

Building in uncertainty

17 March 2026

When confronted with big unknowns, it's tempting to imagine the worst. Amid the fog of war, our investment process aims to manage the risks while not missing the boat if things suddenly take a turn for the better.

In uncertain times, humans tend to fill knowledge gaps with worst-case scenarios. That's the conclusion of a study referenced in a recent Financial Times article. Even though the piece was talking about uncertainty in the workplace, the psychology could equally apply to worldviews and how they affect our attitudes to investing.

The situation in Iran is already deep into the Donald Rumsfeld territory of 'knowns' and 'unknowns' – the 'fog of war' metaphor is as apt as ever. But there are still plenty of facts that we can work with. And our investment process is built to handle situations such as this.

Taking stock

As the war with Iran runs into its third week financial markets, on the surface, are showing a commendable degree of equanimity in the face of alarming

Quick take:

- Relative calm has returned, though market uncertainty is still elevated.
- There are some benefits of dollar exposure; bonds look vulnerable.
- Preparing for the worst needs to be balanced against capturing potential future returns.

headlines. As of Monday's close, the MSCI All-Countries World Index was around 5% off its all-time closing high on 26 February. Last week's divergence in performance between different regions and sectors was much less pronounced than in the first week of hostilities. A lot of the speculative and leveraged traders (those using borrowed funds) were flushed out pretty quickly. Last week the S&P 500 fell 1.6%, for example, while the 2.0% loss for the MSCI World ex-US was not a lot worse.

Even so, the US has benefitted from some relative advantages, not least its position as a net exporter of oil and gas. That has been reflected in a decent rally for the dollar, with the DXY trade-weighted dollar

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index up close to 3% since the outbreak of hostilities.

The dollar has strengthened amid the war



Source: FactSet, DXY trade-weighted index, as of 17 Mar.

The case for diversification

Sterling is down from \$1.35 to \$1.33, but it's the euro that has taken the biggest hit, falling from €1.18 to €1.15 per dollar. For non-US-based global equity investors, that will have provided a nice cushion of higher returns when translated back to the home currency. And the high proportion of dollar revenues for UK large caps will also have helped. This underlines the benefits of global diversification. It also provides some justification for our reluctance to put currency hedges on non-sterling equities and other so-called risk assets. That is, unless we have a very specific reason to (such as a policy to devalue the currency in question as was effectively the case with the yen in the era of 'Abenomics').

What about other diversifiers that we hold alongside these risk assets? The challenge when choosing your insurance is that you have to know what you are insuring against. The dollar's fall after last year's 'liberation day' tariffs created havoc in terms of portfolio volatility. This time the dollar has risen. Given what happened in 2025, that has probably caught a fair few traders off balance.

A market troubled by a new inflationary threat is not a good environment for bonds. The Bloomberg Global Aggregate Index of investment-grade (higher credit quality) bonds has fallen 3% this month. With bonds continuing to move in tandem with equities, they're providing no diversification benefit.

This throws the concept of a 60:40 equity/bond portfolio up in the air or even out of the window. This was the 'go to' strategy for many investors for the two decades up to 2021, a period when equities and bonds tended to move in opposite directions, which dampened portfolio volatility and boosted risk-adjusted returns.

The demise of this 'sure thing' emphasises why we put such effort into selecting the right components of the diversifiers

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bucket in balanced portfolios. It's not clear to me that the penny has dropped with everyone in the industry yet, with 'lifestyle' type pension funds still pushing investors deeper into the bond market the closer they get to retirement. If one is going to own bonds in this environment of higher inflation and greater volatility, we believe the best strategy is to stick with those with a shorter time to maturity. Of course, there can be tactical opportunities to increase duration and that is always under consideration.

A world of higher inflation

The correlation 'regime shift' that has been in place since 2021 is driven by inflation. Core US inflation (excluding the more volatile items of food and energy) of 2% seems to be the tipping point. And we are stuck above that level at the moment, having been largely below it for the previous two decades. It might well be that we fall below it again in the future if the promises (or threats) of AI materialise, but it's definitely off the agenda for now.

There are plenty of factors that feed into structurally higher inflation (and inflation volatility). These include domestic politics (with a bias towards more populist policies), geopolitics (with the current situation being an obvious example), climate change, and the energy transition.

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And all with a potential side order of demographic shifts (although economists differ on whether ageing populations will be inflationary or deflationary).

