

## Tactical Asset Allocation: Steady outlook, nimble moves

- ▶ **Growth outlook has improved in recent months – we see payback period later this year.**
- ▶ **Inflation continues to moderate as expected with limited evidence of tariff impact so far.**
- ▶ **While monetary and fiscal stance might turn easier, we see tariff uncertainty persisting.**
- ▶ **We remain cautiously optimistic in the near-term but also nimble as opportunities arise.**

### Growth outlook: A tale of two sectors

The US economy continues to show resilience in services, while manufacturing is staging a cautious revival. GDP has been volatile with Q1 seeing a marginal contraction and Q2 seeing a sharp uptick – both driven by a sharp rise in imports and the subsequent fall. Inventory rebuilding is underway, particularly in industrials and consumer staples. Companies are front-loading purchases to hedge against future tariff hikes, which has temporarily boosted factory output. However, this momentum may not be sustainable. As inventories normalize and demand softens, the payback could come later this year in the form of slower production and margin pressure. Supply chains, far from being stretched. Logistics networks are operating near full capacity, but without the bottlenecks seen in 2021–2022. That said, the cost of resilience is rising — firms are paying more for flexibility, redundancy, and tariff-proof sourcing. These costs may not show up in headline inflation immediately, but they erode profitability and investment appetite over time.

### Inflation outlook: Sticky, not spiraling

So far, runaway inflation has not materialized, but the underlying dynamics are shifting. The July CPI print showed a modest rise, with core inflation at 3.1% YoY, still well above the Fed's 2% target. Importantly, producer price inflation surged at its fastest pace since early 2022, suggesting that businesses are now feeling the pinch of higher input costs. Tariffs are beginning to bite more visibly in goods categories, particularly apparel, footwear, and electronics. According to Yale's Budget Lab, shoe prices have risen 39%, and apparel is up 37% in the short run. While firms initially absorbed these costs through margin compression and budget shifts, that buffer is thinning. As inventories turn over, higher sticker prices are creeping in. We estimate that consumers will absorb roughly 33% of tariff-related costs, with the remainder either absorbed by producers or deferred through supply chain adjustments. This cost-sharing dynamic has helped prevent a sharp inflation spike, but the risk is that this may not hold indefinitely. Nevertheless, as goods inflation picks up, the services inflation will likely cool further, creating an offset.

### Labor market: From tight to tepid

The labor market is clearly softening, with payroll growth slowing and unemployment edging higher. The July jobs report showed just 73,000 new jobs, and the three-month average has dropped to 35,000, the weakest stretch since the pandemic onset. The unemployment rate ticked up. This slowdown is not yet a collapse – but it is a marked shift from the tight conditions of late 2024. Labor supply and demand appear to be shrinking in tandem, creating what Fed Chair Powell called a "curious kind of balance". Job openings are down, layoffs are up, and wage growth has stalled, suggesting that bargaining power is fading. Immigration restrictions have further constrained labor availability, especially in construction and logistics. This has contributed to higher shelter costs, which remain a key driver of sticky inflation. Rents in major metro areas continue to outpace income growth, and housing affordability remains a political flashpoint heading into the fall.

### Tariff uncertainty persists: A fragile balancing act

Despite months of market adaptation, the US economy remains deeply entangled in tariff uncertainty. While some sectors have begun to absorb the shock, the broader macro picture is still clouded by policy unpredictability, legal challenges, and uneven cost transmission. We estimate the effective tariff burden in its steady state is between 15% and 20%, the highest sustained level since the 1930s. This range reflects both direct levies and indirect cost pass-through, notwithstanding retaliatory measures from key trading partners. The recent ruling by the US Court of Appeals, which deemed most of President Trump's reciprocal tariffs illegal but allowed them to remain in place until mid-October, has only added to the ambiguity. With the administration signaling intent to appeal, markets are bracing for a potential Supreme Court showdown that could redefine executive trade authority heading into 2026.

### Policy outlook: Fed on the fence

The Federal Reserve is now openly signaling rate cuts, with a very high probability of easing in September, according to CME FedWatch. Governor Waller has called for cuts to begin this month, citing the need to support a weakening labor market. With internal dissents, the Fed is walking a tightrope between inflation control and growth support. The Fed's preferred inflation gauge — the PCE index — rose 2.6% in July, with core PCE at 2.9% YoY, both above target but largely as expected. While headline inflation is not surging, the tariff-driven cost pressures are expected to build through Q4. Powell has warned that the Fed will not allow a "one-time increase in the price level" to become a persistent inflation problem. This balancing act is complicated by political pressure challenging Fed's independence. Trump's

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tariff agenda remains central to his economic strategy, and any Fed action that appears to counteract it could invite criticism. At the same time, the Fed must respond to real-time data, and the labor market's deterioration may force its hand. We expect Fed to cut rates by 75bps over the remainder of the year.

