HARTFORDFUNDS
Our benchmark is the investor.®

Historic Hikes: Thoughts on the New US Tariffs

The April 2 announcement raised tariffs to their highest since the 1930s, leading to sweeping economic and market effects.

Insight from sub-adviser Wellington Management

Michael Medeiros
Macro Strategist

John Butler
Macro Strategist

President Donald Trump announced a ground-breaking increase in US import tariffs. Under the plan, the US would apply a near-universal tariff of 10% on all goods imports into the US, with additional tariffs imposed on those countries or regions that run significant surpluses in their goods trade with the US, including the European Union, Switzerland, China, Vietnam, and Taiwan.

Why Is This Announcement So Ground-Breaking?

While it's impossible to say at this stage whether we've reached maximum escalation, the announcement implies:

- **A step change in scale:** The Trump administration had already announced previous tariff increases on specific sectors or imports, but the scale of these new tariffs is unprecedented and at levels that are very much at the higher end of what markets were anticipating.
- **A fundamental rupture in global-trade relations:** Negotiations could eventually reduce the impact of these tariffs, even if the risk of further sectoral tariffs can't be excluded, but it nevertheless represents a major challenge to globalization with the US now actively reversing decades of trade liberalization.
- **Far-reaching macro and market implications:** Beyond the immediate risk-off market response, it's possible investors may reconsider their long-term allocations, and by doing so, start a reversal in capital flows away from the US.

Key Points

- The tariff policies introduced on April 2 greatly exceeded market expectations.
- Market implications are grim—near-term growth/inflation trade-offs are likely to worsen dramatically, and we could see an immediate recession and a significant short-term spike in inflation.
- Europe may now be in a position to engage in preemptive monetary and fiscal policy, as the tariffs could encourage capital to flow out of the US.

Immediate Reactions from our Global and US Macro Strategists:

Michael Medeiros, Macro Strategist

Before I unpack the economic and market implications of the sweeping tariffs the Trump administration introduced on April 2 (which have raised the effective tariff rate to the highest level since the 1930s), I want to acknowledge that this is an early response to a nascent policy. The situation is likely to evolve, and I believe actual tariff rates may end up varying day-to-day or week-to-week.

The Tariffs

As part of this new policy, a universal 10% tariff on all countries will take effect on April 5. Additional, reciprocal tariffs will be implemented on April 9. These are a purported response to tariffs imposed on the US by other nations. The Trump administration asserts that these tariffs are only half of what other countries impose on the US and positions this halving as a kindness on the part of the US.

There are a few particularly notable aspects of the new policies. First, the tariff rate for China appears to be stacking, meaning that while the new, reciprocal tariff is 34%, the effective rate is 54% given the 20% already imposed earlier this year. It also ends duty-free de-minimis treatment for covered goods (previously, imported goods valued at or under $800 were duty-free). Next, the administration mentioned exemptions to future Section 232 tariffs, applied to gold, autos, and energy/critical materials. Investigations into pharma and semiconductors are expected, as well. Finally, on a relative basis, Canada and Mexico will continue to receive no tariffs on

US-Mexico-Canada (USMCA)-compliant goods, a 25% tariff on non-USMCA compliant goods, and a 10% tariff on non-USMCA-compliant energy and potash.

Let's turn our attention to timing. In theory, because the reciprocal tariffs are meant to be enacted a week after the announcement, there's room for negotiation. In my view, the administration is likely calculating that using an aggressive starting point increases the probability that other countries make concessions, which the US could accept before or immediately following implementation. I suspect the administration would view such concessions as both a testament to US strength and a means of retaining some revenue from a fiscal perspective. The latter point is important—a reconciliation process may lead to higher debt levels over the medium term, with a current policy baseline and the addition of further tax cuts beyond the extension of the Tax Cuts and Jobs Act.

> The magnitude of the tariffs could erode, if not destroy, trust among US allies.

As part of this conversation, it's worth noting the April 2 judicial election results revealed that voters are souring on the Trump administration. This type of feedback can be a disciplinarian, but Trump is steadfast in his conviction in the efficacy of tariffs, which he seems to view as a solution to structural issues around labor share of income and income inequality. It remains to be seen whether they will achieve the desired outcome over time.

