Investment Insight

Taking the sting out of shocks

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For Financial Professionals Only

Key Takeaways

- Market trends defy war and tariff fears
- US government making a clean break from the past
- Active strategies as diversifiers

Taking the sting out of stocks

Despite all the publicity, this year's biggest winners and losers have much less to do with the shocks of war and tariffs than you might expect. Emerging markets and Europe have outperformed despite being big exporting economies, while the US dollar has fallen in value and inflation and interest rates have moved down.

Surprising market outcomes are often more about what's already priced in, before the shock hits. When the worst happens, the impact is often less for markets out of favour, deeply unpopular and lowly priced. Latin American equities are a great example, they have been a top performer this year, in spite of the wild west tariff shoot out.

So how can investors reduce sensitivity to shocks?

Start by accepting that we are in a transition period when the range of feasible outcomes has increased, as the new US government aims to make a clean break from the past. Uncertainty is greater because all countries are impacted, when the dominant world power changes its economic and foreign policy. This makes it an opportune time to ensure portfolios have different sources of risk and return and hence can deal with a broader range of scenarios.

A first step is holding assets that can really pay off when economic conditions dramatically change. The classics are inflation linked bonds (when inflation rears up) and high-quality sovereign bonds (for when growth takes a hit). Together they are a handy way of tackling the potential inflationary and recessionary impact of military and trade conflicts and the emerging disinflationary pulse of Artificial Intelligence. We recently topped up our exposure to Inflation Linked Bonds and UK Government Bonds, following a rise in yields.

A second is investing in markets that reflect low expectations and so have more potential to surprise on the upside. The more markets you can research, the more opportunities you can uncover. You can improve your chances of finding them by combining company level with industry and country research. Our portfolio positioning in Korea, Brazil and US healthcare reflect the output of joint efforts between Morningstar Equity Research, Multi Asset Research and our portfolio management team.

A third is to extract extra returns from active investment strategies. We recently added exposure to select liquid alternative investments for our lower risk and shorter horizon portfolios, to help manage shocks and heightened market volatility. Here we focused on strategies that can complement traditional active strategies that seek to outperform equity and bond markets.

Examples include seeking to profit from negative as well as positive views, using cost-effective ways to insure against specific types of scenarios, exploiting shifts in trends and intentionally keeping sensitivity low to market movements.

The hard part is to find managers with demonstrable skill and funds with fees low enough for investors to get a fair share of the gains. We know from our own research that only a minority of active managers outperform. So you need to be highly selective. Working with our Morningstar Manager Research colleagues, we have allocated to a diverse range of managers and strategies in relevant Morningstar Managed Portfolios and multi asset funds.

Active strategies, competitively priced assets, and a diverse range of asset classes can all help investors navigate market shocks-strengthened by comprehensive Morningstar research into global companies, markets, and investment managers.

Important Information

 All data sourced from Morningstar Direct as at 20 June 2025 unless stated otherwise.

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