The Implications of America First

> **"I would like to come back as the bond market. You can intimidate everybody."**
>
> ~ James Carville

On April 2, President Trump proposed a substantial reengineering in U.S. trade policy that, to a great extent, is likely to determine the direction of global markets for years to come. While the magnitude of the tariffs was surprising, the ongoing shift away from globalization was not unexpected.

In Q1 2022, we posited that the pandemic had exposed the underlying imbalances and fissures caused by globalization and the vulnerabilities inherent in integrated global supply chains. Additionally, the repositioning of global supply chains would accelerate a move toward a multipolar world, resulting in less efficient (albeit more resilient) regionalized trade that would likely lead to a higher steady state of inflation, interest rates and market volatility.

The recent tariffs have accelerated the move to a multipolar world. In this Commentary, we discuss the implications for the global economy, the markets and the positioning of LNW portfolios.

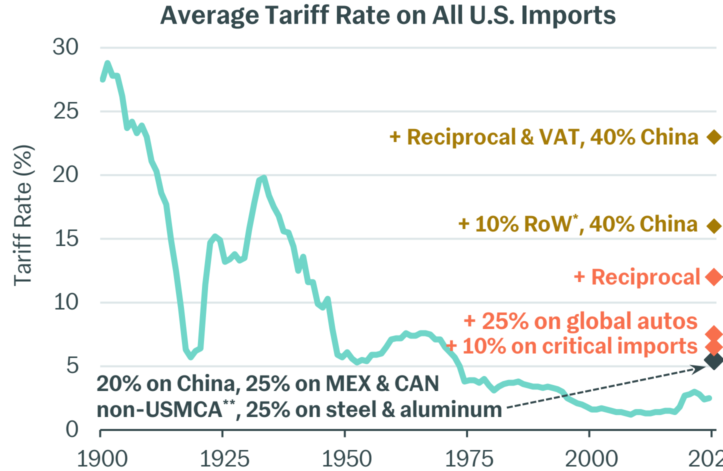
The Big Picture

In effect, the Trump Administration is modifying the post-WWII order – a system of globalization built by the U.S. to promote geopolitical stability, rebuild allies, and contain Communism – all while securing American strategic and economic leadership.

Over time, globalization has empowered economic competitors (e.g. China) and hollowed out U.S. industrial capacity while making way for a robust, service-dominated economy. With that said, the system the U.S. built began to benefit some rivals more than itself, with China leveraging open markets and state control to undercut U.S. firms.

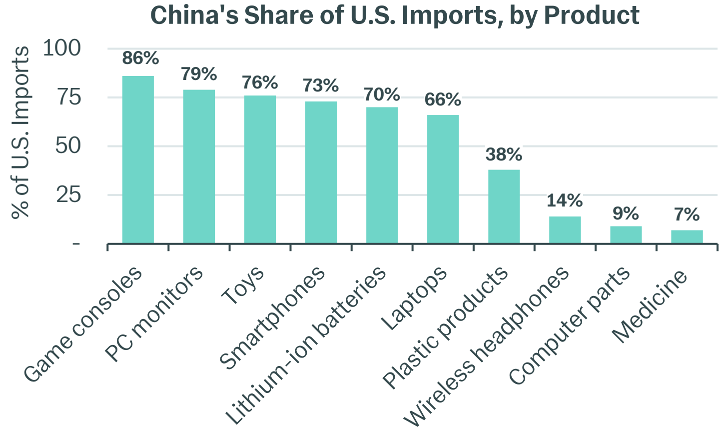
Looking forward, we believe the U.S. isn't likely to walk away from international engagement, but it is rewriting the rules to emphasize domestic supply chain resilience, national security, and strategic leverage through bilateralism and targeted protectionism.

Average Tariff Rate on All U.S. Imports



*RoW = Rest of World; **USMCA = US Mexico Canada Trade Agreement.
Source: Tax Foundation as of April 4, 2025.

