APRIL 2025

SIX QUESTIONS INVESTORS ARE ASKING RIGHT NOW

Executive Summary

- While the situation on tariffs is fluid, these measures serve as a reminder that tariffs are a cornerstone of President Trump's economic agenda and something investors will have to navigate throughout 2025 and beyond. The role of trade tariffs will likely be twofold: a negotiating tool on one hand, and a source of revenue on the other.
- Recently announced tariffs pose both upside risks to inflation AND downside risks to employment, leaving the Fed in a tough spot to manage their dual mandate of stable prices and full employment.
- Artificial intelligence (AI) and Wall Street's fascination with it are both here to stay. AI will continue to be a focal point for big business over the next decade as companies invest in the essential infrastructure, such as data centers and computing resources, required to implement AI.
- Looking ahead, our view is that the fracturing of international relationships into blocs is likely to continue, with newly elected administrations driven by mandates to tame price inflation, boost national security and, in some cases, break with the status quo.
- While recent market volatility may seem unnerving, market fluctuations are common and are considered a healthy part of all market cycles.

Niladri 'Neel' Mukherjee
TIAA Wealth Management
Chief Investment Officer

"I've been everywhere man," in 2025. New York, Colorado, North Carolina, Florida, California, Nevada. My goal: to meet with as many TIAA Wealth Management clients and advisors as possible and answer whatever questions they have about how we are managing their money at a time of unusual geopolitical upheaval and elevated market volatility. What have I learned? From coast to coast and places in between, the message from clients has one common thread: In a swiftly changing environment, investors crave clarity.

In this month's CIO Perspectives, we try to provide that. I delve into the six questions my team and I have fielded most in an eventful first quarter of the year.

Question 1: Trade tariffs have dominated the headlines in recent months. Can you tell me more about the new administration's prioritization of tariffs, how they are likely to function, and how they might impact investors?

As we attempt to understand the direction and implications of the new administration's tariff policy, let's look back at the series of events leading up to it. On February 1, 2025, the White House announced a 25% tariff on imports from Mexico and Canada, with a reduced 10% rate on energy resources, and an additional 10% tariff on imports from China. The measures against Canada and Mexico were delayed twice as the two countries agreed to deploy additional troops to the U.S. border to patrol the flow of illegal drugs and immigration. However, the 10% duty on Chinese goods remains in place, and a 25% tariff has been imposed on all steel and aluminum imports.

Fast forward to April 2, President Trump announced a series of reciprocal trade tariffs on nearly all imports entering the U.S. A baseline tariff of 10% will be applied to all imports, effective Saturday, April 5. Additionally, higher tariffs were imposed on specific countries, including China (34%), Japan (24%), and the European Union (20%). These country-specific tariffs will take effect at midnight on April 9, potentially allowing for negotiations in the coming days. This announcement immediately shook markets as investors had hoped for careful implementation, but instead were confronted with a worse-than-expected trade scenario. We wrote about these latest measures in our recent Focus*Point*.

While the situation remains fluid, these measures serve as a reminder that tariffs are a cornerstone of President Trump's economic agenda and something investors will have to navigate throughout 2025 and beyond. The role of trade tariffs will likely be twofold: a negotiating tool on one hand, and a source of revenue on the other. Trade tariffs raise the price of imports and are paid by U.S. companies importing foreign goods.

