The Tatton Weekly

Healthy market rumours

10 October 2025

This week's topics:

Volatility on the horizon

How stable are stablecoins?

Serial French government collapse isn't a Euro crisis

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French cartoon opportunity, Morten Morland, 6 October 2025

Volatility on the horizon

Stock markets keep pushing at all-time highs earlier this week, but with less enthusiasm than a few weeks ago. Then, late on Friday, a renewed Trump tariff threat against China's rare earth export restrictions was enough to immediately send markets down 2%.

Solid growth in corporate earnings has been investors' main source of excitement over the last six months, and that growth does not look under any immediate threat. But the same investors are looking increasingly nervous. Doubts are creeping in about whether AI companies are all they are cracked up to be and, relatedly, there are signs that the long period of low volatility could come to an end. There are few reasons to panic – but the reasons to be wholly positive are weaker than they were.

The UK needs a 'debt restructuring'

The autumn budget is fast approaching and everyone expects tax rises. If the government has to raise taxes (and the 'budget black hole' warnings suggest it does), putting up base rate income taxes would do the least economic harm. To maintain Labour's electoral pledges, though, it looks more likely the treasury will raid banks or savings.

The UK is in this situation because of a debt problem – but not the debt problem you might think. It is not so much that the state has overspent, rather that bond yields are too high relative to Britain's low growth. Our cheap bond prices (the inverse of yields) are not attracting foreign investors to the extent they should.

Post-Brexit, global investors have considered Britain's market unattractive. For UK stocks, this is because of weak productivity and poor financial liquidity. For bonds, it is largely because our national debt is poorly structured, with too much long-term bond issuance and not enough short-term. As we have argued before, this bond imbalance is a legacy of historical pension fund regulation.

The problem can be solved. The government could issue more short-term bonds (aided by interest rate cuts) and use the money to buy back its own long-term bonds at significantly cheaper prices than it sold them. This would be even more effective in easing government finances than the Bank of England reducing their bond sales . The media would inevitably accuse the government of 'fiscal dominance', but we know many UK bond managers that would welcome the move. If the treasury can properly match bond demand to bond supply, lower its long-term interest costs and improve its balance sheet in the process, what is not to like?

AI heading for near-term reversal?

Lately, there has been a cacophony of debate about a potential bubble in AI investment. This was prompted by concerns of circular 'vendor financing' – like Nvidia's deal with OpenAI, which looks a lot like giving a company money to buy your own microchips. Given how genuinely profitable many of the big tech companies are, bubble talk is exaggerated. Big tech price-to-forward-earnings valuations are significantly lower than in the run up to the dotcom bubble, for example.

There are reasons to be concerned, though.

AI-related earnings have been one of the main drivers of global stock markets, and a massive part of that has been demand for cutting edge microchips. However, we note that the H100 rental index (from Silicon Data, tracking the hourly price of hiring Nvidia's H100, the GPU at the heart of the AI computing revolution) has fallen 29%.

While a decline was expected, the fall in the H100 rate is towards the bottom of the expected -20% to -30% range. Oddly, Nvidia's older chips are still going up in price, and everyone expects demand for high-tech computing to drive long-term returns. But the H100 rent index's fall tells us that there is currently more than enough 'compute' supply.

This suggests that Nvidia and its peers – the world's biggest stocks – could be vulnerable to a share price correction, as investors reassess their high valuations. This does not mean we are negative about AI investment overall. Indeed, over the long-term, the *users* of AI should benefit from lower chip costs. The problem right now is that many of the biggest tech companies have become so interconnected, on the financing side, that a squeeze on chip earnings could threaten short-term profits across the sector.

Volatility could return, as the shutdown keeps markets in the dark

If markets' leading lights are not shining as brightly, investors will struggle to get more optimistic. That, combined with the tapering of global liquidity we have discussed recently, means we should not be surprised if market bullishness runs out of steam soon.

This could lead to increased volatility. US stock index volatility has fallen to quite low levels, in both actual and implied terms (how much it costs to insure your stocks). But when you look at individual stocks – and particularly the biggest ones in the S&P 500 – volatility has noticeably increased in recent weeks. Rising individual stock volatility amid a calm index can indicate rising tensions, and it may be a signal of shifting market narratives. And since equity 'risk' is usually identified with how sharply prices move, equities are getting riskier, and index-level volatility may well start to rise.

