



Investment Insights

Our monthly look at what's driving global markets

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Opposing forces

Sometimes financial markets send out conflicting signals



John Wyn-Evans, Head of Market Analysis

The 1982 Dire Straits song *Industrial Disease* paints a picture of social and economic problems that seem appropriate to the times in which we live. Included in the British band's song is the thought-provoking line, "Two men say they're Jesus, one of them must be wrong."

Financial markets can also send out conflicting signals, just like the two rival seers in the Dire Straits track.

For example, many equity markets are climbing to new all-time highs, suggesting that all is well in the world. On the other hand, longer-term bond yields in many of the same countries (which move in the opposite direction to bond prices) are reaching their highest points of the present economic cycle, even though inflationary pressures are easing (figure 1.1). They're even revisiting levels not seen since the 1990s. The existence of conflicting signals from two different markets is a troubling conundrum we need to solve when it comes to constructing client portfolios for the long term.

First, let's look at the key recent market developments. Equities have continued their recovery from the lows made on 'Liberation Day', when US President Donald Trump unveiled his 'reciprocal tariffs'. The average global tariff rate for goods exports to the US will rise to

17.4%, up from 2.4% last year, according to the widely quoted Budget Lab at Yale (figure 1.2).

However, investors have come to terms with the reality – at least they now know what they're dealing with. The second-quarter results season for US corporate earnings was quite good. This suggested that companies are finding a way to cope with the prospect of having to import more expensive materials and products, although cutting other costs to maintain profits could lead to weakness elsewhere in the economy. We're certainly seeing some evidence of slower employment growth in the US. This is exacerbated by a more restrictive immigration policy that's part of the same America First mentality that made Trump increase tariffs.

Being intelligent about artificial intelligence

Investment in artificial intelligence (AI), raising the prospect of future productivity gains for those employing it, has been the driving force behind equity returns since the launch of ChatGPT in late 2022.

But there have been occasional moments of uncertainty. The latest occurred in August, when a

Figure 1.1: France feels the pressure

The gap between French and German 10-year government bond yields has begun to climb as investors weigh rising economic uncertainty in France.



Source: LSEG, Rathbones

paper from MIT Nanda, an AI initiative started by the Massachusetts Institute of Technology, questioned the returns achieved by businesses that had implemented AI-based solutions.

However, a careful reading of the MIT report suggests that the problem lies not in the technology, but in the implementation. In other words, AI-based applications may well deliver better returns once management works out to use them better.

What does this mean for investors? They continue to give companies the benefit of the doubt over AI, when considering both the high investment in data centres and the effectiveness of corporate adoption of it. But we're acutely aware that, as with other technological innovations in the past, there will be an increasing gap between the winners and the losers. Think of Google's search engine, trouncing Yahoo's; remember too Betamax's beating at the hands of VHS video tapes. This tendency might have less influence on overall market levels, since the winners and losers in any market will to a degree counterbalance each other. However, the US is by far the most exposed to any disappointment, if its tech companies' investment in AI bears only slow-growing fruit.

All things considered, though, because of this phenomenon of winners and losers, we will be reducing the threat of AI hype to our clients' portfolios mainly through our individual stock selection rather than our relative investment in different financial markets.

The political dimension

Politics remains a factor for investors to consider. The policies with the most influence on global financial markets are those emanating from the White House.

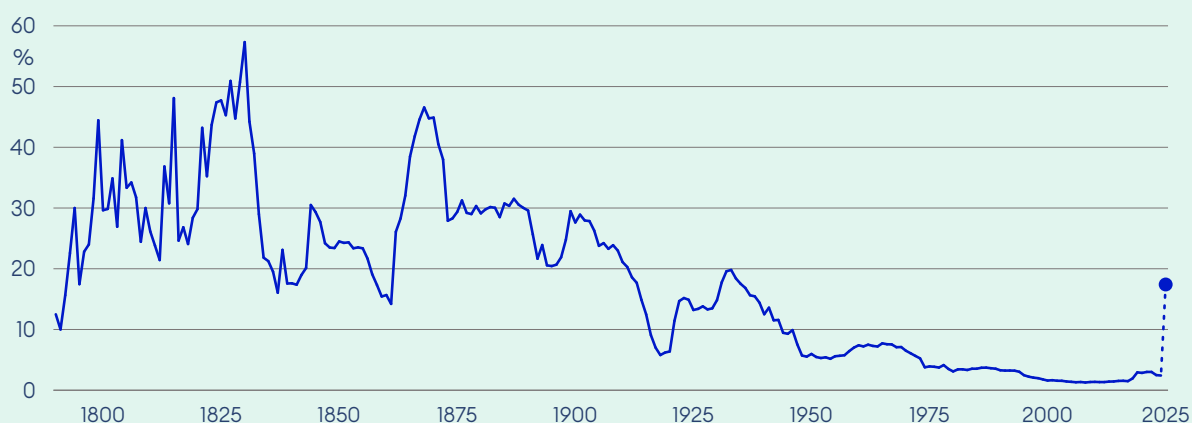
We await the Supreme Court's ruling on the legality of the tariffs imposed by Trump. This might hang on the interpretation of what constitutes a security threat. When announcing tariffs, the President cited the 1977 International Emergency Economic Powers Act, which allows the executive to take emergency action in response to threats. The 31 August to 1 September international summit, hosted by China, will have done nothing to reduce Maga Republicans' belief that their country is under threat. It was attended by the leaders of (among others) Russia, North Korea, Pakistan, Iran and, perhaps most worryingly, India.

