

Markets shrug off geopolitics and stay near highs

Commentators point to the apparent disconnect between subdued economic growth, persistent inflation (and hence upward pressure on interest rates), conflict-induced geopolitical tensions and yet rising asset prices. We suggest other dynamics have been at work.



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Almost four months after the first missiles being launched at Iranian targets global equity markets are within a whisker of all-time highs and investor sentiment is also riding high by many measures. Is the outlook really that rosy?

Higher oil prices may not represent economic disaster after all

2026 has proved a fascinating period. Given that the US and Iran remain short of a comprehensive agreement, fueling Israel's security concerns, one could argue that energy markets are remarkably relaxed.

Perhaps commentators have overlooked Iran's needs to sell oil as much as others need to purchase it; and the availability of now significantly depleted inventories. Global demand may be subdued relative to historic levels (particularly in China), yet the ability of producers to reroute supply probably means that the world is now better able to absorb an energy shock.

Anchoring the bond market is paramount for central bankers

The knock-on consequences of conflict, temporary spikes in oil and stickier inflation may cause a headache for central banks. Indeed, the European Central Bank's June decision to raise interest rates despite sluggish economic growth looks curious, given that much of the European region's 3% plus inflation has little to do with strong demand.

Key points

- Geopolitical and political events continue to dominate the news headlines, even as equity prices have hit new highs.
- Oil prices have quietly declined to levels just below those seen prior to the US/Israel and Iran conflict.
- Private credit markets continue to exhibit signs of (orderly) stress but not signalling systemic problems ahead.
- Corporate health looks strong, particularly US company margin expansion and expectations for future earnings growth.
- Following a strong start to 2026, several clouds have gathered so we are not surprised to see markets take a breather here.

Other central banks also look constrained by inflation, with the Bank of England holding rates at 3.75% in the UK despite subdued growth. In the US, we think recently appointed Fed Chair Warsh will likely seek to optimise for inflation and economic growth simultaneously while disregarding pressures from President Trump.

Future inflation trends lie at the heart of central bank analysis because inflation, via interest rates, influences virtually all asset prices. As rates move higher (and, commensurately, bond yields), so does the opportunity cost of holding gold, while asset valuations decrease (assuming everything else stays the same).

This long-standing relationship represents a further curiosity for investors this year. The fact that for the most part equity valuations haven't declined (and in some cases have got more expensive) leads us to the next most important story of this year – earnings.

Earnings momentum underpinning markets

Most of our client portfolios comprise investments in companies' equity or their debt. Whilst news headlines tend to focus on politics, geopolitics and the economy, we spend as much time examining corporate health and wellbeing, particularly cash flow generation and profit growth.

Political turbulence returns to Westminster

The resignation of the UK's Prime Minister, Sir Keir Starmer, just two years after Labour's landslide election victory, has dominated UK headlines. His successor will be the seventh Prime Minister in little more than a decade and inherit a policy trilemma: obstacles to borrowing more (fiscal rules), increasing taxes (manifesto pledges on core taxes) and/or cutting back on spending (back bench pressure from marginal seats).

Generally voters are increasingly dissatisfied, blaming leaders who seem unable to solve the myriad issues, including high immigration, the rising cost of living, high youth unemployment and rising tax burdens on individuals and companies.

The need for government investment in ageing infrastructure, defence assets, clean energy and healthcare modernisation is clear. However, without stronger economic growth or cuts in welfare spending, investors potentially face higher taxes, increased borrowing and further pressure on growth. For this reason, portfolio holdings of UK and other government debt remain short term and limited.

Despite all the challenges associated with the Trump regime's imposed tariffs; supply chain issues stemming from the closure of the Strait of Hormuz, and localised tax hikes (UK) amongst others, the resilience of corporate earnings during this period of geopolitical turbulence has been of significant comfort for investors.

Indeed, looking at the world's largest economy, the growth in US corporate profits has been spectacular. The most recent quarter's results show that for the 500 largest US companies in aggregate, profits rose by 29% year over year with seven out of eleven industry categories delivering double-digit gains. This marks the sixth consecutive quarter of double-digit gains, so it is clearly no one-off, although real wage growth has stagnated.

Technology companies represent around a third of the US market and half of all corporate spending is now allocated to technology. With the advent of artificial intelligence and its rampant build out, we remain constructive, even if we acknowledge pockets of speculative excess, such as SpaceX shares briefly trading at more than 100 times revenue.

Closing thoughts

As we assess today's data across economies and markets to guide portfolio construction, we conclude that much of today's bad news is already well known, even if it is not fully discounted.

By contrast, we do not think investors fully appreciate the tech productivity story unfolding in corporate America. Barring an unpredictable shock, we believe earnings growth, supported by expanding margins, will continue to underpin the relatively high valuations seen in markets today.

We are keeping a close eye on inflation and the bond market's reaction to that data in case central banks decide to spoil the party, a risk we see as probably the biggest for investors in the months ahead.

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