

Market Returns

| (Returns in £) | 1 month | 3 months | 6 months | 1 year |
|-----------------|---------|----------|----------|--------|
| UK Equities | 0.3% | 4.5% | 4.6% | 8.7% |
| Global Equities | 0.3% | 8.3% | 3.0% | 11.1% |
| UK Gilts | -1.1% | 0.0% | -2.3% | -5.7% |
| UK Property | 0.3% | 1.2% | 2.5% | 5.4% |
| Gold | 2.3% | 4.6% | 12.5% | 33.6% |
| Commodities | -0.9% | 5.0% | -4.6% | 10.9% |
| Sterling | 0.9% | -1.1% | 0.7% | 0.7% |

Returns to 31st August 2025. Source: Refinitiv

Market Overview

August is normally a quiet summer holiday month, with limited news flow, however, we live in the 'new normal' and there has been plenty to occupy the minds of markets. Aside from the increasing budget constraints in the UK, as the government is seemingly unable to contain costs, France is facing a confidence vote on the 8th, that Prime Minister Bayrou looks likely to lose, and President Trump has doubled down on his attacks on the Federal Reserve Bank and its independence. All shifts that have bothered bond markets. In addition, various tariffs have now been imposed by the US, including a doubling of tariffs on India (to 50%), only for the US Appeals Court to rule that many exceed Presidential authority. The US Supreme Court will now hear the case and tariffs remain in place till 14th October.

Company earnings reports, for the half year, have generally reassured, particularly Artificial Intelligence (AI) related, where capital investment is being poured in at extraordinary levels. The flip side of this is where companies are reporting negative impacts from tariffs. This is particularly true for the car industry, where even US manufacturers have quantified heavy costs from tariffs on imported components. Whether these tariffs remain in place or are rescinded, they are certainly disruptive and will have a cost on economic activity.

Inflation is also impacted by tariffs and is gradually rising in the US, giving the US Fed a dilemma as employment simultaneously cools. Although generally quiescent elsewhere, inflation seems to be an Anglo-Saxon issue as UK inflation rose to an 18-month high and ahead of expectations. This undoubtedly impinges on the ability of the Bank of England to cut interest rates this year. A factor that helped strengthen sterling in August.

Given the heightened state of economic uncertainty and geopolitical conflict, it should not be a surprise that gold gave the best returns over the month and indeed the last year. Although reasons to worry are manifest, they are built into expectations and with inflation set to ease by the end of the year and with it interest rates, there are positives on the horizon as well.

OPEC+ continues to raise production quotas, with the price of oil currently settled around the high \$60s per barrel. The market looks well supplied into 2026 but is obviously sensitive to Middle East hostilities and sanctions on Russia. European gas prices have eased helping their inflation outlook, with storage filling nicely ahead of winter. Industrial metal prices have settled following the introduction of US tariffs. Gold continues to rise on its safe haven status. Food prices are creating some problems this year, as harvests look to be down on yield in the northern hemisphere.

Global supply chains have improved after a long period of disruption, but not back to the level of efficiency pre-Covid. Now tariffs are causing disruption to the global supply chain as other suppliers or alternative demand are sought. China has become the dominant supplier in a number of crucial areas, such as rare earth metals where they control ~90% of global processed supply and have used that advantage to counter US trade restrictions.

A global interest rate cutting cycle (bar Japan) is still in place. Although there are different views on the pace and extent of cuts, they will help small companies' finances and households with mortgages. The yields on long bonds have been more affected by sensitivity to the growing levels of government debt across the western world, than weak economic outlooks. Along with tariff uncertainty, this continues to act as an impediment against long term investment decision taking.

Property fund mergers in 2024 have been followed by a significant number of takeovers for property REITs as their large discounts to underlying asset value has attracted international interest. With rents continuing to rise and vacancy rates at low levels, property still looks attractive, where share price discounts remain. Listed infrastructure trusts also trade on wide discounts, renewable energy focused ones still face uncertainty on generation levels and prices, but new regulations should provide more certainty on long term power pricing. Despite windfall taxes and higher debt costs there is still plenty of room to grow.

Political policy continues to be fluid, with plenty of U-turns both here and abroad, and a confidence vote in France likely to go against the government. The shift towards nationalist politics remains current, but markets are now more focused on fiscal policy and budgets. In the US Trump's 'Big, Beautiful Bill' passed into legislation, cementing significant deficits for the foreseeable future; unless tariffs generate significantly more revenue than expected.

Despite flirting with technical recessions (two successive quarters of economic contraction) in Europe a full-on recession has so far been avoided; the fabled 'soft-landing'. However, economic activity and confidence remain subdued and many governments are struggling to achieve lift-off speed. Meanwhile the tricky issue of how to fund greater levels of defence spending only adds to the deficit problem. Softness is now beginning to emerge in the employment market, although real wages have grown after a long period of erosion and a rise in household savings means consumer finances are generally quite healthy.

Company results announced for the second quarter of 2025 have held up well in general, with aggregate reported profits still advancing. This has been especially true for the dominant US tech companies driving the push of AI, but more mixed elsewhere. Some companies are already forecasting significant tariff costs, as rates start to be implemented. Consumers have been showing greater price sensitivity and some industrial companies have reported demand weakness, this is particularly true of car companies, who have been slashing their forecasts.

Despite the current ceasefire between Israel and Iran, conflict continues to rage elsewhere, and lasting peace feels some way-away. This has led to a substantial policy shift in Europe, with recognition that there will need to be a significant increase in defence spending, to 'be prepared'. Some companies will be beneficiaries of this, but with spending cuts elsewhere needed to try and balance the books, there will also be losers. Looking through all the uncertainty we still see positive investment returns but expect bumps along the way.

Market Outlook

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|---------------------|---|
| Equities | Stock markets continued their strong run in August, shrugging off worries about tariffs, as company results and AI demand reassured. Hopes of US interest rate cuts have added support, as economic data reports confirm weak activity and softening employment trends. Although there have been some legal challenges to US tariff implementation, a number are in effect and will impact on trade and prices, further pressuring economic growth. |
| Fixed Interest | Following the Bank of England interest rate cut last month, the US Fed is likely to follow suit later this month, as their labour market cools. However, the attempt to fire a member of the Federal Reserve Bank by President Trump is seen as an attack on its independence. This allied to surging fiscal deficits is undermining long bonds, across the Western world, steepening yield curves. This in turn impinges on long term investment decisions; certainly, bond markets are taking a less sanguine view on economic outlooks, than equities. |
| Commercial Property | There has been a marked pick-up in M&A activity in property trusts (REITs), as market stabilisation and steep discounts to quoted asset values have attracted takeover offers. This has probably been aided by a growing consensus that supply and demand have settled down and rental yields for good quality property are rising. Additionally, with higher build costs and higher energy standards required, it is cheaper to buy, than to build new. |
| Alternative Assets | Infrastructure investment funds offer benefits for exposure to physical assets, some with attractive inflation linked contracts, and growth tied to improved connectivity and de-carbonising economies; although build costs are high. Debt costs, that weighed on the valuations of private equity and infrastructure trusts, remain an issue but de-gearing is taking place. Absolute Return strategies have shown some defensiveness but generally offer low returns and we continue to choose sparingly. |
| Cash | The investment return on cash and cash like instruments has peaked and is expected to gradually decline through this year. |

Thorntons Investments

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