What we liked

- **Brent crude fell back toward $78-80:** erasing nearly all of its war premium and removing the dominant 2026 inflation threat, with the conditional reopening of Hormuz and the end of the naval blockade convincing investors the disruption that had pushed prices above $120 was over.

- **The RBA paused after three consecutive hikes:** holding the cash rate at 4.35% on 16 June as headline CPI fell to 4.2% from 4.6% and the jobless rate rose to 4.5%, easing pressure on mortgage holders and signalling the tightening cycle may be near its peak.

- **US-Iran interim peace framework:** took effect mid-June, with Iran agreeing to reopen the Strait of Hormuz and the US lifting its naval blockade. Japan's Nikkei soared 5.5% and South Korea's Kospi jumped as much as 5.7% on the news, the single biggest risk-on catalyst of the month after nearly four months of energy-supply disruption.

- **US labour market beat expectations:** with nonfarm payrolls rising 172,000 in May against a consensus near 80,000, pointing to underlying economic resilience even amid the energy shock and reinforcing the soft-landing narrative.

- **UK headline inflation held below expectations:** at 2.8% in May, down from a March peak of 3.3% and below the 3.0% markets expected, and the Bank of England revised its near-term inflation forecasts lower after the ceasefire eased energy prices.

- **China's deflation cycle eased:** helped paradoxically by the oil shock, as higher imported energy costs pushed Chinese prices out of outright deflation and forecasters lifted 2026 CPI projections, a modest positive for nominal growth and Chinese corporate earnings.

What we didn't like

- **Australian inflation stayed well above target:** with core ticking up, headline CPI at 4.2% remaining far above the 2-3% band while the preferred trimmed-mean measure rose from 3.3% to 3.4%, leaving the door open to further tightening.

- **The Fed turned decisively hawkish under Kevin Warsh:** holding at 3.50-3.75% but lifting the 2026 median dot to 3.8% from 3.4%, flipping from an implied cut to a hike-leaning path, with 17 of 18 officials judging inflation risks tilted to the upside.

- **The ECB delivered its first rate hike since 2023:** raising all three key rates by 25bp to take the deposit rate to 2.25% after eurozone inflation accelerated to 3.2% in May, and revised its inflation forecasts upward.

- **Bank of Japan hiked to a three-decade high:** raising its policy rate 25bp to 1.0%, the highest since 1995, with wholesale inflation at 6.3%, tightening global liquidity and adding a headwind for carry trades.

- **UK services inflation re-accelerated to 3.7% from 3.2%:** the gauge the Bank of England watches most closely for domestic, wage-driven pressure, and two MPC members dissented in favour of a hike to 4.0%, keeping rate-cut prospects on hold.

- **China's domestic demand and property sector stayed weak:** with retail sales growth barely exceeding 1% year-on-year and property remaining a persistent drag on investment, and the IMF flagging entrenched deflationary pressure and over-reliance on exports.

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 conflict around Iran pushed energy prices sharply higher and disrupted the supply of essential goods such as fertiliser and sulphuric acid. The picture has since improved markedly: a ceasefire has held since April, and in June the United States and Iran signed a memorandum of understanding intended to end the conflict and reopen the Strait of Hormuz. Traffic is resuming and oil has fallen back toward the mid-70s a barrel, well below its wartime peak above $100. The recovery is real but fragile, with the deal not yet final, parts of the strait still hazardous, and the governing arrangements unresolved. We have tilted our portfolios toward companies with strong structural growth that are less exposed to any renewed supply disruption.

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 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, but some have recently shifted back toward raising rates as inflation has picked up, creating fresh headwinds. Until we see the US Federal Reserve, European Central Bank 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.

The change of Fed leadership sharpens this caution. The new chair, Kevin Warsh, has signalled a more hawkish stance: a greater willingness to keep rates higher and to reduce the Fed's balance sheet (the roughly $6.7 trillion of bonds it holds to influence financial conditions). Drawing that pool down withdraws money from the system and leans against both inflation and asset prices. Our base case is that this keeps policy tighter for longer than markets had hoped, reinforcing our cautious view on rates without derailing the recovery.

