

A Message From Our Chief Investment Officer

Pay to play

Morningstar Wealth

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Key points

- Staying invested pays off
- A pay to play world
- Tariff impacts ahead
- Dig deeper and diversify

For Financial Professionals and their clients

investors have benefitted from staying invested this year. Returns year to date are above long term averages vs inflation rates and cash returns. As we have noted before, the global economy has turned out better than feared while there has been a rebound in today's Artificial Intelligence leaders and big gains for the perceived beneficiaries of President Donald Trump's reign. Stock prices have also risen in response to better than expected US Corporate profits in the second quarter of 2025.

What next? Well we think investors should expect US government action to continue to surprise and add to market volatility, now that "pay to play" policy is being applied more broadly. What started with trade has spread to defence and now the treatment of individual companies.

With trade, foreigners pay Uncle Sam higher tariffs for the privilege of selling into the world's wealthiest country, though in many cases this catches US companies too because their supply chains are global.

With defence, the price is the cost of buying US manufactured weapons that might have been provided by the US directly via alliances. For example \$1bn will be spent by Netherlands, Sweden, Norway and Denmark to support Ukraine¹.

With companies, there is now the precedent of explicit payments to get around existing restrictions, examples include Nvidia and AMD paying 15%² of their revenues from sales of chips and semiconductor exports to China. It's an echo of the shift away from rules- based global trade, so backroom bargaining may matter more, though it can of course also be rapidly reversed.

For investors this is not good news as it reduces transparency and increases uncertainty, but it does not fundamentally change the longer term economic and market outlook. The biggest impact of "pay to play" is the higher tariffs that will depress economic growth and boost inflation, given just how much tariffs rates have risen (from 2.4% in 2024 to 18.3% as at August 1 2025 based on US weighted average tariff rate³). But effects are diluted by exemptions and exclusions, the offsetting disinflationary impact of AI adoption and the impacts of changes in interest rates and tax rates. Morningstar's base case is 1.3% economic growth and 3.2% inflation for the US in 2026, followed by higher growth and lower inflation.

After the mid-year rally, emerging markets still offer better prospects than most developed markets though there are pockets of value such as US smaller companies, beaten up healthcare and consumer staples companies, communication services and the UK. We have been taking profits on China as share prices have risen on the back of firmer economic and profit fundamentals and growing interest from foreign investors. Latin America and Korea both continue to stand out as undervalued opportunities that are in the earlier stages of their recovery.

Overall then, investors are well served in this environment by digging deeper and diversifying to generate and hold onto returns. We continue to leverage heavily on Morningstar's bottom-up company research to assess the most likely impact of abrupt changes in US government policy and finding where value lies. Portfolios remain broadly diversified to reduce the risk that come with highly concentrated markets and the potential for shocks from policy changes.

Source: (1) Financial Times, (2) Morningstar Equity Research, (3) Morningstar

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