Brompton Insights

Putting the "if" in Tariff

March 20, 2025

Funds in focus: Brompton Enhanced Multi-Asset Income ETF (BMAX)

The proposed tariffs by U.S. President Donald Trump during his second term have introduced significant uncertainty into global markets, reshaping investor strategies and recalibrating risk assessments. Unlike his first term, where tariffs were implemented amidst modest market valuations and subdued volatility, the current economic landscape features elevated stock prices, heightened policy uncertainty, and tighter financial conditions.

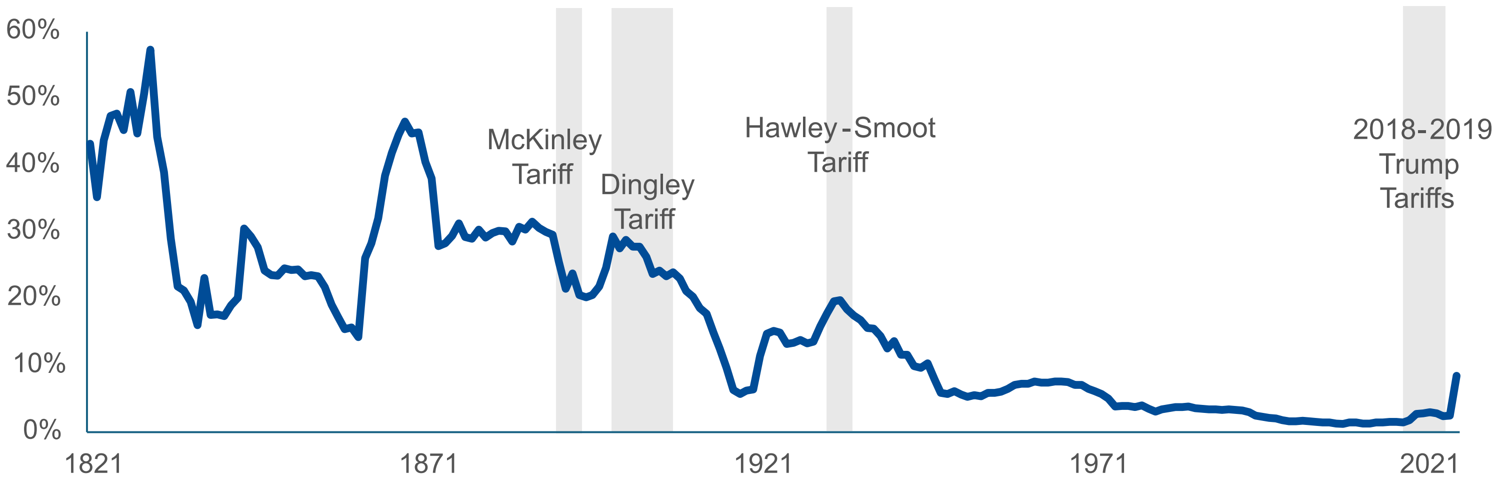
Lessons From Trump 1.0 and What's Different This Time

Unlike the first time Donald Trump was in power, this time the tariffs are far more wide-ranging in terms of both industries and countries. Allies such as Canada and Mexico, who were not targeted with broad-based tariffs during Trump's first term, are now firmly in the crosshairs.

So far, President Trump has issued tariffs against Canada, Mexico, China and the European Union, while threatening a global tariff. An initial 10% tariff on all Chinese imports went into effect in February, increasing to 20% in March. For Canada and Mexico, 25% tariffs on all goods, except certain Canadian Energy imports that are taxed at 10% . While some of these tariffs have been delayed to April, the full proposed approach would raise the average tariff rate from its baseline level of 2.5% in 2024 to an estimated 8.4% - the highest since 1946[1].

Trump's Average Tariff Rate Would Be Highest Since 1946

Average Tariff Rate on All Imports, Historical Rates from 1890-2023, Projected Rate for 2024, Estimated Rate for 2025 Under Trump's Imposed Tariffs



