

# THE BIG PICTURE

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## TRADE & SECURITY

- A clear strategy that closely links trade and national security is being articulated by U.S. Treasury Secretary Scott Bessent and Stephan Miran, the Chair of the Council of Economic Advisors
- The Administration contends that many nations have unfairly benefitted from America's willingness to serve as global security provider and reserve currency provider (allowing others to freely transact around the world in U.S. dollars)
- U.S. willingness to borrow to fund military superiority has therefore allowed allies to underfund their own defense
- The White House wants to bolster the U.S. industrial base while promoting burden sharing by allies that includes more defense procurement with American firms
- When countries manipulate their currency to benefit exports and then pump excess dollars back into U.S. assets, it can also fuel the kind of malinvestment that contributed to the 2008 collapse of the U.S. housing market

# UNSUSTAINABLE



- To some extent, American trade policy had become unsustainable in recent years
- Foreigners have been subsidizing high levels of U.S. consumption and borrowing, both of which Secretary Bessent seeks to address
- Global demand for U.S. dollars has made the greenback artificially strong to the detriment of the U.S. tradeable goods sector
- While Americans can buy imported items for cheaper, it makes U.S. exports more expensive for overseas buyers
- For the last thirty years, foreigners have been selling goods to the United States, accumulating dollars, and then reinvesting those dollars in American stocks, Treasury bonds, credit, and real estate
- This has enabled the U.S. to keep borrowing costs low despite large fiscal deficits running north of 6% of GDP
- Both Presidents Nixon (in 1971) and Reagan (in 1985) threatened the use of tariffs to prod other nations to revalue their currencies



## TRUMP BLUEPRINT

- In the Trump Administration's blueprint, surplus nations like China must consume more so that the U.S. can absorb fewer exports and borrow less
- China's internal consumer demand is not strong enough to support its industrial capacity – which must then export surplus goods to markets like the U.S. and Europe
- The household savings rate in China is high, in part, because the state provides a limited social safety net despite its Communist roots
- The Trump policy approach appears to be aimed at walling-off China while pursuing closer trade integration with nations like India, who offer a large middle class
- Applying broad global tariffs prevents the Chinese from easily circumventing trade barriers by simply “friend-shoring” production to other countries as they did during President Trump's first term
- But decoupling China from the rest of the world is not easy as it is the top trading partner for 120 countries (source: J. Hinz)



## COURSE CORRECTION

- U.S. stocks staged a relief rally as President Trump appeared to soften some of his tariff positions and walked-back threats to replace Fed Chair Jay Powell before his term expires in May of 2026
- Even Treasury Secretary Bessent referred to draconian 145% tariffs on Chinese imports as “unsustainable” – amounting to a de facto trade embargo on our largest trading partner
- Team Trump turned to de-escalation after yields spiked on long-duration Treasuries
- Many now expect some form of Federal Reserve intervention similar to Yield Curve Control to stabilize the long-end of the bond market as well as a relaxing of rules that would enable banks to own more Treasuries
- Liquidity conditions, which typically impact risk assets with around a three-month lag, also improved during the first quarter
- Looking to offset eroding consumer and business confidence, the Trump White House is moving quickly with major tax legislation that could bolster economic growth

A close-up photograph of two people in business suits shaking hands. The person on the left is wearing a dark blue suit jacket, and the person on the right is wearing a light-colored suit jacket. The background is blurred, showing other people in a professional setting.

## ECONOMIC IMPACTS?

- It is very difficult to model the economic impact of shifting tariff headlines, including potential supply chain disruptions
- While preserving jobs in some industries, tariffs inevitably lead to job cuts in others
- Since actual trade deals typically take months or even years to finalize, potential quick announcement of “deals” should be viewed more as a framework or memorandum of understanding
- In addition, the Chinese failed to live up to their obligations under the agreement struck during the first Trump presidency, purchasing only roughly 58% of the \$200 billion of additional U.S. exports it had pledged to buy (source: Peterson Institute)
- While the President views tariffs as an invaluable revenue source that can help to fund tax cuts, an estimated 90% of the money earned from China tariffs during the first Trump administration was directed toward compensating US farmers for their losses from Chinese retaliation (source: Council on Foreign Relations)



## INDUSTRIAL JOBS?

- President Trump wants to use tariff policy to promote the reindustrialization of America and a resurgence in manufacturing jobs
- But the share of manufacturing employment has been steadily declining in both countries with trade deficits *and* trade surpluses
- Manufacturing accounts for only roughly 10% of US GDP while the manufacturing workforce represents a mere 8% of the labor market
- With the average age of manufacturing workers steadily rising, advanced manufacturing more closely resembles engineering than the physically-demanding factory work of the past
- Yet, manufacturing output has held steady despite declining workers thanks to technological progress and automation
- Some experts warn that tariffs threaten to blunt competition, thus slowing manufacturing productivity growth and output permanently - even if price increases are only temporarily

