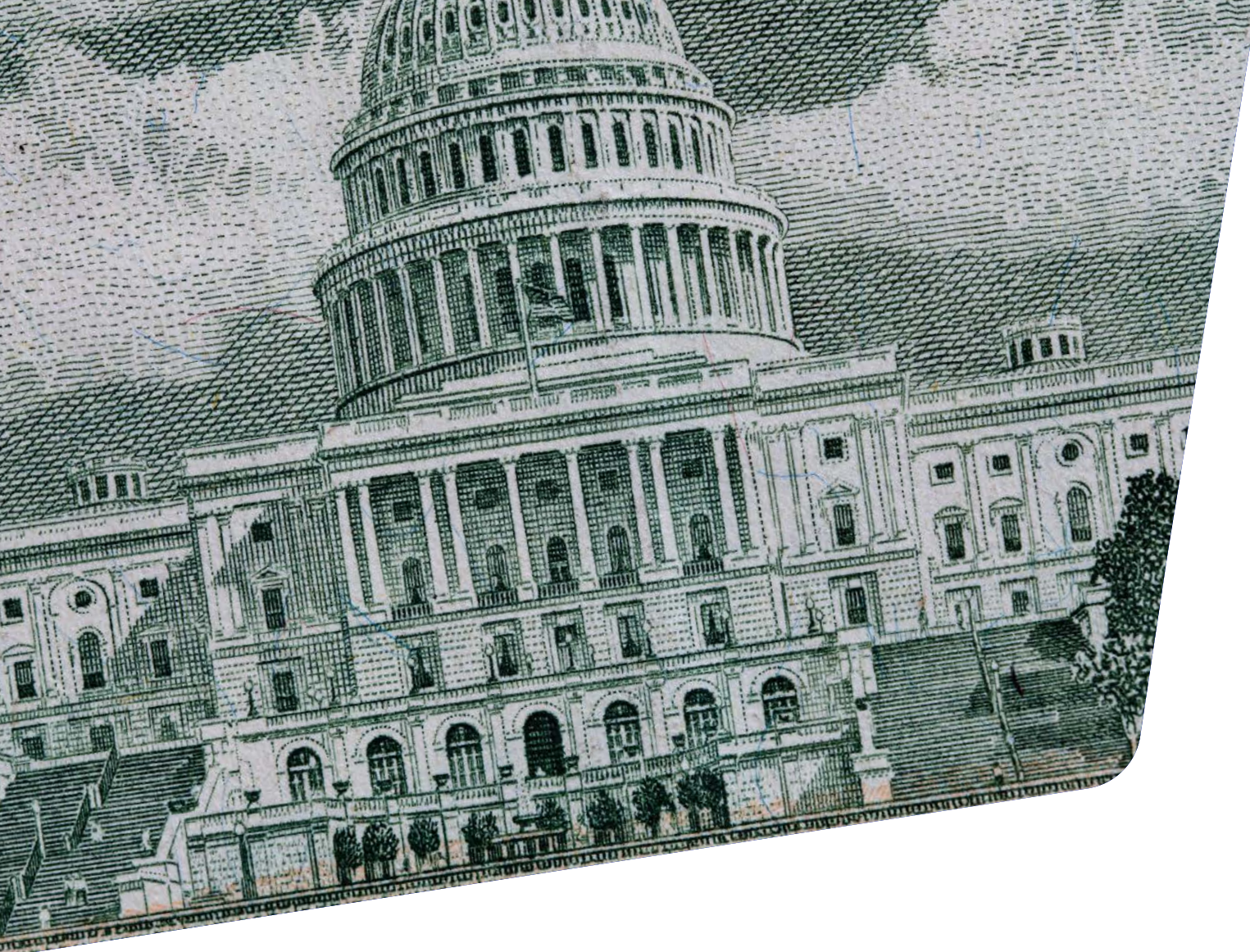




Investment Insights

Our monthly look at what's driving global markets

Richer, not wiser

Balanced portfolios have edged higher, despite uncertainty

Cleared for take-off

The investment case for industrials rests on a recovery with room to run

Breaking with convention

Investors' old assumptions about US mid-terms may no longer hold

Quick take

In this month's issue

Richer, not wiser

Balanced portfolios have edged higher, despite uncertainty

Investors are likely to be slightly better off after the third quarter, even though the big questions around Iran, AI, interest rates, and the UK Budget remain unresolved.