### Investor implications: Positioning for volatility

Markets are pricing in rate cuts, tariff risk, and sector rotation. Equities have rallied on AI optimism and easing hopes, but bond yields remain volatile. The 60/40 portfolio has rebounded, but dispersion across sectors is widening. Tariff uncertainty, labor market fragility, and inflation stickiness will likely dominate the narrative during September – a month historically seen as one of weakness – in both equities and long-duration bonds. Tactical positioning, quality bias, and liquidity management remain key.

### Tactical Asset Allocation (TAA)

We remain cautiously optimistic in our tactical positioning with a neutral stance on equities (with a slight overweight bias now) and neutral fixed income (with a slight underweight bias). Within equities we maintain our preference for US equities overall by adding a 2ppt off-benchmark position to US homebuilder equities, we fund this by trimming our OW position in North America equities to 1ppt (from 2ppt) and trimming our cash position to 1ppt (from 2ppt). Elsewhere within equities, we remain OW on Japan, neutral on Europe, and underweight on emerging markets. Our fixed income positioning is largely unchanged.

### Changes to our Tactical trade ideas list

- ▷ We introduce a tactical position in US Homebuilders equities with the targeted upside of 20% and a stop-loss of 10%.
- ▷ We close our preference for UK gilts over other developed market sovereigns. UK gilts have underperformed other developed market sovereigns over the holding period – resulting in a loss in our position. We see no respite for UK gilts outlook this side of the Autumn budget which is scheduled for late-October.

### Rationale for adding US homebuilder equities

- ▷ This adjustment can help in making TAA higher beta to the interest rate cut cycle, given our expectations for the Fed rate path.
- ▷ US homebuilder equities have performed in line with the market year-to-date and underperformed over the past year, and could outperform over the next six months as interest rates come down.
- ▷ The most direct channel is the pass through from Fed rate cuts to mortgage rates. Historically, a 50-75 bps Fed funds reduction can pull the average 30Y fixed mortgage rate down by 30–60 bps within a quarter. Mortgage rate relief should unlock demand.
- ▷ Furthermore, new-build advantage remains as resale supply remains constrained. Recent price cuts and incentives should be seen as a strategic, not desperate, tool. Builders exercising operational discipline on inventory and starts.
- ▷ Industry confidence remains amid regulatory relief under the Trump administration.
- ▷ Profits are sensitive to policy interest rates. Builders typically use revolving credit facilities, land acquisition loans, and project specific financing. Rate cuts lower their interest expense, reducing the cost per unit built. This savings can offset part of the cost of sales incentives, keeping EBIT margins from deteriorating even in competitive markets.
- ▷ Furthermore, we think this sector is strategic given President Trump's campaign promises on housing and could see material support measures rolled out over the next few months. Some of these could include:
  - ▷ Standardising local building and zoning codes – that could accelerate project approvals and boost volumes.
  - ▷ Creating tariff exemptions for housing materials and reducing closing costs – that could result in input costs dropping and thereby boosting margins and sentiment.
  - ▷ Declaring national housing emergency as floated by US Treasury Secretary Bessent could lead to improving sentiment around the sector.
- ▷ Homebuilders sector equities exhibit lower correlation (0.70 over the past three years) to the overall US market cap-weighted equity benchmarks. This means that the sector can provide a shield during any tech-driven sell-off in US equities.
- ▷ Downside risk to the sector comes from a stagflationary macro environment (which is not our base-case).

# Tactical Asset Allocation

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## Tactical Asset Allocation

Exhibit 1: Tactical Asset Allocation with a 3m-6m view

Asset Class	Positioning					Balanced		
	SUW	UW	N	OW	SOW	SAA	TAA	Active
<b>Equities</b>						<b>41.2</b>	<b>43.1</b>	<b>1.9</b>
North America						25.8	26.8	1.0
US Homebuilders						0.0	2.0	2.0
Europe						7.0	7.0	0.0
Japan						2.3	2.8	0.5
APac ex Japan						5.0	3.8	-1.2
EM ex Asia						1.0	0.7	-0.3
<b>Fixed Income</b>						<b>58.8</b>	<b>56.9</b>	<b>-1.9</b>
DM Treasuries IG						32.9	32.9	0.0
DM Corporate IG						12.5	12.5	0.0
EM USD Sovereigns IG						0.8	0.8	0.0
EM LCY IG						5.1	4.5	-0.6
EM Corporate IG						0.6	0.3	-0.3
Global HY						5.0	5.0	0.0
Cash						2.0	1.0	-1.0
<b>Alternatives</b>						<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