Meanwhile, the 8 September loss of a confidence vote by French Prime Minister François Bayrou highlights governments' difficulties faced in controlling their fiscal deficits. It echoes the climbdown by the UK's Labour government over welfare reforms, although that was the result of a revolt from its own backbenchers rather than a recalcitrant opposition. Higher spending in a world of higher interest rates leads to more tax revenue being spent on servicing the debt (figure 1.3). This is a problem that Chancellor Rachel Reeves will have to address in the Autumn Budget – most probably with higher taxes rather than spending cuts.

Investors are demanding higher interest payments to account for such risks. This can generate a vicious spiral, where the debt becomes more unsustainable, leading to even higher interest rates because debt service costs are higher. Letting the economy run hot and allowing inflation to remain high is one tempting solution by governments to a high debt burden. This is a threat that steers us towards a preference for fixed income assets with shorter maturity dates. We believe they will be less volatile and could also benefit from any reductions in the Bank of England base rate.

Figure 1.2: The rising cost of trade

The average effective tariff rate in the US (customs duty revenue as a percentage of goods imports) is still low compared with most of the nineteenth century but is projected to surge to 17.4%.



Source: Historical Statistics of the US Ea424-434, Monthly Treasury Statement, Bureau of Economic Analysis, The Budget Lab analysis, Rathbones

We also believe that increased geopolitical tension and the effects of climate change could raise the rate of inflation. At the very least, they could make it more volatile. For example, particularly bad harvests, which are more likely because of climate change, could suddenly push up commodity prices.

While we're comfortable being fully invested in equities, current valuations don't justify being overweight relative to other asset classes.

Turning the European supertanker

This is particularly the case for US equities, which trade at levels consistent with past market peaks, judged on several measures. And yet, betting heavily against the US is a mug's game over the long term. US companies remain the leaders in the current wave of technological innovation, backed by deep pools of capital and a never-say-die entrepreneurial spirit. We don't subscribe to claims that the US equity market is in a bubble similar to the one that formed at the turn of the millennium. The leading companies are exceptionally profitable and generate strong cashflows from their operations, many of which are underpinned by regular subscriptions rather than unpredictable one-off purchases. Rather than relying on debt, as in the first internet boom, they're using that cash to invest in the future.

We continue to see attractive prospects for European equities. This might be akin to turning round the proverbial supertanker, and some investors will become impatient with how long it takes. But there does seem to be, finally, a recognition by national governments that attitudes to regulation need to soften. There's also a growing sense that innovation requires more support. Much of this change in thinking stemmed from a report

