Market Flash: The Fed is showcasing firmness but in practice is treading cautiously.

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- **This week's inflation data in the US offered markets some unexpected relief.**
- **US-Iran tensions are now in a low intensity conflict but the consequences could still prove damaging for commodities.**
- **A risk premium on short US rates and the choppy geopolitical context have led to the Momentum Asset trade unwinding, particularly for semiconductors**

This week's inflation data in the US offered markets some unexpected relief. June's CPI fell 0.4%, the first monthly contraction since 2020. Underlying inflation was stable around 3% over a year. Underlying PPI only rose 0.2% over a month (+4.7% over a year). The overall index slowed to 5.5%, a move which made the probability of Fed hike this month fall significantly. However, the Fed thinks that data is no more than a technical signal. Kevin Warsh said the mission was not yet over and Lisa Cook said the bank should be ready to act in the absence of any more tangible disinflation. Regional governors from Jeffrey Schmid to Lorie Logan said any change in direction would be premature. The data lift pressure but do not mark the end of the inflation-fighting cycle.

The economic data suggest a growth/inflation cocktail that warrants central banks opting for the status quo. Elsewhere, US-Iran tensions moved into low-intensity conflict mode but the consequences for commodities could still be serious. Repeated US strikes and Iran's reprisal threats targeting regional infrastructure have fuelled uncertainty, keeping Brent crude around $85 and government bond yields at still elevated levels. We are seeing a mutual demonstration of resistance to pain. Both camps want to prove that they can weather the costs before a politically acceptable solution is found. But this time, Donald Trump seems to have room to escalate matters while Iran has interest in striking harder before its position weakens. The danger is that the conflict could spread to regional targets like Saudi Arabia or UAE infrastructure.

Even so, the central scenario is still a gradual de-escalation even if the Strait of Hormuz is closed and oil tanker movements are at risk. Ahead of the midterms, Donald Trump has no interest in allowing an energy crisis to take root. And regional actors like Pakistan are trying to get both sides back to the negotiating table. The White House has also reaffirmed that it is open to diplomacy. We think Brent crude could trade between $65-85 up to the end of this year, provided Hormuz reopens, Middle East production returns to normal, albeit slowly, and Chinese demand falls if oil prices surge. In this way, inflationary pressure could gradually ease.

The risk premium on US short rates and the choppy geopolitical situation has also led to the Momentum Asset trade unwinding, particularly for semiconductor stocks, the Nasdaq and South Korea. So far, each reassuring piece of news on inflation or growth has been rapidly offset by mounting Middle East tensions or by the Fed taking a more hawkish stance. We are, in fact, in a period of transition: US inflation is easing but not so much as to fall to target levels, the Fed appears to be turning more hawkish while tailoring its decisions to each report, geopolitical risk remains serious but could fall back, oil is trading at tension levels with normalisation dependent on de-escalation and doubts are plaguing assets which have risen the most.

As we think there is a chance for disinflation to continue, we are more comfortable combining an overweight position in risk assets (equities and high yield credit) with an overweight in government bonds and real interest rates. We are still hedged against the risk of the dollar losing ground again.

European equities

The second quarter earnings season kicked off this week. As usual, large caps were first, with close to 15% of Europe's market cap reporting. The first results were encouraging and market themes continued to broaden.

The first results generally won investor approval. Luxury group **Richemont** saw 20% growth, picking up speed from the previous quarter, once again driven by jewellery. Growth beat expectations in every major region, led by Japan and the US. Earnings momentum among tech and AI stocks continued even if the market's reaction suggested that the theme was running out of steam. **ASML** reported a sales and margins beat and raised guidance for the third quarter and 2026 as a whole thanks to persistently strong demand. **ABB** also had an excellent quarter, sweeping past consensus expectations. The group's order book hit a record $30bn, mainly due to electrification. The group also launched a bid on **Rotork** at a 74% premium. In industrials, **Atlas Copco** rebounded from a weaker first quarter. New orders beat expectations across all divisions with a particularly strong showing from its semiconductor activity. **Técnicas Reunidas** raised order book guidance after securing most of its annual target. Momentum at **Publicis** improved in the second quarter and management tightened guidance towards the top of the spread.

