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War and Peace – 2025 edition

As the summer of 2025 rolled on, geopolitical concerns continued to rumble around the world. Peace overtures were tried and failed, tariff deadlines came and went, and central banks wrestled with the contradictions embedded in markets.

Q2 was a broadly positive one for growth – at least in the US, which grew by 3% – while the UK economy displayed considerably more weakness (growing only 0.3%), flirting with stagflation once more. Investors voted with their feet when it came to bond prices – they sold off at the longer end of the curve, while short term bonds were popular as in the short-term rate cuts were expected.

Some uncharted waters are now becoming “norms” – e.g. debating the impact of tariffs, and the now quarterly charade of a scramble to announce a “deal” only for the details to remain elusive. The flooding of the zone continued when it came to policy – with a cross-current of geopolitical news, diverging inflation figures, diverging currencies and diverging equity market sectors presenting a revolving door of narratives.

Key Developments since the last quarterly update:

- **The New Global Trade “Balance”** Markets have lurched from shock and disarray at the President’s Liberation Day tariffs to taking them in their stride. Overall this has been attributable to the slowed transmission effects of these tariffs, the fact that many purchases were frontloaded and that some companies can absorb price rises. It is clear that there will be some sectors affected more than others and that causation will be difficult to assign in any case.
- **Rate cuts – for some** As inflation diverged, and surprised on the upside in the UK, it heralded a pause for rate cuts by the Bank of England, while the US Fed seemed poised to cut rates again in September. The institution continues to stand firm under pressure from the US President to

cut rates, remaining data dependent although fragile employment data seemed set to tip the scale next month.

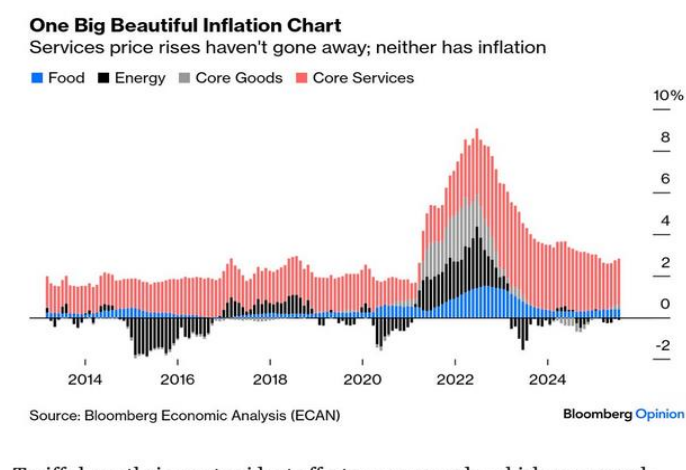
- **Equity Markets break away** Equity markets broke positively in the US with a particular streak for large-cap tech stocks, continuing some of the euphoria of the “fever dream” from the second quarter, but punishing laggards severely. Emerging markets and Asia were back in vogue, as it was perceived that investors had “over sold” emerging markets and their growth potential. To date, the large are getting larger when it comes to Mega-Cap tech stocks as a number have burst through the \$3 trillion market cap value.
- **Shock therapy.** While President Trump is no stranger to shock and awe tactics the series of events – such as the taking by the US of a 10% stake in Intel, the vocal calling on CEOs to resign, the firing of government officials and use of the national guard, there has been a volley of uncertainty that continues to cloud market developments in the US.

Current Macro Snapshot

Growth persists, but is it hanging by a thread

When the US labour numbers were revised downwards a few weeks ago, the President did not like what he saw, and promptly “shot the messenger”, firing the Head of the Bureau of Labour Statistics. This rattled markets, not only because it was unprecedented, but it also threw into question the trustworthiness of all statistics, which have typically been subject to backdated revision and lack of consistency and saliency.

