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Royal London Asset Management Market Review and Outlook

Quarterly Overview

30 June 2026

Overview

Overview

Headlines and markets were dominated by the US and Iran during the past quarter. The disruption to oil supply via the Strait of Hormuz pushed oil prices to levels last seen following the Russian invasion of Ukraine in 2022. Although a ceasefire was announced towards the end of the period, causing prices to ease, these remain above pre-crisis levels.

From a macroeconomic perspective, growth forecasts remain subdued, and inflation remains above central bank target levels. The major change over the quarter was central bank rate expectations. At the start of the period, markets were pricing in multiple hikes in the US, euro zone and UK, but these expectations were tempered as the period progressed – with the changing outlook the key driver of markets over the quarter.

In the wake of the conflict in the Middle East, business surveys pointed to slower growth in Q2. The UK and euro area composite PMI business survey data indicated a modest contraction in private sector output. The US composite PMI held up better, above 50 and rising over most of Q2. Manufacturing was supported by firms bringing forward activity ahead of expected price rises and potential shortages. However, as tensions in the Middle East calmed and the oil price fell, the June survey data pointed to some unwind of that support.

Higher oil and gas prices pushed up headline inflation across most economies, primarily via fuel and energy-related components. Business surveys also pointed to a squeeze on input costs and a deterioration in delivery times, reflecting supply chain disruptions. By June, however, there were signs of easing supply chain disruptions following increased shipping flows through the Strait of Hormuz.

The US Federal Reserve kept rates on hold in both April and June. The June participant projections, however, showed nine out of 18 participants pencilling in a 2026 rate hike alongside upward revisions to the median inflation forecast, although the projections would not have fully reflected the fall in the oil price seen later in the quarter. Kevin Warsh replaced Jerome Powell as chairman of the US Federal Reserve and in June held his first press conference. He avoided giving guidance on the path for interest rates but struck a more hawkish tone than many anticipated.

US tariff refunds under the IEEPA framework began, but the US announced a new 10-12.5% tariff on a large number of trading partners relating to forced labour in supply chains. US Q1 GDP (released in Q2) grew a respectable 2.1% quarter-on-quarter annualised, after 0.5% in Q4 (which was affected by the government shutdown). Business surveys continued to signal solid growth in Q2.

The European Central Bank (ECB) raised rates by 25bp in June as the inflation impact of higher energy prices showed signs of broadening. Euro area GDP fell 0.2% quarter-on-quarter in Q1, although the fall was exaggerated by GDP volatility in Ireland.

The Bank of England (BoE) kept rates on hold with two members voting for a rate hike. By the end of the quarter, given lower oil prices, markets had lowered expectations of future rate hikes from both the ECB and BoE from levels seen earlier in the quarter. UK GDP growth was strong in Q1 by UK standards, increasing by 0.6% quarter-on-quarter (non-annualised) after 0.1% quarter-on-quarter in Q4. However, business surveys pointed to a significant slowing in Q2.

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Political uncertainty rose in the UK, where poor local election results were ultimately followed by the resignation of UK Prime Minister Keir Starmer. By the end of the quarter, former Greater Manchester Mayor Andy Burnham was widely expected to succeed him.

Labour market trends have diverged somewhat. In the US, employment growth saw signs of increased momentum after a year of subdued employment growth. The euro area unemployment rate remained near historically low levels. However, the UK labour market remained soft. The number of payrolled employees fell on average over April and May, though the unemployment rate was relatively stable. Vacancies have fallen and the PMI employment indicator remained weak compared to other countries.

Headline inflation jumped in most economies, reflecting higher energy costs. In the US, CPI inflation jumped up from 2.4% year-on-year in February to 4.2% year-on-year by May. UK inflation has been bumpy over the quarter but is widely expected to rise after household energy bills reflect higher wholesale prices in July (when the Ofgem price cap updates). In the euro area, higher energy prices pushed inflation from near the 2% target to 3.2% by May.

Government bond markets remained volatile during the second quarter as markets balanced persistent inflation pressures, shifting central bank expectations and ongoing geopolitical uncertainty. However, markets moved away from the sharp repricing seen in the first quarter, with some support returning to duration by quarter end as energy prices retreated, and fears of a prolonged supply shock eased. Yield movements were driven less by expectations of imminent rate cuts and more by concerns that policy rates may need to remain higher for longer. Short-dated bonds experienced the largest swings as markets reassessed monetary policy paths, while longer-dated yields reflected uncertainty around inflation, growth and fiscal borrowing requirements, particularly, in the UK, in view of the potential change of UK prime minister and policy changes that this might also bring.

