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# Investment Committee Series

Q3 Outlook - August 2025

Q1



Q2



Q3



Q4

# Table of content

**01** Introduction p.3

---

**02** Decisions we made p.4

---

**03** What does the future hold for investors? p.8

---

**04** Around the world p.9

---

**05** When tenpin bowling was the future:  
What it teaches us about AI p.10

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# 01

# Introduction

Global equity markets touched all-time highs this quarter as investors shrugged off tariff headlines. Earlier in Q2, markets were highly sensitive to tariff-related news, but this impact is fading as investors cheer lower-than-feared tariff rates.

Economic data also reflects continued resilience in the global economy and equity market returns were boosted by strong performance in the artificial intelligence (AI) sector.

The global economy continues to grow, though momentum has slowed since 2024. This growth downshift stems from the US. Despite this cooling, the US economy remains resilient, bolstered by strong consumer spending and a tight labour market. The recently proposed US budget, dubbed the 'Big Beautiful Bill,' could boost the economy through tax cuts and increased spending, offsetting potential weakness from tariffs.

In Europe, our outlook is cautiously optimistic, supported by stronger-than-expected economic indicators in the first half of the year, with Germany's increased fiscal spending providing additional support. In contrast, UK growth is stagnant, with hopes for a lift in GDP from government spending fading. Persistently low consumer confidence in China continues to hold back a sustained economic recovery in the mainland.

Inflation continues to ease gradually, though persistent services inflation remains a challenge. In the US, the inflationary impact of tariffs is uncertain, prompting the Federal Reserve to adopt a more cautious stance. Unlike other major central banks, which are reducing interest rates, the Federal Reserve's hawkishness positions it as an outlier.

The US dollar experienced its weakest start to the year since 1973. While no single factor explains the move, we think the relative decline in US growth expectations compared to the other major economies is the culprit. While the US economy has been resilient, initial forecasts for 2025 were overly optimistic, leading to a normalisation of growth projections.

Overall, the global economic backdrop is broadly constructive. However, we are mindful that the full impact of tariffs is likely to materialise in the coming months, prompting close monitoring of incoming economic data.

**Eren Osman**  
Managing Director,  
Wealth Management



# 02

## Decisions we made

Over the past quarter we made four key changes to our portfolios. We have:

- Decreased our government bond allocation and introduced a new fixed income position
- Partially hedged US equity exposure to euros
- Increased equities, including adding to our Emerging Markets allocation
- Initiated a position in gold.

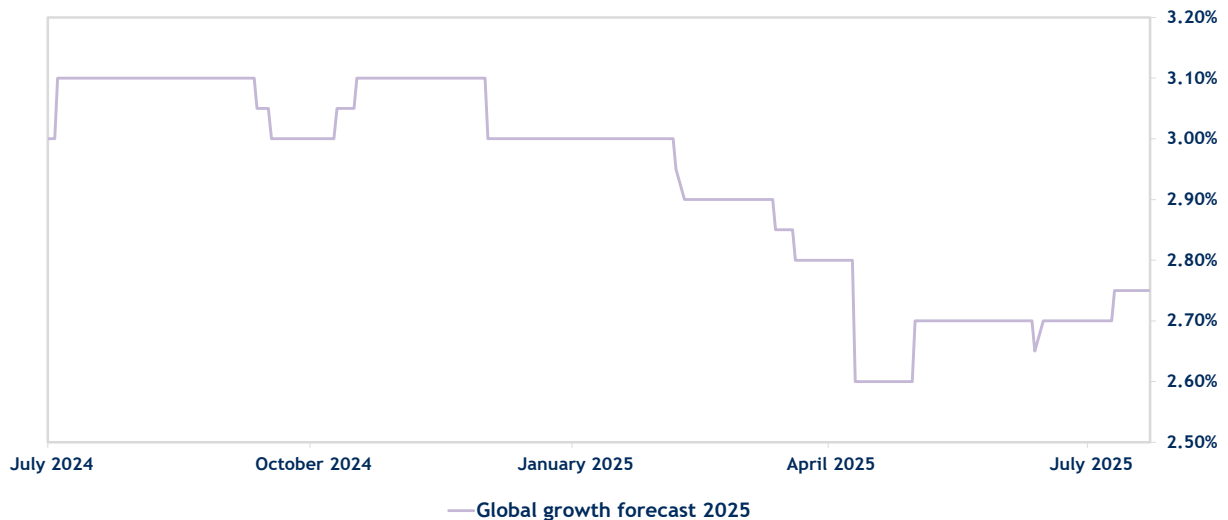
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We think the announcement of significant German government spending on infrastructure and defence could be a game changer for economic growth.”

