Tariffs, Taxes & Turmoil

Last year we witnessed unprecedented levels of political turmoil, and there were many reasons why this was the case. 2024 was a year in which there were elections in sixty countries. Voters all over the world turned out incumbents time and again. Upset by rising prices for basic goods and services as well as cultural issues which in many countries just boiled down to a rejection of seemingly ever-increasing waves of immigrants, electorates lurched to the left (in the United Kingdom) but mostly to the right (in the US, Germany, France, the list could go on…).

In South Korea, voters gave the opposition Democratic Party a majority of seats in the National Assembly as an apparent check on President Yoon Suk Yeol of the People Power Party, only to see Yoon attempt unilaterally, and illegally, to try to declare martial law six months later. He was promptly impeached creating a power vacuum which caused the KOSPI to fall almost 6% while globally stocks were flat. Japan's LDP which has been in power for almost the entire period of time since WWII, lost their majority in Parliament. In India, PM Narendra Modi and his BJP as expected won their third consecutive election, but in a major upset did not win a majority of seats and is now governing from a coalition. Snap elections in the UK saw an end to 14 years of Tory rule. And of course, in the US Donald Trump the once and future president won a surprisingly easy return to power along with a majority in seats for his Republican party in both houses of Congress.

Why so much talk about politics? Because it influences markets. Politics always has an effect on equity markets but of late that has been particularly true. Trump's win in the US led to a Trump Trade rally, or at least a rally in Trump related investments. While the S&P 500 was 'only' up ~7% in the month after the election, the stock of Tesla (closely associated with Trump ally, Elon Musk) was up 42%. Also, up 42% in the last month, was Bitcoin, known to be a favorite investment of VP-elect JD Vance and his supporters in Silicon Valley.

Tariffs The incoming American president has proposed a 60% tariff on US imports from China. The People's Republic did not help their case at all as they recently announced that their trade surplus reached almost $1 trillion in 2024 as their exports swamped the globe, while China's own businesses and households, experiencing a prolonged slowdown, spent cautiously on imports. No country has ever had a trade surplus as great as China does today, but that's a very specific case. China decided a long time ago they wanted to be the "factory of the world", using their ~1.5-billion-person population to produce massive amounts of goods for the consumption of the rest of the world. Tariffs might be justified in such a case. In fact, the Biden Administration maintained the Trump-era tariffs. If Biden kept the tariffs, then the case for tariffs against China was not a partisan one. However, the president-elect has also proposed tariffs on America's allies in Europe. He has even proposed tariffs of 25% on America's neighbors: Canada and Mexico. Tariffs on China are bipartisan; tariffs on allies and neighbors are something entirely different. Pundits are proposing that the friends and neighbors tariffs are merely a negotiating tactic being used by a president who spent a professional lifetime negotiating big deals. His political allies say he should not be taken at his word. But that is the problem: the evolving and unpredictable nature of America's trade policy was a significant source of uncertainty for businesses and investors during Trump's prior presidency. Apparently, it will be so again.

Taxes In October the French Finance Minister Antoine Armand proposed a budget that would attack what was perceived at the time to be his country's biggest threat: a budget deficit of 6.1%, more than twice the target in the Eurozone. Most of the work would be done with spending cuts. However, there was going to be an increase in taxes on big corporations and wealthy individuals. Already under scrutiny from ratings agencies, Brussels (headquarters of the European Commission, the primary governing body of the Eurozone) and most important of all, financial markets, the French needed to get their financial house in order in no uncertain terms. Unfortunately, France's government, was ousted in a historic no-confidence vote at the beginning of December, marking the first such collapse since 1962. The political upheaval was the result of a miscalculation where the President, the Prime Minister and Finance Minister Armand thought they had the votes to overcome strong opposition to the austerity measures in Armand's 2025 budget, but they did not! This unprecedented political action leaves France without a stable government and introduces significant uncertainty into financial markets. No surprise, French stocks have underperformed the Eurozone index while Germany, Italy and Spain have all outperformed.

In the US taxes are also in the news as the president-elect has promised to renew the 2017 tax cuts. Those cuts represented a very significant tailwind to stocks then. Investors today are expecting stocks to respond now as they did seven years ago. Those expectations may not be met. Today, with their small majority in the House, and a budget deficit at 6% of GDP versus 3.5% at the end of 2017, Republicans may not be able to cut taxes enough to boost earnings enough to justify a further rally in a stock market which has already reacted very favorably to the former president's return to power.

Turmoil American tariffs may well end up taxing global equity investors, but they will almost certainly vex them. The global economy is probably slowing, although it may not be. Only one major broker dealer is calling for a major correction in US stocks but undoubtedly valuations in the US are stretched. Valuations in Europe are more attractive, perhaps slightly less unattractive is a more accurate description, but European stocks have underperformed US stocks for a very long time while being more attractive from a valuation perspective. In reality, US stocks have dominated the world for the past fifteen years because of their ability to generate earnings. In good times and bad US stocks led by the Magnificent Seven have consistently generated better earnings than their global counterparts. Will this trend continue into the coming year? No one can know the answer to that question, but owning a well-diversified portfolio of high-Quality stocks trading at a discount will position a portfolio very well, irrespective of what the tumultuous next year brings.