



tariffs

Made in the USA

Market Insights

July 2025

Made in the USA

The rhetoric emanating from the U.S. belies numerous vulnerabilities. The good news is that the administration seems to understand this and is moving towards pragmatism

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Well, it's here. The tariff war has been reignited post July 9th. Yesterday, the Trump administration announced a 35% tariff that marks a dramatic escalation in U.S.–Canada trade tensions with potentially serious impact on prices, supply chains, and diplomatic relations. The window to negotiate exemptions or to work out a broader deal is narrow—just a few weeks before the August deadline.

The original deadline was July 9th, however few trade deals have been announced. On July 3rd President Trump said that his administration will probably start notifying trading partners of the new U.S. tariffs effective August 1 and then a few days later, on July 7th, he unveiled the first in a wave of promised letters that warn of higher tariff rates. President Trump also announced on July 7th new rates on a number of countries, including Japan, South Korea, Malaysia, Kazakhstan and South Africa. Markets were taken by surprise by the April 2 “Liberation Day” announcement, wherein the White House issued aggressive reciprocal tariffs on virtually all U.S. trading partners. Since then, the economic policy uncertainty index has climbed to 296.9 — setting aside the pandemic, this is the second highest level since 1985, and the VIX climbed to 57.96 – the fourth largest level recorded since 1995. Although equity markets have since rebounded, the 10- and 30-year Treasury yields remain stubbornly above 4.2% and 4.6%, respectively, atypical against a backdrop of heightened recessionary fears. While the rhetoric has heated up in recent days, final tariff rates remain unknown. It is challenging to gauge market reaction to headline risk, however, there is no doubt that the risk of increased volatility remains elevated.

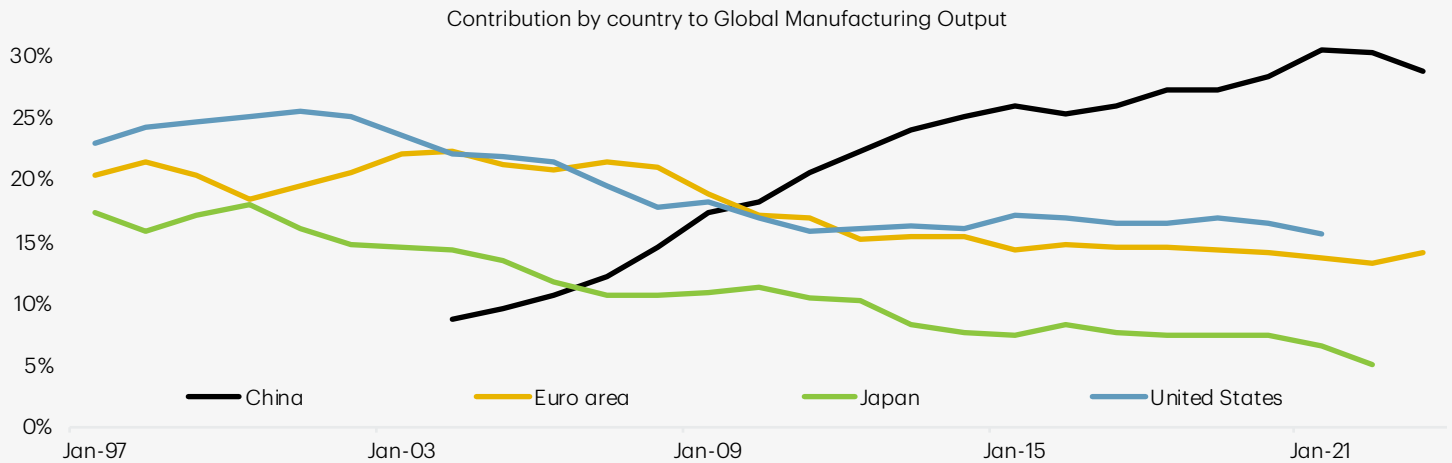
In environments of elevated uncertainty and volatility, we are even more focused on evaluating what we do know and avoiding an overreaction to what we don't.

America doesn't hold all the cards.

The U.S. administration is aware of its vulnerability in this tariff war and, as a result, will act pragmatically even as it issues aggressive pronouncements. While we think that tariffs are here to stay, we're also of the opinion that the U.S. administration will use tariffs as a tool for negotiating better terms of trade rather than as a tool for dismantling the global economic order.

