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CIOs' View on Announcement of US Reciprocal Tariff and Impact on Major Markets

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The following are our views and outlooks on the recent market turmoil since the announcement of reciprocal tariff by the US Trump Administration, covering global and Japanese equities, global bond, and foreign exchange markets.

Global Equity Market Outlook

Takahiro Nakayama, Senior Managing Director,

Chief Investment Officer - Active Global Investments

The US equity market experienced a decline of over 10% on the 3rd and 4th of April, following the announcement of reciprocal tariffs by US President Donald Trump on the 2nd. The policy imposes a uniform base tariff of 10% on all imported goods and additional levy for countries and regions depending on existing tariffs and non-tariff barriers. The additional tax rates have been harsher than market expectations, set at 24% for Japan, 20% for the EU (European Union), and 54% for China including the tariffs already implemented. The EU and China have indicated plans to impose retaliatory tariffs on US imports in response, leading to significant declines in stock prices amid escalating trade war concerns.

The reciprocal tariffs announced by the US to reduce the trade deficit, if implemented as is, are expected to raise the effective tariff rate to the mid-20% range, marking the highest level since the post-war era. Such high tariffs are likely to reduce consumer spending in the US through increased prices for imported goods, potentially leading to an economic downturn. As President Trump pushes to 'revive' American manufacturing, there is growing concern about the broad impact of this change given the significant adjustments it may cause to the current global supply chain. On the other hand, President Trump has also signaled his willingness to negotiations, not ruling out the possibility of tariff reductions. In addition, if these tariffs are used as a source of revenue to extend income tax cuts or reduce corporate taxes, it is expected to provide some degree of stimulus to the economy.

We believe that the corporate earnings trends for 2025 will be important indicator for assessing future market trends. Assuming the forecast for the S&P500 to see earnings growth of 11% in 2025 holds, the valuation of the S&P 500 index is likely to adjust from around 25x at the end of last year to about 19x. However, we expect the earnings growth forecast to be downgraded once the impact of the reciprocal tariffs have been factored in. If we assume zero growth (profit levels equal to the previous year), EPS would be around $243, which at 20x PER would put the S&P 500 index at between 4,800 and 4,900.

Furthermore, the difficulty for companies to assess the impact of reciprocal tariffs undermines the reliability of the forecasts, potentially leading to a decline in valuations or increased volatility in the near term. In this context, we expect a market characterized by high volatility, given the potential for significant changes in tariff policies and the earnings of affected companies.

Attention will also be focused on the movements of the Federal Reserve (Fed). Fed Chairman Jerome Powell indicated a wait-and-see stance during a speech on April 4th. However, we believe the Fed could be compelled to lower rates in response to the potential slowdown in the job market and economic stagnation, while remaining vigilant about inflation risks posed by tariffs. We will continue to monitor the Fed's developments closely.

While keeping an eye on various countries' tariff policies, monetary policies, and corporate earnings trends, we aim to capitalize on undervalued valuations of stocks that are believed to be relatively less affected by tariffs, as well as those expected to see continued demand expansion even under uncertain economic conditions.

Japanese Equity Market Outlook

Shintaro Harada, CIO – Active Japanese Equity

The Japanese stock market experienced further declines on April 7th, with the Nikkei Stock Average falling below its 2024 low of 31,458 yen (on August 5, 2024), highlighting the depth of the impact of US tariffs.

While it is common for markets to rebound after a sharp drop from one-off events, a surge in macro and micro uncertainties beyond expectations has made the impact of tariffs difficult to measure. Additionally, it is challenging to gauge the realistic impact in the future, leading us to believe that the market will remain in the current range with a certain degree of volatility.

That being said, TOPIX's PER has dropped to the 12x range following the decline, which is a level recorded only a few times since the GFC in 2008: after the Great East Japan Earthquake in 2011, the political turmoil period before the second Abe administration in 2012, the China Shock in 2015, and the early stages of the COVID-19 pandemic in 2020. Given this context, one could argue that the recent decline in stock prices has already factored in the series of disruptions expected from the tariffs. However, considering the increasing possibility of a slowdown in the US economy, there may be further downside to the PER levels when factoring in the economic slowdown on a global scale.

