RATHBONES

Weekly Digest

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Unfinished business

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Markets keep circling familiar risks, but earnings resilience and shifting rate expectations continue to reward investors who look beyond the headlines.

Quick take:

- Steady earnings and savings flows have kept balanced portfolios moving higher.
- Surprising market reactions can reveal more than the headlines themselves.
- Interest rate expectations will steer equities as inflation and energy risks persist.

One might hope that not having written a weekly since the end of July, I would find a lot of new fodder – or at least some firmer answers to the questions that investors keep asking. But, sadly, no. (Before you accuse me of being bone idle, there were two Monthly Digests!) We are apparently stuck in an endless series of loops. The seemingly interminable hostilities between the US and Iran. Concerns that bond markets are about to collapse. And limitless AI-related spending, with little certainty that the returns will justify it.

The only one that might have a firm end date is the current debate over the state of the UK's public finances, now that we know that the Budget will be on 28 October. But I can't be 100% sure of that, given how many government spending plans have had to be ripped up in the last few years – not to mention the bewildering regularity with which Chancellors of the Exchequer have been replaced too.

If this all seems very familiar ground, I make no apologies. But look on the bright side. The lack of major developments has delivered steady incremental gains for balanced portfolios over the last few weeks as corporate earnings growth surpasses expectations and savings continue to accumulate.

The first cut is the cheapest

A fun game to play when considering markets is to look at asset price movements (shares, bonds, commodities, whatever you fancy) in the wake of news, economic data, or an earnings release, and deduce from them what the news actually was. It's a useful way to test whether you're in tune with current market psychology or if the market's reaction function – how, and how much, it reacts to different information – is evolving. Investor sentiment and positioning are also important to monitor, especially given that trends in both thought and price action can persist for some time before the elastic gets overstretched.

For example, it's possible to judge where we might be in an equity market cycle by the reaction to results. For instance, if even better-than-expected results elicit no more than a yawn or even a fall in the share price, then one can infer that future growth is already largely reflected in the share price, or at least that investors own enough shares for now. The same goes (but in the opposite direction) for a poor setup, which results in a higher share price. If there is one thing that can discombobulate inexperienced investors, this is it. All news is history. Markets are looking to the future.

On the other hand, an unexpected profit bonanza or warning that triggers an exceptional respective share price rise or fall can sometimes be the harbinger of a new cycle in which analysts repeatedly raise or lower their earnings forecasts. Probably the most famous example in recent years was the first-quarter results announcement from chipmaker Nvidia in May 2023. It blasted through all forecasts, and the shares rose 24% in one day. It would have been very easy to think that one had missed out on all the gains after such a move, but its stock has since risen by another 500%. Some technical analysts (chartists) are still waiting for that gap in the share price chart to be filled…

It might be even more difficult, psychologically, to sell a share that's just had a negative profit warning. That's because we're programmed as humans to anchor our valuations to the preceding peak. That makes us reluctant to sell a share at less than this peak. It's even worse if selling turns a paper loss into an actual one. I always remember the advice given to me by the market makers (jobbers) at Smith New Court as they channelled their inner Rod Stewart: "The first cut is the cheapest!"

