CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

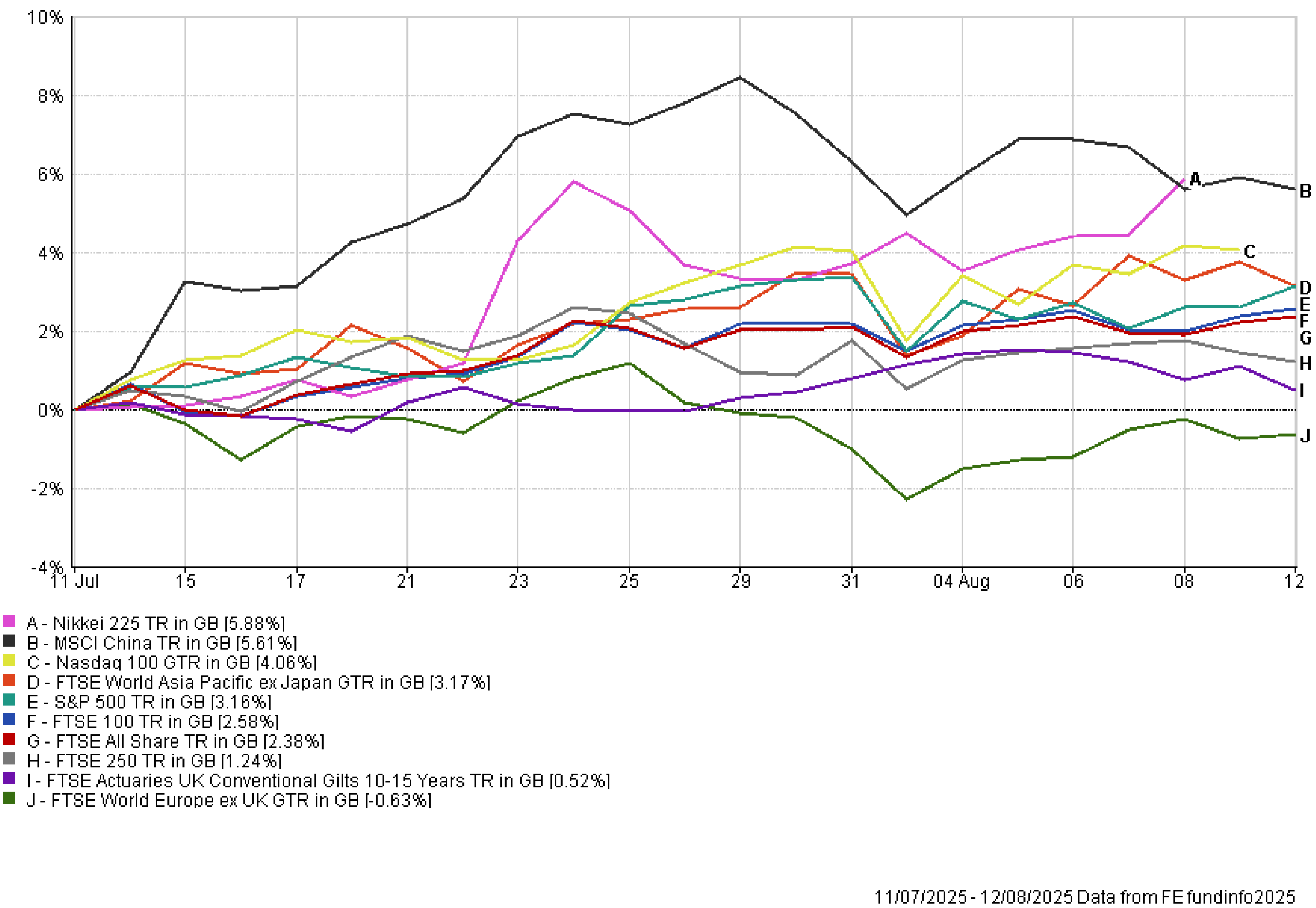
INVESTMENT COMMENTARY

12 AUGUST 2025

OVERVIEW

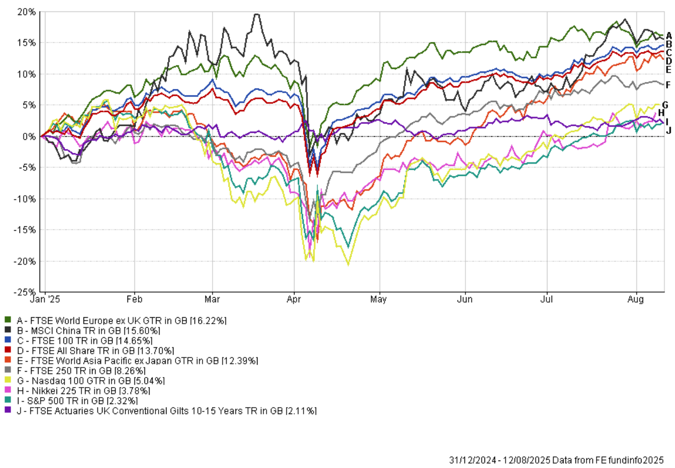
US trade tariffs have once again been dominating headlines with investor sentiment swayed by progress in negotiations. Since the last Investment Commentary (26 June 2025), the original three month extension of the US tariff deadline expired on 8 July followed by the further extension to 1 August 2025. Over the last few weeks, a flow of trade agreements has culminated in the European Union and Japan's deals being agreed just prior to 1 August deadline. Equity markets fell in the wake of the deadline expiration. As we write there are around 90 countries yet to reach deals including Taiwan, India, Brazil, Switzerland and Canada (in respect of goods not covered by the North America trade deal of 2020) as these countries seek to negotiate better tariff rates. The trade war truce between the US and China has been extended once again in recent days so supporting market sentiment. Whilst tariff levels have greatly reduced from the initial levels imposed on 'Liberation Day', countries are still paying more to export their goods to the US with the overall effective rate of tariffs estimated to be around 17% (Yale Budget Lab), which is the highest since the 1930's. It would also appear that investors have been taking gains at various points after the strong recovery in equity markets after 'Liberation Day' falls in early April 2025 – particularly ahead of light trading expected through August.

