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The Impact of the U.S.–China Tariff Policies on Stock Market Sectors and Investor Sentiment

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ABSTRACT

The U.S.-China tariff policies have brought significant uncertainty into the financial markets, contributing to stock market volatility and raising concerns about future trade policies. This study examines how U.S.-China tariff policies affect stock market sectors and investor sentiment. While existing research analyzes these two dimensions separately, this study addresses a gap in research by integrating both perspectives.

Using a literature-based synthesis, this paper synthesises insights from 16 academic and industry studies published primarily between 2015 and 2025. This study explores how different stock market sectors respond unevenly to tariff policies, emphasizing differences in trade exposure, supply chain dependence, and market structure. At the same time, this paper examines the role of investor sentiment in shaping market reactions to tariff-related uncertainty, focusing on how expectations and perceived risk influence short-term market behavior.

This study's findings offer insights into how future trade or policy shocks may affect market volatility, cross-sector risk transmission, and investor sentiment.

Keywords: Industry sectors, Investor sentiment, Stock market, Tariff policies

1. Introduction

Since the U.S. reintroduced high tariffs on Chinese imports in April 2025, global markets have experienced significant volatility. The Dow Jones Industrial Average dropped 1679 points on April 3, losing more than $3 trillion in market value in a single day. This market volatility was not limited to financial indicators, it quickly translated into the real economy. As the U.S. announced new tariff policies, consumer goods prices–from electronics to everyday supplies–began to rise. This is not the first trade war between the U.S.and China: it happened before in

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2018, when similar protectionist policies triggered widespread stock market volatility and rising prices.

Economic policy and financial markets are inseparatable: past research has shown that monetary and trade policy interact with the market in a dynamic, two-way relationship (Rigobon & Sack, 2003). Monetary policy has the ability to affect stock markets, especially during bear markets, while movements in the stock markets can influence future policies in turn (Chen, 2007). Similarly, research on trade policy shows that tariff announcements can significantly impact stock returns, especially in the early stages of trade conflicts when the gap between the positively and negatively impacted sectors are more visible (McCarthy, 2019). These patterns show that market movements are not merely reactions to existing policies but also to the expectations of future policies. Financial markets, being inherently forward-looking, adjust quickly to anticipated policy. This emphasizes the crucial role of investor sentiment in shaping how trade policies affect the markets: during trade tensions, negative sentiment amplifies volatility (Bissoondoyal-Bheenick et al., 2022).

This study aims to find how tariff policies influence different stock market sectors and investor sentiment in the context of the U.S.--China trade conflict. This paper conducts a literature review of approximately 16 academic and industry articles primarily published between 2015 and 2025, covering themes such as trade policy, tariffs, and market reactions. Rather than collecting new empirical data, this paper identifies correlations, patterns, and recurring insights across existing studies. By synthesizing research findings from economics, finance, and behavioral studies, the study provides a comprehensive understanding of how tariff policies impact both sectoral stock performance and investor sentiment.

Previous studies have shown that tariffs can trigger sector-specific volatility, with industries such as technology and manufacturing often experiencing losses, while others such as utilities and domestic service sectors may benefit. However, few studies have systematically compared how these sectoral reactions differ or how investor sentiment amplifies these effects. Investor sentiment plays a crucial role because financial markets are forward-looking, which means that they not only respond to tangible economic changes but also to expectations and uncertainty about future policies. Negative sentiment can heighten volatility and increase market connectedness across economies, meaning that pessimistic outlooks can intensify cross-market contagion. This is often overlooked in studies regarding tariffs purely as economic policies rather than psychological catalysts. The research gap lies in the lack of studies combining market reactions to tariffs with investor sentiment. While previous studies have explored how the industrial sections are impacted by tariffs or examined investor sentiment during crises, few have synthesized findings across both areas to find a common pattern between tariffs and these two factors. This study offers a holistic view of market responses to the U.S.-China tariff policies by

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providing insight into a broader pattern of how future tariff policies might affect different sectors of the market and investor confidence.

This study is a preliminary, interpretive, and literature-based analysis that relies on secondary sources rather than primary data. The analysis focuses on patterns and interpretations, not on precise forecasting of future market movements. Given that the research relied on case studies affected by previous tariff policies, the findings reflect general trends, and the conclusion should be interpreted with this context in mind. The next section outlines the systematic approach used to select and analyze relevant literature.