The US government shutdown is an unhelpful addition to this mix. Not only could it hurt the economy, but it means the US is not publishing its usual economic data. Markets feed off information, and when there is not much information available they fixate on what they have.

This week, the Federal Reserve (unaffected by the shutdown) published August US consumer credit data that came in well below expectations. This particular data series is two months behind and varies substantially, so investors usually take it with a pinch of salt. Meanwhile the JP Morgan-Chase credit card weekly spending looked very soft at the end of September. Without the usual dataflow, minor datapoints are making people nervous.

Today's US consumer sentiment data from the University of Michigan shows people are unhappy, but not getting unhappier. Current conditions have improved slightly, but consumers are slightly more pessimistic. Inflation expectations for next year remained high at 4.6%, though down from last month's 4.7%.

The markets remain unconcerned today and the growth and profit outlooks remain solid. However, a patch of volatility is becoming more likely.

How stable are stablecoins?

Stablecoins feature regularly in the financial news these days. Last week, Bank of England (BoE) governor Andrew Bailey wrote a Financial Times opinion piece arguing that the digital assets could promote financial innovation and cut reliance on banks. This week, it emerged that the BoE might relax its limits on holdings of stablecoin, following warnings that the UK is falling behind the US.

At this point, it looks inevitable that stablecoins will play a much bigger role in global finance. Investors and policymakers need to think clearly about the impact they will have.

It doesn't take a GENIUS to want a digital dollar

Stablecoins are cryptocurrencies whose value is pegged to another asset, like fiat currencies or gold. The pegs are maintained by a store of those assets, typically cash or 'near-money' instruments. Stablecoins are distinct from hypothetical Central Bank Digital Currency (CBDC), in that they are issued by private institutions. But to live up to the name "stablecoin", they rely heavily on 'risk free' assets. Overwhelmingly, the stablecoins currently in circulation are backed by short-term US treasury bonds.

The US government has encouraged this situation. The Trump administration has thrown its weight behind stablecoins, passing the "GENIUS Act" in July. That has been something of a liftoff moment for the sector. The act allows private banks to launch their own dollar-pegged stablecoins, as long as they are backed by treasury bonds.

The biggest stablecoins currently are Tether's USDT ($370bn in circulation) and Circle's USDC ($75bn in circulation). They are essentially US dollars with an extra transactional wrapper. In our current banking system, we are used to the notion of private money – created by banks and backed, in part, by lending through the fractional reserve system. But stablecoins are more like shares in a money market fund – backed by cash and high-quality short-term debt, and therefore extremely liquid.

Why would you want this digital dollar instead of a regular dollar? Stablecoins utilise the technology underlying cryptocurrencies – like the decentralised Blockchain system – to allow for instant, 24/7 transactions that do not require lengthy settlement procedures. Analysts at Citi have called stablecoins the catalyst for blockchain's "ChatGPT moment" of widespread adoption.

Stablecoins are a money-maker for Washington

Everyone wants more efficient trading, but European policymakers are wary that stablecoins could undermine financial stability. They worry stablecoin issuers will seek riskier assets to back their tokens as the sector grows, raising the risk of devaluation and a run on stablecoin holdings. Relatedly, the European Central Bank (ECB) has warned that widespread use of dollar-backed stablecoins could undermine its ability to control monetary policy. For these reasons, the ECB (and the BoE, before Bailey's recent change of heart) has nailed its colours to the CBDC mast instead.

It should be no surprise that the US is in favour of stablecoins. It is not *necessary* for stablecoins to be backed by US dollars, but the dollar is the world reserve currency and Washington was an early mover on (de-)regulation. Citi analysts expect the dollar's dominance in the international stablecoin market to continue as the market expands (to as much as $4tn in circulation by 2030), essentially giving the world easier access to dollars.

Not only does that give the Federal Reserve control over the world's leading digital currencies, it also ensures future demand for US debt – allowing the government to borrow more at lower yields.

This could solve two serious problems for the US: the non-cyclical expansion of national debt and deficit over the long-term, and, more recently, a loss of global confidence in the dollar. If the whole world is able to store its money in dollar-backed holdings (perhaps including some less-than-reputable but cash-rich actors) those problems will feel much lighter.

