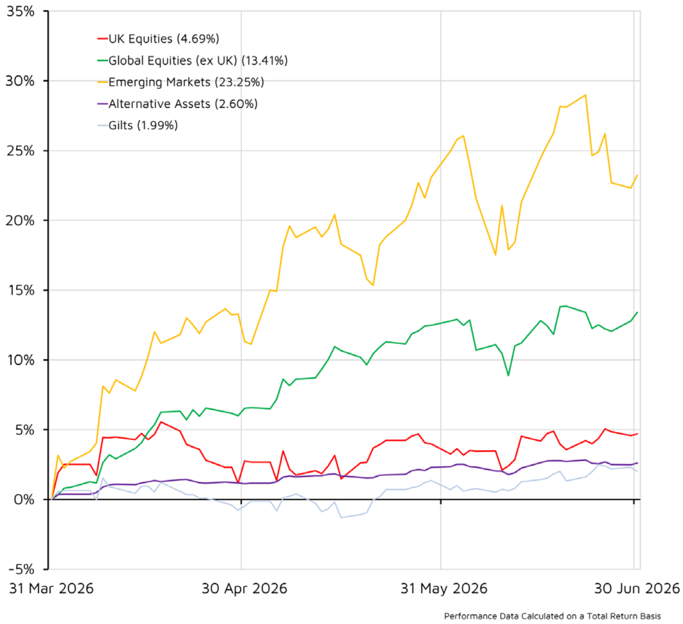
SUMMER OUTLOOK

REVIEW OF THE PAST QUARTER:

The tech rally roared back this quarter. Investors looked past the energy shock and chased the AI trade as sentiment was helped by strong first-quarter US earnings. Big tech firms earmarked $750bn for AI spending in 2026, and chipmakers and hardware firms saw revenues surge as buyers scrambled for scarce supplies. Confidence replaced fear and several leading AI companies, including SpaceX, kicked off IPOs at trillion-dollar valuations. Every developed market except the UK posted double-digit gains, led by technology and communications. South Korea soared 70% on its chip boom, while Brazil slumped as foreign money fled.

Oil and gas prices were calmer than feared. Iran's blockade of the Strait of Hormuz remained in place, and millions of barrels of daily output remained halted. Even so, crude oil touched $126 a barrel before falling well below $80 on news that Iran and the US would permanently end the fighting.

Bonds took a bumpier road but finished with modest gains. Early on, investors braced for stagflation as higher energy costs and shipping disruption stoked inflation fears, and bets swung from rate cuts to rate rises. The mood turned when a framework for negotiations was signed by US and Iran in mid-June. Inflation also came in softer than expected, wage growth stayed weak, and gilts and European government bonds rallied. US treasury bonds followed, trailing gilts, and investment-grade corporates outperformed government debt.



ASSET CLASS RETURNS

Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	EmergingMarkets	Alternative Assets
+0.89%	+1.99%	-1.05%	+2.57%	+4.69%	+13.41	+23.25%	+2.60%

MARKET OUTLOOK:

Both Washington and Tehran want the fighting over. A short-term deal has reopened the Strait of Hormuz, with more talks to follow, though shipping companies remain wary of renewed conflict. Lost production should keep oil and gas prices near current levels in the short-term but oil supply is expected to overshoot early in 2027 bringing downward pressure on energy prices and supporting consumer activity and company profits. Less inflationary pressure means the rate hiking cycle from central banks may be shallower than forecast only a few weeks ago. In the US, Jerome Powell has been replaced by Kevin Warsh as chair of the Federal Reserve. Investors will be watching the July and September meetings for the cuts US president Donald Trump wants. Warsh hopes to scrap forward guidance, the projections and the 'dot plot' and has so far appeared more open to interest rate hikes than expected.

In equities, the AI revolution shows no sign of slowing. It is a secular force lifting investment and earnings expectations, and the cash needed for mass adoption has reversed a two-decade trend. After 20 years of buybacks, the US market has stopped shrinking. Goldman Sachs forecasts $225bn of new IPOs this year, and $675bn once other share offerings are counted, with more to come. AI spending is likely to continue to support emerging market equities and any pickup in manufacturing is likely to see any rally broaden from its reliance on technology stocks.

WHAT TO LOOK FOR IN THE NEXT QUARTER:

- **UK:** Bank of England interest rate meetings on 30 July and 17 September. The Office for National Statistics publishes inflation figures on 22 July, 19 August and 16 September. GDP growth for the second quarter is due in mid-August.
- **US:** Federal Reserve interest rate decisions on 29 July and 16 September. These are the first meetings led by Kevin Warsh, who took over as chair in May. CPI inflation data for June due on 14 July. Official estimate of second-quarter growth is due on 30 July. The non-farm payrolls monthly jobs report is due on 2 July and 7 August. The Kansas City Fed hosts the Jackson Hole symposium of central banks from 27 to 29 August.
- **Eurozone:** European Central Bank interest rate decisions on 23 July and 10 September. GDP for the second quarter is due on 30 July, and the July inflation reading is released on 31 July.
- **Other:** The Bank of Japan interest rate decisions on 31 July and 18 September. China releases its second-quarter growth figures along with industrial output and retail sales on 15 July.

ASSET CLASS SCENARIOS:

UK EQUITY

Most likely: The UK is in a better position as inflation falls below expectations and much of the energy shock eases, even though the situation remains fragile allowing the Bank of England a cautious approach to raising rates. Large companies with global earnings should remain resilient, while quality domestic companies and rate-sensitive sectors recover if inflation stays contained. Smaller companies and lower-quality cyclicals face greater challenges.

