

THE QUEEN'S GAMBIT—CHESS-GAMING TARIFFS

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Part 1: Aphorisms vs. Simulations

We've seen exogenous shocks impact markets before—not only in distal history (like the 1987 crash) but more recently as well: in 2020, it was CoViD; in 2025, it's tariffs; and arguably, in between, the Fed's rate recalcitrance of 2022.

As we've written previously, exogenous shocks often surprise the market and trigger crash-like responses. However, because they don't stem from underlying economic weakness or market dysfunction, they tend to resolve in the direction of the preexisting market regime.

The CoViD crash, for instance, recovered swiftly from a -37% drawdown, while the -27% drawdown of 2022 was promptly followed by the strong rally of 2023-2024. Historically, crashes are transient, transactional, episodic, and reversible—as long as they hit within a bullish market regime, as we believe is currently the case.

Still, unlike pandemics—where control is hard-won—tariffs are geo-economic struggles, more akin to geopolitical conflicts. Their dynamic and strategic nature makes them non-deterministic (not a simple X -> Y outcome) and resistant to economic aphorisms (“tariffs are always XYZ”).

Moreover, like all economic interactions, tariffs unfold over complex decision chains—an ideal domain for behavioral finance. As such, the most effective way to analyze them is through simulations involving human agents or neural networks and in strategic frameworks like war games or chess analogs.

Recently, the New York Times reported on a live trade war simulation involving two dozen experts at a Washington think tank [1]. The surprising conclusion: the US could achieve a path to victory using tariffs to strike piecemeal advantageous trade agreements. A far cry from many pundits' vociferous verdict that “tariffs are taxes on consumers” and, therefore, a unilateral burden.

With a background in behavioral finance and chess playing [2], however, I staged a different kind of simulation. This fusion has proven valuable before—most notably in capturing the dynamic of the post-2021 inflation surge, which proved resistant to the Fed's formulaic monetary policy [3].

So, are you ready to chess-game the tariff wars? A wealth of insight awaits investors who are ready to play it out!

[1] New York Times—Jim Tankersley (4/1/2025) “Inside a Trade War Game: There Is a Path to Victory,” updated by Ana Swanson (4/2/2025) “Want to Play a Game? Global Trade War is the New Washington Pastime.”

[2] <https://fa.wellsfargoadvisors.com/gnh-capital-group/team.htm>

[3] <https://fa.wellsfargoadvisors.com/gnh-capital-group/mediahandler/media/644371/GNH%20Capital%20Group%20-%20Behavioral%20Inflationomics.pdf>



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Part 2: The Five Kernel Variations

In the Chess Game of Tariffs, White is the Consumer/Importing Nation, and Black is the Producer/ Exporter Nation.

White opens with the Tariff Gambit, and the game branches out into two kernel variations based on Black's response.

1.0 *ABSORB VARIATION*:

Black chooses to pay the tariff, holding prices steady to defend market share and continue exporting. It's a swift check-mate –White wins!

Though this variation may seem implausible, the vast scale, profitability, and hyper-competitiveness of the U.S. market make it hard for global producers to forgo. When firms can't absorb tariffs, home governments often step in with export subsidies (like South Korea's recent fund helping its exporters cover tariff costs).

If Black refuses to absorb the tariff and instead attempts to pass it on to White, the game branches into four key variations, depending on White's response.

2.1 *PASS VARIATION*:

White rejects the price increase and refrains from purchasing. Though there may be short-term disappointment, retaining capital is a win—unspent money can compound or be redeployed. Black, meanwhile, is immediately penalized: unsold goods mean unrecovered costs, idle capacity, mounting debt, and risk of obsolescence. Especially with the US market being largely unsubstitutable, White wins—Black loses.

2.2 *DELAY VARIATION*:

White reacts to price increases by postponing the purchase. Again, while this may come with some disappointment or deferred gratification, the delay allows White to retain its capital, which continues to compound. For Black, however, the postponement is an immediate economic drag, as it ties up resources in unsold goods and faces the mounting costs of holding inventory that is subject to obsolescence. White is sailing into a winning endgame.

2.3 *SUBSTITUTE VARIATION*:

White redirects its purchase to a non- or partially-tariffed alternative—a win for White, which avoids some or all of the extra cost, and a clear loss for Black, which is left fully or partially uncompensated. The risk to Black grows significantly if the importing country can secure comparable goods at substantially lower or no tariffs—translating into an early loss for Black.

2.4 *PAY VARIATION*:

Where White proceeds with the tariffed purchase—by choice of necessity. This is often miscast as a blanket loss for White, echoing the familiar refrain “tariffs are a tax on the consumer.” But not so fast! The importing country collects the tariff and can redeploy the revenue to ease the impact—through tax breaks or subsidies. While this is the only variation where White is disadvantaged, smart policy can turn it into a draw.

It's four wins and a draw for White, four losses and a draw for Black—sharpening the New York Times' live simulation with a clearer behavioral map and an explicit odds calculus.

We'll explore the implications for investors in Part 3.

Part 3: Winning the Loser's Game

In Part 2, we identified Five Variations that give White (the Consumer/Importing Nation) four winning setups and a draw. A decisive advantage.