In the UK, 10-year gilt yields rose above 5% during May before retracing some of those gains, ending June at 4.76%. US Treasury yields also moved higher over the quarter, with the 10-year Treasury yield ending June at 4.44%, down from 4.92% at the end of March. Across Europe, government bond markets experienced similar volatility as markets adjusted expectations for the pace of future policy easing. The German 10-year bund yield was 2.87% at the end of the second quarter, down from 2.98% three months prior.

The sterling investment grade credit market (iBoxx non-gilt index) returned 2.64% over the period under review. Spreads ended the second quarter at 0.76% (iBoxx), compared to 0.85% (iBoxx) at the end of March.

Global and UK Government Bonds

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Global and UK Government Bonds continued

Oil prices hit their peak in early April, sitting well above \$100 per barrel, with volatility continuing through the period. As expectations around a potential ceasefire grew, and with it the re-opening of the Strait of Hormuz, the oil price began to decline. That in turn saw a repricing of market inflation and interest rate expectations, and lower bond yields.

Government bond yields hit quarter-highs in mid-May and then fell into quarter-end, which mirrored the duration positioning of the fund, with our longest relative position coming when 10-year maturity gilt yields were above 5.1% in the period. Our duration position was the key driver of outperformance in the quarter.

On top of the geopolitical concerns, domestic government bond markets were also weighing developments around the ongoing Labour party leadership. Pressure began to mount on Prime Minister Keir Starmer's premiership ahead of the Makerfield by-election, which Andy Burnham subsequently won, ultimately leading to the resignation of Starmer as Prime Minister – with an expected coronation of Burnham to come at some point in the third quarter.

In gilt markets, the long end of the curve came under the most pressure amid this political infighting, with markets unsure if a Burnham-led administration would stick to the 'fiscal rules' laid out by the current government. Burnham has publicly stated his intention to follow these 'rules,' which has added an element of calm to long-dated gilts.

The combination of these two factors – volatility at both home and abroad – led to the gilt yield curve steepening over the quarter. This effect was led by the front-end of the curve driving the rally in the second quarter, after markets began to readjust expectations for central banks hiking interest rates. The steepening of yield curves was a theme across global markets.

Global Credit and High Yield

Over the three months to the end of June, global high yield markets recovered strongly from the volatility seen earlier in the year, with returns supported by an improvement in geopolitical sentiment, resilient macroeconomic data and continued confidence in corporate fundamentals. April marked the turning point for risk assets. Although there was no firm resolution to the conflict in the Middle East, the ceasefire helped investors assume that the Strait of Hormuz would reopen sooner rather than later and that the broader impact on the global economy would be contained. This improvement in sentiment, combined with stronger macro data, drove a tightening in high yield spreads. Government bond yields moved higher, but the strength of spread tightening more than offset this, allowing the market to produce positive returns in the first month of the quarter.

The rally broadened in May, with global high yield markets ending the month strongly as investors increasingly expected the war in the Middle East to end. Spreads tightened further. Performance was broadly positive across the market, with the exception of consumer goods, and the rally became more pronounced in the second half of the month.

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Global Credit and High Yield continued

European assets outperformed other regions on a relative basis, having been among the areas most affected by the earlier outbreak of the conflict, while BB and single B rated assets both delivered positive returns, with single B assets slightly ahead on a relative basis, which was reflected in the fund's outperformance with our overweight position versus the benchmark.

In June, markets remained resilient despite a more challenging rates backdrop, as government bond yields rose. High yield spreads still tightened further, ending the quarter at 238bps, helping the asset class deliver a strong quarterly return. This meant that, over the full three-month period, the market benefited from a consistent compression in credit spreads, even as government bond yields moved higher.

In the high yield market, the ICE BofAML (BB-B) Global Non-Financial High Yield Index (sterling hedged) benchmark returned 2.96% in the second quarter with spreads ending the three-month period at 238bps, tightening from 297bps, at the start of the quarter. At the end of the period, the index's yield-to-worst stood at 6.26% down from 6.75% three months earlier. In the broader-based high yield index, which includes CCC rated bonds, yield-to-worst fell to 6.78% from 7.42%.