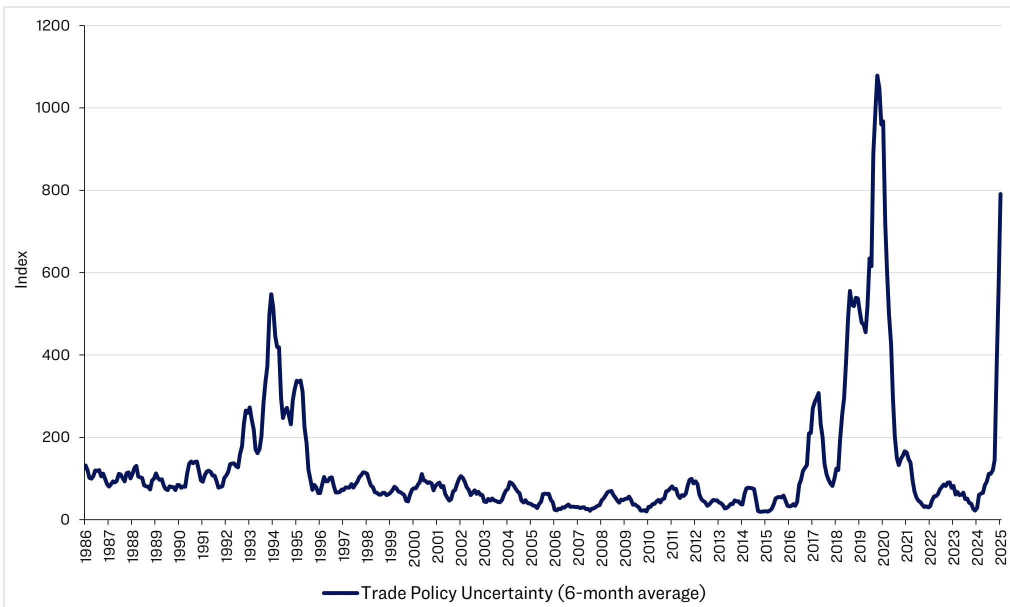
There are three ways these higher import prices can be absorbed:

- Exporters in targeted countries (like China) lower their prices to maintain competitiveness and retain their market share.
- U.S. importers absorb most of the price increase, which would lead to higher input costs and lower profit margins.
- Or U.S. importers pass higher input costs on to consumers, with a direct impact on price inflation, affordability, and aggregate demand.

Our view is that we could see a combination of the three, with the situation getting even more complicated if trade partners respond with retaliatory measures. If trade partners impose retaliatory tariffs on U.S. exports, it could squeeze U.S. profits even more. As a result, the risks to the economy stem not only from the actual implementation of trade tariffs but also from the cascading impacts. Uncertainty surrounding trade could have material impacts on capital expenditure plans, headcount decisions, business sentiment, consumer confidence, and more (Figure 1).

FIGURE 1

As a result of ongoing tariff talk, trade uncertainty has risen to levels last seen during the last Trump Administration.



Source: Economic Policy Uncertainty Index (Baker, Bloom and Davis), TIAA Wealth Chief Investment Office.

Looking ahead, a permanent shift to a more protectionist stance might eventually result in lower market participation by foreign investors, with potentially detrimental repercussions on the demand for U.S. stocks and bonds. Protectionism could accelerate the fragmentation of the global economy into blocs—a trend we highlighted in our 2025 Outlook—with China and Eurozone economies reducing their economic and strategic dependence on the U.S. There could also be ramifications for the U.S. dollar, although (as we discussed in our recent Focus*Point*) we still do not see the conditions in place for the dollar to lose its status as the global reserve currency.

Our baseline case for markets this year, as outlined in the 2025 Outlook, anticipated moderate gains for stocks and projected that the U.S. economy would outperform globally. We are monitoring tariffs and trade wars as major risks to our baseline consensus and expect market volatility to remain elevated in response to the threats they pose. In this environment, it is crucial for investors to stay anchored to up-to-date financial plans and ensure diversification within and across asset classes. We anticipate that rising risks to economic growth will lead to declining bond yields (and rising bond prices) during periods of volatility, which can partially offset equity drawdowns. Ensuring investments are appropriately diversified across equities, bonds, and cash holdings according to risk profile will be vital in navigating this ever-changing landscape.