2. Research Design

To investigate how the U.S.-China tariff policies have influenced stock market sectors and investor sentiment, we use the systematic literature review approach. This method allows for a comprehensive and structured analysis of existing literature that connects findings from different studies to reveal a broader pattern. The systematic literature review method creates connections between independent studies from investment finance, behavioral finance, and financial market operations. It provides insights to identify recurring relationships between tariff policies, market sectors, and investor sentiment.

The dataset of this study included 16 academic and industry articles published primarily between 2016 and 2025. This range was selected because it captured the most relevant and recent analysis of the U.S.-China trade conflict, as the stock market demonstrated the highest volatility after the trade policies were released. While the majority of studies fall within this timeframe, a few earlier theoretical papers were also included to provide the conceptual background of this study. For example, works published before 2015 examined how monetary policies affected the stock market in general and how investor sentiment historically impacted sectors differently.

For works published between 2016-2025, only studies that explicitly address the U.S.-China tariff policies and explore their sectoral effects or investor sentiment were included in the sample. They are primarily data-based studies that either offer empirical evidence or theoretical insights relevant to stock market responses during the trade wars. Opinion pieces and studies not focusing on how trade policies affect different market sectors or investor sentiment were excluded to maintain consistency across sources.

Among the 16 articles reviewed in this study, 7 focused on sectoral impacts and 9 analyzed the connection between investor sentiment and the stock market A few of the articles include analysis about both market sectors and investor sentiment.

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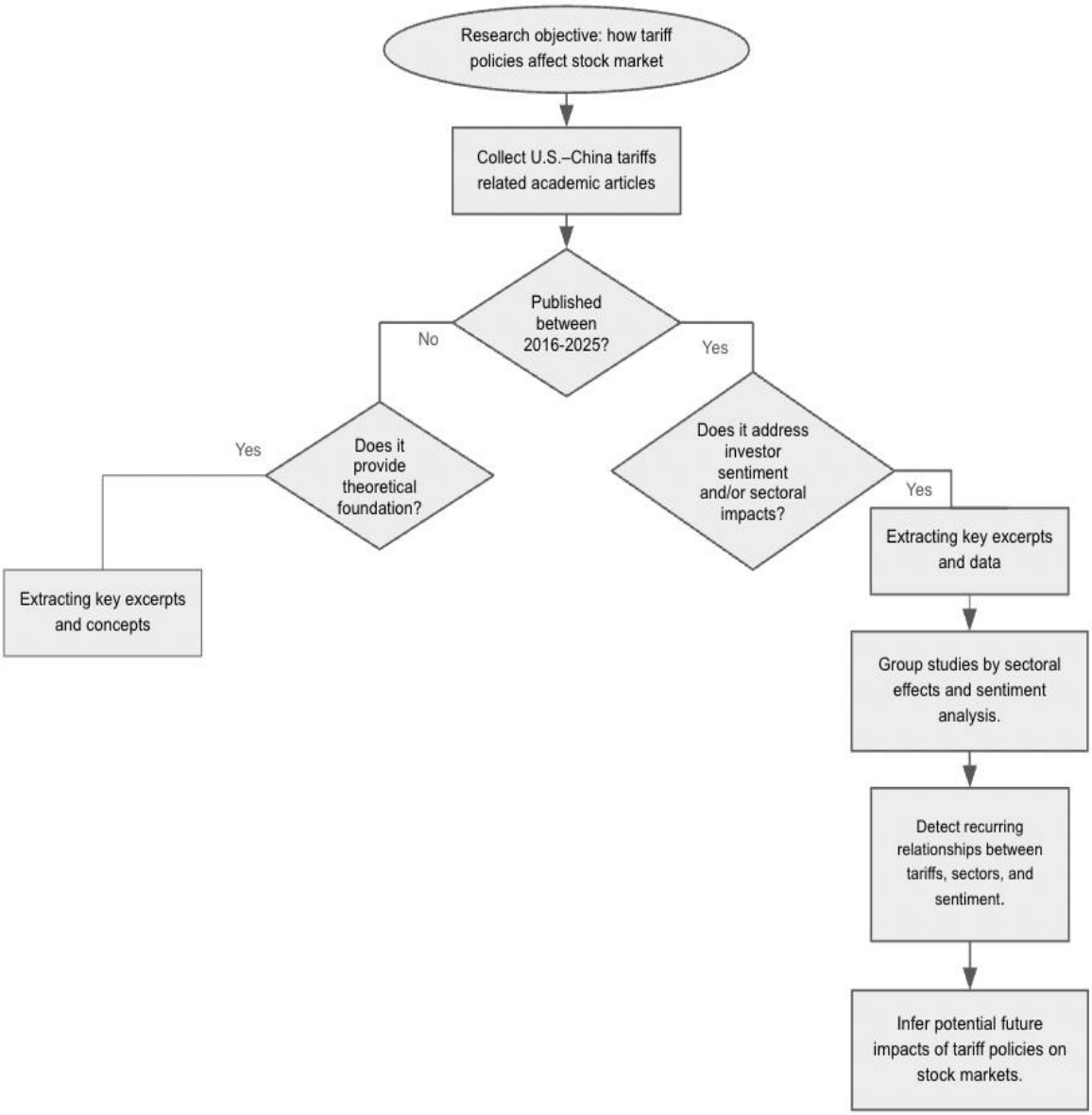
We started our analysis by extracting key excerpts and data related to sectoral responses and investor sentiment from each of the 20 selected articles systematically. We focused on extracting information about how specific sectors were impacted differently and its quantitative evidence. For example, Selmi et al. (2020) used abnormal returns (AR) and cumulative ARs (CAR) to quantify the sectoral responses to the stock market during the US-China trade war.

