

Current Positioning

August 2025

The past month summed up

Beep beep beep! Amid relief that tariffs haven't sunk the economy and increasing confidence that the AI revolution will extend far into the future, some overexuberance alarms are ringing.

The rationale

Our central view remains that economies continue to make progress but within a slightly elevated inflationary framework. While major risks seem to have diminished for the moment, there remains significant uncertainty as to how policy might ultimately influence the future economic trajectory.

With a relatively balanced outlook between the positive and the negative this can lead to wide ranging interpretations of the future environment. For most participants in the market, which in the US recently reached a record high, everything is looking pretty rosy: for ourselves we believe the wide spread of prospective outcomes cautions against getting over-excited.

No recession yet?

For the bulls everything looks good, especially when measured against three months ago when markets took a nosedive on fears that President Trump's tariff plans would kickstart a downturn both at home and across the globe. As of now that has not come to pass and with trade agreements piling up the president is pivoting from using tariffs for economic policy to using them as a tool of geopolitics: for example, threatening Brazil with higher tariffs because of the prosecution of his ally Jair Bolsonaro and even a suggestion in a Norwegian paper that tariffs were dangled alongside a request that Trump be awarded the Nobel Peace Prize.

That's not to say tariffs don't matter economically, with the average rate likely to settle near 15%, more than five times the level at the start of the year. Thus, all eyes recently have been on employment numbers as an important bellwether of the economy – rising tariffs mean rising prices, leading to a slower economy, leading to fewer jobs. The information from the jobs market at present seems to be balanced – there has been a sharp downturn in the number of new jobs created, adding just 73,000 in July while numbers for May and June were revised lower by more than 250,000. All in all, the number of new jobs created from May to July slipped by more than two thirds from the previous three months. And yet the unemployment rate has remained fairly steady, indicating that while few jobs are being created no one is being fired – yet.

Earnings bonanza

Another area that's showing real resilience is company earnings. Bank of America reported that its global earnings revision ratio at the end of July had hit a 43-month high of 0.98 meaning globally that much the same number of companies were reporting upgrades as opposed to downgrades. In earlier data the US, the hotseat of the AI revolution, was at 1.24 while Europe slipped from a sluggish 0.61 to a slightly more sluggish 0.58. Positive news from outside the US however came from one of the more recent poor performers in the world, with China's revision ratio advancing from 0.58 to 0.78.

In terms of actual reporting, of the 90% of US companies that have posted earnings thus far, 80% have come in ahead of expectations. US earnings are up 11% year-on-year and expectations for 2026 are even higher. Part of the explanation for the relative buoyancy of the US (and for some emerging nations) has been the strong downward movement of the US dollar since the start of the year – the dollar index which measures the greenback against a basket of other currencies has dropped close to 10% since the start of 2025. A lower US dollar makes it more profitable for US companies to trade abroad (often economies and businesses in emerging nations use the US dollar in their international dealings so they will have benefited similarly).

By contrast, earnings in Europe have flat lined, as tariffs and a stronger euro hampered growth. The automotive industry, a large constituent of European industry, has been particularly dented by US tariffs and Chinese exports.

A falling dollar alongside tariffs means the cost of goods and doing business in the US should be climbing, sending inflation higher. For the moment though inflation seems largely stable, coming in at 2.7% in July, slightly lower than had been predicted by economists. Lower corporate tax returns suggest companies are absorbing some tariffs costs, keeping a lid on inflation. That news helped send stocks even higher on the expectation that more moderate inflation would help the Federal Reserve cut interest rates sooner – indeed futures markets were near unanimous in pricing a quarter point cut in September's meeting. As we know, lower interest rates should mean an even more active economy.

What's your problem?

All of this sounds OK, so what's the problem you may ask? In relation to inflation, it's not that we think it's climbing anywhere near to the 9% level that we saw in the years after the Covid emergency, but that it's stuck well above the Fed's target of 2% and tariffs could take it higher. In fact, that sums up where we are overall at present: it's not that a disaster is imminent but it's just that the spread of risks has now enveloped a large part of our outlook. Thus, inflation may stay higher for longer meaning interest rates stay stuck at higher levels, with ramifications for borrowing, including debts that need refinancing into next year as well as the cost of funding governments.

Party time?

However, for markets the most immediate risk at present may be evident in the signs of over exuberance that are starting to pop up. You may be able to explain away record market highs after those significant earning numbers, but it's important to bear in mind some of the earnings revisions are due to more upbeat assessments that followed very negative outlooks caused by the fear of Donald Trump's tariffs.

It seems that retail investors are behind some of the more excitable activities of markets, as recent moves prompt comparisons with some of the acronymic excesses seen in 2021. Much commentary in recent weeks has centred on so-called DORK stocks, named after doughnut seller Krispy Kreme (stock code DNUT), real estate platform Opendoor, mortgage business Rocket and retailer Kohl's. These are deeply damaged businesses where prices jumped irrationally as investors rowed in behind companies that institutional investors had been shunning (Opendoor's shares climbed by a factor of almost 10 over a few days).

At the same time crypto investors, sensing strong regulatory tail winds from the Trump administration, have been looking to cash in, with exchange operator Bullish – yes, it's really called that – raising over \$1.1 billion in a recent flotation. To add to the sense of irrationality, artificial-intelligence business Perplexity AI made an audacious bid to buy Google's Chrome browser for price of \$34.5 billion, well in excess of the start-up's estimated value of \$18 billion.

Bubbles are always presaged by signs of excess that just seem to defy rationality and gravity. We are not at the stage yet where the proportion of such events would make us alter our strategy but it's definitely something to keep an eye on.

Conclusion

With a relatively well performing economy and a market that's buoyant there's a lot to be positive about at present; the major risks of recession or rampant inflation seem to have diminished in recent months. However, as near-term uncertainty as to the direction of the market and the economy seems to have improved in many areas, so the range of longer-term outcomes has been getting wider. That uncertainty is unlikely to recede

given geopolitical circumstances and ongoing questions as to whether the amount of investment into so-far unproven AI technologies yields a longer-term profit.

Mindful of the signs of building exuberance and high valuations, we do not feel it prudent to respond to recent improvements in markets in a way that would leave us vulnerable to a correction or instability. We are instead comfortable with the balance in our portfolio that allows us to run with the positive market momentum in our equity portfolios while retaining some protection against shocks or drawdowns through bonds, gold and other alternative investments.

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