Tatton
Investment Management

Tatton Autumn Outlook 2025

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Overview

2025 has been a year of great political upheaval. In our annual outlook last December, we argued that investors were too positive about US stocks and too negative about the prospects elsewhere. Sure enough, as we come into Autumn, US underperformance – due to a weak dollar – has been the main equity market theme of the year.

Tariffs have dominated the narrative. Donald Trump's levies (either imposed or threatened) have hurt some of the US' major trading partners – most notably Canada, which now seems to be in a recession. But markets have consistently judged tariffs as primarily hurting US consumer demand, and hence weighing on growth in the world's largest economy. The full economic impact of tariffs has still not been felt and may not for some time, either due to temporary suspensions or inventory stock.

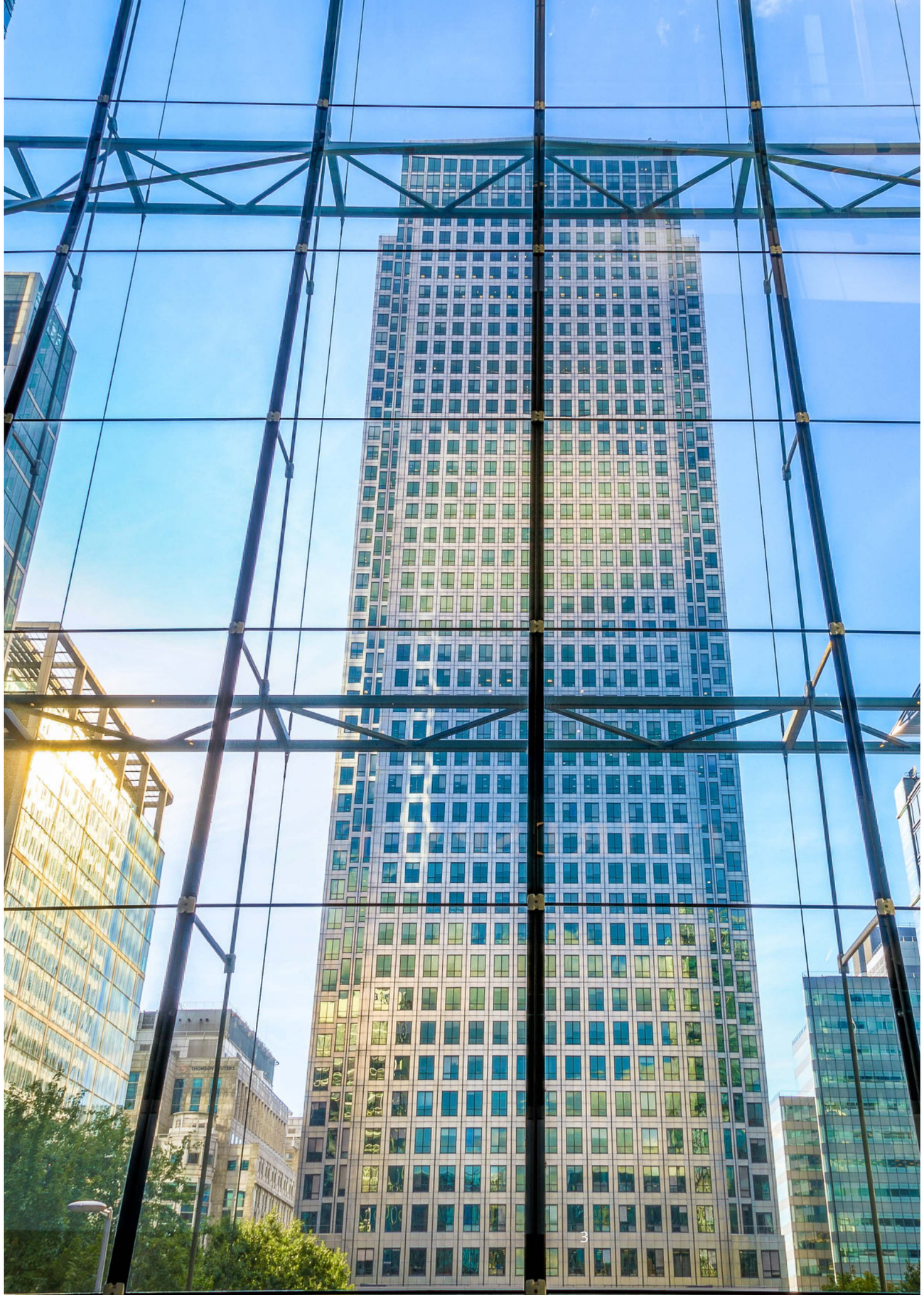
It is already clear, though, that the US economy is more resilient to tariffs than feared. Even with the latest labour market weakness, there is no realistic chance of recession in the next few months – as many feared earlier this year. Since the 'Liberation Day' sell-off in April, company earnings forecasts have been consistently revised up across the board.

