



The Strait and narrow

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With developments in the Middle East continuing to shift the balance of power, and Brent crude trading at \$113 per barrel, one might reasonably expect markets to be trading with caution.

Yet, as many clients will have seen from recent portfolio returns, markets have largely looked through the conflict. US equities, in particular, have quietly returned to all-time highs, doing so with remarkably little fanfare.

What, until recently, appeared to be a faltering bull case for mega cap technology and artificial intelligence has reasserted itself as the central engine of this rally. Semiconductor indices have risen over 30% since the start of the month. Reports of the death of the “buy the dip” mentality have, once again, been greatly exaggerated. This almost Pavlovian response to market weakness remains firmly in place. Institutional investors, too, appear committed to capturing every inch of the rebound. In a competitive investment landscape, the reality that one manager’s caution can quickly become another’s outperformance

continues to incentivise staying invested, with only a minority willing to step away from the crowd.

Importantly, this is not purely a story of sentiment. As we move through the first quarter earnings season, the fundamental backdrop has strengthened meaningfully. Twelve-month forward earnings expectations have been revised higher by \$600 billion in just four months, a 12% increase and the largest upward revision outside of a post-recession recovery on record.

This strength is not confined to technology. Around 80% of companies reporting in Q1 have beaten expectations, ahead of the long run average of 77%, with average earnings growth of 12% compared to a typical 7%. These are, by any measure, exceptional conditions. The S&P 500's 13% rally from its March lows reflects just how positively markets have responded. It couldn't have come at a better moment for portfolios. Managers and advisors who collectively extolled the message of "stay invested" have once again proven their worth as stewards of their client's capital.

Looking ahead, our central view remains constructive. Markets are open for business, earnings are growing, demand remains resilient and consumer spending continues to hold up. We expect the US economy to expand through 2026 whilst Europe is likely to deliver modest growth of around 0.5%, while the UK should remain in positive territory, albeit only just above stall speed. In aggregate, this should be sufficient to support continued positive investor sentiment and further market gains, with global equities well placed to outperform.

The optimistic scenario for 2026 centres on a renewed surge in AI driven enthusiasm. Should this gather pace, we could see a more aggressive, sentiment led rally, often referred to as a "melt up". While beneficial for short term performance, rallies driven predominantly by sentiment rather than valuation require careful handling. Our approach remains to participate, while maintaining the discipline to step back before excesses fully unwind. As ever, easier said than done.

There is, however, an important caveat, the longer the strait of Hormuz remains closed introduces a more complex and nuanced set of risks. Whilst this might seem apparent, it does stand in sharp contrast to the current equity market rally which does suggest that investors are not properly factoring in the risks.

To our mind, the immediate risk is a quick resolution appears uncertain and tanker traffic through the strait has effectively halted. The last shipments prior to the escalation are only now reaching their destinations, meaning global supply will remain constrained for some time, even in the event of an immediate reopening.

Markets, for now, appear willing to look through this disruption, arguably pricing in a path towards an immediate de-escalation. That optimism helps explain why equities continue to respond more to earnings strength than geopolitical risk. However, a more durable recovery in both economic conditions and market confidence ultimately depends on a credible resolution and one coming through in the coming weeks. While there is clear incentive for all parties to reach an agreement, the path to one remains far from straightforward. The balance of probabilities suggests a prolonged period of tension and stalemate rather than a swift or decisive outcome. This messy resolution does extend the duration of the strait being closed.

In this scenario, the economic impact becomes increasingly relevant. Disruptions to energy supply are already feeding through into areas such as transport, freight, fertilisers, and industrial inputs, with knock on effects for food prices and broader consumer costs. Higher petrol prices further erode disposable income, raising the risk of a slowdown in discretionary spending and, in time, pressure on those corporate earnings which are currently so strong.

Ordinarily, central banks might offset such a slowdown through lower interest rates. However, when inflation remains above target, as it seems to be heading, their flexibility to stimulate spending is limited. Prolonged disruption in the Strait risks sustaining inflationary pressure, constraining policy support and increasing the likelihood of a more challenging growth environment resulting in the potential of a recession.

Despite these risks, markets continue to focus on the strength of current earnings. That may prove justified in the near term, but it does leave valuations more exposed should the inflationary impact intensify.

From a portfolio perspective, we are prepared for both outcomes. Should tensions ease and the Strait reopen, our full and diversified equity exposure will benefit from continued market strength. At the same time, we have been gradually adding defensive elements around this long equity position. Volatility protection remains attractively priced relative to the risks being discounted and we are looking at buying some of this into client portfolios. If we are wrong and the market rallies we can drop this protection but should markets come under pressure, volatility-based investments can be highly lucrative right at a time when everything else goes in reverse.

Allocations to inflation linked bonds and cash have been increased, providing resilience within portfolios. We also retain a positive long-term view on gold, which typically performs well in environments where inflation rises and confidence in fiat currencies weakens as investors go in search of a more dependable store of value. Our exposure to commodities and selective hedge fund strategies continues to provide diversification and an additional layer of defence against geopolitical shocks.

While the horizon has become more uncertain, our overall stance remains balanced to account for both the bull and bear cases which continue to fight for dominance on a daily basis. We are constructive on markets given the strength of earnings, but increasingly mindful of the risks posed by prolonged geopolitical disruption. As such, we are maintaining equity exposure while incrementally strengthening portfolio defences as previously mentioned.

At its core, our role is one of stewardship. It is not only about capturing returns when conditions are favourable, but also about preserving capital when the environment becomes more challenging. It is only with that dual mandate can we deliver clients a smooth investment journey over multiple market cycles and multiple challenges. Whatever path markets take in the months ahead, we remain focused on navigating that journey with discipline, diversification, and a clear commitment to our clients' long-term objectives.

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