THE AI RALLY’S ACHILLES HEEL

The sudden re-escalation of U.S.-China trade tensions—manifested in Washington's retaliatory tariff threats and Beijing’s calculated throttling of rare earth exports—has returned a familiar, unwanted chill to global markets. Uncertainty, the bane of capital, is again ascendant.

The immediate anxiety will likely persist through the middle of November. Big deals require last-minute theatre, and the recent tit-for-tat moves—China restricting access to vital minerals, Washington threatening 100 percent tariffs—are less a total collapse than a predictable stage of high-stakes negotiation. Escalation is now a fundamental tactic.

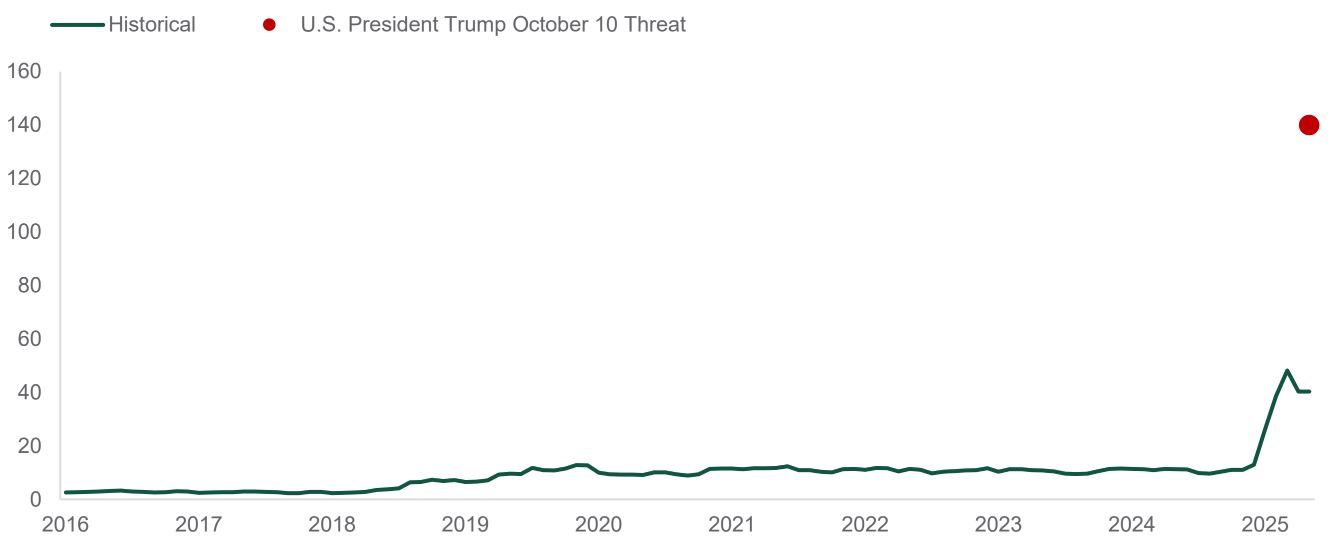
Beijing knows its leverage: it holds a near-monopoly on the processing of rare earth metals, essential for everything from consumer electronics to advanced defense systems. Washington's counter-lever is access to its vast domestic market and its insurmountable lead in advanced technology, particularly semiconductors and the know-how underpinning the entire Artificial Intelligence (AI) value chain. China requires the latter to fulfill its technological ambitions; the U.S. needs the former to maintain global manufacturing efficiency.

The critical variable remains the incentive for a deal. Both sides have too much to lose to let negotiations fail entirely. The economic costs of a full decoupling—slower growth, higher inflation, and deeply disrupted supply chains—are catastrophic for the world's two largest economies. Rational self-interest dictates that an agreement, however fragile or temporary, will be reached. Expect a choreographed climb-down before the final deadline.

Yet, even a limited trade pact will not dispel the technology-led vulnerability that has permeated equity markets. The recent rally in both Chinese and U.S. stocks is rooted heavily in optimism around AI and its related technological infrastructure. The constant escalation around access and restrictions in the broader tech value chain—U.S. chip controls versus Chinese rare earth controls—is a direct attack on the future earnings of these high-flying companies. This friction acts as a structural fault line, meaning that greater volatility is not a bug of the current trade stand-off but a feature of the emerging geopolitical landscape.

RESURGENT U.S.-CHINA TRADE TENSIONS

U.S. EFFECTIVE TARIFF RATE OF IMPORTS FROM CHINA (%)



Source: Northern Trust Asset Management, Bloomberg. Effective tariff rate is calculated tariffs as a percent of imports. October 10 threat is an approximation that does not include potential exclusions. Data from 3/31/2016 through 7/31/2025. Historical trends are not predictive of future results.

POSITIONING SCENARIOS

Reflation (20% probability)

Policies of the U.S. administration have a net stimulative effect, leading to above-trend growth, persistent inflation and a pause in the Fed rate-cutting cycle.

Soft Landing (45% probability)

Global growth slows but remains positive via two potential paths: i) tariff policy eases; ii) the U.S. economy is more resilient than expected and avoids a major deterioration in the consumer backdrop.

Supply Restraint (30% probability)

Supply-side shocks from higher tariffs in addition to broader policy uncertainty weigh on consumer and corporate activity while halting the disinflationary process until a recession takes shape.

Stagflation (5% probability)

Initially similar to the Supply Restraint scenario, but the rise in inflation is more persistent. As a result of slower monetary policy support, the recession is deeper and longer.

Note: Probabilities are assumed from proprietary research and are subject to change.

DEFINITIONS

S&P 500 Equal Weighted Index: The equal-weighted version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the index is allocated a fixed weight – or 0.2% of the index total at each quarterly rebalance.