The past month summed up

Markets have found an equilibrium of sorts, but it's too early to sound the all-clear given the reverberating global upheaval.

The rationale

Our view remains that the economic and market outlook has become more subdued given a US presidency prone to whipsaw decision-making that can in a moment completely change the dynamics for markets and corporate decision makers. Despite that, the data behind markets and economies remains relatively positive amid the uncertainty.

Optically, there is plenty to concern us: the war in Ukraine continues; the conflict in Gaza shows no sign of resolution, fracturing Israel's relations with Europe and Canada; the US continues to redraw its relationship with the nations of the world, distancing itself from its traditional allies; and, most recently, a new front has opened up between Israel and Iran.

At first glance this could lead investors to despair, particularly those who see risk as being either on or off the table. We view the world with vigilance but equanimity, supported by the relatively healthy state of US markets and stability across much of the economic world. Most market participants seem to be looking beyond the mayhem, and are still focused on longer-term opportunities, the most prominent of which is once again the potential for profits that could be generated by advances in artificial intelligence.

Well oiled

However, the risks should not be ignored. Given the wider conflict in the Middle East, the price of oil has shot up in recent days. However, it still remains well below $80 and some way off the highs over $120 that persisted when Russia invaded Ukraine and inflation shocked markets. The price has been extremely low of late amid high production levels from oil producing countries. Unless prices move sustainably higher, we believe the effects on inflation and growth will be contained.

Our gaze then focuses on the US given its importance in the global economy and as the locus for many of the securities held by investors around the world. Here the signals are mixed. US consumer sentiment, a historic bellwether given the centrality of consumer spending in the US economy, climbed in June, after declining for the previous six months. Even with the measure still at relatively low levels, that pessimism hasn't found its way into the general economy. Ever since COVID there has been something of a fissure between how people feel and how they behave, and they are still spending as if everything is OK.

Again, while the number of jobs being created is lower than last year when the employment market was still booming – the average until May this year was 124,000 a month compared with 168,000 in 2024 – the decline isn't so drastic as to set off alarm bells. And on the key measure of GDP things look OK – while it shrank an annualised 0.2% in the first quarter the reason was essentially technical, with imports mushrooming as companies tried to beat the introduction of tariffs. There's every chance that the pendulum swings back the other way – the Atlanta Federal Reserve's live estimate has GDP growing at 3.4% this quarter. That would see the average over the first half of the year close to 1.6%, hardly a disaster.

Back on track

Investors themselves seem to be more sanguine with the MSCI World index climbing 5.5% last month, its highest May return in 16 years. According to Bank of America, investors are less pessimistic than beforehand, with 59% expecting weaker global growth in May compared to 82% in April. The so-called soft landing – that the economy recovers from higher interest rates and inflation without going into recession – has returned to being the consensus viewpoint. There's also corporate evidence that things are on the up, with Bank of America's Global Earnings Revision ratio climbing from 0.53 to 0.61 amid a better-than-expected reporting season in the US.

What are investors to make of all of this? It's possible tariffs might reenergise inflationary tendencies that had seemed to be on the retreat, whilst the ever-changing policy backdrop causes companies and consumers to sit on their hands. However, the Federal Reserve, even under relentless pressure from Donald Trump to cut rates, is very clearly sticking to plans to do so only when it feels it can without overheating the economy. This may be coming, but not yet.

Markets in the US have recovered to where they were before the threat of tariffs sent them rapidly lower in April, a bounce that has taken them back to the historically expensive valuations of the beginning of the year, leaving a narrow margin for economic error. This keeps us from being too enthusiastic about increasing exposure to the US.

Goodbye DOGE, hello deficits.

If equity markets aren't showing a wariness in relation to the actions of the US presidency, the same cannot be said of bond markets. As we mentioned previously, bonds – particularly those of the US government – are traditionally seen as a safe haven. However, US Treasury prices marched downwards along with equities at the height of tariff uncertainty.

Much of the fear in relation to US government debt comes from the perceived indifference of the Trump administration towards balancing the books and there is scepticism that the President will reduce massive borrowing levels. Witness the furore over Trump's "Big Beautiful bill" and the spat with Elon Musk (now overshadowed, possibly conveniently, by the unrest in Los Angeles) over its spending commitments.

Our response is to continue to avoid US Treasuries. Furthermore, worries over government spending aren't confined to the US, with the UK spending review suggesting a very tight fiscal situation closer to home. With the negative impact on bonds more keenly felt out into the future, what government debt we do own continues to be in shorter-term, shorter-duration fixed-income assets more akin to cash.

Will the dollar take a Pounding?

By buying assets denominated in a currency, you're essentially buying into a country. With the outlook for the US as a reliable financial and diplomatic partner much more uncertain, the flow of investment, which had been positive for 15 years, is beginning to turn against the US. This has been most keenly felt by the dollar. Indeed, the dollar index, which measures the currency against a basket of others, has declined steadily this year, losing about 10%. To reiterate the point made about bonds, in times of stress it's highly unusual for people not to seek protection stateside – the US has lost some of its sheen as the safest port in a storm. The question then for international investors such as us is what effect does this have on other locations? Is the UK now a better bet?

The answer remains, on balance, no. The relative value of the pound against the dollar – a pound now buys about $1.35, up from $1.22 at the start of the year – has been driven more by dollar negativity than any positive reassessment of the prospects for the UK or the pound. The British economy is still moribund, with retail sales remaining below those before the pandemic. Just as in the US, UK government debt levels are elevated, but the UK doesn't have the firepower afforded by being an economic superpower. Currency is something we watch, particularly to identify any change in long-term dynamics that could impact our clients. The move in the dollar year-to-date has been unhelpful and sentiment towards the US is fragile, but in a currency beauty contest we would still expect the dollar to take the crown.

Conclusion

This is not the time to make bold moves in portfolios. There is a balance between risk and opportunity that means we remain close to our strategic long-term allocation, with a neutral exposure to risk and equities that should be able to prosper even if the near-term outlook temporarily darkens.

Our bond portfolio remains at the shorter end, acknowledging the particular uncertainty in bond markets from higher government debt levels. Gold retains its sheen given global tensions not seen for many years and as an alternative to government ill-discipline.
