

Markets' Indian summer

16 September 2025

Summer seems to have ended quite abruptly in the UK. But financial markets have maintained a sunny mood. It's time for a quick review of where we are and what might be some of the key drivers of markets between now and the end of the year.

Concerns subside in Bondland

Global equity markets, as measured by the MSCI World Index, are reaching new all-time highs. The two main drivers are the ongoing enthusiasm for Artificial Intelligence and optimism about a pickup in global economic growth. Expectations for corporate earnings took a nasty dip after April's Liberation Day, when US President Donald Trump initially announced his 'reciprocal' tariffs. But since then, they've turned much more positive, partly because the second-quarter results season played out well. Global purchasing manager surveys, which are closely watched by financial markets, are generally moving back over 50, the number that divides expansion from contraction. Cyclical stocks are outperforming defensives by a wide margin.

Quick take:

- Stock markets are reaching all-time highs
- One reason is enthusiasm for AI
- Another is optimism about economic growth
- Bond investors' concerns about unsustainable US and UK fiscal deficits have subsided

In Bondland, concerns about unsustainable fiscal deficits in the US and UK have subsided for now, pushing down yields on longer-dated government bonds. We acknowledge that the UK remains fiscally challenged (more on this later). But talk of it needing a bailout by the International Monetary Fund (IMF), by ex-Prime Minister Liz Truss, among others, is no more than partisan scaremongering. The UK had to borrow dollars from the IMF in 1976 to pay back dollar loans taken out to support the pound. That particular risk does not currently exist, since our debts are in sterling. Even rating agency Fitch's downgrade of France's sovereign debt rating from AA- to A+, only the fifth highest

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grade, elicited little more than a yawn from bond investors.

The European Central Bank (ECB) seems to have reached the end of its interest rate-cutting cycle with a deposit rate of 2%. But the Bank of England is stuck at 4%, thanks to sticky inflation (especially wages in the service sector, partly a result of government policy). Investors are now looking forward to the US Federal Reserve resuming its rate-cutting cycle, which has been on hold for a year.

Trouble at Fed

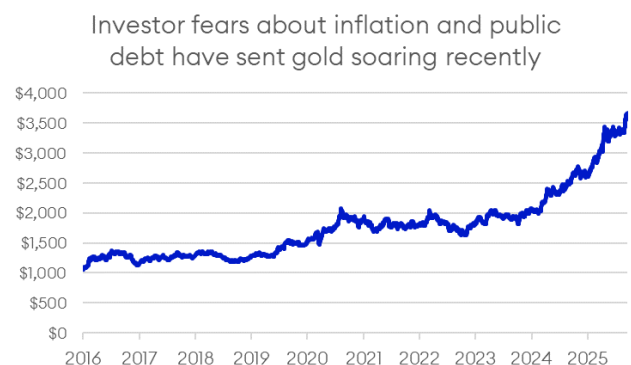
It's been all-go at the Fed over the summer.

One governor, Adriana Kugler, resigned. This allowed Trump to propose the Chair of his Council of Economic Advisors, Stephen Miran, as her temporary replacement. Last year Miran co-wrote a report on reshaping global trade; his recommendations on tariffs informed the President's policies, including Liberation Day. It's fairly clear who'll be pulling his strings.

Fellow governor Lisa Cook is fighting to retain her post against charges of making a fraudulent mortgage application. Whatever the truth of the allegations, they've been politicised to the extreme. Trump is using them as a lever to force her departure, replacing her with someone more likely to do his bidding. The President continues to argue that interest rates are

too high. But then, as a property developer, he probably regards anything above zero as too high.

We should be careful what we wish for. If interest rates are lowered for ideological rather than economic reasons, investors could react badly. If the independence of the Fed is compromised and power over monetary policy is seen as in the President's hands, then fears about higher inflation could dominate the narrative, raising Trump's borrowing costs. Bond investors have already sent a few warning shots to governments this year about the risks of fiscal profligacy, with the US, the UK and France at the sharp end of a scolding.



Source: London Bullion Market Association, Rathbones. Prices are in troy ounces.

Investor worries are also evident in the inexorable increase in the price of gold, another asset hitting new all-time highs. For now, most investors are treating the prospect of a supine Fed setting rates that are too low as a tail risk to be hedged

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rather than something that should shape core portfolios. But gold's message cannot be ignored.

UK Budget countdown

The date of the UK Budget has been fixed for 26 November. Labour is under intense pressure. Losing one cabinet member (Angela Rayner) because of ill-advised personal financial decisions was, perhaps, a misfortune. Having to sack the UK's ambassador to the US because of undisclosed letters of support to a convicted sex offender begins to look like carelessness. This Budget is being set up as something of a last chance for Chancellor Rachel Reeves to right the ship. We're set for another long period of policy kite-flying and speculation. This will be unsettling, as it was in the runup to last year's event. We'll get into the nitty-gritty details of potential spending cuts and (more worryingly) tax increases in the weeks to come, but this has all the makings of a red-letter diary date.

The AI train rolls on

Perhaps the biggest question for investors is whether shares of companies investing in or benefitting from the AI boom will continue to prosper. Recent research from Société Générale, the French bank, tracked the performance of various thematic baskets this year. The outright winner was Global Nuclear. Demand for nuclear energy is rising strongly. It's clean

and consistent, even if expensive to install, and sits well with the enormous potential demand from data centres.