Free from credit – but not free from debt

Citi's report on the stablecoin sector, from September, makes it clear that asset-backed tokens are not going away – certainly not after receiving official backing from the world's largest economy. But it also makes it clear that other digital assets, including free-floating cryptocurrencies and CBDCs, can co-exist and flourish in a growing digital economy. Stablecoins and CBDCs are not VHS and Betamax; there are benefits for both inhabiting a shared ecosystem.

The main benefit is essentially the efficiency and productivity provided by crypto technologies. Some will prefer private stablecoins for this, while others might prefer the stability of central bank issued tokens. European policymakers would do well to promote their own preferred medium within the digital space, rather than trying to put the stablecoin genie back in the bottle.

That being said, ECB officials are not entirely wrong about the risks that come with stablecoin adoption. Much has been made of the potential for issuers to obfuscate risks in the assets they use as collateral (akin to the collapse of crypto platform FTX) but less explored is how the expansion of 'risk free' short-term US bonds could distort the global financial system.

Andrew Bailey made interesting comments about how, in their current form (i.e. under existing and likely regulation) stablecoins are not a means of money creation as we know it. They must be collateralised with short-term government debt or insured deposits, and that stops them from being a mechanism for the provision of private credit. That may be true, but stablecoin creation is still inextricably tied to government debt creation – at least for now. Indeed, stablecoins' entire value is linked to debt provision for a highly leveraged institution with erratic leadership and declining standards of governance. The fact that institution is the US government makes it 'risk free' in name only.

Serial French government collapse isn't a Euro crisis

Government deadlock over the budget threatens to cripple state function and hurt the economy.

That perennial US headline now works just as well translated into French. On Monday, French Prime Minister Sébastien Lecornu resigned after just 26 days in the role, and is now leading discussions to avert a government collapse as caretaker. Disagreements about next year's budget are at the heart of dispute. Considering how bad the impasse could be for the broader European economy, European markets are handling it relatively well. There are good reasons for that, but it does not mean the problem is no big deal.

OATs are not healthy

Ostensibly, Lecornu was forced to resign after failing to agree his proposed cabinet (from a coalition of parties representing a minority of seats) with the National Assembly. On a deeper level, the various parliamentary blocs cannot agree a budget for 2026. President Macron – who appointed Lecornu in September – has reportedly offered to suspend his long-sought pension reforms in order to form a functioning government. The alternative would be dissolution and another election, in which Macron's centre-right faction would almost certainly lose seats.

Budget impasse has been a constant feature since 2024's election delivered a hung parliament. But the problem goes much further back. Macron has been trying to reform pensions and curtail public spending for most of his tenure, but has never commanded broad enough support to do so. Politically, no one can agree to either lower spending or higher taxes. Economically, bond markets will not accept ever-growing debt. In the meantime, France's public debt-to-GDP (113% in 2024) and deficit (5.8%) remain too high for bond market comfort over the longer term.

Renowned economist Mohamed El-Erian warned about France's political crisis in the Financial Times this week, pointing to the sell-off in French government bonds (OATs) and its stock market after Lecornu's resignation. His key warning was that this is not just a problem for France: turmoil in Europe's second-largest economy could spiral to the rest of Europe and the UK. Indeed, UK bonds have sold off more than many European nations in response.