China's Share of U.S. Imports, by Product



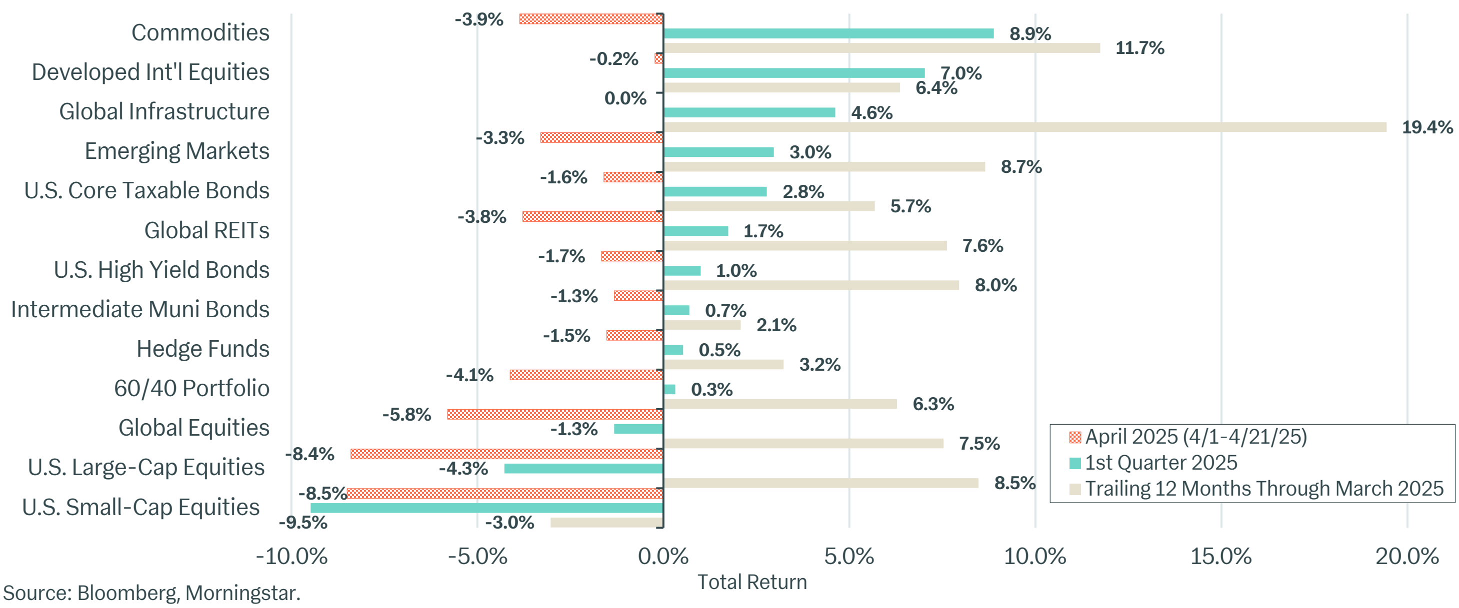
Source: Apollo.

For investors the consequences may be substantial. With a shift toward structural protectionism, we envision more policy driven disruption in global trade, affecting supply chains, inflation and corporate margins – especially for multinationals. Moreover, bilateral tensions (U.S.–China, U.S.–Europe) and regional fragmentation increase geopolitical and regulatory risks.

On the positive side, the reshoring of some production is likely to support industries tied to U.S. infrastructure, domestic manufacturing, energy security, and semiconductors via reshoring incentives and political support.

In my three decades in investment management, the stakes have seldom seemed higher. Yet I also know that resolution is possible. It appears Treasury Secretary Bessent's influence has risen within the Administration relative to the trade hawks (Navarro and Lutnick). Bessent appears to have a more moderate approach to rewiring the world trade order. Additionally, the U.S. and China, drivers of the global economy, each stand to potentially benefit by not viewing this as a zero-sum game. Currently, China produces about a third of everything manufactured in the world and is heading toward 40% while it consumes only about 12%. Meanwhile, the U.S. had a record $1.2 trillion trade deficit in goods last year. Thoughtful negotiation between the two giants can mean more trade, more growth and more jobs for both countries.

