

The lotus effect

The lotus effect is the term used to describe superhydrophobic surfaces: Water droplets almost completely roll off, taking dirt and debris with them. As liquids cannot adhere to these surfaces, grime can be easily wiped off. Just like water on a lotus leaf, many factors of uncertainty seem to be rolling off capital markets without a trace.

For starters, the world is grappling with a multitude of **geopolitical flashpoints**, with Israel's bombing of Iranian nuclear facilities – including air strikes by US forces – triggering the most severe recent volatility. When it comes to weighing up geopolitical event risks, it is important to consider the transmission channels through which shocks such as these could impact the economy and the markets. While it is true that the **oil price** spiked at the time, its level has remained within a normal trading range – and things quickly cooled down again as soon as the spiralling escalation subsided. This is the principal reason why the repercussions for economic sentiment are likely to be limited. As such, apart



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from the oil price, financial markets were also barely ruffled, in turn mitigating the impact on the economy.

Beyond an uncertain political climate, the outlook for the economy and inflation could give investors additional cause for concern. To date, however, many problems associated with the latter have simply been shrugged off as well.

For instance, the fallout of the US government's restrictive trade policies, which were instigated on 2 April, appears to have been contained for the time being. Economically, this is due to a variety of pull-forward effects, particularly for manufacturing industry. Politically, US President Trump's backflip on tariffs and trade barriers has considerably watered down the effect of the policies originally announced at the start of April.

Trump's **90-day pause** ends in the next few days, with uncertainty lingering for companies and consumers. The baseline scenario still entails negative consequences for investment and consumption. Aside from that, even though tariff levels have been temporarily reduced, the US federal government is collecting more money from import duties. This means costs are rising – either for

PUBLICATIONS

→ Fear of going in?

There are signs that "FOGI" – fear of going in – has taken hold among institutional investors amid erratic policymaking and volatility in US markets.

→ The decline of US exceptionalism in Asia?

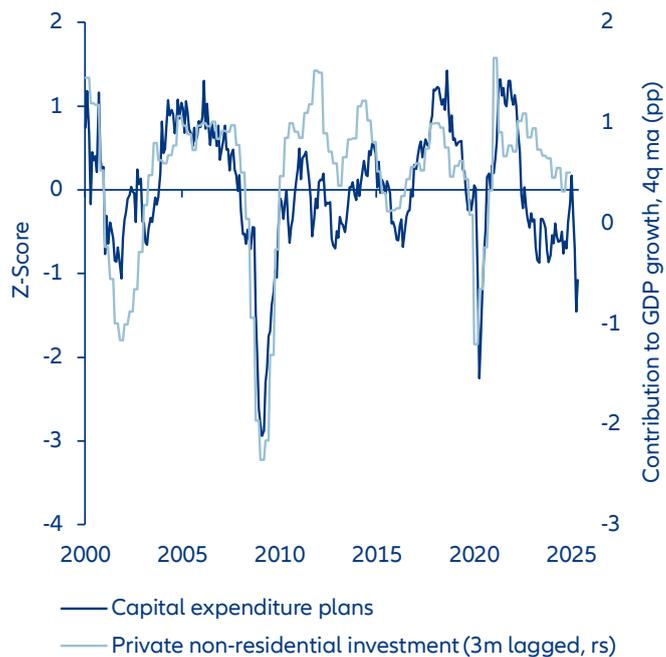
As the world's largest net creditor, we think Asia is uniquely positioned to lead the next wave of capital diversification amid a waning belief in US exceptionalism.

→ Private Markets for all?

The last decade has been an exciting one for private markets. Once the traditional domain of institutional investors, who were often invested in closed-end funds with a very long-term investment horizon, the asset class has changed.

importers or exporters in the form of lower profit margins, or for the consumer in the form of higher prices. So far, the extent to which these effects have filtered through to economic data has been manageable. A large number of suppliers still appear to be selling goods they had stockpiled prior to the tariff

US companies could react to tariff policy with investment restraint



Source: Allianz Global Investors Global Economics & Strategy, Bloomberg (data as of 17 June 2025). Past performance, or any prediction, projection or forecast, is not indicative of future performance.

Market overview as of 01.07.2025

Equity Indices		
DAX		23,673
Euro Stoxx 50		5,282
S&P 500		6,198
Nasdaq		20,203
Nikkei 225		39,762
Interest Rates %		
USA	3 Months	4.33
	2 Years	3.77
	10 Years	4.22
Euroland	3 Months	1.94
	2 Years	1.86
	10 Years	2.60
Japan	3 Months	0.77
	2 Years	0.71
	10 Years	1.40
FX		
USD/EUR		1.181
Raw Materials		
Oil (Brent, USD/Barrel)		67.1

announcement and are monitoring the situation. However, in surveys, they have already indicated that they are prepared to rapidly increase prices. Consequently, there is a danger that an unwelcome combination of dwindling economic activity and higher prices may continue to unfold.

