RJL PCS: MARKET PERSPECTIVES

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Market Perspectives: The Week After Liberation Day Takes Markets on a Roller Coaster Ride

What a week! Markets sold off dramatically since last week, in response to the U.S. reciprocal tariffs announced on April 2 that were far higher than anyone expected. Then, the U.S. and China started multiple rounds of escalating responses to each other, before a 90-day pause was announced on the 60 countries that faced tariffs of up to 50%, although a base rate of 10% on most countries remains in place.

As we walk through the following sections, explaining how we got here and what might happen next, the takeaway is that the environment is so uncertain and dynamic that investors need to remain focused on their long-term plans, including return objectives, asset mix and positioning that is appropriate for their risk tolerance. While the following days, weeks, and months, could be sometimes gut-wrenching in financial markets, most investors have an investing horizon that outlives one political administration or economic/market cycle, and should be positioned accordingly.

What just happened?

To recap, President Trump had just enacted 'reciprocal' tariffs on 60 countries, of up to 50%, and above the 10% base rate tariff on most of the rest of the world, before announcing a 90-day pause on implementing the higher rates on all countries except China. After this initial plan was detailed on April 2, what President Trump termed 'Liberation Day', stock markets around the world went on a roller coaster ride, alternating between dismay at the potential for a global economic slowdown, U.S. recession, and inflation, versus the expectation of this mostly being a negotiation tactic, with concessions from various governments and short-term off-ramps allowing the President to defer, lower, or remove these tariffs. This volatility might have been best exemplified on April 7, when a social media post erroneously claimed that President Trump was considering a 90-day deferral to the April 9 implementation. After two solid days of stock market declines, Monday started with another 3% drop at the opening on the S&P 500 before the post on X prompted a global sigh of relief and an 8% jump in the key index within minutes before a denial from the White House sent the market right back down, to end the day off 0.2%. The most significant follow-up has been back-and-forth escalation between the U.S. and China, which, as of this writing, has pushed the 'reciprocal' rate on China up to 125%, with retaliatory tariffs on U.S. goods entering China now at 84%, with the ball back in China's court.

Reciprocal tariffs are actually about trade deficits

To set the record straight, we should acknowledge that the 'reciprocal' tariffs that were announced on April 2 were not based on the tariff rates in the targeted countries, against U.S. goods, as was expected. Instead, the calculation used by the U.S. was actually all about the trade deficits that the U.S. has with each country. That is, if the country exports more into the U.S. than it imports from the U.S., that's a trade deficit from the U.S. perspective, which is why many developing countries were hit with high tariff rates. They generally produce inexpensive goods that the U.S. consumer, or industries, want access to, but the population in that country is likely not affluent enough to purchase the more expensive goods, like machinery or aircraft, that the U.S. exports. This trade deficit was then divided by the value of goods that the U.S. exports to each country to achieve a ratio, that was then represented as the 'tariff charged to the U.S.A., including currency manipulation and trade barriers', before the U.S. government then took that ratio and divided it by half to determine its 'reciprocal' tariff to be applied against each country. Using this logic, certain countries that the U.S. actually sells more to than it imports from, creating a U.S. trade surplus, like the U.K. and Australia, would have therefore had a negative ratio, but those were rounded up to the 10% base rate anyway.

Reciprocal tariff rates shocked everyone

Most onlookers to this process were shocked at the reciprocal tariff rates, likely because they had been building forecasts on actual tariffs that countries charged on U.S. goods, and then estimating what additional factors, such as value-added taxes, or a number representing non-tariff barriers, like Canada's supply management system, might be layered on top of those. Markets quickly reacted to the perceived excessive taxes, expecting that this would significantly impact global trade, increase prices for American consumers, and increase the likelihood of a U.S. recession and global economic slowdown. Global equity markets proceeded to decline.

Please read domestic and foreign disclosure/risk information beginning on page 5

How can countries negotiate these rates down?

