May 1, 2025

MidWestOne™
PRIVATE WEALTH

CAPITAL MARKETS OUTLOOK

Trumpian Tariff Policies Cannot Last

Market optimism surged following the 2024 US elections on expectations of pro-growth economic policies from the incoming Trump administration. The year began with the assumption of continued US economic expansion, despite the risk of a reacceleration in inflation, while global economies seemed poised for a slow-growth flight path. Yet, with less than 100 days into President Trump's second term we have seen a material shift in the global capital market landscape. Uncertainty has escalated on the heels of Trump's trade policies, and investors have steadily exited US assets, including US treasuries, and shifted into their global counterparts.

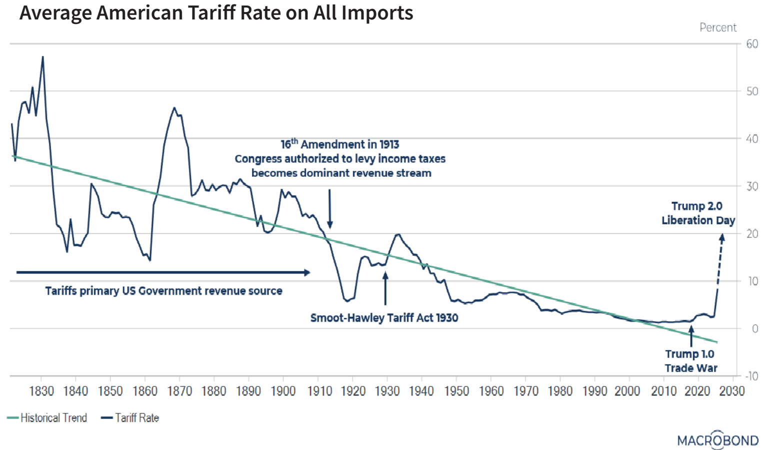
The vacillating levies placed on North American trading partners combined with the monumental tariffs applied on trading partners around the world have upended the global financial market outlook. Sentiment has shifted materially lower in response, and capital has fled the US. Through Q1, global equity markets are outpacing US counterparts by +10% to +25% as the major US equity indices have sold off materially, some of which have moved into bear market territory. The credit markets have experienced similar pain as investment grade and high yield corporate credit spreads expanded to the highest levels seen over the trailing 12 months. Remarkably, even US treasuries have not been immune. Historically, during periods of heightened market volatility US treasuries typically rally as investors rush into the global safe-haven asset. However, US treasuries have failed to rally during this recent bout of market weakness, suggesting in part a growing concern around the stability and reliability of US debt. At present, many US tariffs have been paused, with the exception China. Still, it remains to be seen if meaningful trade resolutions will be achieved. Be that as it may, we do not expect US trade policy uncertainty to persist over the near-term. The economic and political consequences of an extended trade conflict are too severe, suggesting that judiciousness will eventually prevail.

US Tariff Policy, a Historical Overview

When viewed within the context of history, the trade policies enacted by President Trump in this administration significantly diverges from the long-term trend dating back to the founding of the United States. The average American tariff rate following the April 2 "Liberation Day" announcement has pushed trade levies to levels not seen in well over a century. The magnitude of the tariffs imposed and the protectionist rhetoric coming out of the White House is a clear departure from a global trade paradigm to an isolationist model centered around an American production and manufacturing economy. Yet, the feasibility of such a paradigm shift may prove to be quite difficult as services presently account for more than 75% of US GDP. At a minimum, the lead time and capital investments necessary for the expansion of a US manufacturing economy would be substantial.

Further, the aggressiveness of Trump's recent trade policies runs counter to the lessons learned from the Smoot-Hawley Tariff Act of 1930. With the onset of the Great Depression in October of 1929, the US dramatically raised tariffs on tens of thousands of imported goods under Smoot-Hawley with the aim of protecting American agriculture and manufacturing. However, other nations responded with retaliatory tariffs of their own, ultimately leading to a collapse in global trade and further exacerbating the effects of the Great Depression. Smoot-Hawley trade policy clearly illustrates the risks of protectionist strategies to international trade and economic activity.

