

Quarterly Financial Market Update, June 2026

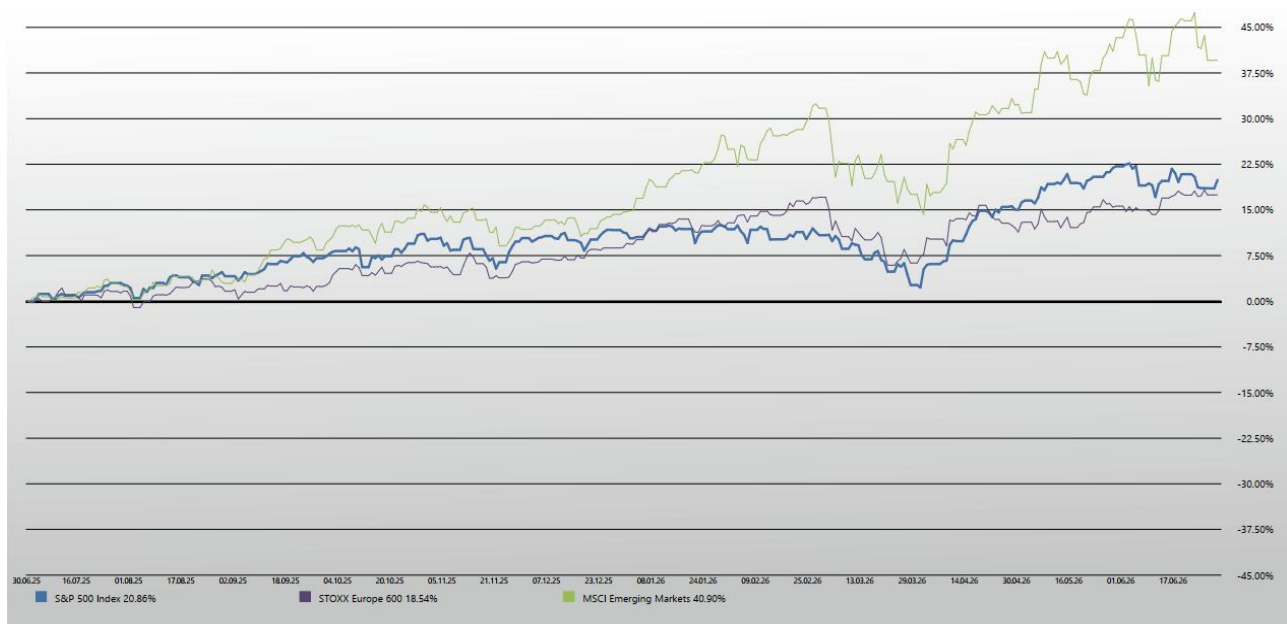
The second quarter of the year was very positive for equity investors, despite ongoing uncertainties in the Middle East. During the quarter, equity prices fully recovered from March's trough on hopes of a resolution of the conflict between the USA and Iran, ongoing optimism on Artificial Intelligence (AI) spending and a better-than-expected economic environment. Rising inflation rates and less accommodative central banks did not derail the overall investors' risk-on stance.

During the quarter, global equity prices gained 14.5%. Emerging Markets led the pack, up 23.3%, whilst Europe lagged slightly behind (+10.1%). US share prices increased 14.9%.

The rise was partly due to an economic environment more resilient than anticipated. For example, the US ISM Manufacturing Index was 54 in May (a reading above 50 means expansion) and the US economy added more jobs than expected. That said, the overall picture is still fragile, as the US GDP growth was 2.1% and durable goods orders were down 4.5% in May.

Also supporting equity prices was the ongoing AI trade, especially with companies active in the semiconductor/chip business. The Philadelphia Stock Exchange Semiconductor Index jumped 87.8% during the quarter. Lately, some profit taking hammered stock prices for this industry, though not enough to erase the rise registered during the past three months.

Equity Index Performance, rolling 12 months (%)



Source: Kestrel Wealth Management

Regarding other asset classes, the gold price continued its decline (-14.1% to USD 4'008.-/oz) which started in late January, as the US dollar appreciated against major currencies.