So far, before the 90-day pause was announced, we have seen countries such as Vietnam offer to cut their tariff rates on U.S. imports to zero (from 12%), and for the E.U. to similarly cut their rates on industrial goods to zero, but these offers have been rejected by the U.S. administration. It would appear that the U.S. is seeking more comprehensive offers to rightsize these trade deficits, or to be otherwise compensated. One could imagine that commitments to purchase goods, such as perhaps U.S. military equipment in massive quantities, to offset these trade deficits would be one such avenue, which would also appease other issues such as NATO spending targets, but considering that countries that the U.S. already has a trade surplus with were not spared from Liberation Day tariffs, there may be other factors to consider.

Another consideration is that President Trump seems to be looking for a dependable stream of revenue (over the next 10 years) from these new taxes to offset tax cuts that he wants to put into the budget. If the tariffs are negotiated away, he will have less leverage with Congress. There is also the conflicting objective of this increased tax revenue, in that if companies do relocate manufacturing to the U.S., as President Trump is suggesting, that tariff revenue would decline. This falls into a 'you can't have your cake and eat it too' type scenario.

Canada and Mexico were relative winners

It would definitely not be correct to say that Canada and Mexico are unaffected by the unfolding tariff tsunami, but Liberation Day did at least not unleash any additional damage, and in fact clarified some treatment under the USMCA trade agreement that could put the countries in a better position than many other trading partners, at least within certain industries and for the immediate future. Goods that are certified as USMCA-compliant, will remain exempt from U.S. tariffs. This currently represents approximately 40% of goods that Canada exports to the U.S., although we expect this rate to roughly double as companies rush to attain certification on goods that were previously otherwise subject to minimal or zero tariffs. Goods that are not USMCA-compliant will be subjected to the rates established in the original 'fentanyl-driven' tariff executive order of 25% on goods other than energy-related products that are subject to a 10% rate. President Trump has suggested that progress on fentanyl and immigration could result in that 25% rate being reduced to 12%. While this was a substantial relief compared to what could have been in place if Canada had been subjected to additional reciprocal tariffs, Canadian businesses are still subjected to other sector-specific tariffs, which include automobiles, auto parts, steel, and aluminum so far.

China and the U.S. escalating

While several countries have implemented modest retaliatory tariffs, China and the U.S. have set off a round of one-up-man ship. The U.S. has imposed and maintained tariffs on various goods from China for a long period, but the U.S. added a new round this year when it first imposed a 10% tariff on China at the same time it announced the first round of 25% tariffs on Canada and Mexico. After China retaliated with 10-15% tariffs on certain U.S. goods, President Trump slapped back with an additional 10%, to bring the level to 20%. When the April 2 package was announced, the U.S. added another 34% to bring the country rate up to 54%. On April 4, China matched that 34% rate. Then, on April 8, President Trump further upped the ante with another 50% tariff on China, bringing the rate up to 104%. Not to be outdone, China matched that increase with a 50% boost of its own to bring its rate up to 84%. The latest move so far has been a further escalation by the U.S., to 125%, while simultaneously giving all other 59 countries subjected to the higher reciprocal tariffs a 90-day reprieve.

Uncertainty may be a good negotiating tool, but it's not good for business

The big question is how long these tariffs may stay in place (if or when they are eventually implemented), and how much damage could be inflicted on the U.S. and other economies as a result. Messaging has been mixed as far as if these tariffs are expected to be permanent or if they could be negotiated down or away completely in the near future. The longer this uncertainty persists, the more damage will be done. While tariffs can cause significant economic damage on all parties, uncertainty can also result in businesses deferring investments, pausing planning for the future, and/or putting off hiring, until the playing field and rules are better established and understood.

While President Trump has created uncertainty with past actions and rhetoric, if we look at the desired outcome of bringing more manufacturing jobs to the U.S., we have to assume that the bias will lean towards tariffs being in place for the longer-term. If companies are expected to relocate manufacturing plants, which could take years and millions or billions of dollars in investments, while also giving up supply chains that may have taken years of perhaps decades to establish, they would have to be convinced that these new barriers to business will be around for the long-term. If there is the expectation that tariffs must just be tolerated for months or perhaps just a few years, it may be more cost-effective to either deal with the tariffs, as implemented, or just shut certain production lines that are uneconomical. For other products that are currently supported by lower-cost labour in other countries, manufacturing might only be moved if it can be automated, and therefore might not significantly improve the jobs picture in the U.S., or will just result in higher costs for the consumer. If these efforts are successful at bringing more manufacturing jobs to the U.S., we could also question where the workers are going to be found. The U.S. currently has a historically low unemployment rate of 4.1%.

