



News or events that may affect your investments

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# Investment impact of a new round of tariffs

## Key takeaways

- The 25% tariffs against Canada and Mexico that President Trump threatened in early February are now in place as of March 4, along with an additional 10% levy on Chinese goods. Potentially more is to come.
- We have been expecting tariffs, and the household and business adjustments to them. We also foresee that importers will make various adjustments that should stretch out and dilute the tariff impacts, and thereby to mitigate the negative tariff impacts.

## What it may mean for investors

- Our guidance favors U.S. Large Cap Equities, with a focus on broader sector participation; Investment Grade Taxable Fixed Income, especially in the maturity range of three to seven years; and Commodities.

As of March 4, the 25% tariffs (10% on imported Canadian oil) that President Trump had suspended in early February are now applied to Canada and Mexico. He also added another 10% tariff to the February 4 levy of 10% on China. During February, the president added or threatened other tariffs, and Table 1 summarizes these measures.

Table 1. A likely schedule to implement tariffs, so far

Country	Tariff rate	Effective date
China	10%	February 4
China	10%	March 4
Mexico	25%	March 4
Canada*	25%	March 4

Product	Tariff rate	Effective date
Steel and aluminum	25%	March 12
Autos	25%	To be announced**
Semiconductor chips	25%	To be announced**
Pharmaceuticals	25%	To be announced**

Universal tariffs	Tariff rate	Effective date
Reciprocal tariffs	To be announced	April 2 or later

Sources: Federal Register, various issues, and Wells Fargo Investment Institute. \*The 25% tariffs on Canada includes a lower 10% carve-out tariff on Canadian oil. \*\*Proposed tariffs on autos, semiconductors, and pharmaceuticals are in a comment period that expires on March 11.

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The retaliation from Canada and China was immediate but measured. Canada responded with \$107 billion in tariffs on U.S. goods, including cars, steel and aluminum, to be phased in between now and March 25. China added 15% tariffs, to take effect next week, mainly on U.S. agricultural products, including soybeans, fruit and beef. Mexico was still considering levies on March 4 but is likely to target some U.S. goods.<sup>1</sup>

The other U.S. tariff threats listed in Table 1 may or may not come about, or the president may rescind some of them, but our interest here is the potential tariff impact and what we believe investors should do now.

## Tariff impacts

It is too soon for economic data or even corporate earnings reports to capture all of the adjustments that households and businesses likely will make, but we offer two points on tariff impacts.

First, people tend to accelerate spending plans ahead of expected uncertainties. Even if President Trump's threats of tariffs are a negotiating strategy, households and businesses may pull forward spending to avoid the risk of buying after tariffs potentially raise a purchase price. This occurred in late 2024, when consumers and businesses front-loaded 2025 spending ahead of any tariff threats that might ultimately stick. The U.S. trade deficit in goods hit an all-time high of \$123 billion in December 2024, and, more telling, the December monthly increase in the goods trade deficit was the largest on record. Auto sales and company inventory building were especially strong, and the January durable goods report released in late February reiterated the pull forward of business and consumer spending.

Our second observation is that spending behavior tends to change over the longer term in ways that can deflect and ultimately dilute negative tariff impacts. Most basically, a tariff imposes a one-time price increase on an imported good and can slow the economy if the price inflation squeezes purchasing power or dampens corporate investment. In particular, tariffs on steel, aluminum, and Canadian crude oil should raise the prices of goods that use these materials. The automotive industry has the highest exposure, in our view, but other heavy machinery industries and homebuilders should also see an impact. Insofar as Canadian producers import components from China, the tariff impact could compound.

We expect production costs to increase. Mexico, Canada, and the U.S. have interconnected operations that distribute production and assembly across borders. Tariffs could snarl border traffic and increase delays (and costs). What's more, every time components or partially finished products enter the U.S., there is potentially another tariff charge. In addition, Canadian crude oil is a heavy grade that U.S. refiners cannot easily replace. This is likely why the tariff is only 10%, but even that tariff level could raise gasoline prices. Finally, the reciprocal tariffs referenced in Table 1 would match U.S. tariffs to those that other countries apply to the U.S. That likely would hit hardest at emerging market economies — notably India, Argentina, Brazil, and South Korea.

