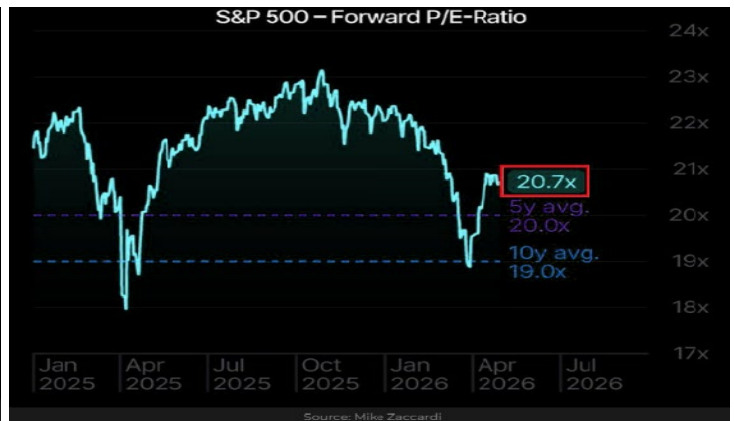
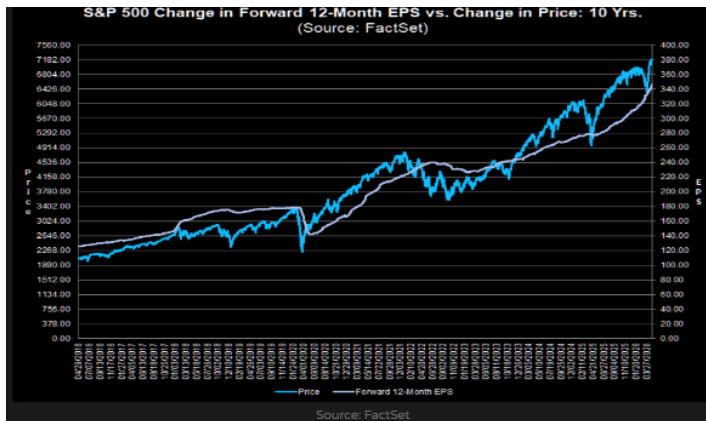


The Straits of Hormuz remains closed, though talks appear to be in progress. As we write, no formal resolution has been announced, although there are reports that one is imminent. For now, bond markets continue to fall as they reflect higher inflation risk. UK 10-year gilt yields are holding firmly above 5%, a level not seen since 2008. Given this conflict, which is driving inflation upwards, equity markets would normally be expected to be down around 15%. So far this year, in local currency terms, most global equity indices are modestly up. Are equity markets being complacent? Clearly, there is an enhanced inflation risk. Central banks were caught sleeping by the impact of the Russian invasion of Ukraine, which led to a sharp and painful increase in interest rates. That event was different: it removed, seemingly permanently, one of the largest suppliers of oil and gas to European and global markets. The Iran situation is perceived to be a temporary logjam. The Ukrainian impact also came just after Covid, when labour markets were very tight, staff shortages were widespread and a whole generation had retired early. This time, unemployment, especially among youth and graduates, is high and wage pressures are subdued. Nevertheless, the inflation impact is negative and probably underpriced in equity markets. The assumption in equity markets remains that Trump has made a major mistake at the wrong time politically and needs a solution. The Iranians, without any democratic pressure, also need a deal but can afford to wait. Markets expect Iran to be holding out for an agreement similar to that reached under President Obama, a move that would exert maximum political pain on President Trump. But that does not explain the strong performance of equity markets. What does is the increasingly rapid evolution of artificial intelligence and, crucially, the very strong performance of the third of the “Key Market Drivers”, corporate profit growth.

