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INVESTMENT UPDATE: 'LIBERATION DAY'

TRUMP'S TARIFFS: HOW SHOULD INVESTORS RESPOND?
4 APRIL 2025

Stock markets have reacted badly to the worse than expected news on US trade policy. We favour a more conservative asset allocation in response – but it's possible to be too gloomy.

On 2 April, US President Donald Trump announced his much-heralded "reciprocal" tariffs on goods imports into the US. There had been much speculation about the outcome, but it still turned out a lot worse than expected.

Furthermore, the tariffs were calculated in such a bizarre way, with reference to existing overall trade deficits as opposed to products or sectors, that it's extremely difficult for countries to propose an immediate solution. Indeed, many are threatening to impose retaliatory tariffs on the US, aggravating the situation. As we write this comment, China has announced a retaliatory 34% tariff on all goods imports from the US, sending equity markets lower again.

Even before this further fall, the initial reaction from equity markets was universally negative. The MSCI All-Country World Index fell by 3.5% on Thursday, with US companies hit harder than most – the S&P 500 index was down 4.8%, its worst daily decline since the onset of the pandemic.

First estimates suggest that, for the US, the measures will increase aggregate consumer prices by 1 to 1.5%, with a similar reduction in future GDP growth. That wouldn't necessarily lead to a US recession, given the relatively high starting point for growth. But it increases the probability of one occurring – and US corporate earnings will almost certainly come under pressure.

This comes at a time when there had already been hints of slowing growth in the US, with both consumer and corporate confidence declining. Neither can we ignore the negative influence of falling stock markets on the real economy: the past accumulation of wealth has been an important factor in supporting US consumption.

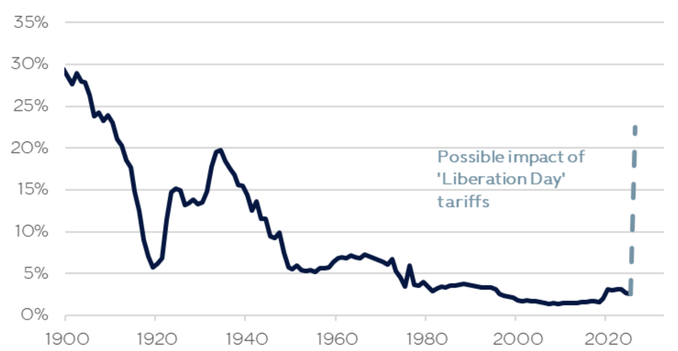
What does this mean for the UK?

The UK has come out of the tariff process relatively unscathed, compared with much of the world: we're subject merely to the 10% universal base rate set by Trump. China, on the other hand, sees its overall tariff rate rise to around 60%, with the EU at 20%. The signs, so far, at least, are that the UK (and within the EU, Italy, for one) are planning a less belligerent response. The UK's stance is helped by the fact that its goods exports to the US, amounting to around £60 billion, are relatively small compared with the UK economy as a whole. But the EU remains our largest trading partner, so a negative effect on it could impact us too, by reducing EU economic growth and hence demand for our exports.

The UK government's Office for Budget Responsibility modelled a 0.6% cut to UK GDP in the event of high tariffs, followed by retaliation. But that appears a far too pessimistic scenario on current evidence. The impact on inflation will also be muted – after all, we're not imposing tariffs on all of our imports, even if we do retaliate. The fall in the dollar on the tariff news, in response to worries about global growth, should also dampen down inflation, if sustained. Dollar weakness puts downward pressure on commodity prices since commodities tend to be priced in dollars. Even so, mindful of the experience of the pandemic, we'll be vigilant for any signs of disruption in supply chains which could create inflationary pressures.

We think this news represents a meaningful change to the investment landscape, which calls for a more conservative asset allocation. Even so, we still envisage what unfolds as more of a correction than a fully-fledged bear market – we certainly see no grounds for a financial crisis. Despite the fact that inflation has been stickier than hoped for, central banks do have rate-cutting capacity. And we can also point to more positive announcements in Europe and China of a stimulus to economies as a counterweight to US policy.

AVERAGE US TARIFFS SET TO SOAR



Source: US Census Bureau, FRED Database, Rathbones

These are all reasons for not taking a more aggressively defensive stance – as is the fact that equities had already discounted some of the risks.

If there's a limit to our defensive posture, might it be opportune to 'buy the dip' in equities? Certainly, we encourage clients with regular savings plans not to switch them off. For existing portfolios, it seems prudent to leave some time for the fog to clear. The course of action pursued by the White House has no precedent in modern times so there's no playbook. This uncertainty demands a higher risk premium – and the risk premium currently priced in remains relatively low by historic standards. Moreover, other indicators that would suggest increased risk of a significant downturn have not moved by as much as we would expect.

Government bonds as insurance

Government bonds have resumed their role as insurance given that growth concerns now outweigh inflation worries. We're happy to increase their weighting within our portfolios and also, tactically, to prefer slightly longer-dated bonds whose prices are more sensitive to changes in prevailing interest rates. Even so, we're wary of taking on too much of this 'duration' risk (buying very long-dated bonds) in a world where fiscal deficits are still high and when we believe that inflation will remain stronger than it was pre-pandemic. March's Spring Statement provided a timely reminder of the fiscal tightrope that UK Chancellor Rachel Reeves is balancing on.

There's also an opportunity to look at other actively managed risk-diversifying strategies with the potential to generate returns in a more volatile financial market environment, whatever the market direction. There are plenty of tools in the box to deal with current events.

In conclusion, this is likely to be a fast-moving situation, and we should not become too gloomy despite the alarming headlines. President Trump could (kindly) be described as mercurial, although other, more damning, adjectives also come to mind. Most commentators have continued to believe him to be "transactional" by nature and it is possible that "phenomenal" deals, as Trump has put it, could be announced soon, de-escalating the risks.

We also observe that he is front-loading a lot of bad news – and that there is still the potential to announce more popular tax cuts and looser regulations. Indeed, that would suit the Republicans' timetable for campaigning ahead of the 2026 mid-term elections. One thing seems highly probable, though: higher levels of volatility will prevail for some time to come, even if that volatility won't be outside of the normal range for equities.

If you would like to hear more, give your Rathbones contact a message or a call. Interested in investing with us? Get in touch to see how we can give you peace of mind and help you grow your wealth.

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