In strategic moves, CPPIB placed 8% of **Elis**. In the fiercely competitive food delivery space, Uber launched a takeover bid on **Delivery Hero** at a 9% premium. **GTT** built on an excellent start to 2026 with new orders for tanks for two additional tankers. **Dassault Aviation** stands to gain from increased French support for Ukraine. The two countries agreed a plan for Ukraine to acquire 16 Rafale fighters. The first deliveries are scheduled for 2028.

US equities

Wall Street edged lower between July 10-16 as inflation eased, the earnings season began and US-Iran tensions escalated. The S&P 500 lost 0.55% and the Nasdaq shed 2.68 %. The Russell 2000 ended the period 0.11% lower. June CPI fell 0.4% over a month, leaving the annual tally at +3.5%. Core CPI was unchanged (+2.6% over a year) while PPI slipped 0.3% over a month. The data reduced the likelihood of a Fed hike this month. Yields on 10-year US Treasuries moved from 4.29% on July 13 to 4.14% on July 16. Even so, the Fed is still treading cautiously as inflation remains above its 2% target.

Tech stocks tumbled 2.68%, dragged down by the 8.48% plunge in the semiconductor index. And yet **TSMC** reported a 77.4% rise in second-quarter net profits while upping its growth forecasts and its investment budget, another indication of strong demand for AI infrastructure. In sharp contrast, **IBM** plunged 25.2% on July 14, its biggest sell-off since 1968, after issuing a warning on its second-quarter sales. Management now expects $17.2bn, or less than the $17.9bn pencilled in by analysts. The group said several contracts had been pushed back with companies shifting investments towards chips and AI servers.

Healthcare gained 0.51%. Sales and adjusted EPS at **Johnson & Johnson**, $25.31bn and $2.90, respectively, beat expectations and the group raised annual guidance. But the share lost ground due to disappointing MedTech revenues which came in at $8.93bn, or slightly less than expected.

Financial services gained 1.89% as the earnings season got off to a good start. **JPMorgan** had a record quarter for earnings and raised guidance on net interest income. **Goldman Sachs** reported historic equity trading revenues and **Wells Fargo** beat expectations thanks to its wealth management and investment banking divisions.

Energy (+3.76%) led sector gains as oil prices rose, along with the risk premium from the US-Iran conflict. Brent crude rose to $85 before falling back. WTI gained around 11% in three trading sessions. Tensions in the Strait of Hormuz are fuelling global supply fears and pushing refining margins higher.

Telecoms trod water in a market where stocks with less direct exposure to semiconductor supply chains were generally in favour.

Emerging markets

The MSCI EM was down 1.54% in USD as of Thursday. China, Mexico and Taiwan were up by 2.56%, 0.70% and 0.68%. Korea, Brazil and India were down 8.84%, 1.62% and 1.51%, respectively.

In **China**, second-quarter GDP grew 4.3% YoY — below the 4.5% consensus, though the GDP deflator turned positive (+1.6%) for the first time in three years. June activity was mixed, with retail sales up 1% YoY (est. -0.1%) and industrial production up 5.3% (est. +4.6%) both surprising positively, while first-half fixed-asset investment fell 5.7% (est. -4.9%). June exports surged 27% YoY (est. +19%), driven by AI-related electronics. Public and private sector efforts led to the landing of an orbital-class reusable rocket booster at sea for the first time — only the second nation after the US to do so. **CXMT**'s Shanghai IPO is set to raise ~$8.5bn — roughly double the $4.3bn flagged at launch last week and nearly twice the amount earmarked for its investment projects. **Apple** finally received Cyberspace Administration approval to launch Apple Intelligence in China — integrating **Alibaba**'s Qwen model (and **Baidu** for some services) after a two-year wait. **Moonshot.ai** released its Kimi K3 model with world frontier lab performance just below Claude Fable 5 and GPT-5.6.

In **South Korea**, the BoK raised its rates by 25bp to 2.75% in line with expectations. The FSC suspended new listings of products tied to Samsung and SK Hynix and raised minimum deposit requirements to 30m won from 10m. Samsung is reportedly planning a ~20% DRAM price hike in the third quarter and is looking at building a new DRAM factory as US onshoring pressure intensifies.

