

### Another Brick in the Wall

3 October 2025

*We look at why artificial intelligence is boosting stock markets – and ponder who the eventual winners might be. We also consider current political risks on both sides of the Atlantic.*

A well-worn stock market adage is that a bull market climbs a wall of worry. For now, it seems, the more courses of bricks that are added the better, because many equity markets around the world reached new all-time highs over the summer.

Sovereign bond markets also found some support, despite persistent concerns about high government debt. And yet, the strongest commodities during the quarter were silver and gold, precious metals considered safe havens in times of stress. The worst was oil, which might seem improbable, given Middle Eastern events – but the price was kept down by plentiful supplies. This has been a helpful restraint on inflation expectations.

As equity markets grind higher, the pressure increases on fund managers who are underweight in them, relative to benchmarks. The fear of being left behind and losing clients can wear down even the strongest-willed sceptics. “As long as the music is playing, you’ve got to get up and

#### Quick take:

- The latest earnings season confirms companies’ consistent ability to generate profit growth.
- But investors eventually need to see productivity improvements from AI.
- Rachel Reeves is under pressure to produce a Budget that calms bond investors without hitting economic growth too hard.

dance,” said Citigroup CEO Chuck Prince in the lead-up to the Global Financial Crisis. Well, the dancefloor is packed, even if some revellers already have a taxi waiting outside.

Of course, it’s not all gloom and doom. It only feels that way, because of the nature of media commentary, founded on an understanding that our attention tends to be drawn to bad news rather than good. We can try to recalibrate our reactions to accommodate that bias. Even so, that’s easier said than done. Consider the persistently downbeat surveys of consumer confidence and the elevated

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readings of indices that measure uncertainty.

### Welcome to the Machine (learning)

From a fundamental investment perspective, the best news has been the consistent ability of companies to generate profit growth. This was shown once again in the latest company results season. As has been the case for a while, US technology companies have led the growth. Investors regard their adoption of artificial intelligence (AI) as an increasingly important component of this.

Even so, there's no shortage of commentary suggesting that this is all too good to be true. Investors have constantly scrutinised corporate adoption of AI applications and tools, mainly because of the huge amounts of capital expenditure on the rapid build-out of data centres. They want to know how much AI will likely boost corporate productivity – and with that, corporate earnings.

If the answer is “not very much”, investors could look askance at the tech companies that have spent heavily on this gambit. US information company S&P Capital IQ calculates that the four American AI ‘hyperscalers’ alone – Alphabet, Amazon, Meta and Microsoft, the quartet of companies investing in AI at the biggest scale – will spend around \$300bn this year, and more in 2026. That doesn't include the spending by privately held

tech companies such as OpenAI and xAI (controlled by Elon Musk). Let alone in the rest of the world by private entities and states.

It's not yet clear whether the spoils will be shared fairly evenly among the developers of large language models or whether it will be a case of winner takes all (or at least winner takes most). Until that's known, investors have an incentive to bet on every horse in the race. But we're acutely aware that whichever ones stumble will be swiftly despatched to the knacker's yard.

A less all-or-nothing approach is to invest in the ‘picks-and-shovels’ companies that are the recipients of this largesse. These can range from chipmakers through construction companies to energy suppliers.

But the ultimate riches might well derive from the companies best able to harness the power of AI – and these might not yet even exist. Remember, for example, that a company like Uber was only enabled by the development of smartphones and the ability to download mobile apps. Conversely, companies that fail to adapt or are disintermediated in some way will not fare well. The speed of AI penetration so far surpasses anything we've ever witnessed, ranging from electricity and telephones through to the internet and smartphones, so we should brace ourselves for rapid further developments.

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### Us and Them

If the corporate world has the potential to split further into the 'haves' and 'have-nots', the same is equally true of society – if not more. Owners of financial assets continue to benefit from rising stock markets. None more so than in the US, where government sources reported a near \$7tn (yes, that's trillion!) increase in household net worth in the second quarter of 2025; more will have been added in the third. The second-quarter number took US household assets to \$186tn, with about two-thirds of that in investments and another quarter housing stock. Liabilities are just \$19.5tn, of which around 60% is mortgage debt, much of it fixed at very low rates.

