Yardeni Research

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Morning Briefing

Tariffs Are More Tumultuous For Foreigners

Check out the accompanying chart collection.

Executive Summary: Global trade is being reordered, and the new US trade policies are likely to slow global economic growth over the near term. But for various reasons, we think the US stock market will outperform its foreign counterparts, especially in the event of a global recession. We maintain our Stay Home, versus Go Global, bias. US stocks are fundamentally stronger than international ones, supported by stronger productivity growth and wider profit margins. … Also: With the US stock market on the precipice of bear market territory, Joe takes a statistical look at bear markets throughout history, including one in 1934 triggered by the White House's reshaping of trade policy.

Tariffs Turmoil I: International Tour. In our April 2 *Morning Briefing*, we explained that if Trump Tariff Turmoil (TTT) did induce a recession, it would likely deal much more pain to international markets and economies than the US. Indeed, Trump 2.0 seems to be operating under that assumption as well—that exporters with big trade surpluses need the US market much more than it needs them. Financial markets were suggesting otherwise until recently, however. The German stock market and the euro, as well as the Chinese stock market, were outperforming US stocks and the dollar.

Despite warming up to some global markets on the back of new stimulus measures (e.g., Germany) earlier in the year, we stuck with our Stay Home (in US stocks) bias. Our conclusion just before stocks sold off en masse on Thursday was this: "In short, we think the US would outperform the rest of the world in the event of a tariff-induced recession. That's why we are maintaining our Stay Home (versus Go Global) bias, recommending that managers of global portfolios overweight US stocks."

Here's how key assets performed following President Trump's shock tariff announcement on Wednesday, from Wednesday's close through the close of trading on Monday: MSCI Germany ETF (-10.0%), MSCI United Kingdom ETF (-11.5%), China Large-Cap ETF (-15.6%), Japan Hedged Equity Fund (-12.3%), S&P 500 (-10.7%), DXY dollar index (-0.7%)

(Note: We used the hedged Japan ETF, as the product is more popular since a weaker yen tends to directly boost Japanese stocks.) Because the dollar fell during this time, converting local-currency gains from abroad into dollars broadly helps the performances of non-US indexes.

Notably, every international market is much cheaper than US large caps on a forward P/E basis (*Fig. 1*).

Stocks rebounded globally on Tuesday as Treasury Secretary Scott Bessent appeared to drive a more negotiation-friendly tone from Trump 2.0. But tariffs aren't going away. Global trade is being reordered, and US policy may very well slow global economic growth in the near term. All in all, we think US stocks will outperform in most economic environments, especially during a global recession. While some allocation to key international markets might be warranted over a long-term time horizon, we are sticking with our Stay Home investment bias.

Here's more on how we're thinking about the US and global economies in the event of a global economic slowdown:

(1) *US domestic economy.* The negative wealth effect from falling asset prices may persist given the purported lack of "policy put" from the Federal Reserve and/or Trump 2.0. Without new stimulus coming down the pipeline and with trade uncertainty weighing on both consumer and business sentiment, even some negotiated deals are unlikely to kick the growth engine into high gear (*Fig. 2* and *Fig. 3*). A growth slowdown is likely this year.

Stocks have been reliant on stimulus and bailouts to stem crises since 2008. Americans, particularly retired Baby Boomers, have used asset gains to dissave and spend despite lack of wage income. Now with falling stock prices and declining real economic activity, risk-averse consumer and business purchasing behavior could very well drag the US economy into a slump.

Still, the US is at full employment, is a net energy exporter, and has a dynamic and flexible services-driven economy (*Fig. 4* and *Fig. 5*). Productivity growth has been strong and can counterweigh pressures from realigning supply chains and less immigration (*Fig. 6*).

(2) *International economies*. Underpinning TTT is Trump 2.0's belief that the rest of the world—namely China—needs America much more than it needs them. That's somewhat true, for several reasons:

- China's external trade balance reached a record $1 trillion surplus in February (*Fig. 7*). Without the US consumer as a source of end demand, China's export-led economic revival strategy may be doomed.
- Germany's manufacturing sector is already being crushed by China's exports, which further prevents the sector's realignment away from US markets to those of China (*Fig. 8*). Not only are foreign exporters upset with China, but the Chinese consumer cannot replace American demand (*Fig. 9*).
- While cutting interest rates isn't a direct tool for offsetting a widescale trade war and the associated uncertainty, it would help to some degree. That said, foreign advanced economies have less monetary stimulus space than the US, as their benchmark interest rates are at lower starting points (*Fig. 10*).

