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Tariff Escalation Entails a Sectoral Growth Shock, Not a Recession

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

President Trump's time-honored tactic of escalating tensions before subsequently deescalating has once again come to the fore. Yet with a 10% universal tariff and a near embargo on China, US tariffs have effectively jumped to a trade-weighted average of 18%, reshaping the global trade landscape. Early shipping data already signal disruption, with empty vessels and declining port activity.

Will this trade shock push the US and the world into recession? From a top-down perspective, our base case is that while growth will stall, we will avoid a recession. To sharpen our outlook and provide further color on the contours of fundamentals going forward, we surveyed our analyst network to assess the impact from a bottom-up perspective.

To start, large cap entities, which feature prominently in investment grade credit, are far better positioned to absorb the impact of tariffs than their smaller counterparts. These companies benefit from greater pricing power and more agile supply chains, and in some cases can take advantage of the disruption.

The industrial sector, which is highly exposed to tariffs, illustrates this resilience. Many industrial players began localizing supply chains in response to the 2018 trade war and are now leveraging those shifts to limit exposure to Chinese imports. While China still dominates certain segments of the supply chain, and several companies have reported low-double-digit earnings drags on a growth basis, large industrial players have generally managed to pass higher input costs on to end customers. Early signs of softening demand and inventory accumulation are emerging, however, following a pull-forward of orders earlier in 2024. Yet while these underlying strains may be reflected in second and third-quarter earnings, they are unlikely to lead to mass layoffs.

In technology, global IT spending is now clearly slowing, with the largest companies cutting back after years of expansion. As a result, they are less exposed to input costs as the AI rollout shifts toward software development and away from hardware investment.

Small to midsized companies, including high yield credit issuers, are finding it more difficult to pass on costs and are thus more exposed to margin compression. Retailers of high-ticket consumer goods are reporting margin compression, as passing costs to end consumers risks bringing on severe demand destruction. Energy and materials firms face higher input prices, though early indications suggest the impacts are less severe than initially feared.

The most direct and critical impacts are on the auto sector and on consumer goods companies that build their business models solely on price. Crucially, the business-to-consumer (B2C) sector – especially goods reliant on price-sensitive consumers – is more vulnerable than business-to-business (B2B) industries, which have the leverage to pass price increases through. The former are extremely vulnerable and could contribute to a higher default rate, yet this is unlikely to pose a systemic risk.

The emerging market landscape is highly differentiated: Some markets are clear beneficiaries of the shifting trade map, while others are likely to be much more challenged. Latin American economies, such as Brazil and Mexico, are already benefiting from trade diversion, with increased agricultural exports and nearshoring trends reshaping regional trade. Apple's recent production expansion in India reflects growing corporate interest in diversifying manufacturing bases. Across emerging

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

markets, currency depreciation has partially cushioned the effect of rising prices, but policy responses and long-term implications vary considerably by country.

Overall, we view the nature of the current shock as more sectoral than systemic. Unlike the broad-based demand collapse during the Covid era, the impact of tariffs is highly concentrated in goods-producing sectors. The US economy remains predominantly service-based, and services are largely unaffected by the tariffs.

That said, the tariff escalation is accelerating deglobalization and supply chain realignment, producing both winners and losers across sectors and geographies. Large firms and select emerging markets may adapt and benefit from the shift, while smaller businesses and exposed sectors, like autos and retail, face more headwinds.

The volatility in both policy and markets is certainly challenging, yet opportunities abound for active managers within and across all major asset classes.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst,
Global Emerging Markets
Fixed Income

CS 3.25 (+0.25)

Despite the announcement of a 90-day pause on "reciprocal" tariffs (excluding China), average-weighted US tariffs remain substantially higher relative to levels over the past 75 years. That and ongoing policy uncertainty are adding significant headwinds to the US economy. The contrast between hard and soft data continues this month, with tariff front-loading effects still evident in the March retail sales and manufacturing numbers, while business and consumer surveys remain much weaker. April surveys are pointing to a weakening in hard data ahead, but the labor market in the near term is not yet showing warning signs. With little clarity on how negotiations will go during the 90-day period and the US enacting further restrictions to trade via export controls, the 12-month outlook will continue to remain dependent on US policy, which continues to be uncertain. We remain marginally skewed to a "Soft Landing" base-case scenario, but the ongoing uncertainty is increasing downside risks.

