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Tariffs: Navigate Short-Term Volatility with a Long-Term Plan

A little over a month has passed since President Trump took office, and while uncertainty remains around his policy agenda, his initial focus appears to be on redefining trade policy via tariffs. Given this, we wanted to share some thoughts on tariffs and their potential impact on the economy and markets.

Tariffs are a tax on imported goods – such as electronics and consumables – that are intended to protect domestic industries and reduce trade deficits. By raising the cost of foreign products, tariffs are designed to shift consumer demand toward American-made goods.

Tariffs affect prices and economic growth over both the long- and short-term.

In the long-term, tariffs reduce productivity – and therefore potential growth – by reallocating the domestic labor force to less productive sectors. More time being spent by workers in less-productive sectors also has the potential to raise costs for the goods and services they create. But tariffs do not operate in a vacuum, and technological improvements by companies may mitigate this impact over time. Tariff policy can also change over time. As such, it is too soon to tell whether tariffs today warrant a change to long-term views.

In the short-term, the cost of tariffs is typically borne by consumers. Companies facing higher costs for foreign inputs often attempt to pass those expenses on to consumers, resulting in higher prices. To the extent these higher costs reduce the ability of consumers to purchase other goods and services, they can be a drag on growth.

Let's apply this framework to today's economy: U.S. growth is roughly 2% (adjusted for inflation) in 1Q, compared to the 3% pace of recent years. Core inflation – which excludes volatile food and energy costs – is running at roughly 3%, down from two years ago but still well above the 2% Federal Reserve (Fed) target.

The impact from the looming tariffs is difficult to quantify, because what they will ultimately look like is still unclear. But analysis from Goldman Sachs suggests that every 1% increase in the overall tariff rate increases U.S. prices by roughly 0.1% and reduces U.S. growth by 0.05%[1]. The most recent tariff announcements would increase the overall tariff rate by 4%, which implies a 0.4% increase to prices and a 0.2% reduction in growth.

[1] *Quantifying Global Growth and Inflation Risks from Tariffs. Source: Goldman Sachs, O'Brien Wealth Partners, as of Feb 21, 2025.*

In other words, while tariffs are a headwind the current proposals are also unlikely – by themselves – to push the economy into recession. And keep in mind that other fiscal changes – such as proposed tax cuts and deregulation – could reduce/mitigate tariff headwinds.

Put it all together and our base case remains that the U.S. expansion continues in 2025, inflation may reaccelerate slightly, and the Fed may end its rate cut cycle at a higher level than previously anticipated.

This outlook is likely conducive to further gains, albeit at a more modest pace. Stocks also remain expensive, which has historically been associated with increased volatility around returns. Bond markets, by comparison, remain cheap and income is still readily available without taking on significant default risk. But at the same time inflation risks can matter more than the growth outlook for bonds. It is still too early to say definitively which dynamic will drive performance for bonds this year.

And remember, short-term turbulence should not be allowed to drive long-term investment fundamentals. As tariffs contribute to market volatility, maintaining a disciplined strategy – anchored in diversification and long-term objectives – remains the optimal path.

If you have any questions about how these developments might influence your portfolio, please do not hesitate to contact your Advisor.

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