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Signal over noise #6: High stakes

Global equity strategy

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- The higher-than-expected tariff measures announced on 2 April will raise the effective tariff rate on US imports to its highest level in at least 100 years, posing significant risks to import-reliant businesses and the broader economy.
- We maintain a Neutral view on equities overall, but see index-buying opportunities if the S&P 500 declines an additional 5-10%—a level at which we would expect the Fed to lower interest to support markets.
- However, a market bottom will likely only materialize when tariff negotiations shift to de-escalation.

The higher-than-expected tariff announcements on 2 April raised the stakes for the global economy. With the announced headline "reciprocal" tariffs reaching up to 46% for the US's trading partners (see Table 1), there is no longer a release valve for US businesses that rely on global imports. The choice now is higher prices or lower profits, neither of which is beneficial to economic growth. What started as a playbook from the *Art of the Deal* has now morphed into a high-stakes, multi-dimensional power game with significant tail risks on all sides.

Table 1 - Announced import duties: no more exhaust valve for US importers

Estimated tariff impact on select economies

	Pre-April 2 effective tariff rate (1)	Headline 'reciprocal' tariff rate announced April 2 (2)	Effective 'reciprocal' tariff rate (with exemptions or additions) (4)	Total effective tariff rate (1) + (3)	Total US imports (USD m)
EU	9.1%	20.0%	13.0%	22.1%	597,907
Mexico	8.4%	0.0%	0.0%	8.4%	503,806
China	33.7%	34.0%	29.3%	62.9%	429,753
Canada	5.7%	0.0%	0.0%	5.7%	412,556
Japan	10.7%	24.0%	13.2%	24.0%	151,290
Vietnam	4.8%	46.0%	39.6%	44.5%	141,407
South Korea	10.1%	25.0%	12.1%	22.2%	130,471
Taiwan	3.1%	36.0%	25.2%	28.3%	115,284
India	4.2%	26.0%	18.5%	22.7%	87,794
Switzerland	0.9%	31.0%	19.7%	20.6%	61,020
Malaysia	1.6%	24.0%	11.6%	13.2%	51,682
Singapore	0.4%	10.0%	5.3%	5.7%	42,663
Indonesia	5.3%	32.0%	30.2%	35.5%	28,137
Australia	0.9%	10.0%	8.2%	9.0%	16,697
Philippines	2.0%	17.0%	13.8%	15.8%	13,949
Bangladesh	15.1%	37.0%	36.9%	51.9%	8,452

Source: US ITC DataWeb, Goldman Sachs, Trade Partnership Worldwide, UBS estimates

Note: To calculate the effective "reciprocal" tariff rate based on the stated exclusions in the 2 April executive order, we excluded pharmaceuticals, semiconductors, copper, gold, steel, aluminum, steel & aluminum derivative products, autos, auto parts, energy, and rare earth products. While these products may have been excluded under the International Emergency

Economic Powers Act (IEEPA), trade investigations may yield separate additional tariffs under Section 232 or Section 301.

What could drive a turn in the markets? We see three "puts" that could revive markets, none of which have strikes close to the S&P 500's current levels: the tariff negotiation put, the monetary policy (Fed) put, and a fiscal policy put. Typically, the stock market bottoms after the announcement of significant monetary or fiscal stimulus (see Table 2).

Table 2 - Fiscal and monetary measures signal the bottom of stock market downturn

Year	Key fiscal measures	Key monetary measures	S&P 500 bottom date
2020	CARES Act (27-Mar-2020)	Fed funds rate 0-0.25% (15-Mar-2020)	23-Mar-2020
2018		Fed signals end of rate hikes (31-Jan-2019)	24-Dec-2018
2011	Budget control Act (02-Aug-2011)	Fed funds rate 0-0.25%	03-Oct-2011
2008	Recovery Act (17-Feb-2009), Bank stress tests (10-Feb-2009), TARP (03-Oct-2008)	Expansion of QE program (18-Mar-2009), Fed funds rate cuts from 5.25% to 0.25% between 2007-2009	09-Mar-2009
2001	Bush tax cuts: 2001 (7-Jun-2001) & 2003 (23-May-2003)	Further Fed funds rate cuts from 1.75% to 1% (06-Nov-2002)	09-Oct-2002

