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Events, dear boy...

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Third-quarter company results, the UK Budget, and next week's US mid-term elections all compete for investors' attention this week, but we don't expect any of them to change our current asset allocation.

It was a welcome change to be able to zoom out a bit in last week's Weekly Digest and take a longer perspective. However, we're going to have to re-attach the macro lens this week as many events are set to demand investors' attention. We're moving into the thick of the third-quarter company results season, while the geopolitical and monetary outlook remains very fuzzy. Government bond markets have rallied from their lows (with bond yields falling commensurately) but traders remain nervous about fiscal deficits – the gap between governments' revenue and spending. Addressing ours in the UK will be a key objective for Chancellor John Healey in Wednesday's Budget.

And then, in a week's time come the US mid-term congressional elections, with the

Quick take:

- Investors eagerly await company results.
- The UK Chancellor has little room to manoeuvre.
- The US mid-terms will give us clues about the 2028 presidential election.

Democrats strongly backed to regain control of the House of Representatives and more tentatively backed to win the Senate too. We've already written about what this might mean for investors. But after Sunday's shock win for the less fancied incumbent President Lula da Silva in Brazil – he'd come only second in the first round – nobody is going to take anything for granted. We don't expect any of these to shift our current asset allocation in the light of all I've set out above, as we seek to invest well to help our clients live well. But, as the late UK Prime Minister Harold Macmillan is said to have noted with his laconic "Events, dear

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boy, events” comment, what happens in political and public life can force change.

Marking the scorecard

As I previewed a few weeks ago, the global quarterly earnings season is set to provide either confirmation or rejection of what has been a strong upward cycle. Looking mainly at the US, it's still early days: only around a quarter of the constituents of the US S&P 500 Index have reported so far – and few of those that are going to hog investors' attention. The big banks always set the ball rolling. Their results, in aggregate, were very respectable without shooting the lights out.

There was some disappointment about the outlook for trading activity given delays to various high-profile initial public offerings, or IPOs (notably frontier AI model developers OpenAI and Anthropic). There was also lingering suspicion that the high net interest margins derived from low cash deposit rates might be vulnerable to disruption from AI agents being let loose to shift money to more generous borrowers – one of those threats in a fast-moving technology cycle which is impossible to fend off entirely. Interest margins are high when there's a large gap between what banks are paying lenders and what they're charging to borrowers. But the key point was the limited signs of a deterioration in consumer or corporate

credit. That speaks to two main factors. One is that the private sector, following almost two decades of putting its house in order after the Global Financial Crisis, is not particularly highly indebted – in contrast to the federal government. The other is that steady gains in wealth continue to support personal balance sheets. Meanwhile the economy trundles on, with third-quarter GDP growth expected to come in at just over 3%.

We get into the meaty section of third-quarter earnings this week. That includes three of the 'hyperscalers' - Alphabet (parent company of Google), Microsoft, and Amazon - that are investing unprecedented amounts of capital into data centre construction and providing a decent chunk of that American growth.

We'll also get reports from several other companies that sit in different parts of the supply chain, from semiconductor chip manufacturers (Korea's SK Hynix and the US' Intel) to power companies (GE Vernova) and component suppliers (Corning, Amphenol).

Every statement will be scoured for evidence of the returns to be made on all this investment. This is especially the case now that frontier model developer Anthropic has filed for its IPO, potentially creating another \$2tn company that will be finding its way into equity indices.

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Healey's constraint

This sounds like it could be some sort of medical condition but reflects the fact that Chancellor John Healey is pretty hemmed in when it comes to [delivering his first Budget](#). His predecessor, Rachel Reeves, had built up a 'fiscal headroom' of around £25bn – the amount by which tax could come in lower than estimated, or spending higher, before the government broke its fiscal rules. But higher bond yields have increased the cost of servicing the country's debts, halving that headroom. This gives Healey limited scope to pursue ambitious spending plans without either cutting spending elsewhere or raising taxes. The former route seems to be permanently blocked off by members of his own party (who have already seen off one Prime Minister who tried to navigate it). But any attempt to raise taxes features the hurdle of the party's last election manifesto, which precludes raising the levels of income tax, corporation tax, VAT, or employees' national insurance.

This list includes by far the biggest contributors to the Treasury's coffers, putting the onus more on taxing wealth. However, the message seems to be getting through (at least to some degree) that this has a more negative impact on Britain's long-term growth potential. Hence, for example, a pre-announcement

that there are no plans to bring the capital gains tax rate in line with income tax.

It looks as though, instead, Healey will unveil a smorgasbord of small adjustments with no main course.

Markets seem to like that, for now. Although gilt yields have been rising this year, our bond market has not fared worse than most other major developed countries – and much better than France's. Sterling's trade-weighted index is testing its post-Brexit highs again, and the pound has risen about 4% versus the euro this year.

If former Prime Minister Liz Truss performed one service for her country, it was blowing up the bond market in such a fashion that it will keep future administrations from doing anything too imprudent for years to come.