Still, people adjust to changes, and we believe industries will have a wide array of ways to blunt price increases - including currency fluctuations, supplier willingness to tolerate lower profit margins, alternative sourcing, and moderating U.S. domestic spending growth. For example, persistent overcapacity at Chinese factories should incline these firms to accept lower prices — essentially paying part of the tariff at the local factory gate — rather than lose the sale altogether. As well, the U.S. dollar's sustained appreciation trend in recent years means that U.S. importers currently pay fewer dollars for goods priced in Canadian, Mexican or Chinese currencies.

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1. Kate Sullivan and Josh Wingrove, "Trump's Widening Tariff War Sparks Quick Retaliation on US (1)," Bloomberg, March 4, 2025; and "Trade wars intensify as U.S. tariffs on Canada, Mexico and China take force," Bloomberg, March 4, 2025.

And U.S. importers can diversify their suppliers. An August 2024 Federal Reserve study found that the 5.5% increase in U.S. imports from Canada, Mexico, and rapidly industrializing Asian economies India, Taiwan, South Korea, and Vietnam matched the 5.1% decline in China's share of U.S. imports between 2017 and 2022.<sup>2</sup> Most of these countries still count heavily on imports from China, but the point is that U.S. firms used the tariffs of 2018 and 2019, and then the COVID-19 pandemic, to adjust their supply chains. We expect that trend to broaden under new tariffs.

### What we favor doing now

Big picture, we believe tariffs are inflationary and can undermine revenue and earnings, but U.S. firms also have significant (and unused) levers to adjust. While the changes take shape, we expect some variability in gross profit margins and valuations. But we also expect the adjustments to play out over the course of several quarters. What's more, stocks within the Capital Goods industry group are currently being driven to a significant extent by long-term trends, especially automation and artificial intelligence, which we expect to remain favorable for earnings growth. We might become more concerned should we see some combination of the following: tariff increases being passed through to consumers faster than we expect, further significant tranches of tariffs, or evidence of capital expenditure reductions.

One final point. Apprehension about policy (tariffs or more generally) do not, by themselves, justify extrapolating to an ever-weaker U.S. economy or looming recession. The U.S. economy is coming off a strong second half of 2024, so a downshift to a more sustainable pace is not unusual. That adjustment appears bigger this time because much spending was pulled out of 2025 into 2024, as mentioned above, but the unusually harsh winter and the California wildfires contributed.

More importantly, we believe, forward-looking indicators will support sustained economic growth. The sharply lower 10-year Treasury yield has lowered mortgage rates and bumped mortgage applications higher in February. We expect further traction for home buyers. Moreover, despite consumer worries over policy uncertainties, there has been little change in consumer plans to purchase services, which have driven the economic expansion since 2021. Last, but not least, cash available in the financial market remains plentiful. Bank lending standards have eased in the past year, and bank reserves are plentiful. Also, cash in money market fund assets were at a record high (going back to 2007) at almost \$7 trillion, as of February 26. We continue to expect a more moderate but positive economic growth pace than in 2024, and our year-end 2025 Consume Price Index (CPI) inflation forecast of 3.3% allows for some tariff-related price increases.

In short, our 2025 outlook anticipates tariffs and their price impact but also allows for the adjustments that households and businesses have made and likely will make in the coming months to blunt and dilute that inflation.<sup>3</sup> Our guidance favors U.S. Large Cap Equities, with a focus on a broadening of sector participation; Investment Grade Taxable Fixed Income, especially in the maturity range of three to seven years; and Commodities. We continue to believe these preferences have the potential to reward investors in 2025.

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2. Trang Hoang and Gordon Lewis, "As the U.S. is Derisking from China, Other Foreign U.S. Suppliers are Relying More on Chinese Imports," FEDS Notes, August 2, 2024.

3. For more details, please see our outlook report, "2025 Outlook: Charting the economy's next chapter," December 10, 2024.

## Risks Considerations

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## Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

Investment Grade bonds - A rating that indicates that a municipal or corporate bond has a relatively low risk of default. Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

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