

## Beware the 'I's of March (Part 1)

Yes, I know that's not how the phrase goes. But as I settle into my new role at The Simmons Partnership, Inc., I couldn't help but include a little of what my wife calls "dad humor" into what will be my first in a series of regular updates on the economy and markets.

The allusion to Shakespeare's classic, *Julius Caesar*, is both self-serving and apt. Coincidentally, many of the economic indicators on my radar recently happen to start with the letter "I"—international trade, inflation, interest rates, and income growth—so it gave me an opportunity to try my hand at wit. Additionally, as investors, we must be conscious of the current political climate and resultant economic uncertainty—we need to understand the political and economic climate that governs markets. However, we also need to remember that while the day-to-day changes in the political wind may drive headline risk, we must not lose focus of our long-term goals.

There's a lot going on, so I decided to split this newsletter into two parts. In this first part, I tackle international trade, a theme that will have consequences for next week's post.

### International Trade

Almost every mainstream economist I know of agrees that tariffs are universally bad for the economy and for consumers. Greg Mankiw, a renowned Harvard economist for whom I have a great deal of respect, summarizes it this way in a recent [blog post](#): *Tariffs reduce productivity because they prevent the international marketplace from allocating resources to their best use. Lower productivity means lower real incomes. Lower real incomes could take the form of either (1) a higher price level for given nominal incomes or (2) lower nominal incomes for a given price level. Whether (1) or (2) occurs depends largely on monetary policy.*

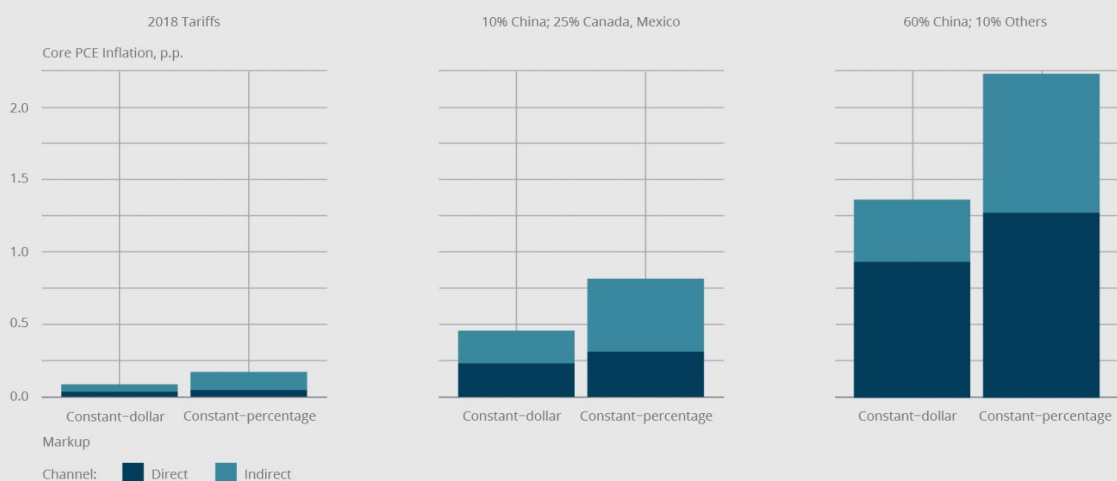
Put simply, tariffs are a tax on foreign goods and when you tax something you get less of it. In this case, we will get fewer imports, lower economic output, and lower growth. Domestic consumers will bear the vast majority of the

additional costs in the form of 1) higher prices (inflation), and/or 2) lower nominal incomes (due to lost productivity and output).

**The point that most people miss in casual conversation is that this result is not simply because the tariffs are passed through directly to consumers—higher prices are the result of a supply shift.** The purpose of tariffs is to protect domestic industry by shifting production away from lower-cost foreign producers. However, in the short-run supply contracts, driving up prices, and reducing output.

In a [recent piece](#), economists at the Federal Reserve Bank of Boston estimate these first-order effects of the latest tariffs on Mexico, Canada, and China could add between 0.5 and 0.8 percentage points to core PCE inflation (which, as of the January estimate, is already at an annualized rate of 2.5%—the next estimate is due out on March 28<sup>th</sup>).

Figure 4: Contribution of 2018 Tariffs and 2025 Tariff Scenarios to PCE Inflation  
Holding the rest of the economy constant