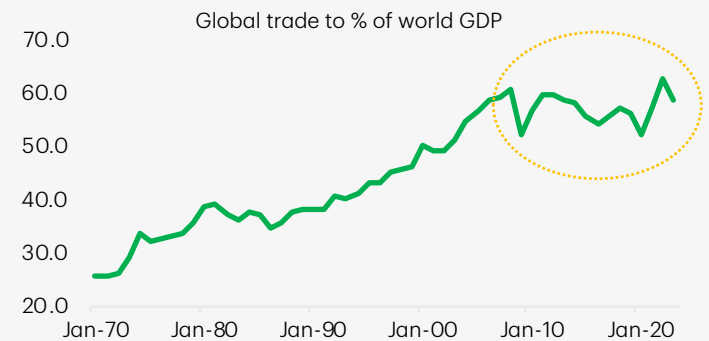
Why globalization needs a refresh

It's reasonable to be concerned about the U.S.'s ballooning trade deficit and its declining share of global manufacturing output. Overproduction in China has led to an imbalance in global manufacturing that has seen, since 2000, more than 50% of all manufacturing growth in the world happen in China (Figure 1). Conversely, American contribution to global manufacturing output has declined from 23% in 1997 to 15.4% in 2023. Post 2007, US' growth in manufacturing output has decelerated from 5.0% between 1997 to 2007 to 2.25% post 2007.

Figure 1: China's dominance calls for a rebalancing

Source: World Bank; Wealth Investment Office as of July 8, 2025

We see a similar trend in Europe as well as Japan. The structural decline in manufacturing capacity can pose national security issues, especially if it were to hinder the production of critical goods. The importance of domestic manufacturing was highlighted by the Covid pandemic, which caused supply chains to break leading to widespread shortages of many products, including semiconductors and healthcare products. This may have highlighted the issue of deglobalization, but in fact, growth in international trade, as a percentage of global GDP, has stagnated since 2008 (Figure 2).

Figure 2: Growth in global trade has stagnated since 2008

Source: World Bank; Wealth Investment Office as of July 8, 2025

This provides some justification for encouraging companies to bring some of their manufacturing onshore. The concern for corporations and their investors is that steep and unanticipated tariffs may cause a shock to the system, leaving insufficient time for companies to adjust.

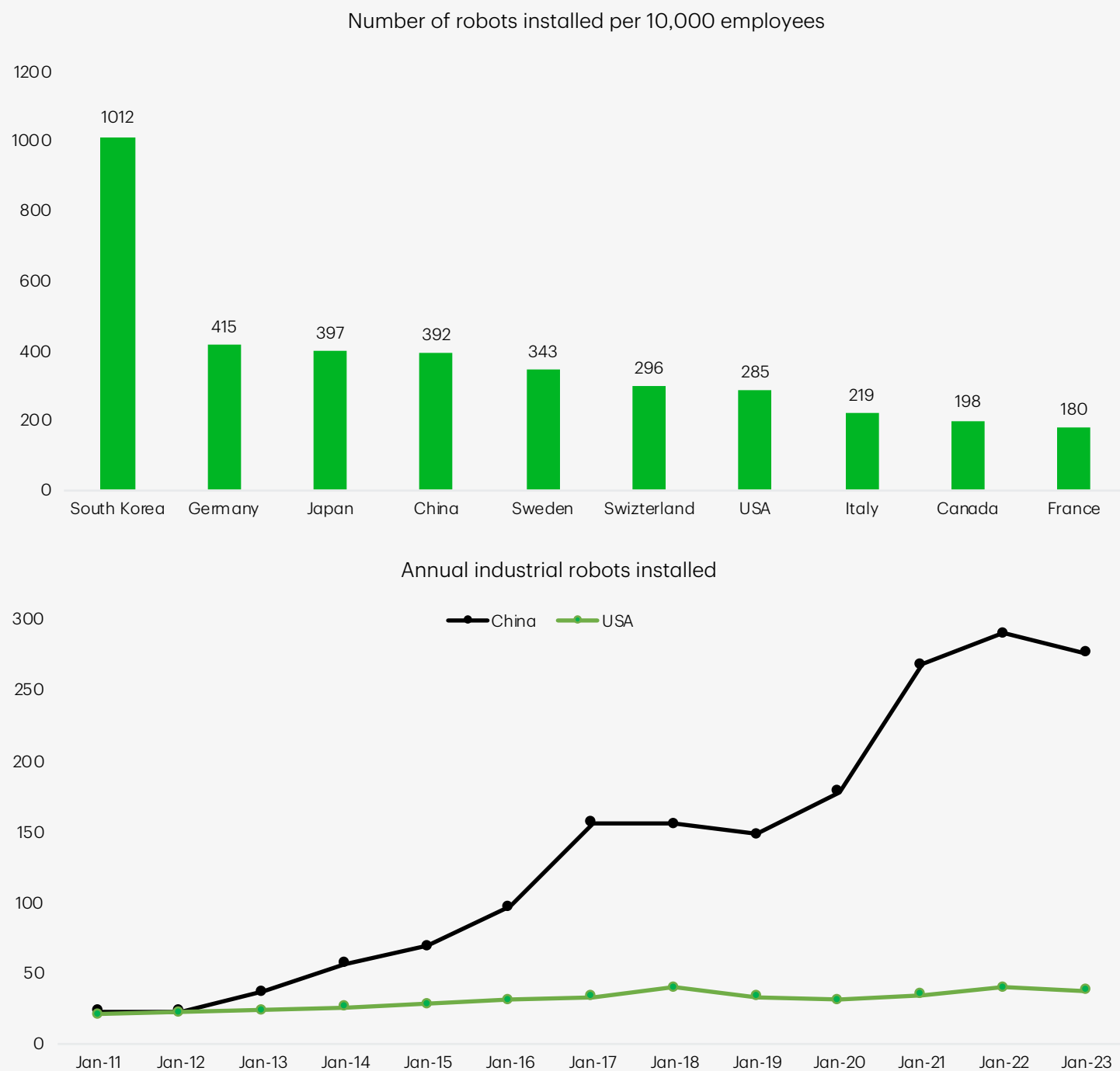
How much manufacturing can the U.S. onshore?