### Colour legend

Current  Previous

Source: Bloomberg, Bloomberg BGN, Bloomberg Indices, Hedge Fund Research, MSCI, Standard & Poor's, LSEG Workspace, and ADCB Asset Management | Notes: \*Positioning recommendations: SUW = Significant Underweight; UW = Underweight; N = Neutral; OW = Overweight; SOW = Significant Overweight. \*\*Based on balanced risk profile. SAA = Strategic Asset Allocation; TAA = Tactical Asset Allocation; Active weight = TAA weight – SAA weight. Weights may not sum to 100% due to rounding.

Exhibit 2: Strategic Asset Allocation

	Cautious	Balanced	Aggressive
<b>Investment objective</b>	Capital Preservation & Moderate growth	Growth & Income	Growth & Moderate Income
<b>Investor Suitability</b>	Moderately Conservative	Moderate	Moderately Aggressive
<b>Asset Allocation</b>			
Equity	20%	35%	65%
Fixed Income	65%	50%	20%
Alternatives	15%	15%	15%

Source: ADCB Asset Management

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## Tactical Trade Ideas

### Exhibit 3: Our high conviction tactical investment themes/trade ideas – open positions

New/Open positions	Asset class	RV?	Date opened	Current date	Performance	Target	Stop
US Mortgage Backed Securities	Fixed Income		11-Apr-25	1-Sep-25	4.2%	5%	-5%
US Small Caps (Russel 2000)	Equities		6-Mar-24	1-Sep-25	14.4%	20%	-15%
Indian equities	Equities		11-Apr-25	1-Sep-25	5.2%	20%	-10%
<b>US Homebuilders</b>	<b>Equities</b>		<b>1-Sep-25</b>	<b>1-Sep-25</b>		<b>20%</b>	<b>-10%</b>
Copper	Commodities		15-Jun-23	1-Sep-25	15.9%		
Silver	Commodities		10-Jun-25	1-Sep-25	11.4%	20%	-10%
<b>Average</b>					<b>10.2%</b>		

Source: Bloomberg, and ADCB Asset Management

### Exhibit 4: Our high conviction tactical investment themes/trade ideas – closed positions

Closed positions	Asset class	RV?	Date opened	Date closed	Performance	Target	Stop
UK gilts over other DM Sov.	Fixed income	Yes	14-Nov-24	1-Sep-25	-2.5%	5%	-5%
High dividend yielders index	Equities		6-Mar-24	10-Jun-25	15.1%	15%	-10%
Gold miner equities	Equities		17-Mar-25	2-Jun-25	20.8%	20%	-10%
SPW relative to SPX	Equities	Yes	6-Mar-24	10-Apr-25	-5.7%	15%	-10%
Gold miner equities	Equities		25-Nov-24	17-Mar-25	22.3%	20%	-10%
UST (7Y-10Y) over other DM Sov.	Fixed income	Yes	5-Jul-22	13-Nov-24	-1.1%		
EU IG Corp over US IG Corp	Fixed income	Yes	9-Jan-23	13-Nov-24	6.0%		
HK equities	Equities		14-Nov-22	13-Nov-24	13.3%		
Chinese hotels & leisure	Equities		14-Nov-22	13-Nov-24	-18.6%		
Chinese semiconductors	Equities		22-Mar-23	13-Nov-24	9.0%		
USDJPY	FX		6-Mar-24	26-Apr-24	-6.0%		
Dow Jones World Consumer Goods	Equities		25-Aug-23	6-Mar-24	1.5%		
Indian equities	Equities		22-May-23	6-Mar-24	31.3%		
Cybersecurity	Equities		22-Mar-23	6-Mar-24	26.9%		
GBPUSD higher	FX		15-Jun-23	20-Sep-23	-3.4%		
US Diversified banks over US Regional banks	Equities	Yes	13-Mar-23	13-Jun-23	24.8%		
Asia investment grade credit	Fixed income		9-Jan-23	14-Jun-23	1.8%		
USDJPY lower	FX		9-Jan-23	14-Jun-23	-6.1%		
GBPEUR lower	FX		9-Jan-23	14-Jun-23	-2.9%		
Gold	Commodities		14-Nov-22	14-Jun-23	9.7%		
Gold miner equities	Equities		14-Nov-22	14-Jun-23	13.1%		
<b>Average</b>					<b>7.1%</b>		

Source: Bloomberg, and ADCB Asset Management

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