



Paul Christopher, CFA

Head of Global Investment Strategy

U.S. – China trade truce triggers stock rally

What's moving markets

- News overnight of a pause in the most severe U.S. and China tariffs prompted stocks to rally this morning.
- Specifically, the two countries agreed to reduce tariffs on each other by 115% each. That takes the U.S. tariff on China down to 30% and the Chinese tariffs on the U.S. down to 10%.

Our perspective

- The clock is ticking on two temporary suspensions: The first on reciprocal tariffs for a large group of countries expires in early July, and now a second one for China that expires in August. The president has bought time for possible deals, but it's not clear yet what kind of agreements will come out of this double pause.
- The one deal we've seen so far – with the U.K. – suggests that tariffs will remain in double-digits, even for countries that make concessions. If we extrapolate similar deals to other countries, we would not expect much reduction in U.S. economic pain.
- The S&P 500 Index remains in a downtrend with the 50-day moving average (dma) below the 200-dma. The index may find support next at the 200-dma (5750) followed by the 50-dma (5549). Resistance is at the all-time closing high (6144).

Implications for investors

- We favor neither chasing rallies nor selling on weakness. History suggests that both the sharpest rallies and retests of recent lows happen early in the equity market bottoming process.
- Instead, long-term investors should incrementally add exposure on down days to high-quality U.S. equity asset classes and sectors, and stay selective in fixed income (see below).
- If the current bounce carries further, investors may want to consider trimming lower quality areas, such as U.S. small-caps or emerging-market equities.

The bigger picture

The big news overnight was that the U.S. and China agreed to reduce tariffs on each other by 11.5% each. That takes the U.S. tariff on China down to 30% and the Chinese tariffs on the U.S. down to 10%. The 30% U.S. tariff would include the 10% universal tariff applied on April 2, 2025 and the 20% February and March 2025 levies to encourage China to block fentanyl shipments to the U.S.¹

So, now the clock is ticking on two temporary suspensions: the first on reciprocal tariffs for a large group of countries expires on July 12, 2025, and now a second one for China that expires 90 days from today. The president has bought time for possible deals, but it is not clear what kind of agreements will emerge from this double pause. U.S. Treasury Secretary Bessent said overnight that China would purchase more from the U.S., but it's uncertain whether that promise would be enough to prevent a return to much higher tariffs by the end of the pause in August.

The one deal we've seen so far – on May 8 with the U.K. – seems underwhelming. The deal will leave the U.S. tariff rate at the basic, universal 10% rate and allow preferential tariff access for imported vehicles from the U.K., and partial relief for steel and aluminum products. In return, the U.K. offered market access to a headline figure of \$5 billion of U.S. exports, mostly across agricultural goods, chemicals and machinery.² However, the absence of a time horizon for these purchases suggests the headline figures could be spread over many years and might include some purchases that would have been made without a trade deal.

Above all, the deal suggests that tariffs will remain in double-digits, even for countries that make concessions. We detected no positive market reaction to this agreement. If we extrapolate similar deals to other countries, especially Canada, Mexico, Japan, Korea, and Europe, we would not expect much reduction in U.S. economic pain.

To sum up, we believe one way to describe the current moment is that financial markets and the economy have entered the eye of the storm. The U.S. economy's pace is slower than last year's but may still avoid a recession, if negotiations move some tariffs lower and especially don't add any new ones. To that end, the two tariff suspensions could be hopeful signs, but the final tariff menu remains uncertain. And if tariff damage is only beginning to be priced into the U.S., it hasn't registered in overseas markets yet. This is all the back part of the storm that we have yet to see.

What to do now

For investors who find themselves overallocated to lower quality areas such as U.S. Small Cap or Emerging Market Equities, this rally provides an attractive opportunity to trim exposure. Even trimming equity exposure more broadly and reallocating to our favorable rated Commodities or in areas within fixed income may make sense if the portfolio is over its equity risk budget.

Our equity guidance prioritizes quality, while our fixed-income guidance emphasizes selectivity. International economies depend more on trade than does the U.S. economy, so we favor U.S. equities. Among the U.S. markets, we favor U.S. Large Cap and Mid Cap Equities and select sectors (Information Technology, Communication Services, Financials, and Energy). We also favor investment-grade fixed income and would focus on corporate bonds and essential-service municipal securities. In our view, the middle range (3 to 7 years) offers the best value at this time, in our view.

1. Akayla Gardner, "Trump Says He May Speak to Xi This Week After Tariffs Truce", Bloomberg, May 12, 2025.

2. "Fact Sheet: U.S.-UK Reach Historic Trade Deal", The White House, May 8, 2025.

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Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

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An index is unmanaged and not available for direct investment.

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