Interestingly, the main way that US underperformance has manifested is through the weakness of the dollar. The world's reserve currency is currently on track for its worst year since 2000. While weighing on US returns (in sterling terms), the dollar's decline also effectively increases global financial liquidity. Since the dollar is the currency of global trade and finance, its weakness makes trade and finance cheaper.

Coming into the end of the year, monetary liquidity should benefit from the US Federal Reserve's interest rate cuts. Financial conditions have eased since the April sell-off, which will eventually support global economic activity.

There are factors that could limit global liquidity going forward, however. Earlier this year, the US Treasury General Account (TGA) was being drawn down due to legal constraints on US government borrowing. That effectively meant that the US treasury was spending its savings, and thereby pushing significant amounts of capital into the global financial system. Now that the treasury is able to borrow more, the TGA is being rebuilt, shutting off that flow of liquidity. That does not necessarily mean markets will go down; it just means further gains will require tangible reasons for positivity. That is because investors will have to raise their own liquidity, rather than it being injected by policymakers.

Overall, the tariff impacts on markets and the world economy have been surprisingly mild so far. Even at current levels, it has been the biggest hike in



effective US tariffs since the 1920s – an episode which preceded a global depression – and yet global stocks are up year-to-date. Markets have also been unmoved by multiple geopolitical flareups this year, from Ukraine-Russia tensions to Israel's bombings of Iran and Qatar.

Markets are usually happy to ignore geopolitical risks – until they are not. There are lingering signs of market anxiety. A weak dollar is often seen as a 'risk on' sign from investors, feeling emboldened to venture beyond the relatively safe investment haven of the US. This time around, it seems more related to the chipping away of the US-led global financial order. The consistent rise in gold prices over the last few years is arguably another sign of creeping institutional decline. Geopolitical risks might not hurt asset prices in the short-term, but they can make downturns worse if and when they come.

One of the biggest political risks would be the introduction of capital controls, either by the Trump administration or in reaction to it. We do not think that is likely over the medium-term, but rumours are growing. Absent those risks, we expect risk assets to keep steadily climbing.

Regions

UK

The UK economy is not nearly as weak as media coverage would have you believe, and UK stocks are among the best performers in 2025. We do have an unhelpful balance of growth and inflation (growth potential is relatively low, so if growth improves it usually comes with high inflation) but the economy is still expanding in real terms. That is partly why the Bank of England (BoE) is less keen on interest rate cuts than the European Central Bank.

Britain's jobs market weakened in the middle of the year, but has improved since. You would expect that to boost demand, but retail sales were disappointing. The explanation is that Britons are saving more; the savings rate has risen to its highest point since the pandemic (although it may be that the August retail sales data indicates a return to mildly stronger consumption).

Even the government is saving. The UK news often talks of stubborn inflation and a "black hole" in government finances – especially when long-term bond yields spiked at the start of September. As we wrote at the time, the yield spike was actually a move up in real (inflation-adjusted) yields, which are supposed to reflect the market's growth expectations.

So, either real yields come down – and are therefore a good buying opportunity – or growth will be stronger than expected. In the last few weeks, long-term yields have indeed fallen back down sharply. But the next big test will be the autumn budget. If it goes badly, households will probably save even more.

Interest rates are still high, and the BoE has been reluctant to cut, due to stubborn inflation. With rates set to fall in the US and Europe, however, we expect the BoE to follow suit. That should support Britain's economy and equity valuations.

US

Long-term US government bond yields have fallen back after a late summer spike, reflecting expectations of weaker growth and interest rate cuts. On the other hand, stock markets have moved up – particularly growth-sensitive small-cap stocks. Lower rates will help smaller companies, which have particularly suffered over the past two years from higher yields. This is very likely why equity investors are looking through the current slow patch to growth later on. It also helps that US corporate earnings have held up particularly well during this period too, expanding at a growth rate of more than 10%.

