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Newsletter

April 13, 2025

Executive Summary

The Trump administration's tariff policy has triggered extreme market volatility. The administration's objectives remain fuzzy and conflicted. There has been criticism about how the administration calculated the tariffs.

There may be problems with this approach, which has been tried before without success.

If the administration's real objective is to renegotiate trade deals, the market may recover quickly. If the administration is trying to reorder the global economy, this may be very difficult.

There may be long-term costs for the U.S. from all this volatility on the global stage. The long-term treasury market has shown signs of weakness as capital may be leaving the country in search of more stable markets. This could be troublesome.

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Market Data as of March 31, 2025

		YTD 2025
U.S. Equities	S&P 500 ETF	-4.28%
International Equities	MSCI EAFE ETF	7.95%
Emerging Markets Equities	MSCI Emerging Mkts ETF	3.87%
U.S. Bond Market	iShares US Core Bond ETF	2.76%
Commodities	S&P GSCI Comm ETF	4.61%
Real Estate	iShares US Real Estate ETF	3.24%

Trade Wars and Market Volatility

On April 2, President Trump announced his tariff plan on what he called "Liberation Day." The tariffs were far higher than the market had expected. Since that time, the U.S. stock market has experienced extreme volatility in almost every trading session. The administration recently announced a 90-day pause in implementing many of these tariffs, except for China. The news is changing rapidly – almost by the hour.

The administration set the tariff rates based on the trade deficit with each country – instead of the tariffs those countries actually charge us. The calculation of the administration's tariffs has been heavily criticized.

The markets are struggling to price in the impact of these massive tariff rates. There have been wide swings in the stock market. Recently, the U.S. treasury market is starting to show signs of stress, which is concerning.

Making matters worse is that the administration's objectives are still fuzzy, even though the president's advisors have been on television every day attempting to explain them. In my view, the administration seems to be pursuing three separate objectives:

Negotiate Better Trade Deals

The administration may be using the tariffs to force our trading partners to renegotiate unfavorable trade deals. The objective would be to reduce tariffs and other trade barriers. There are indications that the administration wants to start negotiating with Japan and South Korea. Negotiating trade agreements with numerous countries all at once (up to 75 of them, according to the administration) may take several weeks or months.

Raise Revenue

The administration has touted that tariffs will fill the government's coffers with billions of dollars in new revenue. This revenue may be used to offset income tax cuts and address our deficit. According to the administration, the tariffs will replace the income tax (to some extent), and this will make the country very wealthy.

Protect Markets and End Globalism

The administration has stated that it believes our trade deficits with certain countries are unsustainable and the U.S. is being "ripped off." There is a desire to eliminate these deficits, protect U.S. workers and markets, and reorder the global economic system. The goal here would be to revive domestic manufacturing, build factories here in the U.S., and onshore supply chains.

There Are Several Problems

First, these goals are largely mutually exclusive. For example, if you negotiate better trade deals, you will drop your tariffs to near zero and the U.S. will not receive significant tariff revenue. Global trade is enhanced and accelerated, not squelched. If you want to terminate globalism and reorder the global economic system, there is no point in negotiating better trade deals.

Second, attempting to reverse globalism and remake the global economy to protect U.S. workers and markets may not be realistic. New factories will cost trillions and take years to build. U.S. workers will demand much higher wages. The average U.S. auto worker makes $70 an hour. The same worker in Mexico makes $7. The average U.S. textile worker makes about $16 an hour. The same worker in Vietnam makes $3. If iPhones were made in the U.S., they would cost over $3,000. Even if all these things could be manufactured in the U.S., would U.S. consumers be able to afford them? Will the new factories employ thousands of underemployed workers, or will they rely heavily on artificial intelligence and robotics – requiring only a few high-tech workers with specialized skills?

Is globalism the real enemy? Over the past 20 years, the U.S. has surged ahead of Europe and Asia when it comes to GDP and income per capita. Overall, we are richer than ever before. That said, there is no denying that not everyone has shared in this wealth. That is the real problem, but it is unclear if the administration's tariff policy will really address it. The U.S. has real advantages in software, law, and finance (all of which we export abroad at great levels), but our advantages in manufacturing have waned over the years as our labor costs have remained comparatively high, robotics and automation have replaced workers, and foreign countries have developed advanced manufacturing scale and expertise.

In my humble view, trade deficits are not, by definition, proof positive that we are "getting ripped off." Sometimes, U.S. consumers want to buy more products from a country than consumers of the other country want to buy from us – especially if they are selling cheap consumer goods and we have expensive services to offer them in return. On the other hand, we do get taken advantage of in certain markets and there are real non-tariff barriers that prevent us from efficiently entering other markets, especially China.

By negotiating better trade deals, the administration may be able to lower these barriers and level the playing field. On the other hand, erecting high tariff walls and engaging in trade wars will increase these barriers, not lower them.

