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Life After the "Liberation Day" Tariff Announcement

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Publishing an outlook in early April 2025 is a hostage to fortune, given the current fluid and fast-moving environment driven by the substantial uncertainties around the path of U.S. economic policy and its effects, not to mention the volatility of equity prices.

We do not attempt to make any kind of definitive prediction about economic outcomes right now, but instead analyse what kind of outcomes are discounted in equity prices. We would argue that even after the circa 10% fall in the first two days after the "Liberation Day" tariff announcements,[1] the markets are implicitly assuming that much of the tariff hikes will soon be reversed, before they have significant impacts on the U.S. economy.

Looking at the state of the markets before the "Liberation Day" tariff announcement, there had been much sound and fury about the slide in equity indices in the first quarter (Q1), but the MSCI World Index finished down just 2%, and the S&P 500 only fell 4%.[2] The Q1 drawdown was focussed on the Tech+ sectors: Information Technology itself, Communication Services, dominated by Alphabet and Meta, and the Consumer Discretionary sector housing Amazon and Tesla. The other eight sectors in the MSCI World Index were all up in the quarter, with a lack of significant performance differential between the defensive and cyclical sectors. We would argue this implies the market was not pricing in major concerns about an economic slowdown, outside some select pockets of Consumer Discretionary such as airlines, hotels and the tariff-hit autos industry. This sanguine attitude was also shown in the market earnings forecasts for 2025 and 2026, which stayed roughly flat in Q1, admittedly helped at the margin by the weakening dollar, still booking in double-digit earnings growth for 2025 and 2026.

This resilience of the market in Q1, ex-Magnificent Seven, suggests investors were not yet focusing on the potential negative headwinds from tariffs but rather had continued to focus on the potential benefits to corporate profitability of the new administration policies, such as deregulation. As a result, the "Liberation Day" tariff announcement came as a shock, sending

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[1] Source: widely reported globally
[2] Source: FactSet, as at 31 March 2025

first equity markets and then bond markets into a spin. The two retreats, firstly on the supposedly reciprocal tariffs in the face of the bond markets, and then on Chinese tech in the face of special interest pleading, have been greeted with relief, with the equity market clawing back most of the April losses.

Despite the relaxations, the net effect has still been a massive increase in the U.S. tariff rate, from around 3% to perhaps 15%.[3] At the time of writing (15 April 2025) there is a 10% tariff rate almost across the board, along with 25% on the non-USMCA products from Mexico and Canada,[4] and 100%+ on Chinese products barring consumer electronics. This is a significant tax on U.S. consumers, which will slow growth and increase inflation, as it stands. There is also massive uncertainty about the future path, with tariffs on pharmaceuticals and semiconductors allegedly in the works, only a 90 day hold on the supposedly reciprocal tariffs, and an open trade war with China. Along with the mechanical demand and supply shock for the U.S. from the tariff hikes, there is very likely to be a severe effect on both consumer and business confidence, which were already trending down in March in anticipation of the imminent tariff announcement. This is on top of potential U.S. growth headwinds from restricting immigration (and thus labour force growth) and DOGE's[5] government spending cuts.

Overall, the announced tariffs, even partly withdrawn, are likely to be a major headwind for growth and earnings, and will potentially also raise the equity risk premium, given the volatile nature of the policy rollout. Looking at the targets of the tariffs, major exporters to the U.S. also face significant challenges, more likely to be a deflationary than an inflationary shock, which may allow more room for monetary stimulus.

At the time of writing, equity markets are only slightly down for the month, and look far from cheap by historic standards, with the MSCI World Index on around 17x forward earnings and the S&P 500 still at 20x.[6] These multiples are on earnings still assumed to be rising double-digit in each of the next two years, a pace we worried about even before the announcement. Both the multiple and earnings will be very vulnerable if the U.S. economy slows to sub-1% growth, though the weakening of the U.S. dollar will offer some support. This implies the market seems to be pricing that there will be sharp reductions in the tariff rates over the next few months, presumably on the back of successful negotiations with the likes of the European Union (EU) and China, and that there will be minimal damage in the meantime. While not impossible, this scenario seems far from a given, particularly after China's retaliation.

As we explained in our recent Global Equity Observer article—The New Tariff Landscape—in terms of the potential impact of tariffs across our global portfolios, we would split them between the direct effects and the more uncertain indirect effects from any retaliation or macroeconomic impacts. At the time of writing, given that our global portfolios are skewed towards services rather than goods, we believe most of our companies should face limited direct impact from these U.S. tariffs, while local manufacturing, high gross margins, pricing power and recurring revenues should help dampen the extent of the impact for the goods producers.

It is possible that retaliation may spread beyond the goods sector, perhaps even with sanctions placed on U.S. technology giants by the EU, but again our companies' high gross margins, pricing power and recurring revenues should help mitigate the impacts on our global portfolios. These same factors should also help the portfolios in the case that the tariffs trigger a significant slowdown and/or recession, as demonstrated by our flagship global strategy which has a history of earnings' robustness in tough economic times. In addition, we have limited exposure to the "Trough of Disillusionment" risk in AI. While our global portfolios own two of the Magnificent Seven, Microsoft and Alphabet, where the adoption of GenAI should provide an extra driver of growth on top of the ongoing transition to cloud, it does not own the other five. Being in the "not owning" bucket has been a significant tailwind to strong relative performance so far this year. If markets are indeed not reflecting a sustained high tariff environment and the sharp economic slowdown it implies, then "not owning" could continue to be a positive as the year progresses.

[3] Source: 15% estimate of average effective tariff rate is the average of 11.5% from The Tax Foundation think tank and 18.5% from the Yale Budget Lab. Both estimates are after substitution effects.

[4] USMCA stands for the United States-Mexico-Canada Agreement, which replaced the North American Free Trade Agreement in 2020.

[5] U.S. Department of Government Efficiency

[6] Source: FactSet, as at 15 April 2025

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DEFINITIONS

The **Magnificent Seven** technology companies are Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia, Tesla.

The **MSCI World Index (USD)** is a free float adjusted market capitalization weighted index that is designed to measure the global equity market performance of developed markets.

The **S&P 500® Index (USD)** measures the performance of the large cap segment of the U.S. equities market, covering approximately 75% of the U.S. equities market.

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