Investors often ask how payoffs evolve under retaliation. The answer: they don't, not fundamentally. These Five Variations are true kernels—their pros and cons persist through tit-for-tat cycles. They deliver consistent payoffs at every level, acting as powerful attractors that shape even the migration between Variations: Raising tariffs from 40% to 80% simply intensifies the pressure, pushing consumers further from Pay toward Delay, Substitute, or Pass. Over time, out of necessity, some Delay may transition to Pay, but others will shift to Substitute or Absorb, as exporters sacrifice to revive sales—still, no fundamental change. In chess terms, a compromised opening doesn't support a commanding mid- or endgame. And as weakness persists, the paths to checkmate Black multiply, likely shortening the match.

So why do participants engage at all, given White's edge?

There are many reasons: ignorance (experts and policymakers captive to clichés and lacking modeling insight), misplaced pride, inertia, complacency, and self-interest (defending entrenched positions is often seen as a fiduciary duty). The most viable reason? Tactical calculation:

Even winning positions demand precise execution. Black's hope is that White missteps under pressure. It's White's to lose—and White may still blunder.

Black also plays on time. With expertise scarce, confusion rampant, and both political and social pressures mounting, even strong players can blink or be forced to fold. A winning setup still needs to be carried through to checkmate—and the clock may run out on White.

Still, Black pays a steep price as its penalties accrue almost instantly, weakening its staying power. In a well-executed game, Black is on a much shorter clock. Investors should take heart: the turmoil of tariff wars is often shorter-lived than its intensity implies. Patience can pay.

So, how should investors navigate a tariff war?

While a portfolio aligned with White has stronger prospects, investors don't need to predict who will blink, blunder, run out of time, or win. Tariff wars resolve by confirming old winners or revealing new ones. Those with market-adaptive, risk-controlled, tax-aware portfolios—preferably rules-based and insulated from sentiment—are engineered to ride out the turmoil and adjust as needed. This is the focus of our strategies.

However, traditional fixed-allocation portfolios can be severely challenged by the record volatility, sharp drawdowns, and potential leadership shifts accompanying generalized tariff wars—such turmoil tends to strain their design limits and push their expected operational envelopes.

Our extensive quantitative background and behavioral finance lens enable us to sidestep Wall Street's groupthink, filtering out market noise to amplify rare, actionable signals. We invite you to explore how our strategies can help you build a resilient portfolio!

Part 4: History Confirms!

Like military conflicts, tariff wars may seem chaotic—but beneath the surface lies an elemental distribution of strengths and weaknesses that shapes the true balance of power. Our chess-gaming simulation captures this structure by mapping the full matrix of behavioral payoffs behind tariff dynamics—casting Consumers/Importers as White and Producers/Exporters as Black.

When White initiates a tariff war, it may seem self-destructive, but in reality (as our title signals), it plays a *gambit*—chess-speak for a calculated sacrifice to gain an advantage. As shown in Part 3, the advantage is decisive: White holds the superior hand, with four wins and a draw across the five possible variations. It's White's game to lose. Yet even the strongest hand must be played out without blinking, blundering, or running out of time under pressure or constraint.

Both our simulation and the one reported by the New York Times converge on the same conclusion—but ours goes further. By modeling behavioral payoffs, instead of running specific negotiations, it generalizes across time and context. Our model explains the historical evolution of tariffs with their dramatic reversals of fortune:

After devastating wars, Germany, Japan, and Taiwan in the 1940s and Korea in the 1950s rose from the ashes as starved consumer societies with no industrial base. They were the White. Facing them was Black—the industrial superpower of the USA.

Leveraging the structural advantage captured in our model, these nations imposed steep tariffs, erected high import barriers, and launched massive (re)industrialization drives. Their gambit as Whites paid off [1]:

Japan consistently outgrew the US in the 1950s (~9.7% vs. ~4.3%), 1960s (~9.0% vs. ~4.4%), 1970s (~4.1% vs. ~3.2%), and 1980s (~4.0% vs. ~3.2%), until its unrelated 1990s real estate crash.

Korea followed suit (1960s ~8.3%, 1970s ~8.0%, 1980s ~7.0%, 1990s ~5.7% vs. ~3.6%, 2000s ~4.3% vs. 2.3%, 2010s ~3.3% vs. ~2.3%). China replicated the same recipe starting in the 1980s (1980s ~10.5%, 1990s ~10.0%, 2000s ~10.5%, 2010s ~7.7%, 2020–2023 ~4.5% vs. 2.1%), as did Taiwan and India.

There are more examples, but the pattern is the same, and the message is clear: back then, the roles were reversed, yet White held the structural advantage and used it to shape the balance of power.

Today, the same players face off again, with roles inverted. And while, as we have seen, the payoff matrix runs deep and is generalizable across history, the outcome isn't fully set. It's still White's to lose, and it must be careful not to blink, blunder, or run out of time.

We invite you to explore with us the opportunity to create a portfolio designed to filter out the noise of tariff oscillations!

[1] Data Source: The World Bank – World Development Indicators; Penn World Table (PWT) – University of Groningen.

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