The Fed is not in a hurry to cut rates given that the impact of tariffs and immigration policy remain uncertain, but Chair Powell highlighted that the Fed expects at least a temporary rise in inflation and indicated some concern about the risks of rising long-run inflation expectations. Powell reiterated the Fed's reaction function to a stagflationary shock, commenting that the Fed will consider how far the economy is from each goal, and the potentially different time horizons over which those respective gaps would be anticipated to close.

Real activity in March was robust, highlighting the strength of the US economy going into this period of substantial headwinds. March retail sales increased by 1.4% month over month (m/m), supported by a temporary rise in auto sales due to front-loaded purchases ahead of the tariffs. Additionally, there was a rebound in restaurant spending in March, which was likely supported by improved weather and may not persist given the potential for uncertainty-induced precautionary savings, a near-term shift in consumption patterns to goods, and weakening real income growth.

Early soft data for April, however, continues to point to substantial weakening in consumer and business expectations. Six-month buying expectations in the NAHB/Wells Fargo housing index have continued to decline since December, while the Philadelphia Fed composite fell to 45.3 from 52.9 and the NY Fed's Business Leaders Survey highlighted the divide between weaker expectations versus current activity. Non-farm payrolls and weekly jobless claims have shown no sign of weakening just yet, but layoffs tracked by the Worker Adjustment and Retraining Notification Act (WARN) are pointing to a cloudier outlook.

Despite the 90-day pause, the European Union still faces a material trade and sentiment shock. Trade diversion from Chinese goods poses further risks to Europe's growth outlook this year until the fiscal impulse plays out. The European Central Bank will likely cut below the neutral rate given that the near-term downside risks to growth have increased, combined with disinflation remaining on track.

Rates

Gunter Seeger
Portfolio Manager, Developed Markets Investment Grade

CS 4.00 (unchanged)

Since last month, when we changed our score to 4.0, the S&P 500 has dropped 9.66% and the 10-year note is higher at 4.39%, a move that seems counter to a flight to quality. While the long bond (30-year) over the same period is a whopping 30 basis points (bps) higher, the movement does not tell the whole story, as the 10-year note reached 3.85% on 6 April in after-hours trading. On that same evening, S&P 500 futures fell below 5,000.

We have also seen disruptions in the repo market and the market for interest rate swaps in US Treasury securities. This year thus far has been incredibly volatile, and we see no reason for that trend to abate; it may even worsen considerably.

The US dollar as represented by the DXY has fallen from 110 in mid-January to 98 as of late April. There seems to be a crisis in confidence among buyers of US Treasury securities. The fear of central bank retribution, not the actual act, is keeping buyers on the sidelines. Other factors contributing to our revised score are angry allies, possible Chinese retribution, and ongoing Powell-Trump tension while Fed fund futures trading forecasts almost four rate cuts this year. Our forecast remains the same.

Credit

Steven Oh, CFA
Global Head of Credit and Fixed Income

CS 3.00 (-0.50)

Economic concerns have continued to weigh on financial markets, with policy actions tilting economic expectations toward the dual threats of higher inflation and lower growth. The Fed will be limited in its ability to offer relief under its dual mandate goals and, additionally, will need to navigate perceptions of bias to maintain its independence. As we commence earnings season, no one will care about reported earnings but instead will be focusing entirely on company outlooks.

Credit markets have been quite orderly, but valuations have widened to reflect higher risks. Nevertheless, the market is still not pricing in much of a recession scenario. While valuations remain tilted toward widening in the near term, we have improved our score to a neutral 3.0 from more defensive levels throughout the year. Our expectation is that a recession, if it does develop, will be mild and that corporate balance sheets are in a strong position to withstand a moderate downturn. Therefore, we believe valuations will remain much tighter than in previous downturns.

We had previously advocated for more defensive investment grade (IG) spreads relative to high yield (HY), but the recent decompression in valuations has resulted in our becoming more neutral in our allocations. We believe that fixed-rate assets offer a more defensive advantage relative to floaters should volatility increase.

Currency (USD Perspective)

Anders Faergemann
Senior Sovereign Portfolio Manager, Emerging Markets Fixed Income

CS 3.50 (+0.75)

The US dollar is at a crossroads after suffering its biggest correction since 2022 against a broad range of currencies amid US President Trump's tariff announcements. The DXY currently hovers around 100, down nearly 10% from its peak. The stronger US dollar in recent years has been driven by strong US consumer growth, higher yield differentials, and the US exceptionalism theme. Market confidence has suffered a significant blow, and a move below 100 could spark further hedging or rotation out of US assets.

