Tariffs And Market Uncertainty: A Drag On Investment Activity

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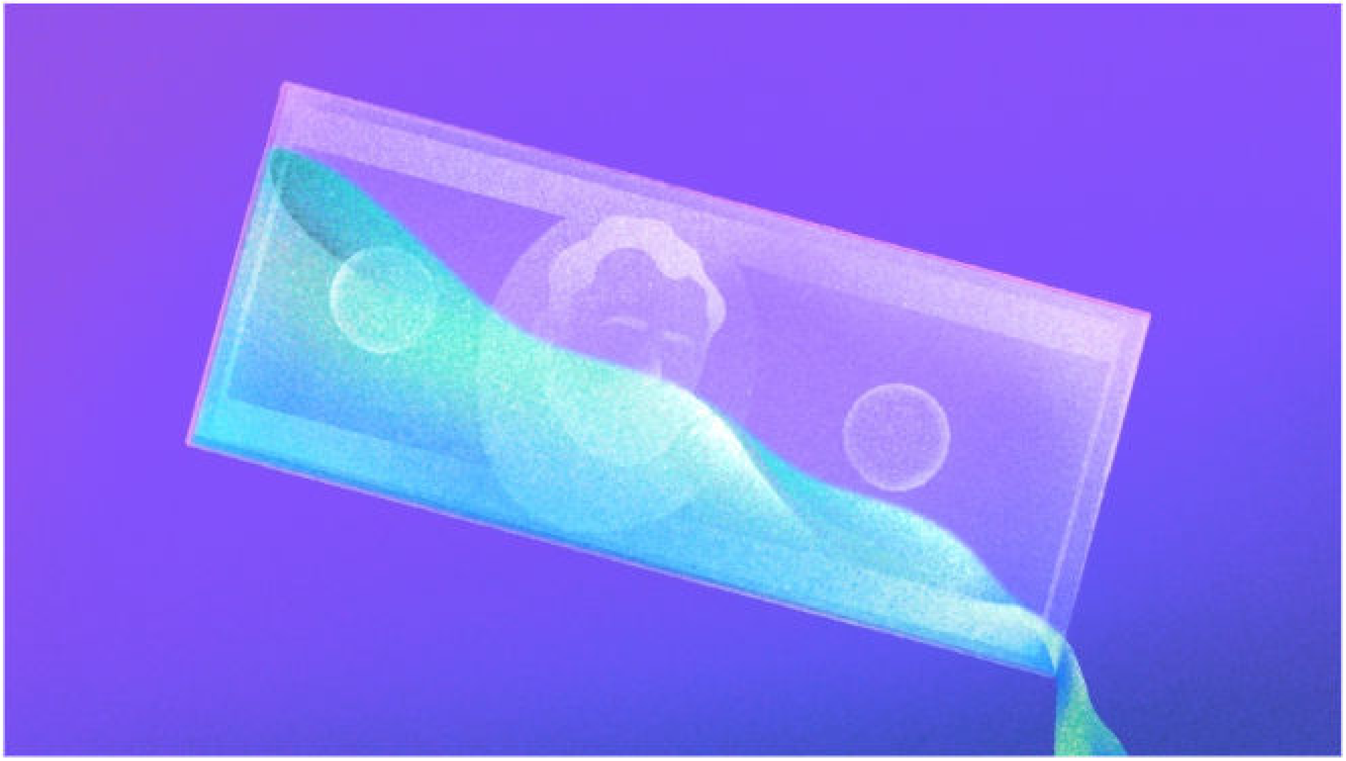

By Michael Mufson

Tariff-related uncertainty is cascading through the investment ecosystem. This environment is particularly challenging for private investors and venture capital investors, who rely on predictable capital markets and functioning global supply chains to drive value creation and liquidity.

Uncertainty in the economy affects all sectors of investing, and family office and private equity sponsored funding deals, especially venture-backed M&A — are no exception. When the investment community is confronted with material uncertainty in the near-term, decision-making becomes a synthesis of the most relevant data available, and a consensus is usually reached.

Currently, the overwhelming conclusion of the markets is clear: Tariffs are not good for the economy or for the global supply infrastructure developed over the past 30-plus years.

The effects of tariffs


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Tariffs function as a tax on American businesses importing foreign products. As such, they increase costs within the supply chain — much like a game of "whisper down the lane," with each participant adding their tariff cost to the next member of the chain. The result is higher consumer prices to cover the newly imposed tax.

Unlike direct payments to the government, these costs cascade through the supply chain, dampening economic activity. Over time, higher costs push buyers toward alternative markets, potentially hurting U.S. exporters.

Retaliatory tariffs from trade partners further strain American industries, decreasing demand for goods such as bourbon from Kentucky, mushrooms from Pennsylvania and wine from California. These demand shocks quickly lead to labor reductions and economic softening.

As a result, companies recoil from capital expenditure commitments or, at the very least, stretch decision-making timelines. Many capital projects will involve deferring technology purchases or postponing investments to a later date — metaphorically "kicking the can down the road."

Venture and growth investors, in turn, impute slowing revenue growth and apply lower valuations to companies seeking capital, based on forecasted slowing or reduced future cash flows. This leads VC- and growth-investor-backed companies to delay potential liquidity events, waiting for more favorable market conditions.

When venture and private equity funds are unable to exit and return capital to their limited partners, pension funds and high-net-worth individuals cannot raise new capital. Without this capital recycling, the flow of new money into the market stalls and may eventually shut down for a period.

Clarity is needed

For investors, tariffs add yet another layer of risk. Venture capital and growth-equity sponsors have responded by prioritizing domestic investments and reducing exposure to global supply chain volatility. This mirrors the trend seen in the latter part of the COVID-19 pandemic when uncertainty around logistics and pricing significantly slowed M&A activity. Depressed valuations discouraged sellers, creating a cautious deal-making environment.

Until there is more clarity around tariff policies, investors will favor U.S.-centric opportunities. However, even that universe is becoming smaller. In summary, the markets are speaking: Tariffs are bad for both the U.S. and the global economy.

Michael Mufson has almost 30 years experience as an investment banker to middle market companies. Prior to the founding of Mufson Howe Hunter in 2004, he served as the founder and head of equity capital markets for Commerce Bancorp (now TD Bank). He previously served as managing director and head of investment banking for Janney Montgomery Scott LLC and was a founding partner of the Philadelphia investment bank Foley Mufson Howe & Co., which was acquired by Janney Montgomery Scott. He started his investment banking career with Butcher & Singer (now Wells Fargo/Wachovia) in 1981. Before that he was with Arthur Young & Co. (now Ernst & Young). Mufson has completed hundreds of M&A deals, private placements, recapitalizations, IPOs, follow-on financings and advisory assignments. He has served as a director of numerous public and private companies and has acted as general partner in venture capital and private equity funds. He received his bachelor's and MBA degrees from George Washington University and is a certified public accountant.

Illustration: Dom Guzman