What we liked

- **RBA Signals a More Balanced View:** The RBA delivered its third consecutive 25 basis point hike to 4.35%, but post-meeting communications did the real work. Governor Bullock was explicit that the Board now has scope to pause, and the major banks moved quickly to confirm rates on hold for the remainder of 2026. For rate-sensitive equities and variable-rate borrowers, confirmation that the terminal rate is here would be the news the market had been waiting for.

- **US Core PCE Offered a Sliver of Relief in an Otherwise Hot Inflation Print:** The April core PCE rose just 0.2% for the month, below the 0.3% consensus, decelerating from March's reading despite headline PCE hitting 3.8% year on year, its highest since May 2023. With the Fed anchored on hold, any evidence that the underlying inflation pulse is not accelerating further is constructive for duration assets and rate-sensitive equities.
- **China Holds Its Nerve on Stimulus:** Beijing kept benchmark lending rates unchanged for an eleventh consecutive month, but the signal was constructive. Resilient Q1 growth reduced the urgency for emergency stimulus, fading deflationary pressure removed a persistent headwind to corporate pricing power, and policymakers signalled they are preserving monetary firepower for when it is actually needed.

- **Tariff Truce Holds Through November:** The US-China bilateral tariff reduction has now been extended twice, most recently through November 2026, keeping effective tariff rates well below the Liberation Day peaks. Each extension reduces the probability of near-term re-escalation and preserves a predictable backdrop for global supply chains and business investment.

- **IPO Market Reopens with a Bang:** SpaceX filed its S-1 on 20 May targeting a $1.75 trillion valuation in what would be the largest public offering in Wall Street history. The filing signals that primary capital markets are open for business again, with OpenAI also signalling its own listing imminently and pointing to a meaningful acceleration in market activity in the second half of 2026.

What we didn’t like

- **The Strait of Hormuz Remains the World's Most Consequential Chokepoint:** More than ten weeks into the conflict, cumulative supply losses have exceeded one billion barrels with more than 14 million barrels per day shut in. The IEA described the situation as an unprecedented supply shock, with Brent having touched $144 at its peak and the global oil market remaining in deficit with inventories drawing at a record pace.

- **Australia's Inflation Problem Runs Deeper Than Fuel Prices:** The RBA's May Statement forecast headline inflation peaking at 4.8% in mid-2026 and underlying inflation remaining above 3% until mid-2027. For households already absorbing three consecutive rate hikes, housing costs up 6.5% annually, and electricity prices 25% higher year on year, the prospect of sustained above-target inflation well into 2027 is a material drag on consumer confidence.

- **US Inflation Reaccelerates to a Three-Year High:** April CPI rose 0.6% for the month, lifting the annual rate to 3.8%, with energy costs up 17.9% year on year and gasoline surging 28.4%. Real average hourly wages turned negative, and markets moved swiftly to price out any prospect of Fed rate cuts through at least the end of 2027.

- **Moody's Strips America of Its Last AAA Rating:** Moody's downgraded the US sovereign credit rating from Aaa to Aa1 on 16 May, the final major agency to do so after S&P in 2011 and Fitch in 2023. The 30-year Treasury yield surged to its highest level since July 2007 in response, adding fresh momentum to the bear steepener that has been building throughout 2026.

- **The One Big Beautiful Bill Makes the Maths Worse:** The House passed the One Big Beautiful Bill Act, which the CBO estimates will add $3.8 trillion to the federal deficit over the decade to 2034. Combined with the Moody's downgrade, the legislation cemented the long end of the Treasury curve as a source of structural volatility rather than a safe haven.

- **Eurozone Stagflation Deepens and the ECB Has No Good Options:** The ECB held rates at 2% with inflation at 3% and Q1 GDP growth of just 0.8% year on year. Deutsche Bank now expects the ECB's next move to be a hike in mid-2027 rather than a cut. Europe faces the most difficult policy configuration among major economies, and the stagflation dynamic shows little sign of resolving.

BASE CASE

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

72% Probability

The closure of the Strait of Hormuz has pushed energy prices higher and disrupted the supply of essential goods such as fertiliser and sulphuric acid. If the blockade continues, these pressures are likely to intensify. We have responded by tilting our portfolios toward companies with strong structural growth that are less exposed to potential supply disruptions.

