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Cross-currents and headwinds

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The holiday season has arrived and whether one's destination be frying on the beach, breathing cool mountain air or all points in between, the chance for a break provides welcome relief. Relief too from the stresses and strains of financial markets where the lived-in experience of 2026 can hardly be said to have been an easy ride. July has proved no exception, emergent big themes remaining top of mind throughout another roller coaster month.

Here we go again! The two biggest themes have been, once again, the uncertainty surrounding the outlook for the war in the Middle East and just as importantly a growing anxiety surrounding the outlook for the technology sector and more specifically the gigantic funding demands, and eventual returns, associated with the booming artificial intelligence industry. A further sub-plot, if any were needed, has proved to be the response of the world's most systemically important central banks to the direct impact of highly volatile energy markets and the pass-through of rising energy costs into price and wage pressures more generally. Nobody said it was going to be easy!

Back in 1929, Irving Fisher, a great and highly respected US economist, argued that the US stock market had reached a permanently high plateau. Fast forward to the 1990s and the then Chairman of the Federal Reserve Alan Greenspan warned of irrational exuberance in financial markets. Both were responding to the formation of bubble conditions in stock markets and both turned out to be wrong! Looking at 2026 from

> *"We had joy, we had fun, we had seasons in the sun,*
> *but the hills that we climbed were just seasons out of time"*
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35,000 feet we witness nothing short of a moment in time; everything is changing both technologically, politically, socially and environmentally, and at warp speed. One thing is clear though, stock market valuations, especially in the United States, have not been this expensive since the Wall Street Crash. The only other time they came this close was at the zenith of the "dot.com" bubble at the end of the last century. As one experienced Goldman Sachs trader put it, succinctly, "gulp!"

But how expensive (and vulnerable) is expensive? To answer the question, one must first agree on an appropriate basis for valuation. Stock markets can be rated on numerous metrics but one, the cyclically adjusted price / earnings ratio, has the benefit of longevity its roots extending back to the late nineteenth century. Using this measure the US benchmark S&P 500 index has averaged 17.8x but with three huge peaks: September 1929 at 32.6x, December 1999 at 44.2x… and July 2026 at 41.4x. Double gulp! What might the now retired Warren Buffet make of all this? The "Sage of Omaha" would cross reference the above against his own preferred indicator, the total value of the global stock market relative to world GDP. What do we find? The Buffet indicator at over 200% and at a new record (and extreme) high this year. What could possibly go wrong?

In truth, what we're all witnessing has nothing to do with getting out of Dodge City as fast as possible, more a rotation into the less volatile, and vulnerable, sectors of the stock market and back into old-world favourites, those with defensive characteristics and reliable dividend payments seen as safe havens during periods of heightened uncertainty. Little wonder that UK and European stock markets, less exposed to the technology sector's vicissitudes, have proved encouragingly resilient.

Seeking out traditionally defensive sectors and financial market assets during times of stress is nothing new of course, but how safe is safe when the whole world seems leveraged to just one theme? Global stock index breadth may only now be expanding, but before that leadership had become narrow and dependent on the AI story. And it goes further; an AI capital expenditure cycle so enormous that it is driving GDP growth, cashflows and even jobs and the employment outlook. This is a cycle fuelled by cash, debt and equity and by extension a world of savings exposed to the AI roll-out both directly and indirectly. Nation states and their burgeoning deficits are not immune and are all, to a greater or lesser (but growing) extent, dependent on the AI growth theme and its ability to ride to the rescue and grow countries, including the UK, out of stretched public finances and sustained fiscal pressures. In a nutshell, this had better work!

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Uncertainty and what TS Eliot once described as a "wilderness of mirrors" ("Gerontion") is everywhere one looks; geopolitically, technologically, socially and more, it raises entirely reasonable questions regarding a tectonic shift into a new and highly volatile paradigm. If the US was once the world's hegemonic and unchallenged global superpower, that stability is now being challenged economically, politically and militarily. If globalisation is fractured and shattering then what must investors and society more generally make of the newly forged tail risks around the increasing balkanisation of scarce natural resources, rising populism, nationalism and protectionism? How can one make thoughtful and measured judgements relating to investing and asset allocation, taking one live example, against a backdrop of a war between the US and Iran (and its proxies) which is simultaneously on again / off again / on again? How, too, to take another, can one accurately model five-year out AI expectations in a world in which the rate of change evolves not just in months but in weeks and in some cases in minutes?

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Then there's climate change and another flock (or bevy) of potential black swans. Wildfires in Canada, Los

Angeles, Spain and France, hurricanes and typhoons gaining in intensity, a heatwave in London and zooming out, a super El Nino, hotter baselines, less abundance and more climate volatility in general, likely giving rise to second order impacts adding not just to a central banker's headache, but also to how investors and asset allocators ruminate about climate and its consequences against uncertain science but instantaneous consequences.

All the above and Andy Burnham too!

All the multiplicity of uncertainties highlighted (and there are numerous others) have one thing in common, they exist in plain sight. History tells us that every storm is followed by a period of calm, even as the half-life of such pauses diminishes. Keeping one's fingers crossed and hoping for the best possible outcome is not exactly a reliable investing thesis. For those investors seeking professional support appropriate to individual circumstances, Raymond James' wealth managers have the experience, skill and expertise necessary to navigate these dangerous conditions. Enjoy the summer, relax and prepare for the challenges that the autumn is sure to bring.