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Tariff Tantrum

By: Simeon Hyman, CFA | Global Investment Strategist

A Glass Half-Full

The announcement of global tariffs by President Trump has rocked markets and much is uncertain, but there are key facts for investors to keep in mind.

Stock fundamentals have been strong recently. There's no definitive method for choosing a historical comparison to the current events but consider the turn of the century.

In 1999, as now, the tech sector accounted for roughly 30% of the S&P 500. What's different is that profit margins in the S&P 500 are nearly double what they were 25 years ago, and critically, debt levels—as measured by Net Debt/EBITDA[1]—are less than half.[2] Valuations also appear more attractive, with a price-to-earnings (P/E) ratio[3] of 22.5 compared to a P/E of 30. Today's 10-year Treasury yield of about 4% compares to just under 6.5% back then, which could imply an additional 3 to 5 multiple increase in the value of that P/E.

Where Are the Risks?

What risks are we facing now versus then? Even before tariffs were announced, confidence was weakening. The latest Conference Board Consumer Confidence reading fell to its lowest level since the height of the pandemic. Furthermore, the ISM Manufacturing Index recently dipped into contractionary territory.[4] The risk is very real that tariffs can dampen economic growth while simultaneously driving up inflation—the dreaded stagflation scenario.

There is, however, a wide range of additional possible outcomes. For example, negotiations could lead to reduced tariffs and more open global trade. There could be tax cuts and deregulation on the horizon. And the Fed might cut rates.

How Should Investors Position in the Current Environment?

Entering this year, investors were already contending with high valuations and an increasingly concentrated S&P 500. Prior to the April 2nd tariff announcement, it was prudent to consider equity strategies that addressed these two risks, and doing so remains a prudent approach to navigating the tariff challenge.

Dividend growth strategies offer one such approach. Given our emphasis on dividend growth as "quality on sale," the S&P 500 Dividend Aristocrats Index's 23% allocation to Consumer Staples appears to be a timely attribute.

1 The net debt-to-EBITDA (earnings before interest depreciation and amortization) ratio is a measurement of leverage, calculated as a company's interest-bearing liabilities minus cash or cash equivalents, divided by its EBITDA.

2 Source: Bloomberg, as of 4/3/25.

3 "Price-to-Earnings" (P/E) shows how much investors are paying for a dollar of a company's earnings. P/E helps to assess the relative value of a company's stock by measuring its share price relative to its earnings.

4 Source: Bloomberg, as of 4/3/25.

The fixed income situation is complex. Bonds, for the first time in a generation, have fulfilled their role this year so far, rising when stocks declined. With the end of quantitative easing, the 10-year Treasury yield began 2025 at a market-driven level high enough to allow for a classic flight-to-safety bond rally. An outright recession might be necessary for bonds to rally further.

Consider the following scenario: GDP growth declines modestly, unemployment rises slightly, but there is no recession. What happens? The Fed may cut rates a couple of times. The long end of the yield curve potentially sells off (i.e., an old-fashioned steepening). This would suggest investors consider favoring shorter duration. While short-duration bonds help mitigate risk, they do not generally diversify stocks. If tariff challenges push the economy into recession, longer-duration bonds may rally further and potentially offset stock losses, as they have so far this year.

Big picture? A barbell strategy including both shorter and longer duration bonds could be appropriate.

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