

## What we liked



- **US Federal Reserve Holds Rates Steady:** The US Federal Reserve held its interest rate steady at 3.50–3.75%, signalling it would only cut further if economic data supported it. Minutes showed officials divided, with some wanting to pause given inflation still running near 3%.
- **US Inflation Continues to Cool:** US inflation continued to cool, with the Consumer Price Index (a measure of the cost of everyday goods and services) falling to 2.4% annually in January – the lowest since May 2025. The jobs market remained stable, with unemployment holding at 4.3%.
- **China Exports Surge, Trade Surplus Hits Record:** China's exports surged 21.8% year-on-year in January–February, smashing forecasts of 7.1%, as its trade surplus hit a record high – a sign of strong global demand for Chinese goods despite ongoing trade tensions with the US.
- **China Industrial Output and Retail Sales Beat Forecasts:** China's factory output rose 6.3% and retail sales grew 2.8% in January–February, both beating forecasts, driven by strong holiday spending over the Lunar New Year period.
- **Japan PMI Hits 33-Month High:** Japan's business activity expanded at its fastest pace in 33 months in February, with growth momentum now outpacing the United States – a notable reversal.
- **UK Business Activity at 22-Month High:** UK business activity grew at its fastest pace in 22 months in February, one of the strongest readings among major developed economies and a sharp turnaround from the prior year.
- **Eurozone Business Outlook Brightens:** The broader eurozone business outlook brightened noticeably in February, with improving confidence and higher growth forecasts for 2026 driven largely by Germany's spending push.

## What we didn't like



- **US-Israel Strikes on Iran:** Middle East conflict escalates. The US and Israel struck Iran on 28 February, triggering retaliatory attacks, the death of Supreme Leader Khamenei, regional airspace shutdowns, and serious threats to the Strait of Hormuz – a key shipping lane carrying around 20% of the world's oil. This single event became the dominant global market story heading into March, raising inflation, energy, and growth risks worldwide.
- **RBA Surprises with Rate Hike:** The Reserve Bank of Australia (RBA) surprised markets by raising the cash rate by 0.25% to 3.85% in February, bucking the global trend of rate cuts. The RBA cited strong consumer spending and a tight jobs market as risks of a wage-price spiral – where rising wages push prices higher in a self-reinforcing loop.
- **US Wholesale Prices Jump:** US wholesale prices (a measure of what producers charge before goods reach consumers) jumped 0.7% in February, a sharp rise that signals inflation pressures are still building in the pipeline.
- **US Jobs Market Weakens:** The US shed 92,000 jobs in February – well worse than the forecast loss of 50,000 – with severe winter weather and a major healthcare worker strike contributing to the weak result.
- **US Services Sector Unexpectedly Accelerates:** The US services sector (businesses like restaurants, banks, and healthcare) unexpectedly accelerated in February, with the ISM Services PMI hitting its highest level since November 2022 at 56.1 – a reading that complicates hopes for further interest rate cuts, as a strong services sector can keep inflation elevated.

## BASE CASE

Our view of the most likely scenario for markets over the coming months, for which our portfolios are currently positioned.



# 75% Probability

Heading into February, company profits were solid, governments were spending to support growth, and credit was flowing freely. That constructive backdrop, while still present, is now being meaningfully tested by the Iran conflict. Higher energy prices are pushing up costs across the economy, and the longer the conflict continues and supply chains remain disrupted, the greater the drag on global economic growth through 2026. In response, we have prudently increased our cash holdings as uncertainty over the economic impact has risen.

It is important to note that we entered this period of uncertainty from a position of relative strength. Company profits were healthy, fiscal spending remained supportive, financial conditions were relatively loose, and oil supply was ample heading into the conflict. These factors provide a reasonable foundation from which the global economy can recover, should the conflict and associated supply chain disruption be contained from here. We continue to expect real assets and sectors tied to supply chain resilience to attract capital and investment.

Inflation had been moderating prior to the conflict, but expectations have shifted higher as energy prices have risen. In the short term, a more inflationary environment is a negative for both economic growth and asset valuations. Should these pressures prove persistent, market and policymaker concern is likely to shift toward the demand destruction that sustained high inflation can cause.

