The Quarterly Perspective

Tariffs Dominate the Outlook

As the U.S. economy was beginning to find balance, proposed tariffs disrupt future expectations.

In the three weeks since the initial "Liberation Day" April 2nd tariff announcement, the news on tariffs has moved at a breakneck pace. As markets digest daily developments, we are offering a summary of our current thoughts on the situation.

The Impact on Markets

- The initial sell-off in equities at the news of reciprocal tariffs showed the market was caught off guard at the size, scale, and scope of tariffs. Granted, everyone had previously expected tariffs, but not to the degree announced on April 2nd.
- Markets are showing heightened sensitivity to trade news in both directions. For example, the news on April 9th declaring a suspension on reciprocal tariffs fueled the S&P 500 to a +9.5% up day.[1]
- The uncertainty about final tariff rules also creates problematic uncertainty for corporate executives who must share forward forecasts for 12-month earnings and revenues. It will be tough for equity markets to fully stabilize until executives can restore confidence in their outlook.
- Notably, bond yields have not moved down so far in this episode. Under a more customary equity market sell-off, it would be typical for bond yields to move down as investors seek safety in U.S. treasury bonds.
- The current market correction appears to have found a recent bottom on April 8th. The S&P 500 is up 6.12% from April 8th to April 22nd.[2]

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On The Frontlines of Trade Policy

- The long-term goals of the president's trade policy have become clearer. They are centered on:
    1) Creating more foreign investment in the U.S.
    2) Repatriating jobs to the U.S.
    3) Improving demand for U.S. exports.
    4) Raising revenue to improve the annual federal budget deficit.
- One of the most difficult challenges lies with the chance that tariff policy could look far different in a few months' time. Trumps propensity to start with big, brash demands as a starting place for negotiations means tariffs have a lot of room to be reduced.
- By attempting to resolve big structural problems, we expect some degree of tariffs to remain structurally in place for the long term.
- The U.S. has a clear "Big 8" in trade relationships with imports making up nearly 62% of all U.S. imports coming from these countries. They include (in order by rank) Mexico, Canada, China, Germany, Japan, South Korea, Vietnam, and Taiwan. When it comes to new trade agreements, these nations will matter more than all the others.[3]

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Along with the founder of Harman Wealth Management, Dean Harman, Riggs also heads Alphalytics Research, a subscription-based research service to investment professionals across the U.S. The service emphasizes rigorous and robust data analytics in the context of the U.S. business cycle.

ABOUT

Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to insightful, objective solutions, and always working solely for the best interest of our clients.

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- As part of the negotiations, the U.S. is seeking to increase demand for U.S. exports in order to reconcile long-standing trade deficits.
- A long list of exemptions has complicated the outlook. These include energy products, construction materials, pharmaceuticals, electronics, and computer parts.

A New Era of De-Chinafication

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- The trade relationship with China is at a nexus point and will look entirely different going forward. To understand our future with China, one must understand the past twenty-five years.
- China, even though a communist, state-run, non-market economy, was allowed into the World Trade Organization in 2001. Western nations were lured by the prospect of selling to China's billion-plus population. In naïve fashion, the West (including the U.S.) assumed that with a taste of capitalism and prosperity, China would liberalize into a mutually beneficial trade partner.
- Since admission, China has been accused of numerous violations of fair economic principles, including:
    1) Subsidizing its domestic industries to undercut global competitors.
    2) Currency pegging and manipulation.
    3) Closing its markets to foreign companies.
    4) Theft and forced transfer of intellectual property.
- China has emerged as a global rival, asserting its interest against the economic and national security interest of the U.S. Moving trade away from China is considered a fundamental priority for both national security and economic security.
- Since Trump's first term, U.S. dependence on Chinese imports has declined from 23% in 2017 to 13% in 2022.[4]

The Impact to the Economy

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- While not without its challenges, the U.S. economy was in a fairly balanced state just prior to the tariff announcement. The latest CPI report showed annual inflation at 2.4% and the unemployment rate 4.2%. Both metrics are idealistic on a historical basis.[5]
- Due to the lag in tariffs, it is likely that more positive economic data is delivered in the next few months. Declining oil prices will likely lead inflation metrics lower in the near term. Likewise, in order to front-run higher prices later, consumers may pull forward a degree of consumption into the 2nd quarter.
- Sentiment and confidence surveys have fully detached from economic hard data. Some are consistent with the pessimistic lows of the global financial crisis of 2008.[6]
- Tariffs are expected to start showing up in the inflation metrics in June and build slowly from there.
- Of the total U.S. GDP, 11% is made up from foreign imported goods.[7]
- Depending upon the research source, the current effective tariff rate is expected to average between 11% and 20%.[8]
- Early expectations for increases in inflation are between 3.0% and 3.6%. These are clearly levels at which the economy can survive without falling into recession.
- Because the economy is at such a different place than 2021, inflation is expected to be confined merely to goods. In the 2021 episode, the economy saw inflationary problems across labor, services, supply chains, and overstimulated demand.