UK Credit

The sterling investment grade credit market (iBoxx non-gilt index) returned 2.64% over the period under review. Spreads ended the second quarter at 0.76% (iBoxx), compared to 0.85% (iBoxx) at the end of March.

Overall, the second quarter was characterised by a robust recovery in fixed income markets, with falling longer-dated yields and supportive credit markets driving returns. Duration was a positive contributor to performance during the quarter.

We were generally positioned long duration – driven by bottom-up credit selection, where we have identified better value in medium and long-dated bonds in recent months. This stance meant we benefited from the decline in yields, particularly during May and June. There was a small negative contribution from curve positioning, thanks to strong performance from short-dated bonds, but the overall impact of our duration and curve positioning was positive.

We remain confident that active management can continue to add value in sterling credit. Diversification by sector and issuer, secured and collateralised debt, and attractive all-in yields remain key portfolio themes. Credit market commoditisation, including price-insensitive buying by annuity providers, passive funds and maturity-focused investors, can create spread dispersion and relative-value opportunities.

We believe this environment should continue to reward detailed credit research, particularly where secured structures, overlooked issuers or less commoditised areas of the market offer additional yield without requiring a disproportionate increase in credit risk.

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Equities and commodities

Headlines and markets were dominated by the US and Iran during the past quarter. The disruption to oil supply via the Strait of Hormuz pushed oil prices to levels last seen following the Russian invasion of Ukraine in 2022. However, a ceasefire was announced towards the end of the period, causing prices to fall back towards pre-crisis levels.

The effect on equities was to cause some volatility, though it was not enough to prevent a positive quarter for most markets. In the US, the main positive driver was further progress among large-cap technology and semiconductor stocks, as investors responded to another solid earnings season, evidence of sustained AI infrastructure spending, and relief that growth momentum remains intact. Strong earnings and technology leadership pushed both the S&P 500 and Nasdaq to fresh highs. However, these gains were tempered towards the end of the quarter, amid significant volatility. There were signs that investors have become increasingly concerned about the narrow nature of the rally, and that valuations among large AI-related technology stocks could have risen too far.

Elsewhere, Asia and emerging markets delivered some prolific returns, driven in particular by Korean and Taiwanese indices, which hit record highs. This reflected the performance of AI-related hardware stocks, including SK Hynix, Samsung and Taiwan Semiconductor Manufacturing Co (TSMC). Demand for advanced microchips and increased memory to boost AI infrastructure is coming from so-called hyperscalers, such as Microsoft, Google and Amazon, which are using these products in their data centres and to enhance their AI capabilities.

Given the relatively low weighting of AI-related technology stocks in European indices, returns from markets in the region were more subdued. However, sectors such as financials, defence and industrials continued to attract investor attention, resulting in positive returns overall.

From a macroeconomic perspective, growth forecasts remain subdued, while inflation is still above central bank target levels. The major change over the quarter was central bank rate expectations. At the start of the period, markets were pricing in multiple hikes in the US, euro zone and UK, but these expectations were tempered as the period progressed – with the changing outlook proving a key driver of markets over the quarter.

Cash markets

During the second quarter of 2026, UK economic news was dominated by the Bank of England's need to balance easing domestic inflation against renewed uncertainty created by higher global energy prices and the potential impact on growth, with the Bank deciding to leave rates unchanged throughout the period. At its June meeting, the Monetary Policy Committee voted 7–2 to keep Bank Rate unchanged at 3.75%, with two members favouring an immediate increase to 4.0%, highlighting growing concern that energy-related inflation pressures could prove more persistent than expected. Although CPI inflation eased to 2.8%, policymakers warned that inflation was likely to rise again later in the year as higher energy costs feed through to the economy. At the same time, signs of a loosening labour market and softer economic growth argued against further tightening, leaving the Bank in a cautious wait-and-see position.

Money market conditions reflected this policy stability. SONIA, the Sterling Overnight Index Average, remained steady throughout the quarter, starting and ending at 3.73%. Market expectations shifted during the quarter, however. Investors entered 2026 anticipating further interest rate cuts, reversing this view and pricing in material rate hikes following the spike in oil prices. Over the course of the second quarter, those expectations have eased, with markets now pricing in a single rate hike from the Bank this year. Two-year gilts, often seen as a proxy for market expectations of BoE rates, therefore moved lower, particularly in June on ceasefire news, falling from 4.41% to 4.18%.

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