One of the administration's key objectives is to accelerate onshore manufacturing and bring middle-class manufacturing jobs back home. However, a key question remains: Does the US have an adequate supply of skilled manufacturing labour to meet this agenda? The share of manufacturing employment stands at 10% in the U.S. versus 14.6% in Europe and 15.6% in Japan — one of the lowest in the developed world. A statistic like this naturally sets up a “chicken and egg” question. Does this represent an economy of workers without jobs, or jobs without workers?

There's also the generational divide to consider. Although Baby Boomers may look fondly upon the stability of factory jobs that may have been lost to cheap imports, younger generations (Millennials and Gen Z, born between 1981 and 2010) do not share that history and may not be as interested in those jobs.

Even if the U.S. managed to convince its major corporations to onshore their manufacturing, there's some doubt as to whether it would lead to the employment bonanza the administration is hoping for. In the digital world of today, it's believed that, for every three factory jobs created, one will go to a human and two will go to industrial robots. Other developed countries with aging populations (South Korea, Germany, Japan, Sweden) are already making progress in this direction. Unfortunately, the U.S. is behind in this respect, with 285 industrial robot installations per 10,000 employees, and unlike China, it's not yet gearing up to mass-produce these kinds of industrial robots. (Figure 3).

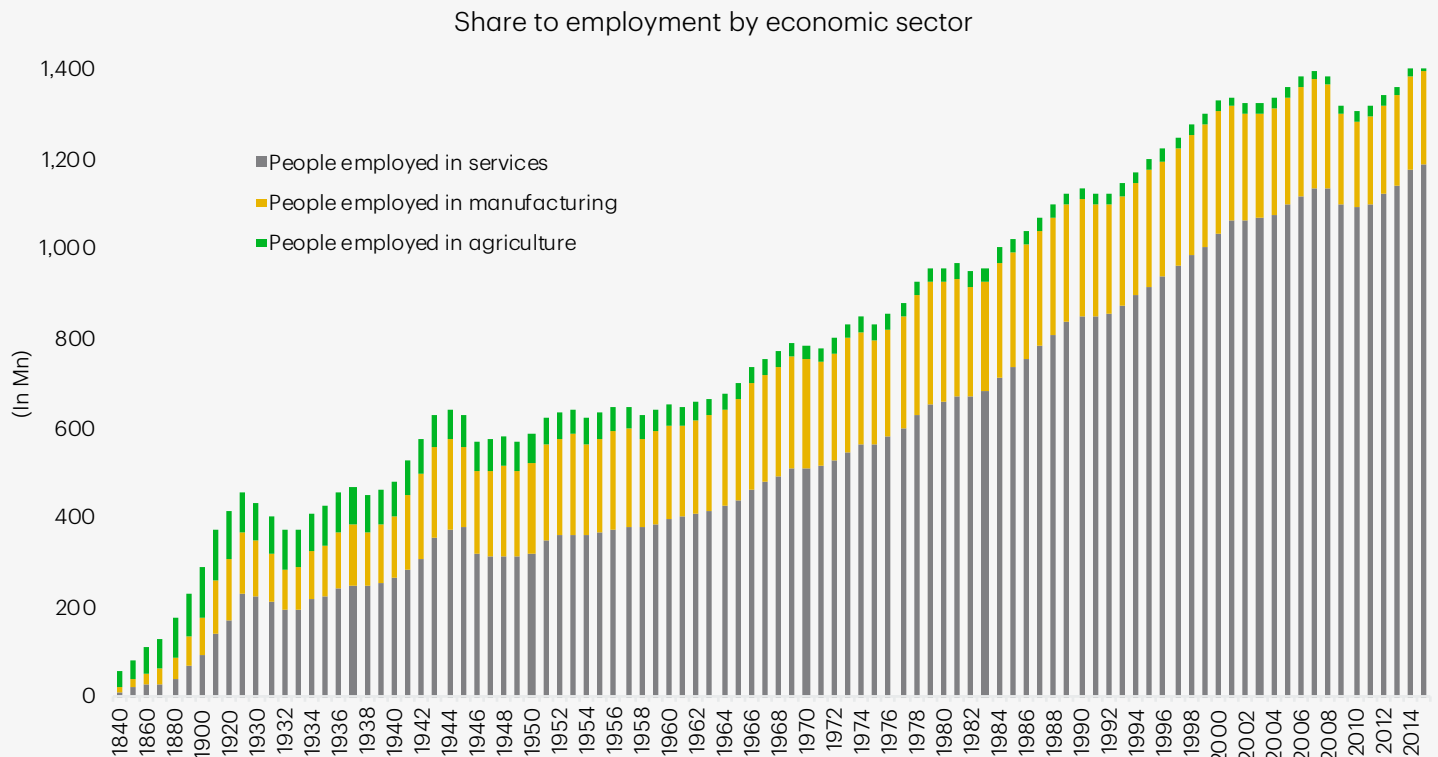
