First Citizens Wealth™

Making Sense

Basis Points | May 6, 2025

Markets Rebound, Uncertainty Remains

1. State of Play

Markets remain fixated on US tariff policy. A month ago, the US raised the average tariff rate to over 20%, ten times last year's level and the highest rate since before the Sixteenth Amendment in 1913 allowed Congress to collect income taxes. New tariffs comprise four main categories: a 10% baseline tariff on nearly all imports, an extra country-by-country "reciprocal" tariff of up to 50%, a 25% tariff on autos and metals, and a 145% tariff on imports from China. Early effects of tariffs on the economy and markets are unfolding but difficult to pin down. The government already collected $17 billion in tariff revenue in April, up from $8 billion in the same period in 2024, and companies are citing the potential for higher costs and lower earnings.[i] **What remains very unclear are the longer-term implications for economic fundamentals and corporate profitability.**

2. Round Trip

US and global equities have been extremely volatile. The S&P 500 fell 12% within a few days of the April 2 tariff announcement and was down 19% from its February 19 all-time high, just short of the official 20% "bear market" indicator.[ii] International equity markets followed similar patterns: all the major international indices sold off by at least 10% through early April on the back of global tariff turmoil. While Hong Kong and Chinese stocks were still down 3%, every other major developed-market equity index recouped losses in the month after the April 2 announcement. Over the last month the US has softened its tariff stance on balance by exempting some products and moving toward trade negotiations. **But if reality falls short of the high expectations for these negotiations, then we would expect equity market volatility to continue and another significant selloff to likely materialize.**

3. Cloudy Data

Official economic data releases like GDP and employment are backward looking and less helpful than usual in evaluating the outlook. Instead, many analysts are favoring soft data like surveys and sentiment indicators, which often lead the hard data but not always reliably, especially during periods of high uncertainty. These readings have weakened noticeably as businesses and households adopted pessimistic views about the outlook compared to earlier this year. **Markets trade on both the hard and the soft data, and the fact that neither currently provides a clear view of the outlook is another reason we expect volatility will persist.**

4. Companies Contend with Uncertainty

The outlook for equities depends not only on how today's policy shock affects the US and global economy but also how businesses respond with their supply chains and pricing strategies. Companies are facing a host of difficult questions. How long will tariffs remain in

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place, and how steep a cost will they impose on the bottom line? Is it possible to raise prices in response to higher costs, or will it be necessary to take a hit to margins? **With such extreme uncertainty, several large US companies have taken the step of withdrawing guidance during their quarterly earnings releases.** Management teams are waiting for the rules of the road going forward, and many companies remain in a 'wait-and-see' posture.

5. Beyond Tariffs

Tariffs are not the only story markets are watching. Markets are priced for the Fed to cut interest rates by 0.75% this year, even as today's policy shock likely puts pressure on both sides of the Fed's "dual mandate" by pushing both inflation and unemployment higher. **In addition, tax policy is about to take a significant place in the market outlook as several major provisions of the 2017 Tax Cuts and Jobs Act are poised to expire.** The consensus view seems to be that these cuts will be extended if not enhanced, but historically narrow margins in the House and the uncomfortable reality that federal spending is higher year-to-date compared to 2024 could complicate passage of a law that further increases the deficit.

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[i] Source: Treasury Department

[ii] Source: Bloomberg. This list includes the US S&P 500 and Nasdaq, the Eurozone EURO STOXX 50, the British FTSE 100, the French CAC 40, the German DAX, the Japanese NIKKEI, the Hong Kong Hang Seng, the Chinese CSI 300.

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