Market Perspectives

Trump, Tariffs & Trade:

Toward a New Global Economic Order

TD Wealth Asset Allocation Committee Positioning Overview Core Asset Class Allocations

- **Modest Overweight Equities:** Global equity market performance has been mixed year-to-date ("YTD") largely due to valuation adjustments as the market considers the potential impact of U.S. tariffs and Artificial Intelligence ("AI") developments. We are overweight equities as we expect positive earnings growth, combined with a backdrop of modest economic growth, to continue to drive attractive relative returns over the medium-term.
- **Modest Underweight Fixed Income:** As Canadian data stabilizes around the Bank of Canada's ("BoC") forecasts despite domestic political uncertainty, U.S. tariff threats are dampening consumer and business expectations. However, the BoC has flexibility to respond to a wide array of possible developments, including quickly lowering the policy rate to provide support to the Canadian economy. As the monetary easing cycle progresses, we expect that bonds will provide diversification benefits, reduce overall portfolio volatility and preserve capital.

- **Modest Overweight Alternatives:** We believe that an allocation to alternative assets can benefit diversified portfolios especially when implemented over the long-term. Alternative assets can provide inflation protection and attractive absolute returns, while acting as long-term portfolio stabilizers via their diversification benefits and less correlated income streams. Given the nature of private asset classes as well as the present phase of value adjustment in several markets and asset classes, we believe that this may be an attractive time to increase or consider an allocation to alternative assets.

Economic Overview

Now that we have a better sense of the magnitude and breadth of the tariffs unleashed by the U.S. Administration on trading partners on the so-called "Liberation Day", the unknown that remains is duration – how long will this economic tremour last? The longer these measures are in place, the more disruptive and destructive these policies will likely be on the global economy. Any "adjustments" made by corporations to re-align supply chains could take years, while consumer patterns and behaviours may also be impacted for an extended period.

In an environment of rapidly changing policies, reciprocal responses, and further "deals" to be negotiated, the TD Wealth Asset Allocation Committee ("we, "the Committee") has been preparing for a range of potential scenarios around the incoming U.S. Administration's policies. There was some optimism around a more measured and prudent approach to perceived trade imbalances, in hopes that those with "cooler heads" in the Administration would prevail. Nevertheless, countries and markets are responding accordingly to the tariff onslaught, and we are actively monitoring in real time key developments that may shape returns and risks going forward.

The global market sell-off following U.S. President Donald Trump's tariff announcement on April 2, has rattled investors, with overseas markets and the S&P 500 Index falling 17.5% below the mid-February all-time high. Countermeasures to U.S. tariffs are emerging, with Canada announcing 25% tariffs on certain U.S. vehicles on April 3, while China reported an additional 34% tariff on all U.S. imports beginning April, 9. In Europe, France's President Emmanuel Macron urged corporations to halt spending in the U.S. U.S. President Trump said he would consider reducing tariffs in return for countries offering something "phenomenal" to the U.S., while also suggesting that sector tariffs on pharmaceuticals and semiconductors could be announced soon. Bond yields have fallen sharply lower, with both the U.S. and German 10-year nominal yields down around 15 basis points ("bps") to 3.88% and 2.50%, respectively. Market volatility pushed the Volatility Index ("VIX") to 41, the highest since the growth scare in the summer of 2024, while U.S. high-yield credit spreads, a gauge of global risk premia, jumped by more than 50bps on April 3, the largest rise since March 2020.

Market Expectations and Outlook

Early estimates from economists highlight that the latest U.S. tariff measures could lower global Gross Domestic Product ("GDP") growth by at least 50bps, with a potential 100 to 150bps drag to U.S. GDP growth, a 100bps drag to China and a 40 to 60bps hit to Eurozone GDP growth. This comes against the backdrop of U.S. growth that has recently started to weaken on the back of softening consumer spending. Even before the latest tariff shock, the global growth outlook had started to darken, given the weakening run-rate of U.S. growth and the unexpected shift in U.S. policy focus from tax cuts to spending cuts. This had already led the MSCI World Index to decline significantly from its all-time high and U.S. high-yield credit spreads, a good gauge of global risk premia, to rise by 80bps from a 17-year low.

To our valued investors, we understand that these unpredictable and unprecedented times can be unsettling, but rest assured, we at TD Asset Management Inc., are employing all of our vast available resources, to assess, analyze, and implement the best course of action(s) going forward as we navigate through these unprecedented times. We are confident that with the right diversification approach and responsive approach to real-time developments in the markets, we will continue to achieve our long-term investment goals together.