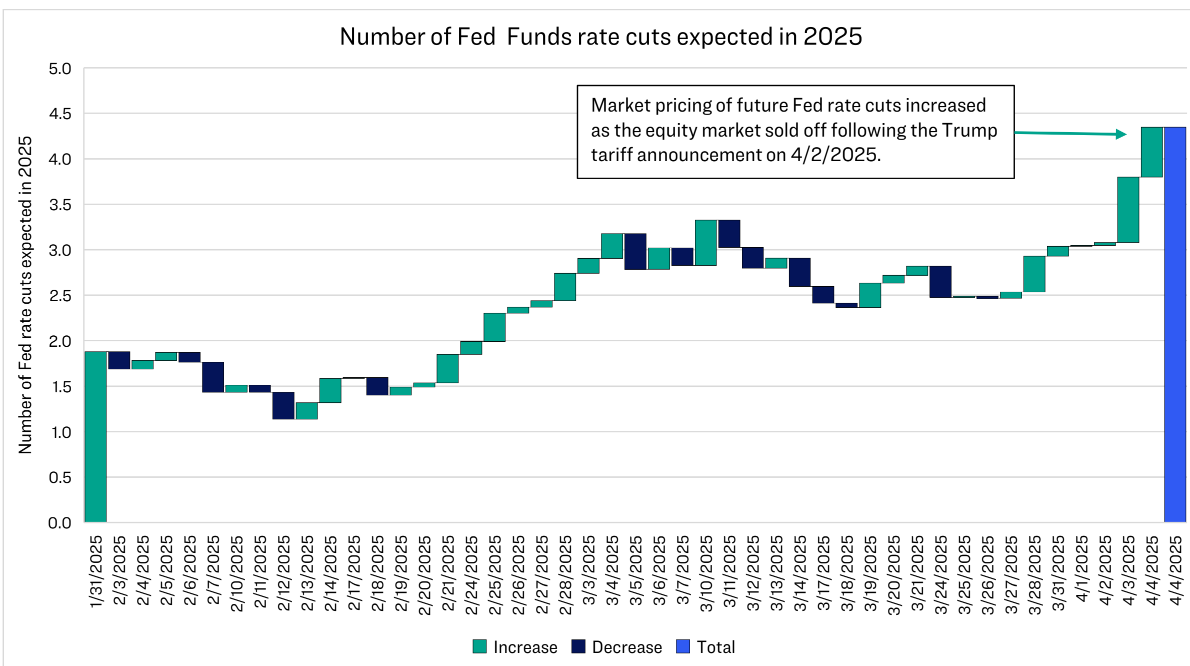
Question 2: Inflation and interest rates were top-of-mind this time last year. What is investor sentiment regarding these two dynamics this year?

A year ago, all eyes were on the Federal Reserve (Fed) amid concerns about rebounding inflation. Investors were patiently digesting Fed Chair Jerome Powell's commentary for signs that the Fed might cut interest rates, even though the inflation rate was still above its 2% target. Jumping to the present, some inflationary pressures persist, but the focus has shifted toward the potential economic slowdown precipitated by the new administration's aggressive tariff policy. As a result, there has been a dramatic drop in interest rates in recent weeks, which is less about inflation normalizing and more reflective of growth concerns.

Recently announced tariffs pose both upside risks to inflation AND downside risks to employment, leaving the Fed in a tough spot to manage their dual mandate of stable prices and full employment. The post-announcement increase in market expectations for Fed rate cuts in 2025 from 3 to more than 4, despite clear upside risks to the inflation outlook, indicates that investors believe the Fed would step in to support the economy if a significant worsening of labor market conditions had to happen (Figure 2). However, our view is that it will be difficult for the Fed to look through the initial spike in price inflation (especially if accompanied by rising inflation consumer expectations) and we therefore view current market expectations as capped until and unless labor market weakness becomes evident.

FIGURE 2

Pricing more Fed rate cuts could be challenging without evidence of growing labor market stress.



