

Ballentine Partners Perspectives

Tariffs and DOGE Scary Headlines: Keep Calm and Carry On

Summary Bullets:

- Market volatility is more likely driven by uncertainty in policies (which are hard to plan for) rather than actual economic damage.
- Scary headlines help sell advertising, but they may not be reliable sources of investment advice. Our view is that the impacts of tariffs and DOGE will be directionally negative in the short term, but not to the degree that the financial press would have you believe.
- There are mitigating factors to the headwinds of tariffs and DOGE. Tariffs are on goods, not services (and our GDP is primarily driven by services). Tariffs are likely to be limited in scope: by products, by countries, by duration, etc.
- DOGE's impact will likely be diluted by legal challenges, political realities, and the eventual absorption of laid-off employees by the private sector, state and local governments, and other federal agencies.
- As we stated in our January letter, it was highly likely that the market would, at some point, suffer a double-digit drawdown, if for no other reason than they are normal and occur with regularity.

There will eventually be clarity. When that happens, markets, businesses, and consumers will adjust to the new reality and carry on, because that's what they've always done.

Part I: Tariffs

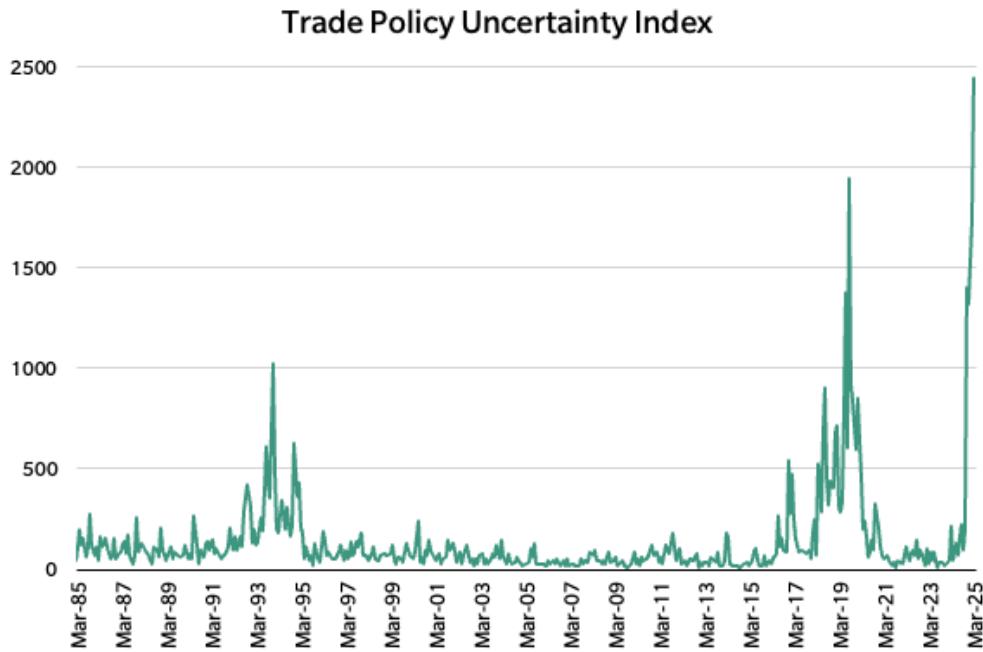
Let's tackle tariffs first. What are tariffs and why do countries use them? Tariffs are taxes, officially called import duties. They have been used by countries throughout history for what economists call "the three R's": revenue, restrictions (to protect domestic industries from competition), and reciprocity (as a bargaining chip). Tariffs were a major source of tax revenue for the first third of our nation's history. Economic policies changed notably after the Great Depression, resulting in the passage of The General Agreement on Tariffs and Trade in 1948, which helped usher in an era of low tariffs. Global trade accelerated as further treaties and agreements moved toward an era of free or freer trade. The average duty on goods subject to a U.S. tariff was less than 4% for the past quarter-century.

And then everything changed.

The new administration is now proposing large tariffs, dusting off the "three R's" playbook to raise government revenue, encourage re-shoring of manufacturing, and as bargaining chips for other desired economic and social goals (immigration restriction and fentanyl crackdowns, specifically).

