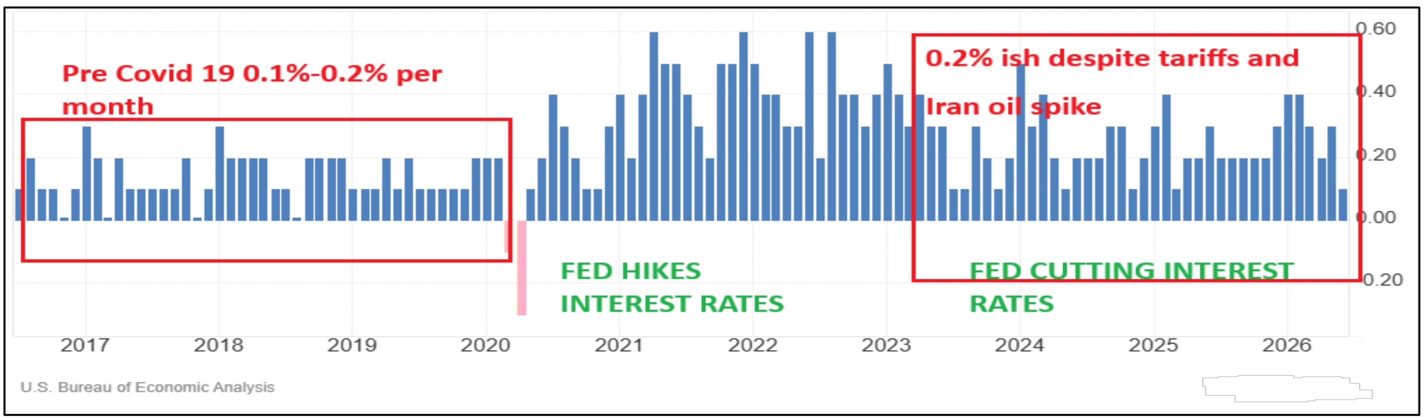
SRS Strategic Retirement Solutions

Market View

US President Donald Trump believed that he had extricated himself from the problem he created in the Strait of Hormuz, however, the Iranians thought otherwise. As we write, the situation remains unresolved, but it appears that a toll system is likely. For markets, all that matters is that oil and gas continue to flow. Brent crude prices fell as Trump stepped back from escalation, and equity markets recovered. Support also came from earnings reports from Microsoft and Amazon, two of the major cloud-computing operators. These showed that there is money to be made from AI. There needs to be, otherwise, the largest capital-expenditure programme in human history will have been for nothing. China once again showed that it is not far behind in the AI race. With Trump humiliated by the Iranians and US weapons stocks allegedly low, might China now be tempted to make a move against one of the Taiwanese islands? In the UK, the government's new leadership seems to be 'going back to the 1970s, a period of economic history that was not good for anyone. Gilts remain under pressure. Markets need to see UK business investment funded by spending cuts. Tax rises are promised instead, which is risky because they rarely generate the budgeted amount. Overall, the cycle remains intact: earnings growth is above normal and is broadening beyond the technology companies. Trump's apparent decision to step back from further military action is helping to ease inflationary pressure, but interest rates remain the principal issue facing markets.

Kevin Warsh and US Inflation (US Core PCE) monthly change



New Federal Reserve Chair Kevin Warsh has struck a hawkish tone on inflation but remained evasive about possible US interest-rate rises. While the Federal Reserve voted to keep its official interest rate steady at 3.5%, Warsh championed a change in how the central bank communicates with markets. Rejecting the notion of a 'soft' or flexible inflation target, he said that the target is strictly 2%, not 'a little over 2%' or any other variation. He warned that more than five years of elevated inflation cannot be cancelled out by one month of modest declines. Warsh also defended his decision to remove forward-looking hints from the policy statement: markets will need to 'play the ball, not the referee'. Accordingly, no guidance was provided for the forthcoming September meeting. He described the current holding pattern as a period of 'watchful thinking' rather than passive waiting. Bond prices fell in response, particularly longer-dated bonds with 25 years or more to maturity, causing yields to rise and the yield curve to steepen. Warsh expressed 'comfort' that longer-term Treasury yields had risen independently, thereby tightening financial conditions on the Fed's behalf. He also cited geopolitical energy shocks from the Middle East and business spending on AI as complex, competing structural forces. Overall, this represents a major change in the Federal Reserve's communication with markets. The Fed intends to be less explicit in its forward guidance, adding uncertainty for investors. Although official interest rates were unchanged, markets are suggesting that rates will rise, the timing, however, remains unclear. The US President may still put pressure on 'his man' as he seeks good news ahead of the mid-term elections.

Big Tech

With interest rates starting to work against the markets, corporate earnings growth remains the key driver, as it should at this stage of the cycle. AI, Big Tech and, in particular, semiconductor companies are delivering exceptionally high rates of growth.

