Trade finance and tariffs

When down is up and South is North

Tariffs continue to dominate headlines, drawing the focus of policymakers, businesses and consumers alike. These trade barriers, often enacted to shield domestic industries, can have profound effects on global commerce. A well-structured trade finance strategy offers investors the potential ability to seize these emerging opportunities.

Since 2007, Federated Hermes has offered investors access to shorter-term trade finance loans that support cross-border transactions between exporters and importers. These self-liquidating investments are secured by the underlying goods and typically float at a spread over short-duration benchmarks like the Secured Overnight Financing Rate (SOFR). This structure offers low interest rate and credit duration exposure, which can make it well-suited for volatile risk environments.

To help mitigate risk, we incorporate safeguards such as permanent control of goods' titles, ring-fenced cash flows and various insurances. The structure of each investment is tailored to the specifics of the transaction, the countries involved and the credit quality of the counterparties.

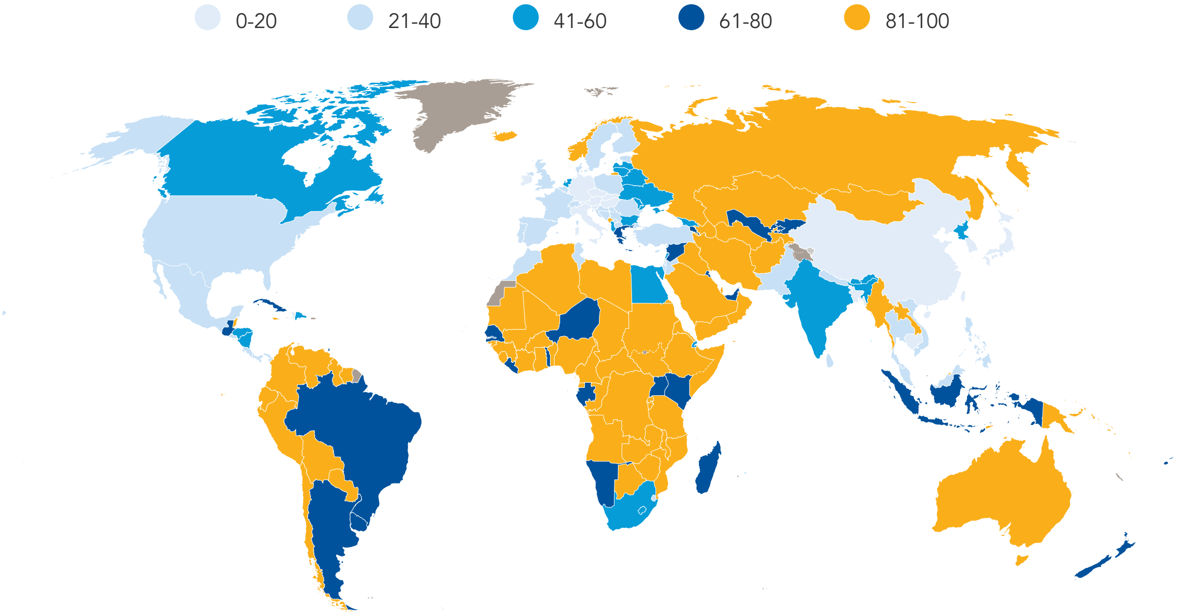
In today's shifting tariff landscape, we believe a well-structured trade finance strategy must balance risk mitigation with the agility to seize emerging opportunities.

Understanding global flow

A successful trade finance strategy begins with a deep understanding of trade flows—particularly the dynamics between North-North and South-South trade.

- **North-North trade** involves high-income economies like the US, Canada, EU nations, Japan and South Korea. These routes typically involve manufactured goods—electronics, vehicles, and machinery—often shipped via containers.
- **South-South trade**, on the other hand, connects developing economies such as Brazil, India, China and South Africa. Here, the focus is on essential goods—food, fuel and medicine—with two-thirds of these economies being dependent on these exports.

Figure 1. Commodities as a percentage of merchandise exports



Source: UN Conference on Trade and Development (UNCTAD)

As shown in the chart above, between 2020 and 2022, 66% of developing countries—and 80% of least developed countries—remained in commodity dependence, with over 60% of their merchandise exports derived from primary commodities. Essential goods are often shielded from high tariffs to ensure affordability and prevent social or economic disruption. Manufactured goods, being less critical to immediate survival, are more likely to face higher tariffs aimed at protecting domestic industries or adjusting trade balances.

