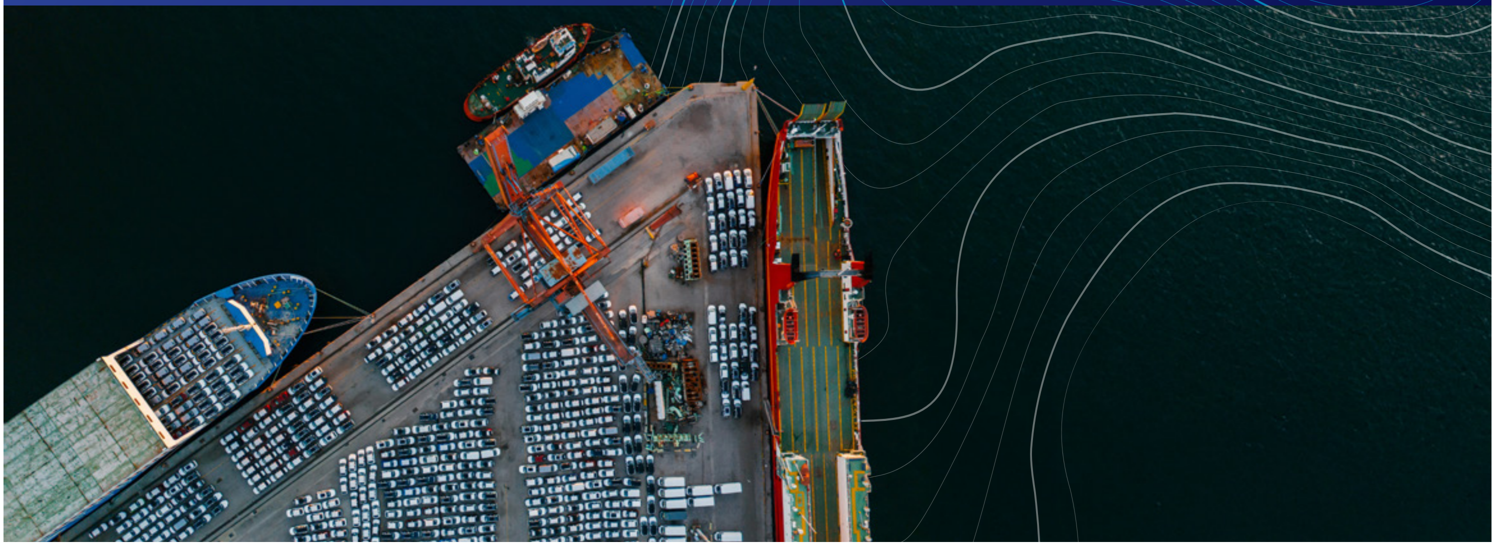

A World of Tariffs

Though Trump had been promoting his great affection for tariffs even before taking office for his second term, the magnitude of the measures announced on April 2—dubbed (presumably without irony) "liberation day" by the administration—spooked financial markets seemingly prepared for less extreme action.

Amid an April 3 rout in global equities, below we provide some key takeaways from the tariff announcement and our initial thoughts about the potential impact. In short, we believe these tariffs are likely to raise prices for US consumers while weighing on domestic economic activity. The rest of the world may see a combination of lower prices and lower economic growth.

Tariffs for All!

The tariff package announced with great fanfare by Trump on April 2 in the White House's Rose Garden consists of two main components:

- A baseline tariff of 10% imposed on all goods imported into the US. This goes into effect April 5.
- Individualized reciprocal tariffs on 60 "bad actors" deemed to have high barriers to US exports, which go into effect April 9. Some of the country's largest trading partners will be subject to these new tariffs, including China (34%), the European Union (20%), Japan (24%), India (26%) South Korea (26%) and Vietnam (47%). These will be levied in addition to any tariffs previously in place.[1]

Notably absent from the above are Canada and Mexico, which are both already subject to the 25% fentanyl-related levies on goods outside the scope of the USMCA trade agreement. Also exempt—for now, at least—are goods from certain industries, such as energy, pharmaceuticals, semiconductors and lumber. Even with these exceptions, tariffs announced year to date imply a US total effective tariff rate of 22.5%, up from 2024's 2.4% and the highest level since the early 1900s.[2]

1. Source: *The Wall Street Journal*; data as of April 3, 2025.
2. Source: The Yale Budget Lab; data as of April 2, 2025.