## CAPITAL FLIGHT?



- Foreign investors have accumulated an estimated \$32 trillion of U.S. assets, including roughly 25% of the equity market (source: Macro Compass)
- After producing a longstanding bid for US assets, foreign investors are reassessing their ownership positions as well as tourism and educational options
- The foreign exodus from U.S. assets has been exacerbated by concerns over political stability and Federal Reserve independence
- Selling by overseas investors has contributed to the U.S. dollar sinking to a three-year low
- A weaker dollar weighs on equity market returns for non-U.S. investors unless positions are currency hedged
- Even if trade tensions are reduced, the forces set in motion by seismic shifts in policy and tone could well likely persist for some period
- The implications of this shift are broad as strong capital markets are needed to fund the reindustrialization that Mr. Trump seeks



## US-LED SLOWDOWN?

- The U.S. economy has been the leader among G7 nations for the last several years
- Now many fear the U.S. could contribute to a global slowdown with recession risks rising
- Survey data continues to flash warning signs of eroding sentiment as well as a slowdown in regional manufacturing and port activity
- Q1 U.S. GDP contracted for the first time since 2022 as companies rushed to accumulate inventory ahead of tariffs
- Some Federal Reserve officials openly conceded that the FOMC may be forced to cut rates as early as June if the tariff policies start to harm the labor market - which has remained resilient due, in part, to continued labor hoarding by employers
- But uncertainty around trade policy potentially blunts the power of Fed rate cuts as businesses are reluctant to invest in an environment increasingly dominated by political rather than business cycle dynamics

## KEY TAKEAWAYS

- We are likely entering a regime of slower growth and higher inflation as the U.S. economy transitions to deglobalization
- Like in 2022, many companies will likely try to pass price hikes through to consumers
- Small businesses, especially those that rely on imports, would be most adversely affected in this environment
- This backdrop is not necessarily a negative for equities if the US economy can skirt deep recession
- Corporate earnings, which are reported in nominal terms, could receive a boost from higher inflation (despite lower volumes) as they did during the Covid period
- Slower growth could also induce more rate cuts from the Federal Reserve, and stocks often historically rally in the year following aggressive Fed easing
- However, the Fed may proceed cautiously on cuts until it gets a better handle on the inflationary impacts from tariffs

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# Glossary

## Fed Easing

Typically refers to a monetary policy action taken by the Federal Reserve (the Fed) to stimulate the economy by increasing the money supply and lowering interest rates. This is often done to combat economic slowdowns, low inflation, or other adverse economic conditions.

## Friend-Shoring

A supply chain strategy where companies source or produce goods in countries that are political or economic allies, aiming to reduce geopolitical risks and strengthen supply chain resilience.

## GDP

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. Though GDP is typically calculated on an annual basis, it is sometimes calculated on a quarterly basis as well. In the U.S., for example, the government releases an annualized GDP estimate for each fiscal quarter and also for the calendar year.

## Household Savings Rate

The percentage of a household's income that is saved rather than spent. This rate is a key indicator of a household's financial health and can reflect their spending and saving habits.

## Recession

A recession is a significant decline in economic activity that lasts for months or even years. Experts declare a recession when a nation's economy experiences negative gross domestic product (GDP), rising levels of unemployment, falling retail sales, and contracting measures of income and manufacturing for an extended period of time.

## Relief Rally

A relief rally is a respite from a broader market sell-off that results in temporarily higher securities prices. Relief rallies often occur when anticipated negative news winds up being positive or less severe than expected.

# Glossary

## Reserve Currency

A large quantity of currency maintained by central banks and other major financial institutions to prepare for investments, transactions, and international debt obligations, or to influence their domestic exchange rate.

## Strong Dollar

Refers to a upward price trend in the value of the U.S. dollar relative to other foreign currencies. The most commonly compared currency is the Euro, so if the Euro is falling in price compared to the dollar, the dollar is said to be strengthening at that time.

## Trade Surplus

An economic measure of a positive balance of trade, where a country's exports exceed its imports.

## University of Michigan Consumer Sentiment Index

A monthly survey of consumer confidence levels in the United States conducted by the University of Michigan. The survey is based on telephone interviews that gather information on consumer expectations for the economy. The index is seen as an important leading economic indicator, as consumer spending accounts for more than half of the U.S. economy.

## Yield Curve

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates (i.e. 2-yr vs 10-yr). The slope of the yield curve (upward, downward, or flat) gives an idea of future interest rate changes and economic activity.

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