Rising inflation and rate expectations have put pressure on bond markets, while strong earnings have kept global equities close to all-time highs.

The Iran War continues to disrupt energy supplies, pushing up prices and adding to inflationary pressure around the world.

AI-related shares have been volatile, highlighting the dangers of leverage, but we remain positive about the technology's long-term financial potential.

With uncertainty still high, diversification remains important for capturing investment opportunities while limiting volatility and downside risk.

Read the full story on page 3.

Cleared for take-off?

The investment case for industrials rests on a recovery with room to run

The industrial recovery has faced repeated setbacks from tariffs, the Iran War, and higher energy costs, but underlying demand remains resilient.

A broader manufacturing rebound could provide further support, with improving orders and activity leaving scope for earnings to exceed expectations.

Longer-term investment in AI infrastructure, power generation, and electricity networks is creating more demand for industrial equipment and expertise.

Growing semiconductor demand and the shift towards local production are providing additional opportunities for suppliers and manufacturers.

While valuations are not cheap, these structural trends could provide high-quality industrial companies with a long runway for growth.

Read the full story on page 5.

Breaking with convention

Investors' assumptions about US mid-terms may no longer hold



This month's cover shows the US Capitol on the back of a \$50 bill, highlighting our look at the shifting balance of power between the White House and Congress.

November's mid-term elections could change control of Congress, potentially placing new constraints on President Trump's freedom of action and reshaping the political landscape.

AI regulation, the cost of living, the Iran War, and mounting government debt are among the key issues that could have important implications for markets and investors.

Yet neither Republicans nor Democrats appear eager to tackle large fiscal deficits, while Trump's willingness to test the limits of presidential power may reduce the impact of a change in Congress.

For investors, old assumptions about mid-term elections may therefore prove less reliable in an increasingly polarised and unpredictable political landscape.

Read the full story on page 7.

Snapshot

The global economy and markets

Key facts and figures from around the world, including the history of US stocks after mid-term elections, rising European defence spending, and UK gilt yields reaching their highest level since 1998. Also features the extraordinary scale of AI-related data centre investment and longer-term trends across global equities, bonds, and currencies.

Find out more on page 9.

This publication shares general information and insight about markets. It should not be taken as financial advice or a recommendation. The value of investments can go down as well as up and you could get back less than you invested.

Richer, not wiser

Balanced portfolios have edged higher, despite uncertainty



John Wyn-Evans, Head of Market Analysis

The last quarter has left most investors none the wiser about the future, but slightly better off. The big questions we asked three months ago remain unanswered. There has been no resolution of the Iran War. Leaving aside the question of the fate of humanity, there remains a cloud of uncertainty hanging over the adoption of AI and the returns that can be generated from it – by both users and providers. With inflationary pressure rising again, the peak of interest rates around the world is not clearly in sight. Here in the UK, clients have their own unanswered question: speculation about the impact of the forthcoming Budget is affecting long-term financial planning.

Bond markets have borne the brunt of investors' concerns, with yields rising sharply for several reasons. This has caused capital losses – falls in the value of their investments – for holders of bonds maturing in more than a couple of years. But equity markets, despite the odd wobble, remain close to all-time highs, driven by strong earnings growth. The second-quarter reporting season was exceptionally strong. Moreover,

the stronger US dollar has helped boost returns for sterling-based portfolios, as US companies make up a large share of global stock market indices.

Iran – the wait continues

The long-hoped-for ceasefire in the Iran War has not materialised. We've always believed that, ultimately, there would be a mutually discovered pain threshold for both sides that would encourage an agreement, with the deadline being November's mid-term US Congressional elections (see my piece on the mid-terms in this issue).

