

The big question

18 November 2025

Many investors are starting to view a correction in the stock market as just a question of timing. This very defensiveness may be helping to guard against their fears coming to fruition. Still, it's right to add a pinch of salt to AI exuberance.

The opening conversational gambit at lunch last Sunday was "Tell us, John – when is the market going to crash?" Not "if", but "when". It's always dangerous to rely on personal anecdotes to inform investment strategy, but the number of times I have been asked versions of this question recently underlines the fact that a lot of people are very worried about what effects a severe market downturn might have on their wealth and the overall economy. More positively, it could also suggest that if so many people are nervous, then they are already defensive so the probability of it happening is less great.

Casino capitalism

I have been tempting fate for a while now by pushing back against the idea of a broad-based bubble and by maintaining that a market crash is not on the cards, at least in the absence of unforeseeable forces. Of course this goes against the grain of the many financial luminaries, including the CEOs of major banks, who are touting the possibility of some sort of market "correction", though with a very indefinite timescale. I still can't help feeling that this is a ruse to have something in print that they can come back to and say, "I told you so." Because none of them seems to be battenning down the hatches from a business perspective.

Quick take

- Against the growing tide of angst, we still don't see a market crash on the cards.
- The most debt-reliant of the big AI-related tech companies are most vulnerable to a setback.
- All eyes will be on Nvidia earnings this week, with a big move expected in either direction.

That's not to say that markets are free from speculative activity and it would better for long-term returns to dampen some of that. Much of this speculation takes place in the US, where the huge increase in options activity has combined with investors' rising use of leverage (borrowing to invest). The expanding range of leveraged Exchange Traded Funds also speaks of an increased appetite for risk as well as a 'get rich quick' mentality. I have no problem with the use of leverage when sensibly combined with other assets to maintain an appropriate overall risk profile for that particular portfolio, but that is not necessarily the case with many in the US today.

In general, I would not agree with people who claim that investing in the stock market is akin to gambling. The numbers show that the average investor who maintains a sensibly diversified portfolio will successfully compound wealth over a reasonable timeframe. Investing involves real companies generating profits, most of which pay dividends. However, the nature of instruments like

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short-dated call options or leveraged ETFs is to take advantage of much shorter-term price movements. I don't deny that this might be a well-researched trade, and that there are some skilled operators who will do well, but there is also a casino mentality evident. Something definitely shifted during the Covid lockdowns, with certain people looking for ways to entertain themselves. The government was sending out "free" money and app-based investment platforms offered easy access to markets. "Meme" stocks and "Covid winners" were the main beneficiaries, but they also fell back to earth with a bang when interest rates went up (and the government cheques stopped coming). This is not the pool of assets in which we tend to fish.

Questioning returns on capex agAI

Speculation today is mainly fuelled by AI enthusiasm and, like all good stock market booms, is based on plausible potential outcomes. As I have discussed in previous commentaries, though, investors are continuing to question the returns that will be made on the hundreds of billions of dollars in annual capital expenditure that are planned. A lot will depend on how much individuals and corporations are willing to spend on using AI-driven tools. That, in turn, will depend on what they can offer. The bull case is that they will provide productivity-enhancing services and create new markets that we cannot yet imagine, as per Amara's Law. The bear case is that they either turn out to be a damp squib or there's a race to the bottom on costs for these tools and profits are competed away.

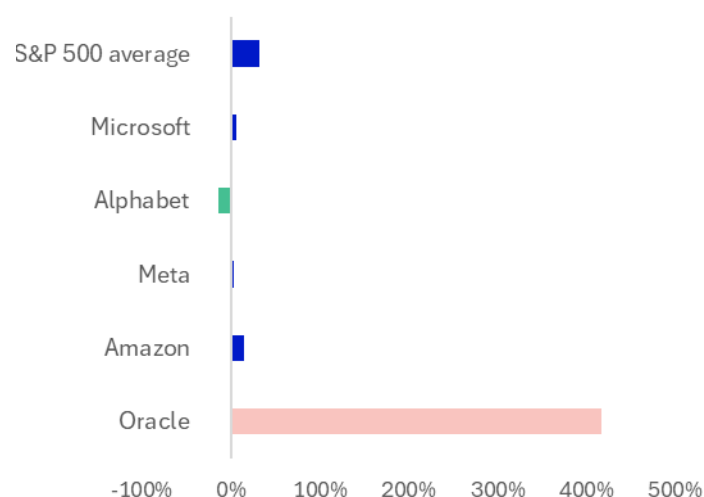
JP Morgan, the investment bank, has calculated that around \$650 billion per annum would have to be spent on AI products such as ChatGPT, into perpetuity, to make them viable. That equates to 0.58% of current global GDP. Put another way, that works out as \$34.72 per month from every current iPhone user, or \$180 per month from every Netflix subscriber. We are aware of claims of even higher revenues needing to be generated, and the only true answer to the question of whether that can be achieved is "nobody knows". At least not yet, leaving investors just as nervous about missing out on the winners as being exposed to the losers.

Even so, lines are being drawn between those companies that are spending out of cashflow and those that are utilising more debt. Of the cloud computing platform providers (known as the

hyperscalers), for example, shares of Meta (one of the bigger debt issuers) are down 23% from their all-time high, while Amazon's shares are down 7%, Alphabet's down 4% and Microsoft's down 6%. Apple, which is not engaging in the 'arms race', is just 1% off its all-time high while Nvidia, the main recipient of capex dollars, is down 8%.