In **Taiwan**, **TSMC** delivered a clean second-quarter beat and raised guidance sharply, lifting the 2026 revenue-growth outlook to slightly above 40% (from >30%) and capex to $60–64bn (from $52–56bn). The company also added another $100bn capex commitment to build 4+ more fabs in the US.

In **India**, June CPI rose 4.38% YoY (est. 4.20%) attributed to supply-side factors from the Middle East conflict. June's trade deficit widened to $30.43bn (est. -$26.5bn, prior -$28.2bn), the largest since January, as the Strait of Hormuz disruptions lifted import costs. The government renegotiated a higher duty-free steel export quota under the UK FTA. HCL Tech reported a beat for the quarter, and strong new bookings but Wipro disappointed on growth and margins and guided for second-quarter revenue of -1.5% to +0.5% QoQ in constant currency, or below expectations. BHEL posted a strong quarter with continued order flow momentum in the power space.

In **Mexico**, June ANTAD same-store sales fell 1.6% YoY (prior +0.8%) and nominal wages decelerated to +7.2% YoY (from 7.9%). **Aeromexico**'s second-quarter revenue rose 13% YoY but operating income collapsed 70% with third-quarter demand described as healthy.

In **Brazil**, retail sales for May grew 0.4% YoY, or below the 1.2% rise expected. The US announced 25% tariffs on a broad range of Brazilian imports effective July 22, following a year-long Section 301 investigation into unfair trade practices. **Movida**'s preliminary second-quarter net income of BRL 135.6mn more than doubled YoY and exceeded its own BRL 110–130mn guidance. **Vale**'s CFO flagged strong iron-ore and copper demand from spending on data centres and electrification but warned the Iran war was raising shipping costs.

Corporate debt

Risk aversion mounted over the week due to significant geopolitical escalation and brutal sector rotation. Repeated US strikes on Iran disrupted shipping in the Strait of Hormuz. Brent crude rose from $76 to $85 (+12%), its biggest move higher since April. At the same time, global risk appetite was hit by the tech stock sell-off. 10-year US Treasury yields rose from 4.56% on Thursday July 10 to 4.53% a week later with a peak at 4.626% on Monday July 13 on fears of oil-induced inflation. Yields eased after PPI in the US came in softer than expected. Yields on the 10-year Bund rose from 3.08% to 3.13% over the same period. This followed a 13bp move higher in the previous week. Markets are now discounting 2 ECB hikes by the end of this year. On credit markets, high yield spreads hardly moved and even tightened a little towards the end of the week, rising 5bp to 250bp. The Xover, however, reacted to a slight return of volatility by widening by 10bp from 245bp to 254bp (as of Friday morning).

The new issues market slowed a little with the arrival of summer. Traditional IG and hybrid segments saw no deals this week. But HY deals continued, notably **Iliad** SA BB+ 4.125% 2031 for €650m and **Pasubio** B- 9.5% 2032 for €400m. There were two notable deals among financials, **Standard Life** with an RT1 for £350m and **Paragon Banking Group** with a T2 for £175m.

Over the week, the Euro Investment Grade indexes dipped 0.34% (+0.52% YTD). High yield only edged 0.11% lower (+1.88% YTD) but the segment is less susceptible to interest rate moves.

GLOSSARY

• Investment Grade: bonds rated as high quality by rating agencies.

• High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

• Senior debt benefits from specific guarantees. Its repayment takes priority over other debts, known as subordinated debt.

• Debt is considered to be subordinated when its redemption depends on the earlier payment of other creditors. To offset the higher risk, subordinated Senior debt has priority over other debt instruments.

• Tier 2 / Tier 3 : subordinated debt segment.

• Duration: the average life of a bond discounted for all interest and capital flows.

• The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

• The so-called "Value" stocks are considered to be undervalued.

• EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortization.

• CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.

• The PMI, for "Purchasing Manager's Index", is an indicator of the economic state of a sector.

• AT1s belong to a family of bank capital securities known as contingent convertibles or “Cocos”. Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

• RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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