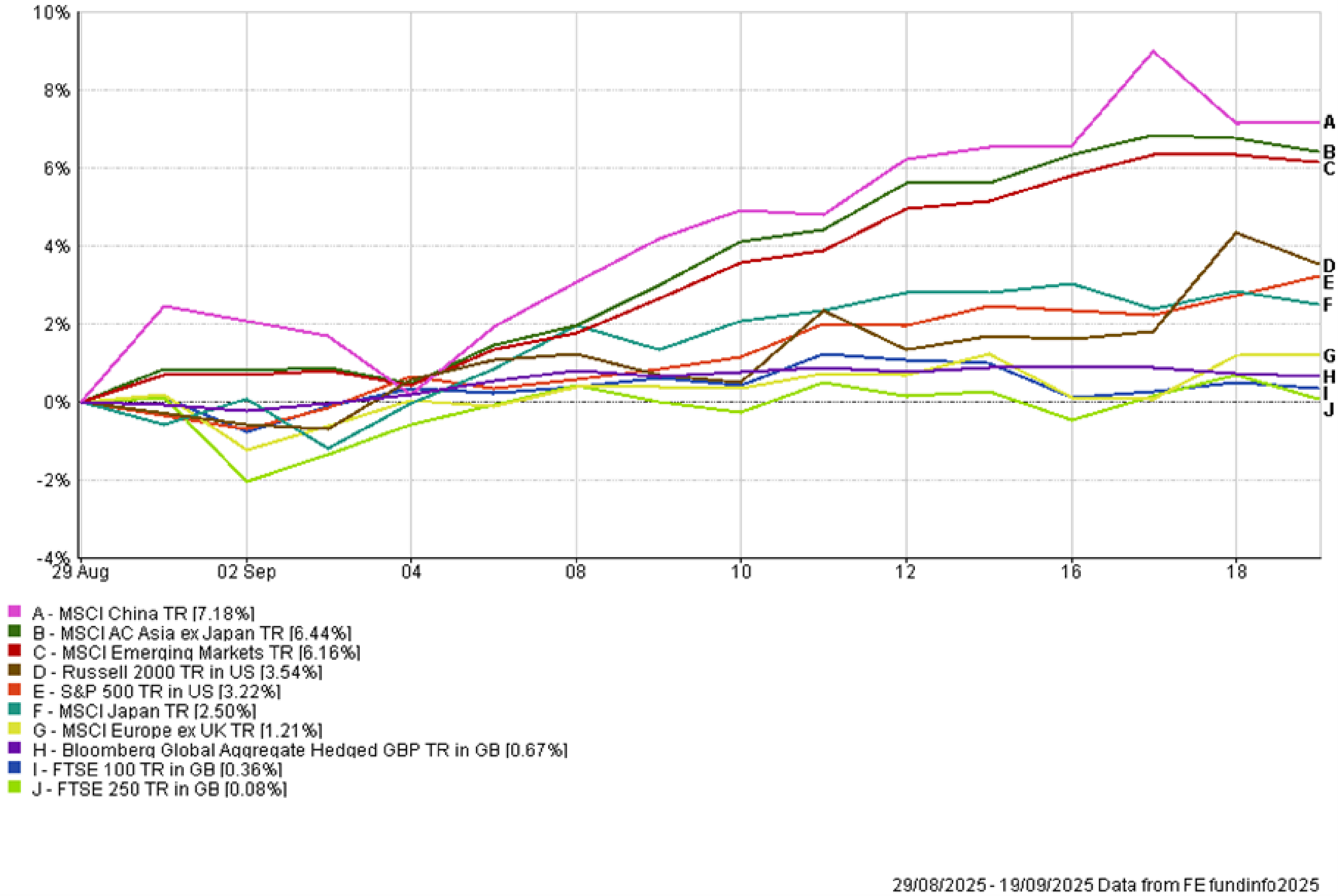
Market Matters - with Tom McGrath

Record Highs for US Stocks as the Fed cuts rates

Markets don't often make history in September, but last week was an exception. All four of the major US benchmarks, the S&P 500, Nasdaq 100, Dow and Russell 2000 closed at record highs together, the first time since late 2021 and only the 26th time this century. For a rally often criticised as narrow, small-caps breaking out alongside big tech gave it a materially different feel.