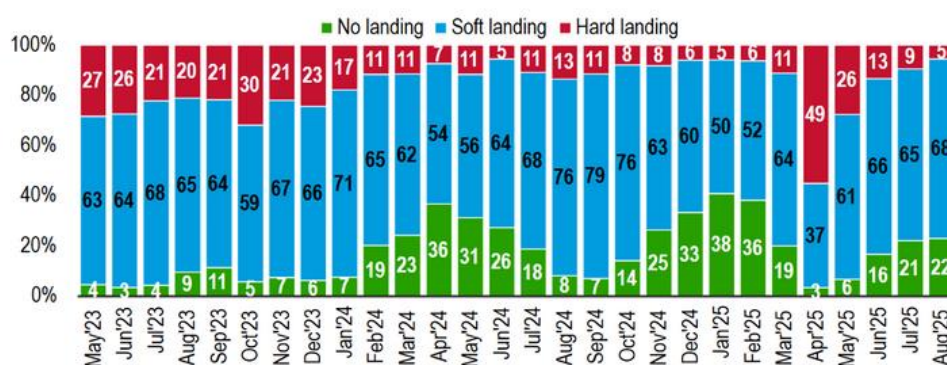
So when headline inflation numbers are released that look generally positive – i.e. low, it is important to break down the underlying drivers of these numbers, and when this is done, it is clear that while lower food and oil prices are driving down the non-core number, core inflation remains somewhat stubbornly high, particularly as driven by services – see chart below.



Growth was particularly high in the US, but some of it may have been driven by lower import volumes as these had been pulled into the first quarter in anticipation of higher tariffs. Discussion of hard landings seems to have ebbed though, as the sentiment chart below shows, and while for some time consumer sentiment was softer than hard economic data would suggest, to some degree a buoyant stock market has been lifting consumer sentiment too.

Chart 1: 68% say soft landing, 22% no landing, just 5% hard landing

What is the most likely outcome for the global economy in the next 12 months?



Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

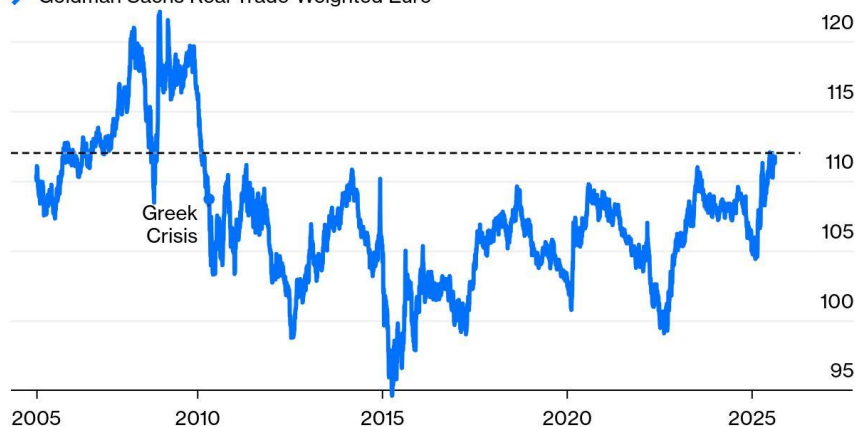
Currency confusion

Typically currency strength follows higher relative yields (interest rates) so it has been interesting that as US rates remain relatively high, the US dollar has weakened and as the ECB has cut rates consistently the Euro is at its strongest level for 15 years.

A 15-Year High for the Euro

The common currency is its strongest since the euro zone crisis

Goldman Sachs Real Trade-Weighted Euro



Source: Bloomberg

Bloomberg Opinion

The weakness of the US dollar will have repercussions for investors and their global asset holdings, so a protracted downwards trajectory would erode the returns enjoyed by the pension fund’s portfolio. While currency volatility typically has little impact on portfolio returns over the long term, this unwind of historic strength in the US dollar could cause some protracted pain in terms of currency losses over months to come.

Individual Asset Class Performance.

