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Commentary

Trade War Intensifies with Chinese Retaliation

- China responds to U.S. tariffs with retaliatory tariffs of its own.
- There is still time for negotiations and deadlines can be extended.
- While we are hopeful the countries will reach a deal, both countries appear willing to tolerate economic pain.

Equity markets continued their slide on Friday as China responded to the tariffs that the United States announced on Wednesday afternoon. As we mentioned in a prior commentary, this would be a very fluid and public situation, playing out in the media. This is contributing to significant investor uncertainty, leading to declines in equity indices.

As a recap, President Trump announced sweeping tariffs this week, including a 10% tariff on all countries (with some exceptions), and reciprocal tariffs targeting countries with higher tariff rates and trade deficits with the United States. This included China, which was one of the hardest hit with reciprocal tariffs at 34%. China responded on Friday with its own reciprocal tariff of 34% on goods coming from the U.S. The S&P 500 was down nearly 6% on Friday as investors moved to safe-haven assets such as U.S. Treasuries, driving bond prices up and yields lower. The 10-year Treasury yield fell below 4%.

A possible silver lining in these tense negotiations between nations could be the timeline itself. The U.S. reciprocal tariffs on China are set to take effect on April 9, followed by Chinese tariffs on the United States on April 10. This window provides time for both sides to negotiate or delay these tariffs. It may also be a way for China to save face. If China caves to Trump's tariffs, they could be perceived as weak. However, with both nations having threatened tariffs, negotiation may now proceed easier without either side appearing to have backed down under pressure.

At the end of the day, no one knows how this will play out. President Trump appears willing to tolerate some economic and market weakness, while foreign nations seem more willing to push back. China holds a unique advantage as they don't even need tariffs. The Chinese Communist Party can simply direct Chinese companies to avoid purchasing U.S. goods.

While the risks of an escalating trade war are significant, there is still time for negotiation and these tariffs could be delayed for further discussions. The Trump administration is unlikely to want prolonged disruptions to the economy and market. It's important to note that tariffs are implemented on companies, not countries. For instance, an American shoe company may manufacture shoes in China and ship them to the United States. China does not pay the tariff to ship shoes to the U.S.; the American shoe company does. Tariffs largely impact American companies making goods abroad. However, the impact on countries often comes later, when companies choose to relocate manufacturing to nations not subject to tariffs—a process that requires both time and substantial investment.

Tariff-related news is fueling concerns around inflation and economic growth. The cost of tariffs will be shared by the companies importing goods and consumers, who are likely to face higher prices. This could potentially hurt corporate profits and dampen consumer spending. While it is too early to predict a recession, the risk is growing if the trade war drags on. The Fed may cut rates sooner than expected, as the inflation caused by tariffs is likely to be transitory. Remember, inflation is the change in the price of goods. In this case, the tariffs would likely lead to a one-time price increase, rather than the persistent inflation we saw during the pandemic.

We believe it's prudent to be well diversified to mitigate risk. This remains a fluid situation that can change quickly. Investors need to stay focused on their long-term objectives and not try to time market movements. We expect continued volatility. As always, please consult your financial professional for guidance during these times.

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