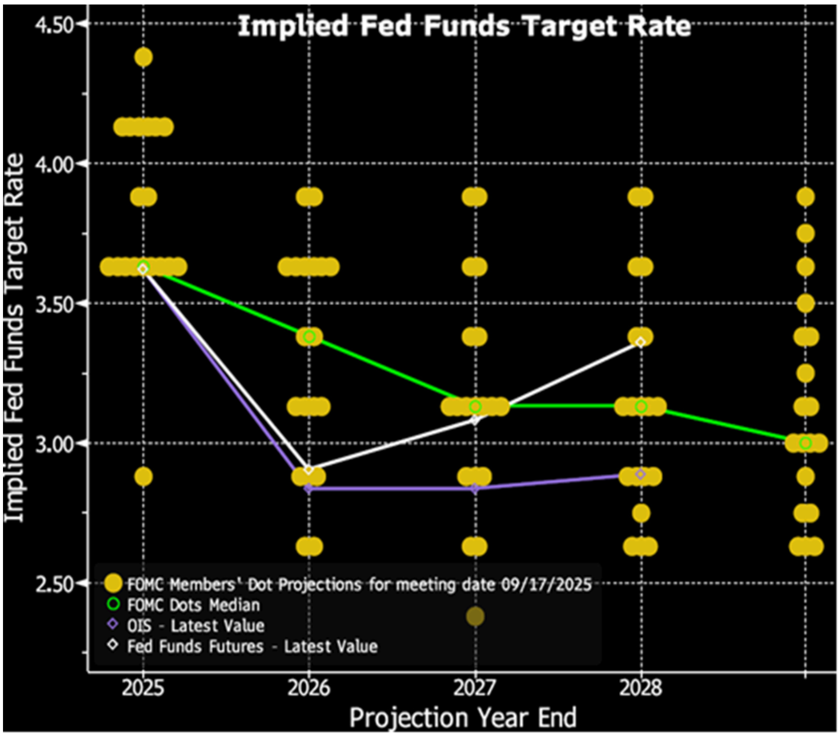
September is usually the toughest month of the year for equities, yet so far it has been anything but. The US has defied the seasonal gloom with gains of more than two percent, while China has surged over seven percent to lead global markets. Asia ex-Japan and emerging markets have followed, but Europe, Japan and the UK have been left largely flat. The spark for Wall Street was the Federal Reserve's first rate cut of the cycle. Powell's commentary fell short of promising a rapid easing path, but the move itself was enough to push stocks higher and keep risk appetite alive. Across the Atlantic, the Bank of England struck a more cautious tone, still wrestling with sticky inflation as growth falters.

FED cuts rates by 0.25%

Powell delivered, but not quite in the way markets wanted. The Fed's September meeting produced the first cut of the cycle, a neat 25 basis points, but nothing more. Hopes of a jumbo half-point move were dashed, with only one governor, the Trump new appointee Stephen Miran, backing such a step. Everyone else fell into line behind Powell. It was actually the lack of dissent that caught the eye, making this one of the stranger FOMC meetings in recent memory.

The initial reaction was muted. Equities wobbled, bond yields gyrated, and the dollar firmed, all signs that this was a hawkish cut rather than the start of an easing cycle. Yet by the end of the week, the collective view was that any cut is better than none, and markets closed Friday on an upward path.

Powell leaned heavily into the labour side of the Fed's mandate, conceding he could no longer say the jobs market was 'very solid', while insisting this was a risk-management move rather than the beginning of a promised path. Meeting-by-meeting remains the mantra. The dot plot only added to the ambiguity, with expectations nudging gently lower but still keeping rates above three per cent through 2027. Traders continue to bet the Fed will ultimately have to cut more, but this meeting actually pushed market expectations slightly higher.