Source: TD Economics

Trump, Tariffs and Trade: Toward a New Global Economic Order

At a glance:

In the following section the WAAC provides an in-depth evaluation of the potential impacts of U.S. tariffs on the global economy, shining the spotlight on the following:

- **Four Reasons Why U.S. President Donald Trump Loves Tariffs**
- **The Global Trade War: 80% is About China**
- **Implications For Investors**

U.S President Donald Trump is often portrayed as mercurial and transactional, but his economic policy framework flows from two principles that he has held for well over a decade. For a start, he believes America is engaged in Cold War 2.0 and it requires the same trifecta of attributes that proved critical against the Soviet Union: economic strength, technological leadership, and superior defense capabilities.

More controversially, Trump maintains America has been too magnanimous in providing countries with access to the American consumer and the country's defense umbrella. He believes admittance to the U.S. market should be conditional on a level playing field and balanced bilateral trade, otherwise tariffs are justified. Similarly for defense, where presidents since Dwight D. Eisenhower have complained that most North Atlantic Treaty Organization ("NATO") countries are free riding on American mettle.

Four Reasons Why Trump Loves Tariffs

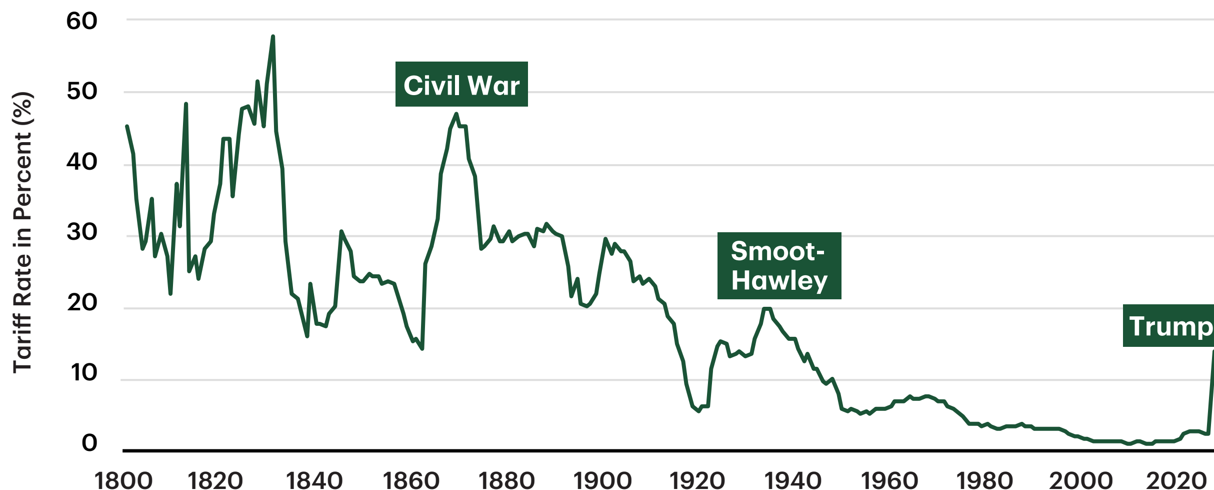
1. Trump has described tariffs as his favourite, the most beautiful word in the dictionary. Trump's first rationale is that he has unilateral power with enormous discretion, so he can enact tariffs quickly. This differentiates from other more conventional forms of industrial policy which are often more efficient from an economics perspective, but requires working with Congress.

2. Second, just the threat of tariffs provides Trump with a great deal of bargaining power to negotiate on both trade and non-trade issues (it also produces some terrific photo ops, usually at Mar-a-Lago). He used this approach recently with Canada and Mexico to emphasize illegal immigration and fentanyl smuggling. With European Union ("EU") countries, Trump highlights NATO spending arrears. While this approach has produced some middling concessions from allies, it has been much less successful with adversaries such as China.

3. Next, tariff revenues could plausibly add $80 billion(bn) to government coffers this year. From the founding of the nation until the American civil war, tariffs were typically above 20% and raised roughly 90% of the federal government's revenue (**Figure 1**). During the youth of America, a tariff was simply the only tax it had the capacity to enforce.

4. Trump's fourth reason for loving tariffs is they could help restore America's manufacturing base. He believes the U.S. needs tariffs to prevent a tsunami of subsidized Chinese exports from continuing to hollow out critical sectors. Tariffs could also incentivize homeshoring of investment, production, and jobs. When Trump talks about homeshoring, he has one particular country in mind, and that is China.

