Investment Views

June 2026

BUTTERFIELD

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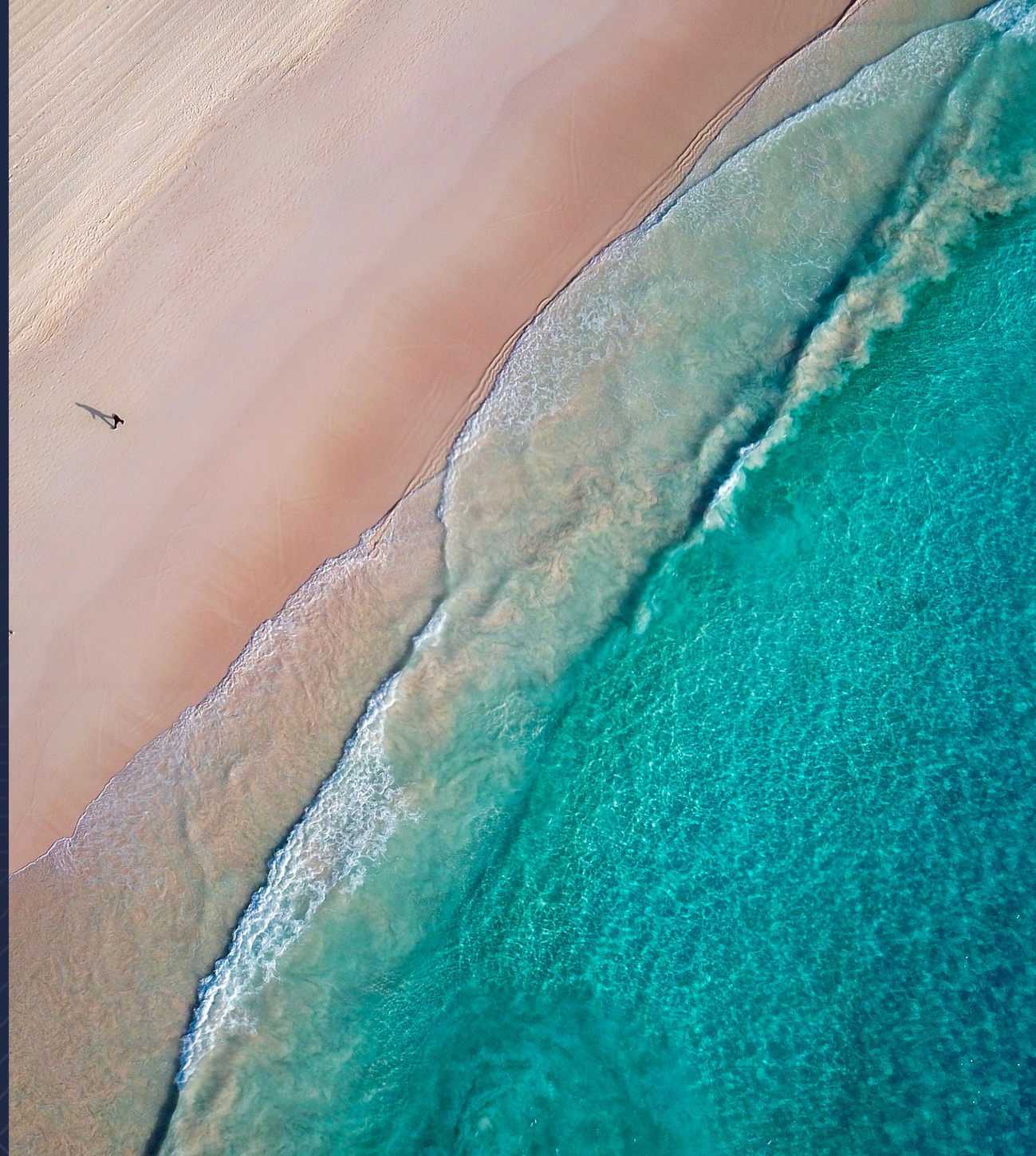
Recoveries, Rockets, and Risk

- Equities rally as oil falls
- AI theme has broadened
- SpaceX IPO in the spotlight

Equity markets have staged an impressive recovery from the sell-off in March caused by the Middle East conflict. In May, global equities returned 4.6% in US dollar terms, led by the Technology sector. The theme of Artificial Intelligence (AI) has dominated financial markets over the last three years, and continues to drive returns at both the sector and individual stock level. It is hard to discuss what is happening in equity markets without quickly turning to AI and there are a number of different dimensions to the theme.