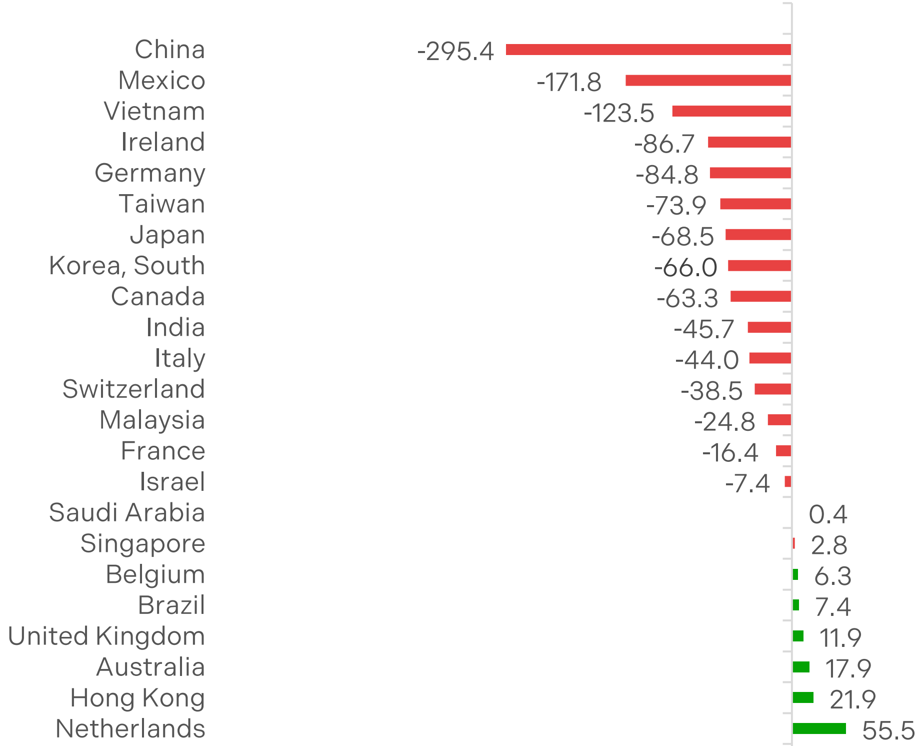
York, E. (2025, March 12). Trump Tariffs: The economic impact of the Trump Trade War. Tax Foundation. https://taxfoundation.org/research/all/federal/trump-tariffs-trade-war/

The administration has also introduced 25% tariffs on global imports of certain products such as steel & aluminum and is evaluating adding them on copper, semiconductors, pharmaceuticals, and automobiles[1].

This contrasts with Trump's first term, where the trade policy was characterized by aggressive rhetoric followed by measured implementation. The first-term tariffs were primarily targeted at specific product categories (such as steel and aluminum) and gradually escalated over time. They also included exemptions for allies such as Canada and Mexico.

Trump wants to use tariffs as a tool to reduce the U.S. trade balance as shown below targeting some of the largest balances first. Note that Canada is far down the list at number 9 but we are tied to Mexico through the USMCA.

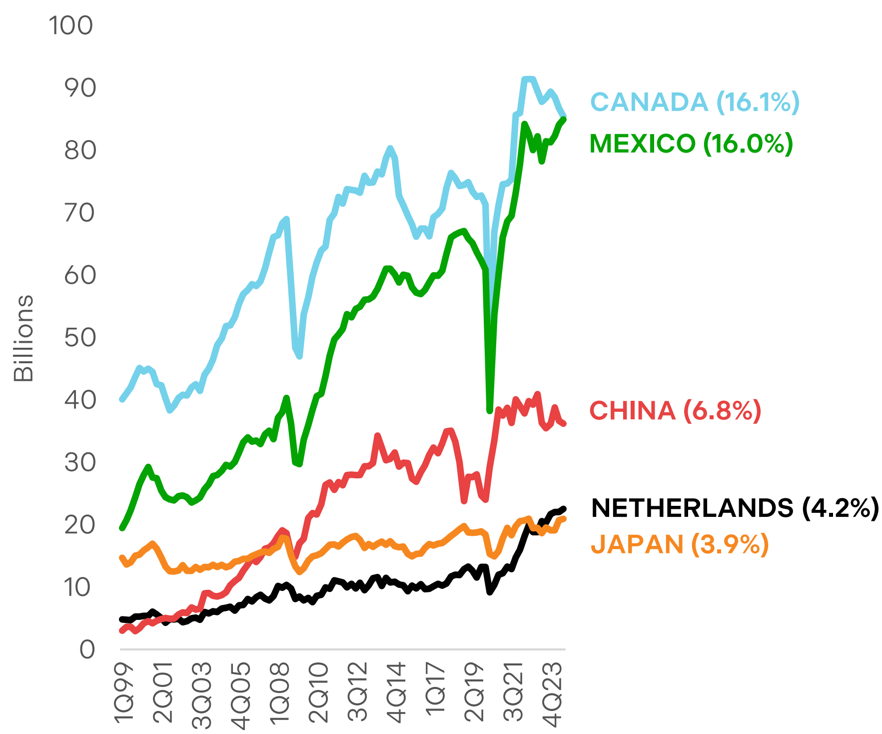
U.S. Trade Balance, 2024 ($Billions)



Source: TD Cowan, March 5, 2025.