Figure 1: U.S. Average Effective Tariff Rate



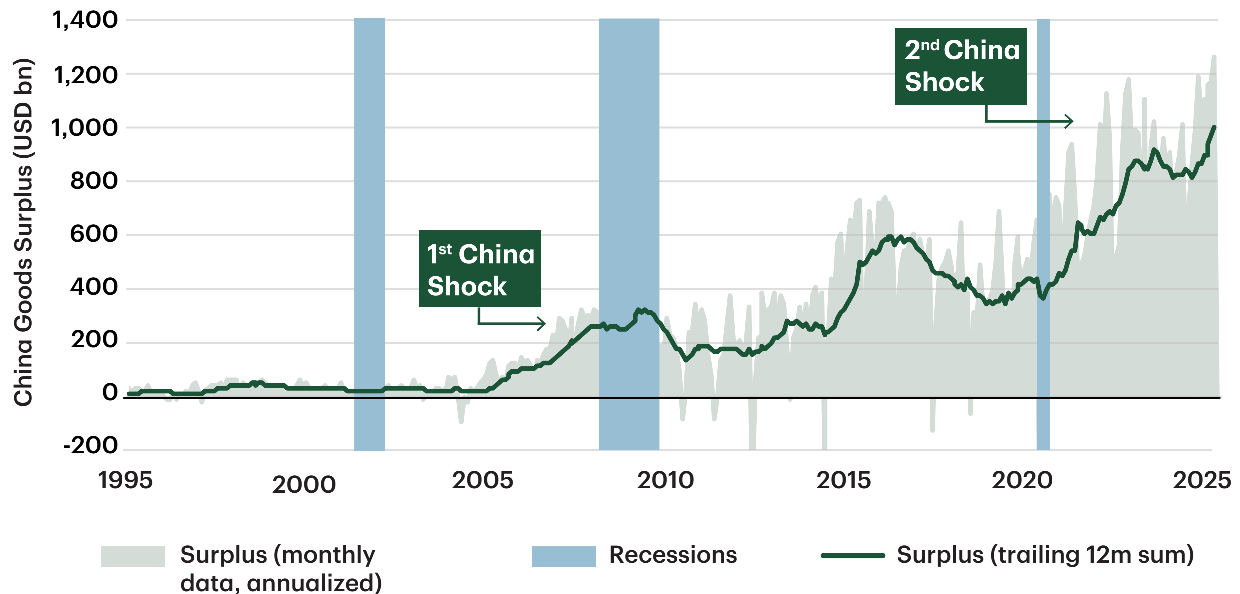
Source: Bloomberg Finance L.P., Bicentennial Edition: Historical Statistics of the United States, Colonial Times to 1970, United States Census Bureau.

Global Trade War: Is 80% About China

China's economic model is incompatible with the post-Cold War global trading system. That is, its extreme form of mercantilism and belief in one-way trade, is unsustainable and has resulted in enormous backlash from its export markets. The objective is for China to become the #1 global manufacturing powerhouse and to dominate the industries of the future (such as Electric Vehicles, batteries, drones, and robots).

This is manifest in China's massive trade surplus, with a run rate of over one trillion U.S. dollars ("USD") (**Figure 2**). This surplus has more than doubled from its pre-COVID-19 level, which was already the largest experienced anywhere in history. To illustrate, Chinese companies now produce 90% of the world's solar panels, 70% of its batteries and 90% of consumer drones. China also produces more than 50% of the world's aluminum, steel, and ships. Further, during the last three years car exports have tripled, with China becoming the world's largest car exporter by units. No one in Beijing should be surprised that their export strategy is facing significant challenges, including trade barriers, outright bans, and the threat of much higher tariffs.

Figure 2: China Goods Surplus (USD bn), to Infinity and Beyond



Source: Bloomberg Finance L.P., as at March 6, 2025.

The New Global Economic Order

With the rise of China, we have moved from a unipolar to a bipolar world. And in this new world order, China is challenging the U.S. in all three domains of power – economic strength, technological prowess, and defense capabilities.