At the front end, AI is software. Applications such as ChatGPT, Claude, and Gemini have grown rapidly and are used by both individuals and businesses for simple questions and complex tasks. However, behind the scenes there is a substantial buildout of infrastructure happening to power this AI revolution. This buildout helps to explain why equity markets have performed well even as geopolitical risks have been elevated.

The recent Memorandum of Understanding between the US and Iran has eased tensions in the Middle East and the flow of oil has



increased. Commodities, such as oil, proved to be good diversifiers in March, whereas bonds struggled. As the oil price has fallen, equities have benefitted and more than recovered their losses. Bond yields have fallen from the highs, but remain higher than before the Middle East conflict broke out.

Markets have also focused on the pipeline of companies looking to list on the stock market through an Initial Public Offering (IPO). The first of these high-profile names has been SpaceX, which was the largest IPO in history, raising $75billion. This valued the company at a huge $1.8 trillion, which for context is not far behind Amazon. Elon Musk's SpaceX has three main divisions. There is Connectivity, which includes the Starlink satellite broadband business and AI, which includes xAI (the Grok AI model) and X (the platform formerly known as Twitter). The company is best known for Space exploration, including the flagship Falcon range of reusable rockets.

A single IPO is not something we would usually cover in the strategy section of this newsletter, but this one is important for a few reasons. Firstly, the scale. The company has listed at a level that puts it as one of the most valuable in the world. Secondly, the value of the company is around 51x the forward revenue, which is far higher than other large technology orientated companies. Essentially, the market is paying a very high premium to own a company that is potentially opening up a new frontier in space. Significant sums are being spent building data centres to power AI, but SpaceX aims to build them in space. They need land, power, and cooling technology. Land is not an issue in space, power can be generated by solar, and there is no need for refrigeration in space.

In recent decades, the supply of new equities in the US market has been relatively muted. Many companies buy back some of their shares each year, so net supply has been low or even negative. An

$75bn

The amount raised by the SpaceX IPO

exception to this was 2021, when a lot of firms listed in the post-Covid period. But then listings fell when interest rates started to increase in 2022.

We have not directly invested in SpaceX, as the company does not fit well within our investment philosophy and framework. Depending on the mandate, some portfolios have exposure through funds we hold managed by third party managers. One of the hedge funds we own in appropriate mandates has been a long-time investor, so made good returns now it has listed.

Risk management is a core part of our investment process, and this includes both absolute risk with the investments we hold, and the risk that we have compared to our respective benchmarks. This includes not owning a stock that is part of the benchmark. There has been a lot of debate around whether SpaceX will be added to the main stock market indices, which is important as that determines whether money flows from investors passively tracking those indices. Some indices, such as the Nasdaq 100, have relaxed their inclusion requirements, while others such as the S&P 500 have not, so this is something that we are monitoring.

Risk Assets Price Hope, Bonds Price Risk

- The oil price has fallen considerably
- US inflation remains elevated
- Caution remains appropriate

May was a challenging month for fixed income markets, as oil, inflation and central bank expectations pulled markets in different directions. Oil prices fell sharply, inflation data moved higher, the US yield curve flattened, and risk assets recovered even as bond markets remained cautious. Rather than a clean risk-on or risk-off environment, markets were trying to judge whether the Middle East shock was temporary, or whether it had changed the inflation and policy outlook more permanently.

