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Special Update: Trade Wars and Market Risk

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Trade headlines continue to weigh on markets as new tariffs go into effect. President Trump recently confirmed tariffs on Canada, Mexico and China, dashing hopes of more extensions or last-minute deals. Additional tariffs are expected in the coming months, including reciprocal ones against countries that impose duties on U.S. goods.

Investors worry that a trade war could raise prices for consumers and businesses, slowing economic growth. As a result, the stock market has pulled back in recent days across major indices and sectors.

Why tariffs are a concern for the market

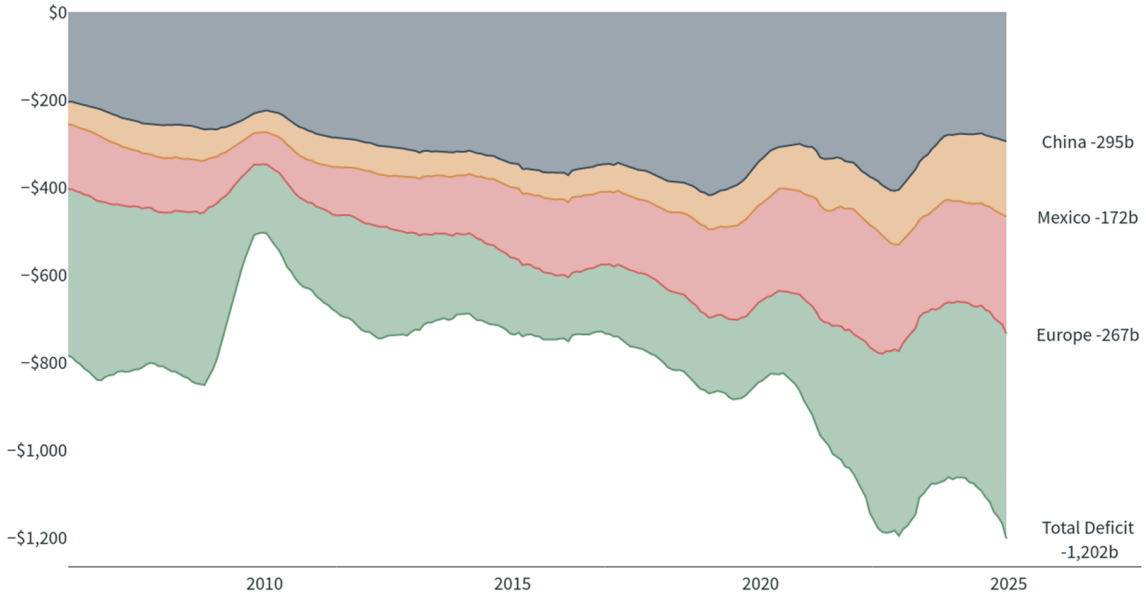
While market swings are never pleasant, it's times like these that personalized, well-constructed portfolios and financial plans truly shine. Just as markets pulled back on trade war concerns in 2017 and 2018, investors have been on edge since the presidential inauguration. History shows that markets can overcome these concerns in the long run, even if the day-to-day swings are uncomfortable.

Tariffs can be concerning because they represent taxes on imported goods that can then be passed on to buyers. With inflation rates still hotter than many would like, tariffs could add further pressure to the prices of everyday necessities. This is made worse if other countries retaliate with their own tariffs, sparking an escalating trade war. As the accompanying chart shows, the U.S. runs a significant trade deficit with many major trading partners.

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U.S. Trade Balance by Country