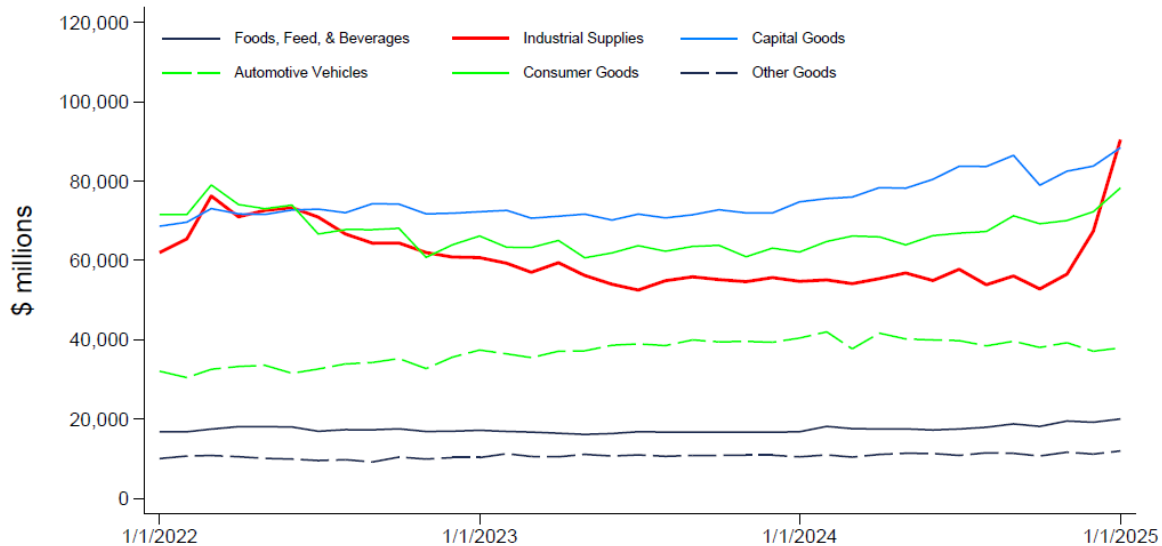
Note(s): We compute the Core PCE contribution of 2018 tariffs using import tariff increases and targeted product-country categories from Fajgelbaum et al. (2019) weighted by the PCE contribution of each product. The country-product contributions refer to 2017 data. We compute the two scenarios for 2025 using our PCE contribution shares and assuming (1) a 25 percent tariff increase on all imports from Canada and Mexico and a 10 percent additional tariff on all imports from China and (2) a 60 percent tariff increase on all imports from China and a 10 percent increase on all other imports.

Source(s): US Bureau of Economic Analysis, US Census Bureau, Fajgelbaum et al. (2019), and authors' calculations.

But second order effects matter too. [To use a specific example](#), last week President Trump threatened a 200% tariff on alcoholic beverages from Europe. If, as a result, your weekend bottle of Veuve Clicquot increases by 80% from \$50 to \$90 (first-order effect), you might simply choose to substitute to a domestic vintage or take to being a bourbon drinker like me. The problem is, the domestic production of wine and spirits is fixed in the short-run and therefore cannot immediately adjust to higher demand, so domestic prices increase too (second-order effect). **The bottom line is this: domestic producers benefit at the expense of domestic consumers—consumers pay more.**

The full impact of the trade war remains to be seen, and it may take some time for price increases to work their way through the economy and into official statistics. Why? For one, businesses and consumers have been pulling forward a lot of economic activity in advance of the tariffs. Case in point, the [March 6<sup>th</sup> release](#) by the U.S. Census Bureau showed a 34% month-over-month increase in the U.S. trade deficit, driven by an increase in imports of industrial supplies, as U.S. firms pulled forward demand for inputs to production ahead of President Trump's tariffs (see graph, below).

Imports of Industrial Goods Surge  
as Firms Pull Forward Demand Ahead of Tariffs

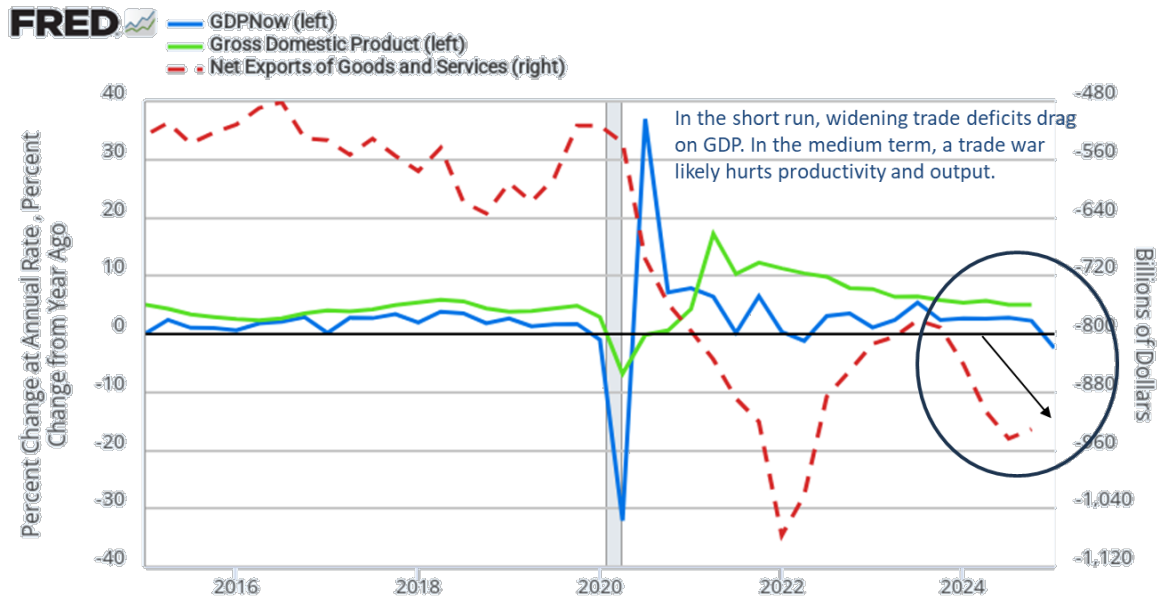


Source: U.S. Census Bureau

[As I noted in a post](#) earlier this month, widening trade deficits will be a drag on GDP in the short run, but in the intermediate term a protracted trade war could erode productivity and output and further damage our reputation with key trading partners.