Key Market Driver Earnings Growth



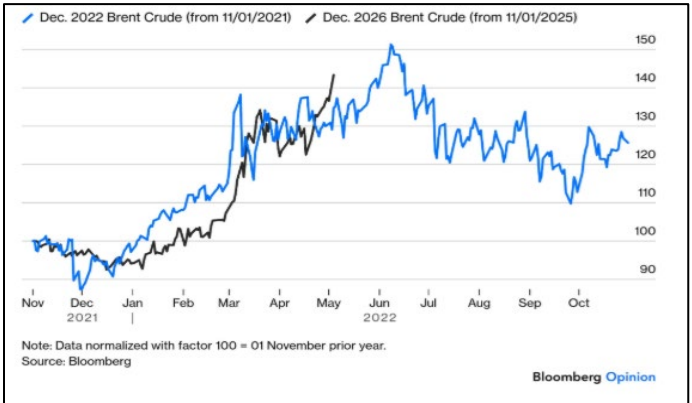
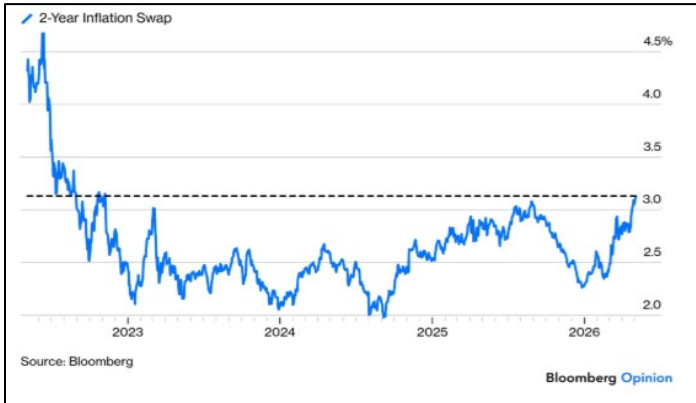
The first chart displays the S&P 500 index (blue) alongside the underlying operating profits of its constituent companies (white). The index is hitting a new all-time high because profitability is doing the same. For the first quarter of 2026, earnings growth over the past 12 months would have been a staggering 27.1%. Part of this reflects AI-related capital expenditure, but for other, more “old-fashioned” industries it represents the classic post-recession recovery pattern, moving from nothing to something can often result in very large percentage gains. Importantly, this earnings growth acts to reduce market valuations. The second chart shows the valuation of the index, which dipped to its 10-year average as the conflict in Iran began. In the context of a new, AI-driven industrial revolution and a data-centre capital expenditure boom, this valuation looked too cheap. Hence, AI trumped Iran. Can growth continue at this pace? History suggests not. A reversion towards the long-term average growth rate of around 9% should be expected.

Inflation

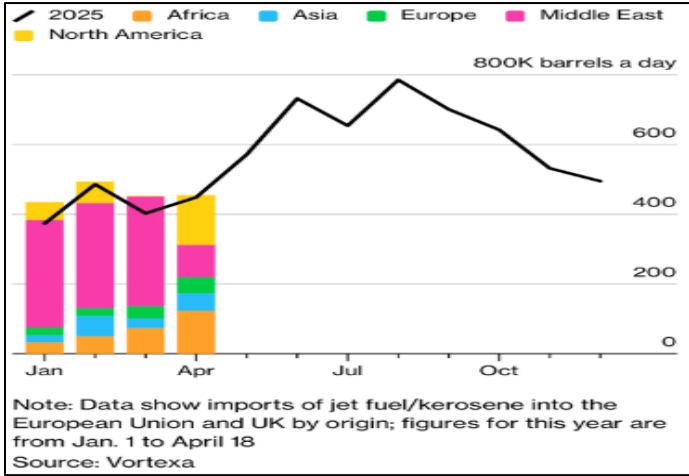
Earnings growth can very easily be snuffed out by the actions of central banks. They can drain liquidity (cash) from the monetary system and raise interest rates, they would do this to “choke-off” excess inflation. Clearly, with crude oil, jet fuel, gasoline, diesel, ammonia and fertiliser all stuck in a massive ship-jam there will be shortages which must force prices up. The danger is, when the Straits reopens there will be an excess of supply that will in turn force prices down. Also, any deal to reopen would probably allow

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even more supply from previously sanctioned Iran. For Central Banks to raise interest rates due to a possibly temporary supply shock is risky. Bond markets are being very cautious, as the first chart below shows inflation expectations are creeping up to 3% but are still 1.5% below the Ukrainian invasion levels. The second chart overlays the current Brent Crude Oil future for December delivery over the 2020 equivalent Ukrainian contract. The percentage move is remarkably similar. The oil and inflation markets are signalling that a deal is needed and soon. Any upward move in either of these charts would not be welcome.



Jet Fuel



For most UK consumers, the immediate question will be whether they can escape to some sunshine this summer. This chart shows that EU and UK jet fuel supplies are currently matching demand. The Middle East has been replaced by Africa (Nigeria) and the US as the primary sources of supply. However, no one really knows whether the US and Nigeria have sufficient spare refining capacity to meet peak demand in June and August. If the Straits reopen soon, there should not be a problem. Airlines are being allowed by their respective regulators to amalgamate flights and temporarily suspend some take-off slots. However, this may not be enough to reduce demand sufficiently to match supply. Ultimately, the summer holidays will depend on the Straits reopening soon.

Markets

Clearly, events in the Middle East are fast-moving and any comments in this newsletter could look very wrong, very quickly. Trump thought he had an off-ramp several times but the Iranians with little more to lose and still seemingly a supply of missiles and drones is squeezing him hard. Markets do move according to the news flow but are able to look through the sometimes-excessive optimism from the US. Running in parallel to the oil news is the AI story. Each new release shows that the software is more capable and advanced than previously thought possible. User growth is exceeding all expectations; the business case remains very strong and semiconductors in short supply. Whilst for now this theme may seem like a “bubble”, however, unlike 2000 the valuations are reasonable. There are pockets of market craziness, but key AI chip supplier Nvidia has a forward PE valuation of 23, fractionally more than the rest of the market and the same as Coca Cola! As we enter the summer doldrums the inflation risk remains very elevated. Trump desperately needs a deal with Iran, will he get one?

May 2026

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Market View