



While trade policy and AI concerns have pressured US equities, strong demand for AI compute and ongoing investment in infrastructure should support long-term growth. (UBS)

Lack of cohesion compounding policy uncertainty

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Global equities extended their losses and volatility picked up over the past 24 hours, as uncertainty over the shape and economic impact of President Donald Trump's tariff plans overshadowed his eventual decision to pause most of his 25% tariffs on Canada and Mexico.

Equity volatility has picked up on the “will-he-won't-he” tariff headlines, with the VIX volatility index rising another three points to 25 on Thursday, its highest level since mid-December. Recent economic data have raised concern among investors that Trump's policies may be hindering the economy. The Fed's Beige Book pointed to weaker growth and persistent inflation pressures in key sectors, while earlier this week the ISM manufacturing index signaled a slowdown in business activity, with rising input costs tied to tariffs.

- **Stock weakness and stability in bonds points to tariff-driven fears.** With stocks falling sharply, but with no offsetting gains for bonds, it suggests that investors' main concern is that tariffs could both push inflation higher and weigh on growth. If the sell-off were solely about weaker growth, bond yields would likely fall along with stocks.
- **Tariff fears are weighing on business sentiment, even in Trump territory.** Texas has long been a political stronghold for President Trump. However, the latest Dallas Fed Beige Book highlighted growing uncertainty among businesses, in manufacturing and services, with firms citing concerns over trade policy and rising input costs tied to tariffs. This shift in sentiment suggests that even in historically Trump-aligned regions, policy uncertainty could weigh on investment and hiring, potentially dragging on broader economic growth. Adding to concerns, this week's ISM

manufacturing index and recent PMI data pointed to rising input costs tied to tariffs, reinforcing concerns over trade-related inflation pressures.

- **Relative stock market performance suggests that Trump is losing the growth narrative to Germany's chancellor-in-waiting, Friedrich Merz.** US equities rallied in the wake of President Trump's election on expectations that his policy agenda would be pro-growth. The market's reaction to his latest tariff moves indicates growing skepticism over his ability to maintain strong growth. Notably, the divergence in equity performance between US and European stocks both this year and this week underscores this dynamic, as investors recalibrate expectations. We believe that Germany's fiscal expansion plans, centered around increased defense spending, have the potential to improve the investment outlook domestically and for the wider European region.
- **The lack of cohesion between Trump and his administration officials is compounding policy uncertainty.** The disconnect between Trump's aggressive trade stance and Commerce Secretary Howard Lutnick's more pragmatic approach—which in turn is sometimes followed by concessions from the President—has complicated the administration's message. When signing the tariff reprieve for Canada, Trump reiterated his view that the tariffs were “something we have to do” and the interruption to tariffs would just be “short term.” This lack of cohesion is creating uncertainty in financial markets and is likely to curb investment decisions, as businesses and investors question whether Trump's policies will ultimately support or hinder economic momentum. Influential parts of the financial press are highly critical of Trump's policy agenda and the President's approval ratings have declined, particularly on trade, foreign policy, and inflation (although immigration approval remains high).

Taking these factors into consideration, this week we have changed the probabilities we attach to our tariff scenarios:

The willingness to impose tariffs against allies and adversaries alike illustrates the extent to which the US administration will go to achieve a range of economic and noneconomic policy goals, thus lowering the odds of ending up in a limited or benign tariff environment. We therefore have reduced the probability of achieving these upside scenarios to 15% from 25%.

Conversely, the additional 25% tariffs on Mexico and Canada fall under our highly aggressive tariff downside scenario if they are sustained. Although we do not believe these tariffs will be sustained, we have opted to increase the probability of the highly aggressive trade downside scenario to 35% from 25%. In our view, the risk that these tariffs will remain in place long enough to weigh on economic activity has increased.

The situation remains highly fluid, but our base case remains at 50%, anticipating aggressive but selective tariffs that heighten market volatility without derailing the economy.

How do we invest?

Our core message remains to stay invested in stocks, with a focus on the US, AI, and power and resources, but also hedging those equity exposures to manage near-term risks. With a 2 April deadline for further tariffs and a looming debt ceiling debate, uncertainty is set to remain high. Investors should also ensure portfolios are well diversified with assets such as quality bonds, gold, and alternatives.

Original report: [Policy uncertainty weighs on stocks, 7 March 2025.](#)

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