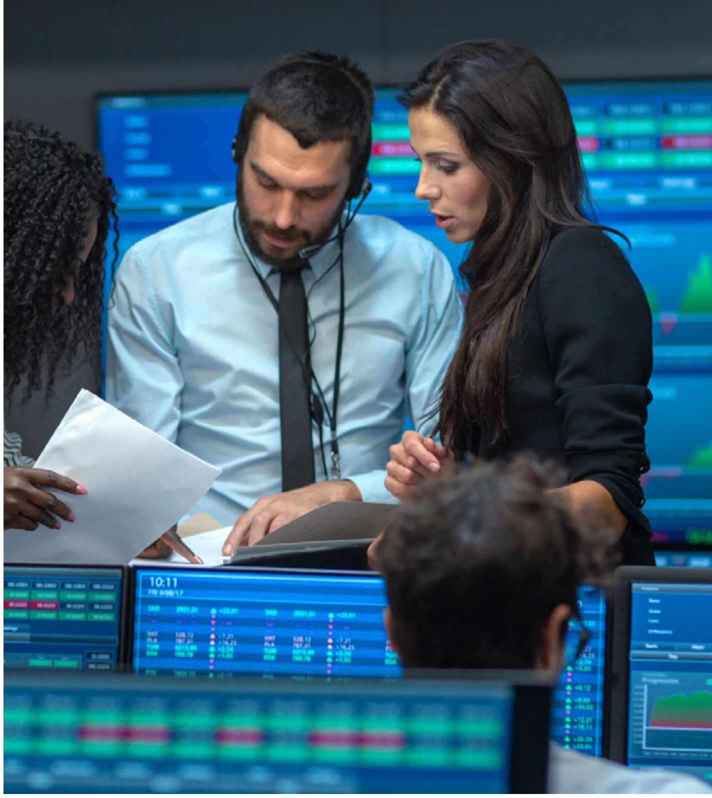
Implications of Tariff-Driven Market Volatility on Fair Value Assessments

Portfolio Valuation and Fund Advisory Services—April 2025

In times of heightened geopolitical and macroeconomic uncertainty, private market investors face renewed pressure to ensure that valuation processes remain robust, principled, and consistent with the relevant valuation standards.

The recent tariff-related policy shifts and the resulting volatility have raised questions around valuation judgment, timing, and governance. As seen during the onset of the COVID-19 pandemic, times of disruption call for heightened attention to fair value discipline, consistency in applying valuation frameworks, increased scrutiny of measurement date assumptions, and stronger oversight of the decision-making process. While the source of volatility may differ, the guiding principles remain the same as in any period of market turbulence. This paper explores how the recent market dislocation can be addressed within fair value frameworks by focusing on judgment, calibration, and governance.



Reinforcing Core Valuation Principles

Periods of market volatility, whether triggered by a global pandemic or geopolitical trade shifts, test the discipline and consistency of valuation practices. However, the core principles of fair value remain unchanged. Under IFRS 13 and ASC 820, fair value is defined as *"the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."*

In this context, three fundamental valuation principles are worth reiterating:

01

Fair value reflects current market conditions at the measurement date, and not a future expected value or long-term holding assumption.

02

Market dislocation does not invalidate the fair value concept. Volatile markets may make pricing more difficult, but the principle remains: determine the exit price that would be received in an orderly transaction under current conditions.

03

Sound judgment is essential when data is stale, inconsistent, or incomplete. Valuation professionals must evaluate whether forward-looking projections, earnings estimates for public market comparables, or other inputs reasonably reflect how a market participant would view the asset as of the measurement date.

These principles helped guide valuation professionals through the early months of the COVID-19 crisis and can be applied today in the face of tariff-related market dislocation. A transparent, documented, and framework-consistent approach remains essential.

IPEV Guidance: Valuation in Dislocated Markets

The International Private Equity and Venture Capital Valuation (IPEV) Guidelines offer practical guidance for valuing investments during periods of market dislocation. In Section 5.3 of its 2022 update to these guidelines, IPEV acknowledged that geopolitical or macroeconomic events can lead to volatile, illiquid, or otherwise dislocated markets.

Importantly, IPEV reaffirmed that the fair value premise remains unchanged, even in periods of disruption. The objective remains to determine the exit price in an orderly transaction under current market conditions. However, professional judgment and additional care may be required to reflect the impact of dislocation on:

Company Operations

Changes to supply chains, cost structures, or customer behavior should be considered, particularly when tariffs materially alter import and export economics.