We will see this theme continue to play out over the next few months. The question for investors is, with Q1 GDP due to be released on April 30<sup>th</sup>, how will the policy decisions coming out of D.C. impact economic growth in

2025? So far, it doesn't look great. Looking at the totality of the shocks so far—slashing government spending, layoffs of federal employees and subsequent spillovers into other sectors (hospitals, universities, defense, government contractors, etc.)—**the probability of a recession has increased substantially.** As of the writing of this piece (March 24<sup>th</sup>), the [Atlanta Fed's GDPNow](#) forecast projected Q1 GDP of -1.8%, down from 2.3% in Q4 of 2024.



Sources: Federal Reserve Bank of Atlanta; U.S. Bureau of Economic Analysis via FRED®  
Shaded areas indicate U.S. recessions.

myf.red/g/1Ee9l

### So what does the trade war mean for your money?

As I will cover in Part 2 of this newsletter, the economy is generally strong. Inflation remains slightly elevated but has moderated from the highs experienced over the past few years. The job market is balanced—unemployment is close to its natural rate and wages are growing. Hiring is constrained but layoff rates are also low—so people are not losing their jobs, but those who are unemployed tend to be unemployed longer. Consumers have generally done okay but sentiment has taken a hit recently—consumers have burned through cash hoarded during the pandemic and they have accumulated record amounts of debt at increasingly higher rates.

We are sitting at a delicate balance—this is the “wait and see” economy. As Federal Reserve Chairman Jay Powell said in his press conference on March 19<sup>th</sup>, “we are well positioned to wait for further clarity.” I see two immediate threats that could push us into recession: a protracted trade war (which could bring a perfect storm of stagnating growth and inflation that economists refer to as “stagflation”) and further erosion of consumer confidence.

Regardless of whether we enter a period of stagflation or outright recession, it will likely be choppy seas ahead for equities. At The Simmons Partnership, Inc., we remain vigilant of further volatility to the downside and are keeping some cash on hand to take advantage of good values in the markets when they arise. As noted in [my post](#) last week, index investors have learned the hard way over the past month that ETFs and index funds that track “the market” are heavily concentrated in a handful of tech stocks that are likely to underperform in a downturn. During turbulent economic times, it is important to have a steady hand at the wheel—having seasoned investment professionals actively managing your portfolio and proactively hedging your downside risk is key to weathering the looming economic storm.

**Ricci L. Reber, Ph.D.**  
Chief Economist and Portfolio Manager  
**The Simmons Partnership, Inc.**

*“Delivering Advice with Passion & Integrity”*  
(443)470-8000 office  
(443)470-8887 direct

**IMPORTANT NOTE FROM THE SIMMONS PARTNERSHIP LLC**

The Simmons Partnership LLC (“The Simmons Partnership”) is an investment advisor located in Maryland. The Simmons Partnership and its representatives are in compliance with the current registration requirements of those states in which The Simmons Partnership maintains clients. The Simmons Partnership may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from registration requirements. The attached selected materials are aggregated by The Simmons Partnership for your information only. The Simmons Partnership is not representing that the views in the attached materials are the only views on the subject matter, or that the views or conclusions depicted in the materials represent guaranteed outcomes. Many of the materials include charts or graphs prepared by third parties. These third parties prepared such charts and graphs using their own information or information they believed to be reliable. The Simmons Partnership has not independently verified either the underlying data or any of the intimated or directly stated conclusions of such materials. The Simmons Partnership does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party, whether linked to The Simmons Partnership’s website or incorporated herein, and takes no responsibility thereof. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly. The distribution of the attached materials should not be construed by any consumer and/or prospective client as The Simmons Partnership’s solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation. Any communication by The Simmons Partnership with a client or prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the person resides. A copy of The Simmons Partnership’s current written disclosure statement discussing The Simmons Partnership’s business operations, services, and fees is available from The Simmons Partnership upon request. Past performance may not be indicative of future results. Historical information about investments or financial markets is not necessarily indicative of future market behavior or the wisdom of any particular investment, investment strategy, or asset allocation. Therefore, no current or prospective client should assume that future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by The Simmons Partnership) or product made reference to directly or indirectly by The Simmons Partnership will be profitable. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will either be suitable or profitable for a client or prospective client’s investment portfolio. Historical performance results for investment indices and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results.