Third, when you impose tariffs on other countries, they usually retaliate. That encourages more counter-retaliation. Once trade wars begin, they can be tough to unwind. As I write, China, Canada, and the EU

have retaliated against the U.S. China may be a tougher opponent than many realize. Higher tariffs will undoubtedly hurt both sides, but the Chinese may have a greater capacity for suffering than we do, as they live in a communist country and have few choices. The Chinese have been looking for a reason to diversify away from the U.S. for many years, and they have already approached the European Union about seeking a better trade deal. We will see what happens.

Fourth, tariffs will cause prices to rise, disrupt supply chains, and lower economic activity. Recessionary risks are elevated. This could cause another painful bout of inflation – just when we recovered from the last episode. The Federal Reserve is in a tough spot. On the one hand, to combat inflation, the Fed would normally raise interest rates to cool off economic activity and bring prices down. On the other hand, if we are heading into a recession, the Fed would normally lower interest rates to encourage more economic activity. Hopefully, we are not heading for a stagflation-type scenario where we have stagnant growth and stubborn inflation at the same time.

We Have Tried This Before

On at least two occasions, significant tariff plans were introduced to protect U.S. workers and markets from foreign competition. Neither action worked out well.

The McKinley Tariff Act of 1890

Back in 1890, then-Representative William McKinley authored the Tariff Act of 1890. The tariff raised the average duty on imports to almost 50%. The purpose of the act was to protect domestic industries and workers from foreign competition. As it turned out, the act was not well received, as Americans suffered a steep increase in prices. In the 1890 election, Republicans lost their majority in the House. In the 1892 election, Republicans lost their majority in the Senate and Democrat Grover Cleveland won the presidential election. In 1894, Congress passed the Wilson-Gorman Tariff Act that lowered McKinley's tariffs. Later, McKinley acknowledged that his tariff act was a mistake.

The Smoot-Hawley Tariff Act of 1930

On June 17, 1930, President Hoover signed the Smoot-Hawley Tariff Act of 1930 into law. Hoover signed the bill against the advice of numerous senior economists. At the time, the Great Depression was bearing down hard. Senator Smoot and Representative Hawley sought to protect jobs and farmers from foreign competition. Unfortunately, the tariff plan did not work and only deepened the depression by reducing global trade and economic activity by 50%. Hoover lost the presidential election in a landslide to FDR in 1932. Most economists and historians believe the Smoot-Hawley Tariff Act was a significant policy error.

Reading the Market

In watching the market carefully, it seems that when the administration says it is pursuing better trade deals, markets react positively. When the administration says that the new tariffs are "nonnegotiable," markets react negatively.

Another segment of the market to watch closely is the long-term U.S. treasury market. Normally, when there is volatility in the stock market, investors will flee to the safety of U.S. treasury bonds. U.S. treasuries have been one of the safest and most stable assets in the world. Since the administration's tariff plan was announced, investors have been selling more long-term treasuries than they have been buying. At first, analysts and market watchers blamed hedge funds that had been unwinding certain esoteric trades that got sideways in the market turmoil. But another disturbing trend seems to be taking place. Some

investors are selling treasuries and investing away from the U.S., as we are not perceived as a stable market for safe-haven assets. We should not forget that the two largest holders of U.S. treasuries are Japan and China. If they sell their U.S. treasury holdings, this will depress bond prices and increase interest rates here in the U.S. That will make financing our huge deficit much, much harder. This is something to keep an eye on.

Potential Long-Term Costs

The rollout of the tariff plan has jolted markets and unnerved and angered our allies and trading partners. There may be long-term damage to our reputation as a reliable and stable partner on the global stage. This may exclude us from lucrative trade deals in the future as many countries will diversify away from us. All of this may have a cost in the long run.

Some feel that taking a hard stance is how to get the best deal with our trading partners. I guess that depends on what tactics you feel are the most effective when negotiating a deal. Some feel the hard approach yields the best results. Others feel that a more respectful approach yields better long-term results. Opinions always vary on this subject, and everyone has their own individual style.

Recommendations

This is a very fluid situation, and whatever recommendations listed here may change with the next tweet or news conference.

If the administration's true objective is to negotiate better trade deals to reduce tariffs and reduce our trade deficit in certain countries, I believe the market will eventually stabilize and then recover. Consider rebalancing back to target levels if you have a well-constructed portfolio and asset allocation.

If the administration is erecting a permanent tariff wall to reorder the global economy, markets will struggle to price in this new reality. A recession is a real possibility. Over time, global investment capital will start to drift away from the U.S. in search of better investment opportunities and more stable markets. If this occurs, it would be wise to carefully reconsider your asset allocation and portfolio choices and redeploy investment capital in search of the best investment opportunities in more stable markets. Take your time in making these adjustments.

Stay tuned. Every day is a new day. If you need guidance with your portfolio, please give me a call.

Thank you.

D. Austin Lewis

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