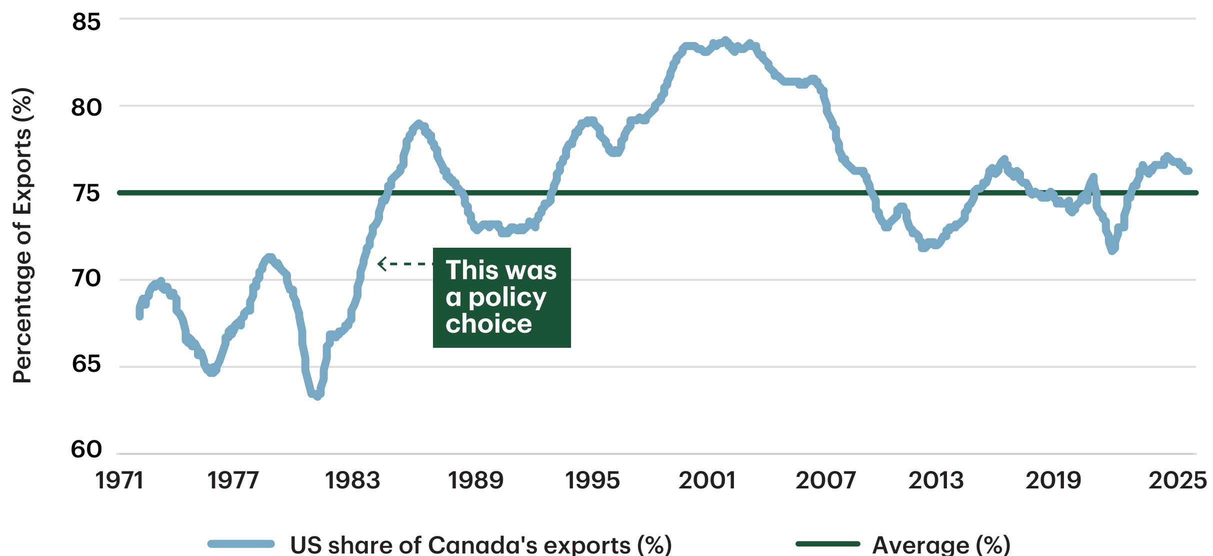
One implication of the new bipolar order is that the two economic behemoths view interdependence as a risk to both global supply chains and national security. This especially applies to semiconductors, energy, the Electric Vehicle supply chain, and critical medical supplies, as well as the defense industry. For the U.S., the new global economic order features a much more expansive and intrusive role for the state. This includes an active industrial policy, including tariffs, to reduce supply chain vulnerabilities and promote national security and resilience.

What is Canada's Role in the New Global Economic Order?

Canada fits into Trump's narrative in two ways. First, it has a bilateral trade surplus and there are long-held, complex disagreements affecting sectors such as autos, energy, lumber, and agriculture. Canada is not at all unique in this regard, however, there are many countries with more extreme bilateral imbalances. Second, coercing and pressuring Canada shows the rest of the world that Trump is serious about the trade war. This is especially important for the big trade deal he would like to negotiate with China during the next couple quarters.

Although Canada's imbalances are not exceptional, it is almost unique in its dependence on the U.S. market (**Figure 3**). The risks associated with this dependency are well known and have been vigorously debated since well before Confederation. However, Canada made an explicit policy decision in the 1980s and 1990s to increase its vulnerability by entering into broader and deeper trade agreements. It remains debatable that this was a prudent course to take.[1]

Figure 3: Share of Canada's Exports Going to the U.S.