Tariff impacts on the economy and inflation

There is a rule of thumb that allows you to estimate the effect of these tariffs on economic growth and the inflation rate in the U.S. If we look at the tariffs collected on all the imports, you get the average effective trade-weighted tariff. Last year, this tax rate was 2.5%. Now, with the April 2 announcements, on top of the other country and sector specific announcements so far, we estimate that the rate will increase to 22.5%, a level not seen in over 100 years. The rule of thumb suggests that a 1% increase in the average tariff rate will decrease economic growth by 0.1% and increase inflation by 0.1%. This 20% increase would therefore translate into a 2% impact to GDP and 2% increase in the inflation rate. This analysis did not include the most recent tariff escalation on China. If we include a rough estimate for that impact, plus other sector-specific tariffs that have been hinted at, including on semiconductors, pharmaceuticals, and minerals, the average effective tariff rate could be over 40%.

With the expectation that the April 2 tariff levels will be walked back or negotiated down, and with only a partial year impact in 2025, our U.S. economics team is lowering our GDP growth forecast for this year from +2.4% to +1.0%, with a 50% chance of a U.S. recession, and our core PCE inflation target goes from +2.4% to +3.5%. The 90-day pause was announced after these forecast revisions, and so might provide further relief as the dust settles. For Canada, we are looking forward to the Bank of Canada's April Monetary Policy Report, to be released with the April 16 interest rate announcement, for updated insights into the impact of announced tariffs on the Canadian economy.

Impact to stock markets and year-end targets

We entered 2025 with the expectation of good earnings growth, but more muted index returns on the S&P 500 and TSX Composite, after a great 2024. Inflation was returning to the 2% target, the central banks were in easing mode, and although DeepSeek cast some doubt on how the A.I. rollout might progress, enthusiasm remained solid for the continuation of that build-out and as we saw more and more companies and sectors expected to improve their efficiency and profitability. Life was good. Markets also had a boost after the U.S. election with the promise of lower taxes and deregulation.

Although tariffs had always been a part of President Trump's platform, most onlookers expected minimal real impacts as these threats would be used to extract various concessions from various countries or industries. Almost no one was really ready for the turbulence that would ensue as the threats and then implementations came fast and furious, with questionable justifications, delays, deferrals, and escalations to any retaliation. As the April 2 tariffs were announced, the seriousness of the real impact prompted revisions to economic growth forecasts and profitability expectations. As we embark on 1Q25 earnings season, we can likely expect companies to withdraw or expand guidance ranges, and to stress the difficulties in operating in such an uncertain environment.

Our U.S. team has reduced their forecast for 2025 EPS from the S&P 500 from US$270 to US$250-255 due to tariffs impacting input costs and therefore profit margins, as well as sales growth reductions as the economy slows. The hardest hit sectors are consumer discretionary, materials, and industrials. With that EPS forecast revision, our year-end target for the S&P 500 goes from 6,375 to 5,800. These forecasts were also revised prior to this 90-day reprieve.

For Canada, a key consideration is the impact to our export markets into the U.S., which will be negatively impacted in general if the U.S. economy slows, and for sectors that will still be impacted by sector specific tariffs and non-USMCA-compliant products. We expect to have more insights into many of these factors as we review the Bank of Canada's April Monetary Policy Report, and as we see revisions to analyst estimates through 1Q25 earnings season. For now, we maintain the year-end target of 26,300 on the TSX Composite that we established in January and note that the TSX Composite is outperforming the S&P 500 by 5-6% YTD.