The stock market reaction and the financial press headlines, however, have focused on the potential negative outcomes. Why? First, the magnitude of the tariffs proposed by the current administration represents a significant break in U.S. policy. Second, there is strong fear that tariffs could usher in a period of stagflation – higher prices plus slower growth, neither of which is desired. Finally, and related, the capital markets have been unnerved by tariffs, as they can dent profits, cause consumers to slow down purchases, and cause companies to slow down investment, creating a self-perpetuating cycle. The optimism of CEOs of both large and small companies – buoyed originally by the promise and prospect of business-friendly policies such as reduced regulations and lower taxes – has turned decidedly pessimistic. Tariffs, originally thought of more benignly as potential negotiating tactics, are now viewed as major frictional costs and disruptions to supply chains and operations, generally. Finally, the rapid changes in strategy – sometimes reversing within hours – have become distractions from other more desirable goals. In a word, tariffs have created massive uncertainty. See the chart below. And the markets do not like it. The S&P 500 has lost, as of this writing, close to 10% from its February 19 high, further fueling the scary headlines.

Potential tariffs are clearly creating economic uncertainty



Source: Economic Policy Uncertainty, Ballentine Partners. The index is calculated using three underlying components: news coverage about policy-related economic uncertainty (2,000 news sources), tax code expiration data, and economic forecaster disagreement.



So, let's discuss Ballentine's views on tariffs at a high level.

Are tariffs inflationary, or will they slow down the economy? Yes.

There are two mechanisms of inflation. The first: U.S. importers, facing the additional tax, will pass some or all of the tariff burden onto consumers through higher prices. The other mechanism is that domestic producers, seeing higher prices on imported competitive products, may opportunistically follow suit.

But tariffs can also have a simultaneous anti-growth, or deflationary effect, as higher prices typically lead to reduced demand. When consumer goods become more expensive, households may cut back on spending, leading to an overall economic slowdown. This negatively impacts hiring, wages, investment in new

capacity, etc. In this way, tariffs act as a brake on economic momentum. More alarming, there is fear (and evidence) that retaliation against the U.S. will spiral into a global trade war, slowing global growth.

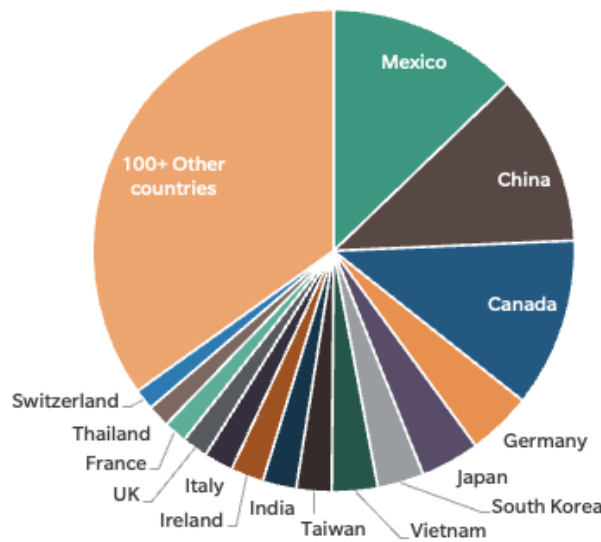
Mitigating factors:

Despite the financial media’s scary headlines, we believe the impact of tariffs may be more muted. First, tariffs apply only to goods, not services. Given that services make up roughly 70% of U.S. consumer spending, the majority of economic activity remains untouched.

Second, the current set of proposed tariffs is relatively narrow in scope. The media focuses on trade disputes with China, Mexico, and Canada, but these three countries account for only approximately one-third of total U.S. imports. The remaining two-thirds come from a diverse spectrum of countries. Now, the situation remains fluid, and we concede that the administration has talked about raising tariffs on other countries, but the focus has been on these three countries so far. Also, many of the proposed tariffs have exemptions, diluting their impact.