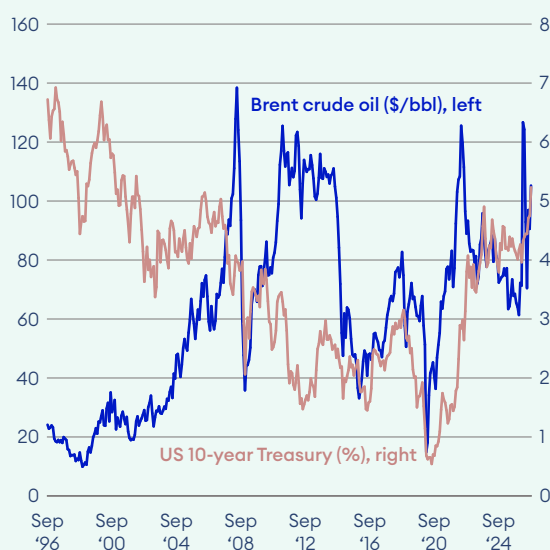
But meanwhile, the stand-off has disrupted supplies of oil, gas, and related commodities. This is most visible, recently, in the retail price of diesel, which is now even higher than during the worst of the spike in energy prices in 2022, after Russia's full-scale invasion of Ukraine. The price move is exacerbated by a shortage of refining capacity, partly caused by Ukraine targeting Russian assets. It's a reminder that the effects of that war cannot be ignored. Other key commodities also remain in short supply. The fact that the global economy has powered on despite the disruption is a testament to its resilience, but we continue to monitor supply chains for signs that the impact is delayed rather than non-existent.

Inflation and interest rates rebound

This all feeds through into inflation, interest rate expectations, and bond yields. Headline consumer price inflation is rising again. In the UK, for example, October's expected increase in the household energy price cap could push inflation above 4%. That's a far cry from the 11.1% reached in 2022, but still an unwelcome reversal of the falling trend we were seeing before the US and Iran locked horns.

Figure 1.1: Crude awakening

Rising oil prices have helped push Treasury yields higher as investors brace for higher inflation.



Source: LSEG, Rathbones

“Bond markets have borne the brunt of investors' concerns, with yields rising sharply for several reasons.”

Higher inflation squeezes households' disposable income and puts government finances under pressure. Bond investors demand higher yields to compensate for inflation eroding the value of their returns, increasing governments' borrowing costs – although inflation can help to reduce the value of their debt, in real terms. The effect is particularly pronounced in the UK because it has issued large amounts of index-linked gilts, where the payout rises in line with inflation.

As for interest rates, this year has seen a sharp reversal of expectations. In January, investors expected several quarter-point cuts from the Bank of England (BoE) and US Federal Reserve (Fed). Now they expect a similar number of increases, or more. Both the Fed and the European Central Bank have embarked on a policy-tightening cycle – a series of measures, typically including interest rate rises, designed to curb inflation. The BoE looks set to follow suit.

We think this will inflict short-term pain, through higher mortgage rates, for example, but deliver the long-term gain of keeping expectations for future inflation under control. We also believe that higher bond yields at least to some degree restore a bond's ability to provide stability for portfolios during a recession (although they may offer less protection during a government debt crisis).

The AI rollercoaster

AI continues to dominate equity-focused discussions, and the technology sector rode a rollercoaster in the third quarter. Earlier in the summer, there were signs that speculation was becoming excessive as investors chased the strongest-performing companies,

Figure 1.2: Korea career

The country's chip-heavy stock index has been volatile this year, but is still up.



Source: LSEG, Rathbones

“
Aschenbrenner, unlike Icarus,
lives to fight another day.
He is already betting on the
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greater circumspection.
”

particularly those producing memory chips. Much of this activity centred on South Korea, where soaring share prices for chipmakers Samsung and SK Hynix – alongside gains for Taiwan's TSMC – helped [emerging market](#) indices outperform. Korean retail investors used leveraged exchange-traded funds (ETFs) – funds that can amplify both gains and losses – to benefit from the boom.

However, they flew a little too close to the sun, and the smallest hints of doubt set off a cascade of selling. One of those caught up in it was a 24-year-old US hedge fund manager, Leopold Aschenbrenner. His fund, Situational Awareness – ironically named after his influential 2024 paper on AI's vast potential – had used borrowed money to build multibillion-dollar positions in leading AI-related shares. When selling began, he was forced to liquidate his entire publicly traded share portfolio, triggering further falls.

Still, Aschenbrenner, unlike Icarus, lives to fight another day. He is already betting on the next leg of growth, but with greater circumspection. We think he is on the right track. AI promises to be a transformational technology, and we remain in the foothills of adoption. No doubt there will be setbacks. We are seeing some in the form of a revolt against data centre construction and potential regulatory intervention as AI models evolve into computer hackers.