Source: TIAA Wealth Chief Investment Office, Bloomberg

To get a better gauge on the progress on inflation, we must take into account the latest economic data. The most common measure of inflation is the Consumer Price Index (CPI), and February's reading was better than expected. Inflation slowed to an annualized rate of 2.8% year-over-year (YoY), down from 3% in January[1]. The latest February reading on the core Personal Consumption Expenditures (PCE), the Federal Reserve's preferred inflation gauge, indicates firmer signs of inflation, particularly in goods, as inflation rose to 2.8% from 2.6% in January. However, given the lingering risk that trade tariffs may boost consumer prices over the next few months, the Fed remains in wait-and-see mode. Pricing more rate cuts into market models could be difficult without more significant labor market weakness.

We must also consider the February and March jobs reports. In February, the U.S. labor market experienced a modest expansion, adding 151,000 nonfarm payroll jobs, slightly below the 12-month average of 168,000[2]. The unemployment rate also ticked up slightly from 4.0% to 4.1%. Assuming the administration's focus on curbing immigration slows labor force growth, a monthly pace of around 150,000 jobs added to the economy is, in our view, above the level required to keep the unemployment rate roughly stable. In March, the jobs report presented a more optimistic outlook despite recent negative tariff headlines and market reactions. The labor market demonstrated remarkable resilience amid significant policy uncertainty, with the addition of 228,000 jobs.

Markets are hopeful the Fed can begin to steer its focus away from inflation and primarily look to support economic growth in the face of trade uncertainty. For now, however, economists anticipate that President Trump's economic policies, including sweeping tariffs and efforts to downsize the federal government, could result in both a slowdown in economic growth and sticky inflation.

In late March, the Fed's policymaking arm, the Federal Open Market Committee (FOMC), concluded its two-day policy meeting, and as expected, made no change to rates. In its statement, the central bank noted that current economic and inflation conditions hadn't changed much, but added that uncertainty around the outlook has increased since the last meeting in late January. In addition, FOMC members marked up their forecasts for inflation and the unemployment rate but lowered their economic growth forecast versus the forecast made in December. Since then, market expectations have evolved around the sooner-than-anticipated roll out of Trump tariffs, which has made Fed rate cut expectations even more difficult to forecast.

Looking ahead further, Powell's term as Fed chair ends in May 2026. President Trump has indicated that he does not intend to reappoint Powell when this current term ends. Powell's departure could mean a shift in the Fed's outlook and policy. A generally hawkish (or generally dovish) Fed can have implications for bond yields and growth paths that we will be keeping an eye on.

Question 3: I keep encountering a lot of information in the media about artificial intelligence (AI), and it can be quite confusing keeping up with all these new developments. How are investors navigating this new technology space, and should I be investing in AI?

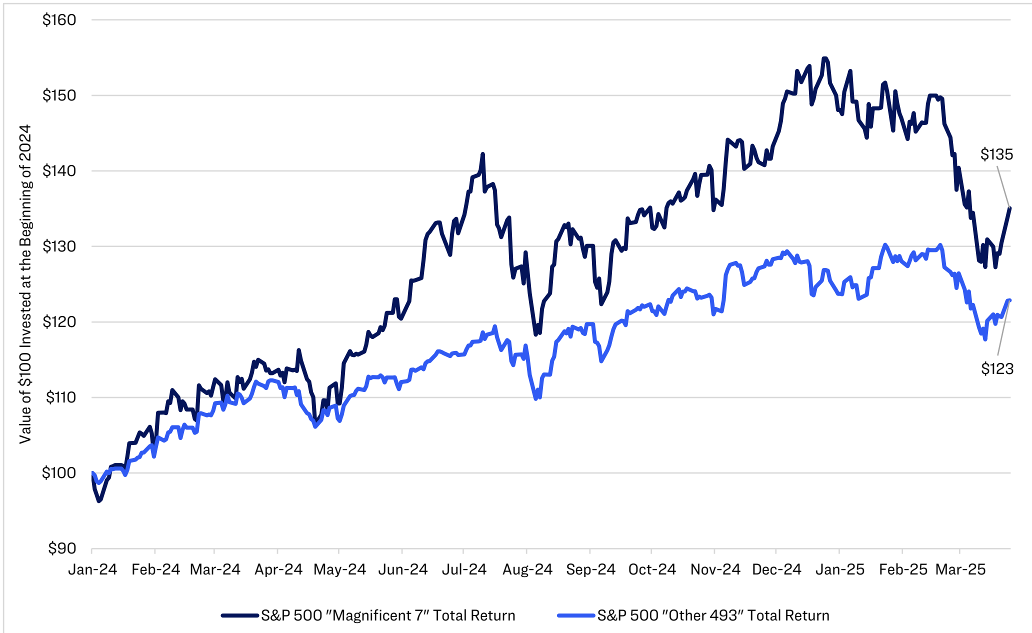
Artificial intelligence and Wall Street's fascination with it are both here to stay. AI will continue to be a focal point for big business over the next decade as companies invest in the essential infrastructure, such as data centers and computing resources, required to implement AI.