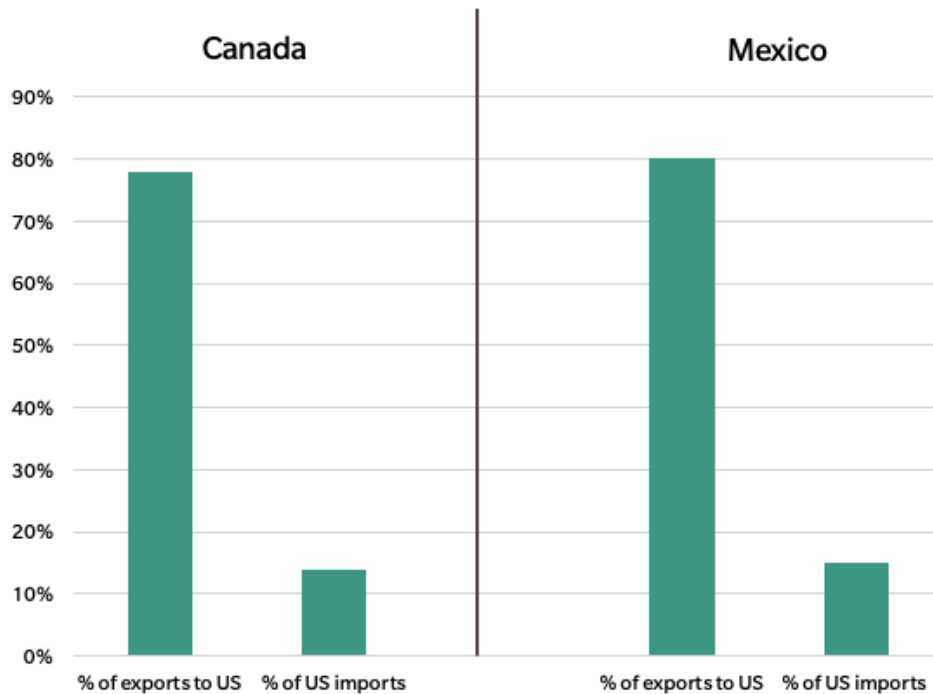
US import picture is more diversified

**US Imports:
More Diversified & Balanced**



Source: Statista

Canada and Mexico need the US more than the other way around



Source: Council on Foreign Affairs

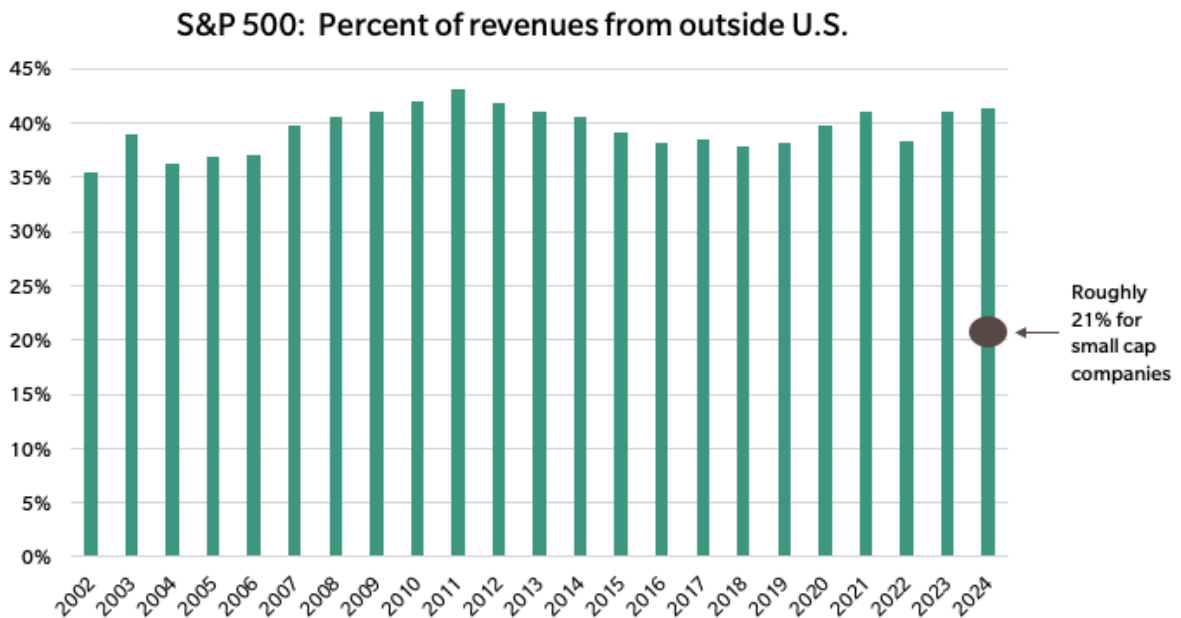


Third, it's plausible that the current administration still views them primarily as a shorter-term negotiating tool rather than a permanent policy shift. The on-again, off-again horse-trading nature of what is playing out certainly lends credence to this idea. If tariffs are being used to pressure trade partners into concessions on other issues—such as immigration enforcement, a crackdown on fentanyl distribution, or reshoring of some manufacturing—then their long-term impact on the economy could be less severe than feared. Canada and Mexico, in particular, are highly dependent on U.S. trade, with 90% of their exports going to the U.S. So if tariffs are indeed a negotiation tool, this puts the U.S. in an extremely strong negotiating position. And the administration is simply playing its strong hand.

Finally, small companies are the backbone of the U.S. economy. Roughly half of all Americans work for companies with fewer than 100 employees, and 99.9% of U.S. businesses are small. Most small businesses do not have complex global supply chains, and most of them generate the vast majority of their revenue from domestic clients. The Russell 2000, a proxy for publicly traded small-cap companies (not small in the