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What's Next

- The U.S. economy, which has demonstrated remarkable GDP growth for the last two years, was expected to move toward a slowdown in 2026. Tariff policy likely pulls that slowdown forward, starting in the third quarter of 2025.
- Pay attention to other things moving in the market that can impact the outlook. Oil prices are at their lowest in four years. Even so, as the economy slows, the Fed will have a pathway to lower interest rates and implement easing into the economy.
- The House of Representatives has moved to start a bill for extending the 2017 tax cuts, set to expire at the end of the year. There is also talk of expanding tax cuts and lowering the overall corporate tax rate.
- Congress will be required to address the federal budget later this year. Expect matters to escalate in September. As usual, things could get dicey over the budget battle.
- Expect a lot of political posturing over the course of the summer. The president will be eager to tout victories, while the opposition will focus on the second order consequences.
- We still anticipate tariff policy could undergo major revisions before things feel final.

Sources:
[1] S&P Dow Jones Indices LLC
[2] Ibid
[3] U.S. Census Bureau
[4] Ibid
[5] U.S. Bureau of Labor Statistics
[6] University of Michigan Survey of Consumers
[7] U.S. Bureau of Economic Analysis
8 Pantheon Macro, The Tax Foundation

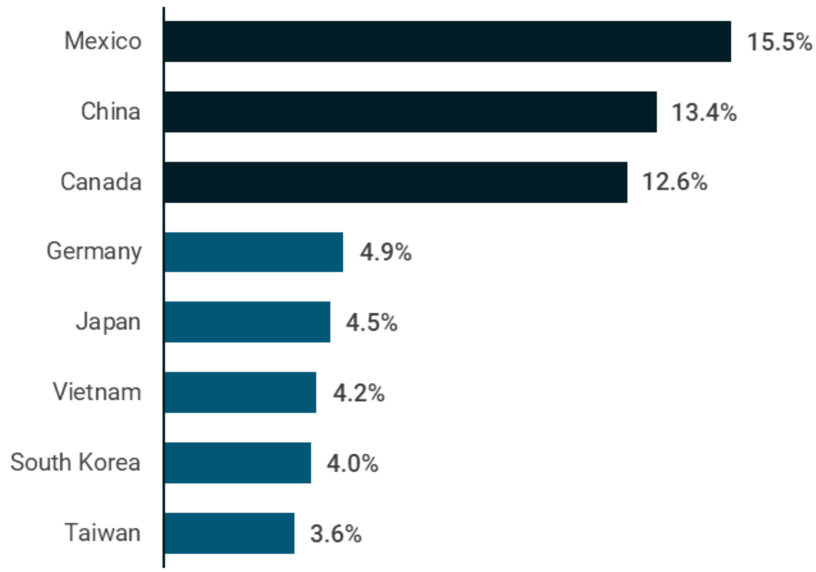
When Looking For Tariff Breakthroughs, Focus on the Big Eight Trading Partners

Top Eight Trading Partners Account for 63% of Imported Goods

With negotiations set in motion, the White House will look for quick wins. As early concessions are announced, realize only eight countries carry the highest proportion of imports. In simple, terms, these relationships proportionately matter most.

Also, consider the eventual impact to inflation. If tariffs are removed or come down on these countries, the final impact to consumers will be less.

U.S. Percentage of Total Imports by Source Country
Calendar year 2024



Source: U.S. Census Bureau

Overlooked Exemptions Lessen the Blow of Impending Tariffs

Exemption Categories Target Key Consumer Areas

As confusion over tariffs remains high, there has been at least near-term relief across several key ares receiving exemptions from current tarrifs.

It is important to note these exemptions are not necessarily permanent. Therefore, they are treated as a warning to U.S. companies to diversify their supply chain or make commitments to manufacture in the U.S. Nonetheless, the exemptions are welcome relief to housing, energy, and health care.

