Investment implications of the Trump tariffs for clients of Douglass Winthrop
April 6, 2025

We write to offer our thoughts on the tariffs announced April 2 by the Trump administration and implications for investors. The tariffs, including an immediate 10% tax on all imported goods and higher rates on individual countries, are the highest in over a century and, according to *The Economist*, would represent a weighted average tariff rate of 24%, up from the 2% level that has prevailed for the past 25 years – a period of staggering productivity gains and wealth creation for Americans. Economic reporting in real time lacks the perspective of history, but it is already clear that the tariffs will have profound effects on markets, the U.S. economy and the rules-based trading system that has prevailed since the Smoot-Hawley tariffs of the 1930s. Absent a reversal of this self-inflicted policy crisis, the U.S. is likely to slip into recession and re-learn the painful truth that protectionism does not create wealth.

While we hardly ever refer to short-term investment results, we start on a reassuring note: most of our clients' portfolios are performing well year to date, with our equity composite returning **+3.1%** (gross of fees, +2.9% net) through March 31, 2025; by comparison, the S&P 500 returned **-4.3%** for the quarter. After the market's steep declines Thursday and Friday, which erased nearly $6 trillion in market capitalization and brought the S&P 500 index to its lowest level in more than a year, our clients' portfolios extended their performance advantage vs. the market. Reasons for our strong relative results were cited in our January 2025 investment letter, wherein we expressed concern over the stock market's valuation and highlighted international stocks as havens of value. Large positions in companies including Nestle and Berkshire Hathaway provided shelter from the carnage afflicting stock markets this year.

Ours is a strategy fit for this moment of unpredictable and, in our judgement, flawed economic policy making.

An historic context

Comparative advantage, an economic principle articulated in 1817 by David Ricardo, posits that countries should produce what they can make at the lowest opportunity cost and trade for the rest. While this ideal state of economic affairs generates *trade deficits* for countries that buy more goods overseas than they produce domestically, it creates wealth for consumers and businesses when supported by strong economic fundamentals. American shoe companies that outsource production to Vietnam use capital that would otherwise be invested in manufacturing to innovate and develop marketing and distribution. Likewise, Nvidia designs advanced computer chips which are manufactured in Taiwan, and Starbucks markets coffee sourced from countries near the equator. Allocating economic activity based on comparative advantage has been the most efficient system ever deployed to create wealth and raise living standards.

As the U.S. economy has relied less on domestic manufacturing, resources have been directed toward higher value services such as technology, medicine and education. Inevitably, this shift in economic activity has caused disruption and a widening wealth gap between knowledge workers and those left behind as manufacturing has moved offshore. Capital flows into the U.S., seeking investment in high-tech industries and safe assets like U.S. Treasuries, have strengthened the trade-weighted dollar, further challenging the competitiveness of U.S.-manufactured goods abroad. Tariffs are a means to address these imbalances and, in the view of the Trump administration, a cost-free way to raise revenue to reduce our national debt and associated interest expense, which now exceeds spending on national defense.

Laudable as these goals are, the costs of tariffs – measured in higher prices (and fewer choices) for consumers, less innovation and weakened international alliances – are higher than the administration suggests. In the short run, consumers will pay more for goods from coffee to cars as companies struggle to absorb higher input costs. Shielded from competition, companies will innovate less with predictable declines in product quality. Policy uncertainty will almost certainly cause corporate leaders to scale back capital investment and job creation, increasing the likelihood of a recession. Longer term, the administration's penchant for deal-making strengthens the hand of politicians at the expense of the free market and erodes a bipartisan consensus for private sector-led trade and rules-based economic policy. America's adversaries will benefit from the perception that the U.S. is no longer a reliable economic or strategic partner.

Investment outlook and advice

In our September 2022 note to clients (*A Case for Owning Quality Stocks)*, written as inflation was rattling financial markets, we urged clients to resist the temptation to sell stocks. Quoting from that note: "the timeless tension between greed and fear amplifies swings in market prices in the short run and causes investors to misallocate capital… Tempting as it may be to time these unhappy periods by selling stocks in hopes of buying back after the storm has passed, that exercise is futile and potentially costly. No one – not Warren Buffett or the investment strategists opining on financial news networks – can reliably time the market." Stay invested, we urged our clients, especially when panic reigns.

Today, as then, the immediate outlook for stocks is unknowable. We do not discount the threat posed to markets and economic growth by tariffs and the transactional way they are being implemented; economic prospects have darkened, and markets will be volatile. An even steeper decline in stock prices looms if Congress or business leaders fail to moderate the worst aspects of the tariff program. However, our confidence in the intrinsic value of our portfolio companies is unchanged. Over time Costco will drive value for its members, MasterCard will process ever more payments, Berkshire will sustain its fortress balance sheet, Nestle will distribute food to the world's fastest-growing populations. Common stocks, augmented by short term, investment grade bonds where appropriate, should be the core of one's long-term investment portfolio, now as always.

Rather than attempt to predict the movement of stock prices or react to news headlines by selling (or buying) stocks, we urge our clients to focus on asset allocation. Your balance between common stocks, fixed income, cash and other assets should reflect your priorities for growth, income and volatility. If you need cash in the next 12 months, you should have that amount in money market funds or Treasury securities, but we urge our clients to resist the temptation to act based on the latest news headlines, unsettling as they may be. Your advisors at Douglass Winthrop are among the most seasoned and experienced professionals in our industry, and we are standing by to help you understand and navigate the markets, keeping your interests and goals paramount as always.

Douglass Winthrop Advisors LLC