Worst Case: The Middle East conflict re-escalates, pushing oil and gas prices up again and reviving pressure on household bills, transport costs and profits. UK inflation accelerates and the Bank of England considers rate hikes. UK equities fall, with consumer-facing and smaller companies underperforming, while energy and defensives provide only partial protection.

Best Case: Energy prices fall, allowing inflation to cool. As growth is modest and the labour market softening, the Bank of England is able to focus on stimulating growth and consumer demand. UK equity gains would broaden out from energy and defensive companies, supported by low valuations, firmer real incomes and an improved confidence.

GLOBAL EQUITY

Most likely: Inflation eases but stays above target as central banks delay interest rate decisions. US equities grind higher, with AI and mega-cap technology leading. In Europe, government support for defence and infrastructure maintains growth at a low level. Domestic defensive stocks beat exporters. In Japan, resilient wages and spending support domestic sectors, while governance reforms lend modest support.

Worst case: Conflict drags on pushing oil back above $100. Central banks keep rate high and growth slows. US equities fall sharply, led by tech stocks as AI spending slows and crowded positions unwind. The energy shock tips Europe into stagflation. Aggressive Japanese rate tightening and global fear lift the yen and drag equities lower.

Best case: The war ends and energy prices settle, disinflation speeds up allowing central banks signal cuts. The US rally broadens. In Europe, lower inflation and stronger spending and investment, especially in defence and the green transition, help the region outperform as exporters recover. In Japan, firm wages, fiscal stimulus and a global recovery lift both domestic and export earnings.

EMERGING MARKET EQUITY

Most Likely: The Fed holds rates through 2026 as inflation slows, providing a steady backdrop. The US dollar stays broadly stable to mildly softer, supporting capital flows into emerging markets. Tensions between the US and Iran keep oil prices high but range-bound, which supports exporters while weighing on importers. The tech sector is the driver of performance, led by semiconductor manufacturers.

Worst Case: The US-Iran war resumes and triggers an energy shock. The strong US dollar triggers capital flows out of emerging markets. China weakens further, while Taiwan and South Korea face a downturn as AI investment stalls. Oil-importing emerging markets enter acute stress, pushing several into recession. Even oil exporters struggle amid collapsing global demand, leaving few emerging markets unscathed.

Best Case: A US-Iran peace agreement drives a sharp decline in oil prices and removes geopolitical uncertainty. Disinflation allows the Fed to cut rates, weakening the US dollar and increasing capital inflows into emerging markets. China recovers, supported by resilient exports, while Taiwan and South Korea benefit from renewed AI-led semiconductor demand.

CASH

Most likely: Money-market returns stay firm as the Bank of England holds rates near current levels. Inflation sits above target, but the worst of the energy-driven pressure has eased since the Middle East ceasefire took hold. The committee is divided and wants clearer evidence before its next move. While it waits, cash and money-market funds keep offering steady, low-risk returns at attractive levels.

Worst case: Energy pressures keep fading and inflation resumes its path towards target. With global tensions easing, the question becomes when the Bank starts cutting again, not whether it raises rates. Falling rates would slowly reduce the return on cash, supporting a move towards shorter-dated bonds and other assets. Even so, many investors hold some cash for safety while the outlook settles.

Best case: Renewed conflict pushes energy prices higher, while sticky services inflation proves hard to shift. The Bank of England raises rates rather than resuming cuts, and the more hawkish voices on the committee grow louder. Higher rates lift money-market returns and strengthen the case for holding cash, even as longer-dated bond funds come under pressure from rising yields.

FIXED INCOME

Most Likely: The Bank of England holds rates as wage growth slows, demand cools and energy prices fall. Gilts gain, led by shorter maturities. UK gilts outperform US and German bonds, though the pound softens. Sterling investment-grade bonds rise as yields fall, but high yield bonds trail. Index-linked gilts gain modestly and offer cover if conflict returns.

Worst Case: The ceasefire collapses and fighting resumes. Energy prices jump, inflation fears return and the Bank of England considers rate hikes. Gilts sell off as borrowing worries deepen sending yields back towards their recent highs. Sterling investment-grade bonds fall as high yield bonds suffer most as defaults loom. Index-linked gilts hold up best, helped by rising inflation expectations.

Best Case: Peace in the Middle East means oil prices remain stable, though they do not fall to pre-war levels. UK inflation cools and the Bank of England cuts more than markets expect and gilts rally across all maturities. Sterling investment-grade bonds lead the gains as yields fall and high yield bonds recover. Index-linked gilts trail ordinary gilts as inflation cover loses its value.

ALTERNATIVES ASSETS

Most Likely: Energy prices ease but stay firm. Commodities and natural-resource equities benefit from resilient growth, structural demand from electrification and AI, and their inflation protection. Gold and silver are supported by some central-bank buying. UK property recovers gently as gilt yields fall. Energy infrastructure and utilities benefit from rising electricity demand, grid investment and energy security.

Worst Case: A peace deal in the Middle East and fast recovery in supply sees energy prices fall. Gold and silver give back part of their wartime gains. UK property is the clear winner as falling yields and better growth lift values. Infrastructure gains from lower borrowing costs, despite softer energy prices.

Best Case: Commodities and natural-resource equities rally as renewed fighting in the Middle East renews supply disruption and instability reinforces their role as inflation hedges. Gold and silver climb to fresh highs as investors seek safety. UK property falls as gilt yields rise and the growth outlook worsens. For infrastructure, energy-linked assets gain while higher borrowing costs weigh on the rest.

Data Sourced from FE Analytics