The collective US household balance sheet is in rude health. But we're seeing weakness in some areas of the economy, with signs of increasing defaults on things such as credit card debt, and car and student loans. The top 1% by wealth account for 30% of the total, with the next 10% controlling 37%. By contrast, the bottom 50% have accumulated just 3% of the country's wealth between them. This is the sort of raw material of which revolutions are made. The irony is that while US President Donald Trump promised his lower-income supporters an increase in living standards, it's disproportionately his wealthy cronies who are lining their pockets (with other asset-

owners also benefiting from the rise in asset prices that comes from various Trump policies). And crony capitalism is not efficient for economies. This situation feels unsustainable, but when will the tide turn? We'll probably have to wait until the November 2026 mid-term elections see how the electorate feels.

The positions in the UK and Europe are far less extreme but still influencing politics. The French government's attempts to cut the budget deficit have been blocked once again, with other parties calling for wealth taxes. The threat of such taxes is in the air in the UK too, with Labour backbenchers demanding a wealth tax, levied on most assets above a certain level of overall wealth. Such redistributive policies are an easy sell, particularly to people of a certain ideology, but fail to allow for the negative incentives of higher taxation, whether it be on wealth or income. The US economist Arthur Laffer famously described a curve (originally on a handy napkin) which illustrates that, at some point, higher taxes generate less income because people either give up working or leave the country.

I've always hoped that we wouldn't have to locate that inflection point through bitter experience, but there's some evidence that we might be there now, at least in some countries. In the UK, we see a wealth tax as a risk, but we see the risk

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specifically of higher property taxes at the top end as greater.

### Money

The complement to fiscal policy can often be monetary policy. Since central banks were granted independence, they've tended to provide a counterweight to government excess (by raising interest rates) or austerity (by lowering them). Witness the zero interest rate policies after the Global Financial Crisis hit or the rapid increase in rates after the pandemic. We may now be transitioning to a new era characterised by 'fiscal dominance'. This is when the weight of government debt becomes so heavy that it can only be alleviated by cutting interest rates. Usually, such a policy will only be enacted in the face of a bond market crisis. The nearest we've come to one in the UK in recent years was the 'mini budget' panic in 2022, during Liz Truss's premiership. But this year's global bond market sell-offs remind us that the market equilibrium is fragile: it doesn't take much to push up yields.

The US government appears more pre-emptive. Trump and other cabinet members have frequently attacked the Federal Reserve (Fed) for keeping interest rates too high, so the White House has tried to take control of the voting process. First it installed a Trump insider, Stephen Miran, when a vacancy opened up. He

was the Chair of the President's Council of Economic Advisers and a key author of many of Trump's current economic policies.

The President has also been trying to lever out Fed governor Lisa Cook on the pretext of misconduct owing to irregularities on a mortgage application (which appear to have been a clerical error). He wants to replace her with someone more sympathetic to his desire for much lower interest rates. The Supreme Court has even made it into this saga: it has allowed Cook to remain in her role at least until January, when it can hear oral arguments.

The danger of 'Fed capture' (by Trump) has eased for now, then. But the weakness of the dollar and the strength of gold are both tied to concerns that the government will pursue inappropriate monetary policy, given that inflation is still uncomfortably above target and economic strength is putting upward pressure on inflation. Indeed, we might not yet have seen the worst of inflation if the lagged effects of tariffs work their way through to consumer prices.

At least there are no such concerns about the Bank of England (BoE) or the European Central Bank. The BoE is resolutely keeping interest rates higher than economic growth calls for, to stave off the threat of higher inflation. But, if push comes to shove, and higher rates and

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bond yields look as though they might threaten our government's solvency, it will be interesting to see how it reacts. Maintaining tight monetary policy to honour an inflation target in the face of a collapsing economy would be a pyrrhic victory.