Tariff Turmoil II: The Rotation Trade. Trump 2.0's America First policies have sparked conversations by major US and international allocators about diversifying their geographic mixes. That will only continue. But we believe some of the rotation trade conversation has been overstated, at least in the intermediate term. On a fundamental basis, US stocks are stronger than international ones, by and large (even though analysts are slow to revise their earnings estimates to reflect the trade war). Here's a quick look at market fundamentals abroad relative to those of the US market:

(1) *Valuation multiples*. Relatively cheap valuations abroad were not enough amid the TTT market selloff. Those cheaper stocks got even cheaper, including relative to the US. A big chunk of pre-TTT correction in the S&P 500 stemmed from the compression of Magnificent-7 stocks' collective valuation multiple. US large-cap value stocks had been holding up better (*Fig. 11*).

The China MSCI stock index currently trades at less than 12 times forward earnings (*Fig. 12*). The EMU MSCI stock index trades at less than 14 times forward earnings (*Fig. 13*). And the Japan MSCI trades just a tad lower than the EMU (*Fig. 14*).

(2) *Forward earnings*. The China MSCI forward earnings per share (EPS) has been tracking sideways (if not declining) since 2017 (*Fig. 15*). Net earnings estimate revisions have been persistently negative since late 2021.

The EMU MSCI forward EPS is around record-high territory but will likely slump in the coming weeks (*Fig. 16*).

The Japanese market's forward earnings has been steadily climbing to new records (*Fig. 17*). We're unsure what the Bessent-led negotiations with Japan will bring—they could very well lead to a strong revaluation of the yen that hurts Japanese companies. But Japan has been one of the better performing international markets for several years, as its economy finally has found some nominal growth.

(3) *Forward profit margins*. Strong productivity growth, and the accompanying wider corporate profit margins it drives, are key components of our Stay Home thesis. US profit margins are much higher than those of the rest of the world and are likely to remain so even as tariffs hurt bottom lines everywhere (*Fig. 18*).

Regardless of who pays for the US customs duties (whether US consumers, importers, or foreign exporters bear the brunt), it will likely be costlier for foreign companies to shift their supply chains and invest in new plants, property, and equipment than for US companies to do so. In a world where costs are rising, we're inclined to stick with the stock market where companies' profit margins are the widest and arguably the least threatened by TTT.

Strategy: Staring Down the Bear. Amid recent days' global trade angst, the S&P 500 price index on Monday briefly entered a bear market on an intraday basis (*Fig. 19*). The index recovered from its steep intraday decline to finish up for the day at the close but remained deep in correction territory. Investors and traders are cheering half-heartedly but bracing for more bad news. The 20% intraday decline in the S&P 500 from its peak just 47 days earlier on February 17 was the swiftest decline into bear market territory (defined as a drop of 20% or greater) since 2020's Great Virus Crisis (GVC).

Back then, the index peaked on February 19, 2020, just before Covid-19 news drove it into a bear's lair in a mere 22 days. But that bear market, which started on March 12, was over before investors knew it (unlike the lockdowns going on at the time). The S&P 500 was back at a record high just five months later, on August 18, 2020.

Prior to the GVC in 2020, the stock market was relatively calm for 33 years, with descents into bear markets happening gradually over many months. The Crash of 1987 put the S&P 500 into a bear market in just 55 days, but that was the first sub-100-day 20% decline in 51 years.

However, there were even swifter 20% declines in the nearly 100 years of daily S&P 500 pricing data since 1928 that Joe has studied. That dataset (which includes Saturday closing prices through the 1950s) uncovered 24 bear markets. The average length of time it took the stock market to fall into them: 224 days.

Here's what else Joe found in the data:

(1) From 1929 to 1934, the S&P 500 fell 20% or more from its record high, or peak, a whopping five times, and in under 100 days each time (*Fig. 20*). For some perspective, the S&P 500 has repeated that sub-100 day 20% decline torture test just twice in the 95 years since then, in 1987 and 2020.

