

What we liked



- **Australian headline inflation eased to 3.8% in the year to June:** with the June-quarter CPI up just 0.6% and automotive fuel down 10.9% in the month on lower world oil prices and extended fuel-excise relief; transport inflation moderated to just 0.1% year-on-year, a constructive disinflation signal for the front end of the Australian curve.
- **The US Federal Reserve held rates at 3.50–3.75% on 29 July:** a fifth consecutive hold, resisting pressure to tighten even as three officials dissented in favour of a 25-basis-point hike (a 9–3 vote); with Chair Warsh keeping the statement short and forward guidance stripped out, the decision to stand pat rather than raise was a modest relief for rate-sensitive assets.
- **US June CPI fell to 3.5%, its biggest monthly drop since 2020:** with headline CPI down 0.4% for the month and core at 2.6% against a 2.9% expected, signalling that the energy-driven inflation spike had peaked; the dollar fell, yields declined and rate-sensitive technology and gold rallied as markets read the shock as fading rather than entrenched.
- **The ECB paused at 2.25% deposit rate on 23 July:** holding after June's hike; although some officials pushed for an immediate further increase, the Governing Council voted unanimously to hold and declined to pre-commit to September, giving European risk assets a brief reprieve from the tightening path.
- **The IMF upgraded China's 2026 growth forecast:** lifting it from 4.4% to 4.6% on the strength of high-tech manufacturing and exports, a constructive signal for emerging-market sentiment and commodity demand.
- **China's late-July Politburo reaffirmed support for "new productive forces":** prioritising AI, electric vehicles and high-end manufacturing; high-tech manufacturing value-added rose 13.3% in the first half and now drives over 40% of growth, a constructive read-through for the structural-growth cohort even as broad stimulus stayed calibrated.

What we didn't liked



- **The RBA kent Australia in a rare tightening bias amid rising unemployment:** with headline inflation slowing to 4.0% in May but underlying inflation accelerating to 3.6% while unemployment rose to 4.4%, above the RBA's forecast, a difficult inflation-versus-jobs bind for a central bank still leaning hawkish.
- **Australian housing and growth showed strain:** with consumer spending slowing and housing prices falling in some capital cities alongside a contractionary federal budget, weighing on the domestic demand outlook.
- **Oil surged back above US\$100 a barrel (Brent), its highest since late May and up around 35–40% on the month:** after Iran-aligned Houthi attacks on two Saudi tankers and a declared Red Sea blockade widened the conflict beyond Hormuz; reintroducing the single biggest inflation headwind just as central banks had begun to price it out; the situation remains volatile and a live risk to both inflation and equity markets.
- **The Bank of England turned more hawkish:** holding at 3.75% but with the dissenting minority doubling to two members voting for 4%, and the chief economist saying publicly that rates will need to rise, an unwelcome shift for UK borrowers and gilts.
- **China's investment slump deepened:** with fixed-asset investment down 5.7% in the first half against a 4.9% expected decline and real-estate investment down 18%, underlining the unresolved property drag on the world's second-largest economy.
- **Japanese yen weakness deepened toward a 40-year low:** with the stubbornly weak currency lifting import costs and driving a spike in wholesale inflation, keeping pressure on the Bank of Japan to stay hawkish, with Goldman Sachs cutting its 12-month USD/JPY forecast to 165, pointing to further yen pressure.

BASE CASE

Our view of the most likely scenario for markets over the coming months.



73% Probability

The conflict around Iran pushed energy prices sharply higher and continues to disrupt the supply of essential goods such as fertiliser and sulphuric acid. The picture remains volatile, with on-again/off-again ceasefires, 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.

While risks abound, the global economy, credit markets and corporate profits remain on a solid footing. Earnings are so far resilient, government spending remains supportive, and borrowing conditions remain relatively easy. These foundations give the global economy a solid base from which to grow, despite the many challenges currently faced.

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. While still high, the recent downward surprises in Australia and the US are encouraging.

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 Walsh, 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. Rising oil prices act to reduce liquidity in the system; current liquidity conditions remain benign, though a recent slowing of liquidity growth is causing us some concern. With government and corporate debt so elevated, an excessive slowing of liquidity could trigger credit-market dysfunction. This is on watch, rather than being a live concern for now.

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. This matters because so much capital, both equity and credit, has been committed to the buildout that it has become systemically important.

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. We remain constructive on risk assets but with slightly higher cash levels for the time being.

BEAR CASE

Our worst-case scenario for the coming months.



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 elevated interest rates, and both profit margins and market prices could fall at the same time.

Large and sustained oil price rises would make this scenario 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 breakdown of the ceasefire or collapse of the 60-day deal would sharpen the risk further. 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 its resource exports, this would directly affect 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.



13% Probability

The bull case is one in which de-escalation with Iran 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, a ceasefire holds, 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 policymakers 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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