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Markets react to Supreme Court tariff ruling

What's moving markets

- On Friday, February 20, the Supreme Court struck down as unconstitutional the bulk of the Trump administration's 2025 tariff increases implemented under emergency provisions and directed the question of tariff refunds to lower courts.
- The widely anticipated announcement helped stocks recoup their early 2026 losses but pressured longer-term U.S. Treasury bond prices.

Our perspective

- We believe the Supreme Court's decision may rekindle fixed-income market jitters over the impact of tariffs on inflation and the U.S. budget deficit.
- We expect the Trump administration to impose levies through a more drawn-out, piecemeal approach under other trade legislation, and we believe that lower-court distribution of refunds will take time.
- Tariffs should remain part of the business landscape, and further uncertainty attends the results of the U.S.-Mexico-Canada trade agreement, due for review this summer.
- Nevertheless, we observe from companies within the Industrials sector (the sector most directly affected by most of the tariffs) that there has been only a modest overall increase in costs and a slight drag on profit margins.
- Ultimately, the more drawn-out application of new tariffs, as well as the prospect of tariff refunds, should support U.S. equity prices, even as these factors weigh more on the federal deficit.
- We reiterate our outlook for moderating service-price inflation to keep a lid on inflation this year.

Implications for investors

- In our view, positive forces like subdued inflation and fiscal stimulus are laying the groundwork for a constructive economic backdrop and further financial-market gains in 2026.
- We prefer to look past bouts of headline-driven market volatility and to focus on an improving global economy and modest inflation.

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This morning's ruling was widely anticipated since oral arguments were first heard by justices in early November, but investors still reacted to this long-awaited official development by sending stocks higher and U.S. Treasury prices lower (yields higher), as the Court's decision rekindled bond-market jitters over the impact of tariffs on the U.S. budget deficit.

We now await clarity around the future path of tariffs, which we believe will include new levies through a more drawn-out, piecemeal approach, targeting specific product sectors or countries under other trade legislation:

- The administration could rely on Section 122 of the Trade Act of 1974 to quickly impose a surcharge of up to 15% for 150 days to address significant balance of payment deficits.
- Another option would be Section 232 of the Trade Expansion Act of 1962, which would restrict imports deemed a threat to U.S. security.
- A third alternative would be Section 301 of the Trade Act of 1974, permitting retaliation against foreign-trade practices deemed discriminatory to U.S. commerce.

The first of these could be implemented quickly as a temporary measure, until procedural steps, including detailed investigations and a comment period, permit tariff implementation under more permanent legislation. On balance, we view procedural hurdles as contributing to more drawn-out tariff implementation than early announcements last year.

Also in question is the precise timing, scope, and method of potential tariff refunds to U.S. importers. The Court's ruling left this issue to a lower court, which we believe will take time to be sorted out. The initial lawsuit challenging the emergency tariffs was filed in April 2025 by a handful of small businesses and a group of states. Yet, more than 1000 plaintiffs have filed cases since November to ensure their eligibility for possible refunds. Further, the court ruling may allow the U.S. government to opt for less cumbersome and more orderly reimbursement to importers with credits toward future import tariffs rather than with cash. Either method could bypass large and immediate cash refunds from the U.S. Treasury that, in turn, might widen the budget deficit and push up bond yields.

Regardless of how tariffs are ultimately enforced, Consumer Price Index (CPI) data has indicated that cooling services prices have been the driving force behind recent disinflation, overshadowing what has been a modest uptick in trade-sensitive core goods prices. The tariff impact on goods inflation has been muted, in part, due to pauses in implementation and a partial reversal of several big April "Liberation-Day" tariff increases following country-specific negotiations last summer. The willingness of foreign factories to absorb some of the tariff expense also dulled the impact of tariffs, as did the pricing power of major U.S. companies. Higher margins among the largest U.S. retailers have allowed them to absorb most of the tariff increases in preventing a widespread price "shock" to consumers, leading to greater market share in the process. Conversely, U.S. businesses (especially smaller firms) with leaner margins may enjoy a temporary reprieve from more piecemeal tariff implementation this year but likely will grapple with ongoing trade-related headwinds, perhaps through 2027, unless they are able to adjust their supply chains. For now, this supports our preference toward high quality, large U.S. equities over small-cap stocks.

What it may mean for investors

We continue to look through the noise of day-to-day headlines by staying focused on key, underlying trends that we believe transcend this morning's tariff ruling. These trends include tax cuts, lower short-term borrowing costs, broadening artificial-intelligence (AI) investment spending, productivity gains, and deregulation. Additionally, disinflation likely will be reinforced by at least a temporary reversal of tariff increases and only a gradual reimposition later this year. In our view, these positive forces will underpin economic and earnings growth in 2026. We favor adding to select areas of equity and bond markets: In fixed income, we prefer high-quality, investment-grade corporate bonds with maturities between three and seven years. In equities, we favor the U.S. Large- and Mid-Cap Equities but would restore international allocations to their strategic target levels. Within the S&P 500 Index sectors, we prefer Financials, Industrials, and Utilities.

Risks Considerations

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. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Definitions

An index is unmanaged and not available for direct investment.

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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