ONE MONTH INVESTMENT MARKET TOTAL STERLING RETURNS

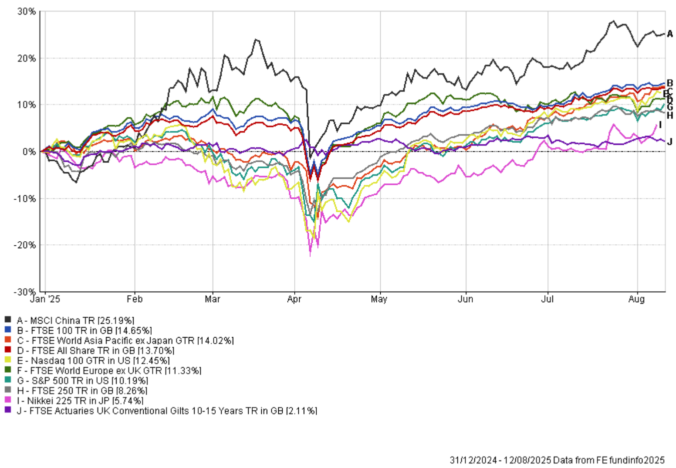


YEAR TO DATE INVESTMENT MARKETS TOTAL RETURNS

Sterling Returns



Local Currency Returns



The US economy is showing some signs of softening, with the labour market slowing over the past three months with new jobs reports for May and June revised downwards. Consumer spending has also cooled over the first half of 2025. Manufacturing activity data indicated that the sector was slowing with new orders and employment in July contracting further. Despite these indicators, second quarter US economic growth sprung back from quarter one contraction to a healthy 3.0% pa. Inflation has also ticked up to 2.7%. Against this background, the US Federal Reserve (Fed) has held interest rates steady at 4.25%-4.5% which remains restrictive. Jay Powell commented that he and most members of the Fed Board felt “that the economy is not performing as though restrictive policy is holding it back inappropriately”. There are concerns that inflation may stay elevated over the next year or so as the impact of the US tariff policy is felt in the economy and that the labour market may weaken further. The US dollar which had seen a recovery in recent weeks after its weakest start to a year since 1973, again fell against the backdrop of the weaker jobs figures. A weaker dollar should make US exports more competitive, whilst imports become more expensive as well as enhancing the foreign earnings of US companies. A weaker dollar has also impacted on the returns of US equity funds in sterling terms as illustrated by the sterling and local currency year-to-date investment returns charts above.

Many equity markets have reached record highs in recent weeks with some of the US mega tech companies driving returns as their second quarter earnings have been strong. Both Nvidia and Microsoft became $4 tn companies in July supported by renewed enthusiasm for AI and the resilience of the US economy. Apple has been exempted from looming semiconductor tariffs as it pledged to invest $600 bn into building manufacturing capacity in the US. Smaller suppliers of components may be in a less fortunate position to move manufacturing to the US.

In contrast to the US, the European Central Bank (ECB) has been cutting interest rates aggressively over the past year in the face of slowing economic growth and above target inflation. The loosening of monetary policy has seen inflation move back to the ECB’s 2.0% target and GDP growth improve to 1.4% pa in the second quarter of 2025. Christine Lagarde, ECB President, commented after the last ECB monetary policy meeting that the policymakers were in “wait and watch” mode as EU/US trade negotiations were still ongoing at that point. The key ECB interest rate was maintained at 2.0%. With a trade agreement now in place, the ECB anticipates that the economic outlook should improve further. However, the imposition of 15.0% tariffs on most EU exports (including cars and pharmaceuticals), a resilient economy and fiscal easing could lead to increasing inflationary pressures. This rate cutting cycle may be at or close to its end. European equity markets reacted positively to the trade agreement.

The Japanese equity market saw a strong return over the past month due to a trade agreement with the US put in place just ahead of the 1 August deadline. The share prices of companies which export significantly to the US soared. A 15.0% tariff was agreed on Japanese exports to the US, including autos. Inflation in Japan still remains above the Bank of Japan's (BoJ) 2% target although eased to 3.3% in June from 3.5% in the previous month. With uncertainty around the US trade deal now reduced, it is expected that the Bank of Japan will resume increasing interest rates as it acts to control inflation as it normalises monetary policy.

Chinese equities have also performed well. With trade negotiations ongoing and a temporary deal in place until November 2025, it appears that a US/China trade deal will be agreed, which has been positive for investor sentiment. Export levels in July grew by more than expected as shipments to countries other than the US increased including European countries, Australia and China's Asia Pacific neighbours. The Chinese currency has been falling in value which also boosted exports recently and the Chinese services sector is showing signs of expansion leading to hopes that consumer demand is improving.

The focus of the fixed interest market has also been concentrated on trade negotiations and on renewed fiscal discipline concerns. Consequently, developed economy government bond yields have been rising whilst corporate bonds have made positive returns against a backdrop of positive, if muted, economic growth and relatively healthy corporate balance sheets. Both the US and UK government bond markets are reacting to increased government spending; the 'Big Beautiful Bill' became law in the US in early July with further tax reductions, increased spending on defence and border security and cuts to social security, likely to be negative for the country's budget deficit. The UK government's concessions on welfare cuts raised doubts in the gilts market over fiscal discipline. Corporate bond markets have been performing relatively well. Robust company earnings - which exceeded expectations particularly in cyclical companies - have underpinned performance across investment grade and high yield bonds.

