

Transcript

Financial Market Commentary – Review of First Half of 2025 and Outlook

Simon Lewis on 24 July 2025

Hello and thank you for joining our latest financial market commentary. Last time, I talked about how investment volatility had increased in the first quarter because of uncertainty about President Trump's economic policies and I left you with a synopsis of Trump's so called Liberation Day, when he announced a wide range of punitive trade tariffs on the rest of the world.

This first chart is a reminder of what happened to the S&P 500 index during the first quarter. As I explained last time, financial markets were initially very positive about the perceived impact of economic policies that favoured less regulation and lower taxation. However, when it became apparent that tariffs were to become the central theme of the Trump administration's economic policy (let's not forget that tariffs are a tax) the US stock market led others abruptly lower.

The Liberation Day tariff announcements caused shock and despair in financial markets because the proposals were much more aggressive than feared and the rationale provided made no economic or mathematical sense.

Financial markets capitulated and it soon became clear that if something didn't change, parts of the global financial system were at risk of failure. Global bond markets showed their disapproval by selling US government debt at an unprecedented rate, pushing yields and therefore the cost of US government borrowing ever higher.

This forced the President to announce a 90-day moratorium on the implementation of tariffs and having seen that Trump would back down under pressure, financial markets stabilised, and a recovery began.

There was a further U-turn to come when Trump announced that he was going to fire the chair of the US Federal Reserve, Jerome Powell, when he had no legal mandate to do so. Markets again showed their disapproval with the result that Trump said his earlier seemingly unequivocal comments had been mistaken.

Robert Armstrong, the New York based financial Times commentator came up with an acronym to describe the situation. The TACO trade, standing for Trump Always Chickens Out implied that investors could rest easy knowing they didn't need to panic because if required, Trump would change tack in the face of significant financial market disruption.

Further delays and watering down of proposals have put investors in a better mood and this, with the help of strong earnings growth in the US tech sector, has allowed financial markets to continue their recovery to deliver a very positive second quarter to broadly make up for the very disappointing first-quarter. Overall, during the first half of the year, the S&P 500 index

posted a positive return. However, there is a caveat. It was a positive return for US dollar-based investors but not necessarily so for others.

This is because another of Trump's core economic policies is to see a decline in the value of the US dollar as he believes that this will make US exports more competitive and correspondingly, US imports more expensive.

With all the policy uncertainty and a not insubstantial loss of faith in the US on the part of its allies and major trading partners, Trump's wish has been granted. For sterling-based investors the US dollar declined by nearly 9% over the first half of the year with the result that a positive dollar return becomes a negative sterling return.

This factor provided a headwind for PMW portfolios, because we have a high US exposure in the equity (share based) portion of our portfolios. However, I'm pleased to say that positive factors combined to enable portfolios to eke out a positive if modest return over the period. This chart shows the return on a PMW Balanced portfolio over the first half of the year and when we look at a 12-month period the position looks encouraging.

Over the first half of 2025 the primary performance headwinds were provided by US medium sized and small companies, which are generally more vulnerable to tariffs and the supply chain disruption that often follows. US large companies fared better because of the scale of the US technology sector. Notably, software is a service and is not affected by tariffs on goods. Global real estate was impacted negatively by the fact that US interest rates did not fall as expected.

But there have been some useful tailwinds. As explained in my last commentary, the outlook for Europe has dramatically improved following the German government's decision to increase spending on defence and infrastructure by up to €1 trillion over the next 10 years. This spending will percolate throughout Europe and European stock markets have already appreciated in anticipation of this.

We have also seen a significant improvement in the share price performance of many large UK companies, which typically earn most of their revenues overseas, with the FTSE 100 index reaching an all-time high. And at the defensive end of portfolios, we've been pleased with the performance of our selected short-dated bond funds, which have allowed us to side-step the difficulties faced by long-dated bonds.

Looking forward, there is a lot to consider, and President Trump's policy whirlwind is likely to remain the centre of attention. Many will disapprove of his style and approach but one cannot deny that he is driving change globally at a pace that conventional diplomacy could not achieve. Whether these changes will be of benefit to the US and the rest of the world remains to be seen.

Many of the policy objectives make sense in isolation but often compete and conflict with others. For example, Trump sees tariffs as a source of leverage to achieve his geopolitical goals as well as a source of revenue that might help to reduce the US fiscal deficit over time or at least help finance tax cuts. He also sees tariffs as a tool to encourage manufacturing back to the US. But success on this front will mean a reduction in imports and a reduction in tariff revenue.

By the time the dust settles, the average tariff rate on US imports is likely to have increased from around 1% to somewhere between 15% and 20% with a wide range of actual rates depending on sector and origin. They will be used as a stick to beat nations that are perceived not to be acting in the US's best interests.