Average American Tariff Rate on All Imports



continued on page 2

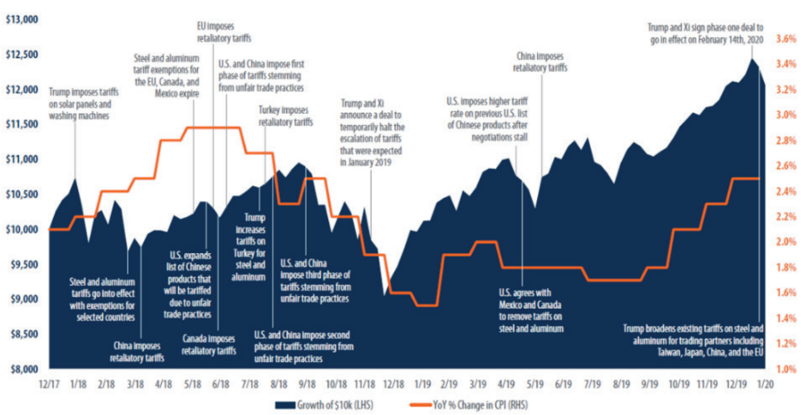
MidWestOne™ PRIVATE WEALTH

CAPITAL MARKETS OUTLOOK

Trump 1.0 Tariff Policy

A study of trade levies implemented during Trump's first administration sheds light on the President's belief in the efficacy of tariffs. Early in Trump's first term tariffs were applied on steel, aluminum, solar panels, washing machines, and a host of other items against the EU, Canada, Mexico, Turkey, and China. While certain tariffs eventually expired, others did not, resulting in retaliatory actions by impacted nations, namely China and Turkey. Nevertheless, tariff activity eventually diminished in the latter half of that first term even as trade negotiations stalled. Using this experience as a guide, it stands to reason that the recent surge in tariff activity early in Trump's second term may also subside in the months ahead.

S&P 500 Growth of $10,000 and YoY CPI Change



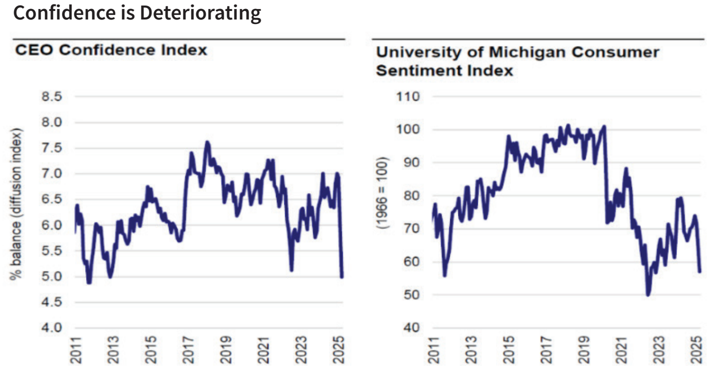
Source: First Trust, Peterson Institute for International Economics, Bloomberg. Data from 12/19/2017 – 1/31/2020

More importantly, inflation remained ranged bound during Trump's first term, with CPI printing between 1.5% and 2.8%. In addition, equity markets, as measured by the S&P 500, moved to new highs during that period as well. These conditions very likely shape Trump's view as it relates to the economic effects of tariffs, presumably providing the evidence needed to pursue global trade levies. Be that as it may, it is important to note that the tariffs applied during Trump's first term pale in comparison to the scale and scope of the tariffs enacted in his second term. Further, global capital market reaction has been alarming in this second round. The US has maintained a global trade policy for many decades during which time economic expansion coincided with declining and/or low tariff rates. The President's dramatic shift away from a global trade model, and the significance of the US economy to the global system is rightly concerning.

Sentiment and Politics are Not Supportive

Elevated uncertainty is detrimental to economic activity, and consumers and corporations alike have expressed their dissatisfaction with President Trump's tariff actions. The University of MI Consumer Sentiment Index has receded sharply YTD and is approaching levels last seen during the post-pandemic inflationary spike of 2022 and the US debt ceiling uncertainty of 2011. Chief Executive Magazine's CEO Confidence Index shows similar concern among corporate executives with recent survey data approaching the lowest levels seen over the past 15 years.