(2) The dataset's first bear market was the Crash of 1929, which occurred in just 51 days. Following its September 7, 1929 record high, the S&P 500 would not reach a record high again until 25 years later on September 22, 1954. The political and trade circumstances surrounding the turmoil of the 1930s draw interesting parallels with today's circumstances.

(3) During 1930, the introduction of the Smoot-Hawley Tariff Act saw the S&P 500 fall more than 20% over 67 days through June 16, 1930 (*Fig. 21*). However, even swifter declines were on tap just a few years later. The market fell 20% over just seven days in September 1932, coinciding with Hitler's rise to power and Germany's re-arming in violation of the Treaty of Versailles.

(4) Less than a year later, in mid-July 1933, the S&P 500 recorded its fastest 20% decline of all time, in just three days from July 18 to July 21. As the world struggled to recover from the Great Depression, President Roosevelt announced in early July that the US would remain off the gold standard in order to pursue long-term price stability at home rather than immediate international currency stabilization.

(5) Not even a year later, in 1934, stocks again were descending into a bear market, this time over the course of 95 days through May 12. That would be the last sub-100 day decline of 20% for 51 years. The source of investors' concern? A reshaping of American trade policy by the President. Having been in office for just a year in 1934, President Roosevelt was hard at work trying to restart America's economic engine. To that end, he signed the Reciprocal Trade Agreements Act into law, which granted the Executive branch the powers to negotiate trade agreements and ultimately reshape trade policy as Trump is doing today.

Calendars

US: Wed: MBA Mortgage Applications; Wholesale Inventories 0.3%; Crude Oil Inventories; FOMC Minutes; Barkin. **Thurs:** Headline & Core CPI 0.1%m/m, 2.6%y/y & 0.3%m/m, 3.0%y/y; Initial Jobless Claims 223k; Federal Budget Balance -$126.5b; Bowman; Harker; Logan; Goolsbee. (FXStreet estimates)

Global: Wed: Japan Machine Tool Orders; Japan Consumer Confidence 34.7; Japan PPI 0.2%m/m, 3.9%y/y; China CPI & PPI 0.1% & -2.3%y/y; Cipollone; Ueda; Balz. **Thurs:** Italy Industrial Production -1.0%; Buch; Tuominen; Bullock. (FXStreet estimates)

US Economic Indicators

NFIB Small Business Optimism Index (*link*): "The implementation of new policy priorities has heightened the level of uncertainty among small business over the past few months," noted Bill Dunkelberg, NFIB's chief economist. "Small business owners have scaled back expectations of sales growth as they better understand how these rearrangements might impact them." The *Small Business Optimism Index (SBOI)* fell for the third month, dropping 3.3 points during March to 97.4, the largest monthly decline since June 2022. It's down 7.7 points from December's recent high of 105.1. Meanwhile, the *Uncertainty Index* fell 8 points to 96 in March, easing from February's reading, which was the second highest on record and down 14 points from October's record high of 110. It remains well above its historical average. In March, seven of the 10 *components of the SBOI* fell, while two rose, with plans to increase inventories unchanged at -1%. Expect the economy to improve (-16ppts to 21%) and sales expectations (-11 to 3) were once again the two biggest drags on the index. Also dragging the index lower were earnings trends (-4 to -28%), now is a good time to expand (-3 to 9), plans to increase employment (-3 to 12), current inventory (-2 to -7), and expected credit conditions (-1 to -4). Meanwhile, both capital outlay plans and current job openings each rose 2ppts to 21% and 40%, respectively. Quality of labor (19%) was the *single most important problem for small business owners* in March, with taxes (18%), inflation (16), cost of labor (11), and poor sales (9) rounding out the top five. The net percentage of owners *raising selling prices* slipped to 26% in March, after increasing from 22% to 32% in February—which was the highest percentage since May 2023—while a net 30% plan price hikes in the next three months, the highest since last March. Turning to *compensation*, a net 38% reported raising compensation in March, up from 33% in both January and February and 29% in December, while a net 19% plan to raise compensation in the next three months, up from 18% in February but down 9ppts from November's recent peak of 28%.

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