



From The CIO's Desk

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Tariff Tantrum

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Since taking office, the new Trump administration has ushered in a slew of proposed policies. These policies have created a level of uncertainty that has not only had an impact on markets, but on the decision making of consumers and companies. This has begun to show in recent economic readings, with markets reacting to the uncertainty. We have actively followed the evolution of policies as well as closely scrutinized recent economic data. In this note, we wanted to offer our perspective around the progression of policies out of Washington, as well as recent evolution in the economy and across markets.

POLICY

As we take a step back and assess what we are hearing out of the administration, it's clear that tariffs will likely be part of the policy framework going forward as an added revenue source for the Federal government. We also believe that tariffs will be used as a tool to negotiate policy. Therefore, it's not necessarily clear what is permanent policy versus a negotiating instrument.

Tariffs, as well as potential immigration policies, have the risk of driving prices higher and adding inflationary pressures. A recent paper by the Federal Reserve estimates an added 20% tariff on imports from China (and a corresponding 10% retaliatory tariff) would increase prices by 0.5% and serve as a little over a -0.5% drag on U.S. economic growth¹. This is clearly not inconsequential, but also not enough to derail the economy in and of itself. What becomes more opaque is exactly what tariffs will be put into place, whether they will be permanent or temporary, and at what cadence.

What this translates into is a policy climate that adds uncertainty. We recognize and acknowledge there are structural changes the Trump Administration is looking to implement, and this will lead to a shift in behaviors and practices that will take time to flow through the economy. Thus, the benefits of these policies may come at a delay relative to the impact. For example, additional tariffs should result in U.S. manufactured goods becoming comparably

more attractive, however, depending on the good, the U.S. manufacturing capacity may not be in place to support the demand. Therefore, additional infrastructure may be required to support this structural shift, which will take some time to develop.

ECONOMIC DATA

Economic data released during February showed readings that largely came in below expectations, indicating signs of a deceleration in the rate of economic growth. These data points included softer than expected consumer spending, few job openings, declines in consumer sentiment, a deceleration in new home construction, and a wider trade deficit. However, when we look at real time data sources, such as credit and debit card activity, we haven't seen a material degradation. In our view, this data suggests that both consumers and companies are electing to pause and defer decisions on larger ticket items as they assess the new policy dynamics. Comments out of economic surveys and from corporate management teams corroborate this view.

While we are seeing a slowdown in several economic indicators, we believe it's too early to conclude what we are witnessing is a permanent shift in the direction of the economy. There are two considerations that would tip the current economic climate from a temporary pause into a more meaningful slowdown. First is if policy uncertainty remains for a protracted period. This could cause companies that are electing to delay expansions and capital expenditures to cancel the projects. Alternatively, if the uncertainty around policy leads to lower asset prices, we worry this could have an adverse impact on consumer spending. In recent years the strength of the consumer has surprised to the upside. This stems from higher income consumers electing to save less and spend more. They have been able to do this due to higher stock prices and improving home prices. Should prices adjust notably lower, we worry that higher income consumers may elect to save more, leading to a retrenchment in consumer spending.

MARKET REACTION

Stock prices have sold off after hitting an all-time high on February 19, 2025. The S&P 500 has retraced 5%, with the technology heavy NASDAQ Composite losing over 8%². We've seen bond yields fall on concerns that policy adjustments will lead to slower economic growth. Given the inverse relationship between bond yields and prices, bonds have provided sound diversification, appreciating 2% over the same period³.

Within the equity market, thus far in 2025 we've seen a reversal in trend as the top performers are generally those segments that were the laggards of 2024. Of note are international stocks, which are up 8% year-to-date versus the S&P 500 that has fallen by just under 2%⁴.

The moderate pullback that has been experienced thus far is part of the natural course of investing. Since the market bottom on October 12, 2022, the S&P 500 has rallied by 67%, with the technology dominated NASDAQ up 79%. Alongside this appreciation, investors as a collective had bullish optimism heading into 2025 and the onset of the new presidential administration. The uncertainty that comes with new policies and an evolving rhetoric is leading to the added volatility that markets have been witnessing. Equity prices may also be experiencing an adjustment as the elevated positive sentiment amongst investors is resetting to a lower level. This more balanced tone is understandable as the short-term and intermediate-term ramifications of new policies are still being sorted out amongst the investment community.

➤ MOVING FORWARD

The evolution in policy, alongside the natural economic progression, feeds into our investment process and decision-making approach. While a lot has been speculated, until there is a more solidified end state and timeline around policies, we believe it's appropriate to be measured and not react too strongly to any particular policy announcement. We do, however, believe now is the time to consider how portfolios might evolve under specific scenarios. For example, we do see risks to the upside on inflation. The magnitude and acuity of any inflationary pressures will be more dependent on what tariffs are implemented and at what levels. The approach to insulating a portfolio from inflationary pressures may be different from what worked during the recent inflationary surge in 2021 and 2022.

Overall, we have expected volatility to pick up under the new administration. It's likely that volatility will remain for a period of time as policies are sorted out and enacted. In such an environment, we remain focused on opportunities that have attractive long-term potential that are less sensitive to the pace of economic growth or policy adjustments.

¹Source: Federal Reserve, How Do Trade Disruptions Affect Inflation? Cuba-Borda and Queralto. February 28, 2025. <https://www.federalreserve.gov/econres/notes/feds-notes/how-do-trade-disruptions-affect-inflation-20250228.html>

²Source: Bloomberg. As of 3/4/2025.

³Source: Bloomberg. As of 3/4/2025. Bond market returns represented by the Bloomberg U.S. Aggregate index.

⁴Source: Bloomberg, 1/1/25-3/4/25. International stocks represented by the MSCI EAFE index.



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