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Monthly Macro View

- The war remains highly uncertain. The US presumably regrets ever starting it, Iran thinks it has leverage and can negotiate very hard and Israel is very keen to continue it. Analysts are divided on where it is going. The impact thus far has been to elevate inflation somewhat and the diminish growth to some extent, albeit less than many had thought likely. The military adventure which has seen the US eliminate a great deal of its military hardware, shows difficulty in protecting its allies and seemingly is in a position where it looks to have gained nothing is likely to cast concerns over the quality of government officials and feed into higher term premia.

- Inflation has persistently been above target in many areas for a considerable period. This has been largely due to shocks and Central Banks have largely looked through it. That has been the correct response. Yet as the Bank of England member, Catherine Mann has pointed out there is a good risk that long periods of inflation can lead to 'persistence'; price setters start assuming higher inflation is more likely. This has been much debated in the UK, but US markets are also showing some signs of adopting this as a risk. Thus far measures of expectations have, until very recently, not shown this strongly and neither have wage settlements. Yet given the weakness of the US institutional framework there is some rational basis for being less certain in the US about a strong long-term commitment to an inflation target. The new Fed Chairman has fed into this by talking about how he might look at different measures to assess the two per cent target as Claudia Sahm and others have highlighted.

- Fiscal issues remain a concern. There is still nothing to see among the general population or the political class to start to control this. It is not an immediate threat, but long-term forecasts are dire and risk premia should and to an extent do reflect this and will continue to do so.

- Taking into account the very abrupt turn in the nature of the United States remains challenging. The effort to turn it into an autocracy, the attacks on individuals and institutions, the reversing of long-held norms by the Supreme Court, the corruption, the failure of the rule of law, the abandoning of the global democratic alliance system, the concentration of extreme wealth to a level not seen since the late nineteenth century and the turning against science and immigration are clearly profound events. The impact on markets has not been anything like these shifts. The equity market has benefited from AI excitement and the ability of companies with strong moats (i.e. a lack of competition) around them to finance data centres without too much strain. The share of the GDP being to capital has been rising, which is clearly positive for earnings. The ability to increase stock buybacks relative to dividends has also been important given tax considerations as has increased gearing. For bonds most of what is happening should increase risk premia to some degree; it is less certain one can trust the United States to pay one back, the inflation targeting is more likely to be challenged and debt metrics are not high in populist regimes.

- Pre-Covid interest rates were very low and Larry Summers coined the term Secular Stagnation to explain this. The argument was there was too much saving (demographics, rising inequality) and too little investment (slower productivity, less capital-intensive cost technology, regulatory banking changes that raised the cost of capital, integrated global supply chains increasing competition). The question is: how much of this has changed? Demographics not at all and inequality has risen. Everything else, though, has shifted away from secular stagnation. It is reasonable, therefore, to see higher interest rates as permanent. From a historical perspective they remain quite subdued, which given the importance of demographics may well be reasonable. However, it appears we are settling into a period where current levels are seen as the norm.

- Currencies are dependent on the war as well as the relative strength of the US economy. We were long AUD before the war and would continue with that. Otherwise, we have little conviction. The US benefits from being an oil exporter, a safe haven if the war worsens and the economy has remained very resilient, but it is increasingly isolating itself internationally and is becoming less trusted. Its debt situation is also troubling in that there is no sign any party wants to control it. Its policies are diminishing rather than enhancing its huge fundamental strengths. There is no clear alternative, though.

- Spread remains tight. Healthy corporates, little sign of concentrations of risk and less trust in governments are all likely contributing to this. Disillusionment with AI hopes could damage this, but it is not a main scenario. There is therefore little reason not to keep a low but positive profile.

