

Market Perspectives

by Algernon Percy – October 2025

Last quarter recap

9.5%

World stock markets end the quarter up 9.5% in sterling terms; but only up 7.6% in US dollar terms.

2%

The US dollar recovers approx. 2% against sterling and the yen.

1998

The French 10-year bond yield rises above Italy's the first time since 1998.

26 years

The Japanese 20-year yield reaches a 26 year high.

\$4trn

NVIDIA becomes a \$4trn company.

30 years

Gold hits an all-time high as, for the first time in 30 years, central banks hold more gold than US treasuries.

“It is not our business to collect trophies, but to try if we can to bring back the world to peaceful habits.”

Viscount Castlereagh
British Foreign Secretary, 1815

The Outlook for Interest Rates

Gilts have underperformed...

Global bond markets generated a modest positive return during the third quarter, with the US 10-year treasury yield staying broadly the same, at 4.2%. UK gilts, however, underperformed, with the 10-year yield rising to 4.7% in spite of the Bank of England cutting rates by 0.25% in August. The real yield on gilts has been rising such that, using market expectations for inflation, it is now one of the highest in the developed world, at 1.9%. This is because the term premium (the additional return that investors demand in order to compensate for unexpected interest rate changes during the life of a long bond) in the UK is high, reflecting a lack of confidence in the Government's ability to curb spending or raise additional revenue from higher taxes, combined with ongoing uncertainty about the likelihood of economic growth rescuing the nation's finances.

...but the numbers are arguably more worrying in the US.

Comparing the deficits of the US and the UK, the situation this side of the Atlantic looks less acute than it is in the US. The UK is forecast to have a 5.2% budget deficit in 2025, falling to 3% in 2027, whereas in the US it is likely to be 6.2% this year, rising to 6.4% in two years' time. Moreover, the level of government debt is higher in the US, at 125% versus 96% in the UK. The United States does have the 'exorbitant privilege' of being able to issue debt in the world's reserve currency, which is certainly an advantage, but when one considers that the Trump administration is actively seeking depreciation of the dollar (which does look overvalued on a purchasing power parity basis), US yields look too low relative to the UK.

Falling overnight rates are supportive.

Overnight rates are on a downward path in both countries, although in the UK the pace of expected interest rate cuts has been tempered by uncomfortably high retail price inflation.

However, the labour market here is, like the US, cooling, with employment numbers falling and wage growth on a declining path. This should be beneficial to inflation numbers both sides of the Atlantic – but the US has yet to see the full effect of trade tariffs feeding through into consumer prices, and it has a healthier overall level of economic growth. Therefore, there is arguably more reason to expect the Bank of England be able to cut rates over the next year than there is the Federal Reserve. Also, there is the added risk in the US that the Fed's interest rate decisions become increasingly politicised.

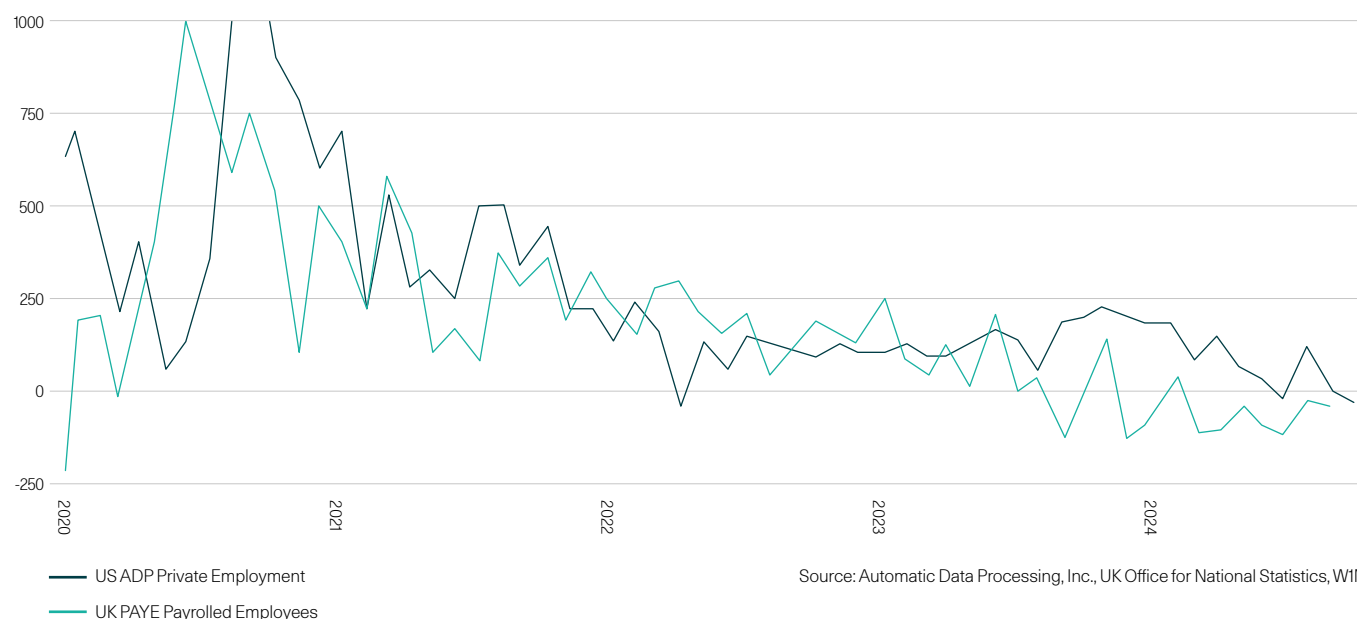
Australian government bonds look attractive.