Figure 3: U.S. lags in use of industrial robots



Source: International Federation of Robotics, ourworldindata; Wealth Investment Office as of July 8, 2025

Historically, the loss in manufacturing jobs has been more than replaced by growth in services. Since 1990, even as manufacturing employment has shrunk 0.9% annually, employment in services has grown by 1.4% (Figure 4), and during this time, the U.S. economy has grown 2.4% a year — the highest among G7 countries. The unemployment rate, meanwhile, has fallen from 5.6% in 1990 to 3.7% in 2023. As countries advance and become wealthier they consume more services such as healthcare and financial, resulting in growth in many services industries. So, while there are reasons to be concerned about the loss of manufacturing, it's not completely straight forward to assume that the transition to a more services-oriented economy has hurt economic growth or led to massive job losses.

Figure 4: Growth in service jobs makes up for losses in manufacturing



Source: ourworldindata; Wealth Investment Office as of July 8, 2025

Will tariffs help the U.S. reduce its deficit

The U.S. administration claims that tariffs will also serve as a source of revenue that would help offset the nation's ballooning deficit. However, this topic is also up for debate. As a tax on consumers, tariffs would indeed raise revenue, but they would also discourage imports. In the short term, higher tariffs will likely raise revenue and inflation, but ultimately, as some consumers decide they cannot afford certain products, demand would fall (alongside living standards) as well as tariff revenue.

