The past month summed up

Victorious US Democrats' proposed limitations on data centre expansion alongside a spectacular fall from grace for one of the leading lights of the artificial intelligence (AI) boom send shudders through technology shares. These developments appear to have catalysed a wider test of investors' confidence levels.

The rationale

We remain positive about the potential for the global economy. The AI capital investment super-cycle, even in the face of concerns about its durability, continues to have a positive impact on the economy, whilst it retains real potential to propel productivity gains in the future. As evidence, US GDP expended at an annualised 3.4% in the third quarter while Goldman Sachs predicts the global economy will expand a healthy 2.8% in 2027. Even UK growth has positively surprised.

That core view is holding steady even amid a raft of new information and hurdles that markets have had to digest in recent weeks. We remain constructive but alive to a building list of risks – capital investment is continuing but as the cycle matures and borrowing costs rise the incidence of hiccups in the progression of AI will increase, quite rightly challenging those with more rose-tinted views.

Indeed, November has seen a significant shakeup. The resounding victory of the Democrats in the US midterm elections will give them control of not only the two houses of Congress but also a selection of governorships in some of the reddest states, including Texas and Ohio. With data centres, billionaires and graft high on the US electorate's list of public enemies it is reasonable to expect the new Congress to be less accommodating to the tech barons – even if they only seek to slow rather than arrest progress.

No signs of a Trump tantrum

The scale of the Democrats victory proved a relief to those that feared that a tight election might have prompted allegations of voter fraud and social unrest. So far so good.

Likewise, there was speculation that Trump would, after the midterms, take the opportunity to ramp up his widely unpopular attacks on Iran, thereby putting even more pressure on energy prices worldwide. In the end he has instead indicated that he's happy for the moment to leave things in a kind of unhappy stalemate, but tensions in the Middle East continue to simmer.

After a day of relief, focus quickly pivoted to what the success of the Democrats might mean. The strength of the US economy has in part been boosted by the deregulating zeal of the Republicans and the Trump administration – that and the positive boost given by tax breaks for businesses and employees that have absorbed some of the economic shocks from foreign policy this year. Challenging these policies, the Democrats have a bias towards tightening scrutiny and the exercise of greater fiscal discipline.

We have already heard noises from veteran senators such as Elizabeth Warren and Bernie Sanders about changes to funding and regulation in areas such as healthcare. There will be more to come once they formally take control in January. For now, the most significant challenge for market strength will be their attitude to the technology sector at a moment where the unbridled optimism seen earlier this year has given way to a more complex debate.

Cold war comfort

That initial rather stolid factor for market unease was rapidly overtaken by a market scandal, which could have taken its inspiration from the pages of a Le Carre novel given its scent of cold war espionage. Nvidia CEO and

tech visionary Jensen Huang was forced to step down amid allegations he had engaged in a litany of affairs, the most significant of which was with a suspected Chinese spy. Neither we nor the market has very strong prurient views on the ability of Huang to stick to his marriage vows. The concerns instead rest on issues such as the future dynamism of the company without his charismatic leadership of more than 30 years and whether the dalliance was a taster of more significant wrongdoing on the part of the company. China and the US have been engaging in a form of economic conflict for a decade and with Huang already summoned before Congress, there are rising risks of fines, sanctions and regulations that could affect both its and the wider technology sector's business plans going forward.

Why wider? Nvidia, at one stage the world's most valuable company, has been central in providing the semiconductors that have powered the AI revolution thus far and has been a dynamic and deep-pocketed supporter of innovative startups – a hit for Nvidia risks being a hit for the entire AI edifice. The fear that this could take a toll on the sector as a whole is amply demonstrated by the fact that a group of senior tech executives including Elon Musk have come out swinging in favour of the embattled Huang. The building uncertainty has meant that tech heavy Nasdaq has slipped more than 10 percent since early October.

Still, we have always argued progress is never linear. The AI revolution is not a single success story and businesses are bigger than one man. Plenty have survived and ultimately thrived following the departure of an inspirational founder (Apple and Microsoft come to mind).

Elsewhere there appears there is still plenty of life in AI even if some share prices have taken a step back. Anthropic, the developers of the "Claude" AI assistant and one of the leaders in AI development, succeeded in a record breaking initial public offering, raising over $100 billion and valuing the company at $1.5 trillion. Nvidia itself this week reported its first set of quarterly results without its founder, with sales more than doubling from a year ago to over $100 billion. More importantly, in a show of confidence in the future, the company raised its expectations for sales growth in 2028 to 75%.

For now, however, the markets are firmly in glass half-empty mode. There are few signs that 2027 will be anything other than another good year for growth and earnings, but uncertainty is building into the years beyond in the face of higher costs, higher funding rates and potentially tighter scrutiny and regulation. These are known unknowns that will only be answered in time, and we are managing the risks and exposures closely whilst recognising the underlying strength and potential.

To reiterate, we believe in much of the fundamentals of what is going on, particularly as regards the benefits of the huge investment going into AI development. But as we have pointed out before, a market so singularly focused on the upside can get spooked quite easily by any upset on the downside.

Bond reboot

While technology might be the most visible element in the fallout from the midterm elections, as significant for investors we believe is that the Democrats will now control Congress, the arm of US government which at least in theory holds the US purse strings. In this topsy-turvy world, where in the past the Democrats might have been considered to be the more fiscally profligate, it actually turns out now that they may well be the ones to take on the role of probity from a President who has shown an appetite for splashing the cash. The prospect that US government spending may be more closely managed should be a fillip to the US bond market.

Another important effect on bonds is the inflation and interest rate outlook. Recently, the effects of the Iran war and resulting higher energy prices have accelerated inflationary pressures – the consumer price index was 0.4% higher in October versus September, faster than the rate that had been anticipated by analysts. Those inflationary pressures are likely to continue into 2027, and we may well see further interest rate rises as central banks try to combat higher prices. However, barring any nasty surprises, inflation will likely peak midway through next year.

Given the UK is our local market what happens here matters, and therefore another significant milestone was the first budget of Chancellor John Healy. This attracted a cautious welcome from the gilt market on the view

that the government was sticking to its fiscal targets, rather than looking to significantly up spending. The UK economy itself is a relative outlier on the upside, with Goldman predicting UK GDP will rise 1.6% in 2026 and 1.4% in 2027.

The final ingredient in this story is the trajectory of yields, which have steadily increased from levels a few years back that were close to zero. They have now returned to pre-financial crisis levels and offer a reasonable premium over inflation. The combination of healthy yields, governments marginally more focused on fiscal discipline and an inflationary environment that could peak in the middle of the next year has raised the attraction of bonds as a stable asset in portfolios, providing an offset should economic conditions deteriorate. Having spent much of the decade below strategic targets we are lifting our fixed income allocation closer to neutral.

Conclusion

Our portfolios remain balanced and we are still constructive on growth but recognise that the risks have increased, as evidenced by the sharp moves in equity markets. Our positive but cautious approach to technology and AI-related investments sits well with the tighter controls for the sector from the new Democrat majority in Congress. The portfolio has proven relatively resilient through a choppier period where the principles of diversification have proven their value.

The availability of decent returns from bond yields alongside a more constructive outlook for fixed income has allowed us to build up the more protective part of the portfolio without ceding the ability to make a fair return. The structural challenges around deficits and disruption remain and so we are still purchasing a greater proportion in shorter-dated bonds which are less susceptible to ongoing inflation and interest-rate related volatility. At a time when risks are on the rise, we think that bonds offer a little more insurance without too much opportunity cost.

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