Accordingly, we are more positive on the outlook for gilts than we are on the US treasury market: the scope for interest rate cuts looks greater over here, and the premium which investors are being paid is higher. Another jurisdiction which attracts us is Australia, where inflation is benign and the 10-year government bond yield is 4.3% – slightly above the US, but with much better dynamics because debt to GDP is just 55% and the annual deficit is only 1%.

Credit markets look somewhat expensive.

On the fixed income asset class as a whole, we remain slightly underweight – partly because we feel that corporate bond spreads are at levels which are generally too low for present circumstances: US investment grade credit only offers 0.8% more than the equivalent US treasury, compared with an average over the last thirty years of 1.5%. That said, we can find individual names which look attractive, particularly in the financial services and energy sectors at the short end of the curve. We recently extended for another year our UK short-dated bond note: it currently offers a yield of 4.5% coupled with extremely low volatility from a list of 25 names, such as Legal & General, Rolls-Royce and National Grid.

US and UK Employment Monthly Change (Thousands)



The Outlook for Equities

Returns have been concentrated in the US stock market.

As regards stock markets, again the story is one of extreme concentration in the US indices: the top ten stocks now account for almost 40% of the S&P500 index and, given that the US is at its highest ever percentage of the world stock market (68%), this is an issue that affects investors everywhere. Moreover, much of the running in the US economy, the earnings growth of the stock market and the index's price appreciation have been centred upon the technology / AI sector – so anyone who has decided not to fish in this pond will have been seriously left out.

Technology has been at the centre of this.

The recovery from the tariff-induced market low in April has been astonishing, amounting to 34% in just under six months. There has been much talk of an AI 'bubble', not simply as a result of soaring share prices, but more pertinently by virtue of some of the less visible numbers behind this boom – after all, many of the largest players in this space are unquoted. Examples include the value of OpenAI (\$500bn), the amount which the Stargate joint venture (in which OpenAI and Oracle partner) intends to spend on data centres etc. over the next four years (also \$500bn), or the operating profit margin of NVIDIA (over 60%). NVIDIA has agreed to invest a sizeable amount of cash (\$100bn) into OpenAI, one of its biggest customers: some may view that as a natural synergy, but it could turn into a dangerous circularity. The result of all this is that, despite only making up around 6% of US GDP, technology investment has recently accounted for 40% of GDP *growth* – so, the huge boom in AI spending has crowded out other areas of investment, some of which are contracting (which probably explains why the US labour market is subdued at the same time as other data suggest the economy is doing well).

The boom could turn into a 'bubble'...

One major difference between now and the technology bubble of 1999-2000 is the phenomenal profitability of today's most valuable companies and the fact that collectively they generate huge amounts of cash, whereas twenty-five years ago it was all about hope value built on accumulating debts. The tech sector's cash

flow today is a function of actual investment spending by the companies' customers. The risk is that much of this investment fails to generate a return and the oft-promised productivity gains from AI turn out to be a mirage; silicon chips depreciate in usefulness and value very quickly as they become obsolete whereas the cables and fibre optics of the last boom had plenty of time eventually to produce a return for their owners.

...but there are still plenty of opportunities out there.