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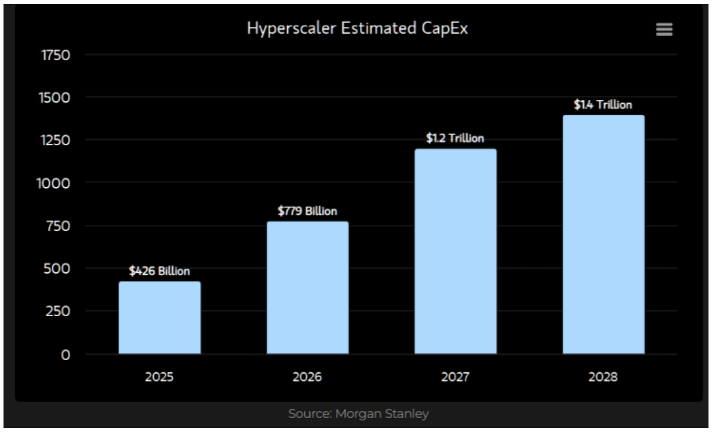
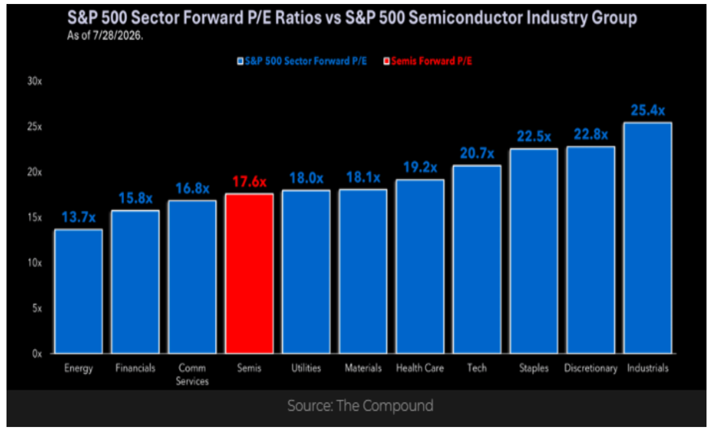
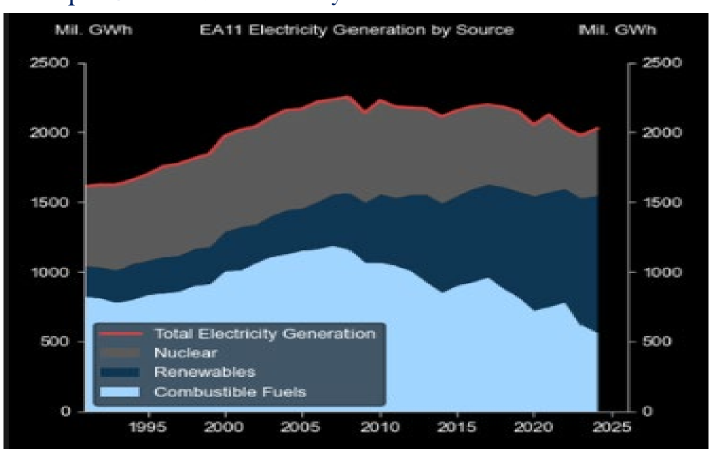




The rest of the market is also reporting good numbers but, as the second table shows, valuations are not particularly cheap, although they remain acceptable for this point in the cycle. In the UK, the new Prime Minister is changing the fiscal rules to release £9 billion. By comparison, companies such as Microsoft, Meta, Google, Oracle and Amazon will spend $1.2 trillion on AI next year. The scale of that contrast makes the UK look irrelevant. Recent earnings show that the technology companies known as "Hyperscalers" are making money from AI and they need to, this is the biggest financial bet since equity markets first developed.

Europe Gas and Electricity



This energy crisis has so far not hit the global economy in the same way as the Ukraine crisis did. The UK, despite Brexit, remains fully integrated into the European electricity system and if there is a price surge in Europe then we suffer as well. Europe has, however, begun to wean itself off combustible (fossil) fuel, as this chart shows. Indeed, their use in electricity generation has halved. Renewables are expensive to build, with a now outdated funding system, but undoubtedly have helped in this crisis. Costs for business and consumers remain high but much of that cost is regulatory.

Markets

The next month will continue to be dominated by the same themes. Will the Strait of Hormuz reopen fully, or will the US make one "final" move against Iran? Earnings growth should remain strong as the global economy recovers. The AI race will continue to experience bouts of nervousness followed by extreme optimism. Crossholdings and funding structures add risk, as does the continued use of the corporate bond market by companies that have traditionally generated enormous amounts of cash. The UK economy is likely to lag. Despite changes to the fiscal rules, the Autumn Budget is expected to raise taxes and speculation over which taxes will increase is likely to hold the economy back until then, repeating the same mistake as the last two Budgets. Gilts cannot realistically make progress until the Budget is announced and importantly, the figures are considered credible. The key 10-year Gilt yields approximately 5%, compared with a base rate of 3.5% and inflation at 2.6%. The danger for the UK is that any growth stimulated by the new leadership could be quickly snuffed out by higher mortgage rates. For global markets, the key issues are AI, Iran and the Bond markets. Bonds highlight that there are stresses in the global financial system.

August 2026

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