

CIO Note

Smooth sailing? Don't get caught in the cross currents

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Key takeaways

- We are yet to see the full impact of tariffs on corporate demand, margins and US inflation but the coming months will be key to observing any meaningful worsening in macroeconomic and corporate data as a follow-through of tariffs.
 - Even within the same sector companies are performing differently because of better product innovation and pricing power, stronger supply chains, geographic or client segment exposure and overall management. This is bound to continue.
 - When the policy and macroeconomic backdrop remains uncertain, we need to focus on the 'micro' – more granular stock level analysis to take advantage of idiosyncratic opportunities, as the new structural changes will generate winners and losers.
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In July we wrote our [Quarterly Outlook](#) entitled "Crisis fatigue". We argued that a case of crisis fatigue appeared to be setting in among investors – as the accumulation of political shocks, policy swings and conflict headlines has trained investors to look past threats that don't immediately materialise in a meaningful way for markets.

In part, this resilience is rational, as geopolitical conflict only impacts risk markets in line with its impact on the underlying economic and corporate fundamentals. However, we argued that the market was getting too used to crying wolf and that desensitisation is, in itself, a risk.

Macro picture unclear

We are now starting to see some signs that may challenge that crisis fatigue. This is not necessarily driven by the US macroeconomic datapoints that the market is so focused on, as these are far from showing a clear picture.

In early August, we saw a poor US payroll number, which was then followed by a better-than-expected one two weeks later. The CPI data showed an improvement in headline inflation and a pick up on the core side, but no clear pass-through of tariff-driven price increases on goods.

Datapoints across the rest of the globe, in Europe and Asia for example, remain weak but with no clear impact from tariffs...not yet anyway. However, changes in macroeconomic data have a lasting impact on risk markets, particularly equities, only *if* they affect earnings.

We have [shown before](#) that the correlation of equity market performance and real GDP growth over the recent past has been tenuous to say the least.

Data reliability

One other consideration (specific to the US) that investors need to take account of is the future reliability of US economic data, at a time when many of the agencies and bodies responsible for collecting it have lost staff to the DOGE (Department of Government Efficiency) spending cuts.

The Bureau of Labor Statistics, even before the commissioner was let go by President Trump, the Census Bureau and the Bureau of Economic Analysis have all lost advisers and employees and have undergone broader cost-cutting. As a consequence, less data is being collected and purchased and more mathematical estimations are being employed. Frankly, we don't know what the overall impact will be on data quality but, for now, it is reason for concern – certainly when it comes to comparisons with past data.

Tariff impact

While the current macroeconomic data leaves us none the wiser, some of the statements from company managements during the most recent earnings releases are showing that the full impact of tariffs is yet to come.

The tariff reprieves during the second quarter of the year mean that we are yet to see the full extent of tariff

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impacts on corporate demand, margins and US inflation. And while some companies have already felt the impact of tariffs on their margins, the recent earnings season has revealed that many corporates are yet to pass on such costs to consumers.

So the impact on broader corporate margins and end demand (if consumers tighten their belts in response to the higher prices) is yet to be fully realised. The next few months will be key in observing any meaningful worsening in the macroeconomic and corporate data as a follow-through of tariffs.

Winners and losers

Does this mean that we need to panic and run for the exit? That is not our conclusion. First, we have learnt over the past few years that equity and credit markets have remained resilient despite a number of macroeconomic and geopolitical concerns, as earnings have weathered many storms.

Second, a peaceful resolution to the conflict in Ukraine could revive areas of the market, particularly in Europe, with companies potentially benefiting from the reconstruction effort, as well as from the likelihood of lower gas prices.

Third, not all companies will be affected equally by market and tariff dynamics. As always, there will be winners and losers.

The earnings season, which is almost drawing to a close, is reiterating a feature that we have become used to, of companies in the same sector performing very differently from each other – either because of better product innovation and pricing power, stronger supply chains,

geographic or client segment exposure and – of course – overall management.

As a consequence of the earnings season, we have seen an increase in return dispersion across stocks globally, within the MSCI All Country World Index, particularly within information technology, healthcare, and consumer discretionary.

The key factor here is not to ignore the risk of tariff-driven margin pressure or demand weakness on the companies in our portfolios, but to understand which corporates are likely to remain more resilient and, in some cases, are actually able to increase their competitiveness.

Focus on the micro

For us, all of the above continues to confirm our stance that, within risk markets, at a time when the policy and macroeconomic backdrop remains uncertain, we need to focus on the 'micro' – more granular stock level analysis to take advantage of idiosyncratic opportunities.

This is particularly true within equities, given the degree of complacency that we have seen. At the index level, valuations of a number of markets will require solid fundamentals ahead to be supported. Hence, to find investment opportunities, our view is that it is best to drill down and look at individual securities rather than overall indices, whether at a country or sector level.



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