Trump's tariffs are starting to impact the US economy – but slowly. American importers built up their inventories ahead of tariffs, and those inventories are now being drawn down. Eventually, importers will have to restock at higher prices. From the latest producer price inflation figures, it looks like demand is strong enough that companies can pass on the extra tariff costs to consumers. Oddly enough, that probably means that consumer spending numbers will increase in the months ahead, even if sales volumes do not.

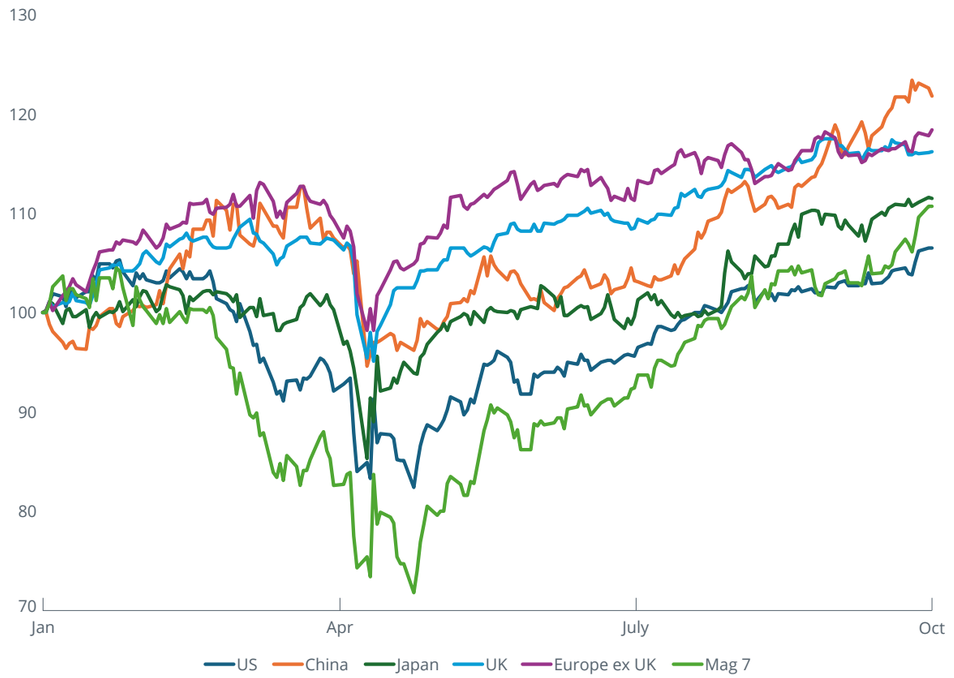
US inflation has picked up recently, and will probably stay elevated for the next few months, as tariffs start to bite. But despite the price hikes, the Federal Reserve does not think that tariffs will cause longer-term inflation pressures. The central bank thinks the cooling labour market will prevent the dreaded wage-price-spiral. Indeed, the Fed wants to cut rates in response to the weaker jobs market, and that looks like a good call – until the job market tightens as result. Smaller companies in particular have been struggling with historically high refinancing rates, so rate cuts will give them breathing room for expansion.

Over the last few years, positivity about US stocks has largely been focussed on the biggest tech companies that benefit from AI investment (although not necessarily the 'Magnificent Seven'). But rate cuts improve the outlook for smaller US companies.

That being said, US large cap equity valuations are high in price-to-earnings terms, compared to other regions. That was previously justified by those companies' extraordinary profit growth – but beyond the Mega Techs, future earnings expectations are starting to look much more normal relative to other global regions. It will be hard for average US stocks to outperform in this environment.

Global Equity Total Return Indices 2025

US, Mag7, China, EU, UK (in GBP terms)



Source: **Tatton IM, Bloomberg: G2324**
SPX Index (S&P 500 INDEX) Bbg M7 US Ch EU JP Daily 31DEC2024-31DEC2025

EUROPE

US tariffs have hurt European manufacturers this year – and they were already struggling. But for European stocks, the generational increase in defence spending has been much more important. Europe's markets have outperformed the US in 2025, thanks to the expected growth boost. Small and mid-cap stocks have particularly benefitted, as the continent builds its technology infrastructure.

The actual growth benefits from defence spending will not be felt until next year or beyond, though. Recently, markets have wondered whether they got ahead of themselves, and the European equity rally has lost steam. Even so, the euro's strength versus the dollar continues – which tells us the slow rotation out of US assets into Europe is still on.