traditional sense, but small by public company standards), derives only 21% of its revenue from outside the U.S. The point is that most companies are shielded from a global trade war, should one ensue. Mega-cap multinational tech companies, on the other hand, are much more exposed, and their stock prices have taken a disproportionate hit. That’s why we are thankful that in client portfolios, we’ve been tilting away from these large-cap companies since last summer.

Large multinationals more exposed to a potential trade war vs. small cap



Source: [Factset](#), LSEG. Small cap companies represented by the Russell 2000.

Part II: DOGE

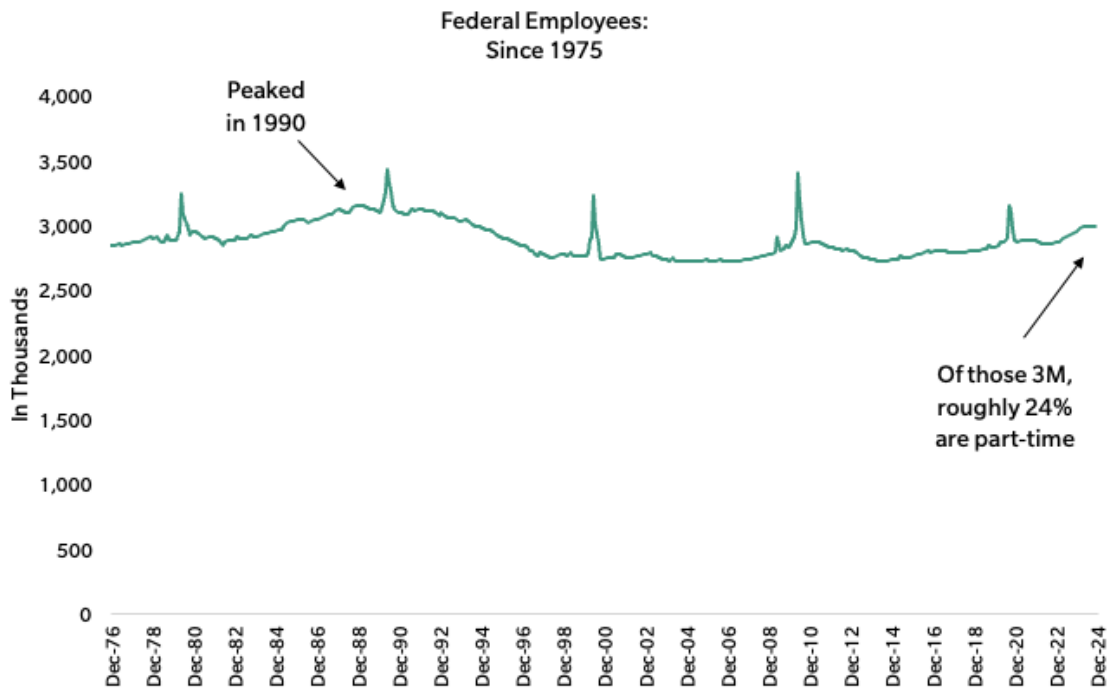
The Department of Government Efficiency (DOGE) was established with a mission to streamline federal bureaucracy, significantly reduce government spending, and address the deficit. Its primary rationale was appealing: shrinking the expansive footprint of government. However, this initiative has stirred

controversy, particularly surrounding fears that substantial federal layoffs could drastically elevate unemployment rates, amongst other worries beyond the scope of our commentary.