Strange times indeed

In reviewing markets for our readers, we often try to temper expectations when things look a bit too exuberant. Perhaps more importantly, we also endeavour to keep a sense of perspective when the emphasis is on gloom and doom, as investors are most at risk of jettisoning sound long-term investments in the face of short-term volatility.

Today, we're in the odd position where the doom-mongers are out in force warning of a bond market crisis, while, from the perspective of a sterling-based investor, global equity markets are at all-time highs. As ever (and channelling Odysseus in this summer's blockbuster film), we aspire not to be seduced by siren voices. Portfolio diversification remains a key discipline in these uncertain times, allowing us to exploit attractive investment opportunities while limiting both volatility and downside risk.

Cleared for take-off?

The investment case for industrials rests on a recovery with room to run



Thomas Lauritzsen, Equity analyst for industrials

The industrial recovery has proved less *Top Gun* and more holding pattern. Tariffs and the closure of the Strait of Hormuz have delayed take-off, but the sector still has powerful engines behind it: a manufacturing rebound and sustained investment in AI infrastructure, power networks, semiconductor capacity, and local production. Valuations are not cheap, but high-quality industrial companies continue to trade at reasonable levels, given their long-term earnings prospects.

The recovery keeps hitting speed bumps

The investment case for industrial companies rests on a manufacturing recovery with room to run. Global manufacturing has endured a prolonged downturn since the post-COVID boom. As the boom ended, supply chains returned to normal, companies ran down existing stocks, and investment in equipment and facilities remained weak. A recovery then began to emerge as inventories rebuilt and early measures of future demand, such as new orders, improved. But momentum stalled after the US government announced widespread import tariffs on 'Liberation Day' in April 2025.

The recovery subsequently became more evident as the harshest tariff announcements didn't come to fruition and companies took mitigating measures. However, expansion suffered another setback on the outbreak of the Iran War and the effective closure of the Strait of Hormuz. With oil at \$100 per barrel and inflation fears pushing up interest rates, conditions are becoming more challenging for the typical industrial company.

Nevertheless, companies serving 'short-cycle' markets (where demand responds relatively quickly to changes in economic conditions or customers' stock levels) continue to report healthy underlying demand. These include industrial machinery, factory automation, and pneumatic equipment, such as air-powered drills. For instance, German technology group Siemens has reported a steady recovery in industrial automation revenue from a 2024 low, although it remains well below the post-pandemic peak.

The wider economic data tell a similar story. Global manufacturing purchasing managers' indices, or PMIs, have remained above the magic number of 50 for much of 2026. A reading above 50 indicates that manufacturing activity is expanding rather than contracting. Recent surveys point to rising production, improving orders, and recovering employment across the US, Europe, and parts of Asia. Even so, the pace of improvement remains well below what would normally be expected during a manufacturing recovery.

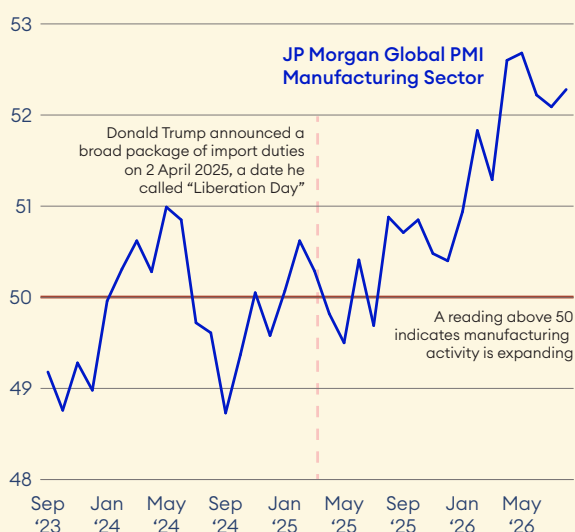
Industrial companies often have high fixed costs, so their profits can rise faster than their sales when demand improves. This means earnings can exceed market expectations during a recovery. Current sector forecasts suggest there's still scope for companies to deliver better earnings than analysts expect.

Large projects offer a longer runway

Larger, longer-term investment projects also provide an encouraging backdrop for industrial companies. These 'long-cycle' businesses typically receive large orders based on particular projects rather than demand. These projects take longer to complete and can provide several years of future work. As a result, they're less affected by the short-term changes in customers' stock levels that influence short-cycle companies. Examples include aerospace and defence, power generation, and electricity grid infrastructure.

