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IN BRIEF

- Globally, economic data was reasonably comforting.
- Financial markets were strong.
- Then it all changed when war was started in the Middle East, even though it was well flagged.

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The world economy, for the most part, is doing just fine.

Since the introduction of trade tariffs by the US last year, economists and financial market commentators have been analysing all the data to assess their impact, with key shorter-term effects being those on inflation, economic growth and levels of trade, along with the longer-term effects of countries becoming more nationalist as globalisation went into reverse. There has been surprisingly little negative impact so far, indeed, economies have remained robust. Clearly, the changing global landscape resulting from countries and regional alliances looking to be more self-sufficient takes a long time to work through, but it is happening.

The news on 20 February that the US Supreme Court ruled that the International Emergency Economic Powers Act did not give the President authority to impose broad import tariffs without explicit congressional approval, was taken quite well by financial markets, but not by the President, who promptly used different powers to impose new tariffs. There will be no quick resolution to this as it is all held up in the courts. But higher tariffs are here to stay, in one form or another.

In February, the key US economy, which has been very strong, saw some modest signs of cooling in the jobs market, inflation was a little lower, retail sales were weaker than expected as was manufacturing industry output. However, there is plenty of room for interest rate cuts, if needed. It was a similar trend in the UK, the problem here is that the absolute level of economic growth is so low, although the year-on-year inflation is trending down, partly as price increases from last year fall out of the calculations. The Bank of England's new concern is the fragile jobs market, but, again, there is room to cut interest rates. Elsewhere, the Eurozone and China are in good shape.

Financial markets took all that as good news.

Bond markets are sensitive to inflation and interest rates. At the simplest level, if interest rates are high or rising, that makes the income paid by bonds, or their yield, less attractive, because bond prices move around there is risk to their capital value, whilst the Pound, Dollar or Euro cash in your deposit account stays the same. In turn, high or rising inflation is considered bad as it means interest rates are likely to stay high in order to reduce inflation. That is usually a negative for bonds as well. Of course, the opposite of all that is also the case.

As I noted above, through February, inflation in major economies trended lower, economies were good but not booming, and expectations of interest rate cuts increased; therefore, bond markets produced some good returns. So did equity markets, partly for the same reasons, but also because we went through a positive "earnings reporting season" for the fourth quarter of 2025, when companies publish their financial results, such as revenues, profits and cash generation, and, possibly more importantly, provide guidance on the outlook for 2026 and beyond.

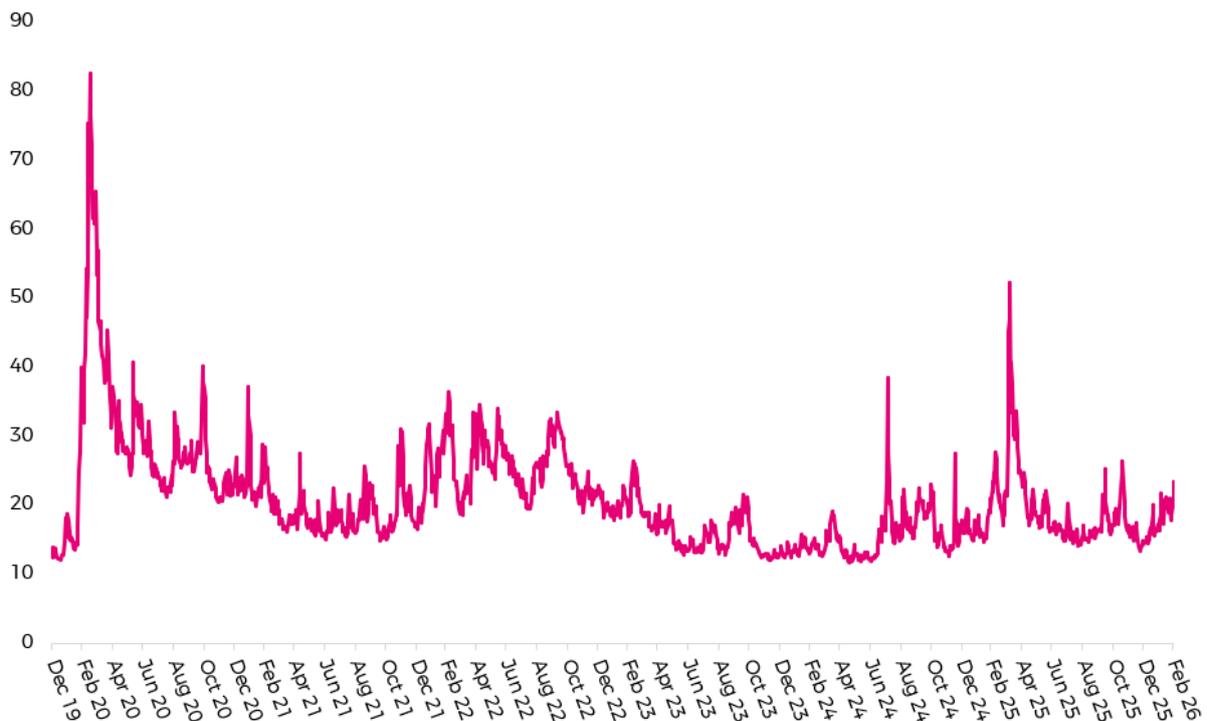
It went well, so equity markets went up. The UK was particularly good, led by large companies, whilst the US lagged, as doubt was cast on the longevity and scale of the impact of the huge spending taking place on AI, meaning some share prices suffered, and there was also a focus on companies that would suffer from the widespread take up of AI. But, overall, a good month for equity markets.

