INVESTMENT SERVICES

Weekly Relative Value

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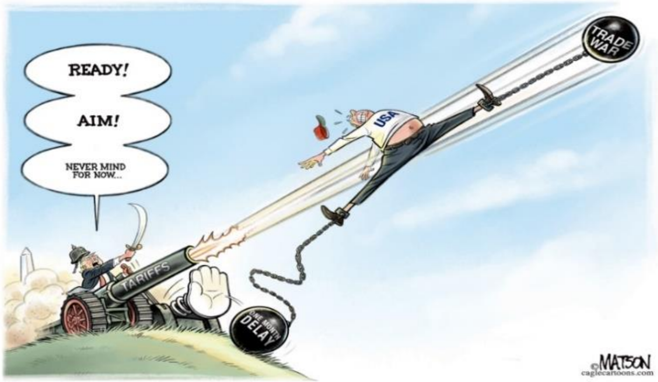
Tariff Torture

*“**There’s no room left for negotiations**.” - President Donald Trump*

Government policies impact spending, regulation and taxation which in turn affects consumption, business investment and overall economic growth. Thus, while mixing politics with economics and finance is always a dicey undertaking it is also necessary.

So, without further ado, let’s get into it.

The President seems to be having fun tormenting his southern and northern neighbors (and investors). However, there has never been anything quite like what we are seeing today. The alleged *“no room left for negotiations”* in the above quote was a month-long ploy to get whatever concessions Trump could from Mexico and Canada, and then ignore them. That game works about once.



Last Tuesday Trump went ahead with the 25% tariffs against Canada and Mexico. The full 25% tariff was on for ALL products except for energy, which saw a 10% boost. But get this — the 25% tariff already being slapped on steel and aluminum will be layered on top of this new sweeping 25% tariff. The tariffs on China are also set to double to 20%.

On Wednesday, less than 24 hours later, the following hit the headlines:

*“We are going to give a **one-month exemption on any autos coming through USMCA**…”*
- Karoline Leavitt, White House Press Secretary

THIS WEEK

- TRADE WARS ARE BAD AND EASY TO LOSE
- THE REAL REASON FOR TARIFFS
- THE DIE IS CAST
- KEEP YOUR EYES ON MARCH 14!
- LABOR CRACKS ARE WIDENING
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

The very next day (Thursday) news came out that Trump is poised to defer his blanket tariffs on Canada and Mexico for ALL goods and services covered by the USMCA until April 2. The Trump Administration exempted some imports from Mexico and Canada from the 25% tariffs, offering another one-month reprieve to goods covered by the USMCA.

You can't make this stuff up.

The matter, however, is far from resolved, as over half the goods imported from those countries aren't compliant under USMCA. Further the White House also says its much-touted reciprocal tariffs targeting nearly all U.S. trade partners are still in the pipeline. The details, they say, will be unveiled on April 2, with rates tailor-made to address whatever policies other countries impose that officials consider unfair — whether in the form of taxes on U.S. tech firms, value-added taxes or other import rules.

"It's a certainty – reciprocal tariffs are coming." – Peter Navarro, White House Trade Advisor

So, in a matter of two days, Trump said, *"tariffs are on, tariffs are off, tariffs are partly on and tariffs are partly off*." You don't know what's going on. Talk about a chaotic and, dare I say, amateurish approach. Executive orders are being signed in a whirling dervish fashion apparently without full consideration. Uncertainty has skyrocketed for companies and markets, with some questioning whether or not the U.S. government has a coherent policy.

"There is no plan."- Scott Lincicome, Vice President, Cato Institute

Bottom line: If you believe Trump tariffs are bluffs that won't happen (or if they do to any extent, they won't be a big deal), you need to wake up and smell the coffee. The turn down the dark alley of tariffs could lead to higher inflation, slower economic growth and a weaker U.S. dollar. It is an economic horror movie in slow motion.

TRADE WARS ARE BAD AND EASY TO LOSE

"***Trade wars are good, and easy to win."*** *– A 2018 Tweet from Donald Trump*

Trump has repeatedly said that trade wars are good and easy to win.

