks—which could provide partial offsets to the current growth drag.

Conclusion: A Dynamic and Uncertain Future

The global economy has entered a highly uncertain period, with tariffs reshaping trade relationships, corporate strategies, and consumer behavior. While higher prices and slower growth are now the baseline expectation, the impact on corporate earnings, consumer confidence, and investment flows remains a key variable.

For investors, the key takeaway is not to overreact to short-term volatility but rather to focus on sectoral divergences and policy-driven offsets. While the U.S. economy remains resilient, the same cannot be said for Canada, Mexico, and other export-driven economies, which now face heightened recession risks.

The next few months will be critical in determining whether these tariffs evolve into a long-term drag on global growth or if policy adjustments can mitigate their impact. As always, markets will adjust accordingly—investors should be prepared for both risks and opportunities in the evolving landscape.

Important Information

Index Definitions

The Standard and Poor’s 500® Index (S&P 500) is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.

The Standard and Poor’s 500® Consumer Staples comprises those companies included in the S&P 500 that are classified as members of the GICS® consumer staples sector.

The Standard and Poor’s 500® Health Care comprises those companies included in the S&P 500 that are classified as members of the GICS® health care sector.

The Standard and Poor’s 500® Real Estate comprises those companies included in the S&P 500 that are classified as members of the GICS® Real Estate sector.

Indices are unmanaged and one cannot invest directly in an index. Index returns do not reflect a deduction for fees or expenses.

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