It is worth noting that we entered this period from a position of strength. Corporate profits were healthy, government spending was supportive, borrowing conditions were relatively easy, and oil supply was plentiful before the conflict began. These foundations give the global economy a solid base from which to recover.

Inflation had been slowing before the conflict, but rising energy prices have pushed expectations higher. In the short term, higher inflation is a headwind for both economic growth and investment returns. If it proves persistent, the greater risk becomes a slowdown in consumer spending and the kind of demand destruction that sustained high prices can cause.

Central banks (the institutions that set interest rates) face a difficult balancing act. Cutting rates can stimulate growth but risks pushing inflation higher. Raising rates can contain inflation but slows the economy. Most central banks cut rates last year and those benefits are still flowing through. However, until we see the US Federal Reserve and the Reserve Bank of Australia signal a greater focus on supporting growth over controlling inflation, we remain cautious on the outlook for interest rates.

Liquidity levels, the flow of money that keeps financial markets functioning, remains important to watch. Higher oil prices effectively pull money out of the financial system, as more household and business income is directed toward energy costs. Encouragingly, both China and the US Treasury continue to provide support to financial markets, which underpins economic activity and commodity demand.

Looking further ahead, structural growth themes remain intact. Investment in artificial intelligence, domestic manufacturing, and energy infrastructure is expected to broaden profit growth across industries over the medium term. In summary, resilient corporate earnings, government spending support, and the lagged effects of last year's rate cuts provide a reasonable foundation for investment markets, though within a more volatile environment than we have seen in recent years.

BEAR CASE

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

14% Probability

The key risk in this scenario is a meaningful pullback in consumer spending, particularly in the United States, which has been the primary engine of global economic growth. If households tighten their belts, company revenues come under pressure at a time when share market valuations are already elevated. Combine that with persistent inflation or reduced support from the US Federal Reserve, and both profit margins and market prices could fall at the same time.

The longer the Iran conflict continues, the more likely this scenario becomes. A sustained oil price spike of 50 to 100% above recent levels would flow directly into consumer prices, squeeze company profit margins, and soften demand simultaneously. This combination of weak growth alongside stubbornly high inflation, known as stagflation, is historically one of the most difficult environments for both shares and bonds. Central banks may find themselves unable to cut rates to support the economy, while high government debt levels limit how much fiscal stimulus (government spending) can cushion the impact.

China adds a further layer of risk. If its property sector weakens further and government stimulus fails to restore confidence, Chinese growth could slow materially. Given Australia's reliance on Chinese demand for our resource exports, this would directly impact Australian national income and corporate earnings. In this scenario, a more defensive investment approach would be warranted, with higher cash holdings, reduced share market 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.

14% Probability

In the most positive scenario, the Iran conflict ends relatively quickly, and a period of recovery follows. Falling energy prices, easing supply pressures, and improving diplomatic relations would support stronger growth while keeping inflation in check. If trade disputes are also resolved, company profits could grow strongly as lower input costs and solid consumer spending support healthy margins. The continued adoption of artificial intelligence and other productivity-enhancing technologies would further lift output and profitability across a wide range of industries, without the widespread job losses that many fear.

Government spending would provide an additional boost. While some fiscal stimulus may create mild inflationary pressure, economic expansion is expected to outpace it. Strong household and business balance sheets mean both consumers and companies are well positioned to respond to improving conditions. For Australia specifically, government spending and the interest rate cuts that began in 2025 would support stronger domestic growth, with relatively low levels of public debt giving policy makers room to act further if needed.

If interest rates remain below the rate of inflation, meaning money remains relatively cheap to borrow in real terms, investment conditions stay supportive for asset prices. In this scenario, a growth-oriented portfolio with relatively low cash holdings and increasing exposure to economically sensitive sectors such as industrials, materials, and financials would be well positioned. The combination of policy support, technological advancement, and strong balance sheets provides a favourable setting for investment markets over the medium term.

0299847774

Suite 6, 11 Oaks Avenue
Dee Why, NSW 2099 Australia