Central banks continue to face a difficult balancing act. Lower interest rates can stimulate growth but risk weakening currencies and pushing bond yields higher, while higher rates help contain inflation at the cost of slowing economic activity. Most central banks cut rates last year, and the lagged benefits of that easing are still filtering through. However, with central banks in both the US and Australia currently focused more on their inflation mandates than on supporting employment, we would need to see a shift in their messaging before becoming more confident in monetary policy as a source of support.

Liquidity, the flow of money that keeps financial markets functioning, remains a critical pillar of the outlook. Higher oil prices effectively draw money out of the financial system as more funds are directed toward energy costs. Encouragingly, China continues to provide liquidity support, which generally underpins economic activity across Asia and supports commodity demand. Any policy shift in the US toward adding further liquidity would lead us to increase our exposure to growth assets.

Longer-term structural themes remain supportive. Investment linked to artificial intelligence, manufacturing reshoring, and energy infrastructure is expected to underpin equity market strength over time, broadening profit growth across industries. In summary, a modestly more defensive position is warranted given the current environment, reflected in our higher cash levels. That said, the combination of earnings resilience, fiscal support, and the lagged effects of monetary easing provides a reasonable foundation for risk assets over the medium term, albeit within a more volatile and uncertain environment than markets have experienced in recent years.

## BEAR CASE

Our worst-case scenario for the coming months, which we are prepared to position for should conditions deteriorate.



## 13% Probability

The bear case centres on a meaningful slowdown in consumer spending, particularly in the United States, as this has been the engine of economic growth over the past few years. If households pull back spending, company revenues come under pressure at a time when share market valuations are already elevated. Add in higher inflation or reduced support from the US Federal Reserve, and both profit margins and market valuations could come under simultaneous pressure. The longer the Iran conflict continues and the more it disrupts oil supply and global supply chains, the more likely this scenario becomes.

A sustained spike in oil prices, say 50 to 100% above recent levels, would feed directly into consumer prices and squeeze corporate margins at the same time as demand softens. This combination of weak growth and stubborn inflation, known as stagflation, is historically one of the most difficult environments for both shares and bonds. In such a scenario, central banks may be unable to cut interest rates even as the economy slows, while high government debt levels limit the capacity for fiscal stimulus to cushion the blow.

China adds a further layer of risk. If the property sector deteriorates further and government stimulus fails to restore confidence, China's growth could slow materially, with direct consequences for Australian national income and corporate earnings given our reliance on Chinese demand for resource exports. Should a major geopolitical shock or credit event coincide with rising bond yields, markets could sell off sharply. In that environment, an even more defensive positioning would be warranted: higher cash, reduced share exposure, and a tilt toward more stable sectors such as healthcare, consumer staples, and utilities.

## BULL CASE

**Our most optimistic view for markets over the coming months.**



## 12% Probability

In the most positive scenario, the Iran conflict ends relatively quickly and a peace dividend follows. Falling energy prices, easing supply chain pressures, and improving diplomatic relations lift growth while keeping inflation in check. Tariff disputes are resolved or contained, and company profits grow strongly as lower input costs and firm consumer demand support healthy margins. The continued adoption of artificial intelligence and other productivity-enhancing technologies further lifts output and profitability across a wide range of industries, without the large-scale job losses that many fear.

Government spending provides an additional boost, and while fiscal stimulus may create some mild inflationary pressure, economic expansion is expected to outpace it. Strong household and business balance sheets mean both consumers and companies are well placed to respond positively to improving conditions. For Australia specifically, government spending and interest rate cuts that began in 2025 support stronger domestic growth, with comparatively lower levels of public debt giving policymakers more room to act if needed.

If interest rates remain below the rate of inflation, meaning money is effectively cheap to borrow in real terms, financial conditions stay loose, encouraging investment and supporting asset prices. For Australian investors, this scenario supports a growth-oriented portfolio with relatively low cash holdings, with increasing exposure to cyclical sectors such as industrials, materials, and financials as conditions improve. The combination of policy support, technological advancement, and strong balance sheets provides a favourable setting for risk assets over the medium term.



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