**Peter Doherty**  
Director, Head of Investment Research



### Growth outlook improved on trade clarity



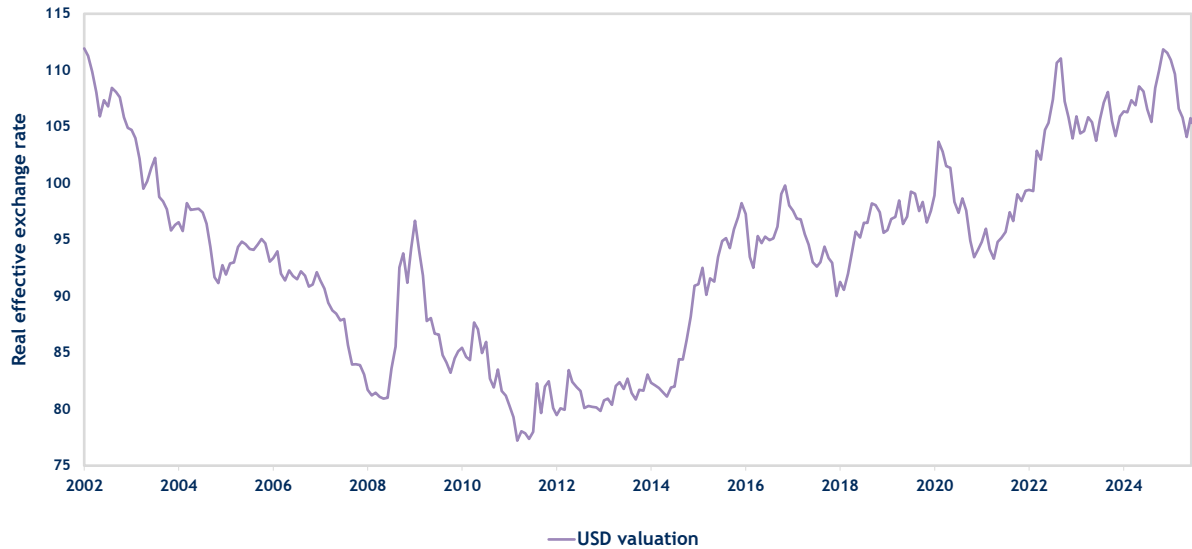
Source: Bloomberg

### Decreased our government bond allocation, introduced collateralised loan obligations (CLOs) within our fixed income allocation

We have reduced exposure to benchmark government securities in favour of global equities, as the resilient global growth (see the chart above) supports the expectation that equities will outperform bonds. Rising yields on longer-dated government bonds, driven by concerns about fiscal deficits, have adversely affected our long-duration bond positions. Nevertheless, we continue to hold these long-term bonds as we view them as a strategic hedge against our increased equity exposure, particularly to mitigate risks if global growth momentum slows further. We do expect yields to stabilise as central banks continue to cut interest rates.

We have introduced a new position in CLOs within our fixed income allocation. This was funded by reducing exposure to European banking debt following its strong performance in the first half of 2025. CLOs are collections of loans made to a wide range of European and American companies where the lending is backed by the company's assets. They offer an alternative to traditional corporate debt and, thanks to their strong securitisation structure, have historically delivered solid returns with lower default rates. After monitoring this space for the past two years, we now find CLOs particularly attractive given their competitive income yields, compared to other corporate bonds.