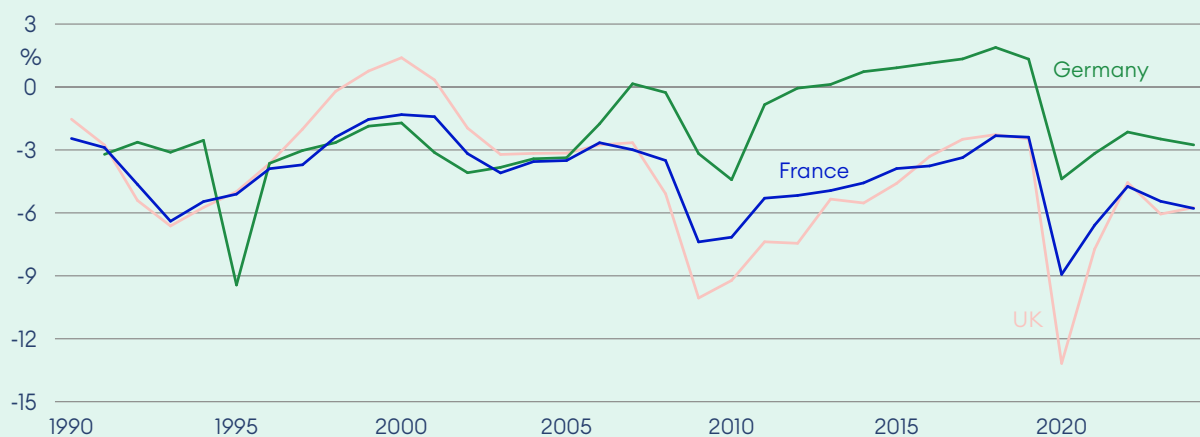
last year by Mario Draghi, ex-President of the European Central Bank and former Italian premier. Germany is leading the way with a €1 trillion fiscal stimulus package, although it's one of the few countries whose finances allow it to be so generous.

Japan has been through a similar phase of economic deflation, where state institutions boost GDP through fiscal and monetary policy. The Japanese stock market has also been supported by corporate governance reform. It's been a source of reasonable returns for us, especially where our chosen fund managers have successfully applied their stock-picking skills to select companies where management attitudes are changing. However, much of this game has now played out, so we have less conviction in the merits of being overweight.

Our Diversifiers (the D in our LED investment approach) remain a way to offset risks in our core fixed income and equity portfolios. Gold has performed exceptionally this year, rising by 38% in dollar and 28% in sterling terms. The core buyers have been (non-US) central bank reserve managers, especially those outside the G7 group of leading developed economies, as they diversify their reserves away from dollars in response to White House policies. Institutional portfolio managers and retail investors see gold as a good foil against (geo)political risk. They also regard it as a hedge against the possibility of the devaluation of fiat currencies (currencies issued by governments) should governments decide to prioritise fiscal expansion over monetary rectitude. This is so-called 'fiscal dominance', a phrase with which we might become increasingly familiar in the years ahead. In other words, more on that later...

Figure 1.3: Governments are in the red

France and the UK have higher deficits than Germany.



Source: IMF, Rathbones. Figures show net borrowing as a share of GDP.

Don't bet the house

The golden age of property investment is over



Oliver Jones, Head of Asset Allocation

The UK's love affair with property investment is apparent across newspapers, daytime TV and social media. An English person's home may be their castle – they've also regarded it as their nest egg (and the same for other Britons). Many have even bought additional castles, such is their ardour for property. Reflecting this, official figures show **more than 2.8mn private landlords in the UK**.

However, the days of strong returns from residential property are already past. The past decade has seen three pieces of bad news. House price growth has been slower; higher interest rates have squeezed the buy-to-let business model; the regulatory treatment of private landlords has become progressively less favourable.

The economic and policy outlook suggests those headwinds won't dissipate. From 1980 to 2016, UK house prices rose 6.7% per year in absolute terms, or 3.3% in real terms (after allowing for inflation). Prices in London rose even faster: 8.5% in absolute and 5.0% in real terms. That rate of capital appreciation is considerable – and investors making an income from renting out properties would have made even more.

It's difficult to compare returns from property exactly with returns from other investments, for various reasons – such as the cost of mending that leaky roof. But taking the crude numbers, the capital appreciation of a portfolio made up of 25% UK equities and 75% international equities would have been only slightly higher at 9.0% per year or 5.5% after inflation (figure 1).

What drove high house prices?

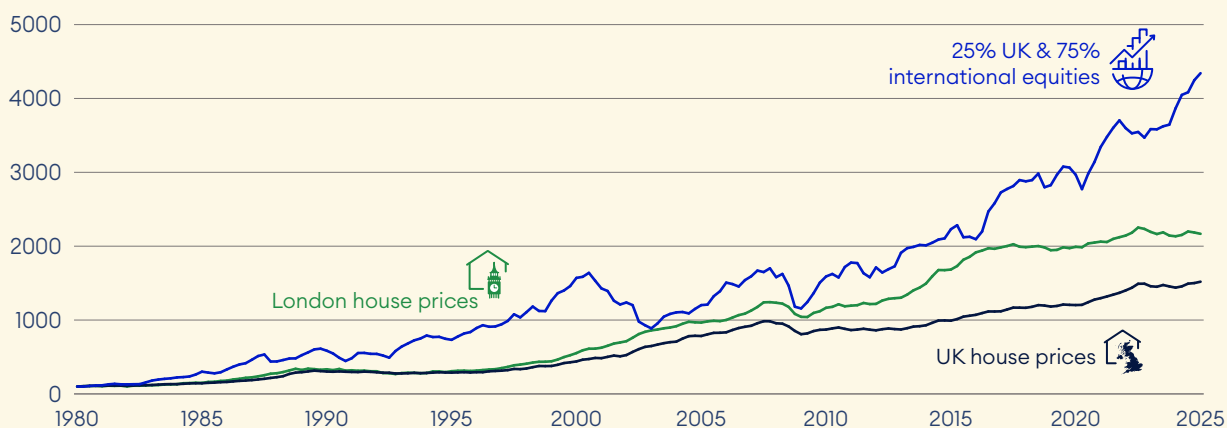
What lay behind this? One cause is higher wages. As earnings have risen in real terms, households have been able to spend more on housing.