The Economic Implications

The magnitude of the tariffs could erode, if not destroy, trust among US allies. A loss of trust may make allies less likely to engage in negotiations than the administration bargains on—a dynamic that may become more clear in the coming days. What's more, a decline in institutional integrity undermines the status of the US dollar (USD) as reserve currency. This risk has now accelerated, and even if the administration walks the tariffs back before implementation, this is unlikely to dissipate. In the short and medium term, I believe these actions:

- Increase the probability of a more sustained rise in inflation volatility;
- Bode poorly for short- and medium-term growth prospects;
- Heighten the probability of the business/economic cycle engaging with negative signals from policy uncertainty; and
- Raise the likelihood of economic nationalism and repatriation.

That said, I'll be surprised if all these tariffs go into effect as announced, which makes analysis of the situation difficult. Uncertainty multiplier effects can be significant—especially when bilateral negotiations with 60 countries may be looming large and potential shifts in tariff rates by the day/week are likely.

John Butler, Macro Strategist

I want to start by emphasizing again how much could change. The extent of China's response and the US administration's tolerance levels for negative blowback, in particular, could alter the trajectory over the near and longer term. However, what we know is that the outlook is bad for growth, from both a US and global perspective, and markets have reacted accordingly. We see a clear risk-off move with equities going down and bonds rallying. What's interesting, though, is that the USD isn't benefiting from its traditional safe-haven status and, rather than rallying, it's doing the opposite by falling against most currencies.

This could be a tentative sign that global investors are reconsidering how they view the US. After all, why are so many of the world's assets parked in the US? It's because the world's largest economy offered growth, return, and liquidity, but also safety and credibility. Tariffs don't only hit growth in the short term, they also change how an international investor might think about what the US has to offer. How the US Federal Reserve (Fed) responds could be a critical part of this changing investor

perception. Tariffs are putting the Fed in a difficult position. The growth shock may put pressure on the Fed to cut rates aggressively, but this may raise demand and, with it, the impact of tariffs on prices, which would push up inflation.

What Does This Mean for a Non-US Investor?

From the perspective of a global investor, it may imply that the US no longer offers the same protection against rising inflation. If the Fed keeps rates elevated to combat above-target inflation, it could face increased political pressure, which could undermine its credibility—a negative for investors. If investors conclude the US is, henceforth, likely to offer less growth, less return, and less safety, we could see a structural reversal of capital flows, to the detriment of the US, which could also translate into a significantly lower dollar and a higher risk premium.[1] Much could change—for example, it's possible that Trump could unwind many of these tariffs—but at the same time, it's hard to negate the sense of rupture. In my opinion, there's a real possibility that we may have witnessed the shotgun start for capital flowing out of the US.

Europe Can Now Engage In Preemptive Monetary and Fiscal Policy

The market reaction to date also suggests a historic shift in its perception of Europe and the eurozone, in particular. Hitherto, in the event of a global shock, Europe always tended to be the weak spot with recurring doubts about credit sustainability forcing the euro area into fiscal tightening. To date, we haven't seen a repeat of that scenario. Instead, what we're seeing is a stronger euro and tight sovereign spreads.[2] Investors appear to view Europe in a fundamentally different light since Germany agreed to a structural fiscal loosening. It means that Europe may finally be able to reposition policy preemptively and adopt a more pro-growth stance. I think this could be an important development for investors to watch, especially if it were to coincide with a return of European investors' capital from the US.

Talk to your financial professional to better understand the impact of shifting policies on your portfolio.

[1] Risk premium is the investment return an asset is expected to yield in excess of the risk-free rate of return.

[2] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

Important Risks: Investing involves risk, including the possible loss of principal. • Foreign investments may be more volatile and less liquid than U.S. investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall.

The views expressed herein are those of Wellington Management, are for informational purposes only, and are subject to change based on prevailing market, economic, and other conditions. The views expressed may not reflect the opinions of Hartford Funds or any other sub-adviser to our funds. They should not be construed as research or investment advice nor should they be considered an offer or solicitation to buy or sell any security. This information is current at the time of writing and may not be reproduced or distributed in whole or in part, for any purpose, without the express written consent of Wellington Management or Hartford Funds.

Mutual funds are distributed by Hartford Funds Distributors, LLC (HFD), Member FINRA. Advisory services are provided by Hartford Funds Management Company, LLC (HFMC). Certain funds are sub-advised by Wellington Management Company LLP. HFMC and Wellington Management are SEC registered investment advisers. HFD and HFMC are not affiliated with any sub-adviser.