Despite widespread anxiety, data suggests that DOGE's impact on employment may be less severe than anticipated. The federal civilian workforce numbers under three million employees, a figure that appears substantial at first glance. Yet, several mitigating factors indicate that the effect on unemployment would be manageable.

First, the number of federal employees has essentially remained flat for 35 years, peaking back in 1990. Since then, despite population and economic growth, the total workforce has been declining, not growing. More importantly, when examined as a percentage of the broader U.S. workforce—which exceeds 160 million—the federal employment rate has decreased by essentially half. See charts below.

The number of Federal employees has essentially been flat to down for 35 years



Source: USAFacts.org, Bureau of Labor Statistics. The peaks are due to increased hiring during census.

As a percent of the U.S. workforce, it's essentially half what it was



Source: USAFacts.org, Bureau of Labor Statistics. The peaks are due to increased hiring during census.



A thought experiment underscores this point: imagine if DOGE terminated every federal employee, an absurd scenario. The unemployment rate would only rise to approximately 5.8%, still below the 50-year average of 6.2%. The U.S. economy grew and prospered for many decades with much higher levels of unemployment.

Thought experiment: What if EVERY Federal employee were let go?

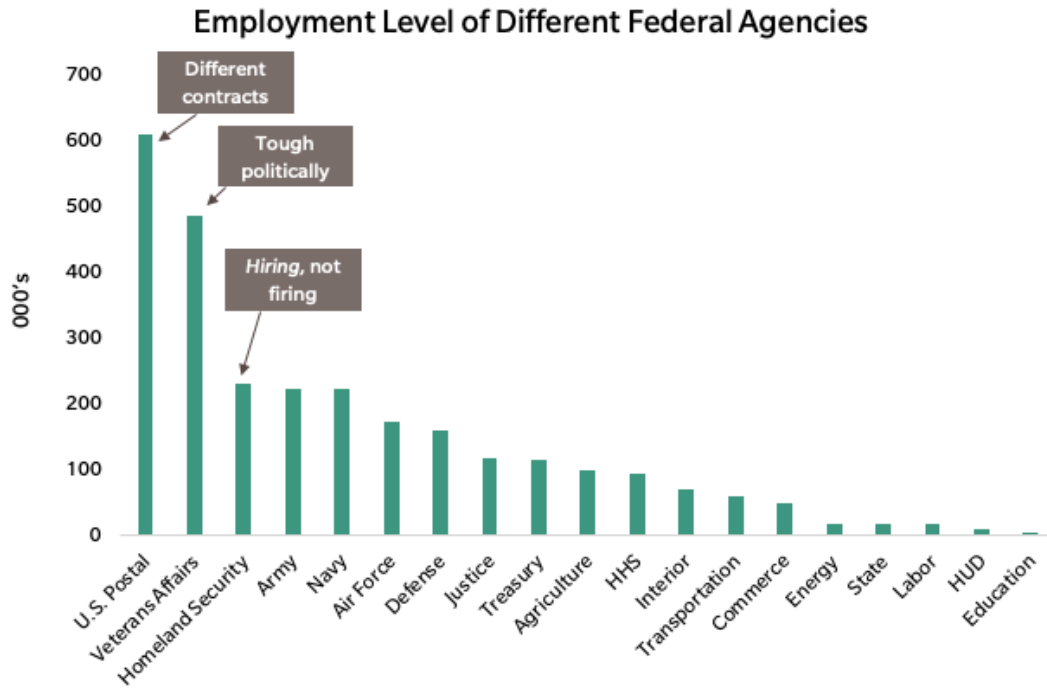


Source: Bureau of Labor Statistics, USAFacts.org, Ballentine Partners



To state the obvious, DOGE layoffs will not be that drastic. Various analysts estimate the number to be around 300,000, or closer to 10%. But even that may be aggressive given structural, political, and legal realities, especially when we look at the employment picture in the chart below. The largest federal employer, the U.S. Postal Service, operates under a unique, self-funded arrangement with separate labor contracts, rendering large unilateral reductions improbable. Reducing doctors, nurses, and hospital staff for veterans' care is problematic for obvious political reasons. The third-largest agency, Homeland Security – the agency responsible for enforcing immigration restrictions – is hiring people, not