Financial Metrics

Valuation professionals must assess whether trailing or forward-looking performance metrics reflect maintainable results from a market participant's viewpoint.

Comparables and Multiples

Multiples should reflect current risk conditions. If forward estimates are not yet updated for tariff effects, trailing or scenario-adjusted inputs may be more appropriate.

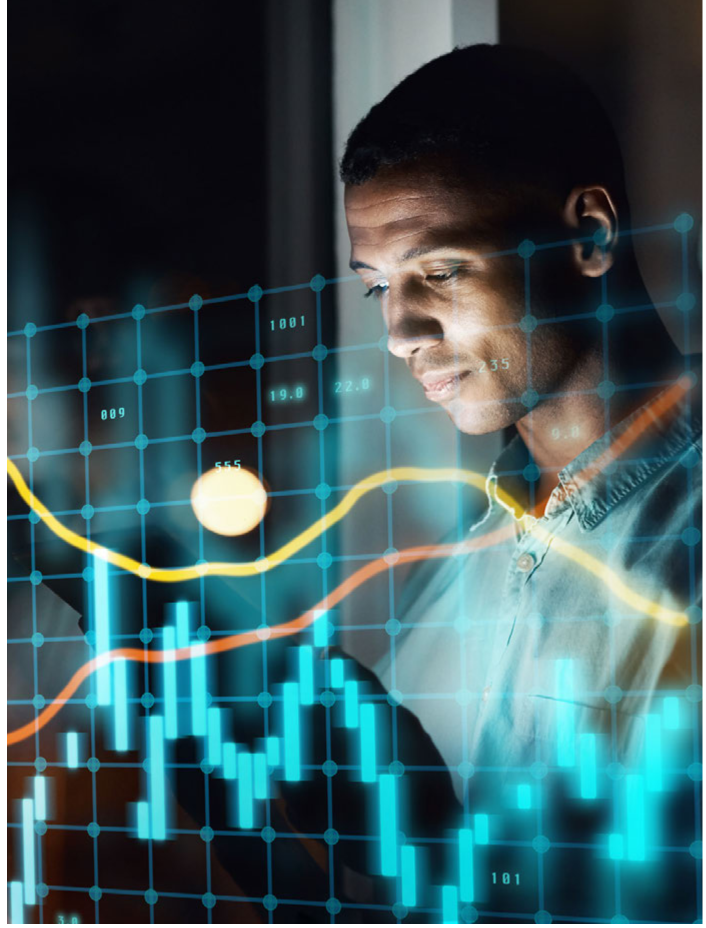
Scenario-Based Analysis

In some cases, it may be necessary to model alternative outcomes and assign probability-weighted values to account for uncertainty in duration or magnitude of the disruption.

Discount Rates and Risk Premiums

Greater uncertainty may justify upward adjustments to discount rates or downward pressures on multiples, even in the absence of transaction evidence.

IPEV's valuation framework reinforces the concept that valuation is not suspended during dislocation; rather, it must become more intentional, reflective, and well-documented. Valuation professionals are expected to adapt their techniques while staying grounded in fair value principles.



Sector Divergence and Market Behavior

One of the more challenging aspects of applying fair value during dislocated markets is that not all companies, even those in the same sector, are affected equally.

This is especially true in the context of tariffs, where the impact often hinges on a company's specific supply chain, customer base, and geographic exposure. For example, two companies in the same industry may show drastically different financial and valuation performance depending on:

- Whether they source components from tariffed countries or have domestic suppliers.
- Whether their customer base is primarily domestic or global.
- How easily they can pass on rising input costs to customers.

This dynamic creates meaningful challenges when selecting and applying comparable company multiples. For example, a 30% decline in the market capitalization of a comparable public company due to its direct exposure to China-related tariffs may not be the most appropriate benchmark for a portfolio company that sources and sells entirely within the U.S. However, such portfolio companies may still be indirectly impacted by tariffs if their key customers or suppliers are exposed to international trade and face rising costs, reduced export volumes, or supply chain disruptions. These ripple effects may lead to reduced purchasing power or operational strain among those customers and suppliers, which in turn could dampen demand for the portfolio company's offerings. As such, while the 30% decline may not directly translate, it can still offer directional insight when applied with appropriate context and judgment.

