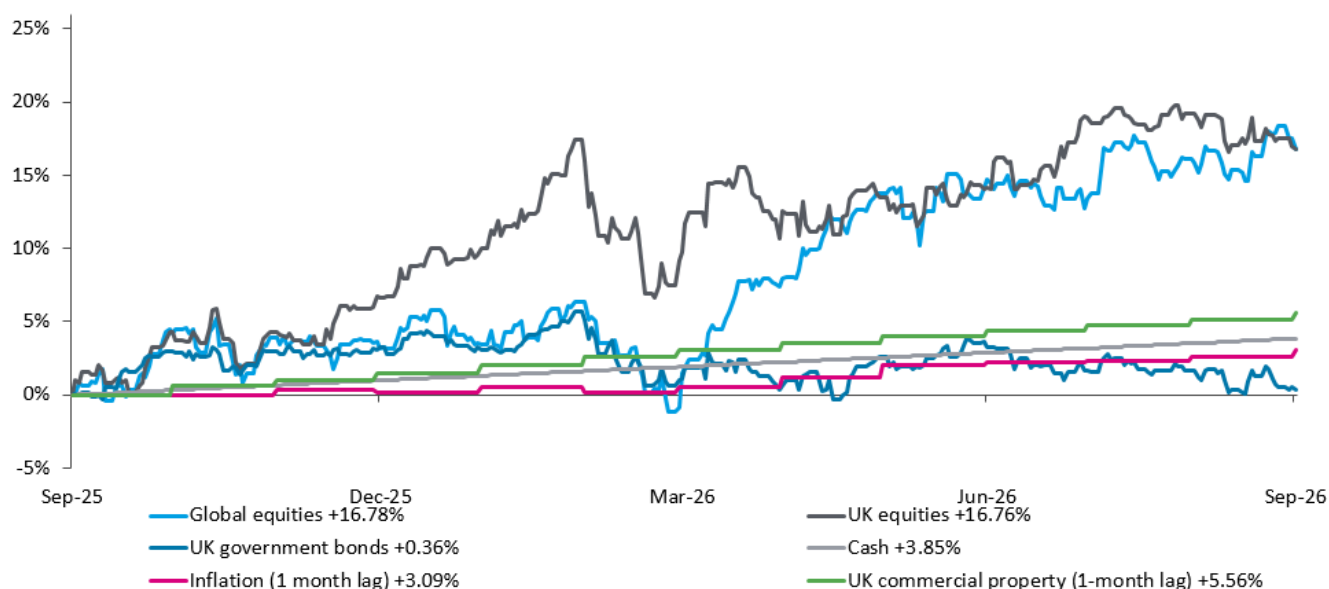


Market review

The headlines

- ▶ **World share prices fell in September, as central banks raised interest rates and bond yields continued to rise.**
- ▶ **The risk exists that central banks may raise interest rates too much or too fast, at a time when investors hold historically large allocations to shares.**
- ▶ **Our current interpretation of rising bond yields in the US is that artificial intelligence (AI) is boosting investors' expectations of long-term real GDP growth.**

Market returns: world share prices fell in September, as central banks started to raise interest rates



Sources: Bloomberg returns in pound sterling as of 30 Sep 2026 (30 Sep 2025=0%). Daily data, except for inflation and UK commercial property, shown monthly. UK government bond returns as per Markit iBoxx £ Gilts Index. Inflation as per the Office of National Statistics' UK Consumer Prices Index, with a one-month lag. UK commercial property as per MSCI UK Monthly Property Index, estimated for the most recent month. Cash returns as per Sterling Overnight Index Average (SONIA). Global and UK equity returns as per MSCI World Index and MSCI UK IMI Index, respectively. **Past performance is not a reliable indicator of future results.**

Economics and markets news

World share prices fell 1.2% in September. Central banks raised interest rates, bond yields rose, and the Middle East war flared up again. US share prices fell 0.4%, while eurozone and UK share prices dropped by 2.0%.⁽¹⁾

Inflation remained above central banks' targets in most developed countries. As a result, the European Central Bank (ECB) and the Federal Reserve (Fed) raised interest rates during September. The Bank of England

(BoE) kept its Official Bank Rate unchanged during September but 'stands ready to act as necessary'.