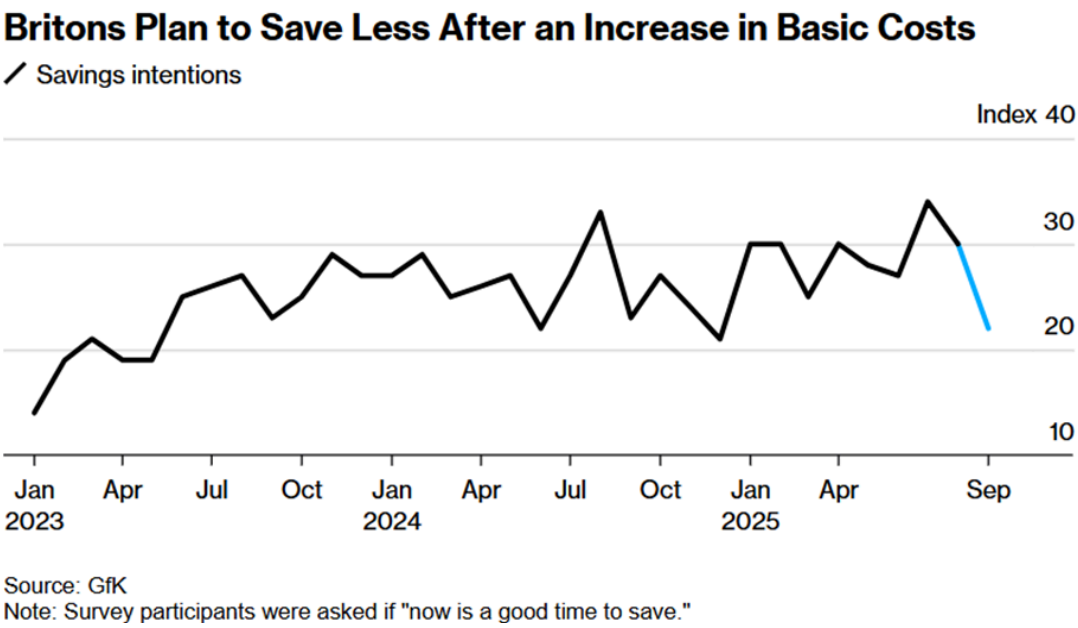


Perhaps the most crucial signal was what didn't happen. Governors Waller and Bowman, both viewed as contenders to succeed Powell, chose not to push for a deeper cut, despite obvious political incentives. Their restraint suggested the Fed's independence is not yet up for grabs, and for those fearing a White House takeover of monetary policy, that was a quietly reassuring outcome.

UK – BOE holds rates steady at 4%

If the Fed meeting left investors with ambiguity, the Bank of England left them with caution. The MPC voted 7–2 to hold Bank Rate at 4%, with only long-standing doves pushing for another quarter-point cut. The message was clear enough: further easing is possible, but it will be "gradual and careful" and heavily dependent on whether the recent uptick in inflation proves sticky. Governor Bailey conceded that the Bank is not done cutting, but he also warned that the timing and scale are now more uncertain than before, given inflation is set to edge back to 4% in the coming months.

That stance reflects the cross-currents in the data. Retail sales rose by 0.5% in August, the third consecutive monthly gain, helped along by warm weather and resilient consumer spending. Volumes are 0.7% higher than a year ago, suggesting households have, for now, shrugged off some of the drag from higher taxes and borrowing costs. But sentiment surveys tell a different story. GfK confidence slipped in September, with households reporting weaker savings intentions and more concern over personal finances. Food and energy bills are once again climbing, and real incomes are likely to come under renewed pressure.



Public finances add another layer of tension. Borrowing in August came in at £18 billion, far above OBR forecasts, leaving the deficit for the year so far £11 billion worse than expected. Debt interest payments are soaring, now close to the size of the defence budget, and public sector net debt sits at 96.4% of GDP. With an Autumn Budget looming on the 26th of November, Chancellor Reeves has little room to manoeuvre. Markets now assume she will be forced into fresh tax rises to plug the gap, and the political pressure to do so will only intensify.