Ideally, valuation professionals should:

- Inquire about the specific impact of tariff policies on the subject company relative to the comparable companies.
- Avoid applying blanket sector multiples without understanding underlying exposure differences.
- Consider adjusting forward metrics or rely more heavily on trailing performance or scenario-adjusted projections, where appropriate.
- When using a discounted cash flow (DCF) analysis, utilize projections that reasonably reflect the expected operational impact of tariffs, and consider adjustments to discount rates to incorporate the increased uncertainty or risk premia.

In practice, the full impact of tariffs on companies may not be immediately known. Updated financial projections, supplier responses, and demand expectations can take time to fully materialize. In the near term, funds may find it helpful to preliminarily bucket their portfolio company investments into low, medium, and high potential impact categories based on their exposure to the recent global tariff policy shifts. While this form of initial bucketing can be a high-level assessment, it can nonetheless serve as a pragmatic starting point to identify which assets warrant closer scrutiny and help refine valuation assumptions as more information becomes available.

> We can be blind to the obvious, and we are also blind to our blindness.
>
> Daniel Kahneman
> *Nobel Prize Winner in Economics*

While a bottoms-up valuation lens that considers both company-specific facts and market participant perspectives is ideal, it may not always be practical, particularly for large portfolios with hundreds of investments or when detailed information is limited. In such cases, sector-level trends or market indices may provide useful directional input, provided it is applied with heightened judgment and appropriate context. While these challenges are especially visible in equity portfolios, they are no less relevant in private credit markets.

Private Credit

Private credit investors may also experience elevated valuation and portfolio monitoring challenges as borrower fundamentals, cost structures, and risk profiles evolve in real time.

Tariffs may impact private credit valuations in several ways, including but not limited to:

- Erosion of borrower profit margins due to rising input costs, especially when borrowers have limited ability to pass through price increases.
- Stress on covenant compliance, particularly where EBITDA metrics weaken or working capital needs spike.
- Reduced refinancing options, as lenders may become more cautious and pricing becomes less favorable in uncertain environments.
- Greater spread volatility across benchmark indices, which may not uniformly reflect idiosyncratic borrower resilience or risk.

Private credit valuations may also require deeper analysis beyond observed changes in spreads and yields of comparable company debt and indices. A thorough comparison of key credit metrics between the portfolio company and its peers may justify a wider or narrower spread adjustment to reflect relative default risk. If private company enterprise and equity values have declined in line with the public markets, the equity cushion supporting the debt will have eroded, resulting in a higher loan-to-value ratio. Additionally, even if current leverage and interest coverage ratios remain within covenant thresholds, continued revenue headwinds or margin pressures could lead to unexpected defaults or liquidity issues. Since valuation relies on known and knowable information, it is important to assess potential risks—especially those tied to foreign trade exposure, pricing power, and global supply chain dependencies—to identify low-, medium-, and high-risk areas across the portfolio.

In the current environment, a well-documented approach to assessing credit quality, adjusting spread assumptions, and benchmarking against updated market data is critical. The same principles of judgment, transparency, and current market participant perspective apply across credit just as they do for equity.

Structured products, such as collateralized loan obligations (CLOs), asset-backed securities (ABSs), and other securitized debt instruments, may also be affected as the credit performance of underlying borrowers becomes more uncertain. Tariff-related pressures on profit margins may increase corporate default risk, and rating downgrades in the pool can also impact test coverage ratios, potentially leading to interest deferrals on junior tranches. Tranches that were previously priced to an early call may switch to maturity, compounding the impact of widening spreads on prices. Structured products backed by pools of consumer debt could face higher losses as a result of tariff-induced inflation. Observable changes in collateral performance can take months to feed through in transaction reports, so valuation professionals must be proactive in calibrating assumptions to prevailing market expectations. Liquidity can also dry up during periods of market volatility, so it is important to have a robust evaluated pricing framework that can translate observed market spread movements implied from the more liquid space across to the less liquid securities.

CLO markets witnessed sharp increases in spreads from March 31, 2025, to April 7, 2025, with junior tranches most impacted due to higher leverage. Market visibility deteriorated significantly, with several junior tranches brought to bids wanted in competition (BWIC) auctions reportedly failing to trade. At the senior level, there have been sizeable trading volumes, but the market has become opaque, with no disclosure following trades. Volatile conditions, combined with a reduction in observable market data, emphasize the importance of robust evaluated pricing models to infer spread levels for less liquid tranches.

	U.S. CLO	European CLO
	Change vs. 3/31 (bps)	Change vs. 3/31 (bps)
AAA	28	26
AA	38	29
A	48	30
BBB	84	46
BB	137	61
B	139	103

Note: Change based on data estimated as of April 7, 2025, at 4:00 p.m. EDT.