The US-Iran conflict flared up, Iran's allies in Yemen attacked Saudi Arabia and Saudi ships, and several countries continued to dip into their oil reserves. As a result, the oil price rose from \$91 per barrel at the end of August to \$108 per barrel at the end of September.

The US dollar strengthened versus the British pound. This boosted returns from dollar assets in pounds.

United States

America's central bank, the Fed, ended months of speculation by raising interest rates in mid-September, in a unanimous vote by the members of the Federal Open Market Committee (FOMC), which sets rates.

The Fed's chairman, Kevin Warsh, pointed out that inflation remained a problem but that the US jobs market and its wider economy were strong.

- Personal consumption expenditure (PCE) inflation, the Fed's preferred inflation gauge, stayed at 3.4%, year on year (yoy), in July, well above the Fed's 2% target.
- The US economy added 162,000 jobs in August, surpassing expectations.
- US gross domestic product (GDP) was confirmed to have grown 2.1% in the 12 months to 30 June 2026.

Persistent price rises and solid economic activity may make an interest rate hike seem uncontroversial. However, for the last few months, investors had doubted that Warsh, a Trump appointee, would raise interest rates. That's because raising interest rates potentially make it harder for the incumbent Republican party and President Trump to win mid-term elections for the US Congress on 3 November.

What's more, Chairman Warsh's press conference after the September rate hike led investors to believe that more hikes may be on the way. Warsh described the Fed's September move as 'removing a dose of accommodation' and emphatically stated that 'today's action starts to show we are serious about this'.

Longer-dated bond yields also rose during September. The yield on 10-year US Treasuries (government bonds), for example, rose from 4.79% at the end of August to 5.29% at the end of September, its highest level since 2007.⁽²⁾

Inflation expectations were little changed over the summer, and comparison with inflation-protected Treasuries shows that rising US Treasury yields were not the result of rising inflation. Rising government deficits also do not explain most of the rise in US Treasury yields, as the price of insuring against a US government default on its bonds has risen only slightly. Instead, it appears that higher expected future economic growth is the main driver of higher long-dated bond yields. The growth in activity from AI is the most likely explanation.

The hypothesis that AI will increase economic growth was consistent with the performance of US shares in September.

- Shares in information technology (IT) and communications advanced, led by Facebook WhatsApp/Instagram owner Meta, which launched its Muse AI assistant in September.
- Prices for health care shares advanced marginally, mainly because biotech firm Moderna released positive clinical testing data for a cancer vaccine that it is developing.

- Share prices in all other industry sectors fell. Utilities were the worst performers, because rising bond yields negatively impact these debt-heavy companies. Consumer discretionary companies such as Lululemon and financial intermediaries such as Charles Schwab also suffered.

The US stock market weakened slightly in September. It remains to be seen if, in coming months, corporate earnings can continue to fuel this rally, even if the Fed embarks on a series of interest rate hikes.

United Kingdom

UK share prices fell 2.0% in September, led by credit bureau Experian, betting firm Entain and online classified advertising business Autotrader Group. Company-specific news aside, many of these firms suffered from investors' continued fear that AI might disrupt their business.

In addition, the price of gold fell from \$4,437 per troy ounce at the end of August to \$4,187 at the end of September, and the price of silver from \$67 to \$60. Gold and silver prices generally perform poorly when interest rates rise, because neither pays an income. As a result, the share prices of UK-listed miners such as Fresnillo and Antofagasta also fell.

On a more positive note, the share prices of UK housebuilders Persimmon and Barratt Redrow rose after Prime Minister Andy Burnham announced his 'Your First Home' scheme for first-time buyers.

As with the US, however, bonds were the main story in UK financial markets in September. Consumer price (CPI) inflation rose from 2.9% yoy in July to 3.1% in August. The BoE did not raise interest rates in September but warned that it might do so later this year, if energy prices continue to stoke inflation. Most forecasts see the Official Bank Rate increase from 3.75% now to 4.80% in 12 months.