### US: Poles Apart

As with many things concerning US politics lately, the following commentary might be rendered out of date by the time it's read. Republicans and Democrats weren't able to agree on spending commitments in the new fiscal year that started in October, so the government has gone into a shutdown. That's not quite as extreme as it sounds, but it does mean furloughing around three-quarters of a million federal workers.

That includes people doing sometimes unsung but important work such as collating economic data (including employment and inflation). As you might imagine, this makes the task of setting suitable monetary policy even more difficult. A shutdown is by no means a rare event, in the historical sweep – and it promises to become more frequent in an increasingly polarised political environment. Much of the disagreement is based on Republicans' desire to reduce various healthcare benefits, which Democrats strongly oppose. Although the proposals passed the House (which has a

small Republican majority), they're now stuck in the Senate, where 60 votes are required to overcome a filibuster. The Republican majority is 53-47. Historically, shutdowns have averaged eight days, but the last one (in 2018) lasted 34.

A rule of thumb is that a week-long shutdown trims around 0.1% to 0.2% from GDP growth. Usually, an off-ramp is found, allowing both sides to claim some sort of victory, often in the face of increasing ire from an inconvenienced electorate. We expect the same path on this occasion, but this episode adds yet another layer of uncertainty to the current economic and investment environment.

### UK: Careful with That Axe, Rachel

Most UK investors are focused on the Budget, arriving 26 November. That leaves time for both the UK's economy and fiscal situation to deteriorate further (or, to look on the bright side, possibly improve) and for the government to fly the kite for various policy shifts. Capital Economics, a consultancy, expects a fiscal shortfall relative to previous expectations at £20bn-30bn. So there will have to be either tax increases or spending cuts – probably a combination.

The government's failure to reduce welfare spending so far this year suggests that the burden will once again be placed on taxpayers. Media reports suggest previously imposed no-go areas, including

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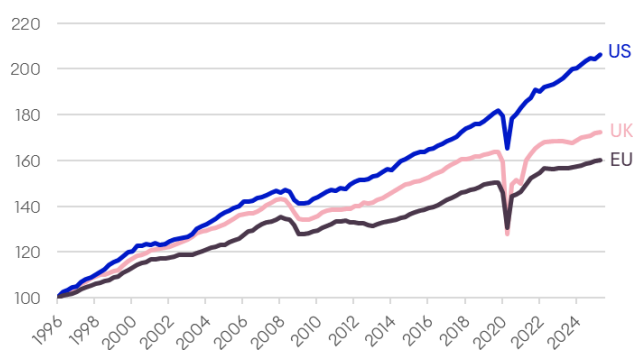
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income tax, are now being considered. There are also perennial concerns about pensions, notably the status of the tax-free lump sum that can be extracted, but also the tax treatment of contributions. And if cuts can't be made to benefits, how much fat is left to trim from government services?

In any event, Chancellor Rachel Reeves is under pressure to produce a Budget that calms the nerves of bond investors while not weighing too heavily on growth, which is already sluggish. In the weeks ahead, we'll publish much more on both the financial market and financial planning implications. Please keep an eye on the website for updates.

### Europe: High Hopes

EU GDP growth lags the US'



Source: FactSet, Rathbones. Real GDP, rebased to 1996.

The European economy is like a supertanker: it tends to remain on a defined course for ages and then needs a long time to turn around. It also takes a

while for messages from the captain to be transmitted to the crew, who then argue amongst themselves about how they should be implemented (admittedly, not on the best-run ships).

The captain, in this case, might be former Italian Prime Minister and ex-President of the European Central Bank, Mario Draghi. He delivered a stinging report in 2024, with strong recommendations about how to improve EU investment, innovation and productivity – and through that, GDP. As at September 2025, only 43 of 383 recommendations had been fully implemented, with another 77 partially so and 176 “in progress”. That leaves 87 awaiting attention.