For UK assets, the picture is nuanced. Equity markets look capable of withstanding a softer economic outlook, especially with company earnings and buybacks still providing support. The real volatility risk lies in gilts. The combination of sticky inflation, a deteriorating fiscal backdrop and looming policy announcements sets up the potential for swings in long-dated yields. The BoE's decision to slow its balance-sheet runoff, particularly at the long end, may cushion some of the blow, but gilt markets will remain hypersensitive in the run-up to November's budget.

Europe – steady as she goes

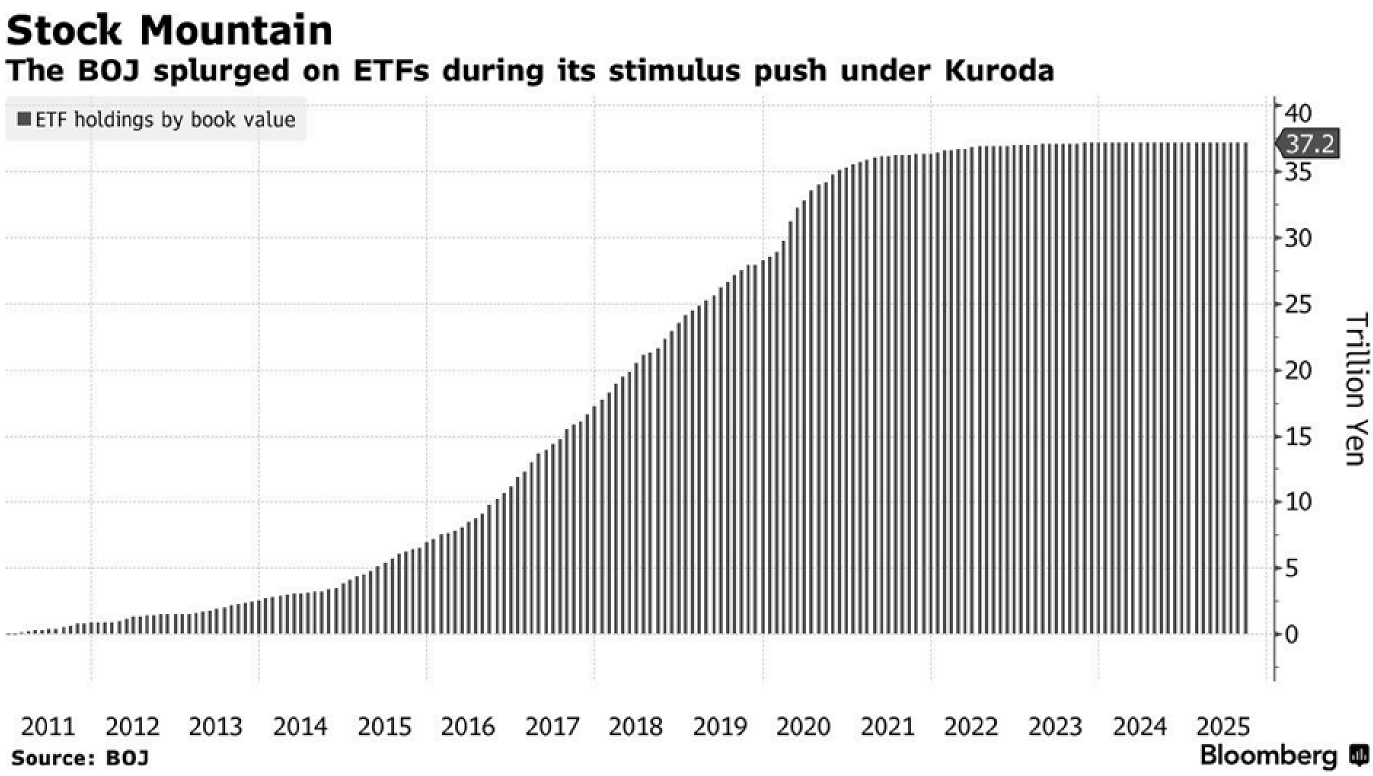
Europe's story was steadier than the headlines suggest. Inflation held at 2% in August, right on the ECB's target, and while wage growth remains brisk at 3.6% year-on-year, it also points to households retaining spending power. Policymakers in Frankfurt will stay cautious, but the overall picture is one of progress rather than fresh alarm.