Fig. 1. Research design process



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After extracting this information, we organized the studies into categories to identify commonalities and contrasts across them. For example, Amiti et al. (2019) found that tariff announcements led to sharp declines in stocks among import-dependent sectors, while sectors with domestic supply chains remained stable. Another study conducted by Bissoondoyal-Bheenick et al. (2022) emphasized how negative investor sentiment amplified these effects. Connecting these findings revealed a recurring correlation between market responses and psychological factors.

Patterns identified across the dataset were then interpreted to infer potential future effects of tariff policies. This review examined the possibility whether future tariff policies may have a bigger impact on the trade-exposed sectors like technology than industries with domestic supply chains. The research design process is illustrated in Figure 1 below.

3. Results

3.1 Impact of Trade Policies on Market Sectors

3.1.1 Dominant Industries (Before Trade War Impact)

Before the U.S.-China trade war began, the stock markets in China and the U.S. were dominated by different industries (Figure 2).

In China's stock market, findings show that public utilities, manufacturing, and financials play a dominant role (Chen & Pantelous, 2021) . A comparative analysis of information transfer between sectors shows that the financial sector is the most active in information exchange in the China stock market because China relies heavily on non-bank financial institutions for corporate financing (Yue et al., 2020). Additionally, the financial sector receives and processes information faster than others. Since financial institutions constantly absorb information about macroeconomic policies and interest rates, they react immediately after trade policy announcements. The price movements in the financial sector tend to lead other sectors, which makes it dominant in the market.

Whereas in the U.S. stock market, financials, mining, retail trade, and manufacturing hold the greatest influence (Chen & Pantelous, 2021). Technology has also rapidly become a dominant industry in the U.S. because now it connects to nearly every other sector. According to Yue et al. (2020), technology is the most active sector in information exchange in the U.S. stock market because the U.S. depends on technological innovation as a drive force of economic growth. Additionally, the largest technology companies hold the biggest capital bases in the U.S. market, reinforcing its industry dominance.