Asset Class Total Returns: 1st Quarter 2025; Past 12 Months; April 2025



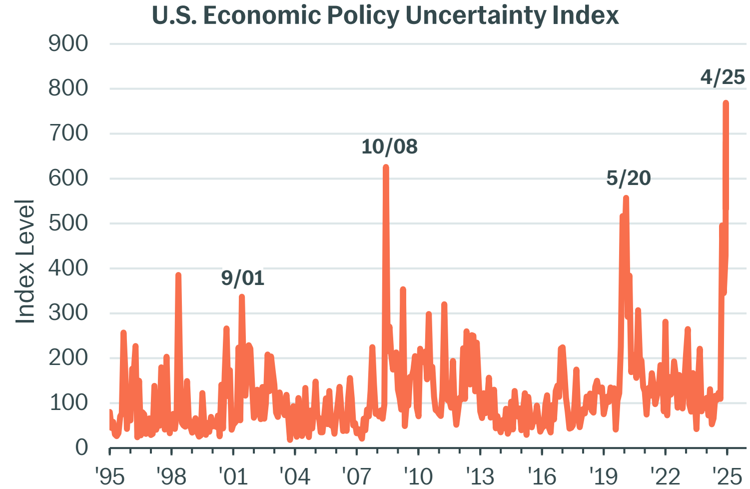
Source: Bloomberg, Morningstar.

Where We Are Now

Market volatility has surged following the tariff announcement as investors and corporate executives globally struggle to decipher the end game. Will the Trump administration's aggressive posturing be a successful negotiating tactic toward more balanced trade relationships? Or is it the starting skirmish of a trade war that leaves no nation unscathed, with huge implications for the global financial system?

No one knows, and the impact of tariffs has not yet manifested in high frequency economic data. Not surprisingly, an uncertainty premium is now being priced into virtually every asset class, creating challenges for risk taking and long-term planning.

U.S. Economic Policy Uncertainty Index



Source: Bloomberg.

The path forward could be bumpy, and the emotional toll exacted by the volatility high. However, it is notable that we have experienced the recent volatility in prior periods of uncertainty. We witnessed a similar level of stock market volatility in Fall 2008 (Global Financial Crisis) and during Spring 2020 (start of the global pandemic).

U.S. stocks are now at or very near the bear market threshold: The S&P 500 was recently almost 20% below its peak. Although the volatility has been gut wrenching, keep in mind that the index is back to where it was about a year ago after a strong run-up starting in October 2022.

Key Factors Likely to Influence Markets

The tariff showdown was triggered by the U.S. government itself. This means reversal in policy is, to a certain extent, in the government's hands, as long as things don't spiral out of control, especially with China. The pause on reciprocal tariffs on all countries except China until July has helped diffuse the possibility of a global trade war. But positive news about trade negotiations is critical to maintain market stability and begin reducing the uncertainty risk premium.

The Fed's willingness to lower interest rates. While U.S. interest rate cuts could stimulate the economy to offset tariffs, the Fed may not lower rates amid great uncertainty about inflation and tariff policy. The good news is that, so far, there is no immediate need for the Fed to take action. The markets seem to be functioning with adequate liquidity.

U.S. government debt levels at all-time highs and vulnerable to rising yields. With total federal debt hovering at $36 trillion (higher than GDP), and U.S. interest payments now over $1 trillion annually, it is the U.S. bond market that has higher relevance in policy making than the equity market. We maintain the point made in our January 2025 Commentary: The level and steepness of the U.S. Treasury curve is likely one of the most important variables for asset prices in 2025. Recently, yields have stabilized. In the early days of COVID, another risk-off period, we also saw a spike in yields before normalization set in (although in that case with help from the Federal Reserve).

