Q2 2026
Market Commentary

The second quarter of 2026 presented investors with considerable geopolitical uncertainty. However, markets proved notably resilient, largely choosing to look beyond the immediate disruption and focus on the prospect of an eventual resolution.

Markets are renowned for disliking uncertainty but sometimes they take the same approach as the proverbial economist and assume that the issue they face is going to be overcome. That is largely what markets did following the attacks on Iran by the US and Israel. Despite the closure of the Strait of Hormuz which effectively denied the world access to a significant proportion of Middle East oil, gas and other key chemical products, the price of oil spiked far less and for a shorter time than one might have originally feared. In part this was because of the significant drawdown from the strategic reserves of many countries. But it was also due to the fact that investors looked through what they believed to be a short-term hiatus.

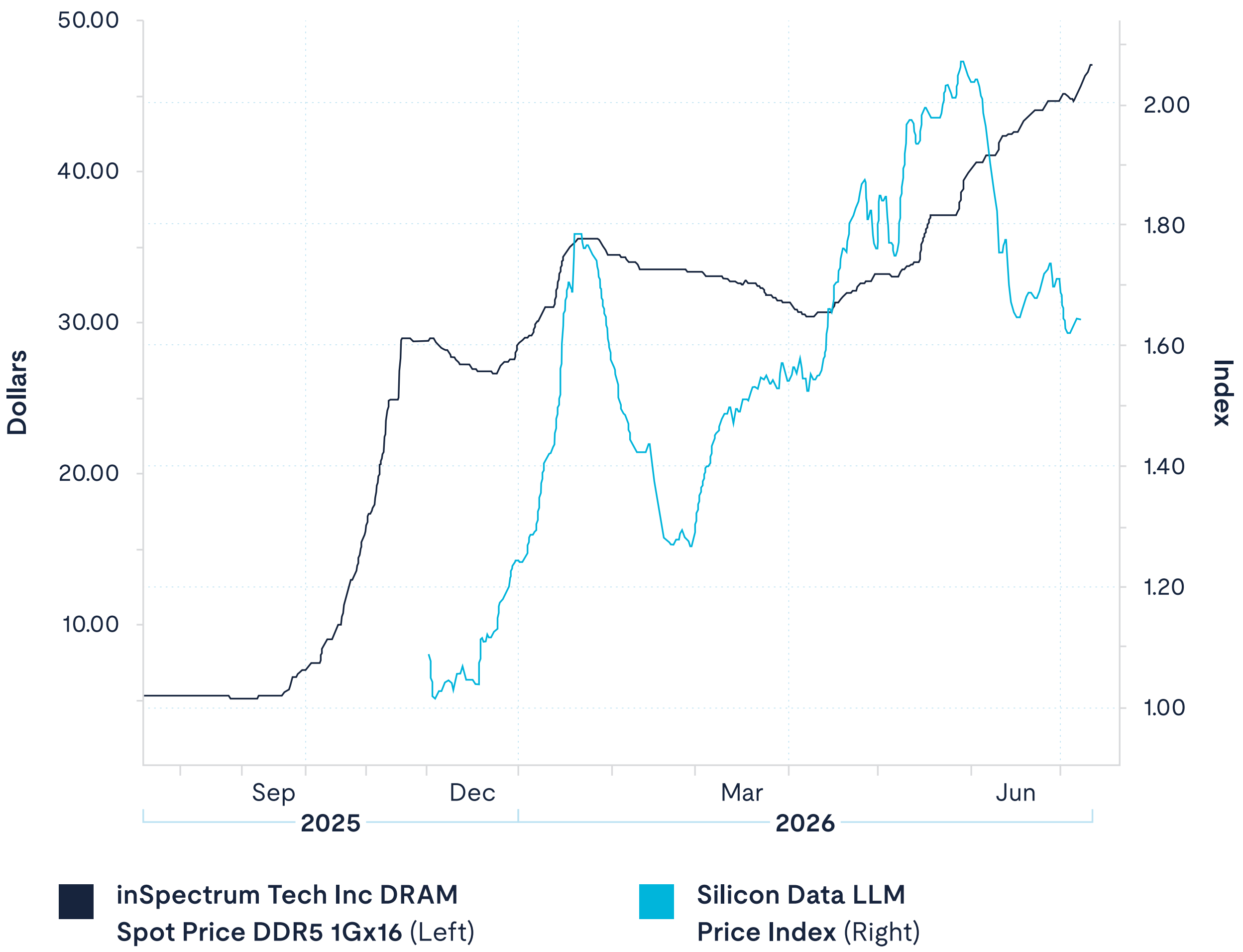
They (and we) determined that both sides were in need of an “off-ramp” and a way to end hostilities that would, ideally, allow each to claim an element of victory. The ceasefire and Memorandum of Understanding (MoU) between the US and Iran appeared to provide that off-ramp and though it took some time to get the final agreement, markets assumed the issue away, driving oil prices back down to pre-attack levels and allowing equity markets to generate strong positive returns as they focussed on other things.

Key amongst those things was the massive growth in announced AI related / data centre CAPEX. This drove the shares of IT hardware stocks higher across the globe, led particularly by Korean and Taiwanese semiconductor firms and helping Asian emerging markets to be among the best performing over the quarter. Digital assets and commodities were the weakest asset classes during the quarter. In addition to the oil price, there were sharp falls in the price of precious metals such as gold and silver, and a number of agricultural commodities. After an initial rally, cryptocurrencies fell back with Bitcoin ending the quarter below $60,000 bringing its fall for the year to 32% and leaving it almost 50% off its high of early October last year.