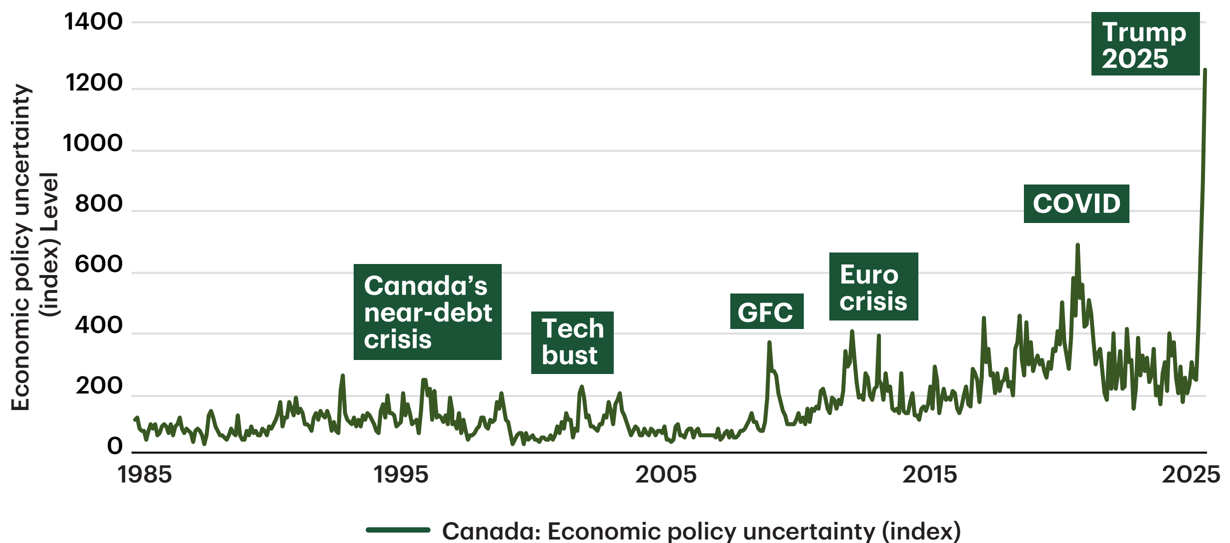


Source: Bloomberg Finance L.P., as at March 6, 2025.

[1]Around the same time, during the early-1990s, Canada reduced its defense spending to well below the 2% of Gross Domestic Product (GDP) NATO commitment. This meant Canada become increasingly dependent on the U.S. defense umbrella and subject to legitimate criticism that it was free riding.

As the trade war escalated in recent months, the macroeconomic outlook for Canada has deteriorated. The Organization for Economic Co-operation and Development ("OECD") expects inflation to average 3% over the next two years (markedly higher than the roughly 2% projected before tariffs were imposed) and Gross Domestic Product ("GDP") growth around 0.7% in both 2025 and 2026 (versus 2.0% pre-tariffs). This places Canada dangerously close to a recession, just a shock away. However, potentially even worse than tariffs is the associated uncertainty, which is at a record high (**Figure 4**).

Figure 4: Canadian Economic Policy Uncertainty



Source: Bloomberg Finance L.P., as at February 28, 2025.

Canada's Negotiating Strategy: The Art of the Deal

The contours of a trade deal are quite clear. For a start, it is critical to understand what is important to Trump and provide him with some easy wins. Examples include improving border security and committing to increase defense spending (to well above 2% of GDP). Canada can also coordinate with the U.S. on policies to both counter China (tariffs, export/import controls, sanctions) and to enhance U.S. capabilities in critical sectors. In fact, these all strike as win-win outcomes.

Second, Canada is a relatively small economy, only 8% the size of the U.S. (using International Monetary Fund estimates for 2025). However, 80% of its trade and border issues are similar to those facing the EU (67% the size of the U.S.), UK (12%), Japan (15%) and Australia (6%). By collaborating with allies, Canada can move from a David vs. Goliath match to a much more balanced negotiation. This also applies to retaliatory measures which need to be coordinated, thoughtful and surgical, but haven't always been.

Trade War: Implications For Investors

The trade war will remain an important market driver through at least 2028. However, we should be careful about analyzing the impact of tariffs in isolation. Trump's overall policy agenda is pro-growth, emphasizing technology, deregulation, and tax cuts. However, the timing of these policies remains unclear.

We expect a more expansive role for the state, driven by national security concerns rather than economics and efficiency. Tariffs and other forms of industrial policy will be used to reduce chokepoints and vulnerabilities, especially in sectors such as semiconductors, energy, critical minerals, medical supplies, shipbuilding, and defense.

Given the elevated level of uncertainty it is important that investors diversify and avoid becoming overly concentrated in the Magnificent 7 stocks, for example, U.S. equities, or the USD. Correlations across regional equity markets are currently the lowest in 30 years, which makes it an especially opportune time to diversify.

Finally, during periods of elevated volatility it is particularly important to emphasize quality. That is, companies generating sustainable free cash flows with a demonstrated track record in capital allocation.

WAAC Current Positioning and Asset Class Outlook

At the end of the first quarter, we are modestly overweight global equites and alternatives, with a modest underweight to fixed income. The following is our positioning rationale and outlook for the individual asset classes. The TD Wealth Asset Allocation Committee meets monthly and makes strategic adjustments to asset class views as the environment unfolds.

Equities | Modest Overweight

Sub Class	Allocation
Canadian Equities	Modest Overweight
U.S. Equities	Modest Overweight
International Equities	Modest Underweight
Emerging Markets	Modest Underweight

The **S&P TSX Composite Index ("TSX")** has tailwinds from expected 2025 earnings growth and the positive impact BoC rate cuts could have on consumers and businesses. Trade negotiations with the U.S. could create uncertainty. Within the TSX, the Financials sector is well-capitalized and the resource sectors generate attractive free cash flow, which in both cases supports distributions to shareholders.

