

Energy and bond markets test the earnings story

Oil's renewed spike, a coordinated turn in central bank policy and a sharp sell-off in government bonds have shifted the backdrop for investors. For now, corporate earnings are doing the heavy lifting.



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In our last letter we noted that higher energy prices had the potential to feed into inflation and pressure growth, and that central banks were reassessing the outlook. Over the summer, that risk has moved from the margins to the centre of the investment debate.

Oil has spiked again; central banks have moved from patience to action and government bond yields have broken through levels not seen in more than two decades. Yet corporate earnings continue to deliver. How concerned should investors be?

Why has oil become the dominant variable again?

After drifting lower into the early summer, oil has once again become the dominant macro variable. In early September, Brent crude rose to around \$97 a barrel amid a wave of US-Iranian strikes in the Strait of Hormuz and went on to reach \$113 shortly afterwards, before moderating marginally into month end to close at \$104, up 14% for the month.

The shortfall is physical rather than speculative. We see that Saudi Arabia produced 5.97 million barrels a day in August, against a target of more than 10 million.

The crude price only tells part of the story. We read that refining margins in the Atlantic Basin hit record levels in August, driven by a sharp rise in the premium for diesel. Diesel, jet fuel and petrochemical feedstocks sit at the base of freight, aviation, agriculture, plastics and manufacturing costs. That makes this a second-round inflation problem, not just a headline one, and it is precisely the kind of inflation central banks find hardest to ignore in our opinion.

Key points

- After easing into the early summer, oil prices have spiked again as disruption in the Strait of Hormuz has intensified. The inflation consequences extend well beyond the petrol pump.
- The Federal Reserve, European Central Bank and Bank of Japan have all raised interest rates this quarter. The Bank of England held, but only narrowly.
- Government bond yields have risen sharply, and the US 10-year Treasury yield has broken decisively above 5%.
- Europe enters winter with gas storage well below normal, leaving the region exposed to high spot prices.
- US corporate earnings remain the standout positive. The latest reporting season was exceptionally strong.
- Our stance remains constructive, though increasingly selective.

How are central banks responding?

As the year has progressed, central banks have increasingly moved from patience to action. The ECB, which raised rates in June, did so again on 10 September, taking its deposit rate to 2.5% and warning that Middle East-driven inflation would keep prices above target for an extended period.

In the US, the Federal Reserve delivered its first rate increase since 2023, a unanimous 12-0 vote that lifted the target range to 3.75-4%. It appears sixteen of nineteen policymakers expect at least one further increase this year. Chair Warsh has been firmly focused on credibility, describing inflation as having been too high for too long.

Japan has also accelerated. The Bank of Japan raised its policy rate to 1.25%, the highest level since 1995, in a 7-2 vote just three months after its previous move. The Bank of England held Bank Rate at 3.75%, but the decision was closer than it looked. Three MPC members voted for an increase, and the Bank now expects inflation to rise to slightly above 4% in early 2027.

What is the bond market telling us?

The consequence has been a significant repricing of government debt. The US 10-year Treasury yield has risen beyond 5.2%, its highest level since May 2002, breaking through a 5% ceiling it had been pressing against for two weeks. Pressure has also come from heavy corporate borrowing, with AI companies raising more than \$1.5 trillion of debt this year, as well as signs of softer demand at Treasury auctions.

This looks like a global phenomenon, with government bond yields in France, Germany, the UK and Japan at multi-year or multi-decade highs.

The real economy feels this directly. It is reported the average US 30-year fixed mortgage rate has climbed to beyond 7.4%, up by over 0.6% since Chair Warsh's Jackson Hole speech. Higher yields also act as a higher discount rate on all future cash flows. Our decision to maintain a below benchmark duration stance for government bond holdings has served clients well this quarter.

Europe's winter problem

Europe had been counting on the Middle East conflict easing in time for cheaper summer gas buying. It has not. By mid-September, we understand EU gas storage was around 69% full, against 81% a year earlier and a five-year seasonal average of 84%. German inventories are especially depleted at roughly 56%, and Qatari force majeure now extends into early November. The result is a scramble for spot cargoes at rising prices, with the front-month Dutch TTF gas contract trading above €82 per MWh.

We view the timing as unhelpful. Short-term Russian LNG contracts have been banned since 25 April, and long-term contracts must end by 1 January 2027, removing a further source of supply in the middle of winter. For a region already contending with sluggish growth and rising interest rates, a cold winter would be an unwelcome combination.

Is there a path to resolution?

Neither of the major conflicts show convincing signs of easing. The Middle East shows no obvious diplomatic path, and uncertainty persists over whether any formal agreement to reopen the Strait of Hormuz is achievable. In Ukraine, President Zelenskyy has called for a trilateral meeting with Presidents Trump and Putin and discussed an energy ceasefire, but fighting continues.

Geopolitical turbulence is now the baseline rather than the exception, and we believe portfolios need to be built accordingly.

Why are equity markets holding up?

Against this backdrop, corporate America continues to deliver. The second-quarter reporting season looks the strongest in years, with blended S&P 500 earnings growth of 50.4%. That figure was flattered by one-off gains at Alphabet and Amazon, but even excluding these two companies, the blended S&P 500 growth rate was calculated as 32%, marking the seventh consecutive quarter of double-digit earnings growth. Revenue growth of 15% was the highest since the fourth quarter of 2021, with semiconductor revenues reported up 77% and energy sector revenues up 43%.

Two further points stand out for us. First, analysts are not cutting forecasts despite higher energy costs. Third-quarter earnings are expected to grow by 28.5%, and we saw analysts raise their estimates through July and August. Second, strong earnings growth has outpaced share price gains, so valuations have moderated. The forward price-to-earnings ratio stood at 19.0x at the time of writing. That offers a measure of protection against the higher discount rates now being applied.

How are we approaching the current environment?

The quarter has confirmed the risk we flagged in June. Central banks have stepped in, and the bond market is demanding more compensation for inflation and fiscal risk. The energy shock is broader and likely more persistent than markets assumed over the summer, and Europe looks particularly vulnerable this winter.

Yet the corporate engine continues to fire. Earnings growth, supported by expanding margins and the ongoing technology investment cycle, has underpinned equity market resilience. It remains the core of our constructive, though increasingly selective, stance. We will be watching inflation data, bond auctions and European energy markets closely over the coming months, and we look forward to updating you again soon.

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Sources. Market data as at 23 September 2026 unless otherwise stated. Sources include FactSet, the International Energy Agency, the Federal Reserve, the European Central Bank, the Bank of Japan, the Bank of England, Gas Infrastructure Europe (AGSI+) and Trading Economics.

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