What we liked



- **US layoffs stayed remarkably low:** with weekly jobless claims falling to 194,000 in mid-October, the lowest since July and close to their lowest level in decades, and announced job cuts the lowest for any September since 2022; employers are holding on to staff, which supports household spending.

- **US business activity stayed strong:** with the October composite PMI reading 57.6, well above the 50 level that separates growth from contraction, as both manufacturing and services kept expanding; it points to an economy still growing at a healthy pace.

- **France avoided a credit rating downgrade:** with Moody's leaving its rating unchanged, albeit with a negative outlook, sparking a rally in French government bonds that helped pull global bond yields lower; it eased one of the sharpest sources of stress in Europe.

- **UK jobs data surprised on the upside:** with unemployment edging down, more workers on payrolls and firms looking to hire more staff for the first time in two years; it suggests the UK economy is holding up better than feared.

- **China's economy beat forecasts:** growing 4.5% over the year to September with factory output and retail sales both firmer, helped by a "mini stimulus" of mortgage subsidies and targeted central bank support; better news from the world's second-largest economy helps global growth and commodity demand.

- **Japan steadied its bond market:** with a 20-year government bond auction drawing the strongest demand on record for that tenor after Prime Minister Takaichi moved to reassure investors on responsible spending; calmer Japanese bond markets reduce the risk of spillover into global interest rates.

What we didn't like



- **The RBA raised the cash rate to 4.85% on 3 November, its fifth increase this year:** a split 6-3 decision after inflation jumped to 4.3% over the year to September and the trimmed mean rose 1.0% over the quarter, faster than expected; the Board sees underlying inflation above 3% for another year, and higher borrowing costs squeeze households and businesses.

- **Australia's economy showed signs of strain:** with 39,300 jobs lost in September against an expected gain of 20,000, unemployment rising to 4.7%, the Treasurer flagging growth likely below the 1.75% forecast in May and the October manufacturing PMI slipping into contraction; a slowing economy with interest rates still rising is a difficult combination for Australian households and businesses.

- **US interest rate expectations kept rising:** the Fed held rates steady in October after September's first rise of this cycle, but two officials voted for another increase and markets now price a December rise as highly likely; with September CPI at 3.7%, above expectations, tighter financial conditions are weighing on risk assets.

- **US hiring slowed sharply:** with employers adding just 29,000 jobs in September against 90,000 expected, earlier months revised down by 60,000 and unemployment rising to 4.2%; a cooling jobs market alongside high inflation is an awkward mix for the US economy.

- **A global bond sell-off pushed borrowing costs to multi-decade highs:** the US 10-year yield held above 5%, near its highest since 2002, France's 10-year reached 5% for the first time since 2002, Japan's 30-year yield hit a record and Australian 10-year yields reached a 15-year high of 5.40%; higher long-term rates raise borrowing costs across the economy and pressure equity valuations.

- **Escalating conflict with Iran pushed oil to a six-month high:** Brent crude closed at US$116.72 a barrel on 23 October after Houthi strikes on Saudi energy sites, with shipping through the Strait of Hormuz still a fraction of pre-war levels; oil is up more than 80% this year, feeding inflation and unsettling markets.

BASE CASE

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



75% Probability

The global economy remains on solid ground. Company profits have held up well, governments are still spending and money remains relatively easy to borrow. We expect profits to keep growing into next year, which gives markets a firm base and is the main reason we stay broadly positive.

Even so, risks are building. The Iran conflict has pushed energy prices higher and disrupted supplies of essentials such as fertiliser and industrial chemicals, while the continued war in Ukraine adds further strain to global supply chains. Disruptions raise costs and slow deliveries, eating into company profits, so we have tilted our portfolios toward businesses with strong, lasting growth that are less exposed.

Inflation had been easing, but higher energy prices have pushed it back up, and rate rises are a blunt tool against supply-driven price pressure. The risk we watch most closely is a cooling economy alongside stubbornly high inflation, because the usual fix for one worsens the other. Australia is a clear example. Inflation rose to 4.3% in the year to September and the Reserve Bank delivered a fifth rate rise this year on 3 November, taking the cash rate to 4.85% in a split 6-3 decision. With mortgage repayments climbing and consumer confidence near record lows, households are cutting back on non-essentials such as retail and dining out, and we remain cautious on businesses that depend on them.