## US dollar valuations are elevated



Source: Bloomberg

### Partially hedged US equity exposure to euros

We have hedged 5% of our US equity exposure, denominated in dollars, into euros to mitigate currency risk. The US dollar typically outperforms in two scenarios: when the US economy is exceptionally strong compared to other economies or during global recessions.

In 2024, US growth expectations far outpaced other regions, attracting significant capital flows and boosting the dollar. Now, with growth expectations moderating and Germany implementing a major fiscal stimulus, the euro may be better supported going forward as the growth gap between the two regions narrows.

We prefer euro over sterling based on our expectation that the Eurozone economy will demonstrate greater resilience, while the Bank of England is likely to cut rates in response to economic weakness – supporting a stronger relative performance for the euro. Furthermore, on a real effective exchange basis US dollar valuations are elevated (see the chart above) while the euro is undervalued on the same measure, which might be a headwind for future returns of US dollar.

### Added to global equities and, within Europe and Japan, shifted towards domestic allocations. Increased our Emerging Markets allocation with proceeds from the UK.

We have increased our equity exposure, reflecting our growing confidence in global economic growth. This allocation has been implemented through a diversified global equity market passive fund.

We have maintained an overweight position in Europe, where recent economic data has positively surprised despite subdued performance over the past few years. We think the announcement of significant German government spending on infrastructure and defence could be a game changer for economic growth. Accordingly, we have rotated our European exposure toward more domestically focused companies that are poised to benefit from local policies, while trimming positions with higher US revenue exposure to mitigate tariff-related risks.

In the US, we hold a slight overweight in the Magnificent Seven stocks, which we view as key beneficiaries of the AI revolution. We are particularly constructive on the Big Four hyperscalers – Meta, Amazon, Microsoft, and Alphabet – whose unmatched access to data and distribution gives them a significant advantage. Given the capital-intensive nature of AI, it favours the largest technology firms with strong balance sheets.

In the UK, we trimmed our allocation to an active fund manager with high domestic UK exposure, taking profits after strong performance. The domestic outlook remains weak, compounded by uncertainties in fiscal policy amid global trade tensions.

Proceeds from the UK reduction were reallocated to Emerging Markets, where we have moderated our underweight position. A weaker US dollar is likely to support Emerging Markets assets, as investors seek higher returns in a depreciating dollar environment. Nonetheless, we exercise caution given the potential adverse effects of tariffs on these export-oriented economies.

### **Added to gold**

To further diversify our portfolios, we made a modest allocation to gold. Heightened geopolitical tensions, including ongoing trade disputes and Middle East instability, have prompted several central banks, such as those in China and Russia, to bolster gold reserves while reducing reliance on the US dollar. With a recent dip in gold prices, we see this as a good entry point into an asset that offers both diversification benefits and potential upside.

# 03

## What does the future hold for investors?

This quarter brought a mix of challenges – from shifting tariff headlines to the introduction of the ‘Big Beautiful Bill.’ Throughout, we encouraged investors to focus on fundamentals rather than the noise, and this approach turned out to be beneficial as markets went through a bumpy ride.

Tariff uncertainty has eased and equity markets have returned to all-time highs, supported by continued – though moderating – global economic expansion. Inflation remains on a downward path. While tariffs may cause a temporary rise in prices, the longer-term trend still points lower. This supports our view that the Federal Reserve will resume its rate-cutting cycle, which would be a positive catalyst for growth.

In 2024, US exceptionalism dominated investor attention. Now, with the US economy cooling, investors are beginning to look elsewhere for opportunities. This shift has opened the door to regions and asset classes that had previously been overlooked, such as European markets and precious metals.

The AI sector maintains robust momentum, with hyperscalers including Alphabet, Meta, Amazon, and Microsoft ramping up capital expenditures to approximately \$320 billion in 2025 alone, reflecting strong demand for AI infrastructure and cloud services. Recent earnings underscore sustained AI product and hardware appetite, bolstering our confidence in retaining a meaningful allocation to large US tech firms.