Economic growth in the UK appears to be slowing with GDP estimated to have fallen 0.3% in April and by 0.1% in May. The UK jobs market is also cooling with payroll employment falling for the sixth consecutive month in July but with wage growth holding steady at 5.0% pa in the three months to June. The unemployment rate remained at 4.7% pa over the same time period. The Bank of England cut Bank Rate by 0.25% at its latest Monetary Policy Committee (MPC) meeting in August due to the "gradual loosening" in the jobs markets and slower hiring. However, the MPC vote was very close at 5-4, with the four members voting to hold rates due to inflationary pressures of higher food and energy prices. One member initially voted for a cut of 0.5%. The increases in employers' National Insurance contributions and in the living wage continue to weigh on businesses. The MPC continues to face the twin challenges of lacklustre growth and above target inflation which could lead to interest rates remaining higher for longer. The Chancellor, Rachel Reeves, is now facing difficult decisions in the forthcoming October Budget with the National Institute for Economic and Social Research suggesting that she will need to fill a black hole of £41.2 bn in the public finances. More tax hikes are likely which again could weigh on economic growth, but the Chancellor will have to satisfy the gilts market that public spending is under control. Despite an uncertain economic backdrop, the UK equity market has performed relatively well in the short term with defence-oriented companies making strong returns as defence spending across Europe is planned to increase. Banks saw their share prices rise sharply as a court ruling on unfair car financing agreements removed the threat of widespread compensation. The healthcare sector was boosted by strong earnings updates from some large pharmaceutical companies.

OUR VIEW

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Angela runs Cartlidge Morland's Investment Management team, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

Geopolitical risks, trade tariff volatility, differences in monetary and fiscal policies and rising government debt levels have stoked uncertainty in equity markets yet many equity markets have reached all time highs in recent months. Stock markets are driven by a plethora of influences, including company fundamentals and investor behaviour. Whilst risks persist, there are some positive influences on equity markets. Economic growth whilst not strong is positive, inflation levels in the major economies have fallen from peaks experienced in the last few years as monetary policy has been more restrictive. There are potential stimuli from US tax breaks and from the Chinese government and a degree of uncertainty around tariff levels has been eliminated as the US continues to agree deals with its trading partners. We continue to maintain fully diversified portfolios reflecting objectives and risk tolerance.

In the UK, the government's failure to adopt policies to stimulate shorter term economic growth is unhelpful. No imagination has been shown and the increases in payroll taxes deters hiring and economic expansion. Some of the large infrastructure projects which have been announced, combined with increased defence expenditure, will prove beneficial over the longer term. Without stronger economic growth in the meantime, the Chancellor will struggle to finance it all, especially as welfare/ healthcare spending continues to increase vastly. Fears over further tax increases in the forthcoming Budget are deterring investment – although the UK has maintained its position as Europe's second most popular destination for inward foreign investment.

The fortunes of the FTSE 100 companies' share prices contrast strongly with the weakness of the chronically under-valued FTSE 250 over this year. The latter receive little attention (other than from overseas predators) during a period of pessimism for UK economic prospects. The FTSE 100 companies currently power on because they represent a largely under-valued investment in global growth, which investors are beginning to appreciate.

We are re-deploying portfolio assets currently invested in the FTSE 250 – as there is an 'opportunity cost' in continuing to hold these positions. We have been taking profits in US equities and re-deploying them to Europe; partly as a means of realising them during a less certain period for the US but also as a means of diversifying opportunities. In general terms, most developed markets march very much to the tune of Wall Street and one has to believe in fairly positive sentiment there, to justify optimism in Europe and UK. President Trump's policies will either succeed or fail – the Fed's restrictive monetary policy keeps a lid on what might

OUR VIEW continued

otherwise be a reckless boom whilst Jay Powell remains the Fed Chair. Higher federal spending and reduced taxes are stimulative, increased import tariffs cause uncertainty shorter term and stubborn inflation/elevated interest rates remain unhelpful.

Bond yields remain relatively attractive – although UK inflation has the potential to upset the gilts market if it is not controlled. Debt is always an alternative to equity and corporate balance sheets are strong. We continue to hold both gilt and high quality UK corporate bond funds, at appropriate levels according to objectives and risk tolerance, for the income they produce and the downside protection they offer in periods of equity market volatility.

If you have any queries please do not hesitate to contact your Cartlidge Morland consultant.

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