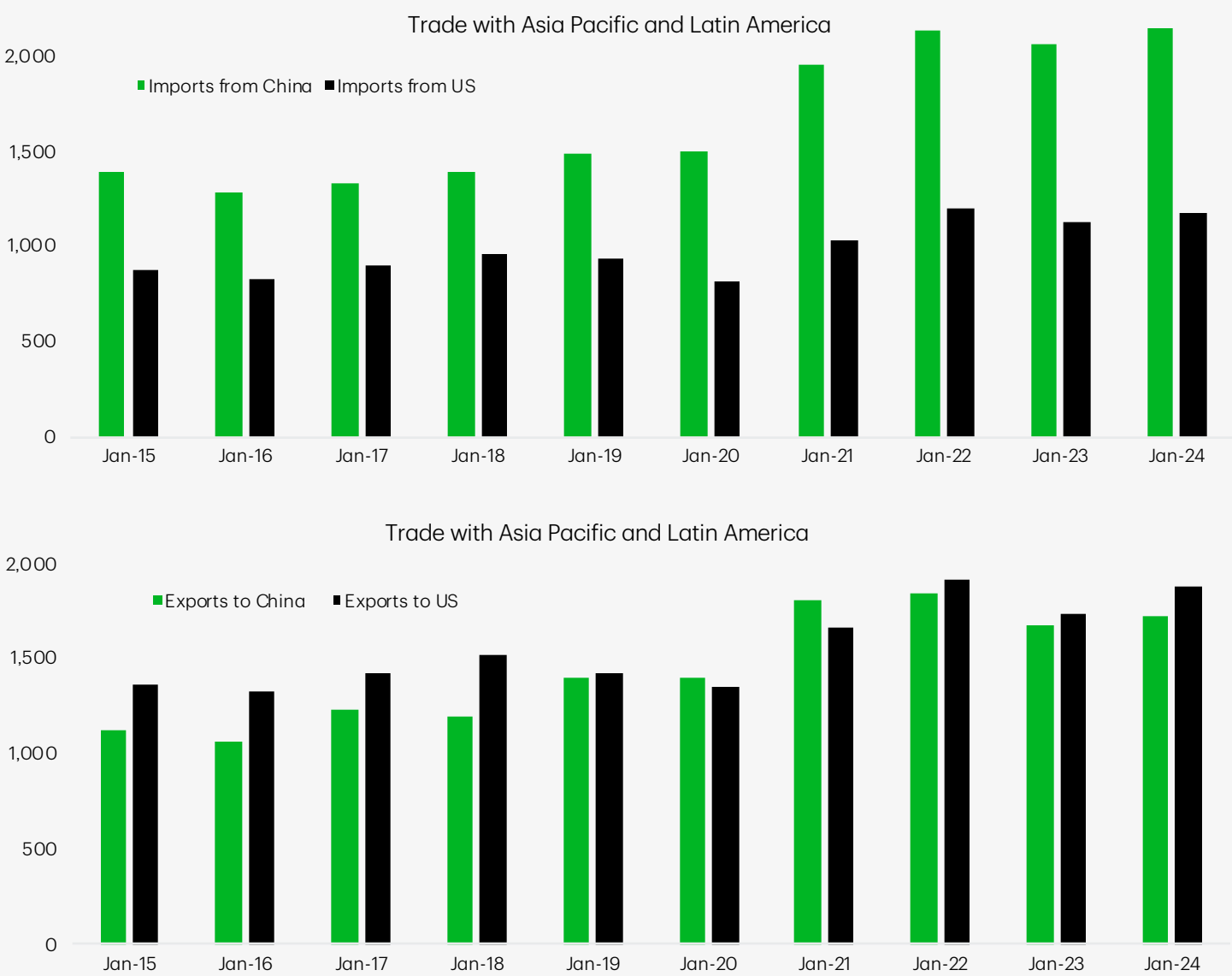
A tariff war could also hurt the U.S. dollar, which from a foreign investor's perspective, could lead to a depreciation of U.S. assets. One of the reasons for the greenback's status as the world's reserve currency comes from America's long-held leadership in the development of globalized trade. The U.S. has developed strategic ties that have favoured the U.S. dollar as well as the inflow of foreign direct investment. A tariff war poses a risk to all of this, given that approximately 30% of USD-denominated debt and 20% of equities are held by foreign investors.

China is more influential than ever

China is in a much stronger position today given its emergence as a global manufacturing powerhouse. Trade reliance on China for Asia Pacific and Latin American countries have increased significantly, with US\$2.1 trillion in imports from China and US\$1.8 trillion in exports to China (versus US\$1.2 trillion in imports from the U.S. and US\$1.9 trillion in exports to the U.S. (Figure 5).

This can be partly attributed to the foreign direct investments made by China in these countries. Between 2005 and March 2023, China provided more than US\$141 billion in loan commitments to Latin American countries and state-owned enterprises. That’s more than the World Bank or the Latin American Development Bank. These loan contracts often contain clauses that would allow China to cancel if the debtor country undertakes policy changes that are unfavourable to the interests of China. Hence, we believe it will be very difficult for the U.S. to influence other countries trade relations with China.