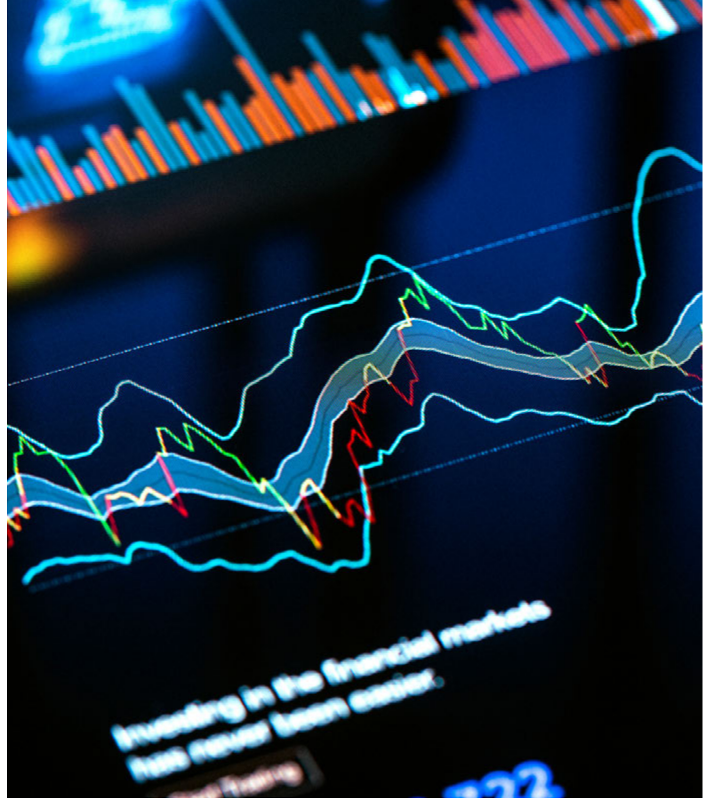
Revisiting Calibration: A Tool, Not a Crutch

In more stable market conditions, calibration is a technique that adjusts valuation inputs implied by a prior arm's-length transaction (i.e., the reference date, which is typically at the time of the initial investment) to current market and portfolio company conditions. In volatile or dislocated markets, these adjustments may be significant.

Fund managers should consider:

- Whether historical inputs still reflect current risks, growth and margin expectations, or market sentiment.
- If changes in company performance, sector outlook, or macro conditions render prior calibrated inputs outdated.
- Whether continued reliance on dated calibration could create the appearance of mechanical or stale valuation practices.

Good valuation practice requires reassessing reference date metrics and determining the appropriate adjustments.



Using Recent Transactions as Calibration Support

While the consideration of recent transactions in the portfolio company is a core part of calibration in any market, contemporaneous activity in other similar companies may offer helpful directional pricing indications. Managers should evaluate the applicability of these transactions. When reasonably comparable, such activity may help further inform valuation inputs for other holdings in the portfolio, particularly those with similar characteristics, including but not limited to:

- **Tariff exposure**
- **Industry sector**
- **Company size and stage of development**
- **Geographic footprint**

Understanding the timing of a recent transaction is crucial. If the pricing and other terms of a recent transaction were negotiated prior to material tariff development, the implied transaction metrics may not reflect current market participant sentiment or perceived risk. Therefore, such transactions may be of limited value when estimating current fair value. In such cases, it may be appropriate to assess the implied valuation metrics of the transaction as of the date the transaction was negotiated and use this as a starting calibration date.

Contemporaneous transactions may not always be directly comparable, but when carefully assessed, they can offer very useful context, particularly in situations where other observable inputs are limited or stale.

Governance, Documentation, and Third-Party Support

Periods of heightened volatility are when valuation governance is tested. While valuation methodologies matter, it is ultimately the strength of a firm's governance framework that ensures valuations remain principled, consistent, and defensible under pressure. Boards of directors, valuation committees, and senior fund leadership play a crucial role in overseeing and reinforcing this discipline. These are the moments when valuation policies and procedures are tested and when clear lines of accountability, sound process, and documentation matter most.

→ **Maintaining alignment between policy and practice while recognizing when changes are warranted.** Significant market volatility may require rethinking inputs, updating valuation frequency, or adapting valuation methodologies, but any change should be carefully evaluated, approved through the proper governance process, and clearly documented.

→ **Challenging and scrutinizing key assumptions**, especially when market data is limited, or company-specific risks have shifted.

