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Tariffs & Turbulence

Why Quality Counts

CRAWFORD
INVESTMENT COUNSEL
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Tariffs are certainly front of mind today for international businesses, consumers, and all market participants. Given the news flow and stock market gyrations, we feel it is appropriate to comment on the subject given its prominence in recent headlines. We have been of the opinion that fair trade across borders is generally a good thing. Our intent here, and in practice, is to be objective observers of unfolding events in the hopes of correctly evaluating their impact on the future course of the economy.

Let's start with the basics. Tariffs are government-imposed duties on imported goods, and they have multifaceted effects on businesses and the broader economy. On one hand, they can protect domestic industries by making imported goods more expensive, potentially benefiting domestic producers. On the other hand, tariffs can increase costs for companies reliant on imported materials that go into finished goods, leading to higher prices for consumers and potential decreases in profit margins. Tariffs have the potential to disrupt supply chains, alter competitive dynamics, and introduce volatility into financial markets. These potential effects only serve to underscore the importance of our fundamental, bottom-up research process and high level of scrutiny in our company due diligence and investment decision-making process.

We have yet to understand the impacts of the tariffs, but in the face of uncertainty, we believe that investing in high-quality companies is the best way to insulate any investment portfolio from potential exogenous risks, such as political policies or macroeconomic headwinds. At Crawford, this means identifying businesses with robust competitive positions, operational efficiency, and strong management teams that possess above average financial flexibility in terms of balance sheet strength. We believe companies with these characteristics should have the propensity to navigate tariff-related challenges effectively. A few examples are outlined below.

First, we search for businesses that have the ability to pass increased costs onto their consumers without significantly affecting demand for their products or services. Think about a global consumer goods company with a strong brand reputation. If tariffs raise the cost of imported raw materials required to produce goods, the business could likely slightly increase prices without significant pushback from customers due to its brand loyalty and premium positioning. At Crawford, we are focused on businesses with strong competitive positions that have products and services that are perceived as essential or superior.

Next, we prefer businesses that possess operational efficiency. Businesses of this nature can help absorb additional costs imposed by tariffs, maintaining profitability even under cost pressures. Here, consider a large industrial manufacturer that implements efficient production techniques and automation to optimize efficiency. When tariffs increase the cost of imported components, the business can offset those added expenses by improving productivity and reducing waste rather than compromising margins or raising prices excessively. Our process seeks to identify businesses with strong cost controls and efficient operations.

Finally, we believe businesses with strong management teams have a better propensity to navigate complex regulatory environments and make strategic decisions to counteract the negative effects of tariffs. Effective management teams with incentives that are aligned with shareholders make sound decisions such as supply chain diversification, ensuring that no single supplier or region dominates its production. This is just one example of how a business with a strong management team is more likely to adapt quickly to trade restrictions, minimizing the risks to the business. We assess management team strength and alignment as a key component of our decision-making framework.

We believe our focus on quality insulates our investors from many of the risks imposed by the political and macroeconomic environment today. Many of our readers know that we are focused on those companies that pay and preferably raise their dividends as an indicator of balance sheet strength, earnings consistency, shareholder-friendly management, and overall operational strength. All of these factors should reduce the range of potential investment outcomes and enable investors to navigate these uncertainties successfully. At Crawford, our commitment to investing in quality remains steadfast, providing our clients with the confidence to invest and stay invested, regardless of the broader landscape at hand.