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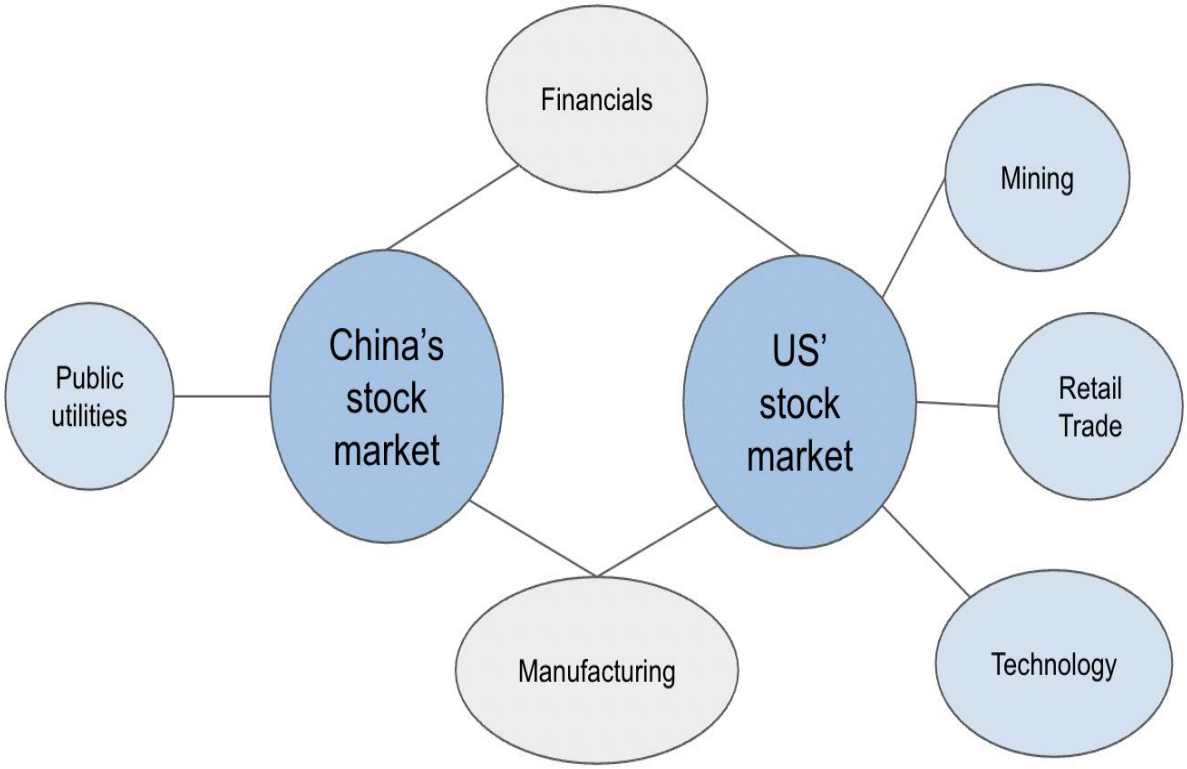
Fig. 2. Dominant industries in the U.S. and China stock markets



3.1.2 Dominant Industries as "Risk transmitters"

When U.S.-China tariff policies were first announced, these dominant industries acted as "risk transmitters" rather than "risk recipients" during uncertainty (Shen et al., 2020) . Risk transmitters do not absorb the risks themselves; instead, they transfer the shocks to other sectors through information exchange and supply chains. The sectors that experience the actual shocks and loss are the risk recipients. In both China and the U.S., dominant sectors, especially financials, absorb new tariff information quickly and pass these shocks to other connected industries without experiencing the largest losses themselves. Their stability comes from their strong capital bases and structural roles in the economy (Figure 3). For example, financial institutions have diversified revenue streams such as interests, insurance products, and capital market activities. They are also less dependent on imports and exports, so tariffs do not directly increase their costs. As a result, they play a buffer role in stabilizing the economic system (Shen et al., 2020)

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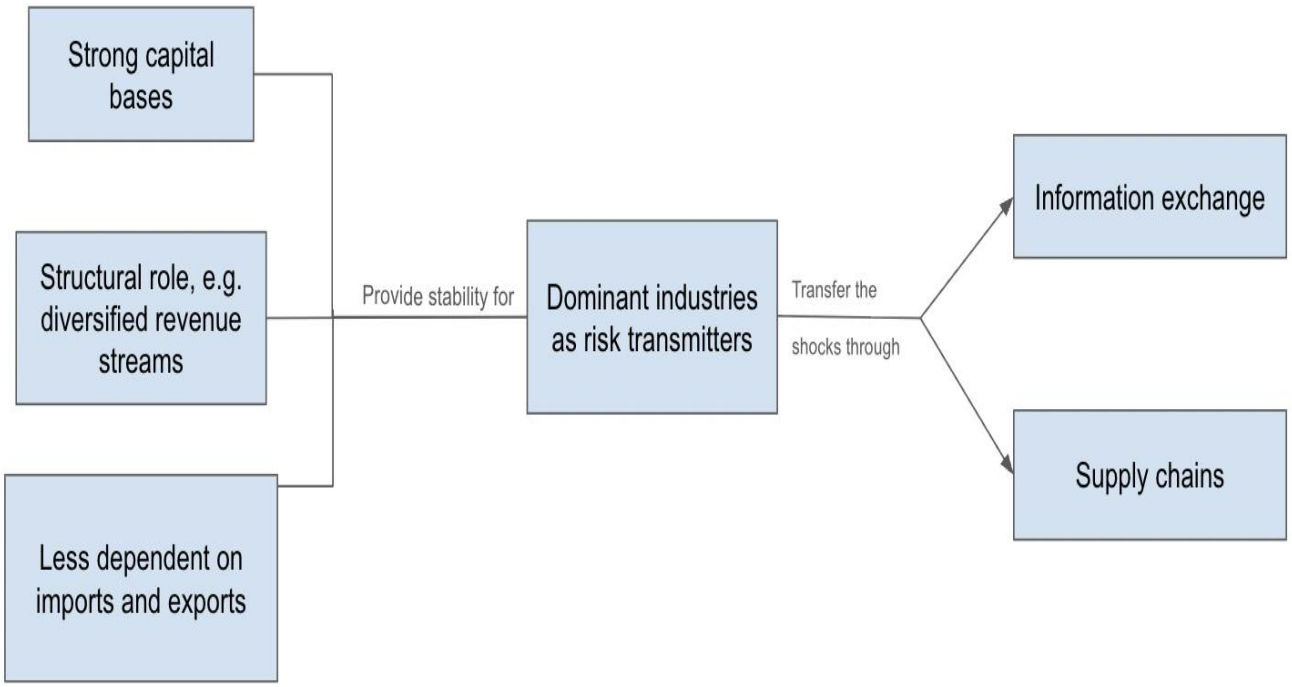
Fig. 3. Dominant industries as risk transmitters