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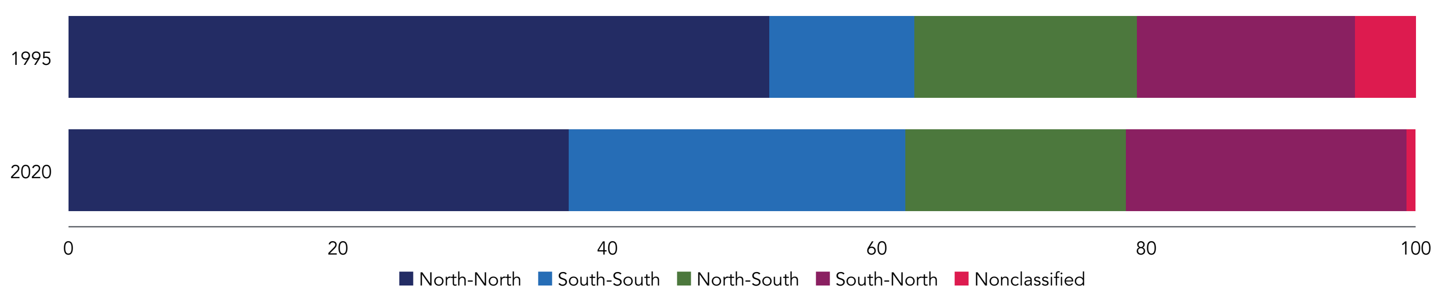
Figure 2. Essential goods vs. manufactured goods

	Essential goods	Manufactured goods
Trade directions	Primarily South to South	Primarily North to North
Focus	• Raw materials • Agricultural products • Energy resources	• Finished products • Machinery • Electronics
Examples	• Grains • Minerals • Crude oil	• Automobiles • Textiles • Technology
Shipping	• Primarily bulk shipping	• Primarily container shipping
Finance	• May involve pre-export finance, supply chain finance or commodity trade finance to support production, storage and transportation	• May involve letters of credit, purchase order finance or invoice discounting
Risk profile	• Price volatility	• Complex supply chains • Quality control • Long production times

The last 25 years have seen a notable shift. Developed economies' share of global trade has declined by almost 15%, while South-South trade has grown by 14.1%, according to UNCTAD. While North-North trade still accounts for 37.1% of global flows, South-South trade now accounts for 25%—a sign of changing global dynamics.

Figure 3. South-South trade growth, 1995-2020



Source: UNCTAD Trade and Development Report, 2022

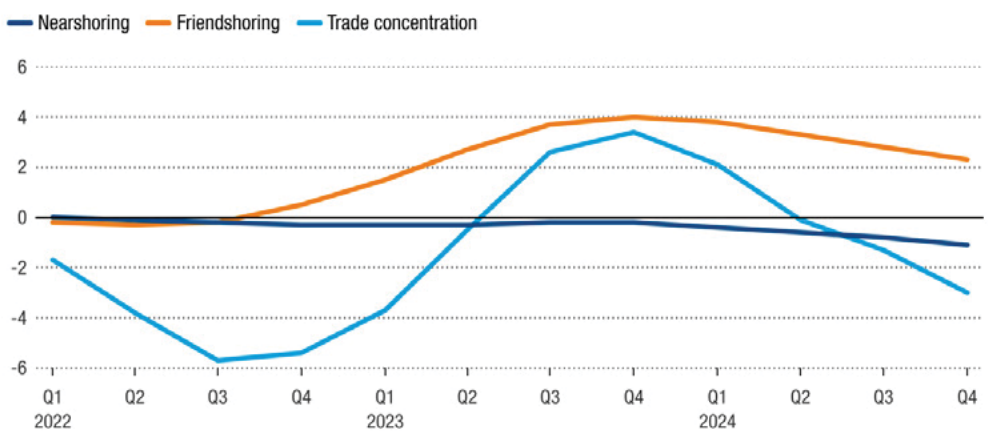
Supply chain strategies

In a world of shifting trade policies, consideration of supply chain strategy may be more critical than ever. Companies which have previously adopted strategies like below are now shifting to accommodate the resurgence in trade between geographically distant countries.

- **Nearshoring** focuses on relocating production or sourcing closer to the company's home country, reducing shipping times and costs while improving supply chain resilience.
- **Friendshoring** involves relocating production and sourcing to countries that share similar political and economic values, aiming to reduce geopolitical risks by partnering with trusted allies.
- **Allyshoring** is similar to friendshoring and emphasises reliance on countries with strong diplomatic ties, focusing on building supply chains with strategic allies to enhance security and stability.

Figure 4 illustrates the evolving dynamics of nearshoring and friendshoring in relation to trade concentration, which reflects the degree of diversification in a country's exports. As shown, both friendshoring activity and trade concentration reached their peak in 2023 before beginning to taper off in 2024. And while friendshoring activity remains above 2021 levels, it has also steadily declined throughout the year. This indicates a shift away from trade among geopolitically-aligned nations, which we believe the introduction of new tariffs is likely to further accelerate.

Figure 4. Nearshoring, friendshoring and trade concentration trends



Source: UNCTAD, 2021–2024

Conclusion: The need for a resilient and adaptive Trade Finance Strategy

Over the last five years, international trade supply chains have undergone significant transformations due to geopolitical tensions, technological advancements and changing consumer expectations. These forces are driving a broader transformation toward supply chains that are more resilient, transparent and sustainable.

Views are as August 2025 and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Past performance is no guarantee of future results.

A word about risk

Diversification does not assure a profit nor protect against loss.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Trade finance-related securities will be located primarily in, or have exposure to, global emerging markets. International investing involves special risks including currency risk, increased volatility, political risks and differences in auditing and other financial standards. Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested.

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