Investment Mistakes During Trade Wars and Emerging Opportunities

By Weichurn Woo

Trade wars often create a tumultuous environment for investors, leading to common mistakes that can undermine financial strategies. As the U.S. also anticipates significant tax cuts and deregulation (as part of Trump's election promises), understanding the pitfalls of higher uncertainty and the potential emerging opportunities is crucial.

Common Investment Mistakes During Trade Wars

1. **Overreacting to Market Volatility**:

   Investors frequently panic during trade wars, leading to impulsive decisions such as selling off stocks at a loss. This reaction can stem from fear of further declines, but it often results in missed opportunities for recovery when markets stabilize.

2. **Neglecting Fundamental Analysis**:

   In the chaos of trade disputes, many investors focus solely on short-term market movements rather than assessing the underlying fundamentals of companies. This oversight can lead to poor investment choices, particularly in sectors that may benefit from government support or shifting consumer behaviour.

3. **Ignoring Diversification**:

   Concentrating investments in a few sectors or stocks can be particularly dangerous during trade wars. Economic disruptions can affect entire industries; thus, a diversified portfolio is essential to mitigate risks associated with sector-specific downturns. An example would be having a high percentage in Nvidia stocks: while all my client portfolios were up decently for January 2025, many non–clients I talked to who had high allocation to Nvidia had a negative month.

4. **Focusing Solely on Previous Winners**:

   Focusing on previous winners in the stock market can lead to significant investment decline, as long-term economic changes can occur from the trade wars, leading to new winners and losers. Investors often chase stocks that have recently performed well, driven by the allure of past success and media hype. However, research shows that top-performing stocks rarely maintain their momentum long term; in fact, many of the best performers in one year fall to the bottom half the following year. This behaviour can result in overvalued investments and increased volatility in the index, as these stocks may not deliver consistent returns. Instead of relying solely on past performance, investors should prioritize a diversified portfolio that considers strong fundamentals and growth potential, rather than being swayed by previous short-term trends and hype.

Potential Investment Opportunities with Tariffs, Expected Tax Cuts and Deregulation

Initially, many investors were expecting the tax cuts and deregulation to occur first, and the tariffs to come closer to 2026. This was not the case. As the U.S. government prepares for what is projected to be the largest tax cut in history alongside deregulation efforts, given that Trump often brags and measures his success by the performance of the US stock markets, several sectors stand out as constructive investment opportunities.

1. **Infrastructure**

Significant Federal Funding: The Trump administration's infrastructure plan aims to allocate substantial federal funds, potentially spurring up to $1.5 trillion in total investment when combined with state, local, and private sector contributions. This influx of capital can lead to numerous projects across various sectors, creating a robust environment for investment.

Streamlined Regulations: A focus on deregulation could expedite project approvals and reduce bureaucratic hurdles. This streamlining is likely to attract more private investment, as companies will face fewer obstacles in getting projects off the ground.

Emphasis on Traditional Infrastructure: The administration is expected to prioritize traditional infrastructure projects such as roads, bridges, and highways, which have been historically underfunded. Investing in these areas can yield immediate economic benefits and job creation.

2. **Travel and Leisure**

Investing in travel and hospitality stocks may present attractive opportunities despite ongoing trade wars, particularly due to several key factors.

Tax Cuts: Anticipated personal and corporate tax cuts under a potential Trump 2.0 administration could increase disposable income for upper-middle class consumers who still do not need to spend a significant portion of their income on basic needs despite tariff costs, encouraging spending on travel and leisure activities. Lower corporate taxes can lead to higher corporate profits, which may boost investment in the travel sector and enhance consumer confidence.

Deregulation: Deregulation initiatives may streamline operations within the travel and hospitality industries, reducing compliance costs and enhancing profitability for companies. This can create a more favourable environment for growth, allowing businesses to invest more in expansion and innovation.

Resilient Seniors Demographic: Perhaps the biggest reason, retired seniors represent a significant market segment that continues to prioritize travel, often regardless of economic conditions. Many seniors have the time and resources to travel, often seeking experiences that enhance their quality of life, as they race against the clock with their continued physical ability to travel. This demographic's consistent demand for travel services can provide stability for hospitality and travel related stocks. The last baby boomer, for example, turns 65 by 2030 in Canada, with approx. 40 % in recent surveys indicating travel is a priority.

3. **Global Small Caps**

Investing in global small-cap stocks may present unique advantages during a trade war, particularly as domestic demand rises in response to increased tariffs on international goods.

Increased Domestic Demand: Fundamentally strong small-cap companies often focus on domestic markets of their home country, allowing them to capitalize on heightened demand from consumers seeking alternatives to higher-priced imported goods. As tariffs increase costs for international competitors, local businesses can gain market share. Trade wars often lead to the affected population developing shifting consumer preferences towards local products in order to support their home country, amidst rising international competition and global economic antagonism.