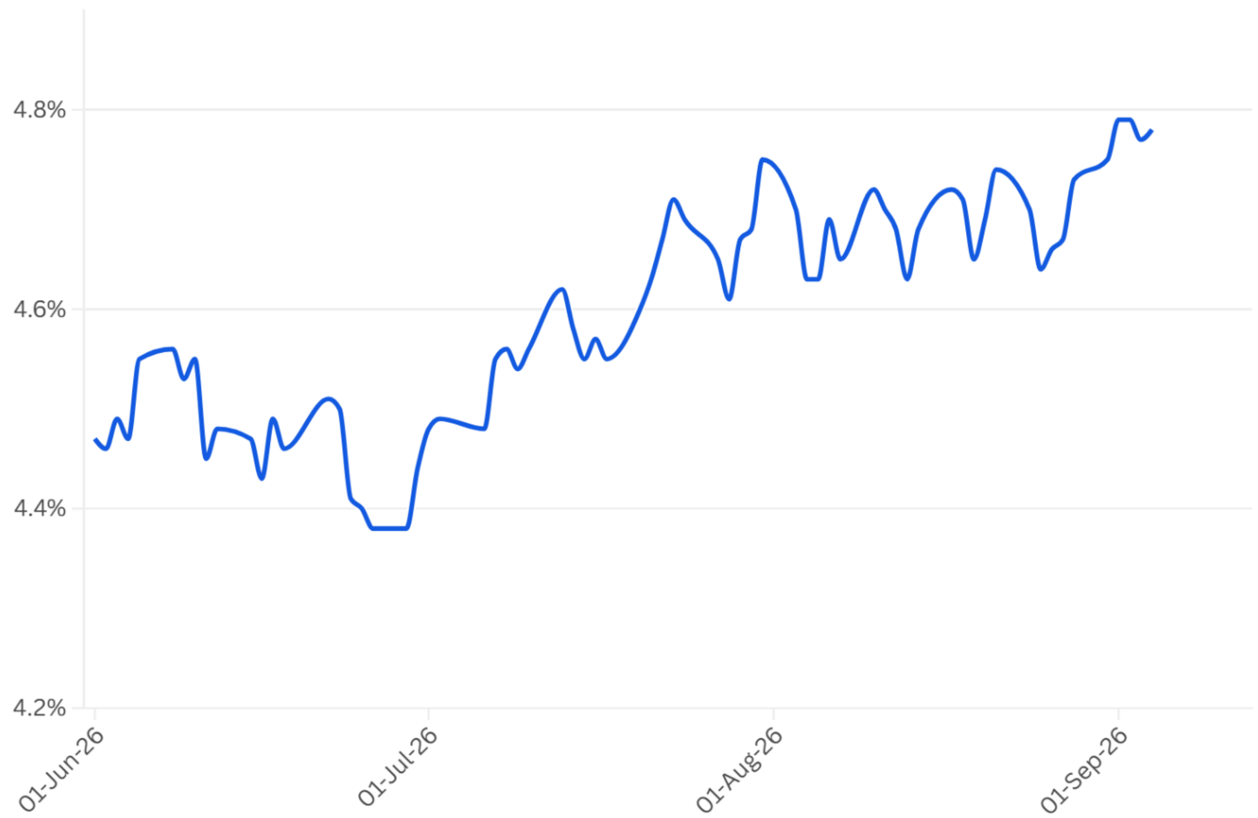
Summer revision

And so, what might we have learned from some of the market action over the summer? I think there were two key periods. The first covered a series of announcements from the US Treasury. Treasury Secretary Scott Bessent first helped Japan support the yen by using some of its euro reserves, which was an unusual move. The Treasury then offered Japan access to a repurchase facility normally accessed to provide liquidity to markets in times of stress. In effect, this means that Japan can 'borrow' dollars against its holdings of US Treasury bonds without having to cash in the bonds to buy yen. Bessent iced this cake with a statement that the Treasury would be doubling the size of its bond buyback programme. This was, ostensibly, another initiative to take illiquid bonds out of the market.

Taken in isolation, all of these announcements might have little signalling power. Taken together, they suggest a desire by the government to cap the yield on US government bonds. Why? Because the cost of servicing the ever-growing pile of debt is becoming, potentially, unsustainable. It remains to be seen whether more overt measures will be needed. Still, the effect was to revive bets

US Treasury yields feel the heat

Inflation fears and changing rate expectations push US borrowing costs higher.



Source: FactSet, Rathbones. Data from 1 June 2026 - 8 September 2026

The value of investments can go down as well as up and you could get back less than you invested. Past performance is not a reliable indicator of future performance. This information should not be taken as financial advice or a recommendation.

that the dollar would lose value ('dollar debasement' trade), which benefitted gold and bitcoin while putting the currency under pressure.

The second series of events occurred over two days last week. On Thursday, Federal Reserve Governor Christopher Waller said he saw more potential for disinflation – a slowdown in the rate of inflation – than was evident in the official data. This sharply reduced the probability of a Fed rate increase next week from above 60% to around 50%. The move galvanised equity traders, with the S&P 500 index gaining more than 1% by its close, the first time it had moved more than 1% in a single trading day for over a month.