Portfolio Positioning

- Rates and Duration

  The crisis in the Middle East has spread from the Strait of Hormuz to the Bab el-Mandeb Strait, and we anticipate a protracted conflict. Furthermore, prices for DRAM (memory) and semiconductors are rising due to demand from AI data centres. Given that the U.S. economy remains resilient thanks to a premiumization strategy targeting the affluent, this is expected to fuel inflation on both the supply and demand sides. Therefore, we will construct our strategy centred on the risk of a resurgence in inflation, rather than the market consensus. We plan to maintain positioning based on a neutral to slightly long duration, flattening yield curve, and focus our bond allocation on resource-rich countries such as Norway and Australia. Given the economic environment described above, the distance to default may shorten for certain issuers; therefore, when spreads widen significantly, we plan to increase our weighting in high-credit-quality issuers.

  Our basic strategy remains the same as last month. We had anticipated a high likelihood that tensions would escalate again, and the situation has unfolded largely as expected. At the same time, the market still views the situation in Iran as resolvable and believes its impact on inflation will be limited. We believe the recent rise in interest rates is driven by an increase in real interest rates—specifically, a rise in risk premiums due to deteriorating global supply and demand conditions and uncertainty regarding future monetary policy. Therefore, we anticipate a further rise in interest rates as the market prices in the impact of high energy prices on long-term inflation. Consequently, we maintain a duration position ranging from neutral to slightly long, expect the yield curve to flatten, and continue our allocation focused on resource-rich countries. Regarding duration, we maintain a longer position in Australia and New Zealand—which are less susceptible to energy price impacts and have relatively limited room for further interest rate hikes—while maintaining a shorter position in Europe, which is more vulnerable to such impacts.

  In Euro area, we maintain and reinforce a neutral stance on short-term rates, broadly in line with current market pricing, which centres the next hike on September and a terminal deposit rate near 3.00%. At its most recent 23 July 2026 meeting, the ECB held all three key rates, leaving the deposit facility rate at 2.25%, with President Lagarde describing the situation as back to the baseline. Market implied policy rates continue to reflect two distinct forces; on the hawkish side, the energy shock has kept headline inflation materially above target, July's flash re-accelerated with core above expectations and broadening through goods, activity has proved firmer than assumed with Q1 revised away and Q2 beating forecasts, and Germany's fiscal expansion still adds a demand impulse; on the dovish side, the ECB's own staff read the shock as cost-push rather than demand-pull, wage settlements and pay expectations remain contained, and second-round effects are still undetected.

  In the UK, market volatility in gilt yields remains notable, with long-dated yields around their highest since 2008. Even so, long-term gilts continue to offer value, and the case has strengthened as the Bank now judges almost the entire rise in the forward curve since the conflict to be risk premium rather than a higher expected policy path, which can compress without the BoE cutting. An expected slowing of QT, skewed away from the long end, adds a technical tailwind, and the quarter's borrowing overshoot reflected debt interest rather than slippage. The elevated term premium still appears to compensate and looks more a demand-structure phenomenon than a verdict on a debt level near the G7's lower end.

  In the Japanese government bond market, there is a risk of further yield increases. Expectations that the Bank of Japan will continue to normalize monetary policy remain strong, while buying pressure from domestic institutional investors appears to have weakened. In particular, demand from life insurance companies and pension funds is becoming less reliable as a stabilizing factor for the market, given current yield levels and rising volatility in the ultra-long-term sector. As a result, Japanese government bond yields could rise further, particularly if inflation expectations remain firm and the Bank of Japan maintains a relatively hawkish stance.

- Currencies

  As previously mentioned, we remain broadly neutral on currency although we maintain a modestly bullish view on AUD because of the divergence of monetary policy between Australia and the US.

  The yen is expected to remain under downward pressure for the time being. Rising crude oil prices are heightening concerns about Japan’s trade and current account balances, and the still-wide interest rate differential continues to exert downward pressure on the yen. Although the government intervened in the FX market as expected, we do not believe this will fundamentally alter the underlying trend of yen weakness in the short term. Rather, the intervention is likely to slow the pace of yen weakness and curb disorderly movements, but it will not completely reverse the trend.

That said, the risk of further intervention remains significant. If the yen’s depreciation accelerates again or exhibits disorderly movements, there is a real possibility of additional intervention, which could trigger a sharp but temporary appreciation of the yen.

Important Information