While the Trump administration has marketed the tariffs as reciprocal, their methodology suggests otherwise. Reciprocal would imply that the tariffs are based on the rates other countries charge on US exports; the individualized tariffs announced yesterday appear to reflect the US goods trade deficit with a country divided by that country's exports to the US, cut in half to be "kind." Meanwhile, those countries with which the US has a small deficit or even a surplus were slapped with a 10% tariff anyway. These parameters make it difficult to ascertain how a country can negotiate its way out of these tariffs.

> Tariffs and ongoing policy uncertainty may cause businesses to restrain investment and encourage consumers to be more cautious.

In terms of economic impact, granular forecasts at this point should be taken with a grain of salt. Economic models are largely sailing uncharted waters given the lack of historical comparisons for protectionism on this scale, and many important variables—including the duration of these tariffs, the potential for additional levies by the US and likely retaliatory actions by US trading partners—remain unknown. However, there are directional conclusions that can be drawn with greater confidence. For the US, we expect the tariffs will raise prices for consumers and weigh on economic activity; the inflationary impacts should be evident in relatively short order while the effect on growth is likely to develop over time. The rest of the world may see a combination of lower prices and lower economic growth.

Considering only these first-order effects underestimates the true economic costs of the tariffs, however, as second-order effects can be powerful. For example, the recently introduced tariffs combined with ongoing policy uncertainty may cause businesses to restrain investment and encourage consumers to become more cautious with their spending, with likely impacts on financial conditions broadly. Moreover, the global scope of the economic shock is likely to amplify its impact; a haircut of, say, 1% in US and China GDP isn't likely to be good for anybody.

Weakening Dollar Comes as a Surprise

Initial market reaction to the news was largely as expected. Equity indexes were sharply lower worldwide, with particular weakness in sectors perceived to be most exposed to the impacts of the new tariff regime, such as energy, information technology and consumer discretionary. In contrast, defensive sectors like consumer staples, utilities and healthcare proved more resilient. Government bonds, including US Treasuries, rallied as investors sought perceived safe havens.[3]

Foreign exchange markets did provide a surprise, however, as the US dollar weakened, contrary to expectations. In theory, the tariffs would be expected to cause an appreciation in the dollar to offset the changes in relative prices worldwide. One potential interpretation of today's dollar weakness is that foreign exchange markets do not expect tariffs to remain intact at these levels for long. Another may be that the interest rate differentials that had supported the US dollar in recent years are narrowing, evidence of which can be seen in market pricing for global policy rates.[4]

With inflation expected to run hotter in the US than the rest of the world, real interest rate differentials could continue to narrow, though easing inflation pressures outside the US could provide other central banks with greater policy flexibility. Regardless, we believe the Federal Reserve's path forward has been complicated by the stagflationary impulse of the tariffs—that is, stagnant economic growth combined with high inflation and rising unemployment. If long-term inflation expectations remain anchored, we believe the Fed will cut rates only in response to a growth slowdown, which is to say that unemployment will need to move higher before the Fed will act. Preemptive cuts are likely off the table given inflationary pressures and uncertainty about the policy outlook.

3. Source: Bloomberg; data as of April 3, 2025.
4. Source: Bloomberg; data as of April 3, 2025.

The Benefit of Ballast

These new tariffs and their far-reaching impact are another investment risk in a world full of them. The aggregate effect of these risks suggests a greater likelihood of nonlinear market moves as an expression of freeform uncertainty and anxiety as opposed to quantifiable statistical risks that can be modeled and managed.

> In our view, the multitude of investment risks suggests a greater likelihood of nonlinear market movements.

We continue to believe that exposure to assets with the potential to demonstrate resilience across multiple states of the world represents a favorable investment path forward. For certain portfolios managed by First Eagle's Global Value team, this has meant significant exposures to what we view as high-quality businesses in sectors like consumer staples and healthcare, and significant underweights in areas such as information technology and consumer discretionary. Meanwhile, a strategic allocation to gold has continued to prove its worth as a potential hedge, while cash holdings position us to take advantage of investment opportunities that may arise from the current market dislocation.

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