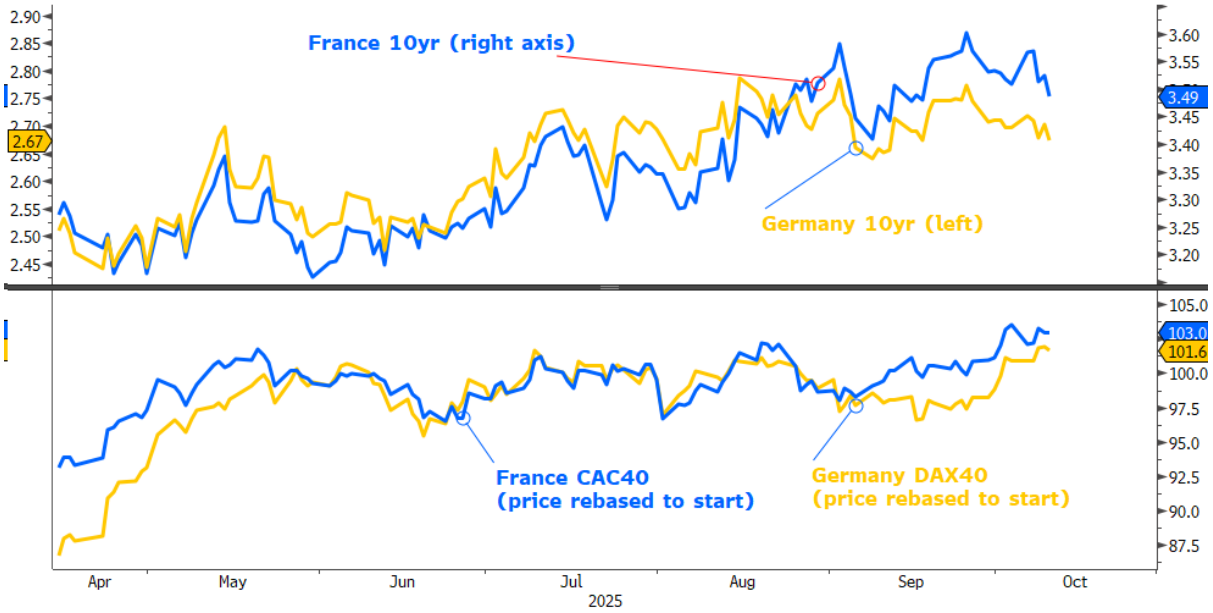
It is not hard to see how debt concerns in one major European economy can threaten the continent as a whole. If you were worried about Greece's crisis or Italy's perennial battles with Brussels, a French debt crisis would be significantly worse. Incidentally, OAT yields moved above Italian yields this week.

Markets say c'est la vie

French assets did not have a great week, but in truth the market reaction was mild. The chart below shows France's bond and equity performance versus Germany, going back to the start of July. OAT yields have widened their spread over Germany in the last few weeks, but not dramatically.

French stocks, meanwhile, have actually outperformed since the start of September. They also recovered all of Monday's losses on Tuesday and Wednesday.

France and Germany
10-year government bond yields and equity indices



Source: Tatton IM, Bloomberg: G2344
YL748982 Corp (FRTR 3 ¼ 11/25/35) Fra DEU bond equity Daily 13APR2025-24OCT2025 Copyright© 2025 Bloomberg Finance L.P. 10-Oct-2025 11:45:04

At a broader level, European stocks are virtually unchanged from a week ago and the euro has only slightly depreciated against the dollar. Why are markets so nonchalant?

The explanation could simply be that markets have stopped caring as much about politics. A decade ago, a French governmental collapse might have led to a sharp bond sell-off but, as we have seen in the US, investors have become accustomed to ignoring the noise and focussing on the economic fundamentals.

Those fundamentals are decent. For a while, economic growth in Europe's so-called 'periphery' has been stronger than in the core nations. And as we have pointed out before, company profit margins are growing pretty well in Europe. In the background, Germany's historic fiscal expansion has led to renewed growth expectations and investment into Europe. Growth can be the magical cure for a debt-laden economy. Perhaps markets are betting that it will lift France out of its unenviable situation.

The problem isn't acute; it's chronic

In any case, markets are telling us that the current political drama is unlikely to lead to another euro crisis and, on balance, that view seems right. But that does not mean everything is fine.

We find it helpful to break up government bond yields into different underlying components – real growth, inflation, and debt risk – to more accurately interpret what markets are saying. In this case,

the debt risk element of OAT yields has increased, suggesting that markets indeed see France as a less reliable borrower. The move is not huge, but the worrying part is that this is not just a short-term panic; it is the culmination of France's chronic inability to agree a sustainable social/pension policy and thereby budget.

We have already seen an impact on UK bonds – which have similar profiles and similar debt challenges (though the UK has a smaller deficit and considerably lower debt-to-GDP ratio).

In a sense, focussing on the risk of a near-term bond market panic misses the point. If OATs spiral, the European Central Bank has the power to intervene and prevent a euro crisis before it starts, and the rest of Europe has the fiscal firepower to stabilise its second-largest economy. France's risk is not that it collapses; it is that the drift continues.