3.1.3 Industries Most Affected

In contrast to the risk-transmitting sectors, several industries in China and the U.S. are significantly more exposed to the disruptions of the tariff policies (Figure 4). Studies show that China's agriculture, forestry, animal husbandry & fishery, semiconductors, transportation infrastructure, textile & apparel, and aerospace equipment industries experienced some of the strongest negative effects (Chen & Pantelous, 2021).

In the U.S., sectors such as banking, fabricated products, agriculture, healthcare, electrical equipment, computer software, and recreation demonstrated the sharpest declines (Chen & Pantelous, 2021). The technology sector was also vulnerable (Selmi et al. 2020) as many U.S. companies rely on Chinese buyers and China-based supply chains. As tariffs increased, China started shifting its high-tech sourcing to more safe and friendly countries like South Korea, Russia, and Canada (Selmi et al., 2020). Other studies show that the Electronic and Information and Communications Technology (ICT) industry's demands lowered by $23 million due to tariffs (Cheng & Wang, 2022). These findings show that sectors that are highly dependent on global supply chains were the most sensitive to uncertainty caused by tariffs.

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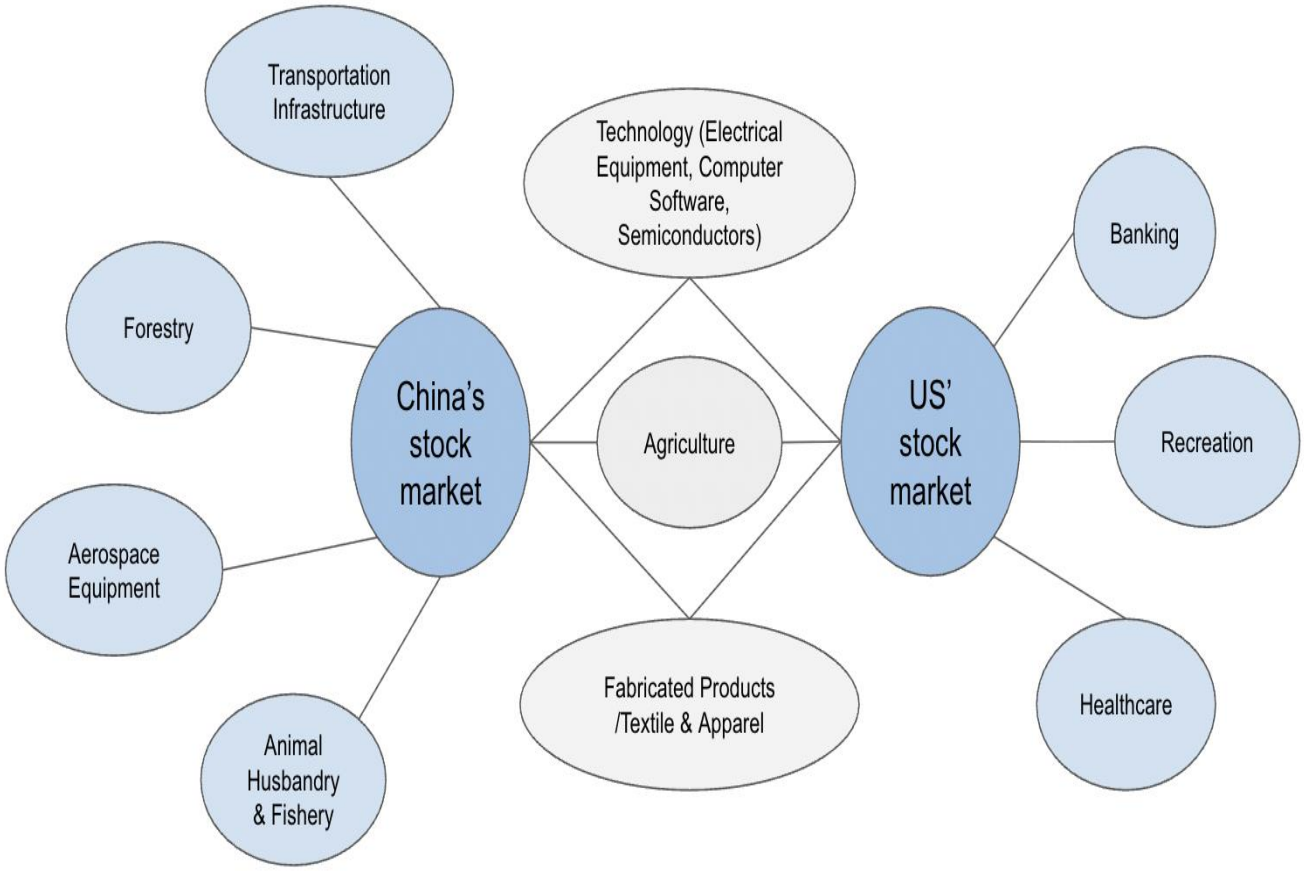
Fig. 4. Most impacted industries in the U.S. and China stock markets



