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tariffs

WHY "TARIFF" HAS TWO F's

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Part 1: The Hidden Picture—Tariffs Everywhere!

The 'Da Vinci Code' was on to something—not only do words have overt meanings, but sometimes they embody cryptographic instructions. To us, that's the case with 'tariffs.'

Today, Global Wall Street is abuzz with tariff debates—how should investors interpret them?

Savvy investors know that 'tariffs' are part of a broader set of *functionally equivalent* trade controls—some with negative connotations (tariffs, duties, levies, excise taxes, trade restrictions, VAT, dumping), others sounding positive (subsidies, grants, aid, support, stimulus). For clarity, we'll use the trending term 'tariffs' as a general label for all trade controls.

Tariffs are neither new nor rare. Over 80% of global trade has flowed through a regime of tariffs for decades! These tariffs exist at all levels, from international to local (a key reason gasoline is 70% more expensive in California than in Mississippi). Free trade is an academic illusion and a geopolitical ruse—not an economic reality. It's always about tariffs—the defense of an existing regime or the strife for a new one.

While free trade advocates decry tariffs as "ineffective" or "detrimental," history shows that every post-WWII economic powerhouse—including Germany, Japan, Korea, Taiwan, and notably China—was partly built on aggressive trade controls, including tariffs!

Far from being the last resort of failing centrally planned economies, tariffs are also widely used in open economies (e.g., Scandinavia, Western Europe) driven by market lobbying.

But aren't tariffs inevitably harmful to consumers? As some economists recently put it, "Isn't a 20% tariff on Mexican avocados a 20% tax on American guacamole consumers?" Statements like this prove John Galbraith's (or Ezra Solomon's) famous quip: "The only function of economic forecasting is to make astrology look respectable."

Markets don't operate with rigid determinism but with dynamic, self-correcting complexity. If tariffs raise Mexican avocado prices, American consumers may shift preferences to other suppliers or foods *faster* than Mexican producers can find new buyers for their perishable crops. More broadly, consumers can adjust faster than exporters can retool their capital-intensive operations.

Additionally, in many cases, the currency of the tariff-imposing country tends to appreciate relative to the exporter's, offsetting 20-60% of the price hike (see the Mexican peso).

Investors should question the claim that since domestic importers—not foreign exporters—pay the tariffs, the costs are merely passed on to consumers. Regardless of who formally pays, the imposing state collects revenue, which can offset consumer burdens and shift buying behavior. This is why foreign exporters worry about tariffs.

So, are tariffs good for the US consumer and markets? As we will explore in Part 2—not so fast!

Part 2: The Hidden Code—Investing by the Double-F Rules

US tariffs fueled the country's growth in the 19th and early 20th centuries but became a headwind when misused during the Great Depression (Smoot-Hawley tariffs). Post-WWII, while trade 'liberalization' is often credited with driving US growth, the nations that grew the most during that period all relied on tariff regimes. Ironically, globalization didn't truly 'liberalize' trade; it merely imposed a new regime of trade controls—a status quo many have grown comfortable with, but now it's being challenged.

Given this mixed history, how should investors position their portfolios? What does the double-F in 'tariffs' instruct us to do? It's as simple as 1-2-3!

1. Don't trust economists' predictions [1]—they were wrong about post-COVID inflation being "transitory" and about a US recession being a "near certainty." The hidden code in 'tariFF'? *Forgo Forecasting*—a key insight now that tariffs have morphed into a negotiation chip and a political football.
2. Remember that in tariff wars, importer nations like the US, with consumer-oriented economies, trade deficits, stronger currencies, and technological superiority, are far less vulnerable than export-oriented nations with trade surpluses, weaker currencies, and technological disadvantages—not the other way around. China and Germany recognize this vulnerability and are working to overcome it. 'TariFF' warns us to beware of *Faulty Framing*.
3. Like our strategies, eschew fix allocations, and adjust to developments while practicing risk controls. Here, double-F in 'tariFF' stands for *Follow Foreign* and *Focus on Factors*, both explained below:

   When tariffs create winners and losers, portfolios can profit by adjusting dynamically to the differential performance of international indices and securities. And when tariff wars backfire globally (less common than headlines suggest), risk-controlled portfolios can turn defensive and lower exposure.

   Our research shows, one key way tariffs impact portfolios is by shifting the *Facto composition* of market opportunity—from Value to Growth, Large-cap to Small-cap, High to Low Volatility, High to Low Quality, Momentum to Mean Reversion, Concentration to Dispersion, or vice versa, depending on the conflict. Unfortunately, traditional management ignores the Factor composition of portfolios, exposing investors to dislocations, including tariff regime changes.

Why does 'tariff' have two F's? To urge investors to *Forgo Forecasting*, avoid *Faulty Framing*, *Follow Foreign* securities, and *Focus on the Factor* composition of their portfolios.

Interested in tariff-proofing your portfolio? We invite you to contact us for a review.

[1] https://www.linkedin.com/posts/konstantinos-kostas-grigorakis-cfa-754264103_who-is-the-best-economist-to-follow-in-activity-7150996145333260288-GX3U?utm_source=share&utm_medium=member_desktop&rcm=ACoAABozTTAB7_bL6T6pkI6yFlzuM8rHnhF3zMQ