Figure 5: China today matches U.S. on trade influence



Source: FactSet, Wealth Investment Office as of July 8, 2025

When the unknowns are greater than the knowns, go back to the drawing board

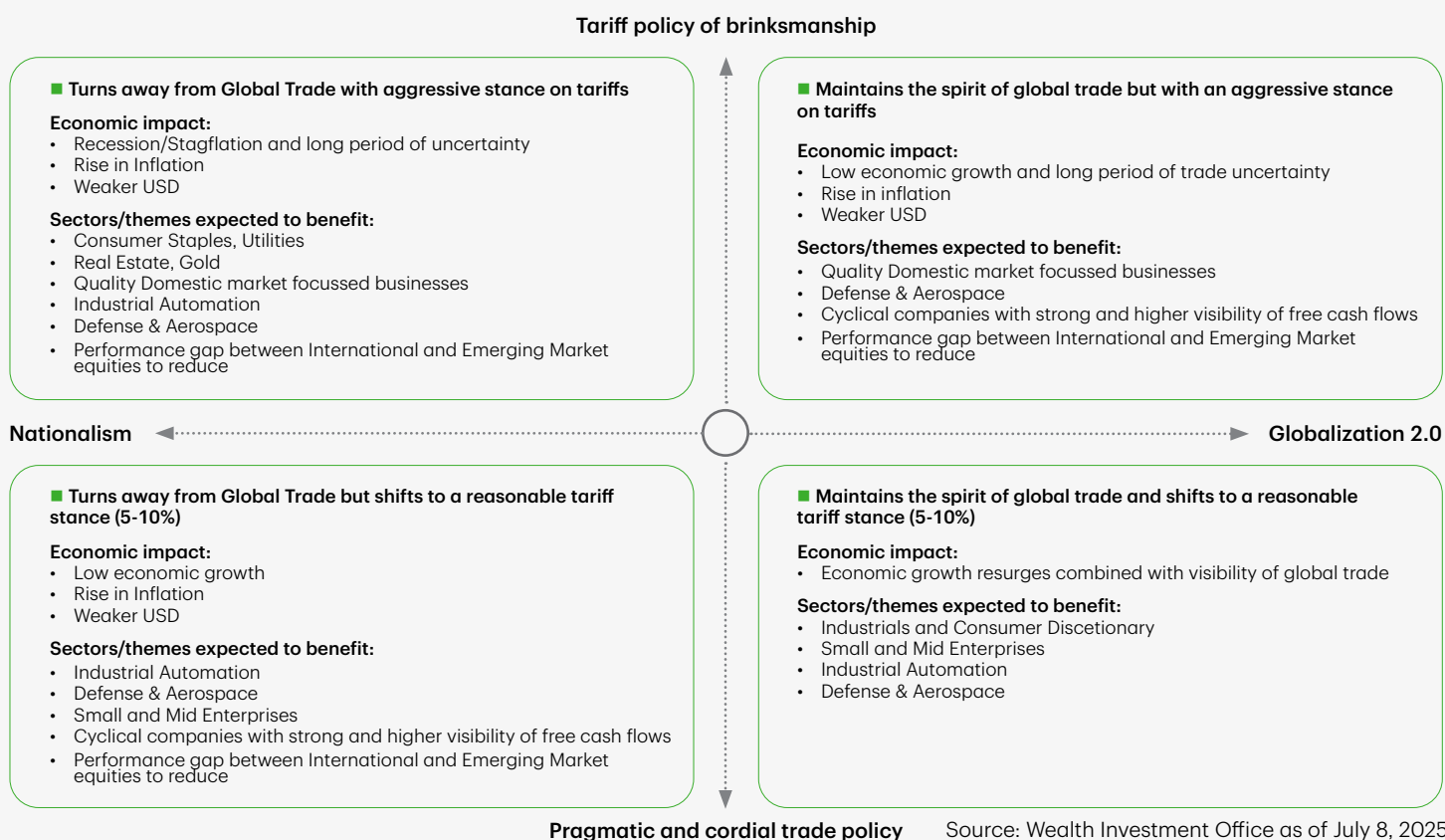
We've broken down the possible outcomes of the trade war into four possible scenarios (Figure 6) and believe the eventual scenario will be determined once the U.S. administration figures out the approach that best suits its agenda.

The best-case scenario is the bottom right section of the grid wherein trade deals are finalized at reasonable tariff levels (from 5% to 10%) and the U.S. continues to operate within the globalized economic order, restricting the goal of becoming a manufacturing powerhouse to products that are critical for U.S. security and safeguards advanced technologies.

The worst-case scenario is the top left-section of the grid, wherein the U.S. moves away from its role in the globalized economic order, insists upon the onshoring of factories at any cost, and implements aggressive tariffs on imports to compensate for cheaper labour offshore. The other two scenarios are blended versions of the best- and worst-case scenarios, wherein the current administration would choose to distort the global trade system but maintain reasonable import tariffs or vice versa.

