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MARKET BRIEFING

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Navigating Tariffs: Impact on the U.S. Economy and Private Equity's Relative Insulation

The Trump Administration has brought a renewed focus on trade policy, particularly around tariffs on imports from key trading partners like China, Mexico, and Canada. While tariffs have historically served multiple strategic purposes, including facilitating trade negotiations, strengthening domestic industries, shaping fiscal policy, and influencing supply chain decisions, the ultimate impact hinges on a complex combination of economic policy and corporate action. With a wide range of possible outcomes, it's prudent for businesses to prepare for challenges, anticipate opportunities and expect a balance of each. Even under a potential downside case, we believe private equity ("PE"), and particularly the U.S. middle market ("MM"), is relatively insulated.

U.S. 2024 Annual Imports – Pre-Election vs. Newly Imposed & Proposed Tariffs

	Pre-Election		Imposed and Potential Trump Tariff Impact					
Type of Goods	Import Value	Current Tariff	China / HK	Mexico	Canada	Rest of World	Potential Impact	Total Tariff
Dutiable	**$981B**	**$76B**	$54B	$12B	$22B	$109B	**$197B**	**$273B**
Non-Dutiable	**$2.1T**	**$0**	$30B	$111B	$74B	$209B	**$424B**	**$424B**
Total	**$3.1T**	**$76B**	$84B	$122B	$96B	$318B	**$621B**	**$697B**

Source: PwC Tariff Industry Analysis relying on U.S. Census Bureau, "Monthly U.S. Imports by North American Industry Classification System (NAICS) Code," January 2024 - December 2024. Note: "Dutiable" goods are those imports upon which duty was paid (e.g., pursuant to the relevant tariff classification and inclusive of Most-Favored Nation duties or special measures). "Non-dutiable" goods are those imports that entered without payment of duty (e.g., conditionally duty-free goods or goods entered under a special program or Free Trade Agreement ("FTA") / exemption).

The Bottom Line: In 2024, the U.S. imported approximately $3.1 trillion in goods with $2.1 trillion entering duty-free. Proposed trade policy changes could impact Free Trade Agreements, imposing tariffs on all imports. As a result, annual tariffs could increase from $76 billion to $697 billion ($273 billion from dutiable goods and $424 billion from previously non-dutiable goods).

Potential Downside Impact of Tariffs on the U.S. Economy

While offsetting economic policies and corporate actions may lead to muted or even positive impacts on the U.S. economy, business leaders are taking protective measures to hedge the uncertainty. Under a potential downside scenario, tariffs could have economic implications affecting both businesses and consumers. Possible impacts could include:

- **Higher Costs for Businesses**: Companies that rely on imported raw materials and components face rising input costs, compressing margins and profitability.
- **Consumer Price Increases**: Higher production costs are often passed on to consumers, with variation in timing and magnitude, leading to inflationary pressures.

- **Demand Softening**: Rising consumer prices and weakening sentiment may lead to reduced demand for certain goods and services.
- **Supply Chain Disruptions**: Many industries depend on global supply chains that are disrupted by tariffs, requiring costly and time-consuming adjustments.
- **Market Volatility**: Uncertainty regarding trade policies can lead to swings in market sentiment, impacting valuations and capital flows.

Despite these potential challenges, private companies tend to be more resilient to the direct consequences of trade policy.

Why Private Equity Is More Insulated

Compared to the broader economy, PE buyout firms have structural advantages that help mitigate the effects of tariffs:

- **Control Over Portfolio Companies**: PE firms actively manage their investments through majority control and board influence, allowing them to make strategic changes to offset tariff-related cost increases.
- **Focus on Value Creation**: Unlike publicly traded companies that may be exposed to short-term market fluctuations, PE firms prioritize long-term value creation through operational improvements and growth strategies that are less dependent on global trade.
- **Favorable Sector Selection**: Many PE firms allocate capital to industries that are less tariff-sensitive, such as service-based, technology-enabled or intellectual property ("IP") oriented businesses across the healthcare, consumer and business services sectors.
- **Lower Price Elasticity**: PE firms investing in mission-critical, non-discretionary products and services often have greater ability to pass on tariff-related cost inflation to customers.

U.S. Middle Market Private Equity: Even Greater Resilience

Within private equity, the U.S. middle market represents a subset of companies with enterprise values typically between $100 million and $1 billion. These businesses may exhibit even greater insulation against tariff risks than larger companies or the broader economy. The key reasons include:

- **Domestic Orientation**: U.S. MM companies often primarily serve U.S. markets, reducing reliance on imported goods and limiting exposure to tariffs.
- **Emphasis on Intangible Assets**: Key assets and value creation initiatives tend to focus on intangibles through branding, innovation, IP and human capital rather than imports.
- **Stakeholder Alignment**: Unlike publicly traded companies, U.S. MM companies are often capitalized by a select group of private equity and private debt investors that are aligned in terms of investment time horizon and strategic vision.

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- **Direct Influence and Agility**: Through board representation and collaboration with management, MM PE sponsors can influence timely and adaptive responses to shifting geopolitical dynamics.

Strategic Considerations for U.S. Middle Market Companies

While U.S. middle market companies may exhibit relative resilience to tariff impacts, proactive management is still essential. Companies should consider:

1. **Supply Chain Flexibility**: Encouraging portfolio companies to diversify suppliers and explore domestic sourcing to minimize tariff exposure.
2. **Operational Efficiencies**: Investing in technology, automation and process improvements to offset rising costs and maintain margins.
3. **Selective Industry Focus**: Prioritizing investments in sectors that are less reliant on global trade, such as business services, healthcare, and non-discretionary consumer products.
4. **Monitoring Trade Policy Developments**: Staying ahead of regulatory changes to anticipate risks and opportunities through active management.
5. **Exploring Government Incentives**: Capitalizing on domestic production incentives, tax credits, and trade policy adjustments that benefit U.S.-based businesses.

Conclusion

While tariffs introduce potential challenges for the U.S. economy, private equity—especially the middle market—remains comparatively insulated due to its domestic focus, operational flexibility, and emphasis on intangible assets and human capital. By strategically managing supply chains, focusing on resilient industries, and leveraging agile governance, middle market PE firms can navigate tariff-related disruptions while continuing to deliver strong value creation.

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Economic and market data is sourced from PitchBook unless stated otherwise.