Key takeaway for investors

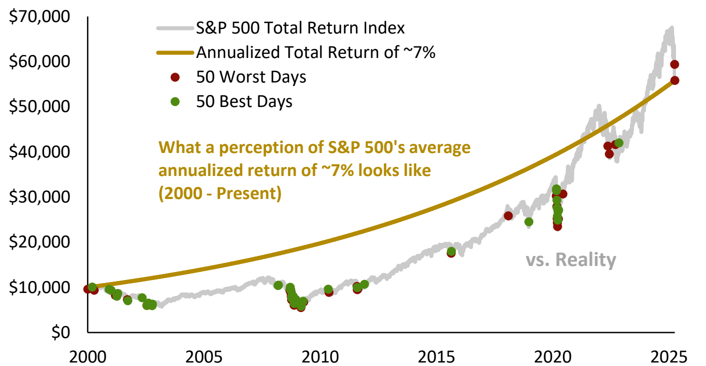
After the two-day market meltdown following April 2, with significant declines of 10.5% on the S&P 500 and 8.4% on the S&P/TSX Composite indices, recent movements have highlighted the extreme volatility in the current market. On one hand, investors are panicking about the potential damage from the steepest American tariff plan in a century. On the other hand, the solid fundamentals of the U.S. economy (if one looks past the tariff impact) have led investors to rush into the market at any sign of positive developments, fearing they might miss out on buying opportunities during this dip.

While it's encouraging that optimism around the North American market persists, there are still no clear indications of how or when the tariff chaos will conclude. We currently anticipate a wide range of possibilities in the market. However, what remains foremost in investors' minds is how to manage their portfolios during these volatile periods. The short answer is to stay invested and diversify investments. Over the decades, adopting a longer investment horizon and maintaining a diversified portfolio have proven to be effective strategies for navigating market volatility.

Why stay invested?

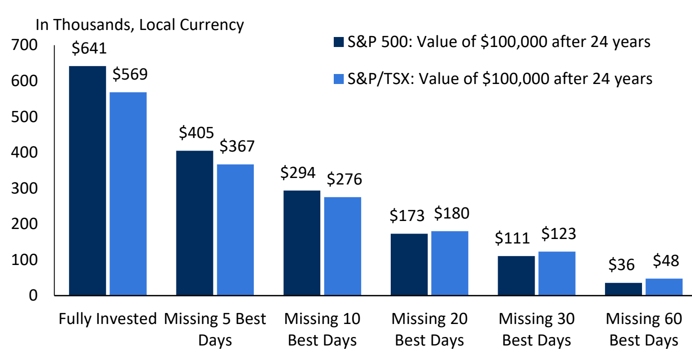
1. Market's best trading days tend to occur shortly after the worst trading days (Chart 1)
2. A significant portion of long-term gains are contributed by a relatively small number of good days (Chart 2)
3. Markets tend to normalize over time, thus longer investment horizon reduces the volatility of returns (Chart 3 & 4)
4. Diversification remains important as the performance of various asset classes can vary significantly from year to year (Chart 5)

Chart 1 - Best Days Tend to Follow Worst Days



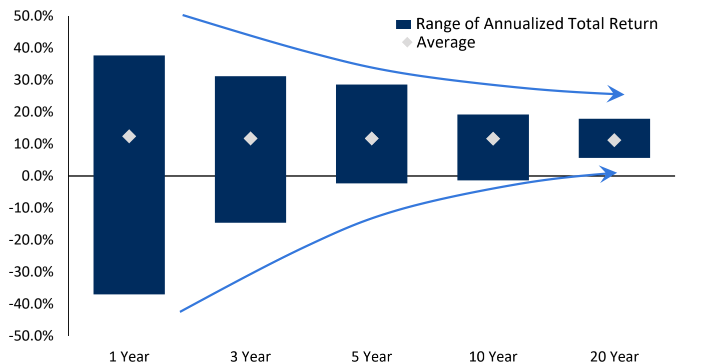
Source: FactSet, Raymond James Ltd.; Data as of April 4, 2025. Initial investment of US$ 10,000 on January 1, 2000.

Chart 2 - Missing the Best Days



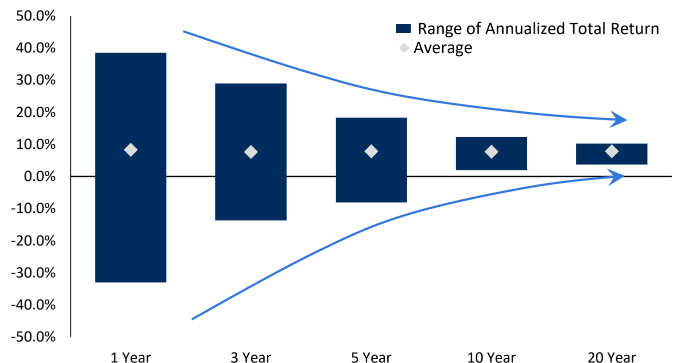
Source: FactSet, Raymond James Ltd.; Data as of December 31, 2024. Initial investment of $100,000 on January 1, 2000.