However, in recent months, investor sentiment for AI stocks has cooled. One reason: There's evidence the gap between the U.S. and China in developing AI technology might not be as wide as generally assumed and that efficient and highly competitive large language models (LLM) can be produced, replicated and commercialized at lower costs (as we wrote about in our January Focus*Point*). The Chinese startup DeepSeek has been at the center of this narrative shift, thanks to a new LLM that relies largely on open-source models (as opposed to increasingly expensive proprietary models). As a result, it has become more difficult to identify the winners in the AI race.

With that said, we remain committed to the opportunities that will present themselves through AI's adoption across all industries. AI has the potential to increase productivity, transform the job market, change business models, and make the process of scientific research and innovation faster and more efficient, some of which we mentioned in our February 2025 CIO Perspectives. That's the big picture, and we're watching to see which companies capitalize fastest. AI remains a long-term megatrend that will impact the global economy, financial markets and geopolitics over the decade (Figure 3).

FIGURE 3

Despite the steep decline in the Magnificent 7 to begin the year, the long-term AI story remains intact.



Source: TIAA Wealth Chief Investment Office, FactSet, As of March 25, 2025

Disclosure: The chart above shows the hypothetical growth of an investment of $100 in both the Magnificent 7 and Other 493 stocks.

Question 4: The geopolitical landscape still seems similarly unstable compared to this time last year. With so many global elections now behind us, do investors have more clarity?

The unprecedented number of global elections that happened in 2024 ushered in significant changes across three levels: international relationships, fiscal policy, and national security.

- Following his re-election in November, President Trump has upended international relationships by threatening and implementing large trade tariffs both on key allies like Canada and the European Union and strategic adversaries like China. In addition, the Trump administration has immediately prioritized a resolution of the Ukraine/Russia conflict—an effort that, so far, has been focused on direct talks with Russia, largely sidestepping the European Union. It's another sign that traditional relationships might be shifting.

- The German election in February 2025 ignited a seismic shift in Germany's traditionally austere fiscal posture. The urgency to revive the domestic economy and to rethink national security strategies has led to the rapid approval of a fiscal package aimed at boosting defense spending and infrastructure investments. The historical connotations of these developments should not be understated. They could jolt the whole European Union into action to reduce reliance on the U.S. and fundamentally rethink its economic growth model.
- Other major elections globally, from France to the UK and Mexico, evidenced similar trends across both developed and emerging markets. They include: increased tension between a long-term focus on fiscal discipline and the need for targeted fiscal spending at a time of rising inequality; the challenges presented by an aging population; large immigration flows caused by climate, war and economic displacement; a shifting and fracturing global order; the rise of AI; and the impact rampant inflation has had on affordability for large segments of the population.

Looking ahead, our view is that the fracturing of international relationships into blocs is likely to continue, with newly elected administrations driven by mandates to tame price inflation, boost national security and, in some cases, break with the status quo. While it is too early to tell what the long-term implications of these political waves could be, our view is that they could continue to engender considerable uncertainty, contributing to market volatility. In this environment, diversification within and across asset classes is recommended.

