Special Feature: The implications of tariffs for portfolios

Portfolios have been designed to be well diversified across asset classes, securities, sectors and countries.

We highlight the importance of ensuring that portfolios are well diversified across the number of investments, asset classes, and countries – even for very large economies like the United States. This is a guiding star of the portfolios that you are invested into. There are a range of asset classes, funds, securities and geographies, as well as different investment strategies employed by the professional fund managers that we select. There is also, in particular, a large underweight on US equities compared to global equity market benchmarks given various asset allocation and fund manager choices that are made in the design of your portfolio.

We believe this diversification will help cushion the impact of the current trade shock roiling markets.

We believe that the diversification in your portfolio will provide for more robust outcomes compared with approaches that concentrate investments in a relatively small number of stocks, asset classes, and geographies. This is no more so than at the present time where markets are being roiled by the Trump Administration announcing tariffs that were much larger than markets expected. As a consequence, equity markets and commodities such as oil have suffered declines that at the time of writing are as large as those seen when the pandemic first hit in early 2020. In contrast, as covered in the market update, bonds rallied globally on the basis that interest rates are likely to head lower to cushion the negative growth impacts of the tariff 'shock'.

Ultimately, we are also confident that the trade shock will dissipate with time, and equity markets will resume their upward climb.

We don't know how the tariff picture will unfold from here, but it is important to bear in mind that there is widespread recognition that a global trade war is in no-one's interest, even within the Trump administration. By the time you read this, some countries or sectors may have 'negotiated' a better deal and markets may have rallied back in response. Even if there is no quick resolution, there is a good chance that the legislative branch of government will put pressure on the executive branch, especially if – as is likely – US consumers and businesses suffer from a policy that is undoubtedly very damaging for the US economy.

Our view is that this shock, like other shocks markets have faced, will eventually pass. Ultimately markets will recover and march upwards (see Figure 1). In addition, history also tells us that large rallies typically follow large declines over the medium-term (see Figure 2).

While we remain confident in the long-term outlook for equities, the two key areas to watch are retaliation and inflation. History shows us that if tariffs escalate into a tit-for-tat tariff war, with widespread retaliatory tariffs, then global trade and economic activity could fall quickly. So far, most countries have been cautious about retaliating. The second big uncertainty is whether the initial one-off CPI impact of tariffs in the US leads to ongoing, or "second-round" inflation. The Fed will allow the initial impact through without tightening – there is after all nothing they can do about it – but may become more hawkish if there are signs that tariffs may generate ongoing, persistent inflation. The key implication for portfolios, apart from monitoring inflation, is to ensure that you retain the asset classes that help protect against inflation shocks, such as infrastructure, property and gold.

New Zealand has a relatively well diversified set of trading relationships, and we are perhaps better placed to weather the trade shock – this time- than many other nations.

Closer to home, New Zealand has been slapped with a relatively low tariff rate of 10% and some interesting modelling by an AUT professor of economics[1] estimates we could *benefit* overall as demand for our exports to the US increases relative to other countries facing higher tariffs (see Figure 3). This modelling only considers a 'static' re-allocation of trade given changes in end producer and consumer prices, rather than the dynamic effects and factors such as monetary policy, and as such should be taken with a pinch of salt. But some comforting facts are that the US only takes around 12% of our total exports by value, with much of this focussed on meat that could in principle be sold to other markets.

New Zealand is also fortunate to have a relatively well diversified set of trading partners - ranging from traditional markets like the UK, EU, the US and Australia, to China which is currently our largest trading partner at around 20%, to fast growing economies with large populations in Asia (India, Indonesia, Vietnam, etc) that will likely become more important over time (see figure 4). To draw a parallel with the design of your portfolios, trade officials and successive governments have long sought to diversify our trading relationships, dating back to the mother-of-all trade shocks NZ had in 1972 when we lost preferential access to the UK (ironically as it is now) on it electing to join the European common market.

