May 19, 2026

BILBoard May 2026 – Running on fumes



Based on the Asset Allocation Committee on May 5 2026

The conflict in the Middle East is now well into its third month, with traffic through the Strait of Hormuz still largely at a standstill despite a ceasefire and repeated attempts to reopen the route. The disruption is beginning to feed more visibly into the real economy: rising prices, particularly for energy, are being felt worldwide, and early signs of a slowdown are emerging, most notably in the services sector. Manufacturing activity has, for now, remained more resilient, although part of this strength likely reflects front loading in anticipation of further supply chain disruption.

In Europe, the energy shock has largely reversed any recovery that was anticipated at the start of the year, leaving the economy facing weak growth and rising stagflationary risk. In contrast, the US economy is fueled by consumer spending, AI-related capex, firm corporate earnings, and continued gains in equity markets. However, these drivers may become less reliable as the conflict continues, pressuring disposable income and pushing up borrowing costs.

A key area of attention is the shift in interest rate expectations. Markets continue to anticipate two to three ECB rate hikes this year, expectations that we find rather amplified even though the ECB could deliver a hike should inflationary pressures continue to heat up. In the US, a notable shift has occurred in recent days, with markets now pricing out the possibility of rate cuts. With the economy exhibiting relative strength, it is becoming more difficult for policymakers to look through the current inflation shock, somewhat narrowing the Fed's room for manoeuvre.

The key question now is how long the current momentum can be sustained if pressures persist. With inflation proving more persistent and policy flexibility constrained, the global economy appears to be running on diminishing buffers - still moving but increasingly running on fumes.

MACROECONOMIC OUTLOOK

The US economy remains relatively resilient. Consumers have held on until now, helped by tax rebates and a stabilising labour market, while investment, particularly in AI-related sectors, puts a meaningful floor under growth. The latter is also supporting equity markets. Markets have largely been overlooking the risks arising from the conflict in the Middle East. Credit spreads have re-traced the majority of their widening, suggesting little evidence of stress or a repricing of economic risk. On the equity side, following the correction in March, markets have rebounded strongly and continue to display resilience despite the geopolitical backdrop, supported by solid earnings, optimism around AI, and hopes that diplomacy will ultimately prevail in the Middle East.

However, this resilience is increasingly challenged by rising energy prices and elevated inflation. This limits the Federal Reserve's ability to ease policy, and has led market participants to rule out any interest rate cuts in 2026, with some even starting to price in rate hikes in 2027. This raises concerns about how long the current resilience can be sustained, particularly as households begin to feel the squeeze from higher living costs and diminishing buffers, and the consumer, so far one of the main engines of growth, risks starting to run out of fuel.

In addition, the "wealth effect" from rising equity markets is becoming less certain amid volatility, as was evident in March, adding another layer of uncertainty. Although markets have largely focused on strong earnings rather than the conflict itself, they remain highly sensitive to negative developments that could result in the conflict continuing or even escalating.

The outlook for the Eurozone economy has deteriorated markedly since the start of the conflict, with the region becoming increasingly exposed to a stagflationary environment. Growth remains weak and uneven, with indicators of economic activity pointing to a contraction in the services sector and limited resilience in manufacturing, which is partly supported by temporary stockpiling. Meanwhile, rising energy prices are pushing up inflation, eroding household purchasing power and weighing on already fragile consumer confidence and retail demand. Unlike the US, Europe's reliance on energy imports leaves it particularly vulnerable to sustained price shocks, which further weaken the terms of trade.

In China, higher energy costs are also starting to seep into the economy, pushing up producer prices and tightening margins for manufacturers despite still moderate consumer inflation, as state controls and large oil reserves help cushion the immediate impact. The economy

remained resilient at the start of the year, expanding by 5% in Q1. Growth was supported by exports and strong activity in high tech manufacturing sectors, but underlying momentum is uneven. Domestic demand remains weak, while some of the recent strength in industrial activity may reflect front loading ahead of potential supply disruptions.

INVESTMENT STRATEGY

Against this backdrop, within our portfolios we **further switched a part of our European equity exposure towards the US**. **The US** continues to be **the region offering the most growth potential**, in combination with being relatively well positioned in the ongoing conflict as a net energy exporter. The Q1 2026 earnings season has, thus far, brought **exceptionally strong results** that have pushed major indices like the S&P 500 and Nasdaq to fresh highs. Expectations for 2026 EPS growth have been rising steadily, while for Europe, earnings revisions show much weaker momentum due to its reliance on imported energy and global supply chains, lower exposure to AI profit pools, and weaker productivity growth.

We prefer to increase this exposure through an **actively-managed US equity fund** in order to obtain exposure to quality firms with sound fundamentals. This also helps navigate concentration and capex execution risk.

This trade was **EUR-hedged** so as not to further increase our dollar exposure. While the greenback has benefitted from its safe haven status amid geopolitical uncertainty, this could fade should we see tensions in the Middle East simmer down.

In addition, given the unpredictability of the situation in the Middle East, as well as the fact that any perceived setback in the AI theme could increase market volatility, we have **added downside protection on our US equity exposure** using a put-spread with maturity mid-September 2026.

Conclusion

The global economy continues to move forward, but increasingly on **diminishing buffers**, which could be eroded quickly if the conflict were to continue. Higher energy prices, persistent inflation and constrained monetary policy flexibility are **eroding both corporate and household resilience**, leaving growth more vulnerable to shocks. In this environment, **the margin for error by central banks is becoming increasingly thin.**

In particular, US earnings have been the driver of market sentiment. Should **signs of fatigue** emerge, whether through weaker consumer demand, pressure on margins, or disappointment in AI-related capex returns, sentiment could deteriorate, putting the current resilience at risk.

As such, we believe it is essential to **remain invested but selective**, combining exposure **to quality growth with a well-diversified portfolio**. Our recent adjustments, including reallocating towards US equities, maintaining currency discipline, and implementing downside protection, reflect this balanced approach.



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