Confidence is Deteriorating



Source: Chief Executive Magazine CEO Confidence Index 3/25, University of Michigan Consumer Sentiment Index 3/25

At the same time, there is a high probability that the uncertainty regarding tariffs has begun to influence consumer behavior. Retail sales activity surged over the first quarter, driven largely by motor vehicle purchases. This "hard" economic data is consistent with the growing narrative around consumers frontloading large, durable goods purchases to avoid the growing risk of oncoming inflation. Inflation induced changes in consumer behavior such as these are typically not positive for economic activity as they pull consumption activity forward and have the potential to reduce consumption going into the future.

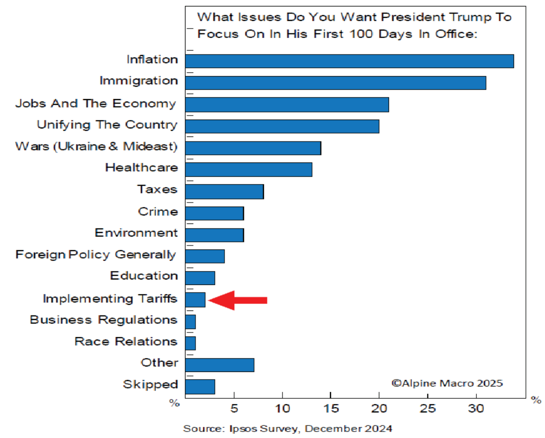
continued on page 3

MidWestOne™ PRIVATE WEALTH

CAPITAL MARKETS OUTLOOK

In addition, there are political constraints on how long a global trade war can continue. Voter surveys concerning which issues the President should focus attention over the first 100 days in office shows implementing tariffs near the bottom of the list with less than 5% of respondents. Conversely, issues such as inflation and the economy were at or near the top of the list with over 30% and over 20% of respondents surveyed. That tariffs are widely expected to negatively impact both inflation and the economy, combined with that fact that these effects are detrimental to the issues most important to voters, suggests that there is a substantial political cost to Trump in a sustained trade war. With finite political capital to spend, and tariffs being a high political expense, it is quite plausible that the trade war initiated by Trump dissipates over the near-term. Not only would this be consistent with the pattern exhibited during Trump's first term, but it would, in all likelihood, be politically expedient.

Voters Aren't Excited About Tariffs



So Where Do We Go From Here?

President Trump campaigned aggressively on implementing tariffs, and given Congressional authority to unilaterally act on this issue, it should come as no surprise that he has taken quick action, even if the magnitude far exceeds any expectations. However, the overwhelming consensus among capital market participants is that trade conflicts are ultimately harmful to the global economy, as foreshadowed by the violent reactions across the global capital markets. Combined with an unpopularity among consumers and corporations, along with a meaningful risk of political backlash, a protracted global trade conflict by the Trump administration is unlikely. Nevertheless, until US tariff policies display greater clarity, high levels of volatility across the global financial ecosystem should be expected.

Our guidance through this uncertainty is to assume a defensive posture across equities and fixed income while expanding diversification across the globe and among asset sectors. Within equities, our recommendation is to lean into large companies in noncyclical sectors with high dividend paying capacity, as well as expanding international exposure with an emphasis on developed market economies. Regarding fixed income, we advocate for a neutral duration stance however believe positioning for yield curve steepening is necessary. Further, we advise improving overall credit quality while simultaneously reducing sensitivity to further selloffs across credit assets. Lastly, we feel there is a compelling case for holding ample cash reserves and alternative assets such as real estate and commodities to add stability and enhance diversification.

It is our view that Trump's tariff policies will have a limited shelf life, and that volatility will be elevated in the interim. Nevertheless, we also believe that it is prudent to look ahead to the economic policies in the queue, such as taxation and deregulation. The preliminary language around individual and corporate taxes, as well as changes in the regulatory environment should be supportive of the capital markets. We strongly recommend that investors are prepared to respond once the fog of Trumpian tariff policies clear.