It's quite rare to be this close to a Fed meeting with the call on what will happen to rates still a coin toss: will the Fed raise them or not? This suggests the potential for sharper moves in risk assets if the outlook becomes clearer. Maybe this is what the new Chair, Kevin Warsh, actually wants, given his disdain for 'forward guidance', where central banks signal how they expect to set interest rates in future.

As if to prove the point, Friday's US employment data was much stronger than forecast, and the rate hike probability round-tripped back to over 60%, with equities giving back some of their gains. What I take from this is, in the short term at least, that equities will be most influenced by interest rate expectations.

They, in turn, will be driven by economic data (such as this Friday's US inflation data release) and the volatility of energy prices. With oil back up close to $100 a barrel due to further hostilities in the Middle East, and refined product prices (especially diesel) hitting new highs due to limited refining capacity, inflationary pressure is building. The Fed will therefore face increasing pressure to prevent expectations of persistently higher inflation from becoming embedded.

Weekly Digest

Regional highlights

UK. The UK economy has remained resilient over the summer. World Cup effect? The 'Burnham Bounce'? We can't be sure. The return of rain, another increase in energy prices and the usual pre-Budget uncertainty will be the test. The timeliest data we get on economies is from surveys, and the monthly purchasing manager surveys tend to be the most comprehensive. The latest S&P Global Purchasing Managers' index (PMI) series was relatively upbeat. The Manufacturing index came in at 51.7 with Services at 52.5. Readings above 50 indicate economic growth. Only Construction remains in the doldrums at 44.3, beset by the recent increase in mortgage rates, higher input costs and a still-sclerotic planning consent process. Although official employment data show limited growth in the labour market, some more up-to-date surveys have shown an increase in hiring intentions. We can only hope that the new Chancellor, John Healey, finds a way to undo the damage to employers done by his predecessor. On the interest rate front, the Bank of England remains on hold for now, with higher inflation pressures balanced by a flat labour market (as per the official data). Market pricing suggests a limited chance of a rate rise next week, although there is one expected by year-end. Much will depend on how things develop in the Middle East.

US. The US is in much ruder health. Yes, a lot of the growth is down to AI-related capital expenditure, but wealth effects are also encouraging households to consume. Employment growth is another key driver of consumer sentiment, and the latest payroll data provided a positive surprise. Non-farm payrolls increased by 162k in August, up from a July figure that was revised up from -23k to +21k and against an expected 55k. Wage growth ticked down from 3.2% to 3.1% as expected and the unemployment rate was unchanged at 4.1% as Labor Force Participation increased from 61.4% to 61.6% vs an expected 61.5%. That's about as 'Goldilocks' as it gets. Even so, with bond markets under pressure owing to inflation fears (amongst other influences), there is some onus on the Federal Reserve to act, and markets currently place around a 60% probability on a rate increase at next week's policy meeting.

Europe. The theme of economic resilience applies to Europe, too. Eurozone GDP growth in Q2 was revised up to 0.6% quarter-on-quarter, although Ireland was responsible for about half of that (thanks to the fact that a lot of US intellectual property-related revenues are booked in Ireland to benefit from lower tax rates). But even excluding Ireland, Eurozone GDP growth was effectively unchanged from Q1 at around 0.3%. Private consumption contributed 0.2% while investment suffered a small contraction. Net trade was a strong contributor. The Eurozone economy has proved to be remarkably resilient to global headwinds this year, helped by government interventions in more fiscally sound economies that have alleviated some of the impact on consumers.

China. China remains the exception that proves the global growth resilience rule. Its official PMIs remain below the 50 mark, with manufacturing at 49.8 and services at 49. Yes, annual GDP growth was 4.3% in Q2, a figure that most Western governments can only aspire to, but a lot of that is driven by state-directed manufacturing, much of which remains unproductive. It's also below past trends as households remain unwilling to open their wallets while house prices remain well below their peaks and show no signs of recovery. Credit growth has also decelerated, suggesting no imminent acceleration in activity.

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