3.1.4 Timing of Impact

The timing of trade war effects varies across sectors. Sectors with high trade dependence react immediately to the tariff announcements, such as technology and industrials. However, several sectors are affected later due to indirect supply chain pressure. Studies show that the increase in production costs for firms that were impacted immediately were passed to firms with which they are linked through domestic trade (Huang et al. 2023). Of the overall 6.0 percent drop in U.S. equity prices, 3.4 percent resulted from broad, common market effects, while 2.6 percent were due to firms with direct or indirect supply chain linkages to China (Amiti et al., 2020). This demonstrates that the decline in U.S. equity prices was driven more by economy-wide market forces than by firms' direct or indirect exposure to China, which means that industries without trade exposures to China can also suffer great losses in the later stage of the tariff announcement because of upstream and downstream connections. These findings indicate that the severity of

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impact is not solely determined by direct trade dependence. The timing of exposure, immediate or delayed, also plays an important role in how industries respond to tariff policies.

In conclusion, dominant sectors that have a strong capital base and are less exposed to global supply chains transmit major losses to other sectors, so they are relatively less affected. On the other hand, innovative and trade-dependent sectors experience stronger and earlier impact. Additionally, sectors that are not directly exposed to China can still be affected in the long-term as they might be influenced by their domestic supply chains.

3.2 Investor Sentiment

3.2.1 What Is Investor Sentiment and Why It Matters

Investor sentiment is a belief about future cash flows and investment risks that is not justified by the facts at hand (Baker & Wurgler, 2007). Sentiment was particularly important in the U.S.–China trade war as sudden tariff announcements created unexpected shocks to the stock markets. These changing policies increased uncertainty about future trade conditions, causing rapid and sometimes exaggerated reactions in the markets as investors adjusted their expectations in real time. As a result, investor sentiment became a key factor in how tariff policies influenced market behavior.

3.2.2 Investors are not always rational

Investors are not always purely rational; rather, their behavior is strongly influenced by emotion and perceived uncertainty. Investor sentiment reflects beliefs about the future market, causing market behavior to deviate from what data alone would predict. During the U.S.-China trade war, tariff announcements increased uncertainty as investors could not anticipate the future behavior of the market. This amplified the investors' sensitivity to negative information and reduced their incentive to invest, particularly in an already downside market (Bissoondoyal-Bheenick et al., 2022). Many investors overreacted to negative news, reducing investment even in sectors with limited exposure to trade, such as utilities. This effect was further intensified by loss aversion, as investors reacted more strongly to negative news than to positive news of equal magnitude, leading to asymmetric volatility patterns in the market (Yang, 2025) (Figure 5). Additionally, smaller, newer, or high-volatility firms, which are common in the technology and electronics industries, were disproportionately affected because investors perceived higher uncertainty and were less confident in the firms' cash flows (Baker & Wurgler, 2007).