The market, however, believes the opposite: **A trade war is bad, is easy to lose and could plunge the U.S. into an avoidable recession.**

As for the equity markets the entire "Trump Bump" has reversed in spectacular fashion. In terms of a scorecard, since inauguration, the S&P 500 is down nearly 5% and China is up 24%. And don't look now but the Euro Stoxx 50 index is now up +17% for the year and it's only two months old whereas the S&P is off -1.9%. Did anyone know back on November 5, 2024 that Trump would be Making Europe Great Again? (MEGA)

Have you noticed that in contrast to Trump 1.0, he no longer sends out messages on social media as to how great the stock market is doing? In Trump 1.0, when the bull market was raging, he tweeted about the stock market 156 times — so far this time around, just once (on Truth Social).

The President tells us that the blame for the stock market wobble was due to *"globalists who see how rich our country is going to be and they don't like it."* That is indeed what he said. In other words, a comment like that (which makes no sense) suggests that he really has given up on the equity market as a barometer of his success (or lack thereof — time will tell).

Clearly, investors in the U.S. stock market are not buying into the Trump trade policies as being good for the economy.

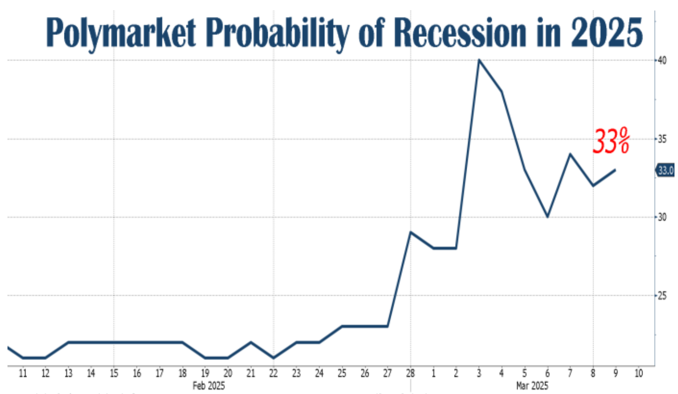
So why the flip-flopping?

Could it be what Ontario Premier said on FOX News?

"If they want to try to annihilate Ontario, ***I will do everything, including cutting off their energy, with a smile on my face.****"- Doug Ford, Premier of Ontario*

Then again, maybe it's about the economy. Maybe it has been the steady diet of below-consensus economic data from retail sales, to housing, to manufacturing. In fact, who would have thought, just four months after the Trump victory, that the following article would be on the front page of the *Wall Street Journal,* "The Recession Trade Is Back on Wall Street**."**

As I have pointed out in this space, the President likes to compare himself to William McKinley, the "Napoleon of Tariffs." The strange thing is that it is never mentioned that the U.S. spent over half of the time in recession in the four years after those tariffs began in 1890 (and then removed in 1894). It's incredible what is so often left out in this narrative.



Or maybe someone pointed out to the President and the Secretary of Commerce that blanket 25% tariffs make ZERO economic sense.

According to the National Association of Home Builders (NAHB), the impact of a 20% tariff on Chinese imports and a 25% tariff on both Canada and Mexico would likely cause a +$1.7 billion annual increase in construction costs.

With homes the most unaffordable ever, do we really want to make U.S. homes even more UNAFFORDABLE?

As for the all-important consumer, the White House's view that the foreign producer (not the consumer) will bear the burden of tariffs is total BUNK! It is absurd. They will not pay us to take their stuff. American consumers will pay tariffs. They will pay higher prices, or they will go without the goods.

"Tariffs are actually, we've had a lot of experience with them. ***They're an act of war****, to some degree… Over time,* ***they are a tax on goods. I mean, the tooth fairy doesn't pay 'em!*** *And then what? You always have to ask that question in economics.* ***You always say, 'And then what?'"*** *- Warren Buffett, CEO & Chairman, Berkshire Hathaway*

Studies show that if the tariffs remain in place, the annual cost for the average U.S. household will be an estimated $1,200 — when you take that number across 130 million households, that will be enough to drive real economic growth to near zero. If so, look at higher unemployment ahead, and that, in turn, will exert a major drag on income and consumption and at the end of the day, lower growth.