The impact of these tariffs is not just limited to rising prices on final goods for consumers or rising costs for companies who elect to absorb them. The state of the global economy, which has enjoyed economic expansion under free trade systems and optimal production locations, needs to be reassessed. Corporates may also add to market woes by deciding to withhold from making major investment decisions amid economic uncertainty. Until clearer perspectives emerge from ongoing negotiations between the US and various countries, we expect stock prices to remain volatile with limited upward potential in the near term.

In such an environment, however, there are still stocks that can maintain relatively strong performance and those that are less affected by tariffs. While it may not be possible to completely avoid the impact, there is a high likelihood that the short term volatility will lead to longer term opportunities as many stocks will likely become attractively valued relative to their medium- to long-term. Uncertain environments are when active stock selection becomes crucial, and we will strive to take advantage of the opportunities presented and maintain the performance of our investment portfolios.

Bond and Currency Market Outlook

Yuji Maeda, Chair of Fixed Income Investment Strategy Committee

Both the US and Japanese bond markets saw significant declines in government bond yields last week, while the yen appreciated versus the US dollar. In response to President Trump's reciprocal tariffs, China announced additional tariffs and export restrictions on rare earth materials, and the European Union (EU) are discussing a wide range of countermeasures, including measures that would impact major US technology companies. However, President Trump has not indicated any willingness to ease the tariff measures as of yet.

While the euro and yen have recently appreciated against the US dollar, emerging market currencies and currencies of commodity-exporting countries including the Australian dollar have declined against the US dollar. The yen momentarily traded below 145 yen per US dollar on April 7th, and this yen appreciation has been observed against many other currencies as well.

Looking ahead in the currency market, we believe the US dollar may continue to weaken against major currencies, including the yen, based on the view that the Federal Reserve (Fed) will resume interest rate cuts. In a speech on April 4th, Chairman Powell indicated a wait-and-see stance amid high uncertainty around the growth and the inflation in the US. However, it is becoming increasingly likely that the strong US labor market will slow down due to Trump's tariffs, and the significant decline in stock prices could add further pressure on US consumer spending. While the Fed is expected to remain vigilant and carefully consider any tariff related inflationary pressures, we believe slowing labor markets and economic stagnation may force the Fed to respond with rate cuts. In such a scenario, we expect the US dollar to depreciate against major currencies like the yen and euro, especially if risk-averse sentiment continues in the stock market.

Additionally, we are paying attention to the longer term impact of US tariff policy leading to the continuous depreciation in the US dollar. The US, which has a huge current account deficit, has relied on the inflow of foreign capital. However, if international trade and financial transactions shrink in the future, there is a risk that the US dollar may depreciate significantly.

In the US bond market, the yield on the 10-year Treasury bonds temporarily fell to 3.85% on April 4th, reaching its lowest level since early October 2024. As signs of an economic slowdown become evident through economic indicators related to the Fed's potential resumption of rate cuts and the adverse effects of tariffs, we believe US Treasury yields will continue to decline. We expect that as the market prices in rate cuts, shorter-term bond yields is apt to show relative decline, resulting in a steeper yield curve.

In the Japanese bond market, significant interest rate declines are occurring against the backdrop of increasing global economic uncertainty. Expectations for an interest rate hikes by the Bank of Japan (BoJ) had driven the yield on the 10-year Japanese government bond to nearly 1.60% in late March, but it has since dropped down to 1.05% (as of 9 a.m. on April 7th). Given that the tariff imposed on Japan is 24%, which is higher than initially anticipated, there is a concern about the negative impact on Japan's economy. However, considering the increasing wage pressure due to domestic labor shortages and the current low level of policy interest rates, we believe the BoJ will continue to explore additional rate hikes. While the market is expected to remain volatile for the time being, considering the possibility of future rate increases by the BoJ, it is unlikely that the 10-year bond yield stays below 1%.

In a market environment where uncertainty is prevalent, we will seek any investment opportunities to generate high and stable investment performance for our clients.

Important Disclosures