Commerce Trust Market Brief with Scott Colbert

March 14, 2025 – How New Tariffs Are Impacting the Economy

Scott Colbert: Good morning. It's Friday, March 14th, and the markets are open. We've seen a reversal in the U.S. stock market given all the administrative focus and recent news regarding tariffs. The S&P 500 (Index), after having been up for most of the year, is now down 5.88%. And as was typical last year, the more you went down or the smaller the capitalization of the company, the worse we've done.

The S&P 400 Midcap (Index) is down now 8.2%, and the Russell 2000 (Index), a measure of small caps (capitalization), is down 10.41%. We have seen a positive return from the international markets. Large-cap international stocks (as measured by the MSCI EAFE Index) are up 8.4%. And even emerging market stocks, despite all the tariff news and the tit-for-tat tariffs back and forth with China are up 3.19% (as measured by the MSCI Emerging Market Index).

This is primarily driven by the lower U.S. dollar, as well as a possible spark in Europe, given the fact that they might have to increase their defense spending. Fixed income has had a positive return, nearly doubling its return from last year. Investment grade bonds (as measured by the Bloomberg U.S. Aggregate Bond Index) have given you (investors) a 2.3% return, largely because interest rates have cooled on the outlook for growth cooling. And the muni (municipal bond) market is barely positive (as measured by the Bloomberg Municipal Index Index), really reflecting how much better on a relative basis last year munis did relative to taxable bonds.

Now, I know we're all worried about a declining stock market. We do want to point out, though, that despite the fact that we've had two magnificent year[s] of returns back in 2023 and 2024, we've had nine instances where we've had back-to-back consecutive market results like that before, since the end of World War Two.

On average in the third year, after two very, very good years, the stock market is amazingly up and on average it's up 13.49% (as measured by the S&P 500 Index). Let's round it and call it 13.5%. Two out of those nine instances, though, the stock market was down. It was down 7.2% in 1977, as interest rates were rising and still in the middle of an economic recovery, though. And in 2000, which was the start of the internet bubble and the downturn and the start of a recession down 9.1%.

So that kind of gives you at least a contextual framework on how we're approaching the S&P 500 this year, given its two historic great years of return. And despite the fact that we have a very cloudy economic and equity market outlook at the moment, at least we had one positive bit of good news last week with the CPI, the consumer price index, cooling a touch.

Year-over-year, core CPI now has come down from 3.3% to 3.1% and the personal consumption expenditure index, which the Fed (Federal Reserve) pays close attention to, is likely to have fallen towards 2.7%. So at least the near-term inflationary pressures as a result of the likely tariffs that are going to be showing up, haven't put any pressure on prices just yet.

So clearly, the market is primarily focused on all the recent tariff news. As of today, we are taxing all of the imports from Canada at a 25% rate or a 10% rate if it's energy-related. In terms of Mexico, we (the Trump administration) might possibly implement a 25% tax as of April 2nd on all goods and services as well, coming from Mexico. With regard to Chinese goods, we had already implemented one 10% across the board tariff, and we've recently doubled that now to 20%.

The U.S. has also imposed a 25% tariff on all steel and aluminum imports, regardless of where they're coming from. And on April 2nd, we're likely to produce additional reciprocal tariffs that the administration feels need to be put in place to level the playing field relative to international tariffs already in place on our goods and services. Finally, the U.S. is threatening to tariff all imports of wine and spirits from Europe at a 200% rate in retaliation for Europe putting on a 50% tax on American exports of whiskey.

Just to take a look at how complicated all these tariffs are, let's take a simple look at one industry, the U.S. auto industry, and the production of cars in North America. General Motors (General Motors Company) Chrysler, which is now Stellantis (Stellantis N.V.), and Ford (Ford Motor Company), produce about 18% to 40% of their cars outside of our borders that they sell here in the United States.

BMW (Bayerische Motoren Werke GmbH) and Mercedes (Mercedes-Benz Group AG) are perhaps the least impacted with an assembly plant down in Mexico. Volkswagen (Volkswagen Group) and Mazda (Mazda Motor Corporation) are the most impacted, with nearly 70% to 80% of the cars sold here in the United States produced in Mexico. Honda (Honda Motor Co., Ltd.) and Toyota (Toyota Motor Corporation) find themselves somewhere in the middle, with plants both in Mexico and up in Canada producing about 40% to 45% of their cars outside of our border that they sell here within the United States.

All these manufacturers are trying to grip with what a 25% tariff on the import of these cars is likely to do (a) to their sticker prices and (b) to the sales production and then (c) what do they need to do going forward to minimize their costs, to maximize their sales? This is not impacting yet the foreign imports that are coming in, but eventually even those are likely to be tariffed. So just a simple thing like cars is being greatly impacted in the short run by the additional tariffs.

To take a look at the bigger picture, let's take a look at what the average tariff rate has been for all imported goods and services historically. We know that they were higher prior to the Great Depression. Most people probably don't know how low they were over the last two (presidential) administrations. And right now, as we sit here today, the average good and service that's imported into our country has been taxed at about a 2.5% rate.

But if all the tariffs currently proposed go into effect, we are looking at a tax rate close to 14%, on average, on all of the goods and services brought into the country. If we still import things like we have been importing, even at these higher prices, that potential impact to our consumer price index this year could be as much as an additional 1.4% of inflation.

And of course, this boxes the Federal Reserve in even if the economy is cooling. Possibly because of all these additional tariffs, they have very limited flexibility to lower interest rates as inflation pushes up. So, it kind of puts the Fed in a box, and of course it's putting the markets in a box. Thus, all the volatility we've recently seen.

So we'll be back in several weeks to discuss all this market-moving news and how it's impacting your portfolios.

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