MainStreet Advisors
Tariffs, Policy Risk, and Market Volatility: 4.4.2025

Tariff Summary

On Wednesday afternoon, the Trump administration unveiled a set of tariffs on most U.S. trading partners that was more aggressive than most market participants expected. A 10% baseline levy was imposed on almost all trading partners effective April 5, with Mexico and Canada excluded but still subject to previously announced 25% tariffs. Additional duties described as "reciprocal" determined by a custom calculation were applied to 60 trading partners with the largest trade imbalances with the U.S. effective April 9. Notable trading partners targeted with the highest tariff rates are China (54%), Vietnam (46%), the European Union (34%), and India (27%). Aluminum, steel, lumber, semiconductors and pharmaceuticals were exempted from the new round of tariffs. According to Capital Economics, if left unchanged, the tariffs would increase the effective average tariff rate from 2.3% in 2024 to 23%-24% in 2025. This would be the highest level since 1900.

President Trump told Reuters reporters Thursday afternoon that he would be open to tariff negotiations with other countries if they offer something "phenomenal." Trump's comments came one hour after top trade advisor Peter Navarro told CNBC that tariffs announced Wednesday were "not a negotiation." In a Bloomberg interview Thursday, Treasury Secretary Scott Bessent said the announced tariffs are "the high end of the number" if trading partners do not retaliate. Bessent suggested targeted nations could take steps to bring their tariff rates down. The staggered implementation dates of the tariffs (April 5 for baseline 10% and April 9 for "reciprocal") suggests a bit of room for bargaining and potential tariff reductions. China announced retaliatory tariffs of 34% against U.S. imports overnight, which was quickly condemned by Trump on social media.

The Trump administration has said their actions are aimed at restoring what they view as fair international trade while raising revenue to help offset tax cuts planned for later this year. Substantial tariff revenue could also potentially reduce the growth trajectory of the national debt. More broadly, their aim is to restore domestic manufacturing by incentivizing domestic goods production. Strategically, the onshoring of certain manufacturing processes would strengthen the U.S. military-industrial base.

Market Reaction

U.S. markets have declined sharply following the announcement with the Dow Jones Industrial Average, S&P 500, and Nasdaq all down 6%-8% since Tuesday's close as of this morning. The S&P 500 is trading below 5,300 this morning, a correction of about 15% from its intraday high of 6,147.43 on February 19. Within the S&P 500, the defensive consumer staples, utilities and healthcare sectors have been the benchmark's top performing groups. More cyclical sectors, including energy, technology and consumer discretionary have been among the weakest areas of the index. Packaged foods, household products, regulated electric utilities, pharmaceuticals, insurers, financial exchanges, health insurers, and healthcare distributors have displayed the most resilience recently. Apparel and footwear retailers, home furnishings retailers, cruise line operators, airlines, banks, and most semiconductor companies suffered the steepest declines yesterday.

Treasury yields in the 2-to-10-year portion of the yield curve fell between 20 and 25 basis points (bps) in recent days, with the 10-year note yield pushing below 4% for the first time since mid-October. WTI crude oil has plunged 12% to $62/ barrel amid a combination of growth concerns and an unexpected increase in production quotas from OPEC and its production partners. Gold has dipped about 2% but is still with 4% of its all-time closing high Wednesday.

This morning's March nonfarm payrolls report was stronger than expected. There were 228,000 net additions compared to the median Bloomberg estimate of 140,000, yet combined payroll gains in January and February were downwardly revised by 49,000. Total government payrolls increased by 19,000, with state and local jobs up 23,000 offset by a 4,000 loss of federal government positions. The unemployment rate ticked up to 4.2%, while average hourly wage growth was subdued at 3.8%. Market participants are likely looking through this morning's decent payroll data, however, and projecting weakness in April.

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Where do we go from here?

Since mid-February, a more defensive risk stance and broader diversification have benefited portfolios, given 1) signs of slowing in select areas of the domestic economy, 2) elevated policy uncertainty around tariffs and government spending, and 3) U.S. large-cap index-level valuations that are full—although not necessarily extended—relative to long-term history. Looking ahead, we acknowledge a weaker fiscal impulse in the U.S. in 2025 compared to stimulus-heavy years of 2021-2024, alongside continued uncertainty about trade policy and government spending.

Yet, we do not think it is time to make significant shifts toward risk-off positioning in investment portfolios given:

1) Overall economic data remains mixed (weak survey data, signs of stability/strength remain in various hard data, including private payrolls, initial jobless claims, retail sales, etc.)

2) Corporate profit growth expectations and company guidance have softened but not rolled over.

3) The Federal Reserve still has ample room to ease policy with further rate cuts and balance sheet expansion.