Economic data was generally more robust than had been feared and allied to concerns that the higher oil price would lead to more inflation, resulted in a change to the expected path of interest rates across the world. This was particularly the case in the US where a couple of strong employment data prints added to the concern that investors had been too optimistic to think that the Fed would be cutting rates later in the year.

Contrasting Signals from AI Spend vs Cost

Token prices fade while DRAM costs continue to climb.



Source: Bloomberg

This view was reinforced when President Trump's newly appointed Chair of the US Federal Reserve, Kevin Warsh, held his first press conference following the June meeting of the Fed. Many had suggested that he might be swayed by Trump and would be dovish on interest rates. However, his comments were actually more hawkish than expected and the outcome of the meeting was that the Fed left the Fed Funds rate unchanged. Nonetheless, his term at the Fed is likely to bring with it significant changes in the way that the institution is run; a fact that was underlined by his announcements that he was establishing a number of working parties to review key elements of the Fed's operations.

One likely casualty of Warsh's term is the so-called "dot-plot" chart showing the anonymised views of members of the Fed Open Markets Committee as to the future path of interest rates. Warsh made it known that he did not contribute to the June version and given his long-held dislike of "forward guidance", we expect there to be far less of it than under his predecessor, Jerome Powell. Investors will, therefore, have to draw their own conclusions based on the available data.

Other central banks were also active during the period. The Reserve Bank of Australia raised its Cash Rate by 25 basis points to 4.35% in May, while June saw the ECB raise its policy rate by a similar amount to 2.25%, and the Bank of Japan raise its policy rate to 1%. In the UK, the situation was complicated by the political shenanigans going on within the governing Labour Party resulting in the resignation of the Prime Minister and the process to "anoint" Andy Burnham as his successor. Given already high long-term interest rates and a steepening yield curve, the Bank of England was cautious about adding further to pressures on a fragile economy. Overall, however, bond markets provided modest positive returns to investors over the quarter with credit markets benefitting from a tightening of spreads.

Issuance in both equity and bond markets ran at very high levels, led by the attention-grabbing IPO of SpaceX. Perhaps more significant, though, was the bond issuance of US hyper-scaler stocks such as Alphabet and Meta in their efforts to raise money to fund their massive capital expenditure plans to build data centres. Though the scale of this expenditure is huge and feeding the short-term enthusiasm for AI-related stocks, one should note that a number of these proposed developments have found it hard to get approval to go ahead.

US residents appear to have significant reservations about the likely impact on their localities and have successfully defeated several projects, including a huge one in Virginia being planned by QTS which is owned by Blackstone. Another indication that some of the momentum behind the economics of artificial intelligence may be under some pressure has come from the fact that the cost of LLM (large language model) tokens has fallen some 20% from its high in May. These are possibly minor bumps along the AI Revolution Road but investors are becoming more selective about which areas and players in the AI value chain will ultimately be successful.

Outlook

From an economic point of view, the outlook for the remainder of the year seems a reasonable one. While inflation remains above target in most countries, it does not look out of control and central banks seem unwilling to tighten significantly unless it picks up again, preferring to let it come down gently. In the meantime, economic growth looks like it will support a gentle expansion, keeping employment markets relatively firm and allowing the consumer scope to continue spending, even if fuel prices remain elevated and eat into their disposable income somewhat.

Corporate profits remain strong and though the aggregate numbers are heavily influenced by the AI-related hardware boom, the most encouraging sign is the increasing breadth being seen across other sectors and geographies.

Developments in the Gulf are clearly an important factor. Since the MoU, oil prices have fallen sharply, and forecasters have turned quickly from being concerned about a severe shortage to predicting that there may be a glut. We think that this is unlikely and that in fact the situation in the Gulf could take some time to resolve itself. Not only do the Iranians and Americans have to agree on a way forward that prevents flare-ups derailing the whole process but the Americans must also ensure that Israel is sufficiently on board with whatever is agreed to allow them to remain on the sidelines.

Given that both Israel and the US have elections coming up soon, and that both their leaders are under pressure, Iran has a great deal of leverage. President Trump has to navigate the November mid-terms against a backdrop of disapproval of his attacks on Iran and dissatisfaction with the fact that the resulting elevated cost of fuel has added to the perception that he is disregarding the importance of the affordability issue for a large number of Americans. Should his Republican Party lose ground in those elections, his ability to complete his term with the same aggressive policy stance is likely to be limited.

The outlook for UK securities is also likely to be heavily influenced by politics. With the soon to be confirmed Andy Burnham in charge of the country, there are almost certainly going to be changes in policy which could rattle the gilt market. So far both Sterling and UK gilts have been relatively sanguine about this change in PM and are giving him the benefit of the doubt. The next clues as to what kind of fiscal environment Burnham wants to create may well come from the appointments he makes to his cabinet, especially who he appoints as Chancellor of the Exchequer.

We remain relatively sanguine regarding the prospects for the next six months, despite the risks outlined above. While it feels like markets need a period of consolidation before making significant advances, we would most likely use such an opportunity to deploy some of the cash balances that we hold in reserve.

Commentary as of 28 July 2026

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