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# Sidestepping near-term uncertainty with selectivity

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**Even as trade tensions intensified again in the past few weeks, markets have remained largely rangebound. Although trade tensions retain the capacity to weigh on markets in the near term, market consensus seems to have coalesced around skepticism that tariffs can be sustained at elevated levels. We would balance the near-term turbulence with the goal of acquiring exposure to equities for the medium term by adding sectors with strong organic growth drivers that can buffer against the near-term volatility.**

In the past few weeks, financial markets have reacted relatively calmly to the twists and turns in tariff negotiations. Since 12 May, the S&P 500 has ranged between 5,800 and 6,000, and the MSCI ACWI has been confined to a 2.1% range during that time. Also, the 10-year US Treasury bond yield has settled into a 4.4-4.6% range, the DXY has drifted lower but remained above the late-April lows, and the VIX equity volatility index is now comfortably below the 1 April levels. With reciprocal tariffs ruled beyond the control of the Trump administration, and negotiations still going on with key US trading partners, investors might be tempted to start positioning for a recovery in risk assets.

To some extent, this sentiment is valid, but some caveats need to be implemented in investors' asset allocation response. Despite the calm, investors should consider a range of risks. Key among these are progress (or lack thereof) on tariff negotiations; US fiscal policy and associated debt concerns; and the US economic growth and inflation trajectory. We explain below why these might create some volatility in the near term, but the medium-term risks remain skewed toward recovery.

**Near-term de-escalation likely to slow; but sustained re-escalation unlikely.** Despite all the “noise” recently about slow and unsatisfactory progress in US-EU and US-China trade talks, plus the doubling of levies on key industrial metals, the “signal” to us remains clear: the Trump administration is clearly aware that a decoupling from key trading partners

like China entails economic pain that it is not willing to endure. In the near term, tariff tensions are likely to ebb and flow, and generate some swings in the market, but markets are likely to remain skeptical of the Trump administration's capacity to keep tariff rates as high as announced on "Liberation Day" given its limited pain threshold. This in turn means that threats of tariff hikes, or laments about slow progress on trade talks, are unlikely to provoke meaningful selloffs.

We expect tariff rates to eventually settle around 15% but to consist more of sectoral tariffs. This though, might prove to be a somewhat protracted process given the need for substantiating investigations. Trade negotiations on this might also prove difficult, extending the period of uncertainty and limiting market upside. This suggests market swings in the near term might skew somewhat to the downside, which might provide opportunities to add exposure to risk assets, albeit selectively.

**Fiscal policy and economic data unlikely to cause an inflection in markets.** The other major issue in the limelight is the budget reconciliation bill, or the "One Big Beautiful Bill" (OB BB). The bill, after passing the House of Representatives, now heads to the Senate, where it is likely to be slightly moderated without substantively altering the potential fiscal impulse in 2026 or the deficit. This means the final version is unlikely to provide bond markets with much reason to push yields significantly higher.

Slightly in the background for the time being is economic data pertaining to US growth momentum and inflation. Market consensus seems to have coalesced around a "muddling through" – GDP growth slowing in the months ahead as inflation remains muted enough to allow policy easing from the Federal Reserve. For economic data to push markets out of their current range-bound regime, growth data will either have to match the resilience of the past two years, or start surprising to the downside. Given the damage to consumer and investor confidence precludes the former, and markets are already pricing in a slowdown making the latter unlikely, markets are unlikely to be pushed out of their recent ranges by economic data.

**Add exposure selectively.** With the risk of near-term turbulence still high, we would be selective in adding exposure to risk assets to position for further upside in equities over the next 12 months. Our adjustments to our asset allocation preferences illustrate this clearly: we have downgraded our view on US equities from Attractive to Neutral; and have upgraded our view on China's tech sector from Neutral to Attractive. Following a rebound in US equities from oversold levels as reciprocal tariffs were largely suspended, we expect near-term upside to be more limited as investors await further clarity on trade, fiscal policy, and the extent of an economic slowdown. As for China tech, we believe the sector is well positioned to rerate, supported by robust earnings growth, ongoing AI innovation, positive cloud trends, and policy support for the innovation economy. Additionally, we view the US and European tech sectors as Attractive as we expect the global tech recovery to continue and still see double-digit earnings growth in 2025.

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