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focus

Farewell to Free Trade?
Trump's Tariffs Rattle Markets

President Donald Trump's 2 April 'Liberation Day' tariff announcement marks one of the most sweeping trade policy shifts in modern history and has sent shockwaves through global markets. The magnitude and breadth of tariffs, and the rapid pace of implementation, surprised investors and raised serious concerns about an escalating trade war and its impact on the global economy. Unfortunately, it is now clear that the Trump administration is inclined to surprise, and policy can evolve rapidly and significantly. This makes for a tricky, disconcerting environment for investors. The key is to remain level-headed, maintain a well-diversified portfolio, and focus on the long term.

FORSYTH BARR

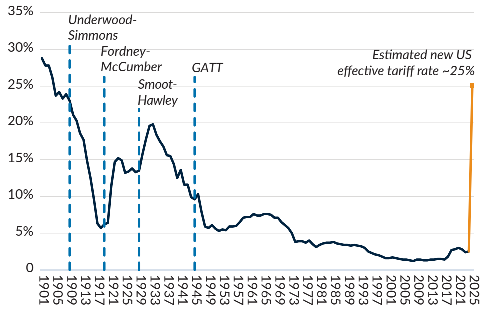
Sweeping tariffs

Trump's tariff plan consists of two main parts: (1) a 10% baseline tariff on imports from all countries (excluding Canada and Mexico) effective 5 April; and (2) additional tariffs on 60 countries deemed the 'worst offenders' on trade, effective 9 April.

Chinese imports face an additional 34% tariff, pushing their total import tax above 60%. The European Union—the US's largest trading partner—was hit with 20%. Japan and South Korea face the 10% base tariff but are hit by industry-specific duties such as a new 25% tariff on US auto imports.

These measures push the average effective US tariff on imports to between 22% and 25%—surpassing the infamous Smoot-Hawley levels of the 1930s and reaching highs not seen since the early 1900s. This will raise the cost of virtually all imported goods in the US.

US AVERAGE EFFECTIVE IMPORT TARIFF RATE



Source: US Tax Foundation, Forsyth Barr analysis

An escalating global trade war?

Unsurprisingly, Trump's announcement drew immediate backlash from trading partners. China was the quickest to retaliate, imposing an additional 34% tariff on all US imports starting 10 April—explicitly matching Trump's levy on Chinese goods. US companies selling into China will now be significantly less competitive. China's response heightened market concerns about an escalating global trade war.

The European Union labelled the tariffs illegal and has vowed to challenge the measures at the World Trade Organisation (WTO), while also weighing counter-tariffs. Numerous other countries have protested and are exploring retaliatory steps.

Some countries are opting for conciliation. India, for example, responded by agreeing to repeal its digital services tax, hoping to appease the Trump administration and negotiate relief from higher tariffs. Vietnam has offered to remove all tariffs on US imports. New Zealand, while expressing that tariffs are unfavourable for trade, has indicated it will not pursue retaliatory measures.

Mounting economic concerns

By design, tariffs are a tax that businesses and consumers bear through higher costs on imported goods.

The scale of Trump's tariffs means American consumers are likely to see noticeable price increases on everyday products, from electronics and appliances to clothing and groceries. Inflation, which had been moderating, could pick up sharply as these import costs filter through to retail shelves. Initial forecasts from economists suggest core inflation could run about 1.5 percentage points higher by year-end than previously projected.

Higher costs will also create a drag for both US and global economic activity—businesses and consumers will have less to spend. Even before 'Liberation Day', trade-policy uncertainty was weighing on US business and consumer confidence. This will only deteriorate further.

Even if Trump backtracks and tariffs are moderated, the overhang of policy uncertainty is likely to weigh on economic activity. When rules are subject to constant change, businesses struggle to plan. Companies are likely to postpone investment and hiring. Consumers will be more cautious with spending. In short, Trump's tariff strategy introduces a significant new headwind to the economy.

Markets shocked

While investors had been bracing for Trump's trade-policy announcement, the severity of the plan still came as a shock. The result was a plunge in share markets and heightened volatility across most asset classes. Over the two sessions following the announcement (Thursday and Friday), the US S&P 500 Index fell about -10.5%—the sharpest decline since the COVID pandemic sell-off in March 2020. Shares of companies most exposed to global trade were hit hardest; however, the broad-based nature of the decline reflects fear of a full trade war and its potential impact on global economic activity and company earnings.