Possibly the most interesting company is Oracle, a late entry to the race and the company that is not only most reliant on debt to fund its growth but also most reliant on a single customer, OpenAI (the company behind ChatGPT). OpenAI's current plans are for more than \$1 trillion of capital expenditure, a large multiple of their very slim annual revenue of just £20 billion. Oracle's shares have given up all the gains they made following the announcement of the deal with OpenAI, and now trade 32% below their peak.

Figure 1: Leverage as a % of total equity



Source: FactSet; net debt/equity as of 17 Nov

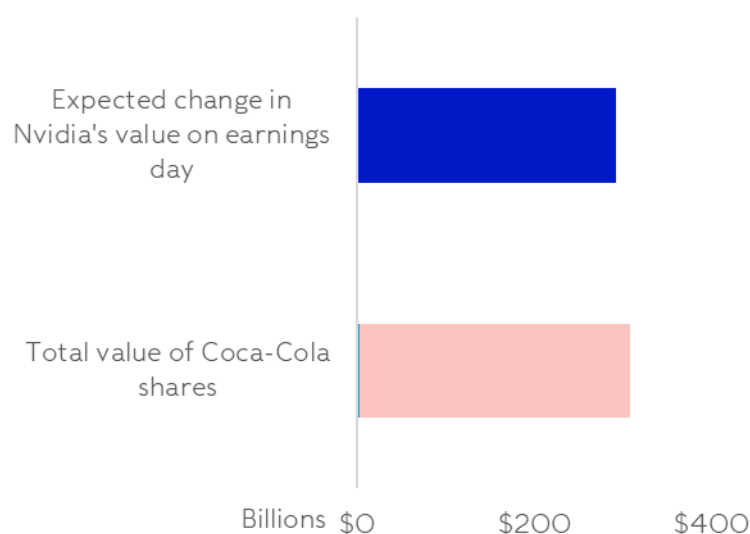
We can also see signs of concern in the price of insuring against debt defaults. Just a few weeks ago, the cost of insurance on Oracle's debt was a lowly 20 cents per \$100 of debt per annum. Now it's more than a dollar. That might also reflect investors buying Oracle's debt insurance (which is a tradeable instrument known as a Credit Default Swap, or CDS) to hedge against wider risks pertaining to the AI build-out. Part of the attraction is that Oracle is one of the few big tech companies that issue these CDSs, but it's still a signal we need to pay attention to.

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Coke Zero?

The third-quarter corporate reporting season still has one big moment ahead: Nvidia's earnings this week. Options prices suggest a 6.45% move in the shares on reporting day. That's worth around \$300bn, equivalent to the market capitalisation of Coca-Cola, a Warren Buffet favourite. Put another way, to have the same effect on the index, Coca-Cola would either have to double or go to zero. I can't help feeling that either of those moves would have a far greater effect on investor sentiment!

Figure 2: Nvidia earnings' big expected impact



Source: FactSet, Rathbones; based on total market capitalisation as of 17 Nov

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Economic highlights

UK. September's GDP data made poor reading for the Chancellor, with activity falling by 0.1% from August's level. The economy grew at just 0.1% in the third versus the second quarter, with annual growth running at 1.3%. The shortfall was largely due to the cyber-attack and consequent production halt at Jaguar Land-Rover, which contributed to an overall drop of 28.6% in UK car manufacturing output. That should at least rebound in coming months. With consumption growth of just 0.2% quarter-on-quarter and business investment falling, the underlying economy remains sluggish. The constant speculation about tax increases in the forthcoming Budget will continue to weigh on sentiment even as the effects of the last Budget's increases in national insurance are still working their way through the employment market. If there is a silver lining, it is that weak activity and (hopefully) non-inflationary fiscal tightening in the Budget will open the door for the Bank of England to cut interest rates sooner. Market-derived pricing indicates a 77% probability of a quarter-point reduction at the 18 December meeting, up from just 20% a month ago.

US. Following the end of the shutdown, we continue to await the return of official government-compiled economic data. Data from the private sector has been mixed: it suggests some weakness in the labour market, although no increase in overall unemployment, despite some recent high-profile job-cut announcements. The main feature has been commentary from Federal Reserve members suggesting, on balance, no intention to cut interest rates at December's meeting. This is mainly owing to lingering inflation concerns, which the lack of fresh data doesn't help alleviate. However, the market still expects rates to be cut by March at the latest.

Europe. The November ZEW survey confirmed mixed economic sentiment in Europe, suggesting the pace of growth is still not picking up. Euro area growth expectations ticked up to 25.0 from 22.7, while German expectations missed estimates, edging down to 38.5 from 39.3. Current conditions in Germany also missed estimates but improved slightly to -78.7 from -80.0. Alongside the decline in the November investor confidence survey from Sentix, there has been no sign of a meaningful pick-up in sentiment data. However, European

economic surprises have improved since mid-October. The second estimate of third quarter Eurozone GDP growth confirmed the initial 0.2% quarter-on-quarter estimate, with employment growth of 0.1%. The European Commission increased its forecast for EU GDP growth in 2025 to 1.4%, from 1.1% in May, while lowering the 2026 estimate to 1.4% from 1.5%. In 2027, the bloc's economy is expected to grow by 1.5%.

China. Signs of weakness in China's economy stretched into October, with one measure of investment recording the sharpest slowdown in years. Annualised retail sales growth of 2.9% was as expected, while industrial production fell short of forecasts at 4.9%. Fixed asset (-1.7%) and property investment (-14.7%) both declined at the sharpest pace since the outbreak of the Covid pandemic. It remains a long wait for the economy to return to a decent pace of growth.

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Greenbank
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enquiries@greenbankinvestments.com
greenbankinvestments.com

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Rathbones Investment Management International
01534 740 500
rathboneimi.com

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