- Equities
- Fixed income

The chart below shows recent performance in main equity indices (at August 26, 2025):

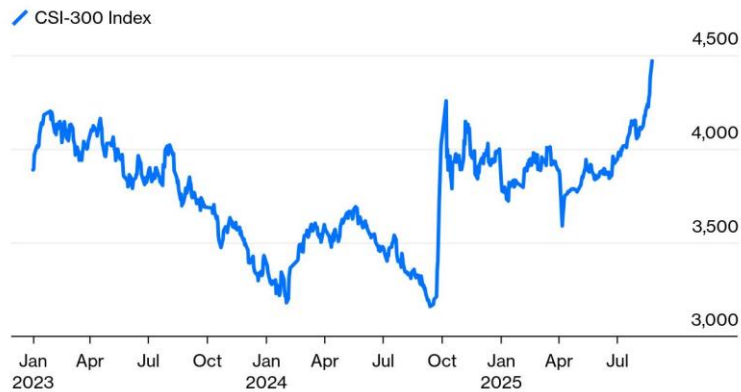
Equity Index	Last 12 months	Year to date (August 26, 2025)
FTSE 100	11.26%	13.37%
S&P 500	14.93%	9.93%
Nasdaq	21.34%	11.57%
Stoxx 600	6.81%	9.18%
Hang Seng	42.80%	27.24%
Shanghai Comp	35.79%	15.41%
Nikkei 225	10.72%	6.27%

The divergence in US v. RoW performance year to date is nicely shown in this chart but it is also clear from the table above that this divergence is continuing. The sharp nature of the equity market “round trip” is masked by the figures, but a little more obvious in these kind of stock charts.

One of the most notable aspects of recent market performance has been the strong performance of Asian stocks, where Chinese stocks have rotated into favour again simply based on being oversold and overlooked in the last cycle. The rising tide of optimism has lifted most ships as the broad market performance chart shows.

Chinese Stocks Have Liftoff, Again

Domestic markets have resumed last year's stimulus-fueled rally



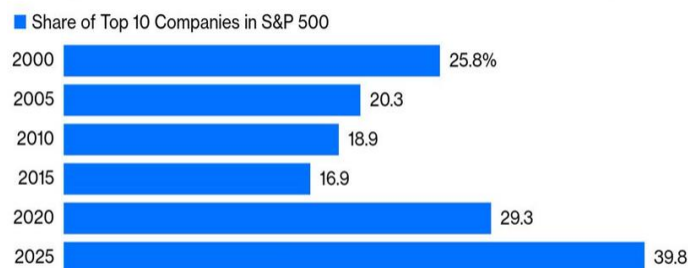
Source: Bloomberg

Bloomberg Opinion

We have written for some time about the growing level of concentration in US markets in particular, and at times it seemed to be purely anecdotal, as over time these markets have always been somewhat concentrated in the top 10 stocks, with different sectors dominating at different times. The chart below, however, shows just how “different” it is this time as the top 10 stocks now total close to 40% of the total market cap of the S&P, a number that is likely to grow as the growth being displayed by some large tech stocks is continuing in an exponential fashion.

This Level of Concentration Is New

The biggest 10 stocks' share of the S&P more than doubled in 10 years



Source: Bloomberg

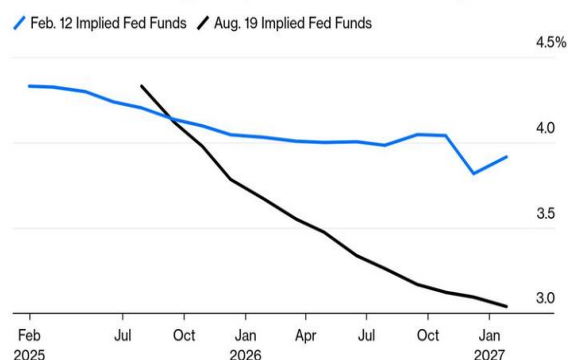
Bloomberg Opinion

Fixed Income

Markets are now rallying around an expected rate cut by the Fed in September (see chart below) and enjoy the transmission of rate cuts from earlier in the quarter from the ECB and the Bank of England.

