RATHBONES

Weekly Digest

By John Wyn-Evans
Head of Market Analysis

Listening to Mr Market

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The year is progressing as we thought it would, with lots of policy threats from the usual source, but limited disruption to markets. In such an informational storm, knowing when to react and when to ignore the commotion will be crucial.

Quick take

- 2026 is playing out as we thought; lots of threats but limited market disruption.
- Getting the balance right between moving too slowly and too quickly will be key.
- There's more than just dollar weakness behind gold's continued surge.

Another week and another round of disruptive policy threats from 'you know who'. Threats of invasion of an allied country; threats of punitive tariffs on anyone who might stand in the way; even bigger tariffs if I don't like what you said about me and you're trying to sign a trade deal with China (hello, Canada!). Yes, 2026 is playing out much as we thought it might. But with limited disruption to financial markets so far.

Even so, it's all very wearing. As investors we are faced with the task of separating signals from noise. What's relevant and what can we ignore. This all takes time and energy and potentially distracts us from doing more productive things. Years ago I read a book on the subject of information theory, and it claimed that humans expend far more effort on filtering out what's not relevant than focusing on what is. It's like chiselling away at a massive block of stone with a toothpick to create a much smaller sculpture.

Thinking fast and slow

Hence a tendency for us to fall back on the sort of 'System 1 and System 2' approach popularised by Daniel Kahneman in *Thinking Fast and Slow*. System 1 allows us to take mental shortcuts and use 'instinct' to make most of our decisions, and it tends to work well. But this approach is subject to error because biases can creep in, or instinct based on historical experience can fail to adapt to changing circumstances. 'System 2' applies much more rigorous analysis to the situation, tending to result in much better answers to complex problems. But it takes a lot more time and resource and is not especially well suited to fast-changing situations.

The tension between the two systems is often evident in investing. When the facts change, it usually makes sense to reassess your position. Many of the most successful traders can change their stance on a sixpence (computers are even better!). At the institutional level, the 'supertanker effect' comes into play, with multiple committees comprised of members with their own biases having to rubber stamp any change of direction.

Greenback blues

I have been regularly amazed during my career in the City when developments that seemed to me to be fully discounted were certainly not. When you're on the front line (and offering advice and opinions as opposed to managing the portfolios), it's harder to put yourself in the slower-moving shoes of the decision-makers. Bearing that in mind, what market movements are attracting my attention today? I would say there are three main ones: the weakening of the dollar; the strength of precious metals (figure 1 shows gold's almost vertical climb); and the shifting of market leadership away from the small group of technology shares that have come to dominate the indices (which I will cover in more detail in next week's Monthly Digest).

Figure 1: Gold's inexorable (?) climb

Source: FactSet, $ per troy ounce, as of 27 Jan

The first cracks in the dollar appeared last April when the Liberation Day tariffs were announced, but the currency has been relatively stable since then, reaching the bottom of its current trading range last October. We argued at the time that there was insufficient evidence for a wholesale exit from dollar-based assets. This view was based on the lack of viable alternatives for liquid (i.e. easy to buy and sell) reserve assets and the dollar's continued dominance in global trade.

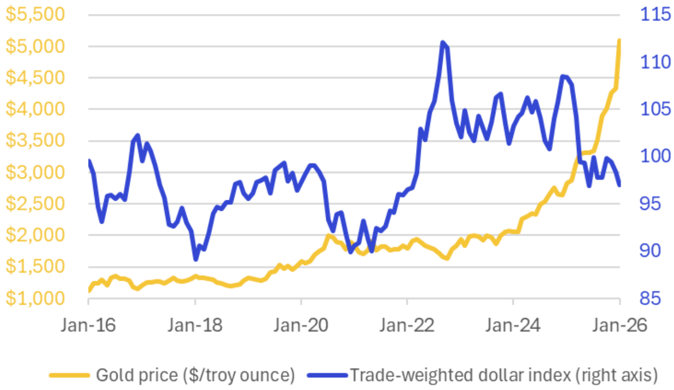
No doubt we will have to revisit those opinions in the light of current events, but staying cognizant of the risk that introducing currency hedges can substantially change our returns relative to benchmarks.

It's also worth noting that our strategic regional allocations are already predicated on a long-term decline in the dollar against sterling, and so further hedging could be seen as 'double counting'.

More precious than ever

Because most commodities are priced in dollars, one would reasonably expect their dollar price to rise when the dollar weakens, to retain their global value. But this year's moves in precious (and base) metals reflect much more than that (figure 2). Gold has punched through $5,000 per ounce, and was up 18% so far in this month alone, while silver is up more than 50% in 2026, moving through $100. The core buyers since 2022 have been central banks replacing some of their dollar reserves with gold. This was a diversification trade driven by fear of dollar-denominated assets, such as Treasury bonds, being frozen by the government in the event of future conflict. And remember that this was under a Joe Biden-led Democratic government.