Tax Cuts and Deregulation: Specifically for American small caps, anticipated tax cuts and deregulation under a Trump 2.0 administration could further enhance profitability for small-cap firms. Lower corporate taxes and reduced regulatory burdens allow these companies to reinvest in growth and expansion, making them more competitive. We may see this also implemented in other countries; for example, in one of the most recent commercials for Conservative leader Pierre Poilievre, he floated the idea of income tax cuts for Canadians, the elimination of carbon tax (has increased from $ 20 per ton in 2019 to $ 95 per ton for April 1, 2025), as well potential reduction in capital gains tax, all of which are measures that could potentially help small-cap businesses listed on the Canadian stock market.

As such, investing in small-cap companies that focus on their home country can offer substantial growth potential as they often adapt more quickly to changing local domestic market conditions than larger companies with international revenues.

4. **Military and Defense**

Companies involved in defense technologies and equipment manufacturing are likely to see increased contracts and funding as national security remains a priority amidst global tensions.

Increased U.S Budget: The U.S. military budget for Fiscal Year 2025 is set at approximately **$851.7 billion** in discretionary funding, reflecting a **3.3% increase** from the previous year's budget. This budget aims to enhance military readiness, support service members, and strengthen the defense industrial base amid growing global threats from nations like China and Russia. The recent stopping of further military aid at the time of this writing (temporary or potentially long term) to Ukraine, Taiwan, and other conflict zones, except that of Israel and Egypt, so that they can spend more on the U.S armed forces themselves, reflects changing priorities under America First.

Trump's Push for Higher Military Spending Among NATO: President Donald Trump has consistently advocated for increased military spending among NATO allies, calling for member countries to allocate **5% of their GDP** to defense in recent Davos meeting. This demand is more than double the current NATO guideline of **2%**, which many countries struggle to meet. Trump's rationale is rooted in the belief that the U.S. shoulders an unfair share of NATO's defense burden, particularly in light of rising global threats, such as those posed by Russia.

The Proposed American Iron Dome: Currently still in the more speculative phase of Trump proposals, inspired by Israel's missile defense system, it is estimated to cost around **$2.47 trillion** to effectively protect the entire continental United States. This figure arises from the need for approximately **24,700 Iron Dome batteries**, each costing about **$100 million**. Given the vast area that needs protection, this ambitious plan would require a massive investment that exceeds the current U.S. military budget significantly. Realistically, if this was to happen, similar to Trump's Wall where it was not completed during his first term, it would require multiple phases of development over long periods of time.

For historical comparison, the Great Wall of China, one of humanity's greatest military infrastructure achievements, cost an estimate of $950 billion dollars when adjusted to inflation today (mostly material cost, as labour cost was very low).

Historical Context: Germany's Economic Struggles During U.S. Tariffs

The economic landscape of the 1920s provides a historical parallel to current trade dynamics. Following World War I, Germany faced severe economic challenges partly due to reparations and U.S. tariffs enacted during America's "Roaring Twenties."

Impact of U.S. Tariffs on Germany: The U.S.'s protectionist measures imposed in 1921 and 1922 limited Germany's ability to export goods to American markets, exacerbating its economic depression during the early 1920s.

This period saw hyperinflation in Germany as the economy struggled under the weight of reparation payments and reduced trade revenues.

Reversal of Fortunes: The situation reversed dramatically when the U.S. entered the Great Depression in the early 1930s. As American demand plummeted due to economic contraction, in addition to the major mistake of imposing more tariffs in 1930 to protect American jobs, Germany began experiencing an economic recovery and boom.

The German government implemented policies that stimulated domestic industrial production and employment, allowing it to emerge from its depression while the U.S. grappled with widespread unemployment and business failures.

Conclusion

Investors navigating through trade wars must remain vigilant against common pitfalls while seizing emerging opportunities presented, such as the expected significant tax cuts and deregulation in the US, as well as key sectors that will be more resilient to tariffs, or potentially may even benefit from it. By learning from historical precedents like the US and Germany's experience during the 1920s and 1930s implementation of US tariffs, investors can better position themselves for success amid fluctuating market conditions and geopolitical uncertainties.

As we move forward into 2025 with optimism and worries via Trump's establishment of a new world economic order, understanding these dynamics will be essential for making informed investment decisions that capitalize on both challenges and opportunities ahead.

If you want to explore post-retirement goals aimed at creating healthy and balanced financial strategies, please contact me at wwoo@researchcapital.com.

Wei Woo, CIM, EPC
Investment Advisor

Research Capital Corporation
3481 Allan Dr. SW
Edmonton, AB, T6W - 3G9
Office: 780 - 460 - 6628
Cell: 780 - 299 - 0760