More encouragingly, recent events have not led to an especially sharp rise in inflation *expectations* among investors. That speaks to two possibilities: either market participants think central banks will lean aggressively against an inflation shock from higher energy prices (e.g. by raising interest rates); or that the war will be concluded relatively swiftly with supplies restored. The latter outcome would obviously be – by far – the preferable one for investors.

Looking for the exit

Are we any closer to divining the outcome on the war and thus being able to take a more positive directional view? The biggest surprise over the past couple of weeks, including for the US government it seems, has been the scale of Iran's response to the attacks. The various Middle East experts I have either heard speaking or read generally conclude that the existing regime, as long as it feels threatened, will continue its current path of action. That does not bode well given the latest comments from the US and Israel suggesting a continuation of the current regime would be unacceptable.

That opens up the risk (though a low-probability one) that, as long as the war

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continues, things could suddenly get worse very fast. This mainly pertains to energy supplies as well as to other key commodities. We are already in a situation where oil production is having to be curtailed owing to the lack of storage facilities. And it's not just a case of flicking a switch and getting supplies up and running again when the situation allows. There is also the risk that more infrastructure is going to be damaged, meaning that production and refining capabilities are offline for longer.

US voters face rising prices at the pump



Source: FactSet, NYMEX, as of 17 March.

And yet we know that there are a lot of parties that would like to see this war end quickly, not least because of the risk of an energy-price shock. And the clock is ticking on US mid-term elections, for which Trump needs to manufacture better news. The 30% increase in petrol prices so far is not doing the Republicans many favours.

All of this makes it impossible to build portfolios based on any highly probable outcome. Somehow, we need to adopt enough safety measures to cushion the impact of a potential escalation while still being able to benefit from an early resolution. As ever, the longer the investment horizon, the easier it can be to ride out short-term volatility. That's why, in the majority of cases, we recommend remaining fully invested but in an appropriately balanced manner.

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Regional highlights

US. Annualised GDP growth in last year's final quarter was revised down to 0.7%, half the initial 1.4% estimate. The revisions were down to weaker business investment, lower estimates of consumer spending on services and less government activity amid the shutdown. Economic growth slowed to 2.1% from 2.8% in 2024, thanks to slower growth in the labour force, the impact of tariffs, and policy uncertainty. With core CPI inflation running at 2.5% in February, even before the effects of the Iran war were felt, there is no scope for the Federal Reserve to cut interest rates soon. The January core PCE price index (the Fed's preferred measure) was even higher at 3.1%.

UK. GDP failed to grow in January, suggesting limited momentum even before Iran-related headwinds materialise. Consumers and businesses face higher fuel prices and interest rates are no longer expected to fall anytime soon. Weaker activity also leads to lower tax revenue while higher bond yields increase the government's interest payments on debt. Whatever relief Chancellor Reeves will have felt from a surprisingly strong tax take ahead of the recent Spring Statement will now have evaporated. She faces being unable to increase fuel duty as planned, as well as potentially having to renew household energy subsidies. It's hard to imagine more tax increases being palatable to close any fiscal gaps. But will the Labour Party have the gumption to cut spending anywhere?

Europe. Though GDP growth was revised lower in the final release of fourth-quarter figures, full-year growth was 1.5% in 2025, the highest in three years. Private consumption was the key growth driver, alongside an increase in investment. Ireland alone contributed 0.4 of a percentage point! Growth at the beginning of 2026 will have been dampened by poor weather and that's before the effects of the war in Iran are felt. Headline CPI inflation of 1.9% in February is manageable but will almost certainly rise. Germany's latest ZEW survey of economic growth expectations plunged from 58 to -0.5, only the second negative reading since 2024. The last one was a blip around 'liberation day'. Then it rebounded quickly. Now it feels more uncertain.

China. Activity data for February was stronger than expected. Industrial production rose an annualised 6.3% over the first two months of the year (a 5.3% gain was expected), with state-driven investment doing the heavy lifting. Retail sales also rose 2.8%, beating expectations of a 2.5% gain. However, this might have been down to the very late lunar New Year holiday, and it doesn't capture the outbreak of war in Iran. In the latest 5-year plan, GDP growth forecasts were downgraded from "around 5%" to "4.5% - 5%". That might not sound much, but for China it's a rare acknowledgement of the slower pace of potential growth that outside observers have been warning of for a long time.

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