"Because of the tariffs imposed by the U.S., ***Americans will pay more for groceries, gas, and cars, and potentially lose thousands of jobs****. Tariffs will* ***disrupt an incredibly successful trading relationship****."*
- Justin Trudeau, Prime Minister of Canada

Automotive industry leaders were among the first to voice concerns. Ford Motor CEO Jim Farley said the tariffs will create *"costs and chaos."*

"A 25% tariff across the Mexico and Canadian border will blow a hole in the U.S. industry that we have never seen." - *Jim Farley, CEO of Ford Motor Company*

According to Anderson Economic Group (AEG), if the tariffs eventually take effect, car prices could rise by between $2,000 and 12,200 for some models.

Executives from Best Buy, Costco, Hasbro, Mattel, Target and Walmart warned consumers that price hikes are likely.

Correct me if I'm wrong, but I don't recall the voting public in 2024 saying that they were aching for a global trade war or for higher prices.

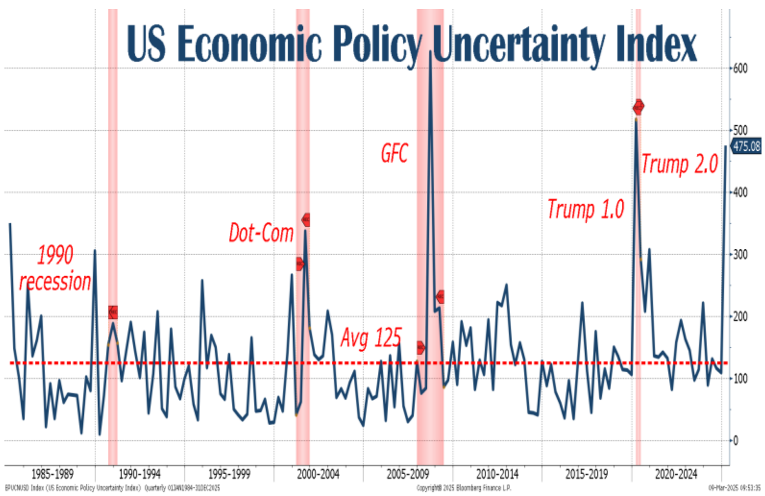
Meanwhile, small businesses will feel the pain from the extremely unwise tariffs. Indeed, 54% of the small businesses polled said that tariffs would negatively affect their companies while just 11% said they would benefit.

"Whipsaw. *That's an accurate description…* ***Can we please, God, know what's going to happen so we can plan accordingly? What I want is no tariffs****.* ***What I want after that is certainty****."*

- Daniel Rogge, CEO of Tormach

Please read the above quote from the *Wall Street Journal* article, "*Inside One CEO's Impossible Mission to Stay Ahead of Trump's Tariffs*"*,* and multiply it by tens of thousands of small businesses.

Since January, the economic policy uncertainty index has spiked 328% (or 447) to a level that in the past signaled a recession. The red shaded bars display it below.



Or maybe somebody showed Mr. Trump the results of the Fed's Beige Book (color and commentary from business executives around the country). Amazingly, the number of times that the word "tariff" was cited in this most recent edition, was 49 — up from 0 in October. As for "uncertainty," that was referenced 45 times—and now above the peak during the pandemic and lockdowns five years ago.

Bottom line: History warns us that high tariffs can backfire. In the 1930s, the Smoot-Hawley Tariff Act passed. The government raised import taxes on thousands of goods in an attempt to protect American jobs. Instead of saving the economy, Smoot-Hawley sparked a global trade war that led to retaliatory tariffs from other countries, slashing international trade and worsening the Great Depression.

As we watch this saga unfold, remember that history doesn't repeat, but it often rhymes.

Where we go from here is anyone's guess. The big theme is UNCERTAINTY! It is ubiquitous. And not likely to go away any time soon. And what we know about uncertainty is that it does three things: it shelves capex spending plans, causes a rise in the personal savings rate, causes a decline in spending and causes slower economic growth.

Indeed, trade wars are bad and easy to lose.