While we remain mindful of risks – such as a tariff-driven growth slowdown – our portfolio is still balanced. We have added higher-yielding assets to enhance income, maintained longer-duration bonds and added to gold as defensive hedges, while also increasing cyclical equity exposure to benefit, if growth continues.

“While we remain mindful of risks – such as a tariff-driven growth slowdown – our portfolio is still balanced.”

**Jason Da Silva**  
Director, Global Investment Strategy





# 04

## Around the world

### Germany

In June, Germany's federal cabinet approved a draft budget for 2025 and a fiscal framework for 2026 that marks a significant shift in the country's economic strategy. The budget includes record levels of public spending to boost the economy, improve infrastructure and strengthen long-term growth. A central pillar of the plan is a robust commitment to defence spending, with allocations set to more than double by 2029, in response to heightened geopolitical tensions and NATO obligations.

### US

Over the 4 July weekend, Texas experienced catastrophic flooding and tornadoes. The event claimed at least 135 lives and caused an estimated \$22 billion in economic losses. Infrastructure damage was severe: roads, bridges, and entire towns were flooded, while major freight corridors and over 400 flights at Dallas-Fort Worth were disrupted.

### Japan

Japan's ruling coalition, led by Prime Minister Shigeru Ishiba, lost control of the Upper House in the July 2025 election – a historic setback that marks the first time since 1955 the Liberal Democratic Party has lacked a majority in both houses of parliament. The defeat reflects growing public frustration over rising living costs and stagnant wages. Ishiba has vowed to remain party leader, citing the urgency of upcoming US tariff negotiations as a reason for continuity.

### UK

In May, the US and UK reached a trade agreement – the first of its kind between the US and one of its trading partners – reversing a limited number of tariffs that had been imposed on the UK by the Trump administration following 'Liberation Day.' While the deal offers some relief to the UK's automotive and steel sectors, it falls short of addressing the broader issue: a sweeping 10% tariff that still applies to nearly all US imports from the UK.

# 05

## When tenpin bowling was the future: What it teaches us about AI

We continue to get questions from clients on whether the surging market values of companies investing in AI signal the next bubble. Jason Da Silva, our Director of Global Investment Strategy, explains how the surprising case of a bubble in tenpin bowling illustrates the key factors investors should watch.

### **The bowling boom: A cautionary tale**

Technological innovation often fuels asset bubbles by driving rapid growth and speculation. In tenpin bowling, the late-1940s introduction of the automatic pinsetter cut labour costs and enabled 24-hour operations, making the sport more accessible.

This sparked an investment boom into the sport: US bowling alleys nearly doubled from 6,600 in 1955 to 12,000 by 1963. Investor enthusiasm followed – Brunswick Corporation's stock (a bowling alley equipment maker) rose 16-fold between 1957 and 1961.

But by the mid-1960s, growth stalled and profitability waned. The industry had overbuilt and misjudged long-term demand. Many alleys were financed by equipment makers like Brunswick, whose stock plunged from \$75 to \$13 in a year as loans soured. Competing leisure options further eroded demand. Today the number of US bowling alleys is less than a third of the 1963 peak.