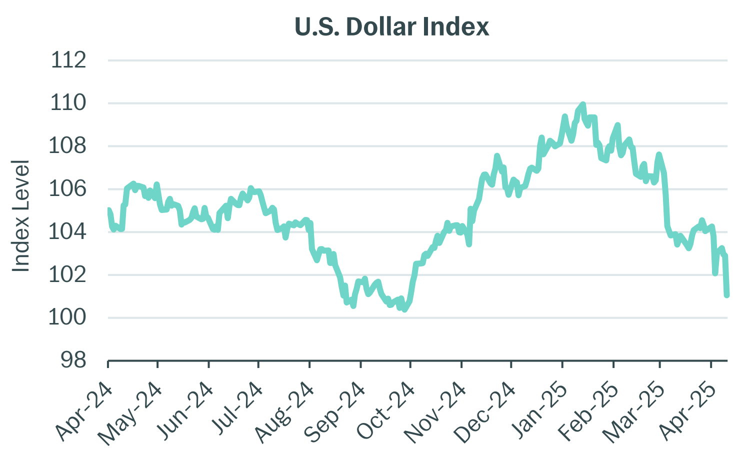
Fed Remains Independent

An independent Federal Reserve is crucial for the stability of U.S. and global markets. So far, Treasury Secretary Bessent seems to have the ear of President Trump in advocating that Fed Chair Powell serve out his term, which expires May 2026.

Kevin Warsh is currently a top contender for Fed Chair in 2026. He is said to have counseled against interfering with the Fed and is known to be a strong advocate for Fed independence. Ultimately, Congress would need to approve a new Fed Chair.

The U.S. dollar status as reserve currency. While the dollar is not likely to lose its status as the global reserve currency for the foreseeable future, the fact that this is being debated is notable. During past crises, global investors rushed to the dollar as a safe haven. During the current tariff induced volatility, the dollar has lost value (although it had been overvalued by some accounts) along with U.S. bonds and stocks.

During the early April spike in Treasury yields, we reached out to the asset managers we work with to get their take. Universally, they viewed the sell-off as a steady unwind by foreign investors of overweight positions in U.S. assets after a long period of outperformance coupled with hedge funds unwinding levered exposures, forcing them to sell their most liquid asset, U.S. Treasuries.



Source: Bloomberg.

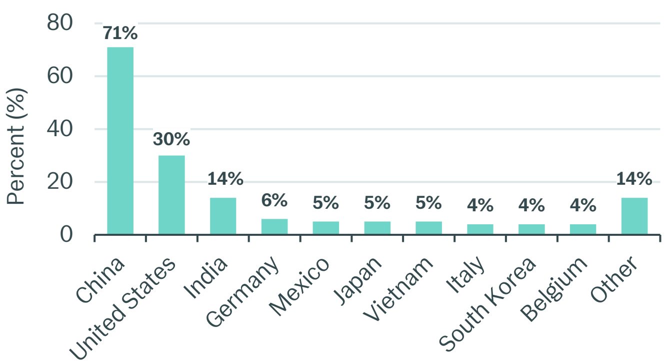
Geopolitical risk. The multi-year wars in Ukraine and Gaza are ongoing, despite many recent efforts to bring them to a resolution. Flare-ups in other parts of the world are also possible.

Implications for the U.S. Economy

The U.S. economy appears stable although weakening. Inflation has remained in check. The factor that can tip the economy into recession is uncertainty: The uncertainty caused by on again, off again tariffs, and uncertainty about U.S. fiscal policy (trimming of the federal workforce, high debt levels, pending tax reform and the timing of deregulation).

If tariffs stay at current levels, the estimated hit to U.S. GDP ranges from 1% to 2%. Why? U.S. importers pay tariffs and pass some or all of them to consumers, crowding out consumption. Also, 40% of U.S. imports are intermediate goods used in U.S. production causing tariffs to have a much broader impact versus the perception they only affect finished goods.

