CERITY PARTNERS®

On Market Volatility:

Is It Time to Panic? (Spoiler Alert: No, It Is Not)

Tariffs and policy uncertainty have spooked investors, but good outcomes for the markets and economy are more probable than you might think.

The 2000 film *U-571* was a submarine warfare movie set during World War II. At best, it is a B-grade movie. Its greatest asset was its all-star cast. Its greatest liability was the miscasting of Matthew McConaughey as a naval lieutenant and Harvey Keitel as a chief petty officer. Nonetheless, there is one interaction between the two of them that climaxes with this excellent line:

> *"Don't you dare say what you said to the boys back there again, 'I don't know.' Those three words will kill a crew, dead as a depth charge. You're the skipper now, and the skipper always knows what to do whether he does or not."*

Maybe investing is like submarining. Financial commentators speak with great certainty about what they "know" about the future. Yet, against this backdrop of extraordinary policy uncertainty, there is little that we objectively know. One can conjecture all one wants about a "Trump Put," whether the Fed will ride to the rescue with rate cuts, or if Congress will intervene to overturn executive action with legislation. However, for the purposes of this commentary, we will avoid speculation and confine ourselves to a discussion of what we believe to be true.

What's Happening and Why

With yesterday's announcement on tariffs, we know more than we did yesterday. The Trump administration will impose 10% universal and reciprocal tariffs. These look to total approximately $620 billion, or 2% of U.S. GDP. Looking past the level and scope of the announced tariffs, we also know President Trump's plan. He has clearly articulated his economic philosophy, regardless of his scattered approach to implementing it. He wants to replace income taxes with tariffs. Remember: he doesn't like income taxes. In the 2016 presidential debates, he famously said he doesn't pay them, and that makes him smart. By contrast, he has also stated that tariffs are "beautiful." His plan is to offset the cost of tariffs with savings from income tax reduction, both individual and corporate. Yes, the average citizen will likely face higher prices due to more expensive imports. But he or she will be able to afford these higher prices due to the elimination of taxes on tips and Social Security, a higher SALT (State and Local Tax) deduction, and so on.

Complementing this ideology is the perceived benefit of foreign countries funding the federal government instead of Americans. The Office of External Revenue Service is not a joke. In theory, production will be brought back to the U.S. and good-paying jobs will follow. Combine that with a smaller, less expensive, and more nimble government, and President Trump's economic policy vision becomes clear.

The Impact on GDP, Taxes, and Investments

The math needed to make that plan work is questionable, but ours is not to opine on its feasibility. The President has made it clear where we are going. To be sure, it is naïve to assume exporting countries will bear 100% of the tariff burden. It is also unlikely that they will bear none of it. So, the actual burden to GDP is not likely to approach the 2% figure. Nor will it be 0%. Consider as well that the U.S. tax-to-GDP ratio was 25.2% in 2022, of which the income tax was 10.5% of GDP. We cannot know at this point how much tariffs will hit GDP, nor how much taxes can be cut to offset.

We are not taking a political position. The simple truth is that this economic policy is going to happen. It could work, but we won't know until it is enacted. Negotiations may slightly alter the course, but not the end goals. Our job is to balance risks versus opportunity in evaluating the investment landscape. The markets have been intensely focused on potential bad outcomes for the past several weeks. **We think investors should consider what could go *right*, as that outcome may be more probable than is popularly accepted.**

We empathize fully with people who are deeply disturbed by the radical changes afoot. Concern is understandable and appropriate. In anticipation of yesterday's announcement, the markets have been in a textbook correction the past few weeks. Now that the new rules are in place, both global markets and the global economy can adjust. That recalibration may occasion volatility, but history shows it's unlikely to last. The recently touted demise of American exceptionalism may be premature.

We opened with a fictional naval reference. We'll close with a factual one. During the U.S. Civil War, Admiral David Farragut uttered the famous words, "Damn the torpedoes, full speed ahead!" There was no discussion of how he got to Mobile Bay or whether the cause of the fledgling country was worth shedding blood. Those decisions had already been made. Ultimately, Admiral Farragut emerged victorious from the Battle of Mobile Bay. The risks are always there. We should remember that the rewards are, too.