The more encouraging signal came from the August PMIs, which showed eurozone manufacturing back in expansion for the first time since early 2022. New orders are improving and domestic demand is finding its feet, offering hope that the industrial cycle is turning. German producer prices also fell 2.2% year-on-year, adding to evidence that upstream inflation pressures are continuing to ease. Together, these shifts hint at a more constructive mix of cooling costs and tentative growth.

Politics, unusually for Europe, was quiet last week, with little (additional) drama to distract investors. That calm gave markets space to focus on fundamentals, and the result was steady performance rather than volatility. European equities have quietly outperformed this year, particularly in small caps and cyclicals, and a firmer macro backdrop gives them scope to build on those gains. Bond markets, meanwhile, continue to weigh wage pressures against easing inflation, but the latest data reinforce the case for gradual policy loosening over the months ahead.

Japan - BOJ leaves rates unchanged

Japan's policy meeting marked another step in the shift away from ultra-easy monetary settings. The Bank of Japan held its policy rate at 0.5% but, in a notable move, announced plans to begin selling down its enormous ETF holdings from early next year. The pace will be glacial relative to the stockpile, yet symbolically it underlines the BOJ's intent to normalise. For the first time since Governor Ueda took Office, two board members dissented in favour of an immediate rate hike, leaving the door open to an increase as soon as October.



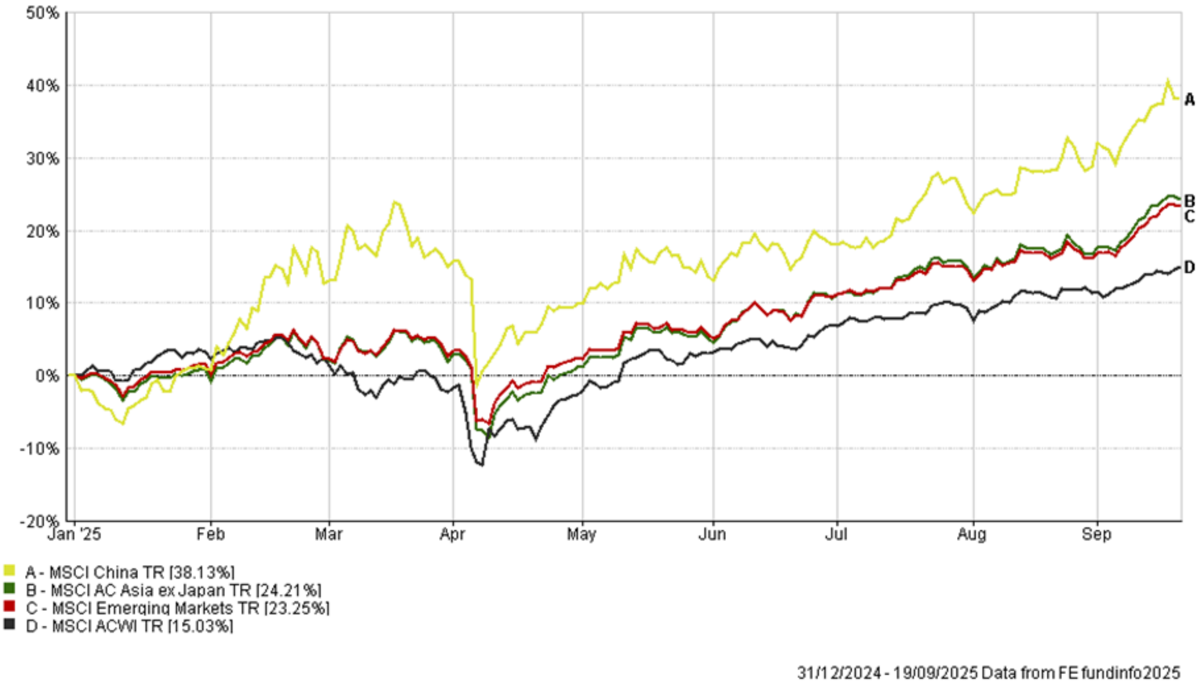
Markets responded with the 'hawkish hold' playbook: equities softened, bond yields pushed higher, and the yen briefly strengthened as investors adjusted to the prospect of a central bank edging toward tighter settings. Yet the broader picture remains supportive. Inflation has eased but still sits above target, allowing the BOJ to proceed carefully. At the same time, the corporate reform agenda continues to drive improvements in shareholder returns, with higher dividends, more buybacks and a greater focus on capital efficiency.

