5-10-25

WSJ Print Edition

The outlook for the global economy might be bad, but bad is better than disastrous.

image

MILLIS/ REUTERS Some investors hope President Trump will soon move on from his tariff fights to focus on tax cuts.

Stocks Fell By Too Much. Now They're Up By Too Much.

STREETWISE |

JAMES MACKINTOSH

The rapid recovery of the S& P 500 is based on hope. A lot has to happen before that hope is justified.

One way to think about the plunge and rebound in stocks since "Liberation Day" on April 2 is that beforehand investors thought a 10% tariff would be the worst case, and afterward they thought a 10% tariff was the best case. Stocks fell because tariffs were far bigger than expected, then recovered when tariffs were delayed and talks began.

The outline of a trade deal between the U.S. and the U.K. on Thursday underlined the point: Tariffs of 10% will apply, but no more. To be clear, this is bad news for trade, as well as for drinkers of Scotch whisky and exporters in both directions.

A tariff of 10% is exactly 10 percentage points too much. But if stocks had already prepared for 10% by April 2, it makes sense that prices should recover to that level—as the S& P 500 has—once investors decided President Trump was likely to make deals to avoid market chaos.

This isn't great! The S& P is still down almost 8% from its February high. But stocks are concerned with what might be, not with what should be. The outlook might be bad, but bad is better than disastrous.

There's another way to think about it, which also justifies a recovery. For a brief moment the week after the "reciprocal" tariffs, it looked as though fear in the market would become self-fulfilling, as cracks appeared in the financial system. Had it been allowed to continue, things could have become truly awful. To put a finger in the air, say there was a 20% chance of a crisis that leads to a 50% fall in share prices—a risk that, all else equal, should justify a 10% lower stock price simply to acknowledge the danger.

Not coincidentally, when Trump backed down in the midst of the market meltdown and delayed the "reciprocal" tariffs on everyone except China, stocks leapt about 10%. Investors now think they don't need to worry about extreme risks, because any time things get really bad, he backs down. He performed a similar U-turn on his implied threat to fire the Federal Reserve chairman.

There's a third support for stocks too: hope that Trump might soon move on from his market-unfriendly tariff and immigration policies to focus on tax cuts.

The trouble with all three stories is that they rely on hope. Hope that Britain's willingness to accept a lopsided trade deal will apply to others, too. Hope that Trump really has received the message and won't bring in another policy investors hate. And hope that Trump is ready to put tariffs behind him, even before his planned sector tariffs on pharmaceuticals and semiconductors, and now also foreign--made movies. (Much of "Star Wars" was filmed in the U.K., and perhaps that was on the mind of the president as the White House tweeted an AI-generated image of Trump wielding a lightsaber from the film's evil Sith Lords.)

The risk is that even if the hopes are fulfilled, it just takes too long. It has taken a third of Trump's 90-day delay to pencil in a deal with Britain, and Britain didn't even have the "recip-rocal" tariff applied, only the flat-rate 10% that applied to everyone.

There are more than 50 countries with higher rates due to snap back in July. And then there is China, with which the U.S. has only just managed a break-the-ice meeting. The danger that tariffs, especially on China, feed through to higher prices and empty shelves is real. The U.S. consumer has been living in the calm before what could be a very large storm, and much slower economic growth. Investors certainly hadn't priced in a halt to China trade before April 2, and if that lasts even for just a few months, it could hurt growth a lot.

Investors need to think of this as art, not science. Stocks fell a lot, perhaps too much. They have now rebounded a lot, perhaps too much.

All this leaves me deeply uncertain. The positive stories justify higher stock prices than at the post-Liberation Day lows, but it feels as though things are worse than was expected before Liberation Day, suggesting that the rebound has gone too far.

The flip side is that the rise of gold—and the devaluation of the dollar—suggest a lot of fear remains. The S& P is down about 5% in gold terms from Liberation Day, and buys 18% less gold than it did at its February high. Think of it this way, and the moves make more sense.

LEAH

No page 3