Between 1980 and 1998, the average UK house price rose by 2.6% above inflation per year. So too did the average wage. As result, the house price-to-earnings ratio – the average house price divided by average earnings – was similar in both years, at around 4.3, although it did fluctuate a lot between these two points (figure 2).

However, since 2000, the ratio has risen to as high as 8 and never fallen below 6. So pay can't be the whole story behind the price rises.

Figure 2.1: Equities leave property trailing

The stock market has been more profitable than property for UK investors over the past 45 years. £100 invested in global equities in 2016 is now worth £174 compared with £134 in UK property and just £111 in London housing.



Source: LSEG, Rathbones

A fall in interest rates helped sustain higher house prices relative to earnings. Double-digit mortgage rates were the norm in the 1980s and early 1990s. But these dropped to as low as 1–2% by the late 2010s. This shift allowed buyers to borrow a lot more money for any given level of monthly repayment, bidding up house prices.

Other changes to the mortgage market have probably helped push UK house prices higher, by increasing the availability of loans and encouraging property investment. These include the entry of banks into the mortgage market, the introduction of buy-to-let mortgages, and market innovations, such as the government’s Help to Buy scheme.

Moreover, housebuilding has failed to keep pace with population growth over the past fifty years or so. In other words, demand has risen faster than supply.

Productivity, rates and policy

But conditions for house price growth now look much less fertile. After a period of far outstripping inflation, average earnings have grown much more slowly lately. Even if we ignore declining real wages in the early 2010s, they’ve only outpaced inflation by 0.5% a year since 2016. In the long run, real-terms wage growth is closely linked to productivity – companies generally only pay their workers more if they’re getting more from them. But productivity growth has in recent years been low – and we don’t foresee a dramatic improvement anytime soon.

Moreover, mortgage rates have risen in the past few years. The average 2-year fixed-rate 75% loan-to-value

mortgage rate has climbed from 1.2% in 2021 to above 4% since 2022, according to the Bank of England. This has pushed up first-time buyers’ repayments. We don’t see a return to the abnormally low interest rate environment of the 2010s.

On top of higher interest rates, unfavourable tax changes and tighter regulation have added to costs. For example, stamp duty on additional properties was hiked in 2016 and again in 2024.

Moreover, the housing supply pipeline is flowing better. Although the government has fallen short of its housebuilding targets for years, the annual net increase in dwellings has crept back up since 2015, returning to above 200,000. On this measure, the housing stock is growing at the fastest rate since the 1960s.