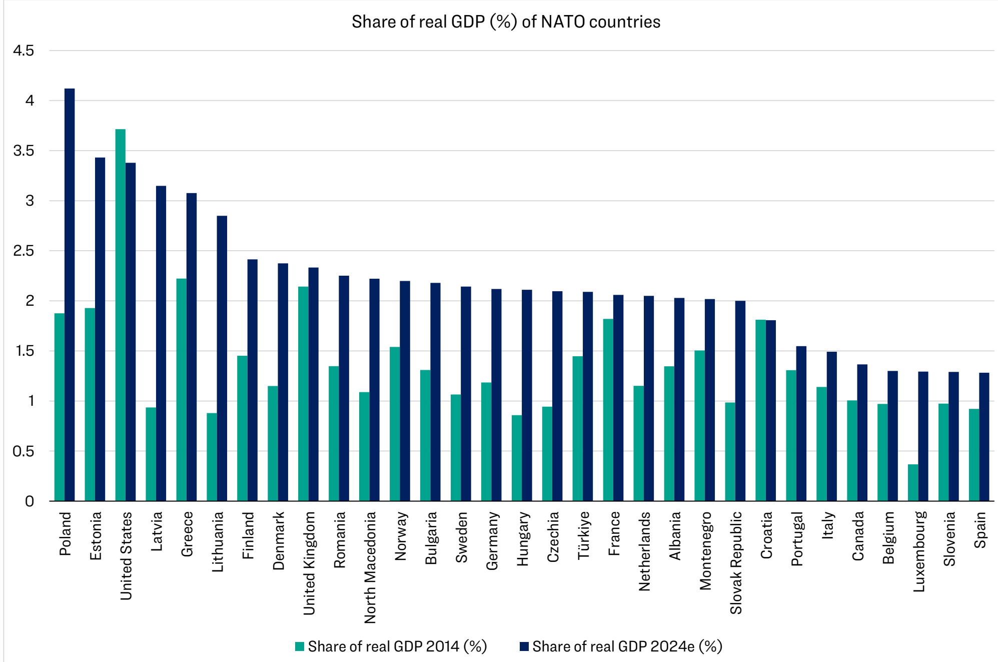
Question 5: The European Union (EU) is taking steps toward becoming less reliant on the U.S. How do you think this will impact major industries on both sides of the Atlantic, and are there opportunities that are investors encouraged by?

The shifting political landscape—particularly with the U.S. potentially decoupling further from the EU in terms of spending and aid—presents both opportunities and challenges for investors. The opportunities stem from the possibility of greater EU investment in defense, infrastructure, and energy production. The challenges are tied to interest rates: New government spending requires new government borrowing, and bond markets might react poorly.

The Trump administration has criticized NATO allies for not meeting their defense spending commitments, often threatening to reduce support (Figure 4). The administration delivered on those threats in recent weeks as the United States paused military aid in Ukraine's war with Russia. This marked a significant departure from the Biden administration, which was committed to the security and aid of Ukraine, NATO, and its European allies.

FIGURE 4

Defense expenditure share of real GDP of NATO Countries 2014 vs. 2024.



Source: TIAA Wealth Chief Investment Office, Bloomberg

In response, European leaders have rallied around Ukraine's President Zelensky. Without U.S. support, however, Europe faces the need for substantial military upgrades. The EU proposed €150B in loans and €650B in national defense spending over the next four years to counter Trump's security withdrawal[3]. Historically debt-averse, Germany has also voted to allow a massive increase in defense and infrastructure spending to address this defense spending shortfall[4].