Historically, deep and prolonged bear markets tend to coincide with a significant contraction in corporate earnings, which puts pressure on employment and capital expenditures. Importantly, meaningful declines in corporate earnings are rare outside of recessionary periods. Although the risks have risen over the past few months, a US recession is not a foregone conclusion. The recent 15% peak-to-trough correction in the S&P 500 that began in mid-February reflects the market's attempt to price in higher odds of an economic slowdown or perhaps a mild recession. As a result, we anticipate risk asset markets will remain choppy and possibly trend sideways to lower over a near-term time frame. At the same time, equity valuations have moderated, which increases the potential for more substantial long-term returns once a new cycle begins. In this market environment with markets pricing slower growth and sticky inflation, we expect diversification across asset classes to be an investor's best friend.

We expect exposure to defensive assets (high-quality bonds, gold, cash) will continue to dull periodic drawdowns in portfolios as volatility is likely to remain elevated for the foreseeable future. In contrast, an appropriately sized allocation to growth assets (equities) enables portfolios to participate in market upside if/when the fiscal and trade policy environments stabilize. Looking further out (second half of 2025), we expect the Trump administration to shift its focus away from trade policy and toward the more growth-positive aspects of its agenda, including tax cuts, supporting domestic manufacturing, and deregulation.

As always, we remind clients of the long-term nature of their investments and the importance of avoiding market timing. History shows that equity markets tend to recover and normalize following periods of steep declines. Maintaining discipline during volatile periods is key. Having a clear and reasonable investment objective is critical because it determines how much risk (volatility) an investor is willing and able to tolerate. The objective should be aligned with an investor's time horizon, distribution requirements, and risk tolerance. For accounts with expected distributions over the next 3-6 months, we recommend raising cash into market rallies and maintaining elevated cash balances until conditions become more favorable.

In the short term, we expect bouts of continued pressure on U.S. stocks along with periods of potentially surprising price strength depending on the headlines and direction of trade, fiscal, and monetary policy. The longer the tariffs as currently exist remain in place, we would anticipate rising odds of a slowing in the U.S. economy and softness in the domestic business cycle. With this in mind, we anticipate recommending moderate shifts toward higher quality asset classes to reflect the changing tone of the policy and market backdrops. As always, we will be watching key market, economic, and sentiment indicators in coming weeks and months to gauge if a more defensive posture in client portfolios is advisable.

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S&P 500 Pullbacks of >5% Since March 2009

Peak	Trough	Duration of decline (Calendar days)	% Decline	Calendar days to next pullback	Return (Trough to next peak)
3/26/09	3/30/09	4	-5.4%	74	20.1%
6/12/09	7/10/09	28	-7.1%	101	24.9%
10/19/09	10/31/09	11	-5.6%	81	11.0%
1/19/10	2/8/10	20	-8.1%	74	15.2%
4/23/10	7/2/10	70	-16.0%	231	31.3%
2/18/11	3/16/11	26	-6.4%	44	8.5%
4/29/11	10/3/11	157	-19.4%	182	29.1%
4/2/12	6/1/12	60	-9.9%	105	14.7%
9/14/12	11/15/12	62	-7.7%	187	23.3%
5/21/13	6/24/13	34	-5.8%	205	17.5%
1/15/14	2/3/14	19	-5.8%	227	15.5%
9/18/14	10/15/14	27	-7.4%	218	15.8%
5/21/15	8/25/15	96	-12.4%	70	13.0%
11/3/15	2/11/16	100	-13.3%	118	15.9%
6/8/16	6/27/16	19	-5.6%	580	43.6%
1/28/18	2/8/18	11	-10.2%	224	13.6%
9/20/18	12/24/18	95	-19.8%	127	25.3%
4/30/19	6/2/19	33	-6.8%	54	10.3%
7/26/19	8/14/19	19	-6.1%	189	17.2%
2/19/20	3/23/20	33	-33.9%	3	17.6%
3/26/20	4/1/20	6	6.1%	68	30.8%
6/8/20	6/10/20	2	-7.1%	84	19.3%
9/2/20	9/23/20	21	-9.6%	344	29.3%
9/2/21	10/4/21	32	-5.2%	91	11.5%
1/3/22	10/12/22	282	-25.4%	49	14.1%
11/30/22	12/28/22	28	-7.3%	36	10.5%
2/2/23	3/13/23	39	-7.8%	140	19.0%
7/31/23	10/27/23	88	-10.3%	153	27.6%
3/28/24	4/19/24	22	-5.5%	88	14.1%
7/16/24	8/5/24	20	-8.5%	195	18.5%
2/19/25		42	-12.2%		
Average		49	-9.9%	145	19.3%
Median		28	-7.7%	112	17.2%

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