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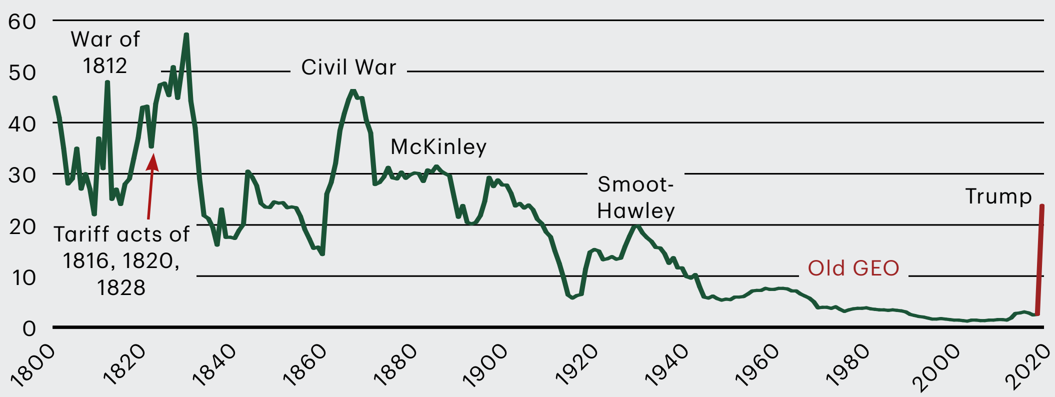
# The Days After Liberation Day

Current headlines are dominated by talk of tariffs following U.S. President Donald Trump's announcement of reciprocal tariffs on roughly 90 countries on what he called "Liberation Day." The President announced a baseline 10% tariff on imports, which was largely already priced into the market, but the additional country-specific tariffs bring the average effective rate to 23%+, the highest it has been in more than 100 years (**Figure 1**) and the market sees this as unreasonable. While the President has now paused the additional country-specific tariffs for most countries for 90 days, the 10% tariff remains in place.

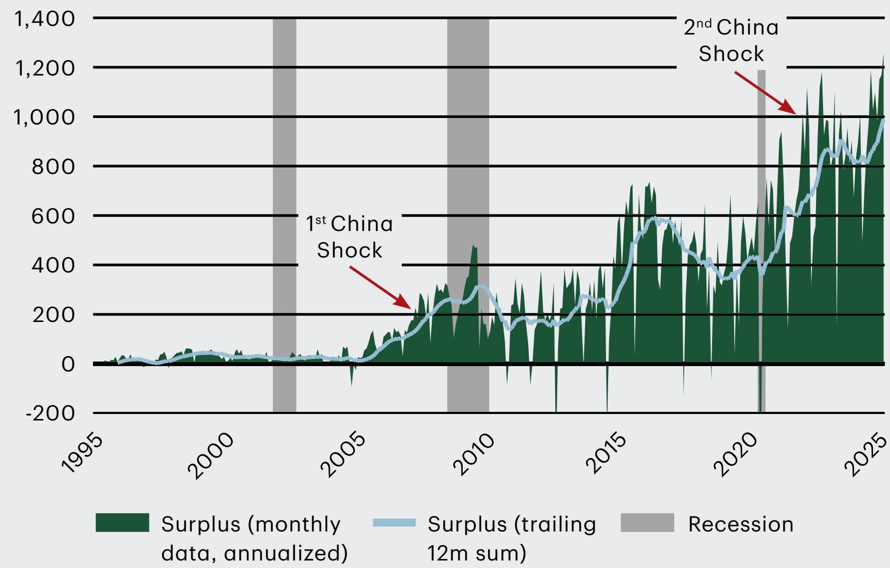
**Figure 1: U.S. average effective tariff rate (%): The highest since 1910**




Sources: Census.gov, Bloomberg Finance L.P.