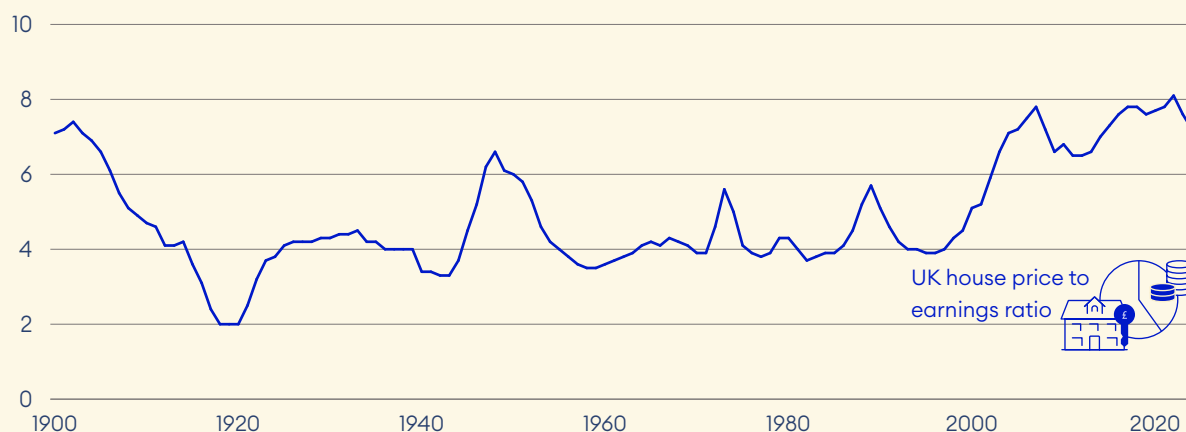
End of the affair

With those fading tailwinds in mind, it’s little surprise that UK house prices have risen by a much more pedestrian 3.7% per year, in absolute terms, since 2016. That’s only about the same as inflation. Over the same period, the portfolio of UK and international equities we mentioned earlier rose by 7.2% a year.

We think this trend will continue. In our view, it may be time for the British to break off their love affair with the housing market and embark on a new one, with a diversified portfolio of financial assets. After all, 10-year UK government bonds offer yields above 4% and there’s a wide selection of high-quality names across the world’s stock markets. It might not be the most romantic of trysts, but we think it’s likely to offer them a better return in the long term.

Figure 2.2: What’s driven house prices over time?

This chart shows average house prices divided by average earnings. For much of the 20th century, UK house prices rose in line with earnings, but since 2000 they’ve climbed far beyond.



Source: LSEG, Bank of England, Rathbones

Counting the cost

Why rising government debts matter for investors



Adam Hoyes, Senior Asset Allocation Analyst

Government debt levels have surged across advanced economies, and they're now a hot topic in politics and financial markets alike. For investors, the key question is what this means for their portfolios, in terms of both risks and opportunities. We answer some of the most pressing questions.

Why is government debt back in the spotlight?

After the Global Financial Crisis in 2008 and the pandemic in 2020, governments borrowed heavily to support their economies. For a while, this seemed manageable because interest rates stayed low. But with bond yields rising sharply in recent years, debt has become more expensive to service, putting public finances under more pressure.

For investors, this matters because government bonds are a foundation of the financial system. Rising debt and higher borrowing costs can ripple through markets, affecting inflation, growth and long-term returns across all asset classes.

How high is government debt and how did we get here?

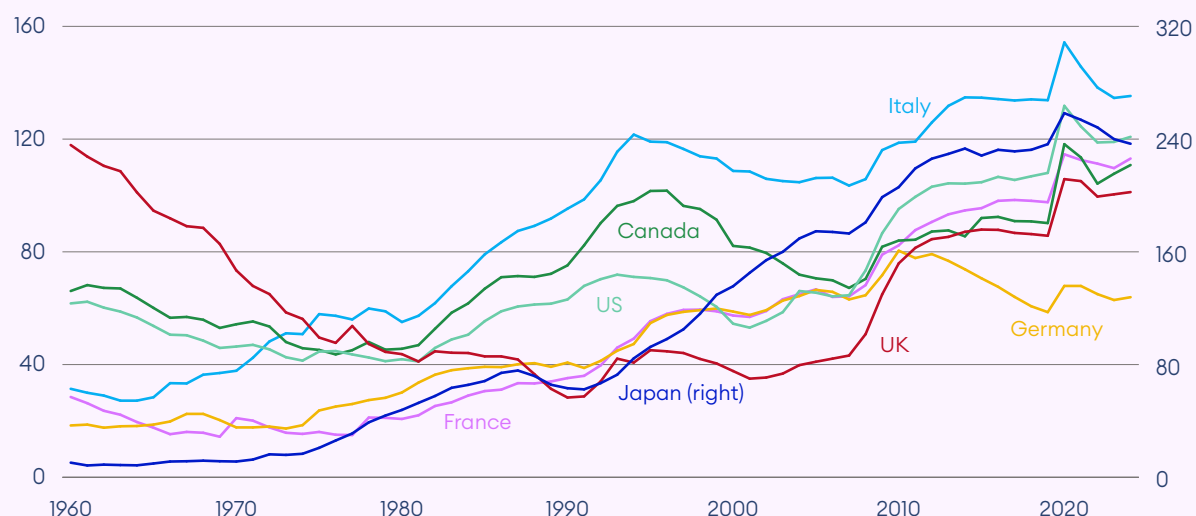
Debt has been climbing relative to GDP for at least the past two decades across most major economies. According to the IMF, US government debt has risen from around 55% of GDP in 2000 to more than 120% today. The UK has followed a similar path, moving from about 35% to over 100% over the same period.