China has been singled out for specific attention because previous promises it has made have not been kept. It has striven to create excess capacity in many sectors through subsidisation of state-owned enterprises and the continued state sponsored theft of intellectual property rights has become another thorny issue. Such matters have been central to the tension between the US and China and perhaps an escalation in tension will provide a more effective pathway to an improvement in behaviour.

Looking closer to home, the outlook for the UK economy is of concern. Our tax burden is at the highest level for 80 years but there is no evident appetite from Government to cut spending. Further tax rises in the Autumn Budget seem inevitable.

There is some evidence that this is driving behavioural changes, with people working less and trying harder to reduce their tax bills. There also appears to be a worrying exodus of wealth from the country.

Global financial markets have been taking note, which is why the UK is required to pay much more interest on what it borrows than comparable countries.

The cost of UK Government borrowing has risen sharply since the artificially low rates that prevailed in the wake of the Covid 19 Pandemic. The rise began when an inflationary spiral took hold towards the end of 2021, further fuelled by the energy crisis that followed Putin's invasion of Ukraine and subsequently exacerbated by the ill-advised mini budget during the remarkably short tenure of Liz Truss. But it's important to appreciate that Government borrowing costs are even higher now than they were then.

Of concern is that the cost of borrowing has continued to rise even though the Bank Rate has been falling this year and is likely to fall further. Although this unusual correlation is a factor in many developed economies, the scale of the change is noticeably greater in the UK than in similar countries.

This chart shows what financial markets are charging to lend money to Governments for a 10-year period. The higher the rate, the less creditworthy the country is perceived to be.

As you can see, the UK is very clearly the poor relation - a situation that prevails whatever the term of borrowing. In summary, we are being charged 75% more than Germany and 40% more than Greece. It's a similar story for longer term debt. And the trend is in the wrong direction, with the rate now even higher than during Lizz Truss's tenure.

It's important to not simply demonise financial markets because they are mean to the UK. Financial institutions have a responsibility to earn an appropriate return for the risk they take with their customers' money. And let's not forget that if we have private pensions and investments, we are such customers.

The UK has run a fiscal deficit consistently over the last 25 years, spending more than tax receipts and borrowing to make up the difference. We've had two major crises to deal with during that time. The financial crisis, when our out-sized banking sector needed a taxpayer bailout and the Covid pandemic, when the generosity of our government comfortably exceeded that of other countries. But those two events are not a sufficient excuse for our predicament.

The problem is that UK politicians of all persuasions have become too used to spraying money around like confetti because it makes them popular. But any fool can spend money. It's bad enough when that money has been hard earned by taxpayers but it's even worse when the money spent is borrowed and will therefore have to be repaid by future generations. Politicians talk much about tackling inter-generational inequality, but the irony is that they only add to it by borrowing money that future generations are expected to service or repay.

In my view, all politicians should be tied to a chair and made to watch the debt clock published by the Taxpayers Alliance. It's not statistically perfect but it is usefully illustrative. Our national debt grows at nearly £5,000 a second, which is £432 million a day. And it doesn't cover unfunded liabilities such as public sector pensions. A couple of hours of forced viewing and our politicians might start to think differently.

So, what do we think you need to be considering in the run up to the next budget?

Let's start with pensions. If you are entitled to make contributions to a pension and will currently benefit from higher rate income tax relief, it makes sense to pay as much as you are able before the Budget. The Chancellor could raise a lot of extra money by changing the way tax-relief is given, which would make future contributions less appealing for many.

If you haven't fully utilised your ISA contribution allowance for this tax year you should aim to before the Budget if you can afford to do so.

If you are thinking of gifting money to trust for future generations of your family, you should think about doing this before the Budget.

As far as future investment strategy concerned, we are understandably negative about the outlook for long-dated UK government bonds, even though we expect the UK bank Rate to continue to fall.

We are also cautious about UK smaller companies because of a deterioration in the domestic economic outlook (larger UK companies generally make most of their money overseas) and we think the US dollar is likely to remain weak.

We see opportunities for large US companies, particularly those outside the tech sector because they have some catching up to do. And US small companies should benefit when US interest rates finally start to fall, which is likely later this year.

In Europe, there is probably more upside to come, particularly for larger companies, as German government spending feeds through the European economy. And short-dated UK bonds should continue to provide effective portfolio insurance during periods of market stress, helping to reduce portfolio volatility.

Overall, we remain cautiously optimistic about portfolio returns over the coming 12 months. Change is often uncomfortable, but it creates opportunity. And with our continued emphasis on diversification, there should always be something in PMW portfolios that is performing well at any given time.

There has been a lot to cover this time, so thank you for persevering and making it this far!

I hope that this update has been useful and I look forward to catching up with you at the end of the third quarter. In the meantime, enjoy the rest of your summer.

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