Figure 2: Gold strength > dollar weakness



Source: FactSet, as of 27 Jan

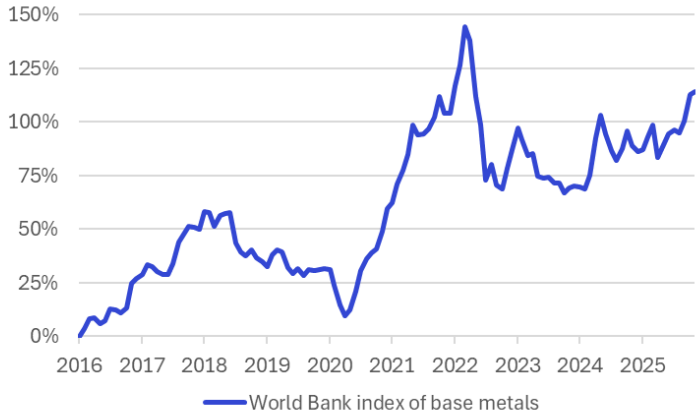
While central bank reserve buying has continued, there are signs of greater allocations being made by individuals and institutions, as the concept of 'dollar debasement' gains more traction.

This can be seen in the known holdings of gold in ETFs (passive investment funds). While not regaining the levels of 2020 (in terms of ounces of gold held), they have been moving steadily higher since April last year, which coincides with Liberation Day. The exposure today in dollar terms is multiples higher.

The biggest problem with gold, other than storing it securely if you buy it in physical form, is valuing it. The long-standing rule of thumb that an ounce of it will always buy a good quality 'decent' men's suit is taking us into bespoke Savile Row territory now. However, if that's anticipating greater debasement of fiat (paper) currencies through inflation, then it might well be justified. Try thinking not of the value of gold going up, but of everything else going down on a relative basis.

As for metals in general, there is increasing discussion of a new world order in which a combination of factors will increase demand (we'll be discussing this in a spotlight on metals mining in our next Investment Insights magazine, due out in early February).

Figure 3: Base metals are also on the rise



Source: Factset, as of 21 Jan

As always in our investment process, we are never going to 'bet the farm' on a single specific possible outcome. But we continue to weigh up all of these risks and opportunities when constructing balanced portfolios.

Don't be greedy!

I'll leave you with a final quote from Warren Buffett, as he was musing on the demise of the hedge fund Long Term Capital Management in the late 1990s. It's an opinion that we should always bear in mind when tempted to take too much risk with our investments. LTCM was (in)famously founded and run by a hugely experienced and successful group of well-heeled investors including various Nobel Prize winners. But, as Buffett commented:

"To make money they didn't have and didn't need, they risked what they had and did need. And that's foolish. It's just plain foolish".

Economic highlights

UK. It was a better week for UK data, so good in fact that Citigroup's Economic Surprise Index jumped back into positive territory for the first time since November. It's impossible to prove that this was down to relief after the Budget, but survey evidence does suggest that. The latest purchasing managers index (PMI) of services activity rose from 51.4 to 54.3, with manufacturing up from 50.6 to 51.6. Both were above expectations, with 50 demarcating the line between expansion and contraction. Retail sales grew 3.1% in December from a year earlier (vs +1.2% expected) and November's reading was revised up too. None of this better activity is a reflection of vastly improved consumer confidence, with GfK's consumer (lack of) confidence index still mired in negative territory (-16). It was last positive in January 2016. Taken in the round, this puts less pressure on the Bank of England to cut interest rates, with a little over one quarter-point reduction now priced in for this year.

US. The PMIs showed slight improvement, with services at 52.5 and manufacturing at 51.9, but less than forecast. Still, 'harder' data continues to suggest decent momentum in the economy, and that comes ahead of the implementation later this year of tax cuts from last year's One Big Beautiful Bill Act. These include bigger tax rebates for individuals and greater tax relief for companies on their capital expenditure. One weaker area of the economy is the housing market, with pending home sales falling 1.3% in December from a year earlier. A 30-year mortgage rate (the predominant term for US mortgages) of more than 6% remains a sticking point. Especially for movers who are currently enjoying a much lower fixed rate that they would have to relinquish if they moved. Hence President Trump's desire to get interest rates down ahead of November's mid-term elections.

Europe. PMIs were more mixed in aggregate, with manufacturing rising from 48.8 to 49.4 but services falling back to 51.9 from 52.4. PMIs for Germany, one of the key engines of Europe's potential recovery, improved in both measures, but manufacturing remains in contractionary territory for now (48.7). France, still mired in political turmoil, was disappointing, with the services reading falling back below 50 to 47.9. As in the UK, Eurozone consumer confidence has a negative reading (-12), but in this case has never been positive since the inception of the survey in 1999!

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enquiries@greenbankinvestments.com

greenbankinvestments.com

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rathboneimi.com

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