From the desk of: New York Life Investments'
Global Market Strategy team

Lauren Goodwin, CFA · Julia Hermann, CFA · Michael LoGalbo, CFA

A defining moment for global trade

U.S. announces reciprocal tariffs, as of 9:00am, 3 April 2025.

Takeaways

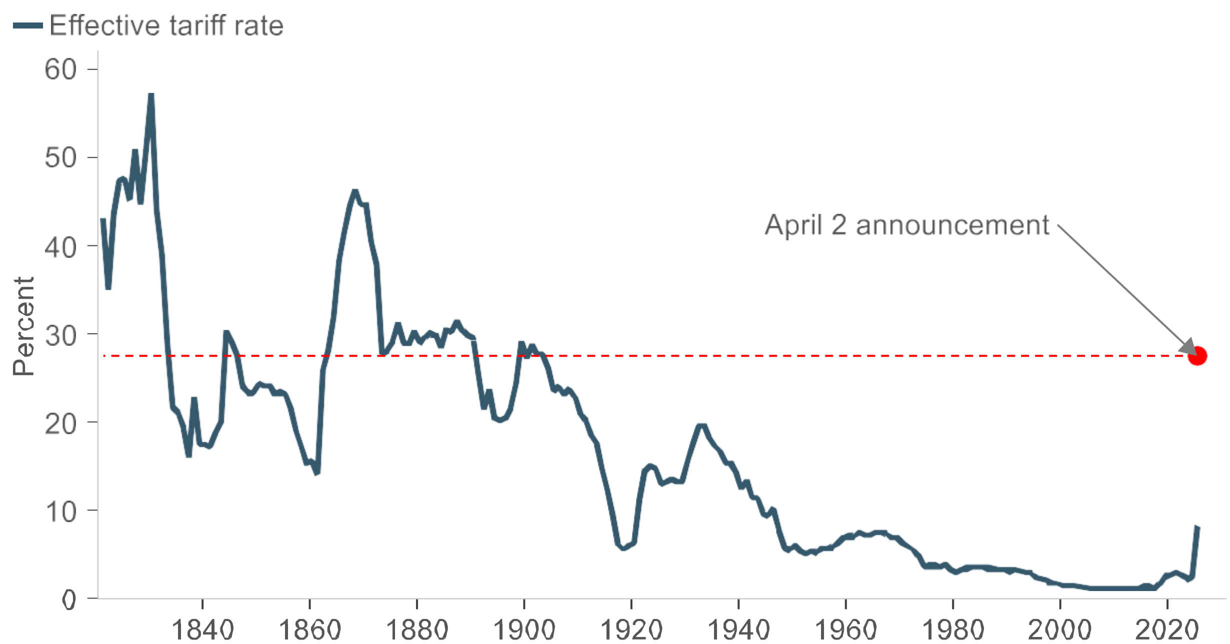
- Reciprocal tariff announcements approximated the market's worst-case scenario.
- Tariffs are both an opening bid for negotiations and a policy approach in themselves. Though targeted concessions are likely for some countries, we expect the average effect tariff rate to be significantly higher.
- These announcements pressure inflation meaningfully to the upside, and growth meaningfully to the downside. This puts the Fed in a bind – and likely on hold – unless employment deteriorates meaningfully or tighter financial conditions (widening credit spreads and/or an equity selloff) threaten growth.
- The risks of both higher inflation and lower growth are now significantly higher. Before this news we had the risk of recession at 15%; that risk is now 45%, and would rise if these tariffs stick or escalate.

It's a big opening move.

In his Liberation Day press conference, President Trump announced the signing of an executive order imposing (1) a 25% on foreign-made automobiles, taking effect now, (2) a baseline 10% tariff rate on all countries, taking effect April 5, and (3) reciprocal tariffs set at half of the U.S. Trade Representative's calculation of that country's tariff and non-tariff barriers to U.S. trade, taking effect on April 9.

The stated objective of these tariffs is to reduce trade imbalances, encourage domestic manufacturing, and strengthen economic security. Here is [President Trump's executive order], a related [fact sheet], and a note on [closing the de minimis exemption].

Trump's new trade policy raises tariffs to 1903 levels



Sources: New York Life Investments Global Market Strategy, Tax Foundation, Macrobond, April 2025.

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What are the headline economic impacts of this announcement?

Trade uncertainty will remain high. Though we have more information now than we did before the announcements, the impact is more negative than most were anticipating, approximating a worst-case scenario. Tariff rates will exceed 10% for 58 countries, including the EU. China will face a 34% additional tariff, bringing the tariff rate on some goods to 54% - close to the 60% target President Trump had mentioned in past communication.

Inflation uncertainty will increase. Back-of-the-envelope estimates of the inflation impact of this announcement come in around a 2.5% increase from the already-too-high core PCE measure.

As we've discussed previously, we're not buyers of the view that tariffs represent a one-off increase in prices. Not only is this not what happened in 2018, in which we saw gradual price increases over a sustained time, but today we have a higher base for inflation and inflation expectations to start with.

Consumer inflation expectations had already risen meaningfully for the near and medium terms. We expect both consumer and market-based inflation expectations (inflation breakevens and swap rates) to rise now. We will be closely watching longer-term inflation expectations as an indicator that confidence is deteriorating.

Growth concerns will rise. Taking a range of estimates from ourselves and other Wall Street contributors:

- Analysts expected Q2 GDP growth to come in near 2.0% before this news; the worst-case revisions now call for -1.0%.
- Analysts expected full-year 2025 GDP growth to reach nearly 2.5% (already too high in our view); they now expect 0.5% GDP growth for the year.