→ **Documenting rationale and decision-making clearly**, including scenario frameworks, adjustments to forecasts, and market context.

→ **Avoiding "valuation by consensus."** Draw on diverse internal input while maintaining objective oversight and guidance.

In addition, third-party valuation support can enhance transparency and reduce potential bias. External providers can offer independent perspectives that can help withstand scrutiny from limited partners, auditors, and regulators.

Ultimately, governance is not just about adhering to policy and procedures. It is about having a disciplined, credible, and adaptable process that holds up in uncertain conditions and maintaining confidence across stakeholders.

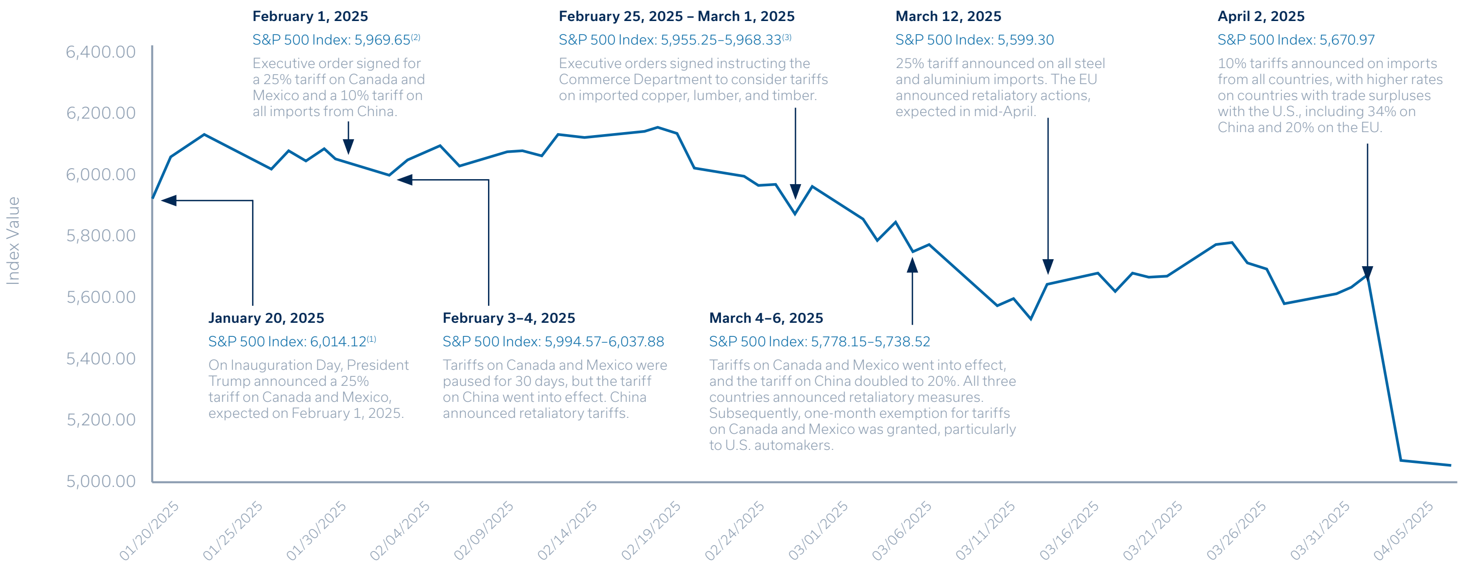
Are Recent Tariff Actions a "Subsequent Event"?

The economic fallout that occurred after the April 2, 2025, tariff announcements has prompted questions about whether these developments should be reflected in March 31, 2025, valuations.

Under U.S. GAAP standards, events occurring after the measurement date are typically classified as:

Type I (Recognized)	**Events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events).**
Type II (Not Recognized)	**Events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, unrecognized subsequent events).**

As shown in the graph below, the S&P 500 reacted to tariff-related news. From January 1, 2025, to February 28, 2025, this index was up slightly. On March 31, 2025, the index closed down approximately 5.8% and 2.7% from February 28, 2025, and March 24, 2025, respectively.



(1) January 20, 2025, is Martin Luther King Jr. Day, a federal holiday. As such, data is used based on opening price on January 21, 2025.
(2) February 1, 2025, is not a trading day. As such, data used is based on opening price on February 3, 2025.
(3) March 1, 2025, is not a trading day. As such, data used is based on opening price on March 3, 2025.
Sources: PBS News and Capital IQ.