THE REAL REASON FOR TARIFFS

*"Mr. Trump **originally justified the tariffs under an emergency law to combat the alleged threat of fentanyl**"*

*"But he claimed Tuesday the **tariffs are needed because "we pay subsidies to Canada and to Mexico of hundreds of billions of dollars" and have "very large deficits with both of them."***

*"That sounds like White House protectionist in chief Peter Navarro. He and his boss love tariffs for their own sake. **Meanwhile, the tariff barrage is causing economic uncertainty and slowing investment— a real thrill a minute."***
- Excerpted from "The Trump Tariff Roller Coaster", Wall Street Journal

If you want to protect domestic industries with tariffs, the government should at least target tariffs on industries it actually competes in. Simply put, blanket tariffs won't protect industries in the U.S that don't exist.

For example: The U.S. doesn't compete with Canada for its heavy oil. They sell us oil at $10-$20 less than West Texas Intermediate (WTI). What a deal! It would be crazy to put a tariff on that oil. *And without that cheap oil, we would be running a large trade surplus with Canada*.

Over 95% of the potash used by American farmers is imported, with 90% of that coming from Canada. The US produces a grand total of 1% of worldwide potash. What industry is Trump protecting domestically?

Do we really want to drive up the cost of groceries for every American family?

Much of the aluminum, zinc, and, most importantly, nickel comes from Canada. Why raise the costs of these basic materials?

Do we want to make cars that no one can afford?

Bottom line: The tariffs are bad and a smoke screen**.** Trump needs the revenue to fund future tax cuts… Right!!

THE DIE IS CAST

*"**We should beware of the demagogues who are willing to declare a Trade war against our friends, weakening our economy, our national security, and the entire free world, all while cynically waving the American flag**…"*
- Ronald Regan, Former U.S. President

The president recently rebuked a 2020 trade deal known as the U.S.-Mexico-Canada Agreement (USMCA) even though he signed it. Indeed, Trump proclaimed the USMCA was the *"best trade deal in history."* The agreement was ratified 89-10 by Congress.

The USMCA was up for renegotiation in June of 2026. But Trump couldn't wait. Instead, he acted unilaterally using drug imports as an excuse.

*"**We will have a long road back to Canada and the U.S. being trusted economic partners again**… Businesses **can't just switch their whole model to avoid tariffs and then go back again, depending on what politicians decide on any given day**."- Matthew Holmes, Executive Vice President, Canadian Chamber of Commerce*

*"It would be better for the economy if the tariffs are short lived, but **unfortunately, removal won't undo all the damage to business relationships, economic activity, and the reliability of the U.S. as a trading partner and place to do business**."*- Erica York, Vice President of Federal Tax Policy, Tax Foundation

In doing so, he has lost the trust and cooperation of our trading partners and neighbors. Let that sink in. Indeed, it's a sad day in U.S. history when a president breaks his own trade deals and increases tariffs on our closest trading partners more than anyone else.

Even if Trump pulls back eventually from tariffs the die has been cast. Nothing will be done that will alleviate this surreal uncertain policy environment.
Who can possibly plan anything with all this uncertainty? Backtracking may only make matters worse by undermining Trump's credibility. This is called trade policy on the go. It would be better that Trump means what he says instead of just saying what he means.

At the same time, the threat has already caused lasting damage in cross-border relations. Trading partners won't have an incentive to open markets to the U.S., allow investments from the U.S. or boost cooperation to curb illegal migration or drug smuggling.

But here we are.

Bottom line: Please spare me the sap on alleged emergencies. There are no trade-related emergencies. There is very little fentanyl or illegal immigrants coming into the U.S. from Canada. Trump is only using that as an excuse to declare an emergency and break the USMCA.

Sadly, Trump has proven he may not honor any deal he signs. That is the unfortunate bottom line, and there will be a huge associated cost.

KEEP YOUR EYES ON MARCH 14!

"Plain and simple: Congress should NOT pass a budget that increases our national debt."
- Maya MacGuineas, President, non-partisan Committee Responsible for a Responsible Federal Budget

Meanwhile, with all the attention being paid to the tariffs and the Department of Government Efficiency (DOGE), lost in all the commotion is the growing prospect of a partial government shutdown on March 14 at midnight.

