FISCHER STRALEM

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Dear Client:

We have spent the past quarter discussing the electric grid as a weak link in the green energy revolution. This past month added an interesting twist in the form of the announced tariffs on Chinese imports on all aspects of electric vehicle production -- batteries, solar cells, critical minerals, and the EVs themselves. The list of trade barriers continues to grow, joining prior increases in steel and aluminum. The rationale isn't original: China heavily subsidizes all of its manufacturing, pushing Chinese companies to produce far more than the world can absorb and then dumping excess products on the market at unfairly low prices.

Under the proposal, tariffs on Chinese EV imports will quadruple to 100%, low-end semiconductors will double to 50%, batteries will more than triple to 25%, while the tariffs on graphite, magnets and non-EV lithium-ion batteries will increase by 25%. These tariffs are surgical and designed to protect the U.S. from supply chain risks associated with strategic goods. The announced tariffs that have the most direct implications for the U.S. businesses are those on graphite, magnets and lithium-ion batteries where China is the sole large-scale producer. The U.S. Commerce Department recommended against placing tariffs on imports of Chinese magnets as recently as 2022 due to our dependence. This is reflected in the implementation push-out to 2026, giving companies time to find alternative sources, spur investment into non-Chinese production and give time for that production to increase. In some cases, the levies apply to areas where China has only a small segment of the U.S. market but are intended to head off a potential deluge of imports.

The administration recently concluded a survey of more than 100 auto, aerospace, defense and other companies about their supply chains (Deloitte 5/24), so this protective trade policy is not being developed in a vacuum or the whim of the President. But it is worth noting that a generally accepted premise of economic theory is that tariffs end up being an encumbrance on growth. Tariffs cause companies to over-pay and pass those extra costs to consumers. Consumers then overpay for goods, thereby reducing their disposable income and savings.

The consensus seems to be that these tariffs reflect political grandstanding before the election and will have little economic impact (for instance, the U.S. doesn't actually import EVs from China anyway!). In fact, recent history suggests that these tariffs will end up as a symbolic exercise and do very little to promote U.S. industry. Recall that the U.S. imposed tariffs on Chinese solar panels in 2012 and, over the next decade, solar panel sales declined a whopping 86% in the U.S. (Bloomberg 5/24). At the same time, the U.S. poured huge subsidies into its own solar industry and still, today, the U.S. produces ~2% of the global solar panel market, while China clings to ~76% (McKinsey 10/23). In short, solar panel tariffs did nothing to prevent China's control of the broader industry and it seems doubtful that these additional tariffs will somehow right the ship. If anything, tariffs risk increasing prices for consumers already hurting from inflation, and inspiring the ire of China, which could choose to retaliate in kind. As always, we will be watching these events evolve.

Regards,

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U.S. Large Cap Equity Strategy