INVESTMENT

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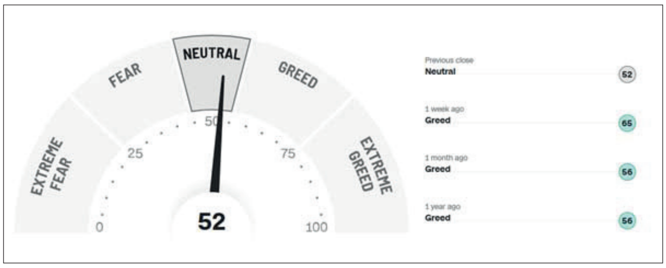
Market Update

We are now nearly three quarters of the way through 2025 and already it is serving up some peaks and troughs. We can see this from CNN's Fear and Greed Index below, which is a barometer of market sentiment. You can see that we are now at 'Neutral', after being firmly in 'Greed' territory for the past few months and being in 'Extreme Fear' in March and April at the point



This highlights how short-term volatility is often just that – short term – and that things can turn surprisingly quickly. Fluctuations in share prices and sentiment are a normal part of the investment landscape and it is best not to get too sucked into what can often be temporary movements. Indeed, we are also able to use this volatility to our advantage, as we did back in March and April, to buy investments at lower levels, recycling cash that we had raised earlier in the year.

WHAT IS HAPPENING WITH INTEREST RATES?

In the UK there is currently a 50% chance of another rate cut this year whilst in the US, where more investor focus is placed, interest rates are expected to be cut at the next meeting in around three weeks' time. On the surface that seems an odd decision as the Fed's preferred measure of inflation, the Personal Consumption Expenditure Price Index, remains well above the Fed's target, as it has been since March 2021. According to the Federal Reserve, inflation should continue to rise over the rest of this year and is not expected to return to target until 2028. Anticipating such an extended period of above target inflation invites scrutiny to the decision-making process, especially when President Trump has been so vocal about his view that interest rates should be much lower.

WHY IS TRUMP SO KEEN FOR INTEREST RATES TO BE CUT?

Trump is frustrated that high rates are holding back the housing sector. In the US the most important interest rate for housing is the 30-year bond yield because US mortgages are very long term. It is common for a fall in short term interest rates to coincide with a fall in long term interest rates but that hasn't been happening recently, as can be seen from the chart.

Various actions taken by the Trump administration (unfunded tax cuts and these latest attempts to undermine central bank independence) make it riskier to hold long term bonds. This is reflected in an increased "term premium"(paying more for longer dated debt). And it means that while the outlook for interest rates has fallen over President Trump's second term, the crucial thirty-year bond yield has not.

WHAT DOES THIS ALL MEAN FOR MARKETS?

Lower short-term interest rates are generally helpful for the stock market as long as they don't reflect a rise in recessionary risks. But, as we approach the end of the second quarter earnings season, fears of a cyclical slowdown remain unrealised. Company results have generally been good and sales for the largest US company Nvidia were in line with analyst expectations.

SO WHAT IS THE CURRENT OUTLOOK?

We expect the global economy to continue to expand, aided by AI themes supporting productivity improvements, which is consistent with corporate profits going up and supports our view of maintaining a good exposure to stocks. That said, markets have travelled a long way since the Liberation Day declines and there are still risks on the horizon, most notably higher inflation and the fact there is limited room for jobs growth. Furthermore, US stock markets remain expensive and very concentrated in just a small handful of companies, with expectations already elevated. We therefore see the benefits of diversifying our exposure outside of the US, where we can find cheaper stocks and less currency risk. We also believe it is prudent have a good allocation to safe haven assets in the form of government bonds and gold, that can perform in their own right but also help protect portfolios in the event of an unexpected downturn.

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