Investors can be impatient when hoped-for change is slow to materialise, and sentiment has not been helped by the travails of France's minority government. It has failed, once again, to advance its plan to cut government spending, losing another Prime Minister, François Bayrou, in a vote of confidence. Germany, at least, remains in a strong position to implement its plans to increase government spending. For now, we retain a positive stance on European equities and the euro.

### Emerging markets: Signs of Life

Traditionally, strong emerging market performance has been associated with either a weak dollar or strong demand for commodities (with China their biggest

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consumer). While dollar weakness has helped emerging market equities this year, the main impetus behind their better performance has been a strong showing for technology companies, with AI a key driver, too. Among the big winners in the second quarter were the Chinese e-commerce and cloud company Alibaba (+58%), Korean consumer and industrial electronics company Samsung (+36%), Chinese social media giant Tencent (+32%) and the Taiwan Semiconductor Manufacturing Company (+24%), which produces around 90% of the global supply of high-value semiconductor chips.

Emerging market equities in aggregate delivered a total return of 11%, but a notable laggard was India's Nifty Fifty index (-7% in dollars). India has attracted Trump's ire in the form of a punitive 50% total tariff rate. Half of that is the original 'reciprocal' rate, with the other half a 'levy' imposed as punishment for continuing to buy oil from Russia. Prime Minister Narendra Modi's high-profile appearance alongside Presidents Xi Jinping of China and Vladimir Putin of Russia at the Shanghai Cooperation Organisation summit did little to help the situation. India has much in its favour in the long term, with a growing, well-educated middle class and a relatively young population. However, its desire to play both sides in the power struggle between the US and China leaves it vulnerable.

### Fixed income (On the Run)

The Bloomberg Global Aggregate Bond Index is +7.9% so far this year, flattered by the weakness of the dollar. The sterling-hedged version has returned 4%. Having sold off in July, government bonds globally recovered ground over the rest of the quarter. Although sovereign bond values have been threatened, we haven't reached any sort of crisis point. The authorities in the US, UK and Japan have all acknowledged the potential stress by reducing the planned issuance of longer-dated government bonds, which has helped ease pressure. There are plenty of bank reserves and savings available to soak up shorter-dated supply. But this isn't a permanent free pass – some fiscal consolidation will be required in the end.

Even so, inflammatory talk of the UK needing to apply to the International Monetary Fund for a bailout is, we believe, wide of the mark. The government has no non-sterling liabilities to speak of, unlike at the time of the 1976 bailout, when it had borrowed dollars to help support the pound. The safety valve will most probably be the pound itself. That has remained relatively stable recently, suggesting no immediate concern, but we'll watch it closely as a barometer of sentiment.

The All UK Conventional Gilts index has delivered a total return of -0.6% over the

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last three months and -1.3% over the past year. Index-Linked Gilts returned -1.6% and -8.5% over the same respective periods. Emerging Market bonds produced a total return of 3.5% in sterling over the three months to end-September (+12.9% over 12m). Global High Yield bonds delivered +4.7% (+6.8% over 12m) in sterling terms.

### The Final Cut

We came into this year highlighting the potential for portfolio appreciation in line with long-term averages, but with increased volatility. That's how things are turning out. Even so, it would have been easy to be scared out of risk assets along the way.

But even when things looked most gloomy, we've always tried to ask ourselves "what could go right?"

For all his flaws, President Trump appears motivated largely by wealth accumulation, which speaks to higher financial asset prices – or at least attempts to halt a major bear market.

Although inflation hasn't returned to target in the world's largest economy, it's well off its highs. Central banks have scope to cut rates should they need to.

The AI spending boom looks set to persist. It will be surprising if this doesn't boost

productivity in the long run, even with caveats about short-term adoption.

Investing is more like a steeplechase than a flat race, although the obstacles tend not to be placed at regular intervals. While it's tempting to spring between them, it's just as important to conserve enough energy to clear the hurdles, if not more so. Diversified portfolios fulfil this imperative, whether through a suitable mix of different asset classes or exposure to different types of company and industry.

*With my thanks (and apologies, in one case) to Pink Floyd for help with the subheadings.*

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