Liquidity levels, the flow of money that keeps financial markets functioning, remain important to watch. The wartime oil spike pulled money out of the system as income was diverted to energy costs; with prices now falling, that drain is easing. Pulling the other way is the Fed, gradually withdrawing support by reducing its balance sheet. Against that, day-to-day funding support from China and the US Treasury continues to underpin activity and commodity demand, so liquidity is now a tug of war rather than a one-way pull.

Looking further ahead, structural growth themes remain intact. Investment in artificial intelligence, manufacturing activity, and energy infrastructure is expected to broaden profit growth across industries over the medium term. One development we are watching within this theme is the rising cost of building artificial intelligence. The specialised chips, power, and data centres needed to train and run these systems have climbed sharply in price, partly on the same energy and supply pressures noted above.

Our base case is that this lifts the bill for the AI rollout without breaking it: the companies leading the investment have the cash flows to fund it, and the expected productivity gains still justify the spend. The better outcome is that competition and engineering bring costs down quickly, widening the profits available to the broader set of companies that use AI rather than just those that build it. The worse outcome is that costs stay high and investors start to question whether the sums being spent will earn an adequate return, weighing most on the highly valued technology names that have led the market.

In summary, resilient corporate earnings, government spending support, and broad availability of credit provide a reasonable foundation for investment markets, though within a more volatile environment than we have seen in recent years, which will include higher asset performance dispersion.

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 and business spending, particularly in the United States, which has been the primary engine of global economic growth and corporate profitability. If households tighten their belts, company revenues come under pressure at a time when share market valuations are already relatively elevated. Were that to coincide with a pullback in the heavy corporate investment now flowing into artificial intelligence, the slowdown could be marked. Combine that with persistent inflation and interest rates, and both profit margins and market prices could fall at the same time.

Should the ceasefire break down or the 60-day deal collapse, this scenario becomes far more likely. Central banks may find themselves unable to cut rates to support the economy due to elevated inflation, while high government debt levels limit how much fiscal stimulus (government spending) can cushion the impact. A renewed closure of the Strait of Hormuz and a sustained oil price spike of 50 to 100% above current levels combined with a more hawkish Fed under Kevin Warsh would make this harder still. If it prioritises fighting inflation and presses on with shrinking the balance sheet just as the economy weakens, it removes the safety net investors have relied on, draining money from the system at the wrong moment and deepening any fall rather than cushioning it. Rising AI build-out costs sharpen the danger from the other side: the market's gains have leaned on a small number of expensive technology companies, and if AI spending keeps climbing while the payoff is delayed, investors may conclude the returns will not justify the outlay. A sharp repricing of those leaders could drag the broader market down, made worse by a Fed unwilling to step in.

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

IThe bull case is one in which the recent de-escalation gathers pace and the cross-currents weighing on markets turn supportive. Falling energy prices, easing supply pressures, and improving diplomatic relations would support stronger global economic 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. In the most positive scenario, the ceasefire holds, the 60-day deal is finalised, and the Strait of Hormuz reopens fully, with a period of recovery following.

In this setting, the two pressures we are watching could resolve in investors' favour. A Warsh Fed seen as genuinely committed to low inflation can help rather than hinder: if markets trust inflation will stay contained, longer-term borrowing costs can fall even as the Fed holds firm, and lower long-term rates tend to support share prices. At the same time, falling energy prices and rapid technological improvement could bring the cost of building AI down faster than expected, shifting its benefits from the handful of companies building it to the much larger group that use it, broadening profit growth rather than concentrating it. A cheaper, more widely shared AI rollout alongside a credible Fed would be a powerful combination for markets.

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 end of the current interest-rate hiking cycle 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.

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