We believe to some extent the U.S. administration has already moved away from the worst-case scenario. It began the trade war with assertive nationalism and imposed aggressive reciprocal tariffs on its trading partners. Over the past three months, however, the U.S. administration has either paused or reduced import tariffs, shown higher interest in finalizing trade deals with countries — especially China — and has pivoted toward a more targeted approach that would require domestic manufacturing of military equipment and certain technologies. While the final outcome remains unknown and will likely be some blend of the above scenarios, we are of the opinion that the global economic order has permanently changed. Global trade may never return to what it was prior to January 20, 2025, when the new administration took office.

Figure 6: Four Scenarios – Nationalism vs. Brinksmanship



Source: Wealth Investment Office as of July 8, 2025

If this is indeed the case, then investors will need to take into account a number of themes that are likely to be in place for the next decade. For one thing, developed countries are likely to support domestic manufacturing capabilities, balancing their reliance on imports and diversifying their supply chains away from China. This will be especially true for goods critical to national security, generating structural tailwinds for defence and aerospace companies, and those engaged in industrial automation. Diversifying supply chains away from the lowest-cost regions will likely also lead to a higher level of inflation than the 2% norm recorded over the past three decades in the U.S.

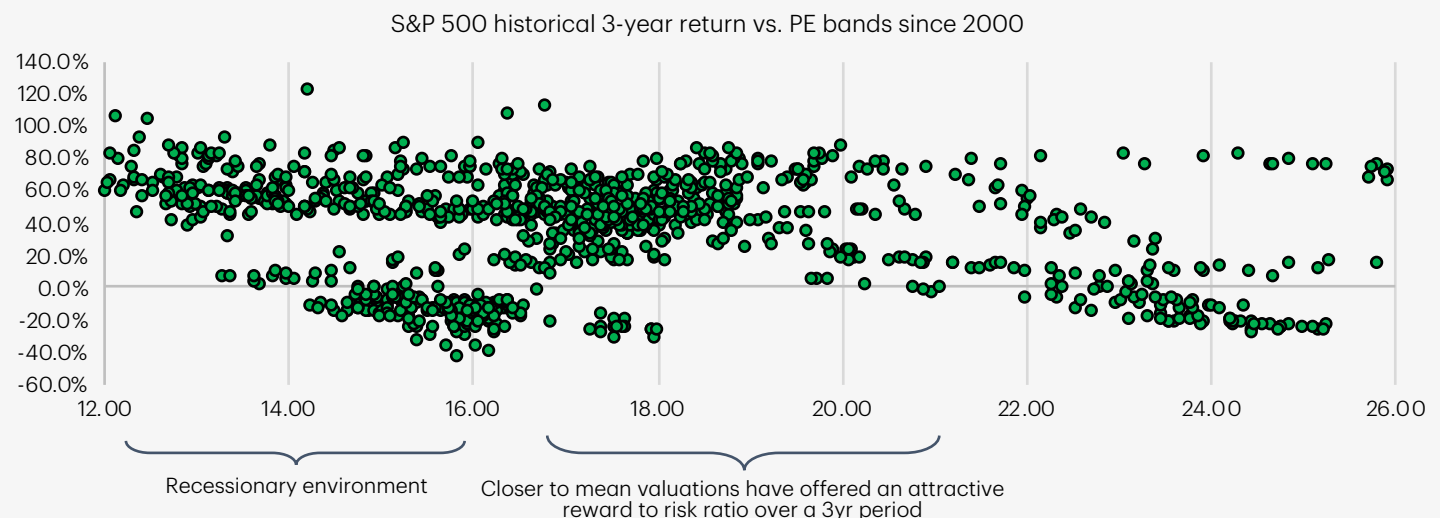
Post GFC crisis, the strong U.S. dollar has been one of the key reasons for the underperformance of the international and emerging market equities relative to U.S. equities. In addition, if countries are compelled to substitute the US export market through trade alliance with other countries, this would further weaken the US dollar. A weakening U.S. dollar may also reduce the premium typically demanded by U.S. equities relative to international and emerging-market equities. While we continue to be underweight international equities due to weaker economic growth prospects over next 12 months, this could be a good time to introduce exposure to international equities in portfolios that do not have exposure, and which may be too overweight U.S. equities.

It would appear that the tectonic plates of world trade are moving and we believe the investment landscape for the next decade could be very different from the past two decades. It has never been more important to have a well-diversified investment portfolio. The coming months may be fraught with heightened volatility and pullbacks. But it's worth noting that, while volatility can be challenging, it also creates attractive opportunities for portfolio managers.