If you think the tariff file is a nail-biter, just wait for what is going to come next on the issue of cobbling together a budget.

The House has cobbled together a stop-gap bill to keep the government running through September, a plan that includes spending growth for defense but steep cuts elsewhere and filled with all sorts of tax goodies that were unveiled during the election campaign — calling for a $4.5 trillion tax reduction alongside $1.5 trillion in expenditure cuts.

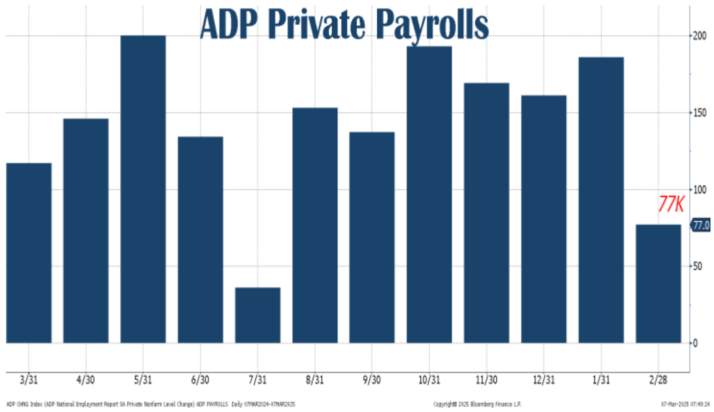
It looks like the House Republicans will vote this in, but it needs 60 votes in the Senate, and this is where things will get dicey since that means the Democrats will need to step up to the plate. The problem is that the Democrats have little incentive to play ball, and any funding bills need to clear a 60-vote threshold in the Senate. I doubt there are seven Democrats willing to vote in favor to pass it.

Bottom Line: More turmoil is likely to come our way. Stay tuned!

LABOR CRACKS ARE WIDENING

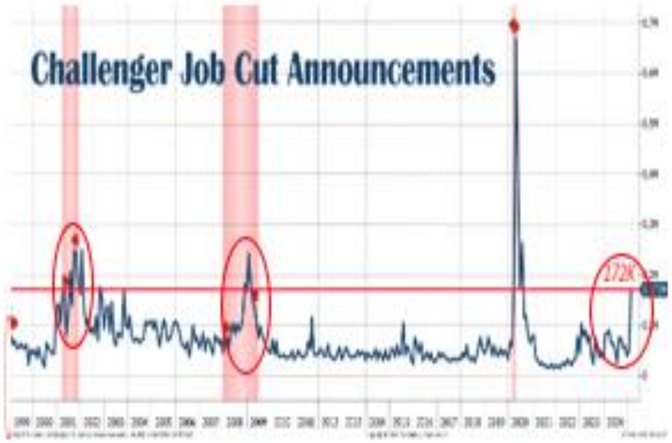
"I think it might be the best number (150,000 jobs) we get for a while."
- Mark Zandi, Chief Economist, Moody's Analytics

The ADP private-payroll data for February showed net job creation of only +77,000, which was about half the consensus of +140,00 and a huge buzzcut from January's +186,000 tally. This was the weakest headline since last July and ranks in the worst five readings over the past four years. Needless to say, a BIG miss and an extension of all the other below-expected economic data of late.

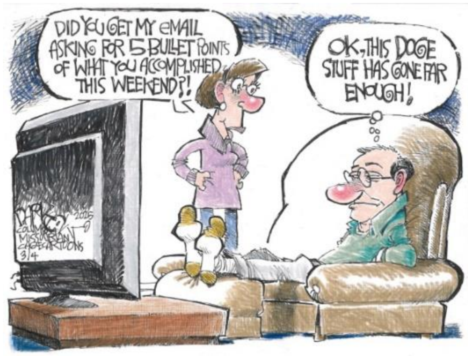


Challenger, Gray & Christmas reported that U.S. employers announced 172,017 layoffs for February, up 245% from January and the highest monthly count since July 2020.

Ignore the non-farm payroll's funky data (see below) and further adjustments and revisions. People are laid off in real time.