Despite the heated rhetoric between Canada and the U.S., we believe there is a deal that can be negotiated considering that Canada is an important trading partner being the top destination for U.S. exports, as shown below. Most of Canada's trade deficit is oil and gas and other commodities, whereas in manufacturing the U.S. has a trade surplus with Canada.

U.S. Trade in Goods by Top 5 Exports (% U.S. total Q3/2024)



Source: TD Cowan, March 5, 2025.

Economic & Market Implications

While the 2018-2019 trade war unfolded during a period of low inflation and economic expansion with relatively modest market valuations, the 2025 tariffs arrive amid heightened economic uncertainty, more stretched market conditions, and elevated inflation. The chart below shows that the valuation of the S&P 500 based on forward price-to-earnings is more expensive now compared to the 2018-2019 period.

S&P 500 12 Month Forward Price Earnings Ratio

Source: Bloomberg, as of March 5, 2025

Further exacerbating the situation is the deterioration in consumer confidence and the decline in household savings rates. Consumer sentiment has worsened since the 2018-2019 period[2], reflecting a more pessimistic outlook among American households. Simultaneously, the household savings rate has dropped from almost 7% in 2018 to less than 5% in 2025[3], indicating that consumers have less financial cushion to absorb potential price increases resulting from tariffs. This reduction in both confidence and savings suggests that American consumers are in a more vulnerable position, potentially leading to a more immediate and pronounced impact on consumer spending patterns.

Tariffs are poised to have a significant impact on the market, creating a challenging environment for companies and investors alike. Businesses will face a difficult decision: either pass on the increased costs to customers, risking a reduction in demand, or absorb the additional expenses, which would negatively affect their profit margins.

Markets are likely to experience continued volatility. During the tariff talks in 2018, equity market volatility increased, as shown by the CBOE Volatility Index in the chart below.

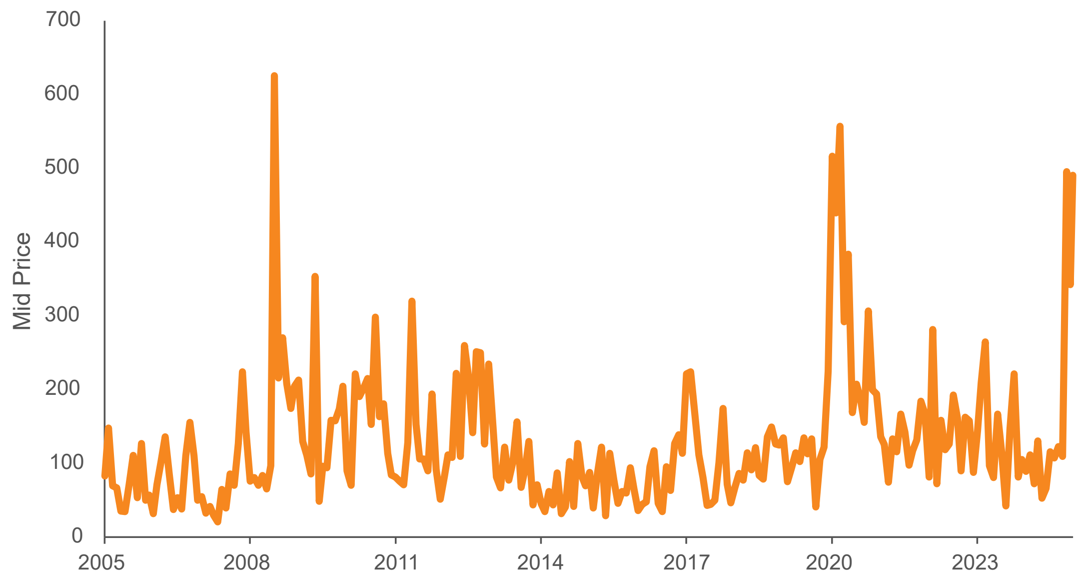
Volatility Spiked During 2018 Tariff Talk

Source: Bloomberg for the period March 6, 2017, to January 3, 2020.