Whilst we do hold some of the mega-cap technology stocks (most notably Alphabet, Amazon and Microsoft, all of which have very well-established and diverse customer bases), we have eschewed what we perceive as the more risky areas like NVIDIA and Tesla. Instead, we also play the AI theme by investing in companies which we believe will benefit from this boom in spending without themselves being so dependent for their success on whether the deliverers of AI do in fact live up to expectations. For example, we like the chip fabricator, TSMC, and we invest in companies such as GE Vernova which will benefit from the explosion in data centres and electricity demand. Even the American building supplies distributor, Ferguson (formerly London-listed Wolseley), said in its latest results statement that the construction of data centres represents an appreciable component of its order book.

Falling interest rates are supportive.

After such a strong run and with valuations looking full, a degree of caution is warranted. However, the US economy marches on in spite of everything, and companies generally are announcing a healthy level of earnings growth (+12% year-on-year in Wall Street's second quarter results season). Whilst the full impact of tariffs is yet to feed through, it looks like the outturn is going to be more benign than initially feared; meanwhile falling interest rates will help the US consumer and support stock markets. Therefore we are comfortable remaining fairly fully invested, and we believe we can participate meaningfully in the tech boom without taking on the degree of concentration and valuation risk that those who invest through the medium of index funds cannot avoid.

2025 US GDP Growth Forecast (%)



Total Return Indices to 30th September 2025

	Sterling Adjusted (%)				US Dollar Adjusted (%)			
	3 Months	6 Months	9 Months	1 Year	3 Months	6 Months	9 Months	1 Year
ICE BofA UK Gilt Index	-0.8	1.2	1.7	-1.9	-	-	-	-
ICE BofA US Treasury Index	-	-	-	-	1.6	2.3	5.4	1.9
ICE BofA Global Broad Market Index (Hedged)	1.3	2.7	4.2	2.4	1.4	2.9	4.3	2.6
MSCI United Kingdom All Cap Index	6.8	11.2	16.7	16.0	5.0	16.0	25.4	16.4
MSCI United Kingdom Index	7.8	10.4	17.5	17.2	5.9	15.1	26.3	17.7
MSCI AC World Index	9.5	15.1	10.2	16.8	7.6	20.0	18.4	17.3
MSCI AC World (ex UK) Index	9.6	15.2	9.9	16.8	7.7	20.2	18.2	17.3
MSCI AC World (ex US) Index	8.8	14.8	17.2	16.0	6.9	19.8	26.0	16.4
S&P Composite Index	10.1	15.0	6.8	17.2	8.1	20.0	14.8	17.6
MSCI Europe (ex UK) Index	4.8	10.7	19.0	13.9	3.0	15.5	27.9	14.3
MSCI Japan	10.0	15.3	12.3	15.9	8.0	20.3	20.7	16.4
MSCI AC Asia Pacific ex Japan Index	11.6	18.6	16.4	14.5	9.7	23.7	25.1	14.9
MSCI Emerging Markets	12.6	18.8	18.6	16.9	10.6	23.9	27.5	17.3
Growth Index	7.4	12.2	8.9	13.3	6.3	15.9	15.5	14.0
Balanced Index	6.2	10.6	8.4	11.4	5.5	13.6	13.9	12.1
Cautious Index	5.0	8.9	7.7	9.4	4.8	11.2	12.2	10.1
Defensive Index	4.0	7.5	7.1	7.7	4.1	9.3	10.8	8.5
Return on Cash £ (1 month deposit rate)	1.0	2.1	3.2	4.4	-	-	-	-
Return on Cash \$ (1 month deposit rate)	-	-	-	-	1.1	2.2	3.3	4.5
Inflation - UK CPI	0.3	2.1	2.7	3.8	-	-	-	-
Inflation - US CPI	-	-	-	-	0.6	1.2	1.8	2.7
Gold Price (£2837.51)	18.5	17.6	35.9	44.0	-	-	-	-
Gold Price (\$3820)	-	-	-	-	16.4	22.7	46.1	44.5
£ vs US\$	-1.8	4.3	7.5	0.4	-	-	-	-
US\$ vs £	-	-	-	-	1.8	-4.1	-7.0	-0.4
£ vs Euro	-1.9	-4.1	-5.3	-4.7	-	-	-	-
US\$ vs Euro	-	-	-	-	-0.1	-8.1	-11.9	-5.0
£ vs Yen	0.4	3.0	1.0	3.6	-	-	-	-
US\$ vs Yen	-	-	-	-	2.2	-1.2	-6.0	3.2

*all MSCI benchmarks are net of tax

Important information

Past performance is not a reliable indicator of future results. The value of investments and the income derived from them may rise as well as fall, and investors may not get back the amount originally invested. Capital security is not guaranteed.

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