Trending Topics | April 3, 2025

Quick Take: What Tariff Shockwaves Mean for Your Portfolio

Despite broadly telegraphing new tariffs, Trump caught markets off guard with the sweeping scope of his policies. Markets are taking the news seriously, given the risk of higher inflation and slower growth at a time when consumer spending and confidence are already under pressure.

What's happening

Yesterday (April 2), President Trump announced 10% universal tariffs, with higher levies on major trading partners. The effective 19% weighted-average increase was just about our worst-case scenario and meaningfully higher than market expectations of 8-9%.

While the administration has a history of making bold pronouncements and then stepping back, the market clearly thinks yesterday was different. There may be some reversals in specific cases, but we believe a significant line has been crossed, and turning back would be difficult at this point.

U.S. markets opened sharply lower:[1] The S&P 500 was down nearly 4% in early trading, with energy, consumer discretionary, and information technology leading the declines. (Consumer staples was the lone positive GICS sector.) WTI crude oil fell over 7% to $66 and change. Gold initially traded higher before turning negative. The U.S. Dollar Index sunk to a six-month low. Bonds rallied, with 10-year Treasury yields closing in on 4% (from a February high of 4.8%).

Macroeconomic implications

We see 0.5-1.0% downside to our 2025 U.S. real GDP estimate of 1.7% as a result of the tariffs. Asian economies (especially China) will likely feel the largest economic downside. We estimate **U.S. inflation will likely rise by 2%**, as measured by core PCE (personal consumption expenditures), from 2.8% currently to 4.8% over the second and third quarters.

This is a proper growth scare with a growing risk of recession: Tariffs act as a tax on the U.S. consumer. Inflation reduces real income, and erosion of confidence threatens both business capex and high-income consumer spending. This shock will likely lead to reduced spending, lower incomes, fewer job openings, and higher layoffs. And this is piling on already-slowing consumer spending and weakening sentiment due to cyclical factors. Upcoming job numbers may further dampen sentiment.

A recession is not our base case, but the probability has materially increased: The proposed tariffs will move the current effective tariff rate from 2.5% to approximately 25%, depending on exemptions on products and countries. We believe these tariff proposals to be the ceiling, providing room for negotiations that will eventually bring down the effective tariff rate in the range of 10% to 15%. While this will impact personal consumption and investment, our base case is not a recession as household and corporate balance sheets still remain healthy but we acknowledge that the probability of a recession has increased. In addition, the downside to growth should be limited as the Fed has the room to cut rates, especially if employment numbers weaken. However, much depends on how much, and for how long, the announced tariffs remain in place.

Capital flowing out of the U.S.: China and Europe equities have outperformed the U.S. year to date. America's post-Bretton Woods Agreement—where allies bought Treasuries and risk assets in exchange

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for security and aid—has shifted as the U.S. pursues its America First agenda. This likely means reduced foreign buying of U.S. assets, which may affect capital flows, the dollar, and interest rates.

Equities

- **Valuations and earnings at risk:** The S&P 500 multiple remains elevated vs historical levels at around 20x P/E (as of 04/02/25). S&P earnings were expected to grow 10% in 2025. We see downside risks to both the multiple and the earnings estimates.
- **Large cap value:** We are positioned defensively in favor of the "stable value" cohort—including consumer staples, REITs, utilities, pharmaceuticals, telecom—which we believe are poised to outperform in the throes of a trade war.
- **Large cap growth:** Given the risks above, we are looking to reduce allocations to more cyclical names across our holdings to a level either commensurate with or lower than the market. Industries most vulnerable to reduced confidence and valuation downside include advertising, software, semiconductors, and capital markets companies.
- **Small cap growth:** In the short term, we are mitigating some of the risk from cyclical holdings with higher tariff exposure. Longer term, we are maintaining our quality bias with sensitivity to relative valuations, paying particular attention to forward growth prospects and fundamentals. We see opportunities in financials and consumer staples. We are also trimming our already-underweight allocation to biotech.
- **Global artificial intelligence:** Even as the administration is taking a more aggressive approach with reciprocal tariffs, we continue to believe Trump wants the U.S. to maintain its leadership in AI. However, companies that rely heavily on overseas supply chains in certain countries may face greater uncertainty. We expect elevated volatility as markets settle into the new policy backdrop.
- **Voya Machine Intelligence:** Our models came into the year defensively positioned, which has proven advantageous. If the selloff continues, extreme dislocations may create opportunities.

Fixed income

- **Corporate credit spreads** have widened, with investment grade spreads increasing by 20 bp from recent lows and high yield spreads up by 82 bp. We believe the market reaction is justified, as growth is likely to slow and inflation is expected to rise if these tariffs remain in place.
- **Interest rates** have fallen, which may seem counterintuitive given the implications for inflation. But keep in mind:

1. The increase in inflation stemming from the tariffs (and potential retaliation) will likely be at least partially offset by easing labor costs as the labor market continues to rebalance, and by shelter inflation aligning with more real-time indicators.
2. The decline in rates has been driven primarily by decreasing real yields (due to slower growth expectations) while inflation breakevens have remained elevated.
3. FOMC members projected higher inflation and lower growth in their latest dot plot, although the median dot for rate cuts remained unchanged.

Multi-asset strategies

- **In equities,** we started more defensive positioning by covering our long-held underweight to emerging market equities in 4Q24. In addition, we're reluctant to chase the European equity rally, given the strong investor flows, which could leave the region vulnerable to disappointment.
- **In fixed income,** we continue hold high-quality securities as a buttress against equity market volatility.

A note about risk

The principal risks are generally those attributable to investing in stocks, bonds, and related derivative instruments. Holdings are subject to market, issuer, and other risks, and their values may fluctuate. Market risk is the risk that securities or other instruments may decline in value due to factors affecting the securities markets or particular industries. Issuer risk is the risk that the value of a security or instrument may decline for reasons specific to the issuer, such as changes in its financial condition.

[1] As of 04/03/25, 10:00 a.m. See end notes for index definitions.

Index definitions: The S&P 500 Index is an unmanaged index that measures the performance of securities of approximately 500 of the largest companies in the United States. The ICE U.S. Dollar Index measures the value of the U.S. dollar relative to a basket of currencies including the euro, yen, British pound, Canadian dollar, Swedish krona and Swiss franc. Crude oil price measured by the West Texas Intermediate front-month futures contract.

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