Oil was the centre of the month's volatility. WTI crude fell around 17%, despite the Strait of Hormuz remaining constrained. That looks counterintuitive, but the market was not only trading current supply, it was also trading weaker demand, inventory use and the possibility of a political deal. China's crude imports and refinery activity fell sharply as refiners cut runs, margins weakened and buyers relied more heavily on inventories. US exports and strategic reserve releases helped cover supply gaps into Europe and Asia, while Japan also leaned on reserves. These buffers helped cap prices, but they are not a permanent fix. Strategic reserves can smooth a disruption but they cannot replace normal oil flows indefinitely.

In the US, the consumer price index accelerated again, led by energy. China also contributed to the global inflation picture through producer prices, with higher input costs passing through the industrial sector even as domestic demand remained weak. That is an awkward combination. China is not generating demand-led inflation, but it may be exporting more cost pressure than before. Incoming Federal Reserve Governor Kevin Warsh faces an uncomfortable starting point: inflation is rising again and the US economy has not weakened enough to justify easier policy.

US Treasuries reflected that tension. Yields rose across the curve, but the curve flattened as the front end and belly adjusted more forcefully to the idea that Fed cuts would be delayed or potentially removed altogether. Two-year US Treasury yields reached a 2026 high of 4.12% during the month. Breakeven inflation rates fell later in May as oil prices declined, suggesting some energy risk premium was being priced out. However, the improvement in market-implied inflation was not enough to change the broader policy debate.

Credit markets were much more comfortable. US high yield spreads tightened supported by resilient earnings, income demand and the recovery in broader risk appetite. Fixed income volatility initially rose with the oil shock, but then fell sharply alongside equity and FX volatility as investors became more confident that the worst of the energy shock may have passed. That helped credit, but it also leaves less room for error. At 257bps, high yield spreads are not pricing much compensation for weaker growth, renewed oil stress or a more hawkish Fed.

Europe and the UK faced a more difficult mix of weaker growth and renewed inflation risk. Eurozone activity data softened, while higher energy costs complicated the European Central Bank's ability to look through inflation. The UK had an additional problem: political and fiscal risk. Heavy local election losses for Labour increased pressure on the government and raised concerns about leadership

4.12%

The 2026 high for two-year US Treasury yields

FIXED INCOME

instability and fiscal slippage ahead of further election risk in June. Gilts remain particularly sensitive to this because the UK has high borrowing costs, weak fiscal flexibility and a recent history of bond-market punishment when fiscal credibility is questioned.

Outside the US and Europe, the picture was more mixed. Japan remained under pressure from imported inflation and currency weakness, with Japanese Government Bond yields moving higher as investors questioned how slowly the Bank of Japan could normalise policy. Canada and Australia benefit from commodity-linked terms of trade, but their bond markets were still pulled by global duration moves, inflation sensitivity and central-bank reaction functions. China was different; government bond yields remained subdued because domestic demand remains weak, property remains a drag and policy is more accommodative. Emerging market debt benefited from carry, lower oil late in the month and calmer volatility, but oil importers and countries with stronger inflation credibility were better placed than those exposed to higher US real yields and dollar strength.

Looking ahead, the investment outlook remains uncertain because the next stage depends heavily on whether the Strait of Hormuz reopens in the coming weeks. Risk assets appear more willing to assume that oil flows normalise, inflation pressure fades and central banks can regain flexibility. Bond markets are less convinced. That caution makes sense. If oil flows resume properly, duration can perform and credit can continue to benefit from calmer volatility. If the reopening is delayed, strategic reserves continue to drain and peak travel demand tightens the market again, inflation risk returns quickly. The macro-outlook is therefore dependent on a geopolitical outcome that is hard to forecast. In that environment, high-quality income, disciplined duration sizing and selectivity across credit and currencies remain more attractive than chasing the risk rally.