The 172,017 in pink slips matches levels seen in the 1990-1991, 2001, 2008-2009 and 2020 recessions. DOGE's efforts are clearly showing through with the chainsaw — 62,242 government layoffs, which is a record by far! Look at what happened in D.C.! An off-the-chart 61,965 firings. More than one-third of the overall job cuts are right there.

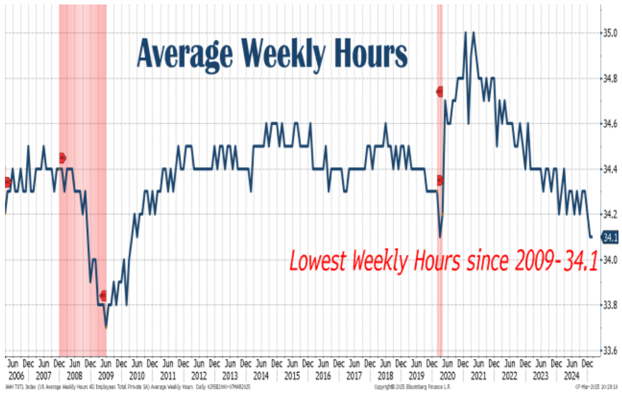


The carnage goes beyond the public sector. The retailers announced 38,956 layoffs last month (a near record) and that is nearly 30 times higher than the 1,387 cutbacks a year ago. The consumer product sector announced 10,625 layoffs, which are up a resounding +76% year-over-year. What are these statistics signaling about the consumer outlook? Layoff plans in the financial sector nearly doubled over the past year to 6,894.

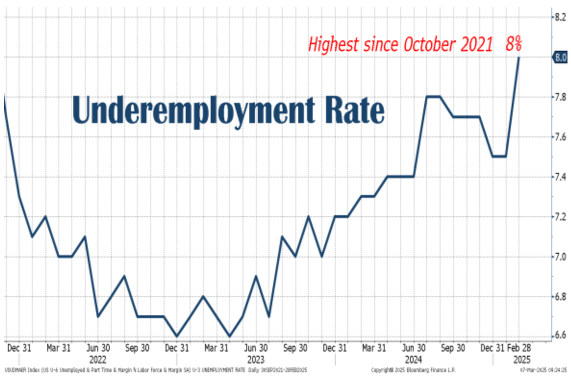
To end the week, the widely watched non-farm payroll report, and should I say, least accurate of all employment reports, showed job gains of 151,000. This was a smidge below the consensus forecast of 160,000. Notably, 15% of the payroll number was magically created by the Bureau of Labor Statistics' birth-death model.

More than 1 in 20 Americans are now working at two jobs or more. This has been the highest share since April 2009 and another sign that the household sector is feeling some pain.

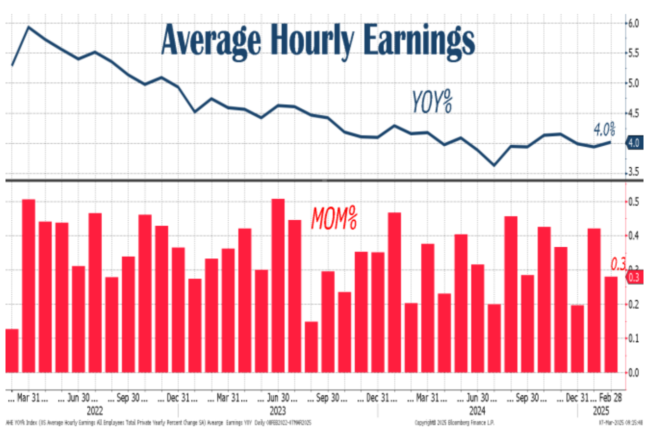
The workweek stagnated at 34.1 hours and is tied for the lowest level in nearly 15 years.



The unemployment rate rose to 4.1% from 4% in January, just above the consensus estimate of 4.0%. More notably, the underemployment rate (U-6), which includes all forms of idle labor, jumped to 8%. This was its highest level since October 2021.



Wages came in as expected at a trend-like +0.3% month over month and January was marked down a touch to +0.4% from +0.5%.



We also know the fast-moving events of recent weeks won't have been captured in February's data. The real test for how public spending cuts, federal government layoffs and the impact of tariffs will become clearer in the months ahead.