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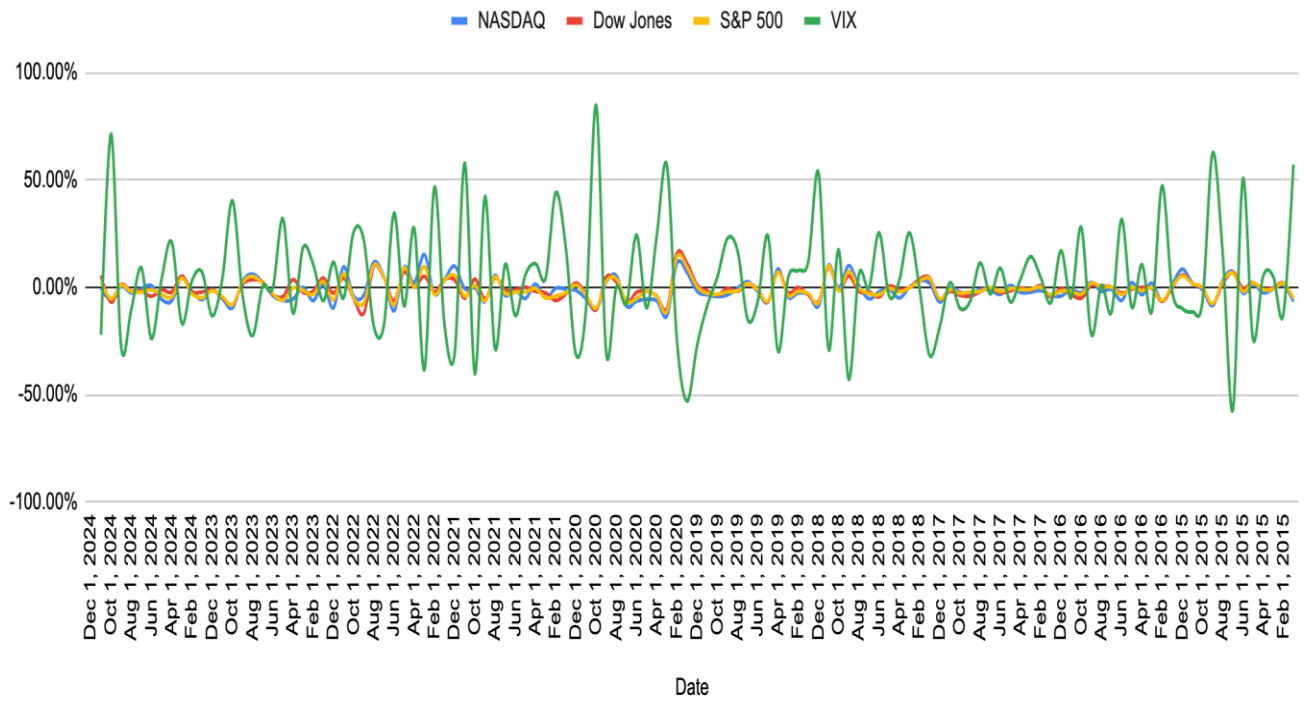
Fig. 5. Index percentage price swings and VIX correlation



3.2.3 How Uncertainty During the Trade War Reduced Confidence

The policy and economic uncertainty in the U.S.-China trade war significantly reduced investor confidence. Since 2016, the U.S. economic policy uncertainty has reached historically high levels due to unpredictable tariff announcements and shifting trade negotiations (Selmi et al., 2020). This heightened uncertainty increased investors' perceived risks, leading them to question whether businesses would continue investing internationally. Fear-driven behavior was magnified as the trade war's increased costs and supply chain disruptions raise the possibility of financial instability, decreasing investors' confidence in further investing in these businesses (Yang, 2025). This uncertainty caused periods of high volatility in the stock markets, with negative sentiment not only spilling over within the U.S. and China but also to their major trading partners (Bissoondoyal-Bheenick, 2022). Moreover, rising policy uncertainty is strongly associated with greater stock price volatility, particularly on the downside (Baker et al., 2016). These findings suggest that the early stages of the trade conflict, when tensions escalated more sharply than expected, were especially damaging to investor confidence.