And, indeed, Global Data Centres was the second-best performing theme, despite a few blips. First came January's scare caused by the DeepSeek generative AI model. The Chinese company claims the model uses a lot less processing power than US rivals, which suggests less demand for data centres. In April saw the Liberation Day tariffs, which threatened to push up the cost of the hardware and construction materials needed by data centres. Finally, August brought a well-publicised paper from MIT Nanda, an academic initiative linked to the Massachusetts Institute of Technology. It suggested genuinely successful adoption of AI was currently low – raising fears about returns on all the investment. *The Economist* magazine raised similar concerns in last week's edition with the leader headline: "What if the \$3 trillion AI investment boom goes wrong?"

It looks as though investors are more than willing to give companies the benefit of the doubt for now. The latest sign came with the publication of third-quarter results from US software company Oracle, which gained 25% last week. It briefly threatened to join the exclusive \$1trn market capitalisation club when it was up 40% at its highest point – making company founder Larry Ellison the world's

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richest man for a few hours. The news of a tripling of its committed forward revenue since the last quarterly update, to \$455bn (much of it tied to data centre development), was undoubtedly impressive. But analysts think \$100bn of that is from ChatGPT owner OpenAI, which currently only generates \$13bn of revenue a year. This highlights the fever-pitch level of expectation.

For anyone worried about another tech bubble, more soothing analysis comes from US bank Goldman Sachs. It calculates that since the start of 2009 (in other words, in the period since the Global Financial Crisis), the tech-laden Nasdaq index is up more than 20 times. The breakdown of those returns is encouraging: 74% is thanks to earnings growth; 16% is from dividends; just 10% is attributable to valuation expansion. As long as earnings are expected to rise, this train can keep rolling. The key risks revolve around the speed of adoption of AI and the ability to start generating revenue from the currently high capital spending. Our analysts are watching both factors like hawks.

But if companies start disappointing, it will probably be near-impossible to predict the exact timing when markets reach a turning point, when optimism fades and profits are banked.

For recent economic highlights, see below.

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UK – GDP was unchanged in July vs June, much as expected, with the economy still showing little momentum. While tax increases from the last budget are still being digested by businesses and households, we now have the threat of more in this year's. A stronger June (+0.4% m/m) means that rolling three-month growth was +0.2%. Manufacturing remains weak, with US tariffs no doubt a factor. Services growth was 0.1%, helped by a gain of 0.4% in health output, a positive surprise since the period included a junior doctors' strike. If inflation were not entrenched at high levels (expected to be running at a headline rate of 3.8% when released later this week), the Bank of England would be rushing to cut the base rate. But for now, it seems stuck at 4%, with no change expected at this week's Monetary Policy Committee meeting. In fact, the market's expecting no more cuts until Easter.

US - Last week's inflation news encouraged the belief that interest rates can come down faster and further. First, the Producer Price Index for August, which measures the selling price charged by US producers, came in at 2.8%, vs an expected 3.5%. Although Core Goods inflation continued to rise as the effects of tariffs flow through the system, investors saw what they wanted to see: an easing of inflationary pressure. Even so, since inflation was declared beaten in the early

1990s cycle, Core Goods PPI has been higher only twice. Once was during the final fling of the noughties real estate boom. The second time was in 2022, when Russia had launched its full-scale of invasion of Ukraine and economic supply and demand had gone haywire after the pandemic. It might, in light of those comparisons, seem like an odd time to be cutting interest rates.

Remember too that because tariffs take a while to kick in, the actual tariff rate for goods entering the US is still not much more than 10% but will shift inexorably higher towards around 17% when fully accounted for. The subsequent CPI data was bang in line with expectations (Core +3.1%), doing nothing to dampen investor bullishness about rate cuts. The fed funds rate is currently 4.25-4.5%. The Federal Reserve is widely expected to cut it by 0.25% this week and a further 0.5% by year end, with another two or three quarter-point cuts in 2026.

Europe - The ECB held rates steady at 2%, as expected. But this was accompanied by hawkish hints that led markets to jettison prospects they'd priced in of another rate cut, to follow the three earlier in the year. The ECB saw the risks to growth as "more balanced" amid fading trade uncertainty and a resilient domestic economy. President Christine Lagarde said the "disinflationary process is over" and repeated that policy is "in a good

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place”. There was a dovish tweak: the ECB revised its 2027 core CPI forecast down from +1.9% to +1.8%. But Lagarde didn’t focus on this, instead calling the downwardly revised +1.9% headline CPI projection for 2027 a “minimal deviation” from target.

China - Economic growth slowed again in August, with key data releases missing consensus estimates on almost every line. Economists attributed this largely to growing external headwinds, including US tariffs and a soggy local labour market. As a result, unemployment ticked up from 5.2% to 5.3%. Retail sales flagged as the benefits of the consumer trade-in programme from earlier in the year wore off. Secondary home sale prices fell in 69 out of 70 cities. It looks as though more stimulus will be required to prevent further slowing, although GDP is still widely expected to grow by around the targeted 5% in Q3. The recent rise in China’s equity indices suggests that investors are already pricing some of that stimulus in.

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