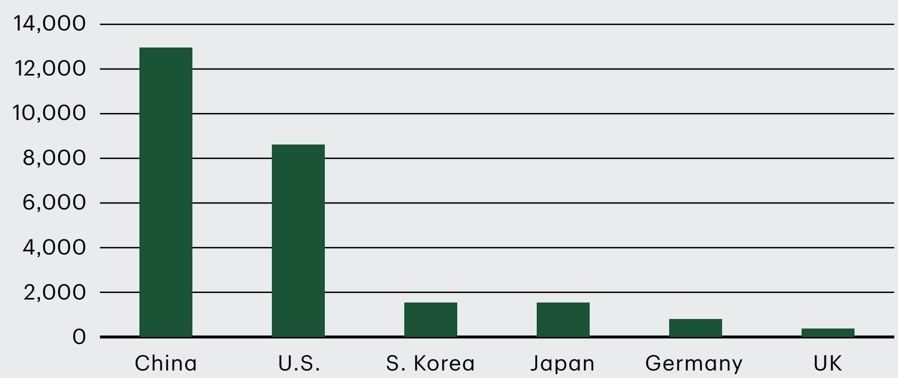
While the "Liberation Day" announcement covered a large swath of the world, the focus of the new global order that the President is trying to usher in is largely on China, with secondary concerns about the EU, as we discussed in our paper Trump Tariffs and Trade: Toward a New Global Economic Order. It was actually China that upended the old global order, challenging the U.S. on all three dimensions of power – economic strength, tech prowess and defense capabilities. As shown in Figure 2, the Chinese goods surplus with the U.S. has a trillion-dollar run rate, largely because China only believes in one-way trade. On tech, China saw many more patents granted than the U.S. in the first 10 months of 2024 as shown in Figure 3, though it is important to note that U.S. patents are cited seven times more often. Finally, on defense, China and Russia combined now spend as much on defense as the U.S. does.

**Figure 2: China goods surplus (USD bn)**




Source: Bloomberg Finance L.P.

**Figure 3: Tech patents granted (during first ten months of 2024)**




Source: Bloomberg Finance L.P.

China initially retaliated against the U.S. tariffs by implementing its own 34% tariff on U.S. imports and devaluing its currency. This led President Trump to increase the tariff to 104% with China then raising its tariff to 84%. The Administration then raised the rate even further, to 125%, and excluded China from the 90 day pause. It remains to be seen how long this tit for tat will draw out.

Given the unpredictability of President Trump's tariff policies (possibly by design), a question on many investors' minds is whether the tariffs are here to stay. That question is also on the minds of many of the leaders of the countries on which the tariffs were imposed. In fact, according to the White House, more than 50 countries have reached out to the U.S. to begin negotiations and a few have already sent trade representatives to DC. For North-East Asian countries, such as Japan, South Korea and Taiwan, there is plenty of room to make a deal. For other countries, where the leaders are close to the President, like Israel and India, a deal should be fairly straightforward. A deal with the EU would be a little more complex as there are a number of tough issues in the relationship including the Value-Added Tax (VAT) which the Administration considers to be a trade barrier, the Digital Services Tax (DST), which impacts large U.S. tech companies and the Common Agriculture Policy (CAP) which relates to agricultural subsidies.

