

The (Trade) War You Start May Not Be the War You Get

May 7, 2025

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It is a cliché of military history that it is easier to start a war than to end one, and the war one starts may not be the war one gets. If recent selloffs in the US Treasury, stock and dollar markets are any indication, this adage may also hold true for trade wars. In my view, the US is facing fiscal and reputational reckonings and changes in fund flows that could be negative for the dollar and other US assets for a period measured in years, not months.

Fiscal contraction

Tariffs are a form of fiscal tightening, which would point to slower real growth, weaker equities, lower yields, lower oil prices and a weaker US dollar. So why do it? The US government needs money. Total net Treasury debt is 98% of GDP, or \$30 trillion. Revenues are in the 17% of GDP range, spending is above 23%. The deficit is 6%-7% of GDP.[1] The bond vigilantes are grooming their horses. Spending cuts are the government's first resort, but neither betting markets nor Street estimates are calling for DOGE cuts to hit the mark. Tackling transfer payments—Medicare, Medicaid, and Social Security—in a serious way is politically fraught and probably not expedient, in my view. That leaves taxes.



There is approximately zero appetite for a bipartisan tax and spending package along the lines of the Bowles-Simpson deficit reduction proposal of 2010 (which failed) in a deeply divided, tax-averse Congress. Tariffs are the one kind of tax that can be enacted by presidential decree. The initial average tariff proposed on "Liberation Day" of about 22%-23% would have amounted to an estimated 1.5%-2.0% of GDP fiscal tightening.

I doubt this will ultimately be the effective rate, but perhaps we land on an effective rate of 12%-15% (a baseline 10% tariff on every country, with much higher rates for China). Stay tuned. This is not equivalent to a value-added tax (VAT), but it rhymes. I believe consumers will ultimately pay most of it, like a VAT (incidence attribution is complicated). Fiscal tightening is not the only near-term challenge to growth; tariff uncertainty alone seems likely to slow discretionary consumer spending and company investment plans. Recession may not be inevitable, but I think a slowdown seems likely.

Reagan-era reversal

I also see potential pain points when I compare today's policy and market realities to history. Current policy settings and portfolio positioning look like the opposite of what we saw from 1980-1982 during the first Reagan administration. Back then, we had a massive fiscal ease (tax cuts, defense buildup) and an even more massive monetary tightening (Volcker). US equities and bond markets were under-owned by the rest of the world after the 1970s inflation decade. Once investors figured out Reaganomics, capital flooded into the US, and the US dollar rose for four years, not peaking until 1985.

Today, the situation is reversed. US equities are heavily held by the rest of the world (about 20% of total), as are Treasuries (33%) and equities were priced for optimism.[2] Fiscal policy is essentially imposing the highest tax hike since 1968, and fed funds futures imply 75-100 basis points of cuts this year.[3] So if the first mix sent the dollar up, maybe the opposite mix will send it down.

Team America is rebranding

Lastly, US equities and the dollar may be rerated lower by non-US investors, who could demand a higher risk premium to invest. Team America is changing its brand. As Leo Lewis wrote in the London Financial Times, writing from Tokyo (two of the largest non-US pools of capital), globalization, rules-based international order and Pax Americana are out.[4] Mercantilism, isolationism and protectionism are in. Investors are used to the Federal Reserve acting as a reducer of volatility. However, recent White House policies have contributed to volatility, and that may persist. Higher risk premia seem reasonable. So do changes in investment and portfolio flows. In my view, several industries could be vulnerable to lower levels of investment:

- Biotech and Pharma: Health & Human Services cuts to research and conflicts between the administration and Ivy League universities could slow or reduce fundamental research, weakening the competitive position of the US pharmaceuticals industry over time. Corporate research and development focuses on drug development, not discovery. Foreign universities are already recruiting top US academic talent.
- Defense: the US defense manufacturers are likely not first choice for euro zone rearmament, as we may now be seen as unreliable.
- Energy: Efforts to revive coal may lead US utilities to be placed on carbon footprint exclusion lists for many major European (and increasingly, Asian) institutional investors.
- Banking, Legal & Technology Services: Foreign asset managers and other business may conduct risk assessments into their US suppliers (custody, IT, legal) and seek local substitutes for critical services.
- Tourism: Heading into the summer season, foreign tourism arrivals are already down.

If you're a non-US investor who already owns US assets, maybe you're thinking about selling some, or at least not adding just now. Global investor sentiment seems to be shifting from a US preference based on exceptional US profitability and growth to an uncertainty-driven buyer's strike to a possible third phase of rebalancing ("sell America"). Perhaps AI and robots will save the US productivity story. But, in my view, the fiscal tailwind that the US economy has benefited from for the past decade seems ended.

On a portfolio flow and policy mix perspective, I'm a dollar bear in this world. That is not a trade war analysis, that is a portfolios flows analysis. We could be looking at a very different, more costly war in my view.



End Notes

[1] Source for all US fiscal figures: US Treasury, <https://fiscaldata.treasury.gov/americas-finance-guide/federal-spending/>

[2] Department of the Treasury, 2023 Foreign Portfolio Holdings of US Securities, published April 2024,

<https://ticdata.treasury.gov/resource-center/data-chart-center/tic/Documents/shla2023r.pdf>.

[3] Source: Bloomberg, data as of 24 April 2025.

[4] Source: Lewis, L. (2025, Mar 27). Japan's apex survival instinct is put to the test. *The Financial Times*.

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