New Beneficiaries of AI Emergee

- Rare outperformance of cheap technology stocks
- Fleeting recovery in software stocks
- South Korean stocks still flying high

Global equities have moved broadly higher since the end of April, extending a sharp rebound from the geopolitical shock in the Middle East that had rattled markets earlier in the year. In the US, the S&P 500 posted nine straight weekly gains, its best run in years. The Nasdaq is up around 16.3% year-to-date through the end of May, powered by AI-related technology stocks.

In May, the Technology sector returned 16%, substantially ahead of all other sectors. There has been a lot of dispersion within the technology sector over the last year. Much of this can be explained by the AI factor. The market has been discriminating between the winners and the losers of the AI revolution. Software has been seen at risk of disruption by new entrants enabled by AI's ability to generate computer code and new software. Profits at many software companies have actually held up well, but the market has marked down the valuation multiples that it is willing to pay. April actually

brought a reprieve, with the Software sector bouncing back after a tough run. Lots of hedge fund investors are taking short positions in software stocks, so whether this is a fundamental reassessment or a bit of squeeze on the investors that are short remains to be seen.

The market moves very quickly when it comes to AI, as the news flow relating the development of the models moves so quickly. Nvidia has been the posterchild winner of the AI revolution, but it has lagged peers over recent months. Value investing has been a popular philosophy for many years. This involves buying cheap companies, for example those with low price to earnings ratios. It has generally been accepted that value investing does not work in the technology sector, as disruption is significant and cheap stocks are likely to be cheap for a reason. Interestingly, we have seen value stocks in the technology sector perform very well in recent months.

For years, state of the art semiconductors (GPUs) made by Nvidia carried almost all the AI premium, while less glamorous chipmakers were left behind. That has changed as memory chips (RAM, DRAM, HBM) have surged. Central Processing Units (CPUs) can be thought of as the “old school” more boring part of computing. However, these are now back in vogue as workloads have increase due to changes in how AI works. “Agentic” AI has been a key theme. Instead of AI acting as a simple chatbot, agents can now complete multi-step tasks which increases demand for technology hardware. Data centres don’t just need the flashiest, most expensive components, they need the everyday building blocks too. Memory, networking chips, and CPUs have seen a surge in demand, and this has been reflected in higher stock prices.

The South Korean stock market has been particularly strong this year, returning 94% through the end of May on booming semiconductor demand. Taiwan has also performed well. These

94%

The amount the South Korean stock market returned through the end of May

two regions now account for more half of the MSCI Emerging Markets index, at 25% and 27% respectively. This has been the key factor driving Emerging Markets outperformance. Japanese equities have also been performing well, driven by Technology, Materials, Financials. Europe by contrast has lagged the US recovery, partly because they have far less exposure to the technology and AI theme driving gains elsewhere.

Equity market momentum cooled in early June, as the swearing in of the new Federal Reserve chair Kevin Warsh brought a more hawkish tone on interest rates. This pushed bond yields higher and triggered a pullback in stocks. We have seen interest rate hikes in the Eurozone, Japan, and Australia in recent month, and the market is pricing in the possibility of higher interest rates in the US too. If interest rates rise due to stronger growth, then equities can do well, but if rates rise due to inflation, then that is a headwind. Growth is holding up well and inflation is also higher than desirable. In this environment, profit growth is key, so second quarter earnings will be watched closely.

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Tel +(441) 299 3817
www.butterfieldgroup.com/Investments

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Tel +(345) 949 7055
www.butterfieldgroup.com

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Tel +44 (0)1481 751000
www.butterfieldgroup.com

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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

	UNDERWEIGHT -	+ OVERWEIGHT
Asset Allocation	FIXED INCOME (MODEST UNDERWEIGHT) EQUITIES (MODEST UNDERWEIGHT)	ALTERNATIVES (MODEST OVERWEIGHT) CASH (MODEST OVERWEIGHT)
Fixed Income		EMERGING MARKET DEBT INFLATION PROTECTION SHORT DURATION HIGH YIELD
Equities Regional		JAPAN EMERGING MARKETS EX CHINA
Equities Sector	CONSUMER DISCRETIONARY REAL ESTATE	UTILITIES

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