ASSET MANAGEMENT VIEWPOINTS

CARY STREET PARTNERS

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Tariffs: Risk or Nonevent?

> **Keep an eye on the bottom line.**

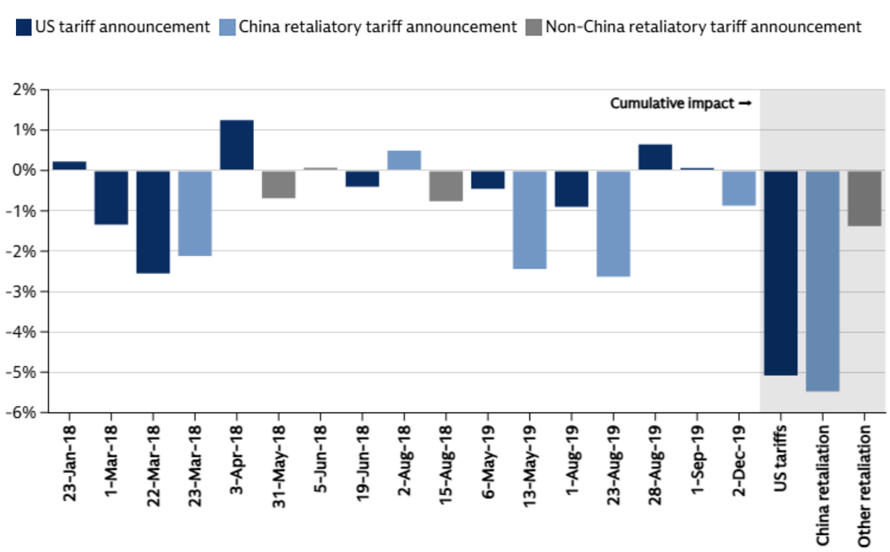
That is the takeaway for investors currently navigating the ubiquitous narrative surrounding potential widespread tariff policy. Setting aside the stagflationary implications of widespread tariff imposition, investors should focus on earnings impact. Stagflation is an economic situation of higher prices coupled with lower growth. Earnings expectations are the most important fundamental input to stock prices. Current 2025 earnings expectations are strong and rising. The downside risk to stocks is that tariffs — if they come about — would create a drag on those expectations.

Handicapping an outcome on potential public policy is very difficult. Markets are showing fatigue on the issue. Conviction has built the idea that levies are more of a tactic than an end in themselves. The dollar has weakened recently, but would almost certainly strengthen if widespread tariffs were imposed. The outcome in this case is very binary, composed of only two possible results: all or nothing. Markets are terrible at pricing this type of outcome until it happens. The market reaction to COVID-19 in 2020 is a good example of this dynamic. Despite U.S. cases emerging in early January, the market kept rising until February 19th, at which point a full-fledged health emergency was in flight. With said backdrop, risk-averse equity investors should consider hedging or adding commodity exposure.

Current S&P 500 earnings expectations for 2025 are for an increase of approximately 13%, ahead of 2024's expected increase of around 10%. Leaning on research from David Kostin's group at Goldman Sachs, every 5% increase in U.S. tariffs would cut S&P earnings per share by roughly 1% to 2%.

A notable offset to a tariff-induced drag could come from a reduction in the corporate income tax rate, which also goes straight to the bottom line, in this case, creating a positive impulse. Any such reduction would have to come through the budget process, which looks like it would take place further into 2025.

Historical S&P 500 Reaction Following Tariff Announcements



Source: Haver Analytics, Goldman Sachs Research

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