Six Months That Transformed Expectations of the Fed

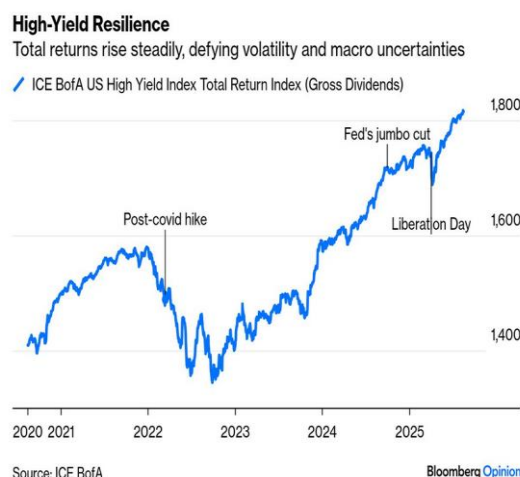
Markets are now making an emphatic bet on sustained easing



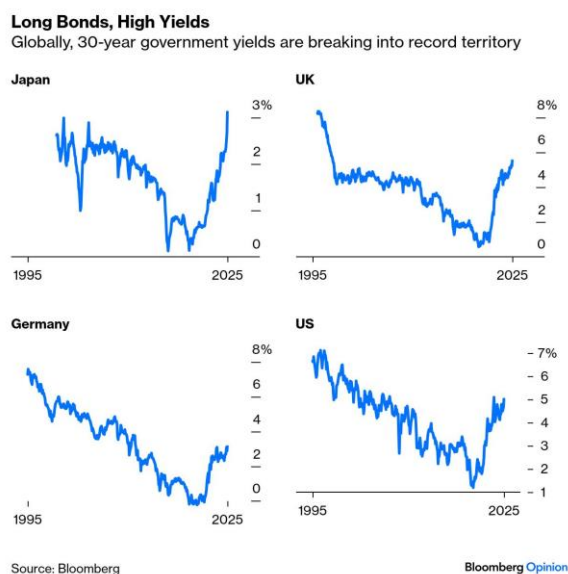
Source: Bloomberg World Interest Rate Probabilities

Bloomberg Opinion

Other bonds – such as high yield – are trading with reasonably tight spreads by historic standards – suggesting that there is a lot of confidence in the creditworthiness of corporates and that perceived default risk is low. Some have attributed this to the burgeoning private credit market, which is said to be absorbing some of the less credit-worthy credits, leaving the public market for only the strongest issuers.



A bigger story in fixed income markets however continues to be the record level yields of longer dated government debt – which has continued on the trajectory shown in this chart last quarter. This suggests an unsettling lack of confidence in certain economies' fiscal situation – namely the UK and the US – and also a break-out from a deflationary stranglehold – Japan.



The Way the Wind Blows

This past quarter was a tricky one for energy, particularly wind energy. The new administration is no fan of wind farms and wind energy and is also no stranger to stopping production mid-project as recently occurred for Orsted, and led to a collapse in the stock and it is now down 40% in the past month. This is a particularly troubling development as uncertainty – whether regulatory or in terms of demand – has long been the deterrent to invest in longer term infrastructure projects.

Outlook

As we move into the last third of the year, much of the roller coaster action tied to the new US administration and tariffs has subsided. While much uncertainty remains, markets seem to have gained confidence from dodging successive bullets and the compelling growth from AI spending. As we look to the rest of the year we will be watching in particular:

- **Making Their Move.** Although long heralded it will be key to see how the US Federal reserve actually acts upon its Jackson Hole guidance. Currently all estimates are at least for one cut, but there will be close watching of data due to the fragile employment data, so the waning days of Powell's chairmanship will be much in focus.
- **Across the Rubicon?** The shock tactics of the second Trump administration have continued apace, from an abrupt firing of a Head of Labour Statistics to a Fed Governor to sending the national guard onto the streets of the nation's capital. While some of this shock factor has been normalized and markets have been somewhat insulated, will one shock be one shock too many, so as to shake confidence in the market performance?
- **The UK's dance with stagflation** Institutional memory is clearly long in the UK when it comes to confidence in government's fiscal stance, and at the mere whiff of incompetence or impasse investors run for the exits. As financial woes mount the UK economy will come increasingly in focus if it leads to asset price distortion, market illiquidity, currency depreciation and other factors that put the portfolio at risk.

A reminder that you can tune in to similar macro overviews weekly on the Markets Happy Hour [youtube channel](#) – where there are new episodes every Thursday evening.

August 26, 2025