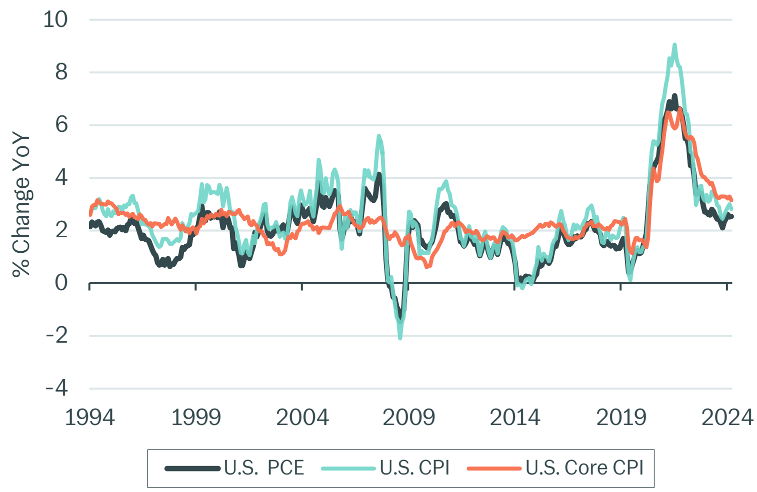
Top Global Suppliers to Amazon.com (2024)



Source: Apollo.

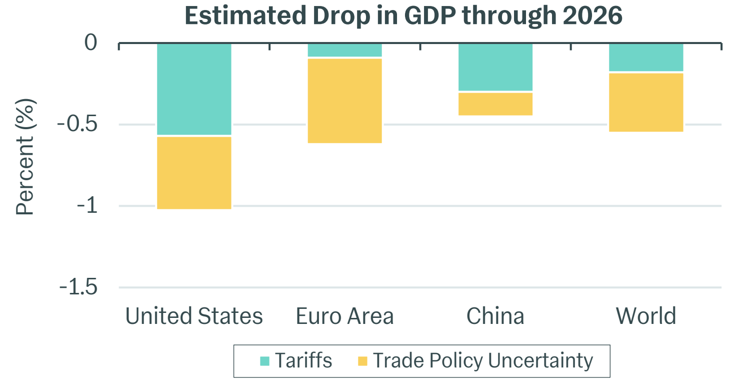
Potential for negotiations and less uncertainty. Since the April 2 tariff rollout in the Rose Garden, there are indications there is room for compromise and movement toward restructuring relationships with our trading partners. In mid-April, China opened up the possibility for trade talks after the U.S. removed tariffs on electronics and car parts. Canada is stepping away from tariffs on U.S. car parts. Europe is pausing retaliatory tariffs for 90 days after threatening to hit U.S. services (banking, digital platforms) as well as goods. With that said, negotiating and reaching agreements with 90 trading partners in 90 days is a tall order. The more likely scenario is high-profile announcements of agreements in principle with details to be worked out.

U.S. Inflation



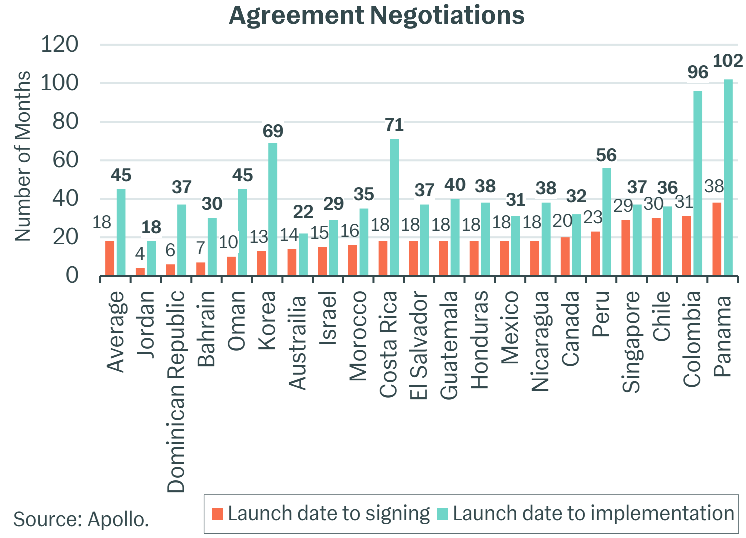
Source: Ycharts, Morningstar.

Impact of Current Tariffs: Estimated Drop in GDP through 2026



Source: IMF, JPMorgan.

