Semper Salutaris
Disciplined Financial Wellness

On The Mark

March 2025 Special Edition

Tariffs: Noise vs Signal

Key Takeaways

- Escalating tariffs have once again caused market volatility.
- Tariffs have the potential to lower economic growth and increase inflation, but **distinguishing between noise and actual implementation is crucial** as discussions continue.
- The impact on markets and the economy depends on how long the tariffs are in place, potentially causing short-term market volatility until deals are struck.

Escalating Tariffs

President Trump has introduced a series of escalating tariffs. Here's what we know so far. For China, an earlier 10% tariff was raised to 20% on March 4 on all imports. Both Canada and Mexico now face 25% tariffs on most goods, with a reduced 10% rate for Canadian energy. Additionally, starting March 12, steel and aluminum imports will face a 25% tariff. Lastly, starting April 2, the administration has proposed reciprocal tariffs against select trading partners to address disadvantages for U.S. companies. As expected, Canada, Mexico, and China retaliated as tariffs took effect.

Tariffs are not surprising, as President Trump had vowed changes to trade, among other things. Nonetheless, the pace of change may leave investors wondering what the objective of tariffs is. Understanding the objective may help separate the noise from the signal of actual long-term implementation.

The administration has discussed tariffs as a strategic tool to address a broad suite of issues. They include curbing the inflow of fentanyl and illegal immigration into the U.S. to help the U.S. economy by incentivizing companies to relocate their manufacturing operations in the U.S. Lastly, tariff revenues could also be used to offset reduced revenues from tax cuts.

Breaking Down the Impact

The impact of 25% tariffs on Mexico and Canada would be costly for all parties, albeit unevenly.

Within the U.S., 43% of all imports, equaling more than $1.3 trillion, came from Canada, China, and Mexico. This is significantly larger than the 2017 tariffs, which targeted roughly $380 billion in goods. Within the U.S. economy, tariffs may benefit particular sectors while harming others. For example, auto industries may see profit margins squeezed as Mexico and Canada account for 52% of imported auto parts. On the other hand, domestic steelmakers and aluminum producers could benefit from reduced foreign imports. Still, the U.S. is less reliant on trade compared to other economies. In 2023, exports of goods and services from the United States made up about 11% of its gross domestic product (GDP), and trade as a whole made up a quarter of GDP.

On the other hand, tariffs will hit Mexico and Canada much harder, as trade makes up about 70% of both economies. Exports to the U.S. alone account for 32% and 21% of their GDP, respectively. The Petersen Institute for International Economics estimates that 25% tariffs would reduce Mexico's and Canada's GDP by 1.7% and 1.2% over five years, respectively. Adding the retaliatory tariffs on top of that compounds the losses for all involved.

Given the significant ramifications for all parties, we believe the latest tariff actions are still likely a negotiating tactic to draw Mexico and Canada into helping secure U.S. borders and negotiate better trading terms. The impact on markets and the economy now depends on how long the 25% tariffs on Canada and Mexico are in place. If they are removed soon, then the impact on the economy will be temporary. However, it is always possible that things will

devolve into a full-blown trade war. If this happens, estimates are that it could reduce U.S. GDP by 1.2% over the next few quarters and add 0.7% to inflation—an outcome that serves no one's best interest.

What Investors Should Do

As noted in our 2025 outlook, we believe the U.S. economy is strong enough to weather temporary tariff uncertainty. Tariffs have the potential to lower economic growth and increase inflation. However, if tariffs are used as a negotiation tool, we don't believe the impact would be material enough to push the U.S. economy into a recession or cause a lasting increase in inflation.

Because the road to policy change is unpredictable, we expect elevated volatility in financial markets. Shocks to growth, inflation, or financial conditions could warrant reducing portfolio risk, while price dislocations could present buying opportunities.

As investors in times of uncertainty, we rely on a tried-and-true principle: You hedge for risks you know; you diversify for risks you don't know. Today, as tariff policies remain a moving target, it is a good time to ensure you are diversified from a geographical and strategy perspective and stay invested as we parse through the noise and focus on the signal of actual implementation.

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