That combination of policy stability and structural reform means the primary driver for Japanese equities is still earnings. Forecasts point to solid growth, underpinned by stronger balance sheets and more disciplined capital allocation. While JGB yields may see bouts of volatility and the yen will remain sensitive to US rate dynamics, Japanese equities retain a constructive outlook. The BOJ's confidence in starting to unwind risk-asset holdings is itself an endorsement of market resilience, and the reform-led uplift in profitability leaves room for further gains.

China & Emerging Markets continue to power ahead

China's latest data showed momentum cooling again, with industrial output slowing to 5.2% in August and retail sales up just 3.4%, the weakest in almost a year. Fixed-asset investment remains lacklustre, leaving the recovery uneven and heavily reliant on targeted support. Yet markets have chosen to focus on the positives. Dollar weakness has eased some of the external pressure, valuations remain at deep discounts to global peers, and China's technology sector has been powering ahead on the back of AI and semiconductor enthusiasm.

That combination has helped Chinese equities rally sharply this month, feeding into broader gains across emerging markets. The latest global fund manager surveys suggest capital is beginning to return, with allocations to EM equities rising from very low levels. In part, this reflects tactical positioning - a hedge against US exceptionalism - but it also signals that investors are starting to recognise relative value in the region.



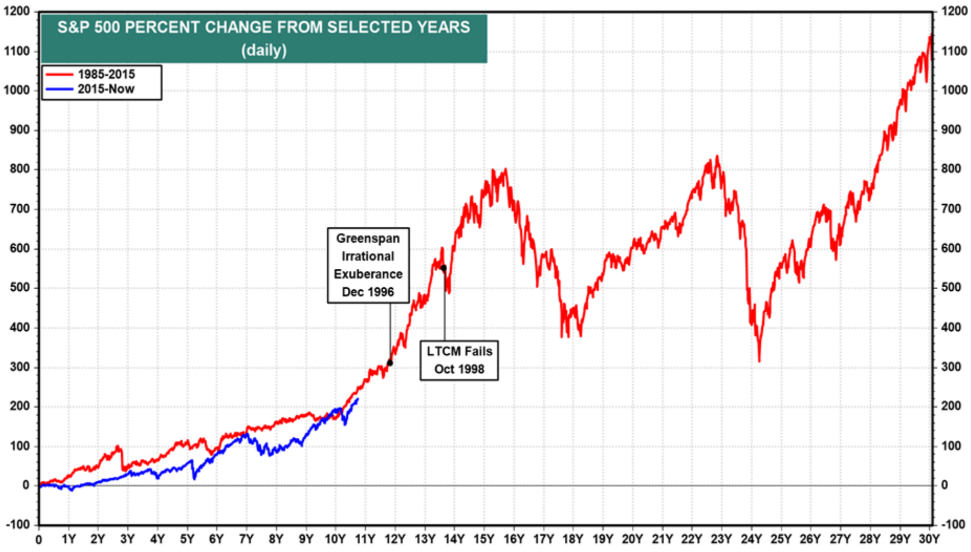
For EM more broadly, the picture is one of resilience despite challenges. India and parts of Southeast Asia continue to deliver robust growth, while exporters tied closely to Chinese demand still face headwinds. Softer global inflation and the prospect of easier Fed policy offer further support, reinforcing the idea that the backdrop for Emerging Market assets may be turning more constructive. The mix of cheap entry points, early signs of inflows and the chance of further Chinese policy support leaves scope for markets to extend gains, even if the economic data remains uneven.