It Takes Time: Duration of U.S. Free Trade Agreement Negotiations



Source: Apollo.

Unless they are reversed or watered down, the Administration's policies indicate the potential for higher inflation in the short-to-intermediate term, greater U.S. debt, and continued uncertainty which suggest a mixed bag for the equity markets but likely headwinds for U.S. Treasuries and the bond markets.

The Trump administration has said it is playing a longer-term game—one that involves taking some short-term pain in order to reshape the global trade regime and to set up a more favorable political and economic environment for the U.S. later. If executed effectively, this could be a case study in political and economic engineering—one that delivers a strategic reset and market resurgence. If the plan goes awry, however, it risks undermining confidence in both the U.S. economy and the Administration itself.

While the likelihood of success of the plan's first phase remains in question, the Trump administration is pursuing a number of policies it says are intended to offset the drag of tariffs and aggressive immigration policies on economic growth. Tax cuts, which must be addressed in 2025 as the 2017 tax cuts expire, and deregulation are each potential pro-growth policies.

Financial Market Implications

Global Equities. Over the past decade, high profitability and growth—especially among globally oriented U.S. tech giants – drew massive capital inflows to U.S. markets. These firms, whose profit margins are roughly double that of the broader S&P 500, dominated investor allocations.

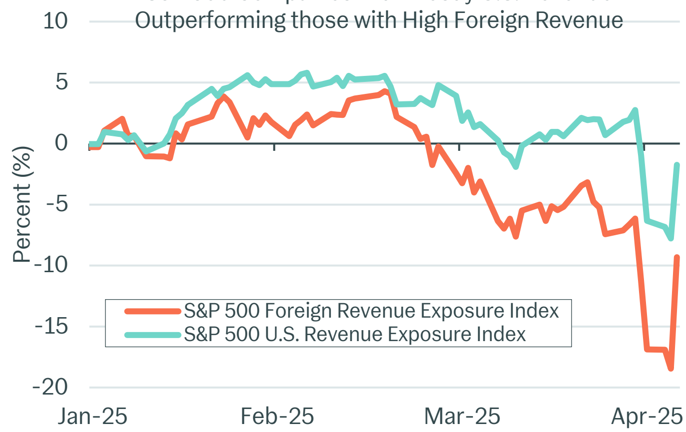
Today, however, rising trade barriers and geopolitical uncertainty are driving a shift toward what some call "national capitalism" – a model focused on domestic self-sufficiency and regional integration. This shift reinforces our 2022 thesis of a fragmented, multipolar world and supports the case for increasing opportunities for investments in non-U.S. markets.

Tariffs may now be accelerating a secular change in market leadership. Within the U.S., companies with mostly domestic revenues and operations have begun to outperform those exposed to global trade flows. The second order negative effects of the tariffs is the potential for non-U.S. businesses and consumers to begin shying away from U.S. products AND services (including those offered by our mega-cap technology companies) thereby putting their top- and bottom-line growth at risk.

Globally, while the U.S. retains structural advantages of scale and innovation, the near-term outlook is softening amid tariff-related headwinds. In contrast, foreign economies—particularly in Europe—have surprised to the upside. Stepped-up spending on defense and growth initiatives, combined with a weaker dollar, could further boost returns on foreign equities if capital continues flowing abroad.