Rolling 12 months. Visible trade, free alongside basis



Latest data point is Dec 2024

Sources: Clearnomics, Census Bureau

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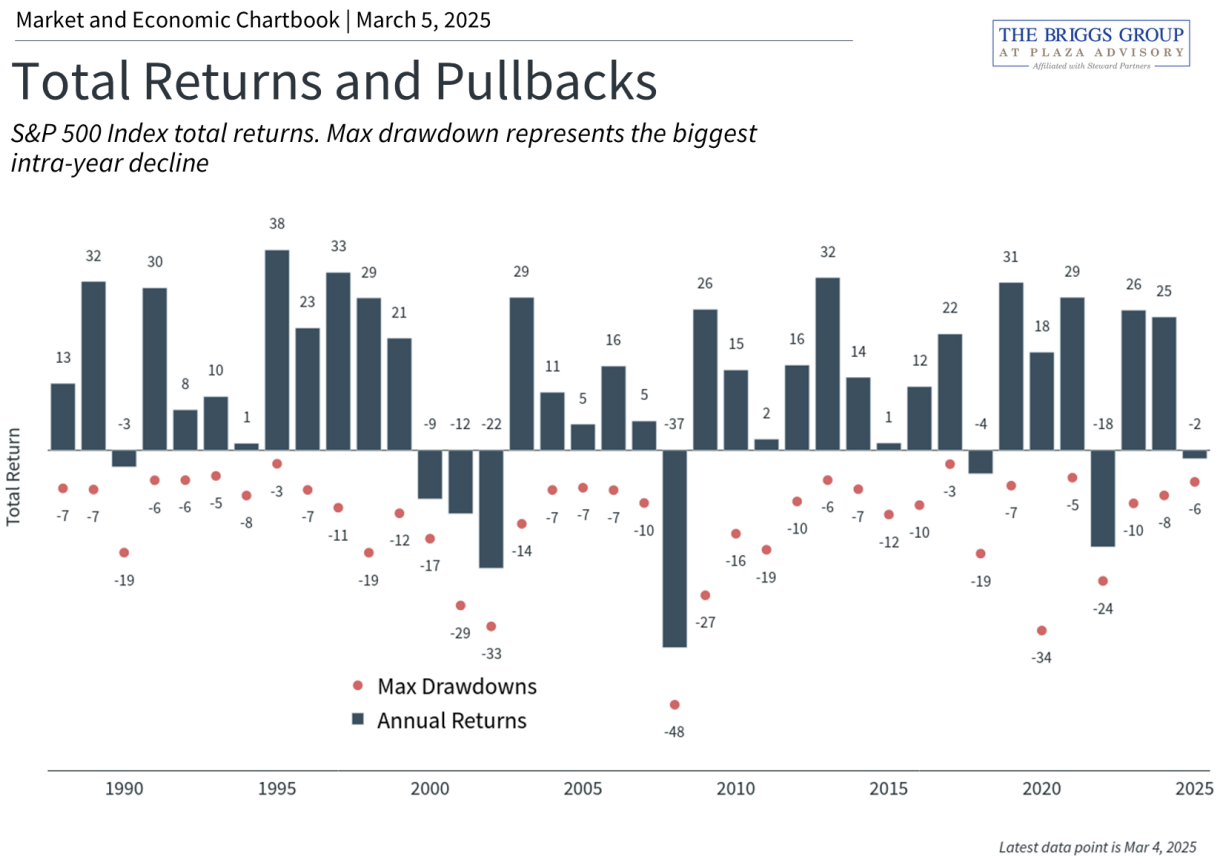
It's important to keep this round of tariffs in perspective. First, the U.S. has a long history of using tariffs dating back to the Industrial Revolution and hitting a peak during the Great Depression. The goal of tariffs is often to protect domestic industries, especially when they involve important or sensitive sectors, such as technology and national security.

Second, the previous round of tariffs during President Trump's first administration led to trade deals with Mexico, China, and others. For the administration, tariffs are often used as a negotiating tactic for other policy objectives, such as curbing unauthorized immigration or imports of illegal drugs.

Third, market reactions to tariff announcements often prove more dramatic than their actual economic impact. This is especially true if tariffs are short-lived or if deals are reached. While markets were choppy from 2017 to 2019 when trade wars were a concern, markets generally performed quite well.

While today's trade war concerns differ in some ways from previous episodes, they are a reminder that market fears don't always translate into reality.

Market pullbacks are a normal part of investing



Given the market's recent swings and the constant news coverage, the S&P 500 has pulled back about 5% at the time of this writing. While this can be unpleasant, the reality is that market pullbacks of this magnitude occur on a regular basis. Pullbacks of this size or worse occurred twice in 2024, three times in 2023, and a dozen times during the 2022 bear market.

With markets reaching new all-time highs over the past few years, some investors may have grown accustomed to markets only moving in one direction. While the current year-to-date performance may not be what many hoped for at the beginning of the year, when much of the focus was pro-growth policies, many aspects of the market remain positive.

For example, corporate earnings grew at a strong pace this past earnings season. Unemployment is still historically low at 4.0%, wages are rising, and productivity growth remains steady. From a risk perspective, high yield credit spreads remain well below pre-pandemic levels. This suggests bond

investors are less nervous about growth prospects than the stock market.

Staying invested is the best way to weather market volatility over time

While technology stocks have struggled, other sectors have performed well over the past several months. Other asset classes and regions have also performed well, reminding investors of the importance of a balanced portfolio. Bonds, for instance, have benefited as interest rates have fallen. As they often do in difficult market environments, positive bond returns have helped to offset stock market declines in diversified portfolios.

History shows that maintaining a long-term approach remains one of the most effective strategies for navigating market volatility. While short-term market swings can be unsettling, investors who stay consistently invested through market cycles have historically captured the benefits of compound returns.

So, although there will be more trade headlines in the coming days, it's important to remember that investing is not about a single day, week, or month. Instead, building and holding a well-constructed portfolio is about achieving financial goals over years and decades.

The bottom line? Trade-related uncertainties have led to a pullback in major indices. History suggests that maintaining a long-term perspective, rather than reacting to daily market moves, is one of the best ways to help achieve financial success.

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For index definitions click here.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Diversification does not guarantee a profit or protect against loss in a declining financial market.

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