The biggest jumps came after the major shocks already discussed – the Global Financial Crisis and the pandemic – when governments borrowed to stabilise their economies. But what's striking is that in most cases, debt hasn't come back down in the good years. Slower growth, ageing populations and the end of the post-Cold War peace dividend that allowed governments to reduce defence spending all mean governments have found it hard to reduce their debt burdens.

As figure 3.1 shows, this is not just a UK or US story. Across almost all G7 economies, debt-to-GDP ratios have ratcheted higher with each crisis, and the trend has been persistently upward.

Figure 3.1: Debt keeps climbing

G7 government debt has risen sharply as a percentage of GDP since 2000 in most major advanced economies. (Right-hand axis applies to Japan only.)



Note: Central government used instead of general government until 1970s in some countries.

Source: IMF Public Finances in Modern History Database, LSEG, Rathbones

Why does an ageing population matter?

Demographics are a key driver of future debt. For much of the second half of the 20th century, the share of dependants – children and pensioners – relative to the working-age population was falling. That eased pressure on public finances and gave governments more fiscal room. But the trend has reversed.

As figure 3.2 highlights, dependency ratios have been rising across the G7, in some cases since the 1990s, and this shift is likely to continue for decades. Governments tend to spend two to three times more on pensioners than on children, while taxes on workers' incomes account for the lion's share of government revenues in most large economies.

This means more money going out just as fewer workers are contributing to tax revenues. For investors, it signals that public finances are likely to remain stretched and that governments may increasingly rely on debt markets to bridge the gap. Doing so is often politically preferable to cutting public spending or hiking taxes.

Is the UK worse off than other countries?

Not really. While headlines often suggest Britain's debt burden is especially worrying, the data tells a more balanced story. UK government debt is high, but depending on the measure used, it's the second or third lowest in the G7, relative to GDP. Looking more broadly, the UK sits towards the middle of the pack internationally (figure 3.3).

Some countries, such as Japan, Italy and the US, are carrying significantly larger burdens. The UK's bigger challenge is in closing its budget deficit and managing higher interest costs in future, but compared to peers like France or the US, it is far from being the outlier some fear.

Could high debt trigger a crisis?

The risk of a sudden debt crisis – where borrowing costs spiral and governments lose access to funding because they can't afford this – is much lower for advanced economies than for the emerging markets that have suffered debt crises in the past. One key reason is that countries like the UK, US and Japan borrow in their own currencies, which gives central banks more options to step in if markets wobble.

We've already seen this in practice. The Bank of England intervened in 2022 to calm gilt markets after the mini-Budget, while the US Federal Reserve has created facilities to limit forced selling of Treasuries (US government bonds). These measures reduce the risk of a short-term funding crisis.

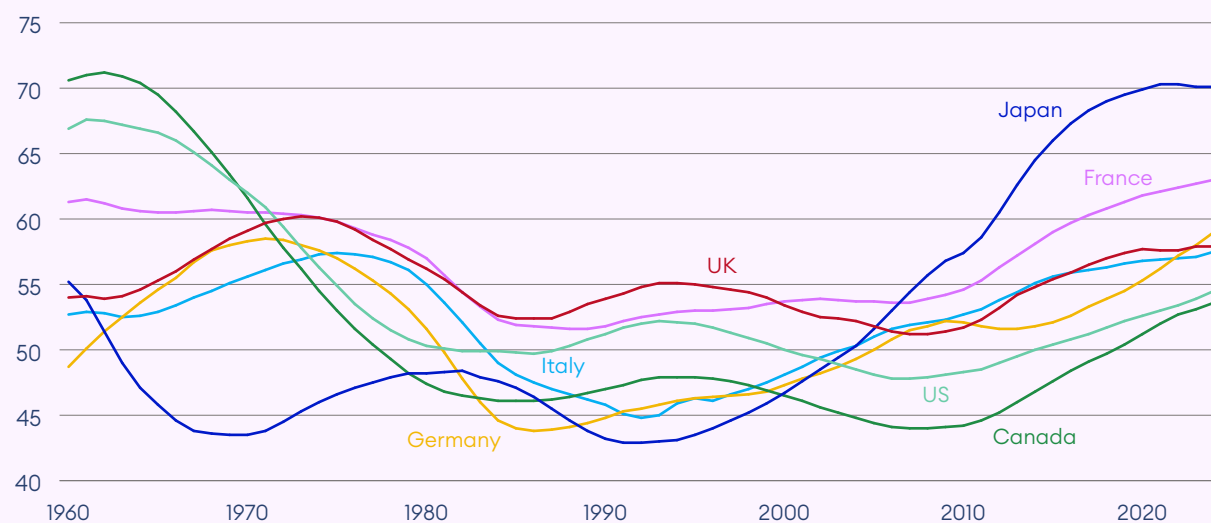
So what are the real risks?