Big Divergence in Stock Performance

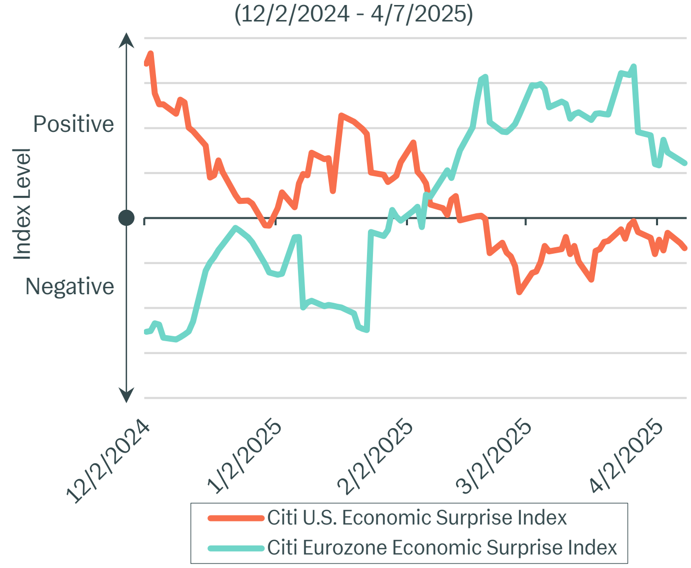
S&P 500 Companies with Mostly U.S. Revenue Outperforming those with High Foreign Revenue



Source: Bloomberg.

Economic Surprises Indexes: U.S. vs. Eurozone

(12/2/2024 - 4/7/2025)



Source: Bloomberg, Bespoke Premium.

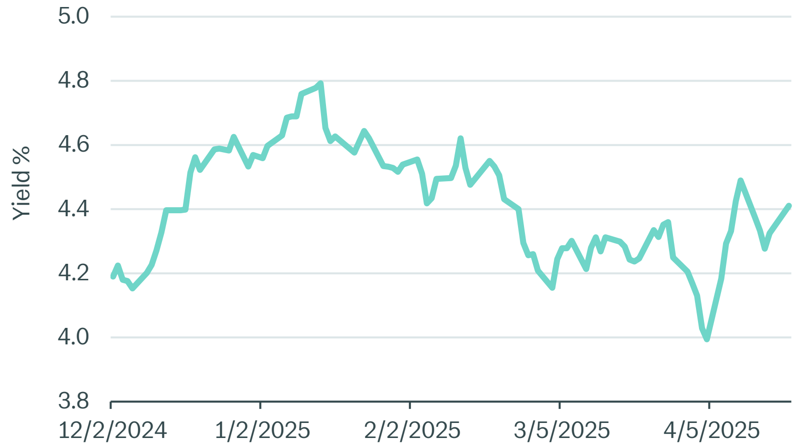
LNW portfolios have long maintained global diversification across the U.S., developed, and emerging markets. As we've noted in prior Commentaries, foreign equity valuations have remained attractive – and with signs of stronger growth abroad and possible weakness in U.S. mega-cap tech, that value may finally be getting noticed.

Fixed Income

We believe the bond markets are often the best early indicator of potential market turbulence and that has certainly held true recently. During the week of April 7 – 11, the yield on 10-year U.S. Treasury bonds soared 50 basis points. This was a historically rapid increase and stoked fears of foreigners selling off U.S. Treasuries.

As stated earlier, our conversations with asset managers indicate the fears may have been overblown as the selling was mostly due to technical reasons. Bond yields have since stopped rising and are actually closer to where they were before the tariff announcement although still volatile day to day.

10-Year U.S. Treasury Yield
as of 04/21/2025



Source: Bloomberg.

Municipal bonds have been among the weakest fixed income performers during the recent market volatility. Munis often lag in times of economic pessimism on investor concerns about local and state tax revenues tied to consumer spending, income growth, and real estate values – all of which could decline in a recession.

At the same time, state and local issuers are contending with federal budget cuts that have opened unexpected funding gaps. To cover shortfalls, they're issuing more debt – adding supply just as seasonal tax-related selling pressures mount. While widespread defaults remain unlikely, this increased supply could weigh on muni performance in the near term.

Longer term, however, tax-exempt bonds are likely to continue offering strong after-tax returns, making them a core component of LNW portfolios. Today's elevated yields further support continued allocation.

The Path Forward

Despite near-term volatility, key structural investment themes remain intact, including AI-driven transformation, infrastructure, and global diversification. AI continues to progress into its second derivative phase, with the potential to reshape industries from healthcare to logistics through meaningful productivity gains, even if near-term monetization remains unclear.