Take the first week of April, for example. Over that time, the price-to-earnings multiple for the S&P 500 declined from 25x to 19x. As can be seen in Figure 7, since 2000, when the S&P 500 has been close to its PE mean of 18x, the index has tended to generate three-year returns around 15%, with few periods of negative performance. In other words, if history is a guide, then the pullback in April offered investors a good entry point, and the months since then have borne that out.

The bottom line is that periods of uncertainty lead to heightened volatility and price pullbacks. But these are the times that also provide an opportunity to invest for the next decade at a much more favourable reward-to-risk ratio.

Figure 7: Volatility creates valuable entry points



Source: FactSet, Wealth Investment Office as of July 8, 2025

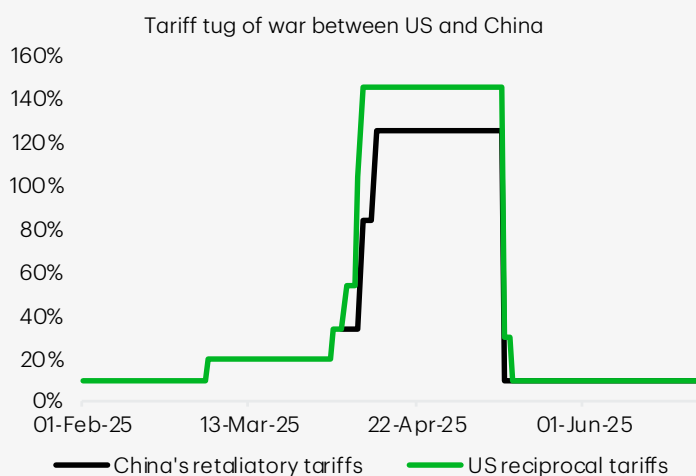
The U.S. has a lot at stake, and the administration knows this

The White House has gone back and forth multiple times on the aggressiveness of its stance. When reciprocal tariffs were announced, electricity, petroleum products and copper were fully exempted, and certain minerals and precious metals were partly exempted, suggesting an intention to not impact critical inputs. Then reciprocal tariffs were paused for 90 days — just seven days after they were announced (except the universal 10% tariff on all imports).

Even as the U.S. and China traded blows, the American administration still chose to exempt certain electronics like smartphones. A month later, the U.S. reduced import tariffs on China from 145% to 30% and thereafter to 10%. Since then, it has shown more willingness to strike a deal (Figure 8).

In North America, the pattern has been similar. The U.S. provided a one-month exemption to automakers from 25% tariffs on vehicles and auto parts imported from Canada and Mexico, and later it also extended credit for up to 15% of the value of vehicles assembled domestically. These credits can be applied against the value of imported parts, allowing time for U.S. automakers to onshore some of their supply. Another recent example is on June 27th, President Trump called off trade talks with Canada over the latter's intention to collect digital services tax from U.S. tech firms. However, after Canada halted its intention to collect digital services tax, the US immediately expressed its willingness to reinstate trade negotiations with Canada.

Figure 8: Tariff tug of war



Source: FactSet; Wealth Investment Office as of July 8, 2025

All this backpedalling amounts to one thing — the U.S. administration is aware of its vulnerability in this tariff war and, as a result, will act pragmatically even as it issues aggressive pronouncements. While we think that tariffs are here to stay, we're also of the opinion that the U.S. administration will use tariffs as a tool for negotiating better terms of trade rather than as a tool for dismantling the global economic order.

Bottom line

It has been 90 days since the reciprocal tariffs were paused, and the U.S. has not been able to finalize many trade deals. On June 27th, China's Ministry of Commerce confirmed details of a trade framework that was signed in London with the U.S., wherein China will review and approve export applications while the U.S. will cancel a range of existing restrictive measures imposed against China. However with other countries like Canada, Mexico, Japan, and the EU, so far the U.S. has not had much success. Moreover, even if it could secure agreements with major trading partners, trade deals with over 149 more nations remain.

To finalize trade negotiations with all its trading partners in a timely manner, the U.S. administration may have to employ a more cordial tone and work towards "win-win" situations. If some onshoring is the goal, the administration must also provide adequate time for both domestic companies and foreign investors/corporations to make the necessary adjustments. The question is not whether the U.S. should continue its trade war, but rather whether it can afford to.

The near-term outlook remains fraught with elevated uncertainty as we navigate a financial world that is in the midst of significant changes. In this type of environment it is even more important to have a process in place and a well-diversified investment portfolio.

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