The **U.S. equity market** valuation has contracted this year on concerns about the impact of U.S. trade policy uncertainty and some skepticism on the long-term development trajectory of AI and datacenters. This, combined with some broadening out of returns, can create opportunities. The U.S. market continues to generate positive earnings growth overall.

International equities have rallied YTD as multiples rebounded from low levels and Germany announced a major fiscal stimulus plan. However, this will take time to implement, earnings growth is low, and tariff risks remain. Japanese equities look attractive on a relative basis with momentum building behind corporate reform but there may be volatility as the Bank of Japan looks to continue raising rates.

Emerging Markets ('EM") central banks, Mexico, South Korea, and Chile, have been cutting rates. EMs might face challenges from potential changes to U.S. trade and tariff policies. China continues to struggle with challenges in its property sector but has announced monetary stimulus that could provide some stabilization for its economy.

Positioning

Fixed Income | Modest Underweight

Sub Class	Allocation
Domestic Government Bonds	Neutral
Investment Grade Corporate Credit	Modest Overweight
Global Bonds – Developed Markets	Neutral
Global Bonds – Emerging Markets	Modest Underweight
High Yield Credit	Neutral

As positive momentum builds for the Canadian economy, headwinds are emerging due to U.S. trade policy uncertainty. The BoC can quickly lower its policy rate to provide support for the Canadian economy. This would result in a steepening of the yield curve as shorter rates would likely fall faster than longer rates.

Investment grade spreads remain tight overall and reflect a modest softening of the global economic backdrop. We see Canadian investment grade corporate bonds as more attractive than U.S. investment grade corporates as spreads in Canada continue to be meaningfully wider.

Global bond markets are grappling with the impact of U.S. tariff threats on inflation, fiscal deficits, global trade, and currency dynamics. Therefore, we expect opportunities across developed market bonds to vary over the next 12 to 18 months.

The recent strengthening of the U.S. Dollar ("USD") has led to a challenging environment for **emerging markets**, particularly those with large U.S. denominated liabilities. Furthermore, the threat of tariffs along with sluggish economic growth outside of the U.S. will cause uncertainty to remain elevated.

All in yields remain attractive although spreads are near historically tight levels and provide little protection from a broader deterioration in credit conditions, weakening consumers or higher Treasury yields. While this is a concern, we see limited scope for these negative drivers to materialize meaningfully in the near-term. As a result, we remain neutral on **high yield bonds** and continue to find value in the mid to higher quality cohort of the market as well as leveraged loans which can provide incremental yields over high yield bonds.

Outlook

Alternatives | Modest Overweight

Sub Class	Allocation
Commercial Mortgages	Modest Overweight
Private Debt (Universe)	Modest Underweight
Domestic Real Estate	Neutral
Global Real Estate	Modest Underweight
Infrastructure	Modest Overweight

Commercial mortgages continue to provide accretive income while insulating investor returns from the increased volatility in interest rates.

Private debt: High credit quality and global diversification provides an income ballast in an uncertain economic environment. Incremental income and potential capital appreciation from interest rate moderation provide upside.

We believe a significant portion of the value adjustments in the **Canadian commercial real estate** space have been taken. Occupancy levels continue to improve, absent Class B & C office, due to recent extreme population growth and limited new supply. Immigration changes will impact market rents, but supply shortfall of the past, particularly in multi-family, is providing continued predictable income growth.

Global real estate: We believe the majority of the value adjustments have occurred in the U.S., UK and Nordic countries, while other regions, such as Australia, are in the midst of value adjustments.

Moderating risk-free rates have been reflected in lower discount rates which has led to strong valuations for **infrastructure assets**. We have seen a shift in focus from core infrastructure assets to core-plus and value add as investors seek greater growth and higher return potential from their infrastructure allocations.

Sub-Asset Classes

Sub Class	Allocation
U.S. Dollar USD	Neutral
Commodities (Gold, Energy, metals, agriculture, carbon)	Modest Overweight

The **USD** has remained strong against global currencies as relative growth differentials have favoured the U.S. economy in past months, and by extension the USD. Some weakness may occur, however, USD provides diversification in portfolios considering the range of risks in the near-term.

Gold continues to benefit from demand from central banks and investors. **Metals** prices have been range bound as most remain balanced. **Oil** has weakened as OPEC+ looks to slowly return supply, but also to manage member commitments and might adjust as market conditions warrant.

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Market

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