Figure 2.1: Back into gear

Global manufacturing is recovering, although momentum remains relatively subdued.



Source: LSEG, Rathbones

Investment in AI infrastructure has clearly been a powerful long-term theme over the last three years or so. While the majority of this spending – about 70% – relates to semiconductors, the sheer scale of investment is also having a meaningful effect on a wide range of traditional industrial end markets.

For instance, data centres require vast amounts of sophisticated electrical equipment supplied by companies such as French energy technology group Schneider Electric and, to a lesser extent, Siemens. Around 40% of Schneider Electric's total revenue comes from data centre investment. This helps explain the company's annual earnings growth of 13% over the past five years and expectations for similar growth over the next five.

AI's appetite collides with the grid

Given the amount of energy AI data centres use, there is increasingly insufficient power generation or grid infrastructure available to meet their needs without affecting other consumers. This comes on top of the continuing shift towards using electricity to power transport and industry, creating the need for sustained investment in energy infrastructure.

Growing waiting times for power generation and electricity network equipment suggest that demand is already exceeding supply. For example, orders at large-scale gas turbine producers such as US energy equipment group GE Vernova and Siemens Energy have risen well above historical norms. Waiting lists for these turbines now extend to five years and beyond in some cases.

With waiting times for equipment and connections to the electricity network continuing to lengthen, many companies are looking for alternative ways to power data centres. 'Speed to power', meaning how quickly a data centre can secure the electricity it needs to begin operating, has become a common concern during construction. Major suppliers of temporary power solutions, including US construction and power equipment manufacturer Caterpillar, are stepping into this space with generation equipment that can operate independently of the grid network.

While the US is at the centre of energy investment, similar developments are underway across Europe. Governments are committing considerable capital to energy grids and new generation capacity, often from renewable sources. This strong underlying demand benefits the companies that manufacture the equipment and extends to a long list of suppliers and related contractors.

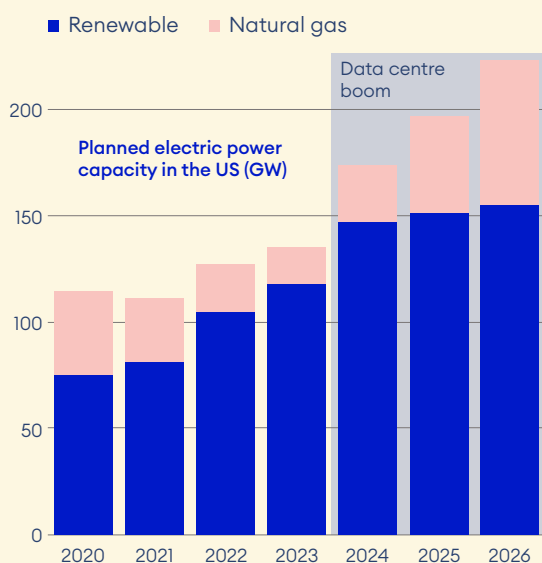
The chip boom reaches industrial suppliers

Semiconductor demand has increased exponentially, and manufacturers are now beginning to increase investment in additional production capacity. In addition to the critical lithography and deposition machines needed to produce chips, semiconductor factories also need large numbers of vacuum pumps and gas treatment systems.

These keep the manufacturing environment free from particles and hazardous gases. Swedish industrial equipment group Atlas Copco is the global leader in vacuum pumps and has reported very strong orders over the past couple of quarters.

Figure 2.2: Gas gets a second wind

The data centre boom is driving power demand as planned gas capacity grows and renewables stagnate.



Source: EIA, FT, Rathbones

Tariffs make local production pay

Tariffs typically harm economic growth. However, as these trends have been continuing for some time, companies worldwide are taking steps to limit their impact. In practice, this means reorganising their operations to serve more customers through local production. As a result, companies are building new manufacturing facilities around the world, creating demand for equipment.

The industrial recovery may still be circling through some turbulence, but its longer-term engines are already running. Investment in AI infrastructure, energy networks, semiconductor capacity, and more local supply chains should sustain demand well beyond the next turn in the economic cycle. If manufacturing gathers speed too, the sector may finally be cleared for take-off.