Trump's pivot, which reined in some reciprocal tariffs, probably prevented a full-blown confidence crisis and further de-dollarization, but the market remains on tenterhooks over the escalation of the trade war with China, and the increase in average tariff rate (15-18 percentage points) still exceeds the most bearish outcomes pre-2 April.

We have turned from mildly bullish on the US dollar to bearish, as international investors will need to review their US dollar exposure upon reflection of a potentially sharp slowdown in the US economy. The stagflationary shock from higher tariffs may prevent the Fed from acting pre-emptively to counteract a US slowdown and extend the current pause in monetary policy easing.

The global trade shock from "Liberation Day" has yet to be felt in the global economy. Our initial take suggests China will face a significant hit to growth, but policymakers there have the tools to stimulate the economy and counter some of the impact. So far, the People's Bank of China has aimed to keep the Chinese yuan stable rather than pursuing a weaker exchange rate.

A combination of weaker growth and disinflation in Europe on the back of higher tariffs leaves the door open for the ECB to continue its easing stance. We have added two more cuts to our ECB policy rate forecast for the next 12 months. The policy mix in Germany will not prevent a growth slump in 2025, but we expect the higher spending on infrastructure and defense to improve the 2026 growth outlook.

Emerging Markets Fixed Income

Sam McDonald
Sovereign Analyst, Global Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 3.00 (unchanged)

Local Markets (Sovereign)
CS 3.00 (unchanged)

The domestic macro environment continues to be favorable for most emerging markets (EMs), but uncertainty over the outlook in the US and other developed market (DM) economies amid the trade war will add headwinds to EM growth in the coming months. Nonetheless, the starting point for fundamentals is stronger in this cycle. Improvements are reflected in sovereign credit rating upgrades, with 2024 having the most since 2011. Looking forward, the balance of upgrade candidates far outweighs downgrade candidates in number and aggregate index weight. These numbers include several potential rising stars (Oman, Serbia, Azerbaijan).

EM spreads remain sensitive to US dynamics and have widened in line with a recent deterioration in US risk sentiment over the past two months. That said, overall spreads have performed remarkably well relative to previous episodes in which concerns over US growth have risen. While rising risks around tariffs will be harmful for some EMs, along with secondary impacts via commodity prices or subdued external demand, countries are swiftly developing a playbook to navigate these headlines. We also highlight that the EM-DM growth differential in 2025 is not only positive but accelerating despite the expected structural slowdown in China. The first quarter saw the largest EM sovereign issuance on record despite a material drop in March, following the uptick in uncertainty stemming from the US. Primary market activity in March fell to US$13 billion, down from US$77 billion in the first two months of the year. Total issuance expectations have been revised upward slightly, but we still expect gross issuance to be broadly comparable to 2024.

In the corporate space, fourth-quarter 2024 results were broadly as expected, with a positive skew in Brazil and Africa. In terms of sectors, we have seen positive beats from consumer goods, metals and mining, and financials, while utilities, industrials, and Colombian oil and gas have missed on the margin. Our current credit trend matrix reflects this, with 15% positives and 11% negatives. The positive skew is more evident in HY, with 23% positives and 17% negatives, while the split is 11% positives and 8% negatives in IG.

Primary activity slightly surprised the market, with a volume of US$50 billion in March, driven primarily by Asia. The regional skew was quite extreme, with Asia accounting for US$37 billion versus Latin America's US$1 billion. Issuers front-loaded ahead of tariff announcements. Issuance in April has been quieter amid the volatility that followed the tariff announcements. Since there is no jump in financing needs anticipated for 2025-2026, companies can afford to wait for market conditions to improve, so we expect a pause. April is a strong month for coupon and principal payments, amounting to US$39 billion, meaning that net issuance will be negative.

The tariff announcements from the Trump administration are a headwind, but likely a manageable one. Barring exceptional cases (such as Mexico), threatened trade action in the EM space largely entails reciprocal tariffs, which would raise existing US duties to match those applied by other countries. From that standpoint, the impact is likely to be limited – not only are there 16 countries where tariffs are zero (due to free trade agreements), but for most of the others, the trade-weighted tariff increase will be less than 10 percentage points and will affect 20% or less of total exports.