These recent developments can lead to several outcomes:

- **Defense sector growth in Europe.** Should the U.S. follow through on reducing defense spending support commitments for the EU and allies, European governments are likely to accelerate spending to bolster and modernize their military capabilities.
- **Energy and resource independence.** Lack of U.S. support could incentivize the EU to diversify its energy sources.
- **Increased spending on infrastructure and technology.** In order to reduce dependence on the U.S., EU member states may explore building out new supply chains, increasing domestic manufacturing, and investing in technology. Potentially, this could lead to greater innovation across the EU.
- **Currency and bond market volatility.** Increased EU spending could lead to higher interest rates and borrowing costs, negatively impacting euro-denominated bonds.

Question 6: With all of the uncertainty in the world today, should I change my investment strategy or alter my portfolio?

There is no shortage of risks these days. Policy disruptions, inflationary pressures, stubbornly high interest rates, geopolitical tensions, rebalancing labor markets and rising budget deficits remain on the table in 2025. All may be significant drivers of market volatility.

What might investors do in light of these worries? Our view is investors are best served by remaining committed to their long-term strategies and by staying the course. Trying to time the market runs the risk of missing out on periods of high returns, which of course would lead to lower portfolio balances. The 10 best days in the S&P 500 over the past 25 years all occurred during periods punctuated by severe market turmoil (i.e., Great Financial Crisis and the COVID pandemic). In March 2025, the S&P 500 entered correction territory, experiencing a 10% decline from its all-time highs. While this may seem unnerving, market fluctuations are common and are considered a healthy part of all market cycles. History demonstrates that those who remain invested during market corrections are generally rewarded in the long run (Figure 5).

FIGURE 5

Market corrections are not infrequent, but they rarely disrupt the long-term tendency of stocks to rise.

				Cumulative Returns	
Event	S&P 500 TR	Year	Next Year	3 Years After	5 Years After
Great Depression	-43.3%	1931	-8.2%	39.3%	175.5%
Great Financial Crisis	-37.0%	2008	26.5%	48.6%	128.2%
1937 Crash	-35.0%	1937	31.1%	17.8%	25.3%
1973-74 Bear Market	-26.5%	1974	37.2%	57.9%	99.6%
Great Depression	-24.9%	1930	-43.3%	-19.9%	16.6%
Dot-Com Crash	-22.1%	2002	28.7%	49.7%	82.9%
The Great Inflation	-18.1%	2022	26.3%	N/A	N/A
1973-74 Bear Market	-14.7%	1973	-26.5%	25.1%	23.7%
Dot-Com Crash	-11.9%	2001	-22.1%	11.2%	35.0%
World War Two (WWII)	-11.6%	1941	20.3%	81.4%	127.6%
Average	**-24.5%**		**7.0%**	**34.6%**	**79.4%**

Source: Morningstar Direct (data as of December 31, 2024).
Chart is sorted on worst annual S&P 500 total return data.

A heightened sense of global uncertainty demonstrates the real need for professional portfolio management when it comes to objectively navigating market volatility. The TIAA Wealth Management team is here to help investors manage these challenging times by identifying and prioritizing their unique, long-term investment goals, risk tolerances, and time horizons. By surrounding each investor with a team of experts, we create tailored investment plans that efficiently and effectively align resources, while maintaining focus on a client's financial needs and objectives. By maintaining a well-diversified portfolio, long-term investors can feel more confident about staying the course through periods of turmoil because they are managing risk, not trying to escape it.

Endnotes

1 https://www.bls.gov/news.release/archives/cpi_03122025.htm
2 https://www.bls.gov/news.release/empsit.nr0.htm
3 https://www.bloomberg.com/news/articles/2025-03-04/eu-proposes-150-billion-in-loans-for-pan-european-defense
4 https://www.bbc.com/news/articles/c62z6gljv2yo

Contributing Authors

John J. Canally, Jr., CFA©
Managing Director,
Chief Portfolio Strategist

Jon Birger
Director, Editorial Strategy, Content and Communications

Alberto Favalli-Ragusini
Director, Investment Strategy

Rob Dziedzic
Investment Content Manager

John Greene
Investment Content Manager

CIO PERSPECTIVES

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IMPORTANT DISCLOSURES

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