COMMENTARY

The Market Reckoning With Tariffs Is Coming Soon

By David R. Breuhan

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As he prepares to take office, President-elect Donald Trump seems to have one thing on his mind: tariffs. "We'll impose new tariffs so that the products in our stores will once again be stamped with those beautiful words, 'Made in the USA,' " Trump said at a Mar-a-Lago news conference on Jan 7. He pledged "very serious tariffs on Mexico and Canada" and even proposed to "tariff Denmark at a very high level" should it not cede Greenland.

There is no greater danger to global commerce and prosperity than the implementation of broad tariffs on all imports entering the U.S. Even targeted tariffs may upset financial markets and invite immediate severe retaliation on American exports. Unilateral tariffs on imported raw materials will burden manufacturers with higher costs and hamper U.S. exporters.

While the failures of tariff policies are well documented, the most important and globally misunderstood aspect of tariffs is their impact on the stock market. Three prominent cases show the risks.

Trump's national strategy to support manufacturing with tariffs eerily resembles President Herbert Hoover's promises made to farmers almost a century ago.

Hoover's campaign pledges in 1928 resulted in the Smoot-Hawley Tariff of 1930. The economic legacy is well known; the tariff's role in the 1929 market crash less so. Many economists blame the gold standard because they misunderstand the forward-looking nature of the human mind. That is the market itself.

Though the tariff bill wouldn't pass until June 1930, markets began discounting future earnings eight months earlier. A front-page article in the New York Times on Oct. 28, 1929, read, "Leaders Insist Tariff Will Pass." Markets fell rapidly, exacerbated by leverage. Retaliation left farmers unable to export. By 1934, global trade dropped 66%, back to the levels of 1905.

In 2001, President George W. Bush and his allies promised the domestic steel industry that 30% tariffs would be imposed on imported steel. In exchange, the House passed a fast-track trade bill, 215 to 214.

Hot rolled steel rose from $210 per ton in December 2001 to $400 per ton in July 2002, an increase of 90%. Cold rolled steel jumped 75%, from $300 to $525. Bush imposed steel tariffs on March 20, 2002. Manufacturers were unable to pass along higher steel prices to their customers, as many fixed contracts prohibited price increases. From March 2002 to March 2003, the manufacturing sector lost 476,000 jobs, more than existed in the entire steel industry, according to the Bureau of Labor Statistics.

Although the Bush steel and lumber tariffs of 2002 were far less than the tariffs of the 1930s, they still hurt equity markets. From March 2002 to May 2003, the S&P 500 index lost some $2 trillion in market capitalization following the imposition of raw material tariffs. The Dow Jones Industrial Average reached a post–Sept. 11, 2001, peak on March 19, 2002, at 10,635.25. The steel tariffs took effect on March 20. Lumber tariffs followed in May. The Dow didn't fully recover until the steel tariffs were lifted on Dec. 4, 2003.

In January 2018, President Trump announced that he would impose tariffs on China. He also imposed tariffs on steel and aluminum imports from Mexico, Canada, and the European Union. Canadian lumber also received a tariff, resulting in higher domestic prices. Retaliation ensued. The market retreated and didn't reach its January high until August.

In 2025, the benefits of what the Trump administration promises with lower oil prices and reduced regulation will be wiped out by a decrease in the market value of stocks. Programmed trading and algorithms account for roughly 70% of daily trades on the exchanges. Announce massive tariffs on day one of the new administration and watch investors head for the exits as the market recalculates future earnings for every company across all markets. The magnitude of Trump's tariffs on millions of imports would far surpass the tariffs levied on over 25,000 goods in 1930.

Since 1947, many rounds of the General Agreement on Tariffs and Trade reopened trading lanes closed by the Smoot-Hawley Tariff of 1930. Trade works and has stood the test of time. Free trade along with strong alliances have enabled the West and other nations to flourish, while Communist nations stagnated. Free trade was so important to the Founding Fathers that it can be found in Article I, Section 9 of the U.S. Constitution.

We need to address China's and other nations' unfair behavior. Free trade must be fair trade. Denial of market access, import quotas, loss of most-favored-nation trading status, expulsion from the World Trade Organization, and repeal of foreign aid are only a few of many options.

In 1968, during the Vietnam War, journalist Peter Arnett questioned a U.S. officer about the destruction of the hamlet of Ben Tre. "It became necessary to destroy the village in order to save it," the officer said.

Let us hope that informed policymakers can counsel Trump to avoid causing havoc in the capital markets at home and abroad.

History sends a warning regarding the impact of tariffs. Do not destroy the village.

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