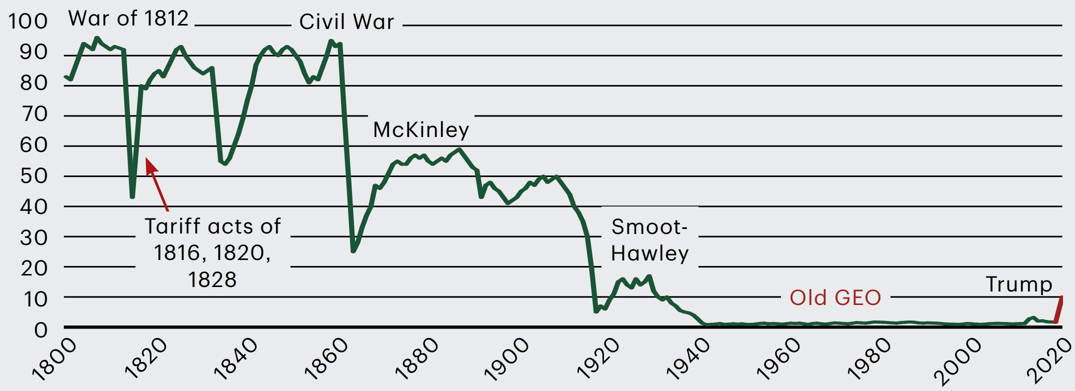
The key upside risk is that the Trump administration pivots hard toward the "Art of the Deal." The U.S. now possesses a great deal of leverage, and easy wins would result if allies increase their defense spending, commit to build factories in America, lower tariffs, reduce non-tariff barriers, buy more U.S. liquified natural gas (LNG) and agriculture products, let their currencies appreciate, and coordinate more fully with the U.S. against their common rivals.

Following negotiations, the next step in the plan is for the Administration to focus on a pro-growth agenda of tax cuts, de-regulation and a pro-tech push. If all goes according to plan, which is admittedly optimistic, the markets will move higher and the economy will accelerate before the 2026 mid-term elections.

While negotiation is sure to take place and changes are likely, we believe that many tariffs will not be negotiated away completely. As mentioned, the President is determined to restructure the global economic order and tariffs are a key tool for achieving that vision. In addition, the Trump administration hopes to use the additional revenue from the tariffs to help pay for additional tax cuts this year as part of the "Big Beautiful Bill." Some predictions believe that the share of Federal revenues coming from tariffs could be as high as $500 billion this year, as shown in **Figure 4**.

While unlikely, if the tariffs remain in place as announced, we believe a recession in 2025 is 60% likely. Using financial/economic betting sites as a gauge, the market believes there is a two-thirds chance that GDP comes in below 0%. In this scenario, we believe that inflation will be above 3.5%, higher than the average for the past 10 years. Finally, the market has priced in 4 or 5 cuts over the next twelve months, though the Fed's last bet on transitory inflation worked out badly, which might make it uneasy. Again, these are the indications if the tariffs go forward as announced, but we believe there will be large-scale changes to many of them. Ultimately, it seems as though the only certainty is uncertainty.

**Figure 4: Share of Federal Revenues from Customs Duties (%)**




Sources: Census.gov, Bloomberg Finance L.P.

## Implications for Investors

In times of market uncertainty, such as the current environment where trade tensions are destabilizing the geopolitical order, it's only natural to feel unsettled. The headlines are noisy, volatility has spiked, and the path forward is unclear. But it is during moments like this that our investment philosophy and processes matter most. Since the inception of TD Epoch in 2004, we have managed client assets based on a singular investment philosophy focused on free cash flow and capital allocation. This philosophy is rooted in first principles of finance and has stood the test of time, through both bull and bear markets, and against the backdrop of significant shocks including the Global Financial Crisis in 2008 and the COVID pandemic in 2020. Our investment processes emphasize rigorous fundamental analysis and integrated risk management. Faithfully sticking to our idea generation, company analysis, and portfolio construction and risk management processes provides an anchor and a compass to navigate these choppy waters without getting swept up in emotion. Our approach takes a long-term perspective, which helps protect against over-reacting to unsettling developments. History has shown that remaining disciplined has rewarded patient investors over time. No one can predict how or when the current tariff war will be resolved. But we do have a firm conviction that the types of companies we invest in — those with strong competitive advantages, that generate free cash flow, have strong balance sheets, and are run by excellent management teams — should have the ability to adapt and endure through this environment and even emerge stronger on the other side. At the portfolio level, diversification across regions, sectors, and business models provides an additional cushion against today's uncertainty and volatility.

We remain committed to managing our clients' assets against this tumultuous backdrop with rigor, discipline, and the humility to accept that the future is unknowable, but our philosophy and process can help guide the way.

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