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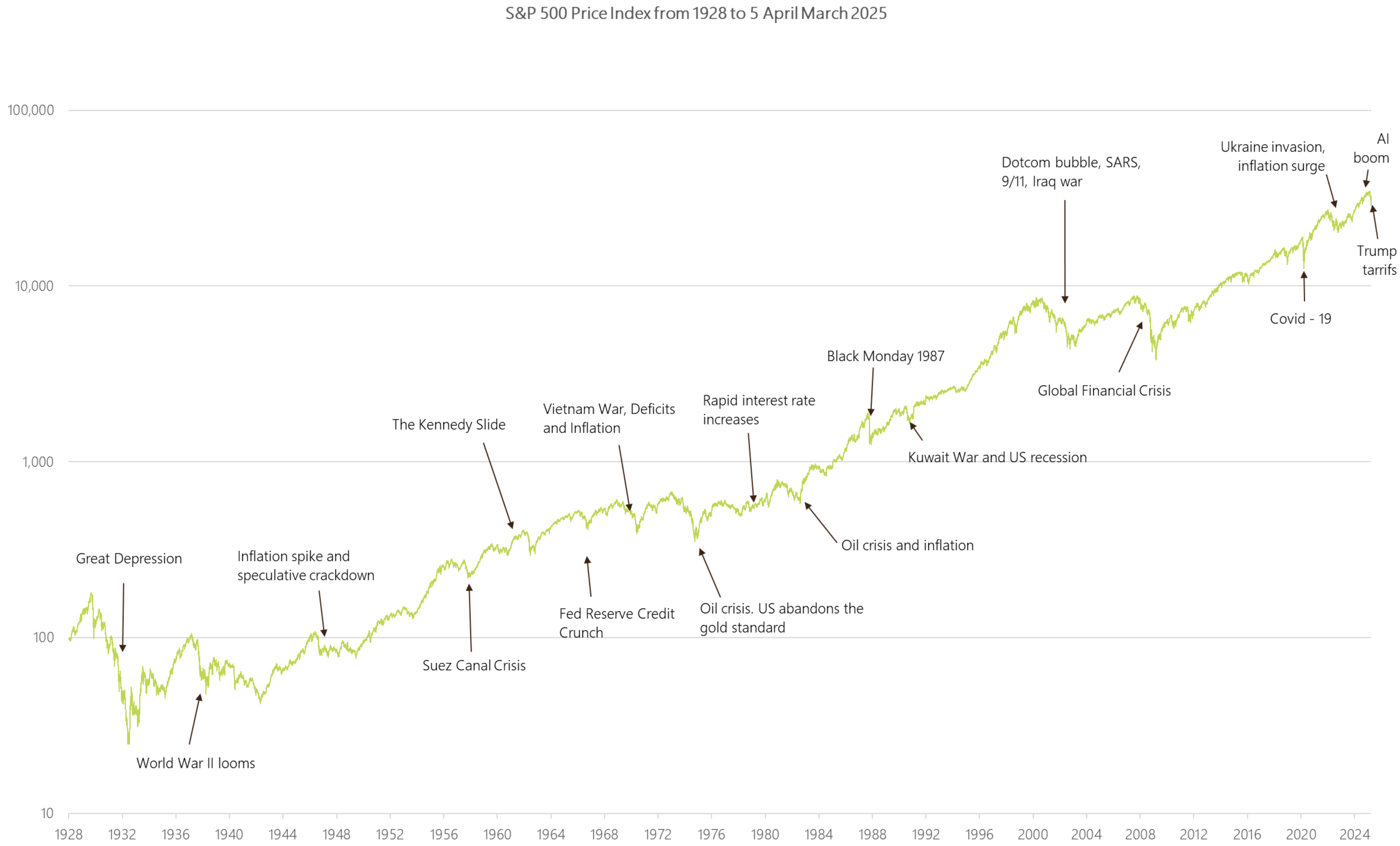
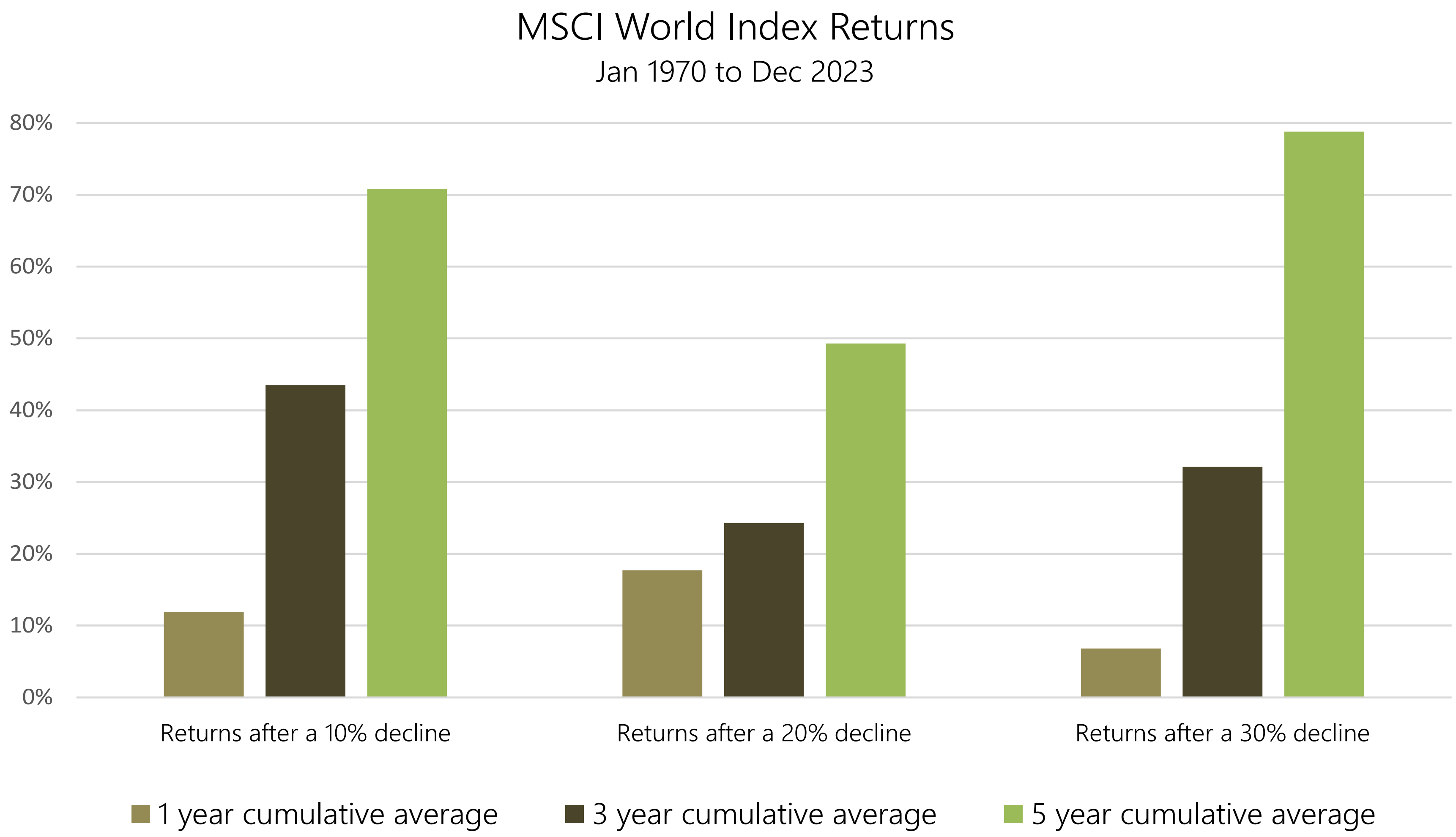
[1] See https://theconversation.com/new-modelling-reveals-full-impact-of-trumps-liberation-day-tariffs-with-the-us-hit-hardest-253320

