



While volatility may persist, CIO continues to see room for gains in equities, supported by resilient earnings, AI-driven tailwinds, and monetary policy easing. (UBS)

Full-scale tariff escalation would raise inflation risks and weigh on equities

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US stocks fell further in volatile trade on Tuesday, following the imposition of new US tariffs on Mexico, Canada, and China.

Fresh 25% tariffs on Mexico and Canada came into effect after midnight on Monday, while tariffs on China were raised by another 10%, bringing the effective tax rate to around 30%. This action was justified by border and narcotics-related issues. President Trump also said that a separate order for reciprocal tariffs would come into effect on 2 April.

Canada retaliated with a 25% tariff on CAD 30bn of US imports, which will be extended to cover a further CAD 125bn of US imports in 21 days if no resolution is reached. China enacted a 10-15% tariff, effective 10 March, targeting a raft of US agricultural products ranging from beef and pork to dairy, fruit, and grains. It also imposed new restrictions on American companies and filed a lawsuit with the World Trade Organization. Mexico is expected to announce its response on Sunday.

- **Our base case assigns a 50% probability to aggressive selective tariffs but no universal tariffs by year-end.** Efforts to protect US technology and limit transshipment may include rules of origin legislation to prevent tariff circumvention on Chinese goods. We also expect the use of section 301 to levy select tariffs on a wide range of EU imports with reciprocal retaliation targeting subsidies and trade imbalances, while tariffs on Canada and Mexico are

likely to be rolled back at least in part. Markets will be watching for any shifts toward broader enforcement, as a full-scale tariff escalation would raise inflation risks and weigh on equities.

- **Concerns about AI have affected tech and AI supply chains.** Reports suggest NVIDIA may reduce orders from TSMC and could face probes for potential US tech export control breaches. This adds to uncertainty from DeepSeek's entry, NVIDIA's margin pressures, and Big 4 data center demand doubts. Despite these issues, the broader AI industry remains on a solid footing, in our view, with demand for AI compute continuing to accelerate. Big 4 capex remains strong, with AI spending projected to reach USD 500bn by 2026. Big tech companies also recently flagged capacity constraints as the main impediment to cloud revenue growth, not insufficient demand. Taking a sector level view, our preferred AI names have an average 2025 free cash flow margin estimate of 29%, nearly triple that of the MSCI All Country World Index. Tech's 2025 earnings outlook also looks robust, with Big 6 and global tech earnings growth estimates at 26% and 19%, respectively.
- **Tariffs complicate the Federal Reserve's path to monetary easing.** Fed funds futures markets are now pricing in three 25-basis-point rate cuts for 2025, up from two before the tariffs were enacted, as markets assess the economic impact of rising trade barriers. The Atlanta Fed's GDPNow estimate for 1Q growth has fallen sharply to 2.8% from +2.3% previously, with net exports subtracting 3.6 percentage points from GDP. However, we view the drop in the GDPNow estimate as more noise than signal. The spike in imports appears to be driven by physical gold inflows, which should not materially impact GDP. Consensus estimates for 1Q growth remain around 1.5%, slightly below previous estimates. The bigger concern is the downside risk to economic momentum posed by this new set of tariffs. While the Fed may look through the inflationary impact of tariffs as a one-time price shock, it could still be difficult to resume rate cuts unless the labor market data start showing weakness.

So, while volatility may persist, we continue to see room for gains in equities, supported by resilient earnings, AI-driven tailwinds, and monetary policy easing. Inflation continues to moderate, Fed policy remains accommodative, and corporate earnings have been solid, reinforcing our view that the S&P 500 can reach 6,600 by year-end.

Original report: [Trade war fears spark volatility, 5 February 2025.](#)

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