Our economic scenarios have changed. Before this news we had the risk of recession at 15%; that risk is now 45%, and would rise if these tariffs stick or escalate.

Fed uncertainty will persist. Higher inflation and inflation expectations won't give the Fed a window to cut right away. We believe the Fed's bias will be to stay on hold as long as possible unless and until growth expectations truly plummet. The Fed can only react to other factors (i.e. tightening financial conditions) if they have a high degree of confidence that their actions won't lead to an increase in inflation expectations. Those conditions aren't yet present.

Market interest rates will be volatile. On the short end of the curve we expect the market to react more to growth concerns (new information) than inflation concerns (already on their radar). On the long end of the curve, we expect two-way volatility as each growth, inflation, and risk-related concerns play out.

Earnings uncertainty will be on the rise. While corporate guidance has deteriorated in recent weeks, it is coming off very strong levels. Guidance is likely to deteriorate meaningfully as Q1 earnings reports are released in coming weeks. In public markets, we are most concerned about small caps and low quality borrowers. In the private markets, we are concerned about the publicly traded large and mega funds.

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What do you expect from the market?

U.S. and global markets are likely in for a rough few days. Though the end game of tariff policy is yet unknown, the face-value impact of these announcements is for lower growth and higher inflation. In response, we anticipate equity market valuations to decline and credit spreads to widen in the near term.

What market levels would cause policymakers to change tack?

- A material and persistent decline in equity markets (bear market; 20% drawdown or more) could catalyze a pivot.
- Rising yields and tighter financial conditions will be tolerated up to a point – especially if equity markets hold up. But stagflation narratives (high yields + poor equity returns) present significant political challenges. The U.S. 10-year yield breaching 5% would likely force a change in policy as high Treasury yields can stifle economic growth.

What would help the market to stabilize?

- Quick capitulation from countries facing highest tariffs, resulting in early downward revisions to reciprocal tariff rates.
- Softening language from key Trump administration officials.
- A Fed "put" (unlikely in the near term, per our note above). Tactically speaking: a weak jobs report on Friday may convince the market that the Fed is more likely to cut. We would fade that expectation in the near term; we don't believe a fed cut is likely *yet* with inflation expectations de-anchoring in real time.

What is the end game of these tariff increases?

Investors have asked if recent tariff announcements are about "negotiating" or about "tariffs that will really stick." It's both.

For some countries, the Trump administration has highlighted clear areas where it would like to see policy change (select examples in below table). However, even before his first term, President Trump expressed a clear preference for reducing the U.S. trade deficit overall. Concerns about global trade imbalances and U.S. manufacturing competitiveness contribute to this policy stance.

Some investors have hoped that concessions from key U.S. trade partners would mean that the ultimate increase in tariffs globally is relatively limited. We do not agree; even as concessions are made with some countries, the average effective tariff rate is likely to remain elevated compared to recent years.

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What's next for trade policy?

The honest answer: no one knows. The end game of tariffs depends not only on U.S. policy announcements but also in how its trading partners respond.

The impact of U.S. tariffs depends on how its trading partners react

	Negotiating points	X-factors
China	Trade deficit National security	Raw materials production USD and CNY strength Taiwan Influence over Russia Influence over Iran Influence over North Korea
Mexico	Trade deficit Immigration cooperation Drug trade cooperation	New USCMA negotiating partners Rising anti-U.S. sentiment
Europe	Trade deficit NATO defense spending	New right-wing European parliament Rising anti-U.S. sentiment

Source: New York Life Investments Global Market Strategy, April 2025. For illustrative purposes only.

Even when final tariff rates settle, their impact on business behavior is uncertain. For example, a Japanese automobile company manufacturing cars in the U.S. with U.S. workers may still have parts and processes that see Canada and Mexico multiple times in their production process.

How should investors navigate this uncertainty?

Amid uncertainty, it is tempting to "wait and see" how conditions stabilize. And certainly, the end game of U.S. trade policy will have an important impact on market outcomes. **However, investment strategy for the next 12 months is about more than just tariffs: trends relating to supply-chain re-globalization – including the fortification and redundancy of energy and tech supply chains – are well under way regardless of current policy**.

For this reason, we see durable actions investors can take that extend beyond near-term volatility expectations.

1) Quality: earnings quality in equities is likely to be most credible in large caps. Cyclical equities and small caps are likely to see the most volatility. In credit: high quality issuers should have no trouble covering their debt expense

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in upcoming quarters, but today's environment makes us shy away from leveraged loans. Our private markets views are more structural in nature, but we favor the relative shelter of the lower middle market.

2) Inflation resilience: we like gold, broad industrial metals, and real assets as an inflation-aware satellite to a portfolio. This is also the time to consider leaning into income generation, in both dividend-yielding equities and through credit diversification. Even with expectations for wider spreads, on a relative credit quality, duration, and yield combination, high yield corporate credit looks strong.
3) Sector exposure isn't about "defensive" vs "cyclical" in the moment: we like infrastructure equities and bonds, as both a near-term inflation play and long-term structural play leveraged to the digital infrastructure buildout. The defense industry has seen heavy investment in the U.S. and has a European tailwind at its back. Utilities, energy, and materials also have the right mix of cyclical buffer paired with structural tailwinds from global investment megatrends.

Please see our note dated 30 March for more extensive investment ideas.

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