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3.2.4 Sentiment Can Push Prices Away From Fundamentals

Investor sentiment can push stock prices away from their fundamental values by amplifying emotional reactions. Empirical evidence shows that positive investor sentiment predicts higher stock risk-adjusted returns in the very short term, but these gains are often followed by price reversals, indicating temporary mispricing rather than actual improvements in fundamentals (Dong & Gil-Bazo, 2020). This pattern is largely driven by non-professional investors, whose optimistic or pessimistic beliefs can increase or decrease stock prices beyond what fundamentals can justify (Statman et al., 2008, Kempf et al., 2014). Theoretical work explains this through the role of noise traders: irrational traders with erroneous beliefs create additional risks that discourage immediate arbitrage, which allows prices to deviate from fundamental values (Li, 2020). However, when sentiment becomes extreme and mispricing reaches a high level, rational investors are incentivized to bet against these noise traders, gradually pushing stock prices back toward their intrinsic values and creating reversal effects (Friedman, 1953; Mendel & Shleifer, 2012; Li, 2014). These findings demonstrate how sentiment can temporarily move markets away from fundamentals, with eventual corrections once emotional reactions are reduced.

3.2.5 Short-Term Market Overreactions to Tariff Announcements

Tariff announcements during the U.S.-China trade war directly influenced short-term market behavior by triggering overreactions driven by investor sentiment. Sudden policy shocks increased perceived risks, leading investors to react emotionally. This resulted in sharp declines in stock prices. Evidence shows a marked rise in the short-term systematic risks of U.S. equities following the escalation of the trade war, which demonstrates that the uncertainty persisted and even intensified after tariff announcements (Selmi et al., 2020). This can be explained by sentiment-driven overreactions, which is how securities often become temporarily mispriced after consistent news, with valuations eventually reverting toward fundamental values (Thaler, 2005). In the context of the U.S.-China trade war, initial market drops heightened uncertainty and fear, showing how emotional responses amplify volatility. In the long term, however, rational investors exploit these mispricings and restore the prices toward their intrinsic values, creating reversal effects (Friedman, 1953). These dynamics demonstrate that negative investor sentiment can lead to short-term market overreactions, but the market stabilizes when the investors reassess the actual economic impact.

In conclusion, the U.S.-China trade war demonstrates that tariff announcements affected stock market performance not only through changes in fundamentals but also by shaping investor psychology. Heightened uncertainty surrounding trade policy intensified negative investor sentiment, which acted as a transmission channel amplifying market reactions beyond the actual economic impact of tariffs. As a result, stock prices often exhibited sharp short-term declines and

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elevated volatility that reflected fear and pessimism. These sentiment-driven overreactions help explain why market responses around key trade war events were often more severe than what the fundamentals can justify. Overall, the interaction between uncertainty caused by tariffs and investor sentiment is crucial for understanding how trade policy shocks translate into stock market behavior.

4. Conclusion

This study examines how U.S.-China tariff policies influence stock market sectors and investor sentiment through a literature-based synthesis. By integrating findings from prior research, this paper provides a comprehensive perspective on how trade policy affects financial markets.

This study highlights clear sectoral differences in market responses to tariff policies. Dominant industries, such as financials, tend to remain more stable and function as risk transmitters rather than risk recipients. Supported by strong capital bases and central roles in information exchange, these sectors absorb policy shocks quickly and transmit them to other sectors without experiencing significant losses themselves. In contrast, trade-dependent and innovation-driven sectors, such as information technology and industrials, face stronger and earlier negative impacts. The timing of these effects is affected by both direct trade exposure and indirect supply chain linkages, causing delayed spillovers to industries that are less exposed to trade.

Investor sentiment plays an important role in amplifying these effects. Heightened uncertainty caused by tariff announcements weakens investor confidence and encourages fear-driven behavior, resulting in higher market volatility. As a result, markets often overreact in the short term, pushing stock prices away from fundamentals until reversal effects happen and corrections are made.

Sectoral vulnerability and investor sentiment are closely related. Negative sentiment intensifies losses in already exposed sectors and facilitates the spread of shocks across the broader market over time. This study demonstrates that policy-induced uncertainty affects markets not only through direct economic channels but also through behavioral responses, offering insights for anticipating future trade or policy shocks.

This analysis is subjected to limitations as it only considers the U.S.-China trade war and relies on qualitative analysis rather than quantitative data. Future research could employ empirical methods and examine other cases to assess the generalizability of these patterns found.

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