### **Enter artificial intelligence**

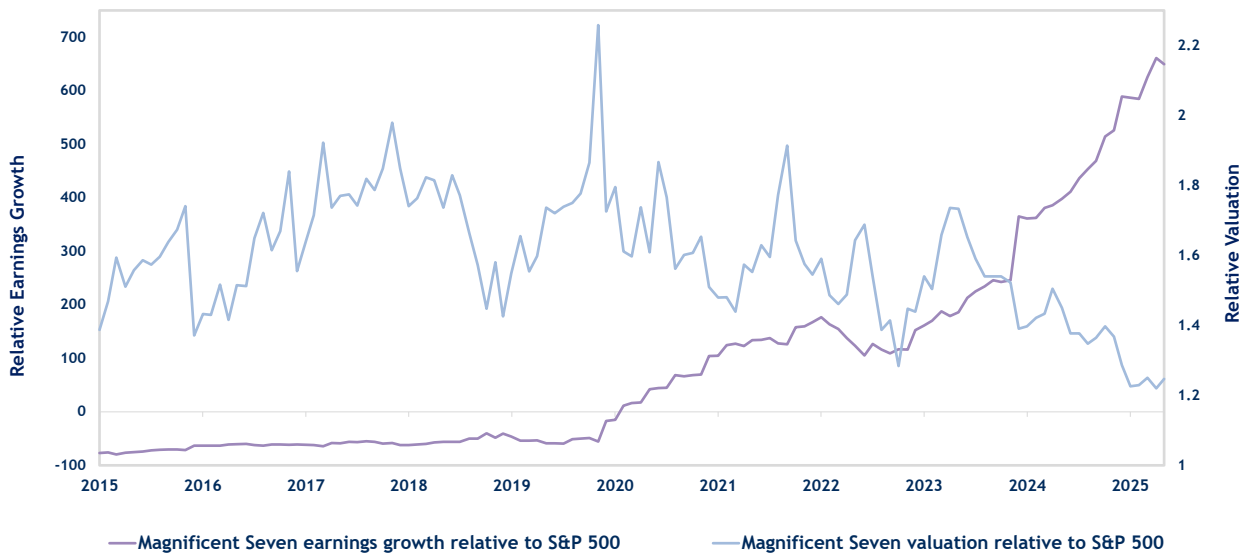
So how does this relate to the current excitement around AI?

We are in the early stages of a significant technological shift. AI's capabilities are real, and progress is happening fast. Unlike bowling – a consumer trend with natural limits – AI is a foundational technology with broad cross-sector potential. Businesses are already reporting measurable productivity gains, and leading AI companies are showing real earnings growth to support strong share price movement. Nvidia revenue surged 69% year-on-year in the first quarter of 2025 to \$44bn and OpenAI recently announced revenues of \$10bn in early 2025, up from \$5.5bn in December 2024.

That said, the risk of excess remains. Capital is pouring into chips, data centres, and startups, and parts of the ecosystem could expand too aggressively.

Valuation discipline is also critical. The bowling bubble showed how prices can decouple from fundamentals. In AI, valuations are varied. However, where much of our client capital is concentrated – in large, diversified tech firms – valuations are not obviously excessive relative to earnings strength and balance sheet quality.

## Big tech trades at its lowest valuation to S&P 500



Source: Bloomberg

### Key lessons for investors

- Real innovation can still attract unrealistic expectations**  
 The automatic pinsetter genuinely transformed bowling. But growth projections still overshot. With AI, the technology is real – but expectations must be grounded.
- Watch for overcapacity and capital misallocation**  
 In the 1960s, too many alleys were built too quickly. Today, it is data centres, AI chips, and startups – some of which may never generate sustainable returns. Focus on firms with clear differentiation and a competitive advantage.
- Valuation discipline**  
 Some AI stocks show stretched multiples untethered to fundamentals. Prioritise businesses with realistic paths to profitability and sustainable margins – avoid those driven purely by narrative.

### How Arbuthnot Latham has invested in AI

Our investment management team has been keeping a close eye on the AI sector. To give our clients exposure to this potential we took a position in a semiconductor fund in Q3 2024 and took a more explicit bet in large-cap tech names through a US top 20 fund at the beginning of 2025.

During the market turmoil in early 2025 we added to both funds when prices dipped.

Our team conducts regular deep dive research, including consulting with fund managers with expertise in the field and experienced individuals in the AI space.

The AI market is not destined to collapse like the bowling industry, but its trajectory depends on whether significant investment translates into durable returns in the future.

History does not repeat, but it often rhymes. By drawing lessons from past bubbles, investors can better navigate both the opportunities – and the pitfalls – of AI.

# Helping you go further

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