Chart 3 - Range of Return by Investment Horizon - S&P 500



Source: FactSet, Raymond James Ltd.; Date range: 1/1/1973 – 12/31/2024. 3-, 5-, 10-, 20-year annualized total returns are calculated on a rolling basis. Returns are listed in local currency.

Chart 4 - Range of Return by Investment Horizon - S&P/TSX Comp



Source: FactSet, Raymond James Ltd.; Date range: 1/1/1973 – 12/31/2024. 3-, 5-, 10-, 20-year annualized total returns are calculated on a rolling basis. Returns are listed in local currency.

Chart 5 - Benefits of Diversification

2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	YTD
U.S. Large Cap Equities 21.59%	Cdn Equities 21.08%	EM Equities 28.26%	U.S. Large Cap Equities 4.23%	U.S. Large Cap Equities 24.84%	U.S. Large Cap Equities 16.32%	U.S. Large Cap Equities 27.61%	Cdn Money Market 1.82%	U.S. Large Cap Equities 22.90%	U.S. Large Cap Equities 36.36%	DM Equities 6.94%
DM Equities 18.95%	U.S. Large Cap Equities 8.09%	DM Equities 16.82%	Cdn Money Market 1.38%	Cdn Equities 22.88%	EM Equities 16.23%	Cdn Equities 25.09%	Cdn Equities -5.84%	DM Equities 15.07%	Cdn Equities 21.65%	EM Equities 3.00%
Balanced Portfolio 7.63%	Balanced Portfolio 7.53%	U.S. Large Cap Equities 13.83%	Cdn IG Corp Bond 1.10%	Balanced Portfolio 16.60%	Balanced Portfolio 9.96%	Balanced Portfolio 12.83%	DM Equities -8.23%	Balanced Portfolio 13.61%	Balanced Portfolio 18.71%	Cdn IG Corp Bond 1.81%
Cdn IG Corp Bond 2.71%	EM Equities 7.34%	Balanced Portfolio 10.40%	Balanced Portfolio -1.58%	DM Equities 15.85%	Cdn IG Corp Bond 8.74%	DM Equities 10.32%	Balanced Portfolio -9.61%	Cdn Equities 11.75%	EM Equities 17.25%	Cdn Equities 1.51%
EM Equities 2.04%	Cdn IG Corp Bond 3.73%	Cdn Equities 9.10%	DM Equities -6.03%	EM Equities 12.45%	DM Equities 5.92%	Cdn Money Market 0.17%	Cdn IG Corp Bond -9.87%	Cdn IG Corp Bond 8.37%	DM Equities 13.24%	Balanced Portfolio 1.08%
Cdn Money Market 0.63%	Cdn Money Market 0.51%	Cdn IG Corp Bond 3.38%	EM Equities -6.88%	Cdn IG Corp Bond 8.05%	Cdn Equities 5.60%	Cdn IG Corp Bond -1.34%	U.S. Large Cap Equities -12.16%	EM Equities 6.88%	Cdn IG Corp Bond 6.97%	Cdn Money Market 0.83%
Cdn Equities -8.32%	DM Equities -2.49%	Cdn Money Market 0.56%	Cdn Equities -8.89%	Cdn Money Market 1.65%	Cdn Money Market 0.86%	EM Equities -3.37%	EM Equities -14.28%	Cdn Money Market 4.71%	Cdn Money Market 4.92%	U.S. Large Cap Equities -4.20%

Source: Morningstar Direct. Total returns in $CAD as of March 31, 2025. DM: Developed Markets ex. U.S. & Canada, EM: Emerging Markets. Balanced Portfolio: 20% Cdn Equities + 25% U.S. Equities + 15% DM Equities + 5% EM Equities + 35% Cdn IG Corp Bond.

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