Further interest rate cuts likely

While stocks fell, bond prices generally rose. Falling bond yields reflected both the 'risk-off' sentiment (investors seeking safe havens) and growing expectations that central banks will enact deeper interest rate cuts to support their economies.

In the near term, the US Federal Reserve faces a difficult dilemma, balancing higher inflation against a weaker growth outlook. However, tariffs will likely cause one-off price-level increases, resulting in weaker demand and

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disinflationary pressures on the other side. Financial markets are now pricing that the Fed will cut interest rates by more than previously anticipated over 2025. Outside the US (including in New Zealand) the softer growth outlook similarly led to expectations of additional interest rate easing by central banks.

Peak trade war concerns?

While the policy direction remains inherently uncertain, it is possible that tariff rates (and market fears) moderate from here. During President Trump's short second tenure so far, the administration has shown a penchant for shock and awe announcements and abrupt policy swings. Comments from White House officials suggest some negotiation is likely. Press Secretary Karoline Leavitt noted President Trump is 'always up for a good negotiation', while Treasury Secretary Scott Bessent told Congress that the announced tariffs were a ceiling, not a floor.

Republicans in Congress will be mindful of a potential economic downturn—the US midterm elections on 3 November 2026 are only 19 months away. Some have already voiced concern. Four Republican Senators supported a (largely symbolic) resolution to block Trump's tariffs on Canada (the House of Representatives is unlikely to pass it).

What should investors do?

The uncertainty around a trade war is likely to keep investors on edge. We wish we could offer clear insight into how Trump's tariff strategy will play out; unfortunately, your guess is as good as ours. We may be at peak trade-war anxiety, and concerns may moderate from here. On the other hand, headlines around negotiations or further retaliation may drive short-term swings in markets. At times like these it's important for investors to maintain a balanced perspective, recognising the market offers both risk and opportunity. A well-constructed investment portfolio can help weather the storm and deliver on long-term objectives, no matter what lies beyond this challenging period.

So, how should investors respond? Below are a few key principles to keep in mind. While these messages may sound trite when markets are plunging and worrying headlines are dominating the media, the reason we return to them is that they are proven over time.

Keep emotions in check: Market volatility can be unnerving—humans are hardwired to be loss averse—but it is important not to make emotionally driven decisions. Timing markets is (at best) exceptionally hard. As investing great Peter Lynch observed: 'Far more money has been lost by investors trying to anticipate corrections than lost in the corrections themselves.' There is every chance that a rash decision in turbulent times may be detrimental to your long-term wealth.

Stay focused on the long term: If your investment goals are long term, short-term market swings should not derail your plan. History shows that economies and companies have navigated all sorts of crises over time and emerged intact on the other side.

> **...A well-diversified portfolio can better withstand shocks like tariffs...**

Ensure your risk is comfortable: Sleeping well at night is valuable. It is prudent to periodically reassess your portfolio to make sure your risk exposure remains appropriate. If you feel uncomfortable with the risk you're bearing, discuss with your Investment Adviser whether adjustments may be appropriate.

Maintain diversification across countries, sectors, and asset classes: A well-diversified portfolio can better withstand shocks like tariffs. Different asset classes react differently—when equities fell after the tariff news, high-quality bonds gained. Diversification across global markets is also important. Trade tensions will hit some countries or sectors harder than others. The New Zealand stock market has held up much better than international markets over recent days, reflecting that much of the market is defensive—meaning many companies' earnings are not significantly impacted by economic cycles—and/or predominantly domestically focused.

Remember that market corrections can offer opportunity: To quote Warren Buffett, 'Be fearful when others are greedy, and greedy when others are fearful'. Disciplined investors look for opportunities during market sell-offs—for example, adding positions in quality companies at more attractive prices. High-quality companies tend to be good at navigating challenging political and economic environments.

Lean on your Investment Adviser: There is no one-size-fits-all answer to navigating volatility. Work with your Adviser to determine the right approach for you. Evidence shows that people who work with an Investment Adviser do, on average, achieve higher long-term returns. A key reason is that having someone consult before you act reduces the chance you'll do something rash you might later regret.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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