Central banks are walking a fine line. Federal Reserve chair Kevin Warsh has signalled US rates will stay higher for longer as he gradually withdraws money from the financial system. Long-term government borrowing costs are also rising worldwide, lifting borrowing costs across the economy and lowering the price investors pay for each dollar of company profit, known as the price-to-earnings, or P/E, ratio. France is the pressure point to watch. Political turmoil has pushed its 10-year borrowing costs above 5%, the highest since 2002, and the gap over Germany to its widest since the 2011 euro debt crisis. Our base case is that this stays a French problem, with the European Central Bank able to step in if needed.

AI spending remains the biggest driver of business investment and market gains, with the largest technology companies on track to spend close to US$800 billion this year. October results showed no sign of a pullback; Microsoft's cloud business grew 48% and Alphabet flagged a significant rise in spending next year. What has changed is the funding. More is now borrowed, and the cost of insuring AI-linked debt against default, measured by credit default swaps (CDS), has hit record highs for companies including Oracle, Alphabet and Meta. We expect spending to continue, led by companies that can fund it from profits, and favour the businesses supplying the power, equipment and infrastructure it relies on.

The US midterm elections were held on 3 November, with the final result still being settled as we write. Polls and betting markets had favoured a "blue sweep", with Democrats winning both the House and Senate. A divided government would most likely mean two years of gridlock with President Trump: fewer new policies, but less room for large new spending or tax cuts, which could ease pressure on bond markets. History is encouraging: since the Second World War, US shares have risen in every 12-month period after a midterm, by around 14% on average, and late October to year end is typically the strongest stretch of the calendar. In short, resilient profits, government spending and available credit give markets a reasonable foundation, though in a more volatile setting. We remain positive but hold a little extra cash, ready to act if volatility creates opportunities.

BEAR CASE

Our worst-case scenario for the coming months.



13% Probability

The main risk is a real pullback in spending by households and businesses, especially in the United States, the main engine of global growth and profits. That would hit company revenues while share prices are already high relative to profits. AI is the trigger to watch. If the rising cost of insuring AI-linked debt spreads from the most indebted players to the large technology companies, borrowing would become harder and spending plans could be cut quickly, hitting the economy and share prices at once. With market gains leaning on a few expensive technology companies, a sharp fall in those leaders could drag the whole market down.

Sustained oil price rises and worsening supply-chain disruption from the wars in Iran and Ukraine would add pressure. With inflation largely supply-driven, central banks may be unable to cut rates, while high government debt limits how much governments can cushion the blow. France's debt troubles could also spread. A loss of confidence in French government bonds could lift borrowing costs in other heavily indebted countries, including Italy, the UK, Japan and the US, pushing long-term rates higher worldwide and squeezing share prices even if earnings hold. A disputed midterm result, or a bitter stand-off between Congress and the White House leading to government shutdowns, would add uncertainty.

Closer to home, the Reserve Bank may need to keep lifting rates, forcing stretched households to cut spending harder and tipping the economy toward recession. China adds risk too. If its property market weakens further and support fails to restore confidence, lower demand for our resource exports would hit national income and company profits directly. Here we would turn more defensive: more cash, less exposure to shares, and a tilt toward steadier sectors such as healthcare, essential household goods and utilities.

BULL CASE

Our most optimistic view for markets over the coming months.



12% Probability

In the bull case, tensions with Iran ease and the pressures on markets turn supportive. Falling energy prices, easing supply-chain strains and better diplomatic relations, including progress in Ukraine, would support stronger growth while keeping inflation in check. At best, ceasefires hold, the key shipping route through the Strait of Hormuz reopens fully, and recovery follows. Resolving trade disputes would also lift profits as costs fall and consumers keep spending.

The pressures we are watching could then turn in investors' favour. If markets trust that inflation is under control, long-term borrowing costs can fall even while the Fed holds rates steady, lifting the price investors pay for each dollar of profit. A credible French budget would narrow the gap over German borrowing costs, removing a source of stress for global bond markets. A clear midterm result followed by gridlock in Washington would limit new government borrowing and leave room for the usual post-midterm rally in shares. Most importantly, if AI spending keeps delivering profits like October's rapid cloud growth, debt worries would ease, credit markets would calm, and the build-out would keep lifting growth and productivity, spreading benefits to the many companies that use AI rather than the few that build it. Government spending would add a further boost, and strong household and company finances leave both well placed to respond.

For Australia, if inflation peaks soon and the Reserve Bank can stop raising rates, pressure on household budgets would ease and spending would recover, while our relatively low public debt gives policymakers room to do more. Here we would favour a growth-focused portfolio with less cash and more exposure to sectors that do well when the economy grows, such as industrials, materials and banks.

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