Geopolitics is perhaps the biggest driver of financial markets today (and probably for a while yet)

US military action against the ruling regime in Iran has been well flagged and it started at the end of the month. It's hard not to consider the awful human impact, but as investors we need to keep emotion out of decision-making. Periods of market volatility are unsettling, but disciplined investing is designed for moments like these.

Unsurprisingly, there has been an immediate negative reaction across many asset classes. The chart below is the VIX Index, which is a widely used measure of expected stock market volatility, derived from derivatives prices on the S&P 500 Index. It is occasionally known as "the fear index" as it goes up in periods of stress or uncertainty.

VIX Index (Volatility) – 31.12.2019 to 04.03.2026



Source: Bloomberg data from 31.12.2019 to 04.03.2026.

As I write this, at 9am on Wednesday 4 March, it is just below 24. That compares to the period when tariffs were announced in April 2024, when it went to over 50, also August 2024, when it nearly hit 40, due to concerning economic data in the US and Japanese economic policy changes, and it peaked at over 82 during Covid, a similar level to the global financial crisis in 2008. It is not out of the normal range experienced since then, suggesting that investors, in aggregate, are not overly concerned by the impacts of this war.

However, we are only a few days into the war and have no clear idea of how long it will last or how widespread the conflict may become. So far, it is fairly well contained. But oil and gas prices have jumped sharply, and that has clear implications for inflation, not just for our own use of petrol and heating, but energy is required across manufacturing and service industries.

As I noted above, higher inflation generally leads to higher interest rates, lower economic growth and falling bond and equity prices. That has happened, and within that, sectors that are particularly at risk, such as banks have suffered, whilst the share prices of energy companies have generally risen.

The two key factors to consider are, firstly, how long the war will last. As of now, there is no clarity to that, all participants are embedded in their position and when the reasons for the conflict are so fundamental and historic, it is difficult to see a negotiated solution, although there have been some before and the risk of a prolonged conflict could be negated by US military power overcoming an adversary.

The rhetoric from all parties does suggest they are ready for the long haul, but they have to say that for now. The longer it lasts, and the longer energy prices remain elevated, the worse the fallout will be.

The second factor is, how widespread the conflict may become. So far, it is regional, but many countries are being attacked, with key energy installations being targeted. If it spreads much further and, for example, European countries are under threat, it is difficult to know what the fallout maybe.

There is also clear misalignment between the US and other major countries, as the President has been critical of the UK's lack of support, as he sees it. Spain refused to allow the US to use joint military bases for strikes on Iran, which led to a threat from the President that the US would no longer do any trade with Spain. These issues may come to nothing, but non-military impacts are likely, and the President does follow through on some of his warnings. These are shorter term considerations.

For the longer term, there can be little doubt that this war will accelerate the growing trend away from globalisation towards nationalism or regionalism. Aligned with that, there is also a shift away from the rules-based international order at present. If that carries on, we have two fundamental and long-lasting changes taking place in the world at the same time.

As I noted earlier, short term periods of market volatility are unsettling, but disciplined investing is designed for moments like these. For the longer term, we have time to consider the implications of those fundamental changes, but markets move fast.

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Glossary

Bonds (or fixed income)

Types of investments that allow investors to loan money to governments and companies, usually in return for a regular fixed level of interest until the bond's maturity date, plus the return of the original value of the bond at the maturity date. The price of bonds will vary, and the investment terms of bonds will also vary.

Equities

Another name for shares (or stock) in a company.

Index

An index is a method of tracking the performance of a group of shares, bonds, other assets or factors. For example, the FTSE 100 Index is made up of the 100 largest companies on the London Stock Exchange.

Risks

Forecasts are not reliable indicators of future returns.

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