Even so, and despite the plaudits the UK government has received from the International Monetary Fund for a viable plan to keep our deficit under control as well as a persistent run of better-than-expected growth, the UK is still fiscally challenged. To meet its fiscal rules, it needs to generate sustainable growth from government spending in the first half of this parliament before tightening the belt closer to the election. I think you can see how that plan might yet fall foul of the electoral cycle.

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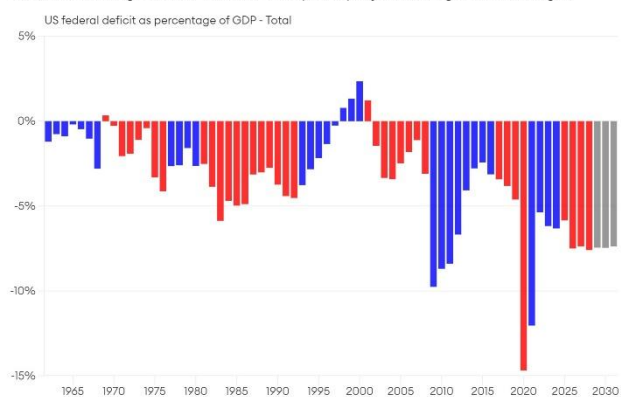
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An eye on 2028

The US mid-term congressional elections usually see the dominant party from the previous Presidential election losing at least one of either the House of Representatives or the Senate. It's difficult to keep voters as happy as you promised you would – and retribution is swift. Not that said voters will ultimately be any happier with the new majority, but it creates at least some sort of illusion that the democratic process is proving effective. If that sounds too cynical, just look at the US's ever-increasing debt pile and widening social divisions under both parties, exacerbated by economic and fiscal policies.

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 grow even larger.



Source: Congressional Budget Office, 1962-2025; IMF estimates, 2026 onwards; Rathbones. Red years are when a Republican President was in office, blue years a Democrat.

In fact, if the Democrats do regain control of both Houses of Congress, that is unlikely to cause a major change in direction for policy as directed from the White House. If anything, a severe loss could make the President even more belligerent in his foreign policy, with implications for the oil price.

The key thing to look out for will be the magnitude of the shift towards the Democrats and what signals that might generate for the Presidential election in 2028. This might be one of those cases of 'be careful what you wish for'. A more progressive President would probably be more in favour of regulating AI. This might possibly be right for humanity, but it might not suit the more near-sighted investment community. And the same goes for possible increases in corporation taxes, which could play some part in narrowing the fiscal deficit but would dampen earnings growth.

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Regional highlights

UK. More good news on the UK economic front, with Citigroup's Economic Surprise Index up to a three-year high of +89. This shows that economists' estimates have been too pessimistic. Admittedly, the resilience in the face of another rise in inflation and a sluggish housing market is quite hard to explain, although much of it seems to be coming from the IT and professional services sectors. Maybe an AI-driven growth spurt? We hope that the data is accurate – not something that the Office of National Statistics (ONS) has had a great reputation for recently.

Last week saw a positive employment report from the ONS. Moreover, October's flash S&P Global survey reported a pickup in the composite Purchasing Managers' Index (PMI) to 53.1 from 52.0 in September, its highest level since February. The gain was driven by the services sector. The services PMI jumped to 53.1, also an eight-month high, as respondents reported an improvement in the new work pipeline. Manufacturers also noted stronger output, despite some supply chain challenges. The rise in the composite employment balance, from 48.4 to 50.7, was encouraging too. It's the first 'expansion' – a reading over 50 – since September 2024.

US. The US' main data releases last week concerned the housing market – and 'concern' is an appropriate word.

Residential property is in a slump, mainly thanks to mortgage rates. In the US, the vast majority of mortgages are taken out for thirty years, although, in reality, the average life of a US mortgage is less than ten years as homeowners move or refinance their mortgages at lower rates. Higher bond yields have forced the mortgage rate back up close to 7.5%, with two negative effects. First, it's just a big stretch for new buyers to take out a mortgage at that level, with other living costs rising. Second, those who locked in their mortgages at much lower rates are reluctant to move house because that would entail paying a much higher rate for a new mortgage (they're generally not transferable). Housing starts, building permits, existing home sales, and mortgage applications are all running at or close to ten-year lows. Housebuilding contributes around 3.5% to US GDP, much less than the contribution of almost 7% at the pre-financial crisis peak in 2005. So at least there's no bubble here. But if you add in all the downstream beneficiaries (from conveyancing to furnishing and decorating) the total is more like 16%. If the AI capex trade breaks down, housing might have to take up some of the slack. Lower bond yields would help a lot.

Europe. The flash October PMIs for the eurozone were a little disappointing, with the composite measure falling 1.2pts to

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51.9. At least that remains in growth territory. The volatile political situation and spike in government borrowing costs meant the downturn in the French composite PMI weighed on the overall picture. It fell from 50.3 to 48.4. Germany's index fell from 53.8 to 52.8, remaining firmly in expansionary territory. That's a result of fiscal stimulus, which is beginning to filter through to the economy. The better sentiment was confirmed by the expectations component of the October Ifo Business Sentiment Survey. The reading rose from 90.4 to 91.6, the highest level since February 2022.

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