According to Goldman Sachs estimates, every five-percentage-point increase in the US tariff rate is projected to reduce S&P 500 earnings per share by approximately 1-2%, with the current tariff measures potentially leading to a 2-3% reduction in S&P 500 EPS forecasts[4].

Furthermore, these tariffs could potentially strengthen the US dollar. This could further impact the earnings of S&P 500 companies, given that they derive 28% of their revenues from outside the United States[4]. Beyond the direct effects on earnings, the introduction of tariffs is likely to inject greater uncertainty into the market, potentially influencing investor sentiment and stock valuations. This leaves the market more vulnerable to corrections. The US Economic Policy Uncertainty Index has risen sharply in 2025, reaching levels not seen since the Great Financial Crisis in 2008 and COVID in 2020, as shown in the chart below.

The US Economic Policy Uncertainty Index has only been higher in recent times during the GFC & COVID



Source: Bloomberg, as of March 3, 2025.

Potential Winners and Losers

Given the high levels of uncertainty and the ever-changing landscape, predicting winners and losers with certainty in the current economic environment is challenging. However, based on what we know so far, several trends and sectors appear poised for relative outperformance.

Services and software companies are likely to outperform goods and hardware businesses, primarily due to the absence of tariffs on services. Additionally, companies with strong pricing power are expected to fare better, as they can pass on tariff-related costs to consumers and potentially even earn a margin on them. Conversely, businesses selling discretionary goods with elastic demand may face difficulties in maintaining profitability.

Companies benefiting from multi-year structural tailwinds (such as AI and reshoring), as well as those in staples, healthcare, and other necessity-driven sectors, are expected to perform well in this uncertain environment. These industries often demonstrate resilience during economic turbulence due to the essential nature of their products and services. Furthermore, businesses with domestic manufacturing capabilities are likely to gain an advantage, as they can avoid many of the tariff-related challenges faced by their import-dependent counterparts.

It is easy to be pessimistic but remember that in the first Trump Presidency the returns for the S&P 500 in his first year were 21.8%. The anticipated tailwinds from lower taxes and regulation are not expected to be realized until later in Trump's second term.

It's important not to overlook global companies, particularly those based in Europe, that have significant sales in the United States. Many of these firms manufacture their US sales within the US, effectively shielding them from tariffs. The recent sell-off in some of these names could present attractive investment opportunities, as they now trade at even more compelling valuations while their fundamental business strengths remain intact. Europe is becoming investable again as the likelihood of stability in Ukraine rises.

Countries such as Canada and Germany are realizing they must become more competitive. The Liberal and Progressive Conservative parties in Canada are both campaigning on ways to increase productivity including reducing regulations and taxes and building more export infrastructure. The new German government has reached a surprise landmark 'Whatever it takes" moment. It has proposed a Euro 500bn+ fiscal package to increase growth including sizeable spending on defense and infrastructure[5].

Conclusion

The prevailing market uncertainty underscores the importance of maintaining a well-diversified portfolio that spans multiple sectors and geographies. This approach helps mitigate risk and capitalize on opportunities across different market segments. Furthermore, the elevated volatility levels have resulted in more attractive call premiums, creating an opportune environment for our call writing strategy to potentially generate additional income and dampen portfolio volatility.

Brompton Enhanced Multi-Asset Income ETF (BMAX) is a globally diversified portfolio with fixed income stabilizers. The equity allocation includes low volatility stocks that tends to outperform in difficult markets and equity securities outside of the U.S. such as Europe that have outperformed this year.

[1] York, E. (2025, March 12). Trump Tariffs: The economic impact of the Trump Trade War. Tax Foundation. https://taxfoundation.org/research/all/federal/trump-tariffs-trade-war/

[2] Source: Bloomberg, as of January 31, 2025. University of Michigan Consumer Sentiment Index (Bloomberg: CONSSENT Index).

[3] Source: Bloomberg, as of January 31, 2025. US Personal Saving as a % of Disposable Personal Income (Bloomberg: PIDSDPS Index).

[4] Source: Goldman Sachs, February 7, 2025. https://www.goldmansachs.com/insights/articles/how-tariffs-are-forecast-to-affect-us-stocks

[5] Kiderlin, S. (2025, March 5). Germany's fiscal U-turn could be a "game changer" for the country's sluggish economy, analysts say. CNBC. https://www.cnbc.com/2025/03/05/germanys-fiscal-u-turn-could-be-a-game-changer-for-the-countrys-sluggish-economy-analysts-say.html

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