Multi-Asset

Sunny Ng, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.50 (unchanged)

Prior to the tariff announcements last month, we had favored reducing risk and diversifying risk allocations to include select non-US allocations that stand to benefit from more structural tailwinds over the intermediate term. The severity and breadth of the resulting announcements, however, exceeded the most extreme scenarios we were contemplating. Importantly, the stagflationary power of tariffs depends on their severity and their duration. As we enter the de-escalation phase, the severity of the trade tariffs is likely to diminish but the duration of the negotiations remains unknown. The longer they last, the higher the likelihood that soft data continues to deteriorate, with hard data lags to follow, and the risk of recession rises. We also, of course, are expecting the one-off impact of tariffs and front-loading to be inflationary in the US in the near term, yet offset somewhat by a slowdown in growth in the latter parts of the year.

Meanwhile, Trump aims to restore the primacy of private sector growth after three years of increasing dependency on government spending. The administration's more business-friendly policies, such as deregulation and tax initiatives, will take time to yield supply-side benefits, but we expect them to come into play in the back half of this year, offering some potential upside that markets currently are not focused on. In line with our view, market prices currently reflect an increased likelihood of a sharp slowdown, yet not a full recession. While we acknowledge the increased risks of recession, our base case continues to be a slowing of growth, not a shrinking economy.

Given the uncertainty regarding the severity of tariffs and duration of the de-escalation phase of tariff negotiations, we remain neutral on risk assets, preferring to focus on allocations with stronger structural tailwinds over the intermediate term. To our eye, valuations are pricing in downside risks, yet the situation remains fluid and we remain highly vigilant.

Global Equity

Ken Ruskin, CFA
Director of Research and Head of Sustainable Investing, Equities

CS 3.00 (unchanged)

Tariff-related volatility continues despite the pause in reciprocal tariffs as investors confront ongoing policy uncertainty as well as potential stagflationary impacts from the tariffs that have been put in place. Talk of US exceptionalism has been replaced by a weaker dollar and the opposite of a flight to safety in US bond yields. Management teams are no better able to predict these macro factors than investors, so we expect management commentary about 2025 earnings growth to be muted this earnings season.

Recession risks have clearly risen in the past few weeks, hitting mature cyclical stocks across sectors. In the medium to long term, we expect industrial automation stocks to benefit from increased protectionism and continued AI-related innovation. The market volatility is presenting opportunities to invest in some of these stocks at more attractive entry points.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager, Global Equities

CS 3.00 (unchanged)

US trade levies and the Russia-Ukraine war continue to dominate the headlines. Trump's tariff policy reversals increased volatility, with some relief coming after he suspended the levies, albeit temporarily. Relations with China continue to worsen, with both countries having adopted retaliatory trade measures. The prospects of the resolution of the war in Ukraine have also become more distant. Against this backdrop, the earnings outlook for companies across global EM became less certain. The market responded by selling off, and the 12-month forward P/E fell from 12.2x to 10.5x. The big unknown is the ultimate earnings impact, which in turn will depend on how tariff negotiations progress.

In India, commerce is undergoing a reset, with the US declaring its strategic objective of reducing bilateral trade deficits. The two countries are in talks, and the signals have been positive. India is increasingly seen as a small net beneficiary of trade relative to other countries. In China, fears of American Depository Receipt (ADR) delisting are adding to market volatility. This may yet prove a good buying opportunity, but it is too early to know.

In Latin America, expectations are shifting to a mild recession in Mexico in 2025. This is an early sign of the impact that the trade war may have. Brazil is seeing a pickup in demand for agricultural products as some countries reduce their reliance on the US.

In EMEA, the peace process in Ukraine is facing worsening odds, with fervent diplomacy by several countries.

Quantitative Research

Qian Yang
Fixed Income Quantitative Strategist

Our US Conviction Score retreated a bit to a neutral 2.96 as curve steepening of 9 bps was offset by credit-spread widening of 11 bps.

Our global credit forecast is negative and favors EM relative to DM. In DM industries, our model favors natural gas, banking, and insurance and dislikes basic industry, consumer cyclicals, and utilities. Among EM industries, the model likes pulp and paper, and financials, and dislikes real estate and diversified companies.

Our global rates model forecasts lower yields for Oceania and Europe and higher yields for Japan, Switzerland, and North America. The model forecasts a steeper curve for North America and Australia and a flatter curve for the rest of the world.

The rates view expressed in our G10 Model portfolio is neutral to overweight global duration. It is overweight France, UK, Italy, and New Zealand; it is underweight the US, Japan, and Germany. Along the curve, it is overweight six-month, 10-year, and 20-year durations, and underweight five-year duration.

All market data, spreads, and index returns are sourced from Bloomberg as of 25 April 2025.

About PineBridge Investments

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 March 2025, the firm managed US$188.9 billion across global asset classes for sophisticated investors around the world.

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