Key Tariff Exemptions in Place as of April 23rd

Energy Products

- Electricity
- Petroleum
- Coal

Pharmaceuticals

- Basic products
- Most Drugs
- Various Ingredients

Construction Materials

- Wood-based sheets and panels
- Sawn Wood
- Raw Lumber

Electronic Components

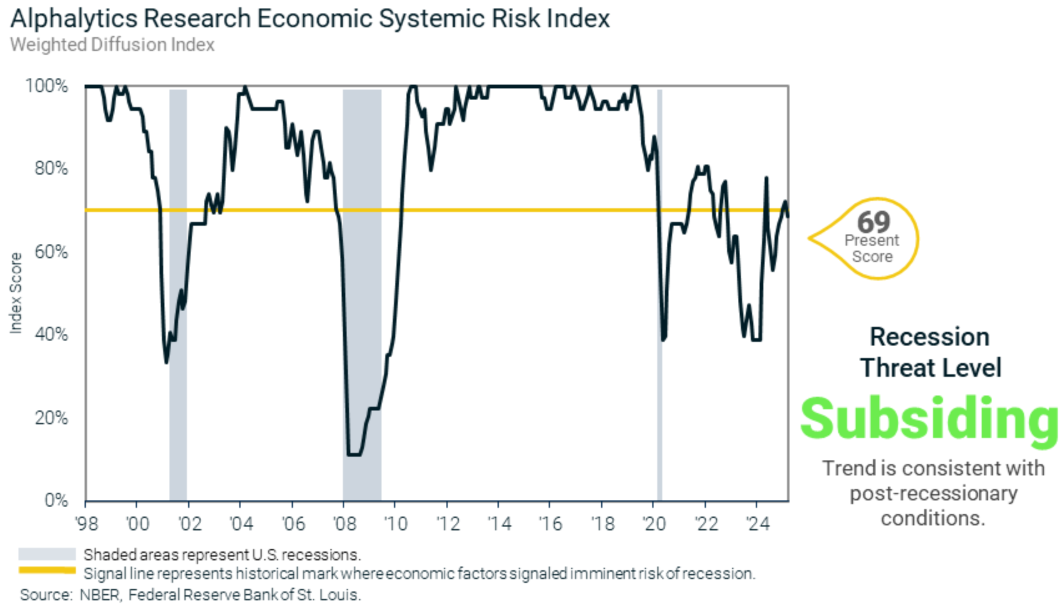
- Chips
- Semiconductors
- Computer parts
- Smartphones

Metals and Minerals

- Precious Metals
- Nickel, lead, Zinc and Tin
- Metallic Minerals
- Copper

Business Cycle Risk Profile

- The latest index reading is consistent with a recovering economy.
- Several of the underlying nine inputs are teetering on their threshold lines.
- In closing out the first quarter, it looks like the worst of the economic threat from inflation and higher rates is behind us.
- Tariffs now pose a future threat, primarily to inflation and a corresponding impact to consumer spending.
- U.S. retail data picked up to 3.1% annual growth.
- Planned interest rate cuts from the Federal Reserve should help support both business activity and investor sentiment in the back half of 2025.



Interpreting the Index Score:

- The index score measures nine economic factors that have demonstrated co-movement with the deteriorating conditions of the past seven recessions dating back to 1970.
- When the index score is at 100, it means all nine of the factors are measuring at levels consistent with past economic expansion.
- When the index score is below 100, it means that one or more of the weighted factors has moved to a level consistent with past economic contractions.
- In aggregate a score of 70 or higher is interpreted as a composite profile consistent with past economic expansion. A score lower than 70 is interpreted as a composite profile consistent with past economic contraction.
- Markets can, and sometimes do, demonstrate volatility even though the economic factors are measuring consistent with expansion.

Interested in Adaptive Business Cycle Investing?

Today's markets, economies, and policies are more complex than ever, challenging investors on what to watch and when to take action.

At Harman Wealth Management, we understand sound investments are uniquely supported by the conditions that favor them. And, when conditions change, so do the investments that benefit.

That's why we conduct rigorous and disciplined tracking of the U.S. business cycle. We also track the cyclical factors that shape our investing environment, like currencies, commodities, and rates. We embrace a world where investing dynamics are constantly evolving and believe it's imperative to have an investment strategy that adapts with it.

With Adaptive Business Cycle Investing we invest consistent with business cycle forces, aligning investments with the conditions driving returns in the present, rather than chasing what worked in the past.

About Harman Wealth Management

At Harman Wealth Management, we provide private, advanced, independent planning and investment management to individuals, families, and institutional clients.

We value in-depth economic research, evidence-based investment methods, and rigorous risk management. We are committed to integrative advanced planning by aligning investment objectives with business cycle opportunities and risks.

At Harman Wealth Management, our aim is to help clients realize their goals within a disciplined, insightful, and rewarding relationship.

For more information about Harman Wealth Management or investing with the business cycle, contact us at 281-719-8601.

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In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Bonds are also subject to other types of risks such as call, credit, liquidity, interest rate, and general market risks.