Company earnings expectations back that up. While European earnings have lagged the US in 2025, the projections for next year and beyond are similar. When you remove the biggest US tech companies, Europe's forward earnings growth is actually better. That should mean that European price-to-earnings valuations should catch up with those in the US.

That valuation catch-up can only happen if European stocks keep outperforming the US. That could change if the relative earnings outlooks diverge – but it is what the fundamentals are telling us right now.

JAPAN

Japan's stock market was the best performer in August, and that positivity has continued this month. We have been positive on Japan for some time, and our long-term investment thesis has not changed: Japan has a highly skilled and globally competitive workforce, and corporate reforms have made companies much more profitable.

Global investors are now catching on to these improvements. The Japanese market has momentum, and we expect that to continue into the end of this year.

CHINA

China has outperformed all other major stock markets in 2025. That is despite persistent economic weakness, tariff pressures from the US and stagnant corporate earnings.

For all China's troubles, investors are betting on a turnaround. The government is determined to stimulate consumer demand and aid corporate profitability – even if they have struggled to deliver convincingly on that front so far. Meanwhile, China's stock market is benefitting from an injection of liquidity. The central bank is keeping key interest rates low, and savers are rotating out of property and bond holdings into equities.

The rally is led by tech companies, which have benefitted greatly from the release of DeepSeek's low-cost AI model. This week, Beijing banned its biggest tech companies from buying Nvidia's microchips – and yet Chinese stocks climbed on the news. This suggests investors (and the government) are confident about China's capacity to produce their own chips.

Politics could upset the apple cart. Tariffs are the most obvious way this could happen, with another deadline approaching in November. But there are also rumours that China might take military action against Taiwan. If that happens, we expect some form of sanctions from the West, which increases the risk of stranded capital. There is plenty to be excited about in China, but foreign investors need to be cautious.

EMERGING MARKETS

Emerging markets (EMs) should benefit from a weaker US dollar, which eases the cost burden of dollar-denominated debt. On the other hand, many EMs are export-led and have been hit with high tariffs by the US.

The start of September saw the annual summit of the Shanghai Cooperation Organisation, attended by more than 20 leaders of non-western countries. The key takeaway was that an alternative to the US-led global order is now a real possibility. EMs are no longer as reliant on the US for export demand and financing as they used to be.

That could benefit EMs, but it also makes their relationship with the US more volatile. That could mean greater geopolitical risks ahead.

Asset Classes

BONDS

Government debt has been building around the world for over a decade – potentially crowding out more productive investments by private debt. This has moved up our measure of governments' 'credit risk' (the difference between government bond yields and equivalent-length interbank swap rates).

However, the spike in long-term government bond yields that we saw a few weeks ago was not a debt panic. As we wrote at the time, real (inflation-adjusted) yields moved up significantly. Normally, that would suggest a move up in growth expectations, but in this case, it was more likely an increase in the 'term premium' (the return investors demand for lending over the long rather than short-term), as governments restructure their debts and issue more long-term bonds.

In any case, long-term yields have come down sharply in the last few weeks, particularly in the US. With interest rates set to fall across the developed world, we think there is room for long-term bond yields to fall even further.

EQUITIES

Global stocks recovered from the 'Liberation Day' sell-off in April, and have generally been resilient in the face of tariff and geopolitical threats since. It has helped that corporate earnings have held up well, particularly among the biggest US tech companies.

We often talk about regional differences in equity performance, but the biggest differentiator this year has been small versus large. Big companies – particularly tech companies involved in AI – have done well for years. Lately, small cap stocks have performed better, due to expectations of lower interest rates (and hence cheaper borrowing).

Markets were awash with liquidity over the summer, which helped all risk assets climb higher. That liquidity came from the last hurrah of pandemic cash infusions and we think it has now tapered off.

Liquidity now needs to come from an increase in bank lending and that requires businesses to believe they can and will be profitable. The signs are that, globally and regionally, business sentiment is improving, judging by the recent Purchasing Manager surveys, and the broad improvement in equity analyst profit estimates.

If businesses are positive, investor optimism will be well-founded.

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Tatton Investment Management Limited
17 St Swithin's Lane, London EC4N 8AL

E: enquiries@tattonim.com
T: 020 7139 1470

www.tattoninvestments.com

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Registered address: Paradigm House, Brooke Court, Wilmslow, Cheshire, SK9 3ND.

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