firing them. And the next three – the Army, Navy, and Air Force – have historically enjoyed strong political support from the conservative wing, so large-scale reductions there are challenging politically. All the headlines these days seem to be on efforts to eliminate the Education Department entirely, but as you see in the chart, you could eliminate twenty Education Departments, and it would still be a rounding error in terms of making a dent in the total picture. Finally, there will be and have been challenges and judge rulings that DOGE does not even have the authority to enact these reductions-in-force.

Structural, legal, and political hurdles to massive layoffs



Source: Apollo, USAFacts.org. U.S. Postal also includes census worker. HHS is Health and Human Services. HUD is Housing and Urban Development.



Additionally, natural attrition and retirements—which occur regularly—and absorption into other federal or state agencies and the private sector will soften DOGE's employment impacts. The private sector alone has recently demonstrated robust job creation, generating approximately 150,000 new positions in the past month.

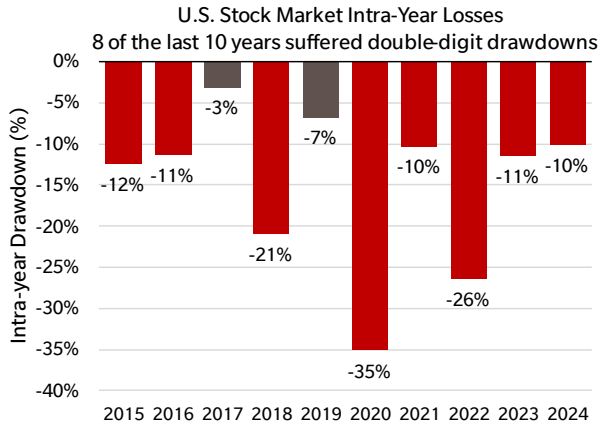
In summary, although DOGE initially sparked fears of significant economic disruption, our take is that the impact will be more tempered.

Concluding Thoughts

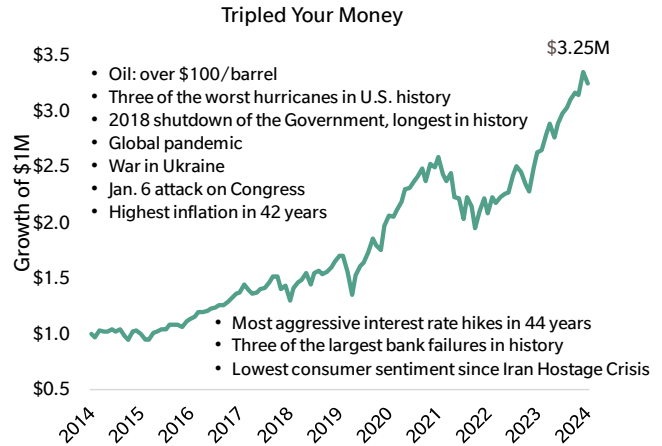
The situation is literally changing day by day, if not hour by hour. This back-and-forth has not inspired confidence, as evidenced by market gyrations. The risks of creating a bout of inflation or a bout of economic slowdown (or both) are very real. And we all need to get mentally prepared for increased market volatility over the next few months. In our January letter, we indicated that a double-digit market correction at some point during 2025 would be likely. It would be completely consistent with the past: double-digit corrections occurred in 2024, 2023, 2022, 2021, 2020, 2018, and 2016...you get the point. These market drawdowns create tremendous angst. And we understand the temptation to try to dodge them. Our advice is to stay the course. Why? Eight of the past ten years suffered double-digit mid-year drawdowns. Yet in that ten-year period, equity markets still tripled your money.

