GIS INSIGHTS

WEEKLY PODCAST

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LOCAL INSIGHT INVESTORS

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TITLE: **Calm Markets, Fine Margins**

TRANSCRIPT:

Host:
Eric, there has been another escalation in the Gulf, oil prices have risen, and concerns around global trade and inflation are returning.
Yet financial markets have remained remarkably calm.
Are investors becoming complacent?

Eric:
Possibly, but I think markets are making an important distinction.
They have stopped reacting simply to the fact that missiles are flying. Instead, they are asking whether those missiles are materially changing the economic outlook.
Geopolitical events can be tragic without immediately becoming systemic for financial markets.
For investors, the key transmission mechanisms are energy prices, shipping costs, inflation and ultimately corporate earnings.
That is why the Strait of Hormuz remains so important.
Roughly one-fifth of the world's oil and gas passes through it. The question is not whether Iran declares the Strait closed. The question is whether ships actually stop moving, insurers withdraw cover and refiners struggle to secure supplies.
So far, traffic has slowed and the cost of transportation and insurance has risen sharply, but the Strait has not experienced a complete and sustained closure.
That explains the market's calm.

Host:
But oil does not necessarily need to reach extreme levels to create problems, does it?

Eric:
Exactly.
The level of oil matters, but volatility can be almost as damaging.
Businesses struggle to plan when energy, freight and insurance costs move unpredictably. Refiners become reluctant to operate at full capacity, airlines face higher fuel costs and manufacturers see pressure building across their supply chains.
We are already seeing refined-product prices, particularly diesel and jet fuel, rise more quickly than crude itself.
That is an important signal.
It suggests that the strain is appearing within the supply chain rather than simply in the headline oil price.
If that continues, inflation could remain higher for longer and central banks will have less freedom to reduce interest rates.
Markets are therefore making three assumptions: that Iran will not sustain a complete closure of Hormuz, that commercial navigation can be protected, and that major energy infrastructure will remain outside the direct conflict.
If any one of those assumptions fails, the investment environment changes quickly.

Host:
Technology shares also came under pressure this week, despite continued evidence of enormous spending on artificial intelligence.
What has changed?

Eric:
The market is beginning to ask a more difficult question.
For the past two years, the question was whether AI demand was real.
We now know that it is.

Companies are spending heavily on semiconductors, data centres, electricity generation and digital infrastructure. American capital-goods imports have reached record levels, so the investment is clearly appearing in the real economy.
But investors are now asking whether all that capital will generate an adequate return.
That is a very different question.
Strong demand for chips does not automatically mean every semiconductor company deserves a higher valuation. Nor does record spending guarantee that the companies financing it will earn attractive returns.
Samsung produced very strong profit guidance and its shares still fell. The SK Hynix listing attracted enormous demand, but investors were unwilling to accept the valuation initially sought.
Those examples suggest that the market is becoming more selective.
AI revenue, AI profit margins and the cost of building AI infrastructure are three different things. Investors are finally beginning to distinguish between them.

Host:
Does that mean the AI investment cycle is coming to an end?
Eric:
No. It means the cycle is maturing.
The spending remains substantial, but the easiest stage of the trade may be behind us.
The next phase is likely to reward the companies that provide genuine bottlenecks: power infrastructure, specialist equipment, cooling systems, memory chips and businesses with real pricing power.
Simply owning a broad collection of AI-related shares may no longer be enough.

Host:
Where does this leave the wider global economy?
Eric:
The economy has been surprisingly resilient.
Business activity remains in expansion territory, American consumers are still spending and parts of Europe and Japan are improving.
But resilience is not the same as immunity.
Household savings are low, government debt is high and inflation was already proving stubborn before this latest energy shock.
That means the global economy can absorb further disruption, but with a much narrower margin of safety.

Host:
So what should investors be watching now?
Eric:
Follow the economics rather than the political announcements.
Watch the ships moving through Hormuz.
Watch shipping insurance and refined-fuel prices.
Watch whether banks begin reporting weaker credit quality.
And watch whether semiconductor companies continue committing capital at the same pace.
Markets are calm because the economic damage remains contained.
But calm markets should not be confused with comfortable markets.
The margin for error is becoming increasingly fine.

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