Longer-dated UK bond yields also rose. The yield on 10-year gilts (UK government bonds) for example, went from 5.06% at the end of August to 5.38% at the end of September, its highest level since 2007.

Unlike the US, however, UK gilt yields did not peak because of accelerating economic growth. Instead, UK inflation expectations rose significantly during September, and the BoE suggested that CPI inflation might rise above 4% in early 2027.

Mainly, however, investors in UK government debt feared that the UK government's credit was deteriorating. The government's debt has ranged from 93% to 95% of GDP for most of this year. Public sector borrowing reached £18.3 billion in August, the second highest ever August number, behind only 2020. Against this backdrop, investors await new Chancellor John Healey's first Autumn Budget on 28 October.

In addition, Prime Minister Burnham vowed to set up a national care service after the next general election, which will also require financing, by taxes or otherwise.

Other markets

Eurozone share prices fell 2.0% in September, mainly because energy prices continued to rise and bond yields spiked. Prices of luxury goods firms and car makers were among the worst performers. On the positive side, the share prices of semiconductor firms ASML and Infineon advanced significantly, as did those of energy firms ENI and Iberdrola.

Eurozone inflation rose from 2.9% in July to 3.2% in August and a survey of economists expects it to come in at 3.6% in September. The ECB raised interest rates by 0.25% during the month. The yield on 10-year German government bonds rose from 3.31% at the end of August to 3.58% at the end of September.

Japanese share prices fell 0.1% during September. The Bank of Japan raised interest rates 0.25% during the month. However, its decision was not unanimous, and the Bank's governor warned against too rapid rate hikes, so its next hike may not come for some time.

Chinese share prices fell by another 4.5% in September. China imports much of its oil, so surging oil prices had a particularly negative effect. At the same time, higher bond yields around the world drew liquidity away out of Chinese markets. The Beijing government rolled out another set of credit and mortgage subsidies, but investors – again – considered that package too small to have a meaningful impact.

⁽¹⁾ Source: MSCI (total return, net of withholding tax, in local currency), except where stated

⁽²⁾ Sources: US Fed, Bank of England, European Central Bank

Looking ahead

Rising interest rates held back the share prices of most non-AI companies in September. With oil currently at more than \$100 per barrel, inflation is likely to head higher in coming months. That, in turn, means that central banks are likely to raise interest rates several more times this year.

Long-dated bond yields have risen disproportionately. From comparing normal bonds with inflation-protected bonds, we can tell that the rise in long-dated bond yields is about more than rising inflation.

Some observers had suggested that higher bond yields are the result of worsening government finances. That

may be the case in some countries. But the price of protection against a US government bond default is no higher now than for most of the past four years.

Our current interpretation is, therefore, that investors have raised their expectations of long-term real GDP growth. A boost from AI technology is the most likely catalyst, which would help explain why the share prices of many AI-related firms have continued to rise.

(It is worth remembering that US companies in the AI and semiconductor industries are set to grow their earnings by more than 80% this year, versus c.34% for the IT sector as a whole and 20%, on average, in all other sectors. All of these are historically high, but AI earnings growth is, by all standards, extraordinary.)

The risk, however, is that central banks may raise interest rates too much or too fast. The Fed, for example, has quickly moved from a loose stance this summer, when interest rates were relatively supportive of economic growth, to a more neutral one, with rates neither stimulating nor restricting the economy. Inflation has exceeded the Fed's target for more than five years and, under its new chairman, it may be keen to return inflation to target sooner than stock market investors are ready to face.

In addition, investors hold historically large investment allocations to shares. Bank of America, for example, notes that its private wealth clients now have the largest allocation to shares in 25 years.

The solid earnings growth of companies listed on the stock market continues to encourage us. We believe that earnings growth will trump rising bond yields when it comes to stock market returns. But it is worth noting that, at extreme levels of positioning, investors are more vulnerable to small things going wrong.

Glossary

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