The lotus effect on the capital markets is also being fuelled by hopes, most of all by the hope that the US government, having U-turned several times already, could shy away from policies that are overly damaging to the economy and the markets. In the US, revenues from tariffs could potentially be used to fund an extension of tax cuts originally passed in 2017. At the moment, proposals are even circulating to introduce additional tax relief on items such as overtime and gratuities. Furthermore, markets are hopeful that last-minute agreements could be reached before the 9 July deadline (even if initially just symbolic) to ease tariffs and trade restrictions. Away from the US political scene and its attention-grabbing drama, the hope is emerging that Europe will tackle some of its to-do list (the banking union being one such example), that it will generate more demand and that, possibly, it will even cut some red tape on the supply side. Notably, it is Germany where a few leading indicators are gradually inching up - a first step has therefore been made.

These hopes, in particular, seem to be acting like the lotus leaf's protective film on the capital markets. Some indexes have recently marked new all-time highs, spearheaded by the leading US index the S&P 500. Accordingly, the technical situation looks promising again. Still, while valuations have rebounded after experiencing a striking recovery since the middle of April, the cushion markets have built up is unlikely to be enough to fend off any unexpected negative surprises. Hopefully, the protective film will hold firm.

Take a moment to let daily life just roll off your back once in a while.

Enjoy your summer vacation.

Yours,
Stefan Rondorf

This suggests the following **tactical allocation for equities and bonds**:

- Since mid-April, global equities have staged an impressive comeback and, in the long run, they remain the preferred asset class. In the short term, though, they will be treading a fine line between optimism and naivety. For this reason, it would be advisable to take a neutral position.
- With valuations back to high levels, the **US equity market**, in particular, has potential to disappoint, especially if signs of weaker growth emerge or if tariffs have an impact on inflation rates. A great deal of political uncertainty also persists.
- The prospect of higher demand has seen **European equity markets** recently put in a strong performance. A tentative but steady recovery in “soft” leading indicators may keep hopes alive. These would be supported by any supply-side uplift in the long term; and, in the short term, a de-escalation in the trade dispute with the United States.
- The recovery on the US equity market has largely passed the US dollar by and, therefore, scepticism among investors over the US dollar’s intrinsic value is still omnipresent. A positive side effect of this for US companies is that their non-US earnings are worth more in US dollars. This is likely to have contributed to temporarily reinforcing US profit forecasts.
- Currently, **US Treasury investors** are keeping a close watch on the direction of US fiscal policy. The unsustainable path of US government debt may continue to prove an Achilles heel for the bond markets. In spite of this, US bond markets should retain their role as a hedge against economic risks. The probability of an imminent recession in the United States appears low, however.
- **European bond markets** could be the beneficiaries of reallocations into the euro area. The ECB is likely to push ahead with its interest rate cutting policy, albeit this has already been sufficiently priced in on the money markets.
- Higher exports, a fiscal stimulus and looser monetary policy are driving a modest improvement in China’s growth outlook. However, **China** continues to struggle with deflation after the property bubble burst in 2021. Further patience is called for when it comes to deleveraging the private sector and stabilising the property market. The trade war with the US is not making the task easier.

- Volatility remains the order of the day on commodity markets. Following a de-escalation in the conflict between Israel and Iran, the oil price fell back again. It appears as if the global supply of oil will be slightly higher than demand over the next few months. Consequently, outside of crises, the oil price is likely to move sideways at best.

Investment theme:

→ Investment income in times of disruption

- **Demographics**: The world’s population is growing but at an increasingly slower rate, while life expectancy is steadily rising. The overall global population is aging, and the potential working-age population is shrinking – most dramatically in industrialised economies.
- **Digitalisation**: “Smart machines” are leading to radical changes in employment structures.
- The question as to what kinds of tasks will remain available for humans to perform and how many jobs will be available inevitably leads to the issue of their remuneration. In this respect, the labour economist Richard Freeman envisages a paradigm shift in the relationship between human and mechanised labour. With a hint of irony, he gets to the heart of the matter when he asks, “Are you going to work for the robot or is the robot going to work for you?”¹
- Consequently, factors such as robots and demographics suggest that the time has come for a conversation on investment income to supplement income from work.
- We need more investment income, especially in an age of smart machines and a state pension scheme creaking under the pressure of demographic change. However, it does not end there. Indeed, investment income can be put to a great many more welcome uses: more money for a holiday, for everyday purchases or as a “grandparents’ grant” to support grandchildren during their apprenticeships and university studies, ...
- Investment income can originate from two sources: interest from bank deposits, coupons paid on bonds or dividends paid on equities.
- In conclusion, the time has come not just to focus on the total return of an investment but also on its expected future cash flows. *Why should our money (or the “robots”) not work for us?*

¹ Freeman, R. B. (2018). **Employee and citizen ownership of business capital in the age of AI Robots**. CSR und Mitarbeiterbeteiligung: Die Kapitalbeteiligung im 21. Jahrhundert–Gerechte Teilhabe statt Umverteilung, 101-108. SpringerGabler. Wiesbaden.

If not mentioned otherwise data and information sources are from LSEG Datastream.

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