Another factor affecting the price of gold was a shift in policies/tones by central banks. Inflation rates have risen significantly as a result of a surge in oil prices following the air strikes carried out by the United States and Israel against Iran. Contrary to what was still expected just a few months ago, rate cuts are no longer on the agenda, at least for the time being. For instance, the Bank of England (BoE) kept its benchmark rate unchanged at 3.75% and the European Central Bank (ECB) increased the main refinancing rate to 2.40% from 2.15%. Even the US Federal Reserve (Fed) maintained its rate (at 3.75% for the upper bound), despite the arrival of its new Chair, Mr. Kevin Warsh (handpicked by President Trump and approved by the Senate). As the US inflation rate increased to 4.2% in

May from 3.3% in March, the Fed could not cut rates to support the economy, somewhat thwarting President Trump's plans.

This also had an impact on interest rates. The second quarter proved to be rather lackluster for bond investors. Overall, bond prices remained virtually unchanged over this period. More hawkish comments from central banks, uncertainties linked to the economic environment and fears of rising government debts, all these elements led to higher interest rates. In the US, the yield curve flattened during the quarter. The yield on the US 10-year government bond added 15 bps to 4.47%, but the yield on the 2-year gained 38 bps to 4.17%. In the UK, the fixed income market has also experienced some turbulence, affected by an additional factor though.

Indeed, UK politics made the headlines again. Following the election of Andy Burnham, mayor of the Greater Manchester, as MP, it is likely that he will be the next leader of the Labour Party. Simultaneously, and facing mounting critics over his policy, Prime Minister Keir Starmer resigned, paving the way for Mr. Burnham to replace him.

Not surprisingly, this overall story impacted the yields and the currency, which were already on a rollercoaster ride due to the inflation and a change of tone from the BoE. The rate on the UK 10-year government bond increased as much as 26 bps to 5.17%, before coming back down to 4.76%. The pound sterling was also relatively weak over the past few weeks against the greenback, down from 1.363 to 1.326.

We advise to continue to focus on high quality bonds. The 4%+ yield in USD and in GBP that investors can obtain without taking much risk is attractive to us. Besides, investing in bonds allows investors to lock in this yield for the years to come, instead of months, all else being equal. Whilst in the short-term the evolution of monetary policies (and inflation) does not call for rate cuts, the long-term trend in yields is more likely down than up. As far as the High Yield segment is concerned, we do not recommend to be exposed to it given the overall economic environment.

The question regarding the Strait of Hormuz remains essential for investors. Despite the recent agreement between the US and Iran to discuss a peace treaty over the next sixty days and the subsequent drop in oil price to USD 73.-/bbl for the Brent (at the time of writing), from as high as USD 118.-/bbl, the situation in the Middle East remains very uncertain, to say the least. Israel's occupation of southern Lebanon and sporadic attacks between the US and Iran could very well reduce the peace talks to tatters. The conditions for opening or closing the strait are vague, to say the least, but this will dictate the evolution of the inflation rate and consequently the future monetary policies from central banks and the progress of the world's economy. Whilst the spectre of stagflation or recession receded over the past weeks, things can change very quickly if the oil price were to skyrocket again.

Equity prices are not cheap, though not overly expensive neither. For example, the S&P 500 Index trades at a forward estimated P/E of 21x, with the consensus expecting corporate's earnings to grow 21% over the next twelve months. That said, a full blockade of the Strait of Hormuz could lead to significant downward revisions in earnings growth, jeopardizing the good year-to-date performance of the equity markets. Therefore, we keep our neutral stance on this asset class, as a principle of caution is warranted, in our opinion.

Over the coming months, it is highly likely that the political and geopolitical drama orchestrated by President Trump, along with his unpredictability, will continue. As a result, volatility is expected to remain high. Tariffs could well return to the forefront, along with questions about share valuations and so on, all against the backdrop of the mid-term elections in November closing in fast.

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