Breaking with convention

Investors' old assumptions about US mid-terms may no longer hold



John Wyn-Evans, Head of Market Analysis

Investors are acutely aware that Donald Trump has, as US President, thrown many conventions out the window. The next convention due for the trash can may well prove to be how we think about the mid-term elections, held on 3 November. What they mean for US politics – and hence for investors – could be changing. This reflects the constitutional battle between President and legislators over who holds the power. It also reflects – in an increasingly polarised Washington – the strange bipartisan consensus that fiscal irresponsibility is nothing to worry about.

What are the mid-terms?

All 435 members of the House of Representatives come up for re-election every two years, alongside one-third of the 100 Senators.

In 2024, the Republicans achieved the Trump trifecta: a Republican president and Republican majorities in both legislative Houses. This reduced constraints on presidential power. Democratic control of one House should reduce presidential freedom of action. Control of both should amplify this; winning 60 Senate seats would supercharge it, by giving the Democrats the ability to push game-changing legislation through Congress (the collective name for both Houses).

The AI headlines have darkened recently. Several industry insiders claim a significant chance that it will wipe out humanity, possibly within a decade. AI business leaders propose a frontier model development 'pause' to give them the time to make it safer. Some of them are calling for government regulation, although Trump is not in favour.

A Democratic-controlled Congress might have the power to rein the industry in, empowered by the weight of public opinion as much as by electoral success. Even before fearing for their lives, voters were voicing concerns about job losses and environmental pollution. Many states and municipalities have declared a moratorium on development. Mid-term candidates have latched on to this.

However, legislators will also be highly sensitive to the risk of Chinese models overtaking US ones, because of a pause on US development. Both parties have adopted an aggressive stance towards China. It's important for investors to monitor this situation because much of this

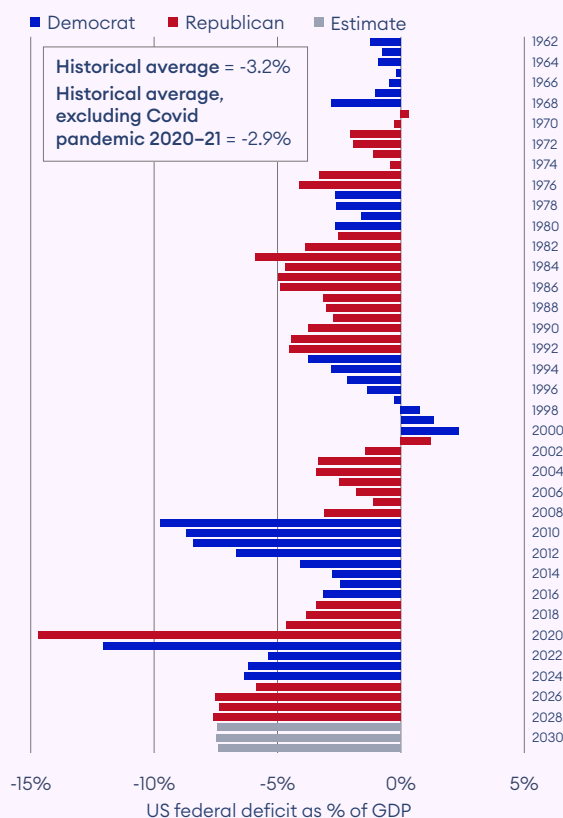
year's corporate earnings growth has been driven by the surge in capital spending (capex) on data centres. That spending extends beyond the US, including to chipmakers in Korea and Taiwan.

The cost of living

This will decide many voters' minds. The hell-for-leather cycle of AI-related capex has contributed to inflation consistently above the US central bank's 2% target. Higher energy prices, pushed up by disruption from the Iran and Ukraine wars, have added to the pressure. Trump's tariffs have also increased inflation.

Figure 3.1: Fiscal incontinence

Joe Biden narrowed the deficit after the pandemic, but it remained well above the historical average. Under Donald Trump, it's projected to get even larger.



Source: Congressional Budget Office, 1962–2025; IMF estimates, 2026 onwards; Rathbones

Democratic victory is unlikely to have much effect on tariffs, generally imposed by presidential executive order. But could Democratic control over one or both Houses make an end to the Iran War more likely?

Since the President has prosecuted this war with no Congressional support, it's not clear that election results will greatly change the situation. Indeed, many policy analysts think Trump may become even more hard-line on Iran once he doesn't have to consider the electorate, whatever the result.

