Tariff Shockwaves: 3 Market Takeaways

Following last week's turbulent equity market and the surprising weakness in bonds, we gathered our thoughts on the markets and what we're watching closely.

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Our take on the markets

1 Market crises are messy and complex. Last week, tariff policy uncertainty fueled market fears. Treasuries sold off, the dollar declined significantly, and implied equity volatility reached 5-year highs. Peak to trough the S&P 500 fell 19% before recovering. While equity markets may have reached capitulation last week with just 15% of all NYSE listed stocks closing above their 200-day moving average, we expect a bumpy ride. It's not our base case, but there may be a retest of the lows in equities if tariff negotiations fail to gain traction.

2 With the U.S. at the epicenter, Treasury yields are likely to remain volatile. Tariff tensions are having a global ripple effect, exacerbated by concerns of lingering above-trend inflation and fiscal deficits. Global investors are demanding higher yields to hold U.S. debt due to the policy uncertainty. In addition, some hedge funds have been aggressively unwinding long positions that are not tenable in a volatile market environment. Against this backdrop, unpredictable policies can cause extreme oscillations in the bond market as investors wait for economic data to confirm any fundamental shifts in the health of the global economy.

3 Traditional sources of safety are not cooperating. The U.S. dollar, which had been overvalued for several years has weakened, and treasury yields have been moving higher. The initial move in yields makes sense as tariffs are short-term inflationary. However, the longer goods prices stay high due to increased costs of tariffs, we think the entire episode may be more disinflationary. Higher prices will act as a tax on consumers and will eventually crimp demand.

What are we watching?

The most pressing for investors: Is the U.S. heading into a recession?

A **tariff deal with a G-7 partner** would go a long way to reducing volatility. In the meantime, we **don't expect clarity on the near-term economic impact until at least May**. April economic releases will not reflect the new environment, and we expect many companies in 1Q earnings reports to pull back on providing guidance on earnings calls due to the uncertainty. We will be listening for comments around labor and the health of the consumer; layoffs, firings, and demand destruction are all words to watch.

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We believe weekly jobless claims will provide the most critical insight into early signs economic weakness. Post-pandemic, labor was difficult to find so companies may try to hold on to their labor force. This weekly indicator will show if this trend persists or shifts.

Finally, U.S. corporations took strategic actions to protect their balance sheets in 2021 by refinancing their debt at very low yields. In the medium term, we don't see much in terms of corporate refinancing risk. This should allow larger companies to absorb a portion of tariff-related costs. We think this favors larger, high-quality companies that have the financial wherewithal to withstand the current volatility.

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