Figure 1: Long run performance of S&P 500



Source: Morningstar

Figure 2: Market bounce backs from large declines



Source: Dimensional Fund Advisers

Figure 3: GDP changes due to new US tariffs with retaliation

Country/Region	Percent	US$ billion	US$ per household ▲
US	−1.45%	−$438.4	−$3,487
Canada	−1.65%	−$38.5	−$2,467
Mexico	−2.24%	−$40.7	−$1,192
Switzerland	−0.32%	−$3.2	−$818
Vietnam	−0.99%	−$5.0	−$196
Taiwan	−0.20%	−$1.6	−$172
China	−0.27%	−$53.1	−$110
Japan	−0.06%	−$2.5	−$46
India	−0.19%	−$8.2	−$28
Thailand	−0.09%	−$0.5	−$27
Indonesia	−0.05%	−$0.7	−$11
United Kingdom	0.00%	−$0.2	−$5
European Union	0.05%	$10.4	$53
Brazil	0.28%	$6.4	$100
Australia	0.07%	$1.4	$134
Korea, Republic of	0.21%	$4.1	$173
New Zealand	0.29%	$0.8	$397
World	**−0.43%**	**−$500.2**	**−$210**

Table: The Conversation • Source: Niven Winchester • Created with Datawrapper

Sources: Elroy Dimson, Paul Marsh and Mike Staunton, DMS Database 2024; Cowles, 1938, FTSE Russell All-World Index Series Monthly Review, December 2023.

Figure 4: New Zealand's top trading partners

Rank	Country	% of total exports	% of total imports	% of total trade
1	China	**22%**	16%	19%
2	Australia	**15%**	15%	15%
3	United States	**16%**	11%	13%
4	European Union	**6%**	12%	9%
5	Singapore	**3%**	6%	5%
6	Japan	**4%**	4%	4%
7	Republic of Korea	**3%**	5%	4%
8	United Kingdom	**4%**	3%	3%
9	Thailand	**2%**	3%	2%
10	Malaysia	**2%**	2%	2%
11	All other	**25%**	23%	24%

Source: Statistics New Zealand, international trade December quarter 2024