KENSHO INVESTMENT GROUP

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KCM CEO Insight: Current Developments in the United States ~ A Changing America, Global Impacts, and Portfolio Strategies for Japanese Investors ~

The U.S. economy has been performing steadily. However, the implementation of Trump tariffs, China's retaliatory measures, and the temporary 90-day suspension of some reciprocal tariffs for countries that did not respond in kind have triggered significant volatility in global equity markets. Just two days ago, rumors of a 90-day suspension of reciprocal tariffs circulated, but when the government subsequently denied the report, global markets plunged into turmoil.

Market participants are finding it increasingly difficult to distinguish fact from fake news, and uncertainty is rising. While upcoming negotiations between the U.S. and various countries may raise hopes for a swift resolution and market stabilization, uncertainty regarding future developments remains.

Let us begin by examining what the Trump administration is fundamentally trying to achieve.

THE U.S. FISCAL AND TRADE DEFICITS

To respond to COVID-19, the U.S. government undertook approximately $11 trillion in fiscal spending. The Federal Reserve (FRB) purchased over $4.5 trillion in government bonds and mortgage-backed securities, injecting massive liquidity into the financial system. As a result, the economy was supported, corporate operations stabilized, but inflation surged.

Currently, the U.S. fiscal deficit stands at about $2 trillion, or roughly 6% of GDP. The trade deficit is around $1 trillion, approximately 3% of GDP. Total government debt (including Treasury securities) exceeds $35 trillion, more than 100% of GDP. This situation is often referred to as the "twin deficits."

ELON MUSK AND STEPHEN MILAN

The Trump administration fundamentally believes that these twin deficits are unsustainable and must be urgently addressed. In my view, the key figures reflecting this belief in policy are Elon Musk, in charge of reducing the fiscal deficit, and Stephen Milan, Chairman of the President's Council of Economic Advisers (CEA), focusing on reducing the trade deficit. Fiscal deficit reduction is expected to settle down once Musk's restructuring efforts conclude. However, predicting the outcomes of trade deficit reduction—centered on revitalizing American manufacturing and led by Milan—is more difficult. Milan has stated, "Deregulation and tax cuts will be needed, but this will take time." This implies a long-term strategy to revitalize American manufacturing and boost personal consumption through regulatory reform and tax policy.

U.S. TRADE NEGOTIATIONS WITH OTHER COUNTRIES

The U.S. is using its tariff policies to pressure other countries. Although retaliatory tariffs by other nations are clearly expected to drive up global inflation and carry more negative consequences than positive, the U.S. and China have entered a tariff escalation war. The EU has also decided to impose retaliatory tariffs.

While negotiations are beginning, the U.S. will likely push other countries to increase imports of American goods by demanding the removal of non-tariff barriers. In response, China and the EU appear to be implementing counter-tariffs to gain negotiating leverage. A key question is whether the U.S. will seek further depreciation of the dollar to enhance the international competitiveness of American products during these negotiations.

STATE OF THE U.S. ECONOMY

In the long run, deregulation and tax reform may have positive effects. However, in the short term, the tariff increases are likely to lead to rising inflation—not only for imports, but also for raw materials and domestic goods due to increased demand. This could trigger global stock market turbulence and a potential economic slowdown.

It's too early to determine whether the U.S. will enter a recession, but in the short term, it is reasonable to assume the growth rate will slow. Typically, when the U.S. economy slows, investors flee to quality assets, resulting in higher demand for U.S. Treasuries. However, due to inflation concerns, interest rates on U.S. Treasuries are also rising. Consequently, we may see increased volatility in both the equity and bond markets.

KEY POINTS GOING FORWARD

The Trump administration's tariff policy introduces heightened uncertainty:

1. How other countries will retaliate.
2. Potential impact on investment and capital flows into the U.S.
3. Effects on corporate earnings.
4. How far the dollar will depreciate.

It is unlikely these issues will be resolved quickly.

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Jamie Dimon, Chairman of JPMorgan Chase, said in a letter to investors:
"By any measure, equity valuations remain well above historical averages. Credit spreads also remain tight. The market appears to be pricing in a soft landing for the U.S. economy, but I am not convinced of that."
He also noted, "It is almost impossible to incorporate quarterly or yearly forecasts with confidence."

Given that continued turbulence and volatility in the U.S. economy and markets is likely, 2025 will be a year where investors must reconsider capital allocation—especially in terms of geographic diversification. With the possibility of countries re-evaluating their relationships with the U.S., Japanese investors in particular may need to reconsider their U.S.-centric investment portfolios.

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