Meanwhile, U.S. infrastructure spending and Europe's rearmament push – what we've called "Europe's Marshall Plan 2.0" – highlight a broader global shift. Germany's €500 billion commitment (which required a constitutional amendment) and the EU's €800 billion collective defense plan point to a decisive move away from U.S.-centric growth and toward regional self-reliance.

There are signs that market movements can influence U.S. policy trajectory. A sharp spike in Treasury yields was quickly followed by a pause in reciprocal tariffs. Similarly, the sell-off in Apple and other tech names coincided with the administration backing off additional tariffs on Chinese electronics. Importers, large and small, have warned that tariff uncertainty is clouding earnings projections and delaying investment. Some Republican lawmakers are now openly questioning the policy path.

The challenge is managing through the short-term policy fog without losing sight of your long-term investment plan. In this environment, disciplined capital allocation, thoughtful diversification, and active rebalancing remain essential. Below are the portfolio exposures we have in place to mitigate risk and capture opportunities. Of course, LNW wealth managers customize portfolios for each client's circumstances, meaning exposures can and will vary by client.

Potential Risk Mitigators

- **Cash allocations.** Over the last several months, we have been topping up cash allocations where appropriate and rebalancing portfolios as part of ongoing risk management. Shorter maturity bonds and cash equivalents offer a similar yield relative to intermediate maturities and, given elevated interest rate volatility, could provide additional ballast.
- **High-quality fixed income and diversifiers** (especially core hedge fund exposures). Both have performed relatively well in the equity market selloff, and we expect they will continue to do so should investors grow increasingly more risk-averse, and the selloff continues.
- **Real assets.** We continue to recommend core positions in real assets, which are specifically included in portfolios as inflation-risk mitigators as well as potential contributors to risk-adjusted returns. Given the potential for accelerated inflation, these exposures have also provided ballast to portfolios and remain attractive.

Potential Risk-Adjusted Return Enhancers

- **Non-U.S. exposures.** We maintain globally diversified equity portfolios. These strategic non-U.S. exposures have increased in importance given the apparent reengineering of the global trade framework possibly leading to stronger performance by non-U.S. stocks. With that said, we are not recommending major shifts as the recent intra-day market volatility underscores a high level of uncertainty regarding tariff policy.
- **Diversifiers.** Private credit and select hedge fund exposures can not only dampen volatility in portfolios but, in some cases, can take advantage of dislocations by providing liquidity at attractive terms to those investors seeking it.
- **Private Equity.** In private equity, middle-market domestic firms may be in a stronger position to navigate the changes in trade policy and may benefit from deregulation and tax reform in the second half of 2025.
- **Special opportunities.** Back in January 2022, we noted that reshoring would be an important secular trend. Going forward, there are likely to be additional opportunities for our managers to invest in public and private markets that are supported by a shift to a multi-polar global trade regime.
- **Portfolio management.** Thoughtful rebalancing and tax-loss harvesting following market inflection points ensures portfolios offer the targeted risk profile needed to achieve client goals, setting portfolios up for success in the years ahead while also reducing the potential drag of taxes.

ABOUT THE AUTHOR

Ronald G. Albahary, CFA® is Chief Investment Officer at LNW. As head of the investment team (see below), Ron determines the firm's investment strategy, directs the investment selection process, and works in tandem with client advisory teams to deliver investment solutions structured to attain each client's unique goals. Prior to joining LNW, Ron served as CIO or CEO at regional investment firms focused on ultra-high-net-worth families and foundations. Earlier in his career, he held leadership positions in the private client business of major global financial institutions, including Merrill Lynch and Northern Trust Private Bank. Ron has a degree in economics from the Wharton School at the University of Pennsylvania and currently serves as advisor to the Center for High Impact Philanthropy at the University of Pennsylvania.

The LNW investment team is comprised of 12 analysts and strategists working together to design and implement investment solutions for client portfolios. Six analysts at the firm hold the Chartered Financial Analyst® designation, with expertise spanning macroeconomics, public and private asset classes across the global capital markets, and impact investing. Collaborating with each other and with client advisors, the investment team's overarching goal is to help clients and their families preserve and grow their wealth over many generations.

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