Tatton
Investment Management

10 October, 2025

Global Equity Markets	10-Oct			Technical	Valuations			
Market	Level	% 1 Week	% 1 Week (GBP)	Short Medium	Div YLD %	LTM PE	NTM PE	10Y AVG NTM PE
UK FTSE 100	9501	+0.3	+0.3	↗ ↗	3.2	14.3	13.1	12.4
UK FTSE 250	22018	-0.4	-0.4	→ ↗	4.0	14.0	12.3	13.6
UK FTSE All-Share	5133	+0.2	+0.2	↗ ↗	3.3	14.2	13.1	12.9
FTSE Small x Inv_Tsts	6083	-0.5	-0.5	→ ↗	4.3	15.8	11.5	11.4
France CAC 40	8026	-0.4	-0.5	→ ↗	3.2	16.6	15.4	13.9
Germany DAX 40	24593	+1.0	+0.9	→ ↗	2.4	17.8	16.0	13.2
US Dow	46474	-0.5	-1.0	↗ ↗	1.6	23.1	20.2	17.6
US S&P 500	6747	+0.3	-0.2	↗ ↗	1.2	25.7	22.8	18.8
US NASDAQ comp	23074	+1.0	+0.5	↗ ↗	0.6	37.0	30.1	25.2
Japan Nikkei 225	45770	+0.7	+1.6	↗ ↗	1.7	22.6	22.6	18.2
World Bloomberg	2308	-0.1	-0.5	↗ ↗	2.3	17.7	15.9	14.6
China mainland	4641	+0.0	-0.3	↗ ↗	1.6	22.7	20.5	17.2
Emerging Bloomberg	1509	-0.0	-0.5	↗ ↗	2.4	18.0	14.8	12.4

FTSE100 Top 6		S&P Global Top 6	(GBP terms)	Global Sectors			(GBP terms)
Company	%	Company	%	Sector	%	Sector	%
AstraZeneca	+16.9	Advanced Micro Devices	+44.2	Tech	+2.8	Staples	-0.4
Hikma Pharmaceuticals	+11.7	UCB	+29.8	Financials	-0.2	Energy	-2.8
Rentokil Initial	+10.7	Yaskawa Electric	+29.1	Health	+6.7	Materials	+1.4
JD Sports Fashion	+10.7	Super Micro Computer	+28.4	Discretionary	+0.3	Utilities	+1.5
3i	+9.8	Coinbase Global	+27.8	Industrials	+1.7	Real_Estate	+0.3
GSK	+9.7	SK hynix	+27.2	Communication	-1.5		

FTSE 100 Bottom 6		S&P Global Bottom 6	(GBP terms)	Fixed Income		
Company	%	Company (GBP terms)	%	Govt bond	%Yield	1 wk chg
Mondi	-16.9	Brookfield	-33.7	UK Govt 5yr Gilt	4.14	-0.04
Entain	-8.0	Mondi	-16.9	UK Govt 10yr Gilt	4.70	-0.05
Coca-Cola HBC	-6.5	Nitori	-13.8	UK Govt 15yr Gilt	5.12	-0.05
BT	-5.4	Ferrari	-13.5	US Govt 10yr Treasury	4.10	-0.09
BP	-4.2	News	-12.1	France Govt 10yr OAT	3.49	-0.08
Rolls-Royce	-3.7	Apollo Global Management	-11.7	Germany Govt 10yr Bund	2.67	-0.08
				Japan Govt 10yr JGB	1.68	+0.03

Currencies			Commodities			UK Mortgage Rate Estimates		
Pair	last	%1W	Cmdty	last	%1W	Rates (LTV c.75%, no fee)	10-Oct	10-Sep
USD per GBP	1.328	-0.9	Oil Brent $:bl	63.85	-0.9	UK BoE base rate	4.00	4.00
GBP per EUR	0.871	-0.2	Gold $:oz	3975.32	+2.4	2yr fixed	4.12	4.13
USD per EUR	1.157	-1.1	Silver $:oz	49.90	+4.6	3yr fixed	4.20	4.12
JPY per USD	152.60	+2.1	Copper $:lb	515.1	+1.4	5yr fixed	4.12	4.14
CNY per USD	7.127	-0.2	Alumnm $:mt	2686.9	+1.4	10yr fixed	4.58	4.49
USD per Bitcoin	121,932	+11.3	Bloomberg Agriculture	53.7	-1.1	Standard variable	6.86	6.86

Prices taken today's current level and final close last week.
LTM PE is the index price as a ratio of last 12 months earnings. NTM PE is next 12 months earnings.
Mortgage estimates are derived from sterling swaps markets and moneyfacts.co.uk

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