



The past month summed up

Markets have continued to surf the wave of AI enthusiasm, but beyond the barrelling tech revolution there are crumbs of concern that prompt us to adjust positioning.

The rationale

While our core view remains essentially positive given a growing economy operating in tandem with huge investment related to the artificial intelligence (AI) revolution, it has moderated somewhat to acknowledge that the US, still at the vanguard of the global economy, is seeing signs of slowdown in the jobs market even as inflation risks may be resurfacing. Added to this are building noises that the AI revolution may be overextended, and an increasing focus on where it could disrupt previously impenetrable business models.

The overall picture for stock markets is complicated. Headline consensus remains focused on the expected benefits of AI and it's not all froth. Company earnings have been extremely resilient – the Bank of America's earnings revision ratio remains above the long-term average, a clear sign of good corporate health. And yet there is no doubt that markets have the appearance of being topky, with the S&P 500 index climbing 15% so far this year while the technology heavy NASDAQ has soared 19%. The prices that investors are paying for the S&P 500 now stand at about 23 times forward earnings, the highest it has been in five years.

Cockroaches

Signs of exuberant behaviour have raised some alarm bells. Open AI, the company behind ChatGPT, has in the past few weeks agreed billion dollar deals with chipmakers AMD and Nvidia. Some analysts are suggesting these are circular in nature – where both parties essentially inflate the value of the other through a transaction with doubts over real tangible benefits from a deal. The FT recently reported that British investor James Anderson, well-known for having spotted the potential of some of the most successful technology titans, is fearful that recent corporate behaviour has echoes of the technology bubble of 2000.

More worrying has been the spate of corporate calamities that some, including JPMorgan Chase CEO Jamie Dimon, are fearful could be a harbinger of markets about to become undone. In recent weeks subprime (remember that term?) auto-lender Tricolor filed for bankruptcy, followed by auto parts supplier First Brands, fuelling speculation that too much easy money may cause contagion across the finance sector. More recently two regional lenders, Western Alliance and Zions Bank, said they may have been exposed to fraud by borrowers. “When you see one cockroach, there are probably more,” Dimon said.

AI victims

The retort from optimists might be that for those worried that the AI revolution is being built on a pyramid of unfounded optimism, it's actually cash and not more risky debt that is the source of much of the investment in the new technology. Analysts at ING estimated recently that investments by larger tech companies will amount to more than \$400 billion in 2026, funded from their operating cash flows.

And yet if the AI revolution is indeed a success, an emerging downside worry is that the market is now looking for those companies that might fall victim to the technological step change. It has been pretty scattergun thus far, with declining stock valuations for a wide range of businesses where the feeling is that AI will do a better, and possibly cheaper, job than is being done at present: from companies providing data analysis to those producing content or creating adverts, there's broad speculation that AI will undercut their business models.

Where's the brake?

The view on the economy is pretty mixed as well. We've talked before about that ongoing tension between not enough growth, tending towards a slowdown, and too much growth, which injects inflation into the economy and can lead to higher interest rates, which in the end snuff out any resurgence.

The US is still doing all in its power to remind us of its exceptionalism, with the Atlanta Federal Reserve's GDPNow model estimating third-quarter growth likely to reach a pulsating 3.8% (for comparison growth in the UK is at about 0.2% at the moment). Headline growth charging ahead at such a rate would normally prompt policy makers to look to rein things in before a stampede builds.

That's not the way things are going Stateside in this most unconventional of years. Interest rates were cut by 25 basis points in September, and the US Government has made no secret of the fact that it wants the Fed to keep slashing away – cheaper money fuels the economy and may make voters more inclined to support whoever is running the country. Even policymakers are keen to keep cutting – the New York Times reported that Fed Vice Chair John Williams said he was backing more interest rate reductions this year, whilst Fed Chair Jay Powell is more worried about weakness in the labour market than an economy unbound.

Beautiful

As we move towards 2026 there is more fuel that could be poured on the fire. Trump's major fiscal legislation – formally known as the One Big Beautiful Bill Act – seeks to further pump prime spending in the economy through cutting taxes for companies and consumers alike. The tax exemption on companies' investments in equipment and research is worth about \$100 billion already this year according to research by Strategas, an investment specialist. They also see tax rebates of \$150 billion flowing back to consumers in February next year, much of which will be spent to further fuel the economy.

And then there are tariffs, which still have the potential to be felt on the supermarket shelves and contribute to those inflationary pressures. Goldman Sachs economists are suggesting that US consumers will take on more than half of the rising costs due to tariffs by the end of the year.

And lest we forget there are still the unnerving, shifting sands of US Government policy. Trump's comments in mid-October on Chinese tariffs both sent stocks lower and helped them recover rapidly whilst the threats to US economic stability continue in the shape of the Trump administration's attempt to fire policymaker Lisa Cook. The combination of unpredictability and increasing bellicosity has done little to deter markets or the economy but is creating rising fears that overseas investors are turning away from the dollar. This partially explains why gold, the ultimate safe haven, continues to climb at the same time as equities.

Meanwhile elsewhere

As always though, even as risks rise in one area so they may point to opportunities elsewhere.

We think there is plenty of potential in equities beyond the US, particularly amongst emerging nations. The decline of the dollar benefits emerging markets who in their international trade tend to use the Greenback; a lower dollar makes it easier for them to sell more abroad. Additionally, signs of stability, if not resurgence, in China, where its exports notched up a six month high even amid US tariffs, will provide a significant boost for countries in its orbit in Asia and beyond.

Correspondingly, while Europe looked like a source of great potential earlier in the year as nations committed to raise their spending on defence and band together to challenge threats emanating from the US and Russia, those expectations have so far failed to come to pass. Talk of increased spending at the moment remains just talk, while political turmoil in places like France makes it very difficult for governments and the wider EU to make bold strategic spending decisions that could boost regional businesses. This could change however, and so Europe remains on our radar.

Conclusion

All of this adds up to some rebalancing across our portfolios. The chance of higher inflation, both in the US and UK, brings down our expectations for the performance of government bonds – the fixed payments of bonds are worth less in an inflationary environment – and as a result we are shedding some of our holdings in this area.

In our equity portfolio we continue to cautiously examine our AI exposure. With a focus on managing out the potential losers from the technological revolution and the gnawing uncertainty in the US, we are reducing some of our exposure to data and analytic companies that sit in ChatGPT's crosshairs. Instead, we are shifting investments into global equities and emerging market investments where businesses have a clearer growth opportunity and the threat from disruption is lower.

Finally, elements the world has in abundant supply at present are volatility and uncertainty, and there are two main ways to take advantage of this: one is through the safety of protective investments such as gold, which remains a core holding; another is through investing with those experts who can exploit a world of increasingly sharp shifts and dispersion, both between and within asset classes, from currencies to commodities. Both of these strategies have great value as diversifiers, especially when equities and bonds have moved more in tandem, as they have in recent years, limiting their ability to balance against each other.

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