Avoiding an acute crisis doesn't mean there are no costs. If governments keep borrowing heavily, central banks may need to use more 'financial repression' – policies that hold down interest rates or channel savings into government debt.

This has happened before. After the Second World War, the UK's debt was around 270% of GDP and the US's 120%. Both countries artificially capped borrowing

Figure 3.2: Fewer workers, more dependants

Ageing populations are adding pressure to government finances, with G7 dependency ratios rising as the share of pensioners grows relative to the working-age population.



Note: The chart shows the number of children and pensioners for every 100 people of working age.

Source: LSEG, Rathbones

costs and directed savings into government bonds. While this helped reduce debt, it acted as a hidden tax on savers, with returns on deposits and government debt falling below inflation for long periods.

For today’s investors, the risks are similar:

- Higher inflation: central banks may find it harder to fight inflation if they take a bigger role in preventing problems in government bond markets.
- Lower growth: if artificially low rates funnel savings into unproductive projects, or inflation is allowed to rise, long-term growth could be weaker.
- Volatile markets: heavy intervention by policymakers can create uncertainty and distortions.

What does this mean for portfolios?

We don’t expect a repeat of the post-war experience, but we do think policies resembling a lighter form of financial repression are more likely in the years ahead. That makes higher and more volatile inflation a risk investors need to take seriously. To prepare for this, we recommend portfolios are positioned with:

- Shorter bond durations, reducing exposure to long-dated bonds that could be hit hardest by higher inflation.
- Diversifiers such as gold and strategies that tend to perform better in inflationary environments.
- Balance across assets, keeping exposure to equities while being mindful that slower growth could weigh on returns.
- An equity selection biased towards quality, highly profitable companies most likely to withstand spikes in inflation.

By incorporating these elements, we aim to keep portfolios resilient to a more challenging environment, without losing sight of the opportunities that come from market dislocations.

What’s the bottom line?

Government debt is unlikely to trigger an immediate major crisis, but it will continue to shape the long-term investment landscape. For clients, the key lesson is that portfolios need to be able to weather higher inflation and more frequent market bumps.

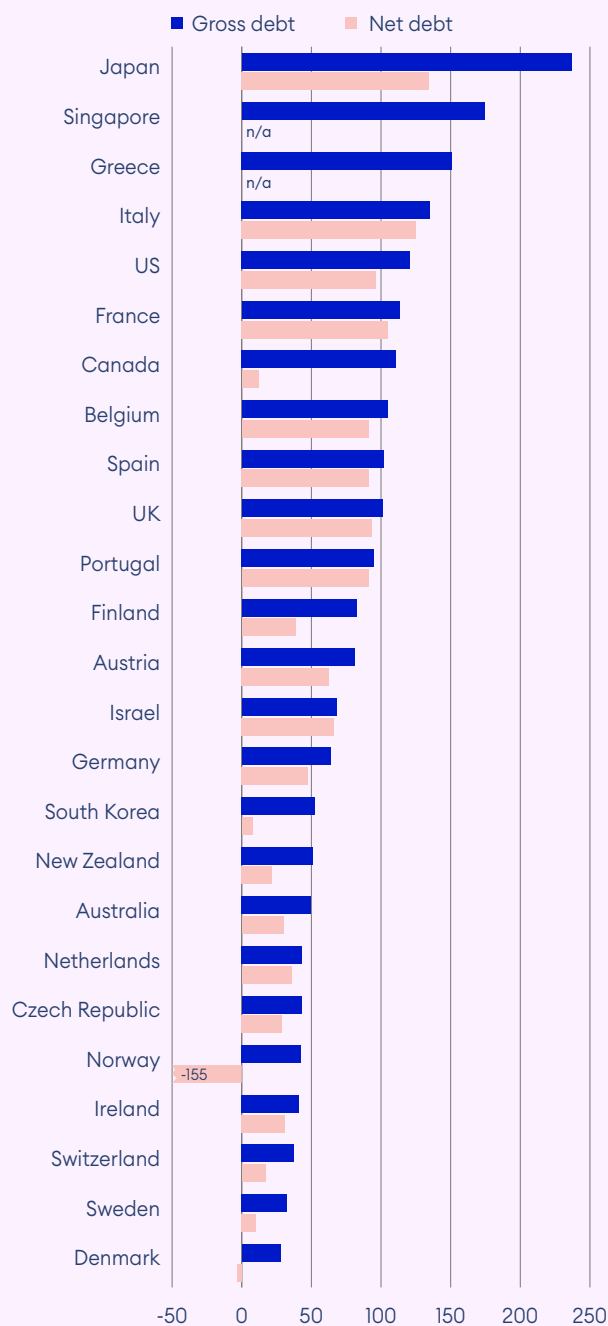
The pressures behind rising debt – slower growth, ageing populations and the political demands for greater public spending – aren’t going away. These challenges are shared across advanced economies, and they suggest an environment where policymakers have less freedom to keep inflation fully under control.