Markets will likely be volatile this year, like past years

Stocks Can Feel Awful Short-term



But Remain Awesome Long-Term



Source: Ballentine, Morningstar data. U.S. equities represented by the Vanguard Total Market ETF (VTI). Each drawdown represents a peak to trough collapse of price in a calendar year. Any investment can result in total loss. Past performance is not necessarily indicative of future performance.



Our base case started the year with a view that economic growth would be “solid” for reasons that bear repeating: a strong consumer, 60-year lows in unemployment, downward-trending inflation, rising real wages, booming AI demand and its required energy and infrastructure investments, AI efficiency gains, cheap valuations in certain pockets of the market, the prospect of lower regulation and lower taxes, the highest profit margins on record, and double-digit earnings growth. This partial list presented a very solid tailwind. But we also acknowledged the very real risks to this base case, tariffs and high valuations among them. It’s entirely possible that our “solid” base case may still prevail, but the shorter-term road ahead has demonstrably gotten rockier in the past three weeks. We don’t want to sound Pollyannaish.

Scary headlines in the financial media help sell advertising, but they may not be good sources of investment advice. Our view is that the impacts of tariffs and DOGE will be directionally negative in the short term, but not nearly to the degree that the financial press would have you believe. There are mitigating factors. And there will eventually be clarity. When that happens, markets, businesses, and consumers will adjust to the new reality and carry on, because that’s what they’ve always done.

About the Authors

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Pete Chiappinelli, CFA, CAIA, Partner & Chief Investment Officer Pete is a Partner and Chief Investment Officer at the firm. He is focused primarily on Asset Allocation in setting strategic direction for client portfolios. Pete has 30 years of experience in research, investment strategy, and thought leadership regarding the management of multi-asset class portfolios, inclusive of equities, fixed income, and alternatives. His work has been featured in leading financial publications such as The Wall Street Journal, The New York Times, Barron's, and others in Canada, Europe, and Asia. His market commentaries have been featured at major industry conferences, in TV documentaries on capital markets history, and on social media outlets. Prior to joining Ballentine Partners in 2022, he was a Senior Portfolio Strategist on GMO's Asset Allocation team. Prior to that, he was an Institutional Portfolio Manager at a specialized unit within Fidelity Investments and was the Managing Director of Institutional Investment Strategy & Research at Putnam Investments. He is a graduate of Carleton College and holds his MBA from The Wharton School at the University of Pennsylvania. Pete holds the Chartered Financial Analyst (CFA) designation, is a member of the CFA Institute and CFA Society Boston, and he holds the CFA Institute Certificate in ESG Investing. He also holds the Chartered Alternative Investment Analyst (CAIA) designation and was the founding President of CAIA Boston. Pete lives in Hingham, MA with his wife, Cheryl, and enjoys travel, cooking (definitely not a "foodie," but a "foodie wannabe"), sourdough breadmaking, and conjuring up ways to embarrass his three children.

Christopher C. Chandler, CFA, CAIA, Chief Investment Officer

Chris is a Partner and Chief Investment Officer at the firm. In his role, Chris leads the client investment teams responsible for portfolio management and delivering customized investment advice to clients. Additionally, Chris leads the team responsible for private and alternative manager due diligence and selection. Chris co-chairs the firm's Investment Committee, which is responsible for firm wide decisions on asset allocation, manager selection and portfolio construction. Prior to joining the firm in 2015, Chris had a 10-year career with GenSpring Family Offices, a multi-family office providing wealth management and family office services to ultra-high net worth families. Chris was a member of the executive team with oversight of the clients' investment experience and implementation through the GenSpring network of family offices. He was one of few key decision makers responsible for shaping the firm's guidance around asset allocation, manager selection, and portfolio construction. Previously, Chris was a Consultant at Hartland & Co, an institutional investment consulting firm to pension plans, endowments and foundations, and an Officer of BNY Mellon working with families. Chris graduated with a B.S.B.A. from Boston University School of Management and an M.B.A. from Case Western Reserve University's Weatherhead School of Management. He holds designations of CFA charter holder and Chartered Alternative Investment Analyst. Chris is a member of the CFA Institute and the CFA Society of South Florida. Chris is married with two children and lives in the Palm Beaches. During his free time, Chris enjoys time with family, fishing, golf, and traveling.

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