Looking Ahead

The last full week of September will test whether its strength can hold. In the US, housing data, durable goods and consumer confidence will give fresh clues on growth and inflation expectations. Europe's flash PMIs and Germany's Ifo will show if the industrial rebound is sticking, while the UK stays preoccupied with fiscal risks ahead of November's budget. Asia's focus will be on China's PMIs and industrial profits, and on Japan's spending data as markets weigh the chance of an October BOJ hike. With equities buoyed by easier policy hopes, dollar softness and renewed Emerging Market interest, the question is whether optimism can extend or will pause for breath.

And Finally...

If you will forgive an indulgence, a word on what could keep this bull market alive. History shows that great rallies often last far longer, and climb far higher, than sceptics expect. Warnings of 'irrational exuberance' tend to arrive years before the peak, and markets have a habit of marching on regardless.

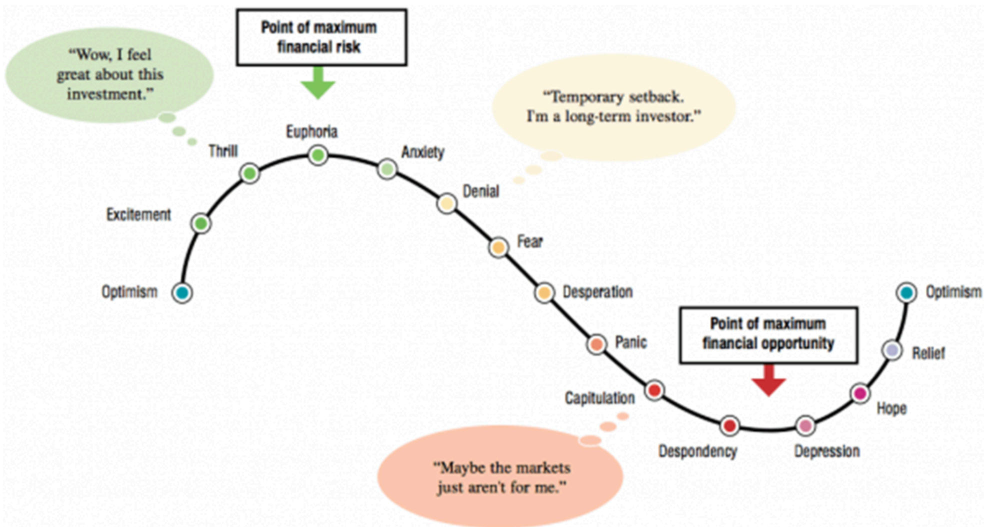


Source: LSEG Datastream and © Yardeni Research. Standard & Poor's.

Valuations today are undeniably stretched, but this cycle has been about more than P/E multiple expansion. Corporate earnings are at record highs, with forecasts still rising into next year. Importantly, strength is no longer confined to the megacaps. Small and mid-caps are beginning to see earnings momentum too, broadening the base of the rally.

The structural backdrop also looks supportive. Innovation in AI, biotech, energy transition and digital finance is driving a new wave of productivity. At the same time, corporate balance sheets are stronger than in past cycles, and households retain savings buffers. Globally, breadth is improving as China rebounds, emerging market flows return, Europe finds its footing, and Japan continues to deliver reform-led shareholder returns. A softer dollar has only reinforced the appeal of looking beyond the US.

Bull markets do not end simply because of age; they end when liquidity tightens and excesses overwhelm fundamentals. For now, liquidity is easing, earnings are resilient and structural innovation is accelerating. Corrections are inevitable, but this still has the feel of a cycle with room to run, not least because many investors remain cautious, with little sign of the euphoria that usually marks a peak. If that holds, the 2020s may yet earn their place alongside the great roaring decades of the past.



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