Bottom line: The more you dig deep, the more you can see cracks widening in the labor market. We shall see the extent to which the Fed looks at headlines or delves into the details but there was nothing "solid" — Fed Chairman Powell's latest depiction — at all about the labor market at the current time.

Disinflationary slack is building in the labor market, and this is what Treasury investors should be keying on.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"The market and the economy have just become hooked, and ***we've become addicted to this government spending****…* ***There's going to be a detox period****." – Scott Bessent, U.S. Secretary of the Treasury*

The recession that never came was because of the most rampant fiscal stimulus the U.S. has ever seen over a five-year period in history outside of WWII, along with the massive wealth effect from rising equities. If the above quote from Bessent proves true, look for less help from Uncle Sam going forward. That means, all things equal, lower growth.

Consumption is now dominated by the richest 10% of Americans who make up nearly half the spending pie and own half the stock market. We have already lost the low-end consumer and the middle-class so if the stock market causes the high-end to pull back, we will be in for the mother of all consumer-led recessions.

Meanwhile, the Atlanta Fed has taken a cleaver (or should I say chain saw) to Q1 economic growth. The widely watched tracker is currently -2.4%!

This is not just about the brief and sharp pre-tariff surge in the trade deficit. Consumer spending is nearly flat, which would be the weakest showing since the height of the pandemic/lockdown recession in the second quarter of 2020. Housing is seen contracting -3.8% (third decline in the past four quarters) and non-residential construction is at -2.0%.

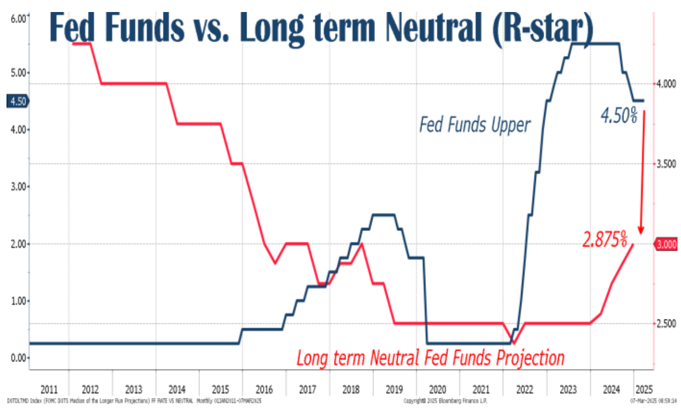
As to the accuracy of this metric (with the exception of the pandemic-influenced periods), the tracking error was generally 1% or less, either up or down. If you add 1-1.5% back into the gross domestic product (GDP) number as a tracking error, it is still negative for the quarter. But there is a lot of data still to come out in the next three weeks. Nonetheless, storm clouds have moved in.

On the inflation front, Treasury Secretary Scott Bessent went on the tapes saying, *"I'm expecting inflation to continue dropping over the year."* However, he doesn't state the reason. **As real wages contract, so will consumer demand, and the recession that ensues will indeed bring inflation down before the year ends.**
And he is right.

However, he doesn't state the reason. **As real wages contract, so will consumer demand, and the recession that ensues will indeed bring inflation down before the year ends.**

As Sergeant Phil Esterhaus of Hill Street Blues reminded us of every week, "*Let's be careful out there.*"

As for the Fed, the only question now is when the next rate cut comes, not if. While it is true that it blew "transitory" back in the inflation surge in 2021 and 2022 back then the Fed stood pat with the funds rate at the zero bound and some -250 basis points below the estimated "neutral" level. You cannot compare that to today's environment where the Fed is on hold with the funds rate more than +130 basis points restrictive when benchmarked against the current official estimate of neutral (R-star).



On February 11, the market put just a 1% probability on the Fed cutting rates four times this year, assuming each cut is 25 basis points. Today, the probability of at least four cuts has risen to 30% while the probability of three or more rate cuts has ballooned to 62%.

Ergo, because of the expected weakness in the economy (and the stock market), along with a more accommodative Fed, I remain bullish on the bond market. Any market sell-offs are an attractive entry point.

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.

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