Between March 31, 2025, and April 2, 2025, global stock indices increased slightly. It was not until after April 2, 2025, when global equity markets had significant declines from their March 31, 2025, levels. The relative stability of global stock indices from March 31, 2025, to President Trump's April 2, 2025, announcement of "reciprocal" tariffs, coupled with the steep declines in these indices after the announcement, leads us to believe that the global equity declines are more consistent with a Type II classification and therefore should not be reflected in March 31, 2025, valuations. We recommend discussing the appropriate accounting treatment of these subsequent events with your auditors and accounting advisors.

	Index Value Change (%)				Index Spread Change (bps)		
	3/31 to 4/2	3/31 to 4/7	4/2 to 4/7		3/31 to 4/2	3/31 to 4/7	4/2 to 4/7
S&P 500	1.1%	-9.8%	-10.7%	**U.S. High Yield**	(13)	106	119
FTSE 100	0.3%	-10.3%	-10.5%	**U.S. High Yield BB**	(12)	82	94
DAXK	1.0%	-10.7%	-11.6%	**U.S. High Yield B**	(15)	118	133
CAC40	0.9%	-11.1%	-11.9%	**U.S. High Yield CCC and Lower**	(3)	209	212
Nikkei 225	0.3%	-12.6%	-12.8%	**First Lien**	0	33	33
Shanghai	0.4%	-7.2%	-7.6%	**Middle Market**	0	87	87
Hang Seng	0.4%	-14.2%	-14.5%	**Second Lien**	0	56	56

Sources: Capital IQ and Refinitiv.

Best practices include:

→ Documenting the rationale for treatment as a Type II, unrecognized event.

→ Monitoring for exposure impacts in future measurement periods (e.g., June 30, 2025).

→ Communicating consistently with stakeholders, including auditors.

Conclusion

Volatile markets do not change the principles of fair value. In the face of increasing uncertainty, discipline, judgment, and strong governance become more than best practices. They are essential.

Houlihan Lokey's valuation professionals have guided clients through every major market disruption of the past five decades. Whether you need support evaluating tariff exposure, reassessing calibration, or documenting valuation decisions for stakeholders, Houlihan Lokey is here to help you navigate complexity with clarity.

The current tariff-related market dislocation potentially affects a wide range of alternative asset classes, each with its own nuance. While this paper focuses on general valuation principles, Houlihan Lokey's Portfolio Valuation and Fund Advisory Services specialists cover private credit, private equity, structured products, real estate, general partner stakes, and beyond.

If you have any questions related to a specific asset class, sector, or valuation methodology, we invite you to reach out. Our team is here to help you navigate these turbulent markets for your financial reporting needs.

In uncertain times, the right partner can make all the difference.

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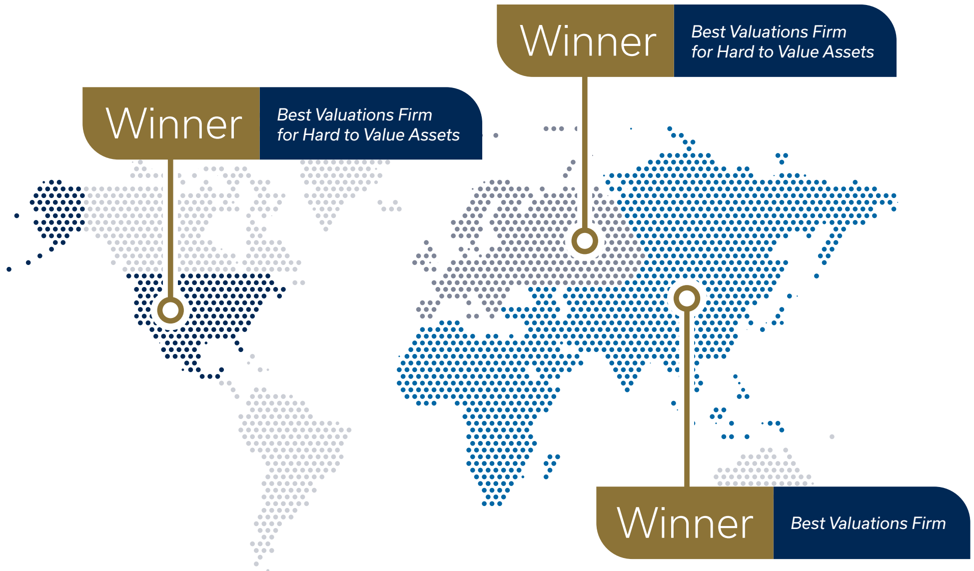

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