

Market Update – Managing the Tariff Uncertainty

In mid-March we provided communication to 'sit tight through the current heightened volatility', which we continue to maintain, at this stage, as markets will be driven by news flow rather than fundamentals in the coming months.

Unfortunately, the highly anticipated tariffs were more punitive than what the market expected. Adding further to uncertainty, China responded shortly afterwards by matching the tariff rate of 34% on US imported goods into China increasing fears of a trade war. These events occurring in quick session have seen a sharp sell-off across global equity markets.

Reading various economist's analysis on the impact, it is estimated the current proposal would see effective US tariffs rise to 25.3%, which would push up prices in the US by 2% and cut growth by almost 1%. These estimates take no account of any potential retaliation from other countries.

In China's case, they will need to unleash significant stimulus to offset the expected 1% to 2% hit to Chinese growth from tariffs. At least some of the stimulus will spill over into fixed asset investment creating demand for Australia's commodities.

It is likely the US will experience a stagflationary shock, followed by a meaningful slowdown in its growth rate. However, we expect there will also be ongoing negotiations between countries surrounding revised deals but overall, a much higher tariff rate is likely to stand than in Trump's first term.

Continued market volatility is expected in coming months as financial markets and the real economy come to grips with the full impact, and the potential for trade war conflict. Consumer and business confidence is also likely to fall, with the bigger risk being new job creation slows, as uncertainty may cause firms to delay or scrap expansion plans.

From a revenue raising perspective some have estimated these tariffs will be close to matching Trump's goal of bringing in US\$500 billion. If he is successful in this, it opens the door for one of Trump's more market friendly policies – tax cuts. Also on Trump's agenda are corporate tax cuts, that would boost US equity market earnings, lending support to stock prices. However, this ignores any impact from counter tariffs, which is clearly possible.

Should growth weaken and unemployment rise, we expect central banks to cut rates more aggressively to support their economies, including Australia, although the US would first have to deal with an initial spike to inflation before they can aggressively cut rates.

As markets have fallen considerably, valuations are more attractive and buying opportunities should present themselves to good active managers with a longer-term focus. With ongoing uncertainty remaining high and markets trading on news flow rather than fundamentals, we cannot say with certainty what will happen, so we are relying on diversification within our portfolios to manage the risk.

Our portfolios have a strong quality bias within them, where fund managers are biased towards underlying companies and assets with stronger balance sheets, strong and proven management, and more reliable revenue flows. Such a bias should be better positioned through periods of heightened market volatility.

To this end, we continue to urge investors to **sit tight through the current heightened volatility** and have a longer-term approach to investing.

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