By actively managing duration and keeping a diversified mix of assets, we believe investors can stay on the right side of the risks, while still capturing opportunities as they arise.

Policies that suppress borrowing costs often come at the expense of savers.

Figure 3.3: Not just a UK problem

Government debt levels are elevated across the developed world and the UK is far from alone.



Note: The chart shows general government debt as a share of GDP. Source: LSEG, Rathbones

Snapshot

The global economy and markets

Figure of the month

24.3%

This is the rise in the UK price of beef and veal in the year to July. At its August meeting, the Bank of England cited food price inflation as a particular concern. The price of food and non-alcoholic drinks is up 4.5%. This could limit its ability to cut rates much further.

At a glance

3.8%

Annual rise in UK consumer prices (CPI) to July 2025

3.0%

Annual growth in world trade volumes to June 2025

4.0%

Bank of England base rate

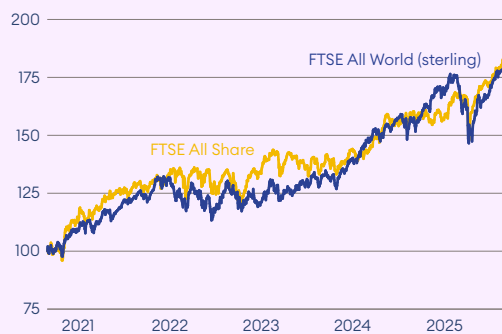
1.2%

Annual growth in G7 GDP to Q2 2025

Key market indicators

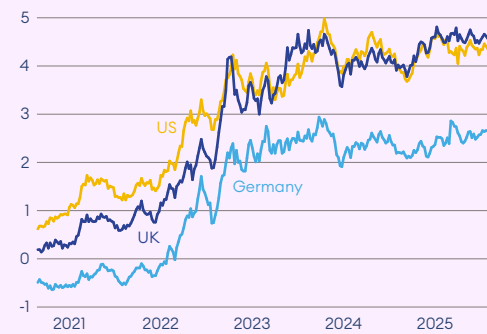
Equities

Total return (1 September 2020 = 100)



Government bonds

10-year yields (%)



Sterling

Value of £1 in dollars and euros



Gold

US dollars per troy ounce



Source: Bank of England, Factset, LSEG, ONS and Rathbones

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



Monthly video update

Stay informed with our regular investment update videos, where Ed Smith, our Co-Chief Investment Officer, explains how geopolitical tensions, market movements and global economic trends could affect your portfolio.



Weekly and monthly digest

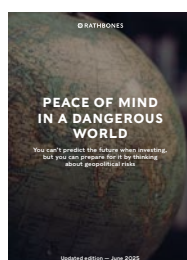
Keep up to date with regular insights from John Wyn-Evans, our Head of Market Analysis, as he explores the key themes shaping the global economy and investment environment.

Research reports

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.



The next decade for the global economy is likely to look very different to the 2010s. *Investing for the next decade* explores how the opportunities in fixed income have changed, the possible outlook for equities and why we believe the extraordinary outperformance of the US could end.



Geopolitical risks have risen in recent years, from conflict in the Middle East to tensions in the Taiwan Strait. *Peace of mind in a dangerous world* outlines the four risks we monitor most closely, the warning signs we look for, and how we prepare portfolios to help protect your investments.

Experience and expertise

Rathbones has a large and experienced in-house research team, covering global equities, fixed income, multi-asset strategies and responsible investing. With specialists dedicated to analysing market trends, sectors and individual securities, our team brings deep insight and rigorous discipline to every portfolio. This depth of knowledge allows us to uncover opportunities, manage risk effectively and respond quickly to changing conditions, helping you to invest with greater confidence.

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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