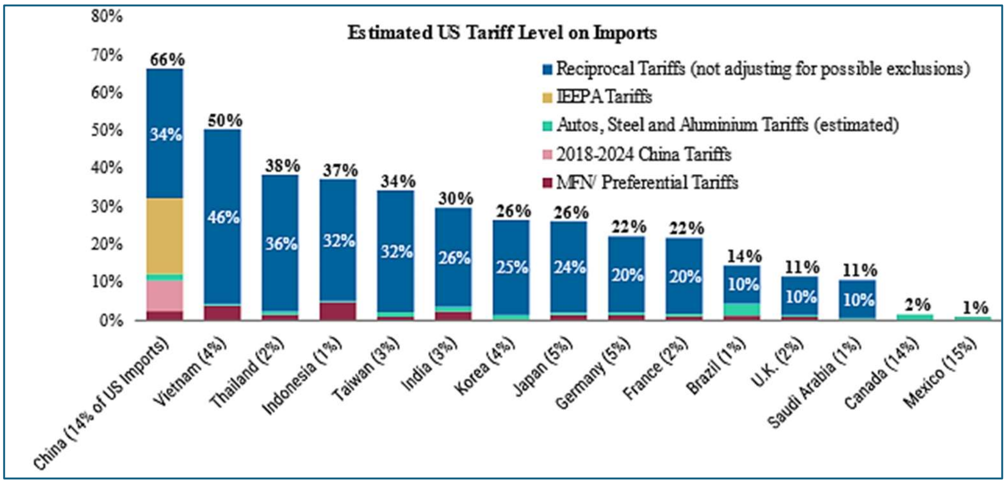
- On April 3rd, the Trump administration announced sweeping "reciprocal" tariffs that were clearly more hawkish than expected, though continued USMCA exemptions for Mexico/Canada provide a partial offset.
- Weighted Average Tariff Rate is ~18.2%, around 3% higher than market expectations. However, ~1/3rd of total imports are exempt, which reduces the impact to a 12.5% increase in the effective tariff rate.
- Along with tariffs announced earlier, the average effective tariff rate is now ~ 18.7%

Negotiations with trading partners could now follow, however key risks lie in the timeline of tariff negotiation and any potential responses. If countries come to the negotiating table in the near-term and lower rates are negotiated that would likely help alleviate some of the pressure on confidence levels. On the other hand, if high tariff rates stay in place and negotiations become long drawn or additional measures are taken with key trading partners, the risk of a recession is likely to rise more materially.



Source: CENSUS, UN Comtrade, White House, US HTS, USITC, WITS, TRAINS.

The probability of a U.S. recession in 2025 is notably higher than earlier in the year, with estimates ranging from 35% to over 50%

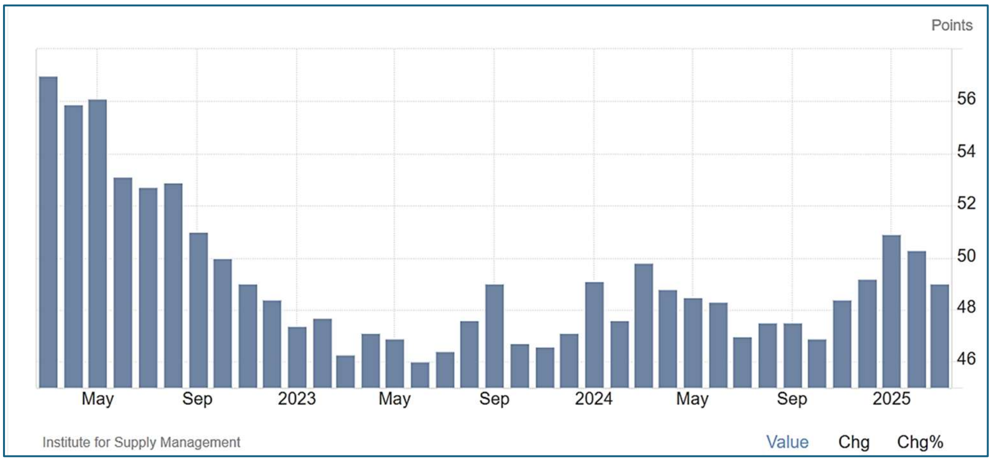
Implications:

- Investors are growing increasingly concerned about stagflation. The fear is that a prolonged tariff/trade war would lead to a combination of weaker growth and higher inflation and that downside risks to growth will dominate upside risks to inflation.

- One important aspect to consider is that tariffs alone may not lead to a sustained rise in inflation. Higher tariffs may lead to a temporary increase in inflation that will give way to renewed disinflation. Like all tax increases, higher tariffs will sap disposable incomes and lead to less household consumption. Over time, this could turn out to be disinflationary.

  (Note: Japan raised VAT from 5% to 8% in 2014, aiming to address fiscal sustainability. The move initially boosted inflation (core CPI rose 1.5% YoY post-hike), but consumption slumped thereafter. BOJ initially underestimated tax hike's deflationary risks, predicting sustained inflation toward its 2% target. However, core CPI growth excluding the tax effect fell to ~1% by late 2014 due to weak demand and falling oil prices)

- Contrary to the U.S. administration's belief that tariffs will lead to a revival in the U.S. Industrial sector, recent ISM survey points to a manufacturing downturn. Not only did the ISM index dip back to 49 in March 2025 from 50.3 in February, but the collapse in new orders-inventories points to more weakness ahead. Importantly, this economic weakness has come even before the implementation of any major tariffs by the Trump administration.



- If the Atlanta Fed's forecast of 1.4% Q1 GDP contraction proves to be correct and Q2 is also weak as widespread tariffs come into effect, the U.S. economy could possibly experience a technical recession in the first half of 2025.

- The Trump administration has largely disregarded signals from financial markets, including the significant decline in equities. The S&P 500 remains firmly in "correction" territory, reflecting more than a 10% drop, while the Nasdaq is nearing a "bear" market with a 20% decline. Despite these developments, the administration has emphasized its focus on Main Street over Wall Street. However, it is inevitable that the pressures in the financial markets will eventually impact the broader economy.

- A disruption in global supply chains will lead to less production. Lower production and spending will eventually mean fewer jobs. U.S. unemployment rate has slowly moved up from a low of 3.4% to about 4.1% now which is still consistent with Fed's estimate as of now. This could however move up if Kansas City Fed's Labor Market Conditions Indicator (LMCI) is taken into consideration which suggests that jobless rate could approach 5% over the coming months.

Outlook for US Equities

Any upside to US equities would likely have to come from either a more dovish Fed or near-term progress on tariff negotiations that could offer a path for lower tariff rates with key trading partners. Having said that there is low probability of the Federal Reserve adopting a dovish stance soon. Also, it's too early to comment on the pace of tariff negotiations and likely impact on tariff rates.

Expect S&P to remain volatile with downward bias (5500 now becoming a key resistance).

Cyclicals, consumer discretionary, small caps could remain under pressure given less pricing power or ability to offset the additional costs.

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For further information please contact Jupiter Wealth Advisors Limited, Office 104-105, Liberty House, DIFC, PO Box 482045, Dubai, United Arab Emirates. Tel: +971 4 558 4099.