The fiscal situation

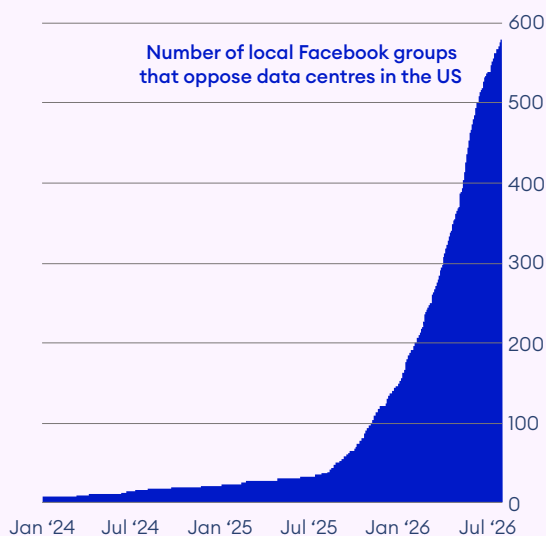
The US 10-year government bond yield hit 5% in September. At least in part, this reflects concerns about the sustainability of government finances. In August, US gross federal debt hit \$40trn – around 125% of GDP. What difference would Democratic electoral success make?

Tax cuts under the One Big Beautiful Bill Act, combined with the costs of the Iran War, mean that the country is running an annual deficit equivalent to 6% of GDP. The President also recently dangled the carrot of a \$5,000 “dividend” to all US adults should the Republicans retain their House majorities. This would cost around \$1.2trn, pouring more gasoline on the fire.

In fact, however, neither side seems keen to rein in spending. Democrats will look to increase social and welfare spending, probably funded by higher taxes on wealth – especially if more left-wing ‘progressive’ candidates are elected. In the absence of an AI-inspired productivity boom – accelerating economic growth and boosting tax revenue – a bond market crisis is probably the only cure for this fiscal incontinence.

Figure 3.2: Not in my back yard

Opposition to data centres has become a hot political issue in the US.



Source: datacenteropposition.com, Rathbones

The case for deadlock

This time round, current opinion polls (and betting markets) suggest that the Democrats will take control of the House of Representatives. The Senate is a much closer call – and 60 Democratic Senators looks extremely unlikely.

Leaving aside political views, many investors argue that either a split Congress – with each party controlling one House – or one unified against the White House is the best outcome for investors, at least over the four years of a presidential term. That's because dramatic changes are less likely, allowing everyone to get on with their business with less interference.

Given Trump's mercurial nature and apparent disregard for legislators, this might be the exception that proves the rule. He's repeatedly tested his power against other institutions of the US state, including both Houses, by ignoring constraints either spelt out in law or set out as convention – and frequently won. So we don't expect to experience a suddenly smooth political ride, even if the Democrats are electorally successful.

Meanwhile, one time-honoured convention – that governments should limit peacetime deficits – had already been abandoned under Democratic President Joe Biden. In other words, what investors need to know is that what they used to know about the mid-terms can, perhaps, no longer be relied upon. Good to know.

On the investor watchlist

Upcoming elections elsewhere in the world matter to investors too. Will Prime Minister Benjamin Netanyahu, who with Trump began the Iran War, remain in power after Israel's October election? His victory would make an inflation-busting end to the Iran War harder.

April sees France's presidential election, with National Rally's leader, Marine le Pen, leading in the polls. Italy's Giorgia Meloni will also face the voters next year. She has brought stability to Italian politics by presiding over the longest-lasting government of modern times, albeit one that hasn't boosted the country's appallingly low underlying growth rate. While there's no federal election due in Germany, local election wins by the far-right AfD party, combined with plummeting confidence in Chancellor Friedrich Merz, mean we cannot rule out change.

This all raises the possibility of more ‘populist’ governments – governments that tend to have little respect for political norms, including a belief in sound finances, because they feel that existing elites have betrayed the people. This could hit the prices of government bonds – particularly long-term debt.

Snapshot

The global economy and markets

Figure of the month

\$69bn

Estimated cost of the world's most expensive data centre, planned by cloud computing company Nscale in West Virginia, as AI demands ever more data. By one estimate, that's one-eighth of the cost of building the Palace of Versailles in today's money, and about 30% more than Latvia's annual economic output.