Source: UBS

But neither the monetary nor the fiscal put is imminent, in our view. Federal Reserve Chair Powell suggested a "wait and see" stance on the inflationary effects of tariffs on Friday and is in no rush to adjust interest rates. And the budget reconciliation process will likely take at least a few more weeks, if not months. The key to a short-term market turn will therefore depend on the President Trump's stance toward trade negotiations, in our view, and equity markets will likely go lower until negotiations shift toward de-escalation.

Here are the signposts that we believe will signal whether we are headed to a hard or soft landing caused by the trade negotiations:

Signposts of an escalatory path

- Retaliatory tariffs from China – *announced*
- Retaliatory tariffs from Europe
- US retaliation to China and European retaliation
- US reiteration of need to recalibrate trade relations
- US wait-and-see approach to tariff offerings from trade partners
- US adds sector tariffs on pharmaceuticals and semiconductors

Signposts of de-escalation:

- Announcing multiple deals with important partners (e.g., Vietnam, India, Cambodia)
- Pushing out the timeline for tariff imposition from 9 April
- Signaling openness to negotiate select tariffs and exemptions, especially for goods with no substitutes
- Constructive negotiations with the EU to lower reciprocal tariffs

There will likely be conflicting signals between the two paths. A possible outcome is a new equity market low after EU retaliation, which may trigger a more conciliatory stance toward tariff resolution. With the average stock downturn during recessionary periods lasting more than one year (see Table 3), an escalatory path risks a political backlash that affects the Republican Party's results during the midterm elections in November 2026. We hence anticipate de-escalatory trade rhetoric with trade concessions following further equity market downside.

Also, after the S&P 500's drawdown approached 15% in 2018, the Fed pivoted its policy stance by lowering its projected path for future rate hikes. This time, we think the Fed is more likely to spring into action when the S&P's decline from the peak is closer to 25%—a level typically associated with recessionary periods—given that current inflationary risks are higher than they were in 2018. So, while we currently hold a Neutral stance on equities overall, we think another 5-10% drop in the S&P could trigger the Fed put, leading to a short-term market rebound.

However, we believe the put that will cement the market bottom is a clear shift in tariff rhetoric toward de-escalation and lower tariffs from 2 April levels. Without this shift, persistent and highly aggressive tariffs would likely lead to a sharp decline in consumer spending and business investment, pushing the market closer to our downside scenario and the S&P 500 toward the 4,000 mark (see "What are some key levels to watch" in our recent CIO Alert).

Table 3 - Stock market performance during past recessions

Recession start	Recession end	Recession duration (months)	S&P 500 peak-to-trough	S&P 500 peak-to-trough duration (months)	S&P 500 recovery duration (months)
Jul-53	May-54	10	-14.8%	8.4	14.3
Aug-57	Apr-58	8	-21.6%	14.9	26.1
Apr-60	Feb-61	10	-13.9%	15.0	18.1
Dec-69	Nov-70	11	-36.1%	18.1	39.8
Nov-73	Mar-75	16	-48.4%	21.2	91.7
Jan-80	Jul-80	6	-17.1%	1.4	5.1
Jul-81	Nov-82	16	-27.1%	20.7	23.7
Jul-90	Oct-90	3	-19.9%	2.9	7.1
Apr-01	Nov-01	7	-49.1%	31.0	87.4
Dec-07	Jun-09	18	-56.8%	17.2	66.6
Feb-20	Apr-20	2	-33.9%	1.1	6.0
Average		9.7	-30.8%	13.8	35.1

Source: NBER Business Cycle Dating, Refinitiv, UBS

Appendix

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