At a glance

78.9%

Midterm election years when the S&P 500 rose in November

5.9%

UK 30-year gilt yield in September – its highest since 1998

€454bn

Projected EU defence spending in 2026, up from €418bn in 2025

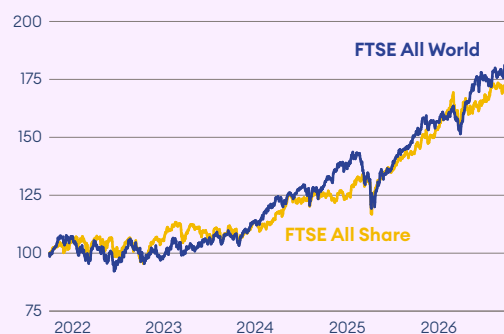
23,000

Rise in US manufacturing jobs in the year to August

Key market indicators

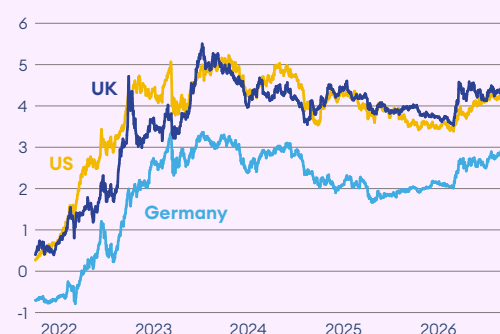
Equities

Total return in sterling (1 October 2021 = 100)



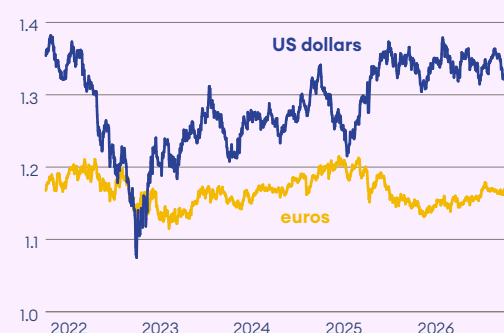
Government bonds

2-year yields (%)



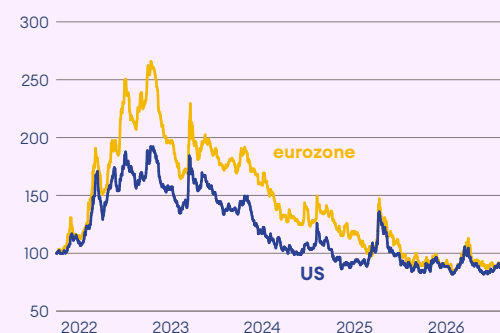
Sterling

Value of £1 in US dollars and euros



Corporate bonds

Option-adjusted spread over government bonds (bp)



Sources: FactSet, LSEG, Rathbones. Past performance is not a reliable indicator of future performance.

Find out more Knowledge and insight

Alongside this monthly *Investment Insights* publication, we share a wide range of updates and analysis, from regular strategy commentary and video briefings to in-depth reports, all designed to help you understand what's driving the global economy, financial markets, and the outlook for investment returns. To explore more, visit www.rathbones.com/en-gb/wealth-management/knowledge-and-insight



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Stay informed with regular update videos from Robert Sears, our Chief Investment Officer, that explain how geopolitical tensions, market movements, and global economic trends could affect your portfolio.



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In line with our focus on long-term investing, we produce in-depth reports. These publications reflect the thinking behind our portfolio decisions and explore how structural trends, risks, and opportunities could affect investors over the long term. We also respond to big events with pieces that explain the implications for markets and your wealth.



Burnham is Prime Minister, Healey Chancellor. What does this mean for investors? We look at what the two new most powerful men in Britain might do for the economy and public finances in office – and what they should do.



The world is growing older. *The longevity economy* looks at the wider economic challenges, and the risks and opportunities in four sectors in which we invest: property, healthcare, must-have consumer goods, and nice-to-have consumer goods. Please also see our slideshow.

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You can access this expertise in a range of ways, from fully bespoke discretionary portfolios to